Official Report
Aithisg Oifigeil

DRAFT

Finance and Public Administration Committee

Comataidh an Ionmhais agus Rianachd Phoblaich

Wednesday 16 September 2026

The Scottish Parliament
Pàrlamaid na h-Alba

Session 7

Wednesday 16 September 2026

CONTENTS

FINANCE AND PUBLIC ADMINISTRATION COMMITTEE
5th Meeting 2026, Session 7

CONVENER

*Clare Haughey (Rutherglen and Cambuslang) (SNP)

DEPUTY CONVENER

*Alan Brown (Kilmarnock and Irvine Valley) (SNP)

COMMITTEE MEMBERS

*Liam Kerr (North East Scotland) (Con)
*Michael Marra (North East Scotland) (Lab)
*Liam McArthur (Orkney Islands) (LD)
*Kim Schmulian (Glasgow) (Reform)
*Pauline Stafford (Bathgate) (SNP)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Sandy Begbie (Scottish Financial Enterprise)
Colin Borland (Federation of Small Businesses)
Juan-Pedro Castro (Future Economy Scotland)
Sara Cowan (Tax Justice Scotland)
Joanne Walker (Chartered Institute of Taxation)

LOCATION

The Robert Burns Room (CR1)

Scottish Parliament

Finance and Public Administration Committee

Wednesday 16 September 2026

[The Convener opened the meeting at 09:30]

Pre-budget Scrutiny 2027-28

The Convener (Clare Haughey): Good morning, and welcome to the fifth meeting in session 7 of the Finance and Public Administration Committee. I have received no apologies for today's meeting. I remind everyone to switch off or put to silent their mobile phones and any other electronic devices.

Under our first agenda item, we will take evidence, as part of the committee's pre-budget scrutiny for 2027-28, on the affordability and sustainability of Scotland's tax and spending plans. I welcome our witnesses: Sandy Begbie, chief executive of Scottish Financial Enterprise, and Colin Borland, Scotland director of the Federation of Small Businesses.

I remind the witnesses not to worry about turning on microphones, which will be controlled by broadcasting staff. If you would like to come into the discussion, please indicate by raising your hand in order to catch the attention of the clerks.

I will start with a general opening question. Can Scotland realistically close its medium-term fiscal gap through stronger economic growth alone, or will sustainable public finances require more significant tax reform and revenue raising alongside growth?

Sandy Begbie (Scottish Financial Enterprise): I would add public sector reform to your question, because there needs to be a combination of economic growth, tax reform—but not tax increases—and public sector reform. There is no single answer to the longer-term fiscal challenge that the Government faces.

I should have said at the beginning of my answer that I sit on the public sector reform steering advisory board and the university funding review group, so I have insight on some of the funding challenges in those areas.

We have created deeply complex tax arrangements in Scotland. We have a number of different bands and cliff edges, which apply not only to Scotland but to the rest of the United Kingdom. In Scotland, we have got ourselves into a position in which about 12 per cent of taxpayers pay almost 70 per cent of the total amount of income tax that is collected. To put that in context, I point out that, if you were running a business that had 100 customers, that would mean that 12 of those customers would account for 70 per cent of your revenue, which would be an unsustainable position.

In our submission, we make it clear that it is important that economic growth is targeted at broadening the tax base, not increasing the tax take. In particular, Scotland needs to create and attract more jobs in the £50,000 to £100,000 salary bracket. The financial services industry, which I represent, pays an average salary of £50,000 a year, which is well above the average salary in Scotland. Scotland should aspire to be a higher-wage economy than it currently is.

In response to your opening question, there needs to be a combination of three things: public sector reform, reform of the tax base and an increase in economic growth, which, if we are honest, has been relatively poor since the financial crisis, not only in Scotland but across the rest of the UK.

The Convener: Before Mr Borland comes in, will you expand on your answer? You mentioned the need for tax reform, not tax increases. What taxes do you want to be reformed?

Sandy Begbie: There needs to be a discussion about the use of tax to stimulate economic growth. We use the word "progressive" about our tax system, but a recent study has shown that our high taxes have resulted in a decrease in the amount of income tax being collected, so we have reached that point of the Laffer curve—if not beyond it. We need to think about how we use tax to attract people and grow the economy; we should not simply be taxing the existing economy more.

As I said, the cliff edges are quite significant. If you earn roughly between £43,500 and £50,000 in Scotland, you pay a marginal tax rate of well over 60 per cent. That is one example of a cliff edge. In the UK, there is the cliff edge in relation to the higher marginal tax rate paid by those earning between £100,000 and £125,000 and everything that goes with that. Therefore, the issue applies not only to Scotland. As has been well documented, the UK probably has the most complex tax code of any country in the western world. As a result, a range of cliff edges have been created.

At the moment, as each budget comes around at the UK and Scottish levels, things are introduced that, in our opinion, merely put sticking plasters over the problem. The mansion tax is the most recent example, and the visitor levy is another good example.

We need to take a step back and look, given the devolved powers that we have, more holistically at what a tax strategy for Scotland that would stimulate economic growth and attract more well-paid jobs to Scotland would look like.

The Convener: Again, I will press you, Mr Begbie. I am not hearing what taxes you would reform. I am hearing about issues, as you view them, with other taxes. What taxes would you reform? What would you change?

Sandy Begbie: For example, the consequences of non-domestic rates for businesses have been significant for a long time. Colin Borland will be more familiar with that issue. However, it is, bluntly, a mess in Scotland, as it is in the UK.

As I have already pointed out, income tax has reached a point where we are no longer attracting any more money in, based on the recent analysis from the Scottish Fiscal Commission. I would therefore look to review income tax.

Land and buildings transaction tax in Scotland is also a huge deterrent. If you speak to housebuilders and people who are closer to the housing market, they will tell you that the housing market in Scotland, and broadly in the UK, is slowing down markedly due to stamp duty.

The Convener: Would you scrap them all?

Sandy Begbie: No. I am not suggesting that I would scrap them all.

The Convener: That is what I am trying to get at.

Sandy Begbie: I am saying that we need to step back and look at the current tax landscape, which has been built up over many years and has many unintended consequences. We are not using tax as a way of thinking about how we grow the economy.

The Convener: I am still not clear on whether I have got to the bottom of that, but we might explore that as we go on.

Colin Borland (Federation of Small Businesses): To answer your question about whether small businesses on their own can do it, I note that the jury is probably out on that. However, if we consider the size of the sector, they can certainly make a pretty big dent in it.

There are 380,000 small, medium and micro businesses in Scotland, employing more than 940,000 people and turning over nearly £100 billion annually. If, for example, we could increase that employment number by 2 per cent, which is a relatively small incremental improvement, we would have an extra 19,000 jobs in the economy. Similarly, if we could increase turnover by 2 per cent, that would be the thick end of £2 billion extra in the economy. There are definitely opportunities, which underlines the need for this budget to be a real budget for the business base: to be about expanding, broadening and strengthening the economic base. That is why we caution in our submission against the current fad of chasing after unicorns and putting all your eggs in the basket labelled “the next big thing”. Instead, it is about thinking about the practical changes that could make it easier to set up and run a business in Scotland.

To pick up on Sandy Begbie’s point, the non-domestic rates system is absolutely ripe for reform. The recent revaluation brought out a number of fairly long-standing issues. At least two of the three moving parts—the rateable value and how it is calculated—are problematic. Then there is the issue of reliefs and how they are applied to the final bill. I think that there were 22, the last time that we counted, and they overlap each other, they are advertised differently, and they are applied differently; some are applied automatically and some are obtained only through application.

We also still seem to have 14 assessors in Scotland. Historically, England and Wales have got by with one assessor. Those 14 assessors are using up to eight different sets of practice notes to assess the same type of property in different areas of the country. All of that seems to involve a lot of duplication, and I think that it leads to some of the communication issues that again became apparent at the last revaluation. If we are looking for areas where we can go in and start this public sector reform agenda, I would very much suggest starting there.

The Convener: I had not asked about the public sector reform agenda. I suppose that I was looking at whether taxes can close that gap or at what else we need to do. What are your suggestions from a small business point of view? I hear what you are saying about rates.

Colin Borland: I would hesitate to hold myself out as an economist or to state what we could actually do, but if we look at the size of the potential prize, we see that if we can get it right, we can make a dent in it. However, that means looking at the overall business environment. What can we do to reduce costs, boost cash flow and make regulation operate a lot more sensibly and proportionately? Those practical things affect the day-to-day training environment. On the other end, given the size of the sector, a small tweak in the lever would make the raw numbers look pretty big.

The Convener: Thank you.

Liam McArthur (Orkney Islands) (LD): It is perhaps slightly unfair to put to you evidence that was submitted by another witness, but I will do it anyway.

Sandy Begbie, this comes on the back of your earlier comments. Later this morning, we will hear from the Chartered Institute of Taxation, which said in its submission:

> "A key risk to devolved tax revenues and the credibility of Scottish taxes is the lack of a regular legislative mechanism for the maintenance of, and amendment to, devolved tax legislation. We remain of the view that a way forward is needed to enable the introduction of a legislative mechanism for Scottish taxes."

Are you sympathetic to that idea? If so, what form could it take to help to address some of the concerns and current issues that are arising in the tax landscape?

Sandy Begbie: I have not seen the submission, so I am not entirely sure what the institute means by that.

Liam McArthur: Is the lack of a regular legislative mechanism for taxation problematic, or are the obstacles elsewhere?

Sandy Begbie: We do not believe that Scotland has a coherent long-term tax strategy within its devolved powers. From a business point of view, with every budget that comes round—this also happens at a UK level—you never quite know what will come up. The tax changes are constant, and investors are looking for stability. Currently, the position at both UK and Scottish levels is that investors do not know what will come in each budget, and there is a lot of speculation.

If there was a long-term tax strategy that laid out the principles underpinning tax policy in Scotland, explained what changes might mean in practice and then put some firm lines in the sand by saying, "These are the taxes, and they are not going to change any further," that could be either good or bad, but it would be clear. From an investor point of view, it is not necessarily the rate of the tax but its stability that is more important. At the moment, we do not have that stability in the UK or in Scotland.

Liam McArthur: To some extent, the Government might argue that it has made quite clear its direction of travel and what it seeks to achieve. Therefore, the decisions and changes that it is making are generally more predictable than you suggest. The concern is more that the direction of travel and the decisions that it takes are ones that, by your estimation, cut against the objective of economic growth and expanding the tax base.

Sandy Begbie: Our angle is that tax policy does not align with the economic growth agenda. That is why I said at the very beginning that, in order to address Scotland's fiscal challenges, we need to address tax, public sector reform and how we drive economic growth. Tax is part of the discussion.

What happens is that we introduce a series of policies that undermine economic growth. The approach to non-domestic rates has been touched on previously. We know from hearing from a range of our members in our industry that the fact that we have a big tax differential is a barrier to attracting higher-rate taxpayers to Scotland. We are unable to attract to Scotland the talent that we want to attract. People come and work here for two or three days a week, but they will not move here, so Scotland loses out on all that discretionary spending at the weekends and so on. People will just not move to Scotland because of the tax differential.

Our point is, at what point does that tax strategy run against the economic growth agenda? Land and buildings transaction tax is another example of that trend. If economic growth is part of the answer to the fiscal challenge, what is the tax strategy to maximise the economic growth that we can generate? At the moment, we feel that it runs counter to the economic growth agenda.

Michael Marra (North East Scotland) (Lab): Mr Begbie, you mentioned in your submission that you think that we are reaching a "tipping point" with the tax system. Can you describe in a little bit more detail why you think that we are at that point? Why is such language appropriate?

09:45

Sandy Begbie: Obviously a lot was written in the press two or three weeks ago about the data from the Scottish Fiscal Commission on the amount of income tax that is raised in Scotland. There is a lot of debate about those issues. Like Colin Borland, I am not an economist, but we have looked at the Laffer curve quite carefully, and we believe that we have reached the tipping point at which the tax take will start to reduce.

We have not been able to factor in behavioural change, such as people either not taking on extra hours, deferring more of their pay into pensions or choosing not to come and live in Scotland. A lot of the models do not take account of such behavioural change, but I think that we are seeing that behavioural change starting to come through. For example, among my membership, there are people who have simply moved to working four days a week in order to avoid going over that £100,000 level, because the marginal rate of tax means that there is just no point working that extra day.

