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Finance and Public Administration Committee

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FINANCE AND PUBLIC ADMINISTRATION COMMITTEE
10th Meeting 2026, Session 7

CONVENER

*Clare Haughey (Rutherglen and Cambuslang) (SNP)

DEPUTY CONVENER

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

COMMITTEE MEMBERS

*Joe Fagan (South Scotland) (Lab)
*Liam Kerr (North East Scotland) (Con)
*Liam McArthur (Orkney Islands) (LD)
*Angela Ross (Edinburgh and Lothians East) (Reform)
*Pauline Stafford (Bathgate) (SNP)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Callum Bridge-Adams (Office for Budget Responsibility)
Professor Jonathan Haskel (Office for Budget Responsibility)
Tom Josephs (Office for Budget Responsibility)

LOCATION

The Robert Burns Room (CR1)

Scottish Parliament

Finance and Public Administration Committee

Wednesday 11 November 2026

[The Convener opened the meeting at 10:30]

Interests

The Convener (Clare Haughey): Good morning, and welcome to the 10th meeting in 2026 of the Finance and Public Administration Committee. I remind everyone to switch off, or put to silent, their mobile phones and any electronic devices.

Agenda item 1 is declaration of interests. In accordance with section 3 of the code of conduct, I invite Angela Ross MSP and Joe Fagan MSP to declare any interests that are relevant to the remit of the committee.

Angela Ross (Edinburgh and Lothians East) (Reform): I declare an interest