Michael Marra: Are you drawing on particular evidence for that conclusion, or is your observation just based on the commentary that you have seen externally and anecdotal evidence?

Sandy Begbie: We run a series of groups inside our own organisation that we use to input into

Government work on tax. We constantly engage with that group of organisations to understand what they are seeing within their own businesses and the impact of tax on the back of that. Therefore, I can say with confidence—I cannot speak for other sectors, but I can certainly say this for our sector—that the fact is that that tax divergence is resulting in behavioural change in the areas that I just mentioned.

Michael Marra: Your group of businesses will typically be financial enterprises that employ quite high-earning people. Can you tell us a little bit more about the kind of measures that you are seeing from those people in those groups? What are they actually doing to deal with that and to change their tax affairs?

Sandy Begbie: We have certainly seen an increase in people paying into pensions, using the tax breaks associated with that. Those tax breaks have always been there, of course, but what happens is that, when you start to increase the taxes, such things get far more attention and focus, so people then start to make that behavioural change. Similarly, some people are reducing the hours that they work in order to keep their salary below a certain level.

We are quite balanced and nuanced about the impact of tax on people. There is not great evidence of people leaving Scotland, because, bluntly, if people in our industry leave Scotland, they are pretty much going to go to London, and the cost base of living there is far higher than it is here. We are not saying that the situation is pushing people out of Scotland. Rather, it is acting as a deterrent to firms that are looking to bring people to Scotland. Given that our sector is growing at 3 per cent to 3.5 per cent a year, we think that further growth could be attained, but the tax regime is acting as a barrier to that, to a degree.

Michael Marra: Does that lead to recruitment challenges as well?

Sandy Begbie: Yes. There are recruitment challenges in the sense of bringing people from elsewhere in the UK to Scotland. The way that we develop the pipeline of people into our sector is predominantly through working closely with universities and colleges. We have managed to influence their curriculums so that we are developing our home-grown pipeline, but the tax regime is still a barrier, particularly at the senior level, as people are saying that, because of the tax differential, they will not move to Scotland. They will take a job in Scotland but they might then choose not to live here and will instead commute two or three days a week.

Michael Marra: Mr Borland, are those phenomena observed in your area?

Colin Borland: Not to the same extent. The last time we asked members about this issue, which was a while ago, the majority were what I would still call basic-rate taxpayers. Being a higher-rate or advanced-rate taxpayer is a problem that most small business owners aspire to have. Further, they are also rooted in the community. Some of them will be very highly globally mobile, but many more of them are physically rooted in communities, so the issue is probably a second-order concern for them. However, we have not asked the question more recently, so we do not have good, reliable, up-to-date data on any sort of behavioural impact.

Michael Marra: There is an interesting divergence between the two areas. Would you say that using a common set of elasticities for the different behavioural effects would be the right or wrong thing to do? By that, I mean that it seems that, on lower rates, behaviour change is less than it is on higher rates. To me, that seems quite obvious. Is that what you are both telling us?

Colin Borland: For our members, there is the element of practicality regarding the nature of their business and their customers, and how mobile that those things are. I am not going to speak for financial services, but you can see that that could be a quite internationally mobile sector. The issue is relevant, but, as I said, we have not specifically asked that question yet.

Sandy Begbie: The issue of mobility that Colin Borland mentioned is important. Clearly, some sectors have higher levels of mobility than others. Most areas in my sector are probably much more mobile than, say, some of the small business areas such as tourism, retail and so on.

My sector employs 157,000 people in Scotland, and we would like to grow that further, but, as I said, attracting people here is increasingly becoming a challenge.

Michael Marra: With regard to the behavioural effects, there are two different areas. There is the issue of the income from a change to the tax rates, which is what the Scottish Fiscal Commission models, and there is the issue that you are describing of the loss of tax income that is not necessarily at the top rate, through people being disincentivised from coming here. I would like to move to the modelling side of the issue, because we will hear evidence from our next set of witnesses about different models that they have applied that do not seem to tally with what you are describing.

Sandy Begbie: It is always difficult to model what you do not get. As I said earlier, we poll our members a lot, and there is no evidence of significant numbers of people leaving Scotland. Therefore, we certainly would not agree with the point that the tax divergence is driving lots of people out of Scotland. However, what we know is that we are not necessarily getting people coming to Scotland, and those conversations about moving to Scotland are proving to be really difficult. You should not forget the issue of land and buildings transaction tax as well, because, if someone who is coming to Scotland buys a house here, it will cost them substantially more than it would south of the border.

It is also difficult to model what we are losing as a result of people not coming to live here, in terms of, for instance, the money that they would spend at the weekend in small businesses, on tourism, in other retail and so on. It goes without saying that there is a natural progression. If we were to attract more people to Scotland, there would be a broader economic benefit, but, as I say, it is very difficult to model.

Michael Marra: You have expressed concerns previously about younger people not returning to Scotland. Could you explain some of that to us?

Sandy Begbie: I have declared an interest, in that I am a member of the university funding review group. However, I can say that Government statistics show that the current policy of capping means that a number of young people will leave Scotland because they cannot get places at university. I am not saying whether the policy is right or wrong; I am just saying that that is what the statistics show. The statistics also show that the majority of those students do not come back to Scotland once they have finished their studies. The effect of young people leaving Scotland in terms of the talent drain has been well documented. That is a challenge.

I also make the point that professional services firms will tell you that, historically, the career path would have involved recruiting people in Leeds or Manchester and then moving them to Glasgow or Edinburgh for five years before moving them to London. However, that is a far harder sell now, because the cost of those five years in Scotland is higher, in terms of the cost of buying a property and so on, and those employees may well be repaying a student loan as well, so their take-home pay is really important and they do not want to lose out further.

The third point that I would make is that, quite often, people who are servicing clients across the UK work only two or three days a week in the office, so there is less of a need for them to make the move to Scotland. The career path that used to be in place has been disrupted.

Michael Marra: I have some questions about another area for Mr Borland, but I will leave them until later.

Pauline Stafford (Bathgate) (SNP): I draw members' attention to my entry in the register of members' interests. I am a sitting councillor on West Lothian Council, in case it comes up later.

Mr Begbie, I wanted to follow up on the point about the evidence that you are using to look at behavioural changes. HM Revenue and Customs data shows that there is net inward migration of taxpayers to Scotland, although I do not know whether that is detailed enough to show what kind of taxpayers they are or what sectors they work in. Do you have any comments on that data?

Does the tax regime alone influence people's decision to come to Scotland, or could other things be priorities for them? If we went back to aligning more with the UK regime, would that be enough to attract the skills that you are talking about, or do we need something else? I think that you mentioned a Beckham-style tax incentive in your written submission.

Sandy Begbie: I will come on to that. We have asked for that HMRC data, but we cannot get hold of it. Net migration is positive, but what are people coming to do here? Are they working? Are they retiring? We cannot get that data, so I do not have any insight on that.

There are a range of factors that people take into account when deciding whether to move: schooling, the stage of their life, family and so on. Again, we are not saying that tax is the only factor in that, as that would be wrong. However, it is a factor that people consider, although there are clearly many others.

That is why I mentioned that there is no obvious evidence of people in great numbers moving to, for example, London, because, although you might retain more of your net income if you did that, the cost of commuting and the cost of your home and so on would be far greater than it would be in Scotland. Even though Edinburgh is expensive, it is nowhere near as expensive as London, so there are a range of other factors involved.

We have been clear that we think that aligning with the rest of the UK would be a good step. Even if that proved challenging, simplifying the Scottish tax regime would be a good step forward. We have introduced a number of different bands, and that creates cliff edges. We should think about how we might want to simplify the regime and make it easier for people to understand.

On the Beckham point, we have devolved responsibility for income tax. We used that tax incentive as an example of being creative. We are not necessarily saying that that is the exact answer, but there are examples of places such as Madrid, which has used it effectively to attract workers into industries that they see as high growth. That attracts people who, in the main, rely very little on public services, so there is not a drain on the wider public services, and it gives them a reduced income tax rate for five or six years. Once they have chosen to stay there, they move on to the normal rate of income tax. Places such as Madrid have used the incentive as a way to attract the talent and skills that they need to grow their economy.

Let us think creatively about how we can use those powers to help stimulate economic growth and attract the type of skills that we want. That incentive might not be the answer, but let us at least think about it.

Liam Kerr (North East Scotland) (Con): Good morning, Mr Begbie. I want to go back to behavioural change, which Michael Marra asked about. I also asked about it last week. You talked about mobility and said that there is no evidence that people are moving away. The Office for National Statistics says that 45 per cent of workers earning £50,000-plus, which I think is roughly the level that your members start at, work remotely or in a hybrid way, compared with around 8 per cent of those earning under £20,000. Apparently, the managerial and professional workforce, which you represent, is the most likely to do hybrid work.

Your submission says that the Scottish tax base is highly reliant on a small number of taxpayers. You say that you are starting to see behavioural change due to the different tax rates, so is there any evidence of that small number of taxpayers making choices about where to base themselves? If so—or in any event—what impact would that have on the economic agenda?

Sandy Begbie: If I understand it, the question is about the connection between working pattern, hybrid working and where people choose to work.

Liam Kerr: Yes.

Sandy Begbie: I go back to my earlier point, which is that, particularly in professional services, we have firms that will have appointed someone to a Scotland-based job, but the individual is not required to be in the office for five days a week, or, say, three days a week, and therefore they will choose not to move to Scotland.

Professional services may also service UK-wide clients, so even if they were based in Scotland, people working for them would still need to travel to other parts of the UK. If you are living elsewhere in the UK, more and more people are saying, “I don’t need to be based in Scotland. Why would I pay more income tax, when hybrid working means I’m only in the office three days a week?” We have firms that have a blanket five days a week. A good example is JP Morgan, which has a clear policy of five days a week in the office. If you come and work for JP Morgan in Scotland, you will have to commute or pay more income tax, but you will be in the office five days a week. However, that is not the norm. Most people are in the office for about three days a week. Hybrid working has changed the way in which people think about location, their quality of life and where they want to be based.

10:00

Liam Kerr: Is there any evidence that people are making the choice not to become Scottish taxpayers?

Sandy Begbie: Yes, and there is data about the number of people who are employed by the public service in Scotland who are not living in Scotland—I can see that data in the press, too. As I say, though, we are constantly engaging our members on this topic. Particularly in the professional services space, there is lots of evidence of people choosing not to move.

Liam Kerr: Mr Borland, it is a slightly different area, but business rates have been mentioned by both of you a couple of times. Mr Begbie said earlier that the situation was a mess. Your submission picks up on the review of what we are calling “anomalies” that was announced in June, I think, following a revaluation in April. Some might say that that review—that planning—ought to have been done prior to launching any significant change. What would you say to that? Is there a general issue with launching change without fully working through the consequences?

Colin Borland: That is a fair point. The review could have been done after the last revaluation, because the issues that emerged this time were pretty much the issues that come round practically all the time. As I said in my opening remarks, of the three moving parts in your business rates bill—your rateable value, the poundage and the reliefs—there are significant issues in the way in which two of them, reliefs and rateable value, are calculated.

I will give you one quick example. Your rateable value is supposed to be a notional idea of how much annual rent you pay on a business property. We had a member who rented an industrial unit from the council. To make the calculations easy, let us say that it was £12,000 a year. His rateable value, determined by officers of the same council, was twice that—£24,000. I phoned him up and said, “Are you some sort of really hot negotiator here? Have you driven a really hard bargain?” He said, “No. I went in and said, ‘I want that unit.’ They said, ‘It’s a grand a month.’ I said, ‘Fine. Where do I sign?’” Someone else—someone who probably works two or three desks away—has come in and got it wrong by a factor of 100 per cent.

That just shows that there are serious issues around methodologies, which is not helped by the fact that, as I said, there are 14 different assessors applying up to eight different codes of practice in the same sectors in different areas of the country. When you think about it, you could just merge that into a single agency and put it under the auspices of Revenue Scotland. That would have the advantage that democratic accountability would increase, because part of the problem is that autonomous bits of government are saying, “I can’t interfere with this. I can’t interfere with that.” That would help address some of that. Not only would it save money, but it would be more efficient and get rid of the patchwork of relief.

It is brilliant that we have reliefs to knock the roughest edges off, but it reminds me a bit of Covid. When we introduced a relief to deal with one problem, we would create another problem elsewhere, so we would run over there and patch that one up. In Covid, people were given a free pass, because it was exceptional times. Here, though, we can see structural issues in how the system operates, even down to the level of the process by which people apply—if, indeed, they have to apply. In another case that we did, it took one of my colleagues, who is as close to an expert as you can get in this, the best part of an afternoon to work out which reliefs to apply and in what order. Some had been automatically applied and some had to be applied for. That member went from a notional bill of about £5,000 down to £950.

Think about all the people who have not come to us to ask those questions because they are doing a thousand other things. They grit their teeth, write the cheque and move on, or, what is worse, they cut something somewhere else. We cannot know how big something unknown is, but the cases that I have mentioned must be the tip of the iceberg when it comes to the number of people who are paying thousands of pounds more than they have to. That is because the system is not simple, transparent or consistent, and we cannot give advice. If there was a single Scottish system, it would be a lot more practical to implement.

There is a raft of issues. We should have looked at them a long time ago but, if we are in the market for silver linings—I very much suggest that we are—at least the most recent experience tells us that the issues have not gone away and were not a one-off, so we should get talking.

Another point that I should mention is that the revaluation notices dropped in about late October but we did not get a Scottish Government budget until January, so people were panicking for months. In particular, people who had fallen out of the small business bonus scheme and had never had a rates bill before were panicking about what they were going to do. They thought that the RV was their total liability and all sorts of other things. However, the bills could not be issued because, until the budget, we do not know what the poundage rate or the reliefs will be. Added to that was the complication that some councils could not apply their reliefs because of information technology issues. Their systems could not cope, so they had to work it out manually.

So, the short answer is yes.

Liam Kerr: On solutions, noting what you say about reliefs, the previous Conservative UK Government froze the small business multiplier for, I think, four consecutive years and introduced 75 per cent business rates relief for retail, hospitality and leisure businesses. Could Scotland learn lessons from that approach on using the rates system more deliberately to support small firms and the high street?

Colin Borland: You can see the attractiveness of that. It is a lot simpler and cleaner to use different poundage rates for different sectors or types of business, rather than have a network of reliefs that are applied inconsistently and that people do not know about—as I said, the last time that we counted, there were 22 of them. The approach that you suggest looks administratively neater. We could do it if we reformed the system and put it under a single body that was accountable to ministers through Revenue Scotland.

Liam Kerr: I am grateful.

Kim Schmulian (Glasgow) (Reform): Mr Begbie, you mentioned student loans briefly. Since the introduction of student loans in Scotland, have they prevented people from going into entry-level jobs? I am an advocate of lifting the rate at which people start paying tax. Is that another factor?

I have personal knowledge of a number of kids who were at school with my sons who, having come through university and looked at their student loan and at the likelihood of getting on to the housing ladder given what they would be able to earn at entry level in Scotland, went to Australia. How much of an impact has that had? Should we have retained the old grant system? Would we be better off now if we had done that?

Sandy Begbie: I cannot talk specifically about student loans, but I have done a lot of work on youth employment. I worked on the young person’s guarantee for the Scottish Government on the back of Covid, and I chair the Developing the Young Workforce employers forum.

You mentioned raising the level at which people pay income tax. I am a big advocate of that. I mentioned simplifying tax. It seems to me that, if we want to leave people with more money in their pockets, raising the point at which people pay the basic rate of income tax is one of the most straightforward ways of doing that. It would allow young people to retain more of what they earn.

We also need to consider the impact of national insurance increases on the youth employment marketplace—Colin Borland will have a view on that, too—as well as the numbers that were set out recently in the Alan Milburn report and other factors that have played into the policy space that have resulted in young people being unemployed or unable to get employment. As a result, young people will choose to go and work elsewhere, including overseas. Partly because of the tax and partly because opportunities are simply not there for them, we are losing that talent. We put them through education and then we lose that talent to the Scottish economy.

Kim Schmulian: Do you have an idea of what the starter rate of tax should be? Have you done any research or do you have any information on that?

Sandy Begbie: That is not something that we would do as a matter of course. Under the current tax rates, people start to pay tax after they have earned £12,571, but there has been a constant hold on the rates and there has been fiscal drag. We need to move away from that, because all that we are doing is pulling more and more people into paying tax.

The threshold should be significantly higher than it is at the moment. I am no expert on the public sector reform agenda, but it strikes me that we are taking money off people, putting it through a machine and then giving it back to them through benefits, welfare and so on. We would be better off trying to leave people with more of that money in the first place. We should absolutely do it at the bottom—we are not suggesting changing anything at the top. We are just saying that we should move the rates up at the bottom.

Kim Schmulian: You would advocate a progressive system that could be evaluated with specific outcomes to see how it was working for the economy as a whole.

Sandy Begbie: Yes.

Kim Schmulian: Mr Borland, you represent small businesses. If I was sitting in a board meeting and looking at the risk registers of many of those businesses, what main challenges would I see, and what would be the highest risks?

Colin Borland: They would concern costs and, flowing from that, margins. For the past 10 to 12 quarters, we have seen costs increase significantly, and they are all the ones that you would expect—the costs of fuel, employment, energy and so on. We would expect things to become more expensive but, until relatively recently, the data that came back from members suggested that revenues were beginning to steadily increase. That seems to have tailed off now, and we are seeing margins getting thinner and thinner.

In some cases, people are still burdened with Covid debt, and other costs are coming down the line towards them. To be blunt, a number of businesses are running out of road. It does not take a genius to work out that, if a business's revenue is going up by 5 per cent and their costs are going up by 10 per cent, that is not sustainable.

Costs are a huge issue, and cash flows are a close second. I refer to the old cliché that what kills businesses is not a lack of profitability but a lack of cash.

Kim Schmulian: How big a factor is crime in the retail sector businesses that you represent?

Colin Borland: That comes up continually, and some of the stories that members have told us are horrific. That needs to be taken a lot more seriously in relation to all retail premises, but in the case of small, independent businesses, the person's house may be on the line. They may have put their family savings into the business and worked for decades to build it up. If people decide that they are going to just take, take, take, that undermines their business model and it may force them out of business. As well as being a personal tragedy, that is something that we should worry about for the whole economy.

Kim Schmulian: I know that police task forces have been formed—

The Convener: We are drifting off the topic that we are looking at today.

Kim Schmulian: Okay. I have a quick question about preventative spend.

The Convener: I will come back to you on that.

Alan Brown (Kilmarnock and Irvine Valley) (SNP): I apologise that I missed the start of the evidence session.

Sandy, I have a question for you that follows on from Liam Kerr's question about behavioural change in relation to tax. You believe that, with hybrid working, there is now some evidence of people taking employment in Scotland but choosing not to live here. How substantial is the evidence base for that? What numbers are we talking about?

Sandy Begbie: That is a good question. We gather evidence only from our membership. We represent only 125 firms, but our membership covers about 80 per cent of the total employment in our sector in Scotland, which is about 157,000 people, because we have all the large firms.

I mentioned earlier that a lot of that happens specifically in the professional services space. In the consultancies, legal firms, accountancy firms and so on, people have a lot more mobility. A lot of them are UK-wide firms. Before Covid, if you were, say, based in Scotland, you would be in your office five days a week, even though you might be servicing UK-wide clients. Covid has undoubtedly changed the world of work, and some form of hybrid arrangement now exists in pretty much all our firms—not all of them, but the vast majority. That gives people much more flexibility about where they stay.

10:15

I can say this with a lot of certainty, because, as I have said, we regularly engage with our membership on how the world of work is evolving as well as behavioural changes. There is a lot of evidence that, particularly in professional services, there are numbers of people who are choosing not to take jobs in Scotland. They will take the appointment, but they will continue to live elsewhere in the UK.

Hybrid working partly allows them to do that, because it means that they have to be in the office only three days a week. They will travel to Edinburgh or Glasgow on a Monday morning and go back on a Wednesday night. In fact, given that a lot of these jobs are increasingly covering UK-wide clients, too, they might as well just stay where they are.

The attraction to come here is just not there. It is partly because of tax, but, as I mentioned in response to an earlier question, tax is not the only factor—there is schooling, there is family and there are other things. I am not saying that it is the only factor.

Alan Brown: I want to explore that a bit further. I presume that companies now recruit on a UK-wide basis. Some people might have chosen, for family reasons, not to apply for a job and to relocate to Scotland, but hybrid working has opened up different opportunities for people that they might not have accessed before.

Sandy Begbie: I will split that into two, if you do not mind.

First of all, if a firm has a job that is based in Scotland, and they want someone who is already employed to take it, it is finding having the conversation with that person about making a move to Scotland far harder. Obviously, it will want to retain its employees, so it might well allow them to stay where they are. A number of executive search firms are members of our group, too, and this topic constantly comes up. When they try to recruit someone to a senior job in Scotland—and I should say that they cover not just our sector, but other sectors, too—that person will ask, “Do I need to be based in Scotland, so do I need to relocate? If so, will I be compensated for the increased tax that I’ll be paying?”

The term “Scottish premium” is a real thing in the recruitment marketplace at executive level, because people are saying, “If I’m being asked to move to Scotland, I’ll need a higher wage to compensate for the increase in tax.” Not all firms can afford to do that.

There is also the higher cost of purchasing your home here versus elsewhere. Moving is already a big cost, but then you have got land and buildings transaction tax on top of that.

Alan Brown: Equally, though, when somebody is weighing up a package, they will see that council tax and house prices are cheaper, so they might make money by selling and relocating to Scotland and have better opportunities.

Sandy Begbie: It depends on where they are moving from, and things are quite balanced in that respect. If you are talking about London, the south-east and that immediate area, you are absolutely right—the cost of living is quite different. However, given that 60 per cent of all jobs are outside of London and the south-east, you now have other big financial centres such as Manchester, Leeds, Bristol and Belfast, and if you are trying to recruit people from those locations, the cost of living differential is far lower than it would be in, say, London and the south-east.

Alan Brown: Just to follow on from—

The Convener: Please be brief.

Alan Brown: Okay. Just to follow on from Kim Schmulian’s question, I would just point out, for clarity, that personal allowance thresholds are set by the UK Government. Therefore, even if you thought that that was a good way of growing the economy and having people paying less tax, it is outwith the Scottish Government’s control. Is that not correct?

Sandy Begbie: That is right, and I have tried to balance my comments by highlighting what are very much UK factors, such as national insurance. We were very much against the employer national insurance increase, because we could see that it was going to have an impact, particularly on youth employment and businesses.

I completely accept what you have said, but the broader point is that, when we, as an organisation or trade body that represents businesses covering the whole of the UK as well as international areas, look at tax, we look at both UK and Scottish Government tax approaches accordingly.

The Convener: We still have a lot of ground still to cover, so I must ask for concise questions and answers. I do appreciate that this is a very complex area.

I call Michael Marra.

Michael Marra: I have a very brief question on non-domestic rates. On 3 June, Parliament voted for

"an immediate and comprehensive review of"

the business rates system. Has either of your organisations been told by the Government about any such "immediate and comprehensive review"?

Colin Borland: Not that I am aware of. I am not aware of the non-domestic rates consultative group having met substantially; I think that it has had one brief meeting since the election. The other group was specifically about hospitality methodology; that is quite a technical one and we are not involved in that, but I would not expect to be involved in it. However, with regard to what is actually happening, I cannot recall anything at the moment.

Sandy Begbie: I am not aware of anything either.

Liam McArthur: On the issue of public sector efficiencies, the FSB has pointed to opportunities in procurement that might open up the ability to sustain economic growth. On the face of it, a simplification of procurement sounds like something that we should all get behind. Past attempts to adjust and simplify procurement have often led to framework agreements, which many small and medium-sized enterprises claim crowd them out and reduce the opportunities for small businesses to participate. How would you see procurement reform—or changes and simplification—working in order to achieve the economic growth that we are looking for?

Colin Borland: You are absolutely right that we have been here before. However, the advantage that we have this time is the passing of the Community Wealth Building (Scotland) Act 2026, which puts statutory duties on public bodies to monitor and report back in a uniform way on how they are spending money. If there is to be further procurement reform, it has to be done in the spirit of the 2026 act.

Historically, one of the problems has been that a lot of this comes down to actions by individual purchasing managers. If you are a purchasing manager and your boss says, "I want this cost reduced by 10 per cent," you go and reduce it by 10 per cent, but you are worried about being a little bit creative, in case it goes wrong. Will your senior management have your back? Will the political leadership have your back? Giving them the courage to take that on—backed up by legislation—is incredibly important.

Liam McArthur: Is it too early to say that there is evidence to demonstrate that the 2026 act changes are leading to the capturing of that kind of data?

Colin Borland: We are involved in a number of groups and discussions that are looking at how exactly the guidance that sits underneath the 2026 act is going to work. We are also in the process of commissioning research to study exactly what that practice should look like. The short answer is yes, it is far too early, but we have given ourselves a fighting chance of delivering it.

The other thing that is important is that the guidance looks at procurement strategies based on a local place. It asks why your local college or hospital is buying the same stuff with its own frameworks; how many fresh sandwiches we need prepared across the key institutions in a particular area in a week; and how we design a contract to meet that need that we can divide up and local people can bid for. Thinking about that creatively and enshrining it in law is helpful, as is being honest about the length of the journey that we need to undertake.

Liam McArthur: I am conscious of the convener's plea for brevity, so I will quickly move on to the issue of business and regulatory impact assessments. Some people suggest that, to an extent, they are more of a tick-box exercise than something that substantively gets to what those impacts are likely to be. In your submission, you talk about trying to front load those assessments earlier in the process. Do you have confidence in the BRIA set-up as things stand, or are there changes to the way in which the assessments are carried out that would improve their value? With regard to the outcomes further down the line, what are the benefits of bringing them into the process earlier on?

Colin Borland: That has to change. It is now on paper that the assessment has to be done, but more importantly, it has to be a BRIA that looks specifically at small business issues. There is a piece of legislation that I cannot quite bring to mind at the moment, but it went through its legislative journey, and two small businesses were spoken to that were impacted completely differently from how a large multinational would be. The assessment has to be focused on the small businesses that will be on the front line of implementing the reform.

I do not downplay the cultural challenge for Government managers of bringing that into the process, which is probably why it needs a little bit of mandatory effort behind it to ensure that it happens. The benefits are that we will know what we are debating. If we implement a measure and it affects 25 per cent of people, we would be able to talk about what the impact would be at 50 or 75 per cent. You could have a more honest conversation rather than making statements of conjecture. You could give us the options that you were looking at and demonstrate that you had costed them and considered the impact. That would be a significant step forward.

Liam McArthur: It would be remiss of me, as the MSP for Orkney, not to point to the need to consider the overlap between BRIAs and island impact assessments, because the business impacts in certain island and rural communities are likely to be different from those in urban and central belt areas.

Colin Borland: That is why you need to consider the matter at that level of detail.

Liam Kerr: On the procurement issue that Liam McArthur asked about, last week, Sandy Begbie, you told the Economy, Tourism and Energy Committee:

> "there are no organisational incentives in the civil service to do anything different on procurement."—[*Official Report*, *Economy, Tourism and Energy Committee*, 8 September 2026; c 12.]

Has there been any noticeable change in approach since the appointment of a Cabinet Secretary for Public Service Reform? Have you seen any change to the institutional barriers to reform?

Sandy Begbie: My comment last week was in the context of discussing how we bring about cultural change in the public sector to think about procurement as a lever for economic growth and to help with the public sector reform agenda. A fellow panel member at that meeting commented that he runs a business but had given up trying to engage with the procurement process and would no longer bid for public sector contracts. That is a small business in Scotland. I am aware of at least one other that has chosen to do exactly the same.

Procurement is absolutely on the agenda in the appointment of the Cabinet Secretary for Public Service Reform, but it is being considered on the basis of how we improve productivity—the performance of the public sector—and its use as a lever to help drive that public sector reform agenda. The question is how we think about using it as a way to increase economic growth as well. It is a process that is carried out. It delivers a particular outcome but, at the moment, it is not being used in a way that aligns with that broader public sector reform agenda.

Liam Kerr: On that public sector reform agenda, I asked Colin Borland about planning and strategy in relation to business rates. In the same vein, in June 2025, the Cabinet Secretary for Public Service Reform said that, to close the looming £5 billion black hole in the public finances, the civil service would shrink by 4 per cent to 5 per cent by 2030. This morning, I read figures showing that, in June this year, the civil service head count was up by 1 per cent. Sandy Begbie, do you get any sense of what the reforms to deliver that reduction might be, whether it is being strategically planned in advance so that we know what the consequences might be and, of course, whether the reductions will be delivered?

Sandy Begbie: I am an adviser to the board. A lot of planning has gone into it. I have been around the agenda for the past three or four years, prior to the current cabinet secretary coming into post. I was also a non-executive director with the Scottish Government from 2004 to 2013, so I have been in and around the public sector for a while.

This is probably the most serious attempt at public sector reform that I have seen. There is a series of workstreams and plans that sits beneath it. I am not belittling it when I say—in fact, I have gone on record as saying—that the size of the challenge is enormous because, to be blunt, you are trying to change an organisation that, to all intents and purposes, has not gone through any significant change over the past decade or so. My background in my corporate career included running three big transformation programmes, so I am well aware of some of the challenges that are associated with that.

From a people perspective, the cost base is high, and reducing the head count was obviously always going to have to be part of the agenda. There will undoubtedly be inefficiencies in the public sector as it stands today, as there are in any large organisation—that is not a criticism of the public sector per se.

10:30

Normally, in a situation in which an organisation has not changed for a period of time, anywhere between a 5 per cent and a 10 per cent efficiency should be achieved relatively straightforwardly, in my experience. That is a reflection of the sheer size of the organisation and the fact that there are working practices that have been ingrained for a long period of time. However, once you get beyond that, you have to really think about how to transform the way in which services are delivered and which services will be delivered.

I have gone on record, including last week, to say that part of the agenda needs to be invest to save. You will hit a limit in how much you can save by simply being more effective and efficient, and you will have to invest in technology and artificial intelligence to change the way in which you deliver services to achieve a lower unit cost, to address the increasing demand in certain parts of the public sector. Therefore, invest to save has to be part of the agenda.

Overall, there are a lot of building blocks in place that I would expect to see for this scale of transformation. Its delivery will undoubtedly be tough, because there are always barriers associated with any big transformation programme, and we still need to get into and deal with the barriers. Procurement is an example of that; I have raised the point that there are no organisational incentives to use procurement differently. It is a big part of the public sector, so that needs to change.

Colin Borland: Sandy Begbie is right. We have all been involved in corporate restructures, and we have all been hauled in by the board or the chair and told to reduce costs by 10 per cent—that is fairly unremarkable in the world of work.

When the stats came out yesterday, I read that the size of the public sector in Scotland has increased by something like 45 per cent since 2019, and I believe that it was the permanent secretary who said that about half of all Scottish Government employees have line management responsibility. That sounds like quite an old-fashioned, pyramid-shaped management structure, which should be ripe for stripping out various layers to achieve a much flatter structure, as most of us have. I will leave that to the people who are managing it—perhaps they would tell me that I am massively oversimplifying things.

There is the publicly quoted figure of the wage bill having gone up by about £1 billion in a year, with most of that down to regradings. Is the annual wage bill about £13 billion? I am not sure, but it is a lot of money. If you could take just 10 per cent out of that and bank it—the first 10 per cent is always the easiest 10 per cent when you do something like this—you would be a healthy way towards the £5 billion savings that we need to find.

Liam Kerr: I am grateful to you both.

Pauline Stafford: My question is for Colin Borland. I liked your comments on being in the market for silver linings, although it might be silver bullets that we are looking for.

I want to touch on your submission and what it says about where SMEs sit in regard to young people and apprenticeships. The fact that your sector is so large means that even small changes could give us quite big gains in that area. Mr Begbie touched on the Milburn report, and your submission states that Scotland sits slightly better than the rest of the UK—at 38 per cent compared with 41 per cent—for young people who are not in education, employment or training. First, is there any significance in that difference that we should be looking at? Are we are doing anything slightly differently that could be expanded? Secondly, what are the barriers to SMEs taking on more apprentices? Should that be tackled at Government level, or is it best tackled at local level?

Colin Borland: On the first point, I am not aware of anything that has emerged from the figures that would explain the difference between Scotland and England. Either way, both figures are still far too high and represent a massive waste of opportunity and talent.

On involving smaller businesses, a really good thing in the programme for government is the fact that the apprenticeship accelerator grant has been confirmed, which we have been calling for for quite a while. One of the barriers to hiring apprentices is, of course, cost. One of our members who is in construction told me that, over the course of a full construction apprenticeship, they are probably looking at about £80,000 for the cost of training, materials and all the rest of it, which is not an insignificant amount of money.

If we can ensure that the grant is focused squarely on smaller employers who will use it to get that decision over the line and is not given as a subsidy to big employers—basically, that would just be giving them money to do what they were going to do anyway—that will have the biggest impact because, to follow on from what was said earlier, small businesses tend to recruit from the local labour market and employ people who are further from the labour market, and they are more likely to employ based on the potential that they can see in people rather than following a mechanical human resources scoring process. In terms of getting people who are furthest from the labour market back into economic activity, our record is pretty good—it is certainly better than the record of the people around us, so that is where you are going to get the biggest bang for that buck.

Pauline Stafford: Have you had any indication as to whether the grant might be targeted in that way?

Colin Borland: Not yet, but I look forward to making that case.

Pauline Stafford: My second question is on work experience. Your submission says that

> “High-quality work experience should be treated as preventative investment”

and that the Government should put in place a national programme in that regard. Can you give us a bit more detail on what you would envisage as being the most effective way of doing that, and how local authorities would fit in?

Colin Borland: One of the things that we have found is that work-experience provision is quite patchy. It can come down to how enlightened a particular headteacher is. There are excellent examples and some not-so-excellent examples. If there were a national system that people could register with and dial into, we could ease some of the burden of bureaucracy.

We need to make it easier for people to offer work experience. We hear stories about local businesses that want to give something back and are interested in providing work experience but they do not know who to approach, and they sometimes find that, when they make an approach, they get rebuffed. Having a national programme would probably help to streamline the system and widen participation.

Sandy Begbie: I will comment on a couple of those points. I mentioned the Milburn report. As I said earlier, like others, I have been around this area for quite a number of years, and I do not think that there is anything in the Milburn report that does not apply to Scotland when it comes to the root causes. We will see what recommendations come out of that report in October.

As was independently validated, the young persons guarantee during Covid had a marked impact on reducing the level of youth unemployment in Scotland to a lower level than the level in the rest of the UK. That guarantee then became mainstream and was put in place in relation to a particular series of events, and more than 25,000 opportunities were created in 18 months to mitigate the impact of the pandemic.

That approach was partly based on the simple premise that, while businesses continue to talk about a lack of skills holding back their growth and productivity, we have a number of young people who are inactive at the moment, so the opportunity exists to reorient the system to connect the young people with those opportunities. Apprenticeships are part of that. The issue is important, because the downstream costs of having young people out of employment are significant, as we talked about in our report on the young persons guarantee.

On the point about work experience, I would highlight a particularly interesting initiative that is being implemented at the moment in Aberdeen, funded by the schools and the council under the developing the young workforce approach. It guarantees that all young people who do not go on to university can access a foundation apprenticeship, depending on their background. Basically, it means that, if you are in fourth year at secondary school, you will be guaranteed a foundation apprenticeship. It is a really interesting idea, and I have spoken to Alan Milburn about it. It sends the message to young people that they can take a different path in life, and it uses the DYW network of local employers to provide those opportunities. Usually, after that foundation apprenticeship, people go on to college to do the full apprenticeship and then into employment.

Pauline Stafford: There is evidence that suggests that, if you catch people before they end up longer-term unemployed, it makes a big difference. Thanks for that.

Kim Schmulian: I have a question for Colin Borland. There is a lot of activity going on to create positive pathways for kids leaving school. However, to a certain extent, they still rely on the kids being proactive in finding that information for themselves. You mentioned the importance of headteachers in that regard. Should there be a more uniform programme of engagement with kids when they are thinking about the next stage of their lives in terms of education and training, and should we give them more support at that stage?

Colin Borland: The more practical advice you can give them, the better, and the more people with that experience you can expose them to, the better. A young person’s parents may have been in the same industry or the same sort of jobs for most of their life and their teachers may have been in that profession for a number of years. The world of work is changing really quickly, so the more of that we can inject into it, the better.

I would also put in a plea for people to point out self-employment and entrepreneurship as a career path. That might not be right for someone at the age of 16, although some people go straight in and launch a brilliant idea, but when someone has learned a trade or profession and, at some point, they think about what their next step should be because they feel that they are stuck in a corporate structure or whatever, their next step may be to move out and climb their own ladder. We ought to big that option up and make it more realistic for kids, and particularly those who do not have a background in a family business, because a lot of that tends to be generational. If we make that a realistic option, it could pay dividends as well.

Kim Schmulian: There is a lot of evidence out there that the kids who are routinely playing truant are the ones who are getting into crime, and they are then the ones who do not enter the labour market. I think that we should do a lot more to identify those kids and help them at that stage. That would take them out of the criminal justice system, which would be good, because that area is cash strapped as well. What do you think about integrating something like that into what you have suggested?

Colin Borland: That is the kind of thing that we mean when we talk about preventative spend. It is about spending money in one place so that we do not have to spend 100 times as much at the other end.

Kim Schmulian: Yes. It is definitely a big issue.

We saw the programme for international student assessment results recently. On science, technology, engineering and mathematics, are you of the view that we are still not doing enough to get kids leaving school with technical abilities and skills that they can take forward into university and college courses? That will help them to get jobs that pay well, which will broaden the tax base.

Colin Borland: When I talk to members about that, they say that the most important skill and the thing that they want people to arrive with is the ability to learn. There is no point in saying, "I want 200 vibe coders and I need them by next Tuesday," because, by the time next Tuesday comes around, you will need something else. Things are moving quickly, so the ability to pick new stuff up quickly and develop and move on is crucial.

The other side of it is soft skills. Not everyone likes that term, because they are actually pretty hard-headed business skills about the ability to answer the phone, to sell, to work as a team, to communicate effectively and so on. However, our members say that those things would really make life easier for them.

Kim Schmulian: I have seen some of that research and it indicates that it does not matter whether the young person is a school leaver, a college leaver or a university leaver. They have the same issues. Maybe more extensive work experience while young people are at school would help with those difficulties in the workplace.

Colin Borland: Anecdotally, that makes perfect sense. We should think about how much we learned in our first Saturday jobs, such as how to deal with the public. Those things turned out to be invaluable and they stay with people for the rest of their careers.

Kim Schmulian: Would that be better entrenched in schools, maybe working in partnership with businesses in the local community?

Colin Borland: I am not too bothered about the mechanism but, as long as it is accessible to local employers, that sounds sensible.

Sandy Begbie: On the point about young people ending up in the justice system, as part of the young persons guarantee, we funded a programme in Dundee, in partnership with the Wise Group, in which we worked with schools, teachers, the council, some employers and the college to identify young people who, without some intervention, were highly likely to end up in the justice system. We worked with just under 70 of them for a year and, with the Wise Group, we also did wraparound support for families, because most of those young people tended to come from families with no parent in employment and from particularly difficult backgrounds. That programme was independently validated and, at the end, we lost only one young person. The rest of them ended up going to college, doing apprenticeships and going into work.

We proved the point about early intervention. At that time, I found out that it costs us about £40,000 a year to keep a young person in prison. The programme that we funded had a high cost, but the figure was about £4,000 per young person. It does not take a lot to work out the cost differential. We have lots of evidence that early intervention works. It is just about having the courage to scale it. I am not underplaying the challenge, which is part of the public sector reform agenda, to do with how we shift some of the resources from dealing with the downstream consequences into prevention. It is hard but, unless we try to find a way through that, we will constantly pick up the downstream consequences of not having that early intervention.

Kim Schmulian: I think that the example of preventative spend that we have both talked about is a no brainer. I know a lot about the work that the Wise Group has done. Did it try to pitch that at a higher level to Government, in terms of funding and being proactive in rolling that out?

Sandy Begbie: We did.

Kim Schmulian: What was the response?

Sandy Begbie: It was a different Government at a different time. We were coming out of Covid and a lot of other things were happening, so I will not comment on that one way or the other. My main point is that we have a lot of pilots and evidence points in Scotland. Through my work with the YPG and DYW, I have said, "Let's not create further evidence points. We already have enough to show what can work." Let us think about whether we can scale them and, if so, how. Not all of them can be scaled, but if they can be, let us try to find a way of doing that.

Kim Schmulian: I am always amazed that young people leave school and still have reading and writing challenges. I had an experience of that recently with a young girl working in my husband's dental practice who could not pass the dental nurse exams because, although she was fantastic in every other respect, she could not get the arithmetic component. I agree with everything that you have said.

The Convener: I thank our witnesses for their time and their evidence.

I will suspend the meeting briefly to allow a changeover of witnesses.

10:46

Meeting suspended.

10:54

On resuming—

The Convener: We will now continue our evidence taking, as part of our pre-budget scrutiny for 2027-28, on the affordability and sustainability of Scotland's tax and spending plans.

I welcome our second panel of witnesses. We have Juan-Pedro Castro, who is an economist at Future Economy Scotland; Sara Cowan, who is a member of Tax Justice Scotland; and Joanne Walker, who is a technical officer for the Low Incomes Tax Reform Group, which is part of the Chartered Institute of Taxation.

I will start off the questions with the same question that I put to the previous panel. Can Scotland realistically close its medium-term fiscal gap through stronger economic growth alone, or will sustainable public finances require more significant tax reform and revenue raising alongside growth? Who would like to start us off on that?

Juan-Pedro Castro (Future Economy Scotland): Aligning economic development policy levers to achieve sustainable economic growth should very much be a core focus of Government. It is a core priority of the current Government, and it will help to support the sustainability of the public finances in the long term. However, the benefits of such an approach are quite uncertain and will materialise only over the medium to long term. As important as it is to get infrastructure and skills strategies right, those measures do not directly address the fiscal gap that we are likely to see over the current session of Parliament. It should definitely be a focus, but it is not enough on its own. Tax reform that raises revenue while also supporting economic growth and remaining fair and progressive should definitely be part of the policy mix.

Sara Cowan (Tax Justice Scotland): Hi, and thank you for the opportunity to participate in this committee discussion. In addition to being a member of Tax Justice Scotland, I work at the Scottish Women's Budget Group, which works to progress women's equality through public budgets and economic policy. I will bring in evidence from both sides.

In the conversation about economic growth, it is vital to consider how, and for what purpose, we seek economic growth, what areas we seek it in and what we, as a society, value. For too long, key areas have not been considered part of economic strategy, particularly those that we would describe as social infrastructure, such social care and childcare. Those areas need to be viewed in terms of both what they provide to society and their role in supporting economic growth.

The Convener: I do not disagree with that, but I asked specifically about the medium-term fiscal gap.

Sara Cowan: Okay. Specifically on your question about whether the gap can be closed through economic growth alone, we consider that fundamental tax reform is needed in Scotland to grow the tax base in a fair and effective way and to contribute to raising more revenue to support public services. That is a vital part of closing the fiscal gap and enabling significantly higher public spending while redistributing income and wealth. Those are the two elements of closing the fiscal gap, and I note the importance of redistribution.

Joanne Walker (Chartered Institute of Taxation): Thank you for the opportunity to speak with you today. We would not normally comment on matters of economy as such, as we are focused mainly on the tax system specifically.

It appears that the fiscal gap will not be closed by economic growth alone, because too many other factors can limit economic growth. One of the other aspects that you must consider is the way in which the fiscal framework shapes our interaction with the UK Government's approach to economic growth and how that affects the funding situation in Scotland.

The Convener: Two out of three of you have mentioned tax reform. What taxes would you reform?

Juan-Pedro Castro: Earlier this year, we published a report called "Funding Scotland's Future: Tax Reform for a Just Transition". It recognises the challenging fiscal situation and proposes tax reform that is deliverable under the current devolved framework.

We propose four specific revenue-raising reforms. We think that council tax needs to be abolished. We propose also to abolish LBTT, which is a very harmful tax on mobility, and replace it with a progressive property tax that is charged at 0.75 per cent of property values up to £400,000 and at 1 per cent beyond that, which would raise more than £200 million.

11:00

Beyond abolishing council tax, which should be a priority in this parliamentary session, we propose abolishing NDR and replacing it with a land value tax that is charged at 2.9 per cent of undeveloped land values. That would have the benefit of not disincentivising business investment, which can hurt businesses that invest in their properties for growth. That would not be the case under a land value tax. We also propose extending it to cover forestry land, not only commercial properties, over the duration of the parliamentary session. That would raise more than £400 million.

Another land-related tax that we propose is a betterment levy, which would be set at 30 per cent of the land value uplift from planning decisions that change the denomination of land from rural land to buildable land. We estimate that a 30 per cent tax could raise £70 million to £80 million.

The proposal that would raise the most money is one that cannot be ignored, given the challenging fiscal situation: we propose further raising income tax. We propose a 1 per cent increase for the bottom three bands, a 2 per cent increase for the top three bands and a lowering of the higher-rate threshold to £40,000. That would raise £1.5 billion after behavioural responses are taken into consideration.

It would be a big change, but, if you look at international comparators, median earners in Scotland are taxed relatively little compared with those in other Organisation for Economic Co-operation and Development countries. In the UK, we like to compare ourselves against the Nordic countries, and Norway and Sweden combine progressive taxation, which we have achieved in Scotland, with a broad-based, higher starting rate of income tax. That would mean asking for a bit more from median earners, but, in exchange, it would fund stronger public services and ensure that Scotland can continue to deliver its proud social contract.

Sara Cowan: We agree that reform of council tax is urgently needed, because it is an outdated and unfair tax that is regressive in nature and that disproportionately impacts those on lower incomes. In the light of the announcement on significant local government reorganisation, it is vital that local government finance is looked at as part of the process. Local government restructuring alone cannot resolve the finance challenges that local government faces.

There is no real logical reason for the current valuation of properties to be based on 1991 property values, so a revaluation of all properties should be the key starting point. The publication of the recent analysis from the council tax consultation demonstrates that there is public support for council tax reform: 82 per cent of respondents to that consultation were in favour of change and 67 per cent were in favour of revaluation. That chimes with the polling that we did on council tax reform at Tax Justice Scotland, which found that five times as many Scots support urgent reform as oppose it. Other Tax Justice Scotland members and the Wellbeing Economy Alliance have done further work to understand people's views around wealth inequality and wealth taxes, with council tax being viewed as one of those taxes, and that also has found strong support for a change to council tax.

Alongside that, there are moves to bring in the private jet levy, which is a really important additional tax power to bring to Scotland. Tax Justice Scotland members and Oxfam Scotland have been clear about setting the rate for that tax as high as possible and have recommended that it should be 10 times higher than the highest rate of air passenger duty.

We support continuing to take a progressive approach to income tax and recognise that Future Economy Scotland's analysis shows the need to bring in further revenue through income tax changes.

Joanne Walker: I agree that council tax reform is required. The valuation position is now 35 years out of date. We would not pay income tax or VAT on the basis of values from 35 years ago, so that needs to be updated.

Also, council tax has two kinds of regressivity built into it. First, as properties in each band move up in value, people in those properties pay proportionally less tax than those in properties lower down in the band. Also, overall, the proportion of tax that is paid in the higher bands gradually gets lower. You could do various things to improve that. You could amend the way that the banding system works.

Secondly, there is an issue with council tax reduction, which is claimed by about 18 per cent of households. Council tax offers a big opportunity for redistribution as well as for revenue raising.

The Convener: We might touch on some of that later.

Joanne Walker: Okay. Reform of council tax could reduce the need for people to claim council tax reduction.

I cannot remember whether it was Sara Cowan or Juan-Pedro Castro who mentioned this, but there needs to be a better understanding of council funding. In particular, the fact that council tax does not fund the whole of council spend is a big issue.

On income tax, the focus tends to be on behavioural change at the higher end of the levels, but there is potential to increase the tax base at the lower end by considering the interactions with the rest of the UK tax system and with the UK benefits system. In particular, universal credit claimants can be discouraged from increasing their work because of the 55 per cent taper. For someone who is claiming universal credit, if a change to the tax rate or to their income tax liability means that their tax liability reduces by, for example, £1,000, their benefit will reduce by £550. That means that they will benefit by only £450, whereas someone higher up the income chain who is not claiming universal credit will see the full benefit of the £1,000 reduction. Things could be done to increase participation lower down the income scale, which would potentially increase the tax base.

The Convener: We will move to questions from members. As members are aware, when we have a panel with three witnesses, we need to tighten our questions and answers so that we get through all the questions and can explore other issues that come up.

Liam McArthur: Good morning. I will direct my question to Joanne Walker. The Chartered Institute of Taxation's written submission says that one of the key risks is

"the lack of a regular legislative mechanism for the maintenance of, and amendment to, devolved tax legislation."

The submission goes on to talk about the value of introducing such a legislative mechanism for Scottish taxes.

The Government has had a long-standing commitment to reform of council tax, which is as yet undelivered. A review is being undertaken of non-domestic rates, and the Parliament passed legislation on taxation fairly recently. The powers seem to be there. I am curious as to what mechanism the institute is alluding to in its written submission and what benefit that might bring in ensuring that the tax landscape is effective in helping economic growth and closing the fiscal gap.

Joanne Walker: Our starting point is that legislation that results in the imposition of a burden—whether a compliance burden or a financial burden—on taxpayers should be set out in primary legislation. That should, in theory, allow wider consultation and provide a longer time for scrutiny in Parliament than is the case with the secondary legislation mechanisms that we currently have. I understand that, if a statutory instrument that is subject to the negative procedure requires an amendment, it just fails—in other words, it cannot be amended—whereas primary legislation can go through a process of scrutiny and amendments can be made as it passes through Parliament. Inevitably, we are not perfect. We are all human and we make mistakes. That means that the people who draft legislation occasionally make errors in drafting, and those mistakes can sometimes be picked up during the scrutiny process, when a bill is passing through Parliament.

After land and buildings transaction tax had been brought in, the additional dwelling supplement was brought in very quickly, and changes had to be made quickly by secondary legislation. There was also a need for further primary legislation to allow those same technical amendments to be made retrospectively. Another limitation of secondary legislation is that it cannot make amendments retrospectively. Although, in many cases, we would not want tax amendments to be retrospective, in some cases it is important for them to be retrospective, and that was the case with land and buildings transaction tax.

We think that it would be helpful to have a spot for amending primary legislation in the calendar—maybe every couple of years rather than every year. That would allow technical and maintenance amendments to be made to primary legislation when those amendments require the making of primary legislation rather than the use of statutory instruments, and it would allow the necessary scrutiny to take place.

A recent example of that is what happened with the Aggregates Tax and Devolved Taxes Administration (Scotland) Act 2024. Part 2 of that act includes amendments to the Revenue Scotland and Tax Powers Act 2014 and long-awaited land and buildings transaction tax amendments, the need for which had first been raised in 2017. Those amendments were brought in seven years later—that is how long it took to find space for them in a piece of primary legislation. If there was something such as a tax bill, that would provide a definite spot for such amendments to be made. We are not necessarily suggesting that Scotland should have an annual finance bill, as the UK does, which leads to the vagaries that sometimes arise when there is the opportunity to produce legislation every year. We are suggesting that having the option to amend tax legislation when that is required would be a valuable addition.

Liam McArthur: Mr Castro, you have set out quite a comprehensive list of reforms. Given the complex interaction between different taxes, do you have a sense that having a mechanism that enabled all those changes to be brought forward simultaneously would allow people to have an understanding of what you were trying to achieve as a whole? Would that be manageable? In a sense, even council tax reform has proved beyond the reach of the Government, despite its having committed to it for successive sessions of Parliament, so I presume that trying to land such a mechanism alongside reforms of the type that you are talking about would just be the Government biting off more than it could chew.

11:15

Juan-Pedro Castro: I agree that the proposals that we talked about earlier are definitely comprehensive and complex. We do not have a view on the preferred legislative mechanisms to address that, but we do think that time for parliamentary consideration and consultations would have to be part of that process. Perhaps, at the consultation stage, separate consultations that address each of the different significant reforms separately would probably be beneficial, but there are no strong views on how that would fit in with the parliamentary schedule.

Michael Marra: Your submission leans very heavily on the “Funding Scotland’s Future” report, so I want to ask some questions about that. Do you think that somebody earning £40,000 is rich?

Juan-Pedro Castro: No. The level of living standards of someone earning £40,000 can vary depending on household composition, but there are definitely some families that would normally just be getting by. The question is hinting at whether a 44 per cent marginal tax rate on that income is perhaps too high for a median earner. We think that it is a significant ask, but it is not out of line with the ask that is made for similar median earners in other OECD countries. Crucially, it would help fund the kind of public services that the Government wants to deliver, many of which are universal and would be beneficial for people in that income bracket, such as free tuition fees and prescriptions. That is an important part of the proposal, in that it raises quite a significant bit of revenue.

Michael Marra: It is a very significant portion of the revenue that you propose. I find it difficult to interrogate, in some respects, because you have done a post-hoc estimate of the behavioural effects and that is not included in the decile tables within the methodology, so it is difficult to see clearly the distribution of impact. I think that the portion is about £1.5 billion of your total £2.3 billion, but at least £660 million of that comes from taxes on those earners. Is that correct?

Juan-Pedro Castro: That is correct. Those earners and earners above that threshold would be paying that higher rate for a longer period. The impact on the margin for a person earning £42,000 is important. The rate changes from 21 per cent to 44 per cent, but the impact on their absolute tax burden is not that significant, because only £2,000 is taxed at that higher rate. We show in the report that two thirds of the additional income that is raised from our proposed reforms will come from people who earn more than £50,000, so it is still in medium-to-high-income territory, but definitely not from those households that are affected by that change in threshold.

Michael Marra: The vast bulk of revenue that has been raised by the Scottish Government in recent years through tax changes also comes from those individuals who have been pulled into higher tax brackets through fiscal drag. The amount of money that has been delivered from the increase in the very top rates of tax is, in essence, vanishingly small. You have proposed an additional 2 per cent uplift to the top rate of tax. Do you know how much that would realise?

Juan-Pedro Castro: We have the numbers in the report. They are divided not by each individual reform but by income brackets, and they show how much would be raised from households earning more than £500,000 or £300,000.

Actually, my bad—in the report, we say that the change to the top rate on a static basis would bring an additional £100 million, which is relatively small within the broader package. When it comes to behavioural adjustment, we do not have the same breakdown, but we know that we would take in roughly—

Michael Marra: It is about £5 million.

Juan-Pedro Castro: From earners over £500,000, yes.

Michael Marra: Those are not even rounding errors. To be honest, I have to say that the whole paper just does not feel very progressive at all, given the impact that the proposal will have on people. A lot of the people you are talking about are teachers, nurses and others who are really struggling with the cost of living day to day.

My reading of the proposition is that the £2.3 billion you talk about would be a potential substitute for the Government’s current approach to trying to address the £5 billion fiscal gap in the public finances. You are, in essence, proposing that a really substantial part of that should be paid by middle earners in Scotland—many of whom are struggling to make ends meet right now—because you recognise that the behavioural effects on the top end are so large that those people will not deliver anything. Is that your proposal?

Juan-Pedro Castro: I think that two things are being confused. As we show in the report, the majority of additional revenue will come from those earning more than £50,000, and it is top earners, at individual level, who will be most impacted by the reforms. That is the case for income tax, and it is also the case for the progressive property tax that we have proposed.

The reason why it will raise less revenue than you might expect is not just behavioural responses but the fact that there are not that many top earners in Scotland to raise £2.6 billion through the income tax system. As a result, we have proposed having an honest conversation about broadening the tax base and asking a bit more from the majority of taxpayers as a way of funding public services.

It is true that a group in the middle will, like those at the top and the rates that they are facing, see a bigger change, but the impact of the average tax rate across their income will not be that significant. Crucially, as I have said, this is what we think is needed to allow for the promise of strong and sustainable public services to be delivered. The efficiency savings proposed by the Government are 100 per cent going to have to be part of the solution, and we welcome efforts to make public service reforms—

Michael Marra: But you have described them as "unrealistic" in your submission.

Juan-Pedro Castro: Yes. I think that expecting to make £1 billion or £1.5 billion of savings over the next five years as a result of efficiencies in the national health service is unrealistic. The NHS is already understaffed and suffering from long waiting lists. There is also the issue that long-term public service reform will require up-front investment to fund the design of the consolidated health boards and the consolidated public bodies. Expecting to close the gap just by making efficiencies is definitely unrealistic, but it should be part of the effort alongside tax reform.

The issue with the efficiency argument is that it is a very short-term and short-sighted effort at closing a specific budget gap that will emerge over the next few years—

Michael Marra: But it has not emerged. It has been created by the Government, and I agree that it has got us in a mess.

Sara, you have talked about changes to the private jet tax. What sort of money would that realise? Do you have a figure for that?

Sara Cowan: These figures come from Oxfam Scotland, which is a member of Tax Justice Scotland and has done the most work on this issue. It thinks that, if the tax is set at the higher rate, it will raise around £30 million a year and £90 million over the course of the parliamentary session.

The important thing about that type of tax is that it has a dual purpose: it can raise revenue, and it might also limit the number of private jet flights. Therefore, it could have an impact on climate, too.

Michael Marra: You are talking about a multiplier of 10. In essence, your logic is to stop people from flying, so that money will trend towards zero.

Sara Cowan: If it is effective at changing behaviour in relation to climate, then yes.

Michael Marra: Is the £30 million before or after that behaviour change?

Sara Cowan: Before.

Michael Marra: So, it will be multiplied by whatever amount. Those are incredibly small numbers, whether we agree on a moral basis whether people should be flying private jets in and out of Dundee to play golf or otherwise. Those are vanishingly small amounts of money, particularly if you are multiplying them by 10 towards zero. Is it not the case that the progressive proposals that you are both bringing to the table do not deal with the scale of the issues?

Sara Cowan: I disagree with that. So far, we have seen inaction on council tax. Changing council tax brings something to the table, but continued inaction leaves an unfair tax in place. It harms public services because it does not bring enough revenue in.

We have reviewed local authority budgets every year for the past four years. We look at the decisions that local authorities make on savings from a gendered point of view. We see decisions being made to cut back on childcare, for example, so that it is delivered from the term after a child's third birthday rather than the week after a child's third birthday. That can leave a gap of five months when someone is not receiving the funded childcare that they are entitled to, given that the Scottish Government says that all three-year-olds will receive funded childcare.

The alternative appears to be inaction on climate change, and that is not good enough for the people of Scotland.

Michael Marra: Back in June—I think that it was 3 June—the Parliament agreed that there should be immediate talks on council tax reform. Have any of your organisations been involved in those talks?

Sara Cowan: I have not.

Michael Marra: Okay. That is little surprising to me.

I will put one last question to Juan-Pedro Castro and then maybe one to Joanne Walker. You mentioned in your submission—

The Convener: Please keep your question very short.

Michael Marra: I will try to be brief. At the beginning of your submission, you talked about economic growth and the need to address that. There is very little in the paper that proposes anything to drive economic growth, other than a renegotiation of the fiscal framework, which is not the same thing. Do you recognise that a renegotiation of the fiscal framework is not a measure by which to achieve economic growth?

Juan-Pedro Castro: Yes. The paper focused on fiscal reform. That was the remit we set ourselves. We have done a lot of work on actions that the Scottish Government can take to promote inclusive growth. Two papers have been published in collaboration with University College London's institute for innovation and public purpose, which considered what would happen if the Government developed a more strategic green industrial strategy that shapes markets and drives investment through having a central role for public investment.

Michael Marra: That would cost quite a lot of money, as opposed to dealing with the fiscal gap. Ms Walker, following on from the evidence that we have taken from Mr Castro, would your organisation be concerned about tax increases on low and medium-tax payers, given your remit?

Joanne Walker: The low income tax reform group is part of the Chartered Institute of Taxation. We do not normally comment on the burden of taxation. We normally comment on the way in which it is administered and operated. We are looking for a simple and effective tax system.

On spreading the burden, I mentioned the interactions with universal credit. Sometimes it is more effective to help people on lower incomes through social security than it is to do so through the tax system. Raising the personal allowance does not help people who are not earning enough to pay tax anyway, so there are other options, such as increasing the work allowance in universal credit. However, that is not in your gift, unfortunately.

Michael Marra: But those interactions are important. That is a good point very well made.

Joanne Walker: Those interactions are key.

11:30

Liam Kerr: Joanne Walker, I turn to Mr Marra's questions about Mr Castro's proposals to increase taxes on everyone, particularly middle earners, and reduce the higher rate threshold to £40,000. The Chartered Institute of Taxation has highlighted that someone earning between £43,000 and £50,000 in Scotland faces a combined marginal income tax and national insurance rate of 50 per cent, which compares with 28 per cent elsewhere in the UK. In practical terms, does that discrepancy risk discouraging people from taking additional hours, overtime and promotion? Are there any other behavioural changes that your organisation fears from that?

Joanne Walker: Anecdotally, we certainly hear that that may affect people's decisions to take on extra work or accept higher pay. There are certainly people throughout the UK who make use of pension contributions to increase their tax relief and, in effect, increase their basic rate band. That is a key way for people who have the ability to reduce the amount of income on which they are paying a higher rate of tax.

Other available options include gift aid donations. However, use of increased pension contributions is a definite thing, whereas evidence on the use other behavioural options is more anecdotal and we do not have the actual data to support that.

Liam Kerr: I am very grateful. I come to Mr Castro—I see that you want to pick up on that question, and this might stimulate your response. In your submission, you specifically say, in relation to increasing the tax rates and reducing the higher rate threshold, that you are "accounting for behavioural responses" when you make your estimates. This committee has heard that there is a dearth of evidence on what those behavioural responses might have been. That rather begs the question: what evidence did your organisation use to account for those behavioural responses, and what behavioural responses did you find?

Juan-Pedro Castro: On the anchoring to the UK and the gap between UK and Scottish tax rates at the £40,000 earnings range, we definitely recognise the issue. The Government has already lowered the higher rate to some extent but might choose not to do that further. In the report, we set out how much the proposed reforms would raise if that higher tax rate was not changed. That is a decision for the Government.

There is a question around whether constantly comparing our tax rates to the UK's makes sense when we are trying to deliver a different quality and scale of public services. Tax cannot remain the same if we are to deliver a different shape of public services.

On behavioural responses, it is true that it is a highly uncertain art. We replicate the methodology that the SFC uses to calculate behavioural responses in its costings of policies for the Scottish budget. That methodology was developed at the time that income tax was devolved and it draws on empirical evidence from cases—mostly from the UK but also from some US studies—where income taxes were changed. It settles on a range of what gets called income elasticity—it is like responsiveness—which varies by income, as evidenced by empirical studies, but it is definitely not a settled question.

We very much encourage and welcome the Scottish Government's efforts to understand specifically what behavioural responses look like in Scotland based on actual policy changes over the past couple of years. I know that there are efforts internally in the civil service to get robust evidence on what that looks like. There have been media reports on whether recent reforms have won or lost earnings. A lot of that has been based on headline results that hide a lot of modelling uncertainty, as recognised in the reports that were being referenced. More evidence is definitely needed.

Liam Kerr: I will move to Joanne Walker, who I suspect might wish to comment on that anyway. The Chartered Institute of Taxation written submission highlights the dearth of evidence on behaviour change and, indeed, the complexity of gathering it. However, it is now 10 years since Derek Mackay, as finance secretary, did not even know what the Laffer curve was, and we are still playing in that environment. Helpfully, the submission references the 2024 tax strategy commitment to, we hope, get that data, but we are still awaiting the evaluation. That will also be used to inform the 2027-28 budget. Joanne Walker, do you have any confidence that it will be ready in time? Mr Castro talked about "robust" data. Do you have any confidence that the conclusions will indeed be robust?

Joanne Walker: I have no knowledge of whether the data will be available in time—I am not in a position to know that. We have outturn results from HMRC, and we have undertakings to look into potential behavioural changes, but I am not aware of when that is to be published. I am sorry, but I cannot comment on that.

Liam Kerr: That is perfectly reasonable. Perhaps the committee can take that forward.

Pauline Stafford: I want to pick up on Juan-Pedro Castro's point about international comparisons. The Tax Justice Scotland written submission points out that

> "Future Economy Scotland have conducted wider analysis of how Scotland's income tax regime compares internationally to OECD countries and consideration of behavioural responses, in modelling … tax reform".

How valuable are those comparisons, given that we are in a devolved context with very few levers available and within the limitations of the fiscal framework? Are those still valuable? Where are you looking specifically that could inform our thinking?

Juan-Pedro Castro: Those comparisons are valuable. It is true that we exist in a devolved context, but that includes the devolution of non-savings, non-dividend income tax, which is a significant portion of the devolved budget, and there is scope to diverge from UK income tax policy, as the Scottish Government has done already. That should be guided less by anchoring to specific UK rates and more by views on the desired structure of the income tax system, based on how much revenue we want to raise and what the progressiveness should be.

European or OECD countries can serve as an example of alternative routes on that. It is true that the relationship to the UK is relevant for some factors such as behavioural responses, but the OECD evidence shows that, in both the UK and Scotland, tax on median earners is way lower than it is in most comparable OECD countries. That is a factor in income tax not raising as much as it otherwise could.

Pauline Stafford: Ms Walker, the Tax Justice Scotland submission argued that broadening the tax base might require a wider public discussion about taxation, which is probably where we are at right now. We have talked a lot about the Laffer curve, and I am thinking about tax literacy among the public and the perception of fairness. Are we at the limit of what we can do with income tax? UK-wide, there has been a lot of talk about wealth tax. Do you think that a wealth tax is important in the devolved context, or are we better to look at reforming the taxes we have? You have talked about council tax, but we have come up against a lot of barriers to council tax reform.

Joanne Walker: A lot can be done on tax literacy. There are misconceptions about council tax, what it pays for and what the intention is for it. There is a huge misconception about income tax and the powers that the Scottish Parliament has. Since 2018 and the start of main income tax diversion, the CIOT has run five polls, using the Diffley Partnership. Earlier this year, we completed the fifth of those surveys, and not only were 70 per cent of people unaware of the ability to claim pension contributions tax relief, but only 21 per cent of people who responded to that survey understood that income tax powers were shared, in effect, between the Scottish Parliament and the UK Parliament, and 47 per cent of people thought that the Scottish Parliament controls the whole of income tax. In some respects, that is quite a big issue that needs to be overcome.

Obviously, at the moment, you could not have a national wealth tax here, but we could have local wealth taxes. From a practical point of view, the difficulty with wealth taxes is that they involve a lot of decisions: what assets you include and how you value them, as well as issues such as whether, if you exclude certain types of assets, people will move everything into those kinds of assets so that you are not able to tax them anyway. There are other options. In effect, we already tax income and gains from wealth, through things such as capital gains tax. Arguably, income tax on rent is a form of tax on income from wealth. Taxing interest and dividends is also a form of taxing income from wealth.

In addition to those options, fairly soon, the Scottish Parliament will have the power to set its own rate on rental income. At the moment, it is just the same as the rate for all non-savings, non-dividend income. The decision on rates might be partly affected by what the UK Government does, but there might also be a decision to be made as to how the Scottish Parliament wants to approach taxation of rental income.

Does that answer your question?

Pauline Stafford: Yes, that is helpful.

Kim Schmulian: Mr Castro, in your opening statement, you talked about international comparators, but the fact is that many countries that have had wealth taxes have ditched them, because they end up being counter-productive. You also talked about the Nordic countries having higher tax rates, which is correct, although I believe that, in those countries, they get many benefits back, particularly in relation to fuel costs. I wonder whether you have got your data correct on how people will react to such measures.

Ms Walker, do you really think that middle-income earners who can now change their working hours quite easily under new employment legislation are going to wear these tax increases, particularly given that we are probably looking at high inflation next year? From a political perspective, I really do not think that any party would be particularly happy about making these moves.

11:45

Juan-Pedro Castro: We explore wealth taxes in our report. We do not recommend pursuing a wealth tax in the devolved context. We sympathise with the rationale behind wealth taxes, but I agree with the limitations and practical considerations that Joanne Walker has set out.

We do not engage so much with the international evidence on wealth taxes because we are not recommending one. We consider that there are better ways of taxing wealth through taxes that are already in place, such as council tax, which is a tax on property, and NDR. I have previously set out some of the recommendations on those specific taxes.

I absolutely agree that there are difficulties in having political conversations about higher taxation, but it has been pointed out that other countries, including the Nordic countries, have higher taxes while providing higher levels of services. That is precisely the conversation that we should be having, and the argument that the Government should seek to make.

It does not make sense to talk about tax in isolation. Obviously, if we had the choice, everyone would rather be taxed less than more. However, taxes fund public services and help to avoid cuts to those services. The Government has an ambitious programme of eradicating poverty, making progress towards climate targets and maintaining strong public services, such as the NHS. That will require further resources.

The Nordic countries that are high tax and provide a high level of public service are precisely what we should aspire to. If we move the dial on tax, we will have more room to manoeuvre on the public services side.

Kim Schmulian: I would argue that, in the Nordic countries, people are supported across the board. Everyone benefits, for example, by getting money back to help with their fuel costs. In this country, we spend money on free prescriptions, although I think that a lot of people would be prepared to pay for them themselves. It is things like that that concern me.

Juan-Pedro Castro: We do not have a position on which specific policies the Scottish Government should prioritise or on what model of universal service provision would be desirable. The Government should set the policy direction. However, we sympathise with the spirit of a social contract that asks a bit more from the taxpayer but delivers more in return, whether that be targeted social security support, such as the Scottish child payment, which is having an amazing effect, or through universal policies such as free tuition, which eases barriers to higher education. We are less concerned about what the next priority should be or which one should be protected most, but we sympathise with that broader principle.

Joanne Walker: On the income tax situation, yes, income tax increases to a level at which the marginal rate is 50 per cent are potentially damaging to people’s perception of whether they should take on extra hours of work. There are recognised behavioural implications.

With regards to people at that level of income, one of the concerns that have been raised is whether the increases will drive migration out of Scotland, but I do not know whether they will be quite enough to do that. The data will tell us in time. However, for the tax band that covers those on incomes between £43,662 and £50,000, the extra tax paid is about £1,500 a year. That is a sizeable chunk.

Kim Schmulian: But that is a foreign holiday for many people.

Joanne Walker: Yes, I know—it is a sizeable chunk of money, but the question is whether it is enough to make someone think, "I'm going to move south of the border." I suppose that it depends; everyone is different and has different circumstances. People have to consider an awful lot of other factors, such as whether they have family connections in Scotland or want to be here for other reasons. You can probably tell from my accent that I am English, but I have lived in Scotland for most of my adult life, since the year 2000. There are reasons why some people come to Scotland and may want to stay here. There are a lot of other factors at play, not just tax.

On people coming into Scotland, we currently have net positive migration—

Kim Schmulian: Is that taxpayers, are you aware?

Joanne Walker: Sorry?

Kim Schmulian: Does that migration into Scotland consist of people who are paying tax?

Joanne Walker: I do not know—

Kim Schmulian: That is clearly a crucial question for us.

Joanne Walker: Yes. With regard to migration in, there is another factor that might affect people in addition to income tax. This discussion has focused very much on income tax, but there is another tax that could play a role, and that is land and buildings transaction tax. It is not a huge revenue raiser for the Scottish Government, although it is fairly sizeable, and the rates are slightly higher here. If someone is looking to come in and they already have another property, the additional dwelling supplement is currently very punitive, as it is set at a very high rate.

We have been talking about income tax a lot, but it is important to remember that land and buildings transaction tax and the additional dwelling supplement could also have an impact on people who are deciding whether or not they can afford to buy a house.

Kim Schmulian: You talked about focusing on tax changes, and you acknowledged that there is probably very little scope for economic growth. However, if someone decides to drop a day a week to get out of the higher-rate tax band, that will inevitably correlate with productivity. With regard to any end benefit, I cannot see that happening, because both aspects will even themselves out, surely.

Joanne Walker: I suppose it also depends on whether employers employ someone else to pick up the slack. Whether they do so in the current climate is a good question, too. I do not disagree with what you are saying—I am commenting on the tax factors.

Kim Schmulian: I think that I can say with some certainty, from my knowledge of employing many people over many years, that if one person reduces their working week by a day, that person's day will not be filled.

Joanne Walker: Yes—it is difficult to fill one day.

Alan Brown: I have a question for Joanne Walker. Liam Kerr asked earlier about comparisons between the marginal tax rates in Scotland and in the rest of the UK. When you do that analysis, do you take into account things such as student tuition fees repayments? That is quite a hefty chunk of someone's income.

Joanne Walker: Every time there is a budget, whether at a UK or Scottish level, I personally run a spreadsheet comparing all the tax liabilities, and it also gives me the marginal tax liabilities and the effective tax rates. I do not add in student tuition fee repayments, but I am very aware of that issue. There are other things too: the high-income child benefit charge kicks in at a certain level—it is now £60,000.

There are a lot of factors that mean that someone could end up with a marginal rate of 100 per cent or more at certain stages. For people on higher incomes over £100,000, it is about 62 per cent. The personal allowance is fully removed at £125,140, and above that the marginal rate drops again. However, there are a lot of spikes. The higher rate to the higher rate bit is just one of many big spikes.

Alan Brown: We are talking about educating people and getting them to understand taxation. The UK Government website says that the threshold for student loan repayments on current loan applications is currently £29,300, which is quite low. People then start paying a marginal additional 9 per cent above that. If we are comparing rates, that 9 per cent is significant if somebody is burdened with it for the rest of their working life.

Joanne Walker: Yes. Unfortunately, there are a lot of different factors that can be taken into account, and it will vary from person to person.

Alan Brown: Sara, you are quite robust about wanting council tax to be abolished and replaced with a property tax. Have you undertaken any modelling to see whether revenues could be grown under those alternative proposals? Your whole argument is about fairness, so could the Scottish Government introduce a system that both was more progressive and could raise additional moneys? Is that a possible outcome?

Sara Cowan: We would view that as a possible outcome. We have not undertaken our own modelling on that, but, ahead of the Scottish Government's consultation on tax, modelling was done on a cost-neutral change in terms of revaluation and some changes to the bands that were consulted on.

The decision on how much revenue could be raised in the future would come at the local level after changes had been made to the system. In reviewing those changes, we would call for gender budget analysis and human rights budget analysis to be part of the budget process and the decision-making process on how high to raise taxes—to look at the impacts that that would have on people and on challenging inequalities, as well as at the benefits that it could bring in raised revenue.

I want to come in on earlier remarks in the conversation on tax and the Scottish public's participation in that. It is a gap in the Scottish budget process that there is no public consultation on the budget more widely. The only way that individuals might be able to feed in is through parliamentary committee scrutiny, which is a hard level for people to get involved in.

If you are looking at how to prioritise decision making in the budget process, it is really important to hear from people—to know and to ensure that you hear from some of the people who are possibly worst affected by the current economic systems. The tax system and the discussion on tax have important roles to play in building trust in our political systems, so there is a real opportunity in widening the discussion. The council tax consultation and the analysis of its results is an important example of that.

Alan Brown: I have another question on council tax reform or moving to a property tax. Has anybody done any work on the possible growth benefits from people having more disposable income? The argument about council tax is that it hurts lower earners a bit more, so has any analysis been done on what that extra disposable income could mean to families?

Sara Cowan: The Institute for Public Policy Research Scotland might have done some analysis on that.

The overarching thing to say is that people with more marginal incomes are more likely to spend their disposable income in local economies. We have done modelling around that when looking at job creation in the care sector and at being able to demonstrate the job creation returns for local economies in terms of both direct and indirect job creation. We know that those on lower incomes—women being a higher proportion of those—are more likely to spend their money locally, so we would expect to see positive effects from that.

We have not done the modelling you refer to, but, as I said, IPPR Scotland might have done.

Juan-Pedro Castro: In our report, we model the potential for revenue raising through council tax reform. Based on our data, the revenue-neutral rate for replacing council tax with a proportional property tax would be something like 0.6 per cent. We instead propose abolishing not only council tax but LBTT and raising the rate to 0.75 per cent of the value of properties, and 1 per cent for properties that are valued at more than £400,000. That would raise additional revenue of £200 million.

It is important to tackle both at the same time because there is a long lead-in time with council tax reform, but there are also medium-term fiscal pressures, so delaying one for the other would be counterproductive.

12:00

We have not done any modelling on the impact on growth of improving the council tax or the property tax system. On council tax, the issue is that people's tax liability is arbitrary—it is based on very old property values rather than current property values—but addressing that, in itself, might not have a huge impact on growth.

We know that LBTT has a big, although hard to quantify, impact on growth. LBTT, which is a tax on the purchase of property, acts as a mobility tax. Someone on middle earnings who moves two or three times over a decade for work reasons will face that tax multiple times, whereas someone who does not move but stays in the same home, even if that home is more valuable, will not face it. We think that the two should be looked at in conjunction.

Liam Kerr: I have a brief question for Mr Castro on an issue that is very important to my region. Future Economy Scotland has argued that the just transition and movement into new industries will be important in growing the future tax base, but, after the recent programme for government, it said that Scotland is

"long on ambition, but too often short on delivery",

and that

"there's still no serious plan to mobilise investment to create green jobs on the scale needed."

Indeed, your submission says that

"Scotland has underperformed in green job creation".

You set out a number of recommendations on how to address that, some of which involve the provision of funding and some of which involve the addressing of the procurement issues that we examined earlier. Is the fundamental problem here a failure of the Scottish Government to invest and/or to prioritise and deliver effectively, and/or a failure to incentivise the private sector investment that might be required?

Juan-Pedro Castro: We mention that in the report. It is also a fiscal question, because, as you will know, the net tax position on income tax depends on Scotland's performance relative to that of the rest of the UK. That means that shocks that affect Scotland but which do not affect the rest of the UK can have an impact on the Scottish budget. Scotland is disproportionately exposed, because the oil and gas industry makes up a disproportionate share of the Scottish workforce and, in particular, of the Scottish high-earning workforce. Ensuring that those workers stay in Scotland and stay in well-paid jobs should be a fiscal priority.

In a previous report, we talked about the failure to transition some of those workers into green jobs. It is worth separating out the decline of oil and gas, which has been driven by the decline of the basin—it is the latest manifestation of a long-term trend—from the urgent need to develop green industries and green industry employment. Scotland's record on that has been weak over the past decade, during which time three oil and gas jobs have been lost for every green energy job that has been created. We think that that is definitely not good enough. We note in the report that there is potential for the trend to shift and for green employment creation to make up for that shortfall.

We call on the Government, under the umbrella of a green industrial strategy, to be more proactive and to invest directly, and take equity stakes, in ScotWind, as well as in key infrastructure projects and retraining, and to promote private investment through vehicles such as the Scottish National Investment Bank, through which it could seek additionality in those sectors.

There is analysis by Robert Gordon University in Aberdeen that says that the potential employment creation could far outweigh job losses in the oil and gas sector, but that that depends on onshoring domestic supply chains here in Scotland and on speedy, ambitious delivery against offshore wind targets. It is very much a case of going faster and harder on the green transition, if we want the green opportunity to materialise.

Liam Kerr: Thank you for that. This is all about growing our tax base and growing the economy, and you mentioned the RGU report. I think that it highlights—please correct me if I am remembering this wrong—that we need two green jobs to replace every one oil and gas job in order to make the figures work. Is that right?

Juan-Pedro Castro: It probably depends on whether you are looking at gross value added or earnings. The GVA gap is definitely much bigger, but a lot of that goes on profits to oil companies or in tax to the UK Exchequer. There is definitely still a significant gap in earnings, which is what matters for income tax. We look at that in our labour market transition report, "Delivering a Just Transition for Scotland's Fossil Fuel Workers". For some industries, we find, using a mix of different data sources, that the gap—although I do not have the exact figure—is comfortably larger than 20 per cent in many cases.

Ensuring that there is good pay in the green sector very much has to be a priority. Even then, it must be recognised that the significant salaries that oil and gas workers earn are unlikely to be replicated across the green supply chain. With regard to the fiscal impact, therefore, we need not only to match an oil and gas job worker to a green job, but to create net jobs as well.

Liam Kerr: I understand.

Liam McArthur: To follow that up, we heard in an earlier session from the Scottish Fiscal Commission that the Scottish Government had got itself into a position where the ScotWind revenues were being used almost as a second reserve. Concerns were raised about that in that evidence session.

To go back to what you say in the report that Mr Kerr mentioned, is the failure to use those ScotWind funds for the purposes of investing in strategic infrastructure, and in other aspects that are required for achieving net zero, inhibiting our ability to realise any fiscal and economic growth benefits from those resources? Do you have any concerns about the approach that the Scottish Government is taking in respect of using that fund, if not to plug gaps in the public finances, to at least cover those gaps in the short term?

Juan-Pedro Castro: Yes, definitely. In the latest Scottish Government budget, ScotWind revenues were used for the resource budget as well, which seems to be misaligned with the idea that the one-off revenue that the Government is getting from the leasing round should be used strategically for long-term economic growth and investment.

I am unsure as to what percentage of the ScotWind revenue of over £700 million has been used up. I think that, in some cases, it has been earmarked for different investment proposals, but it might not actually have been used. There needs to be much more clarity on how much money remains, and it must be ensured that the remaining money is used for long-term investment in green industries in the north-east. The Government's recent announcement that it intends to set up a ScotWind wealth fund is welcome.

We have also argued in our "Rethinking ScotWind: Maximising Scotland's offshore wind potential" report that the auction process should be reconsidered for the next round in order to maximise public revenues and that the Scottish Government should be investing in a percentage of equity in these projects to ensure that it has long-term revenue from the wealth creation that is happening off Scotland's coast.

That is definitely a capital requirement—it will require more capital investment. We have not touched on this today, but capital budgets are even under even more pressure than resource budgets. Nonetheless, finding the capacity to deliver that investment would ensure revenues for the lifespan of those projects, which is as linked to sustainability as it gets.

Pauline Stafford: My question is also on capital investment, although it is not on oil and gas or renewables—it is more on the university sector and how we use that.

The submission from Future Economy Scotland suggests that investment should focus not just on infrastructure assets, but on developing

"domestic supply chains and manufacturing capacity",

so that we can prevent economic benefits from flowing elsewhere when we have invested early on.

I know that you have worked with University College London on a mission-oriented industrial strategy—I am sorry; this is a long-winded question. I also read a report from Heriot-Watt University with the headline, "Scotland has the research. Now it needs the infrastructure to use it." It highlighted Heriot-Watt's Medical Device Manufacturing Centre and talked about whether we should be looking at creating shared infrastructure such as research and development facilities so that we can develop the innovation landscape and use university research to promote economic growth.

Do you have any comments about the current landscape, and whether we should be looking at that area so that our world-class university research does not flow elsewhere, and contributes to our own economic growth?

I hope that you can follow that.

Juan-Pedro Castro: Yes, I follow the logic, but I am afraid that I do not have much to say specifically on that. I am not familiar with the Heriot-Watt report.

I very much agree with the logic of leveraging the university sector and the innovation that is happening in Scotland. That is part of the report on industrial strategy that we produced.

With regard to how that is done through capital investment, I do not have many novel ideas. Nevertheless, it is really important to make sure that we get more economic benefit from the spending that is happening by linking to the domestically produced innovation in our universities and ensuring—as we say in our submission—that a proportion of it is leveraged to support domestic supply chains, as well as using conditionality and creating good jobs that fall under the definition of "fair work".

The Convener: I thank the witnesses for their evidence. We have gone a bit over time, so I thank you for bearing with us and for the information that you have imparted to us this morning.

At our next meeting, on Wednesday 23 September, the committee will continue our evidence sessions on pre-budget scrutiny. That concludes the public part of our meeting.

12:12

Meeting continued in private until 12:34.

This is a draft *Official Report* and is subject to correction between publication and archiving, which will take place no later than 35 working days after the date of the meeting. The most up-to-date version is available here:
https://www.parliament.scot/chamber-and-committees/official-report

Members and other meeting participants who wish to suggest corrections to their contributions should contact the Official Report.

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

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

The deadline for corrections to this edition is 20 working days after the date of publication.

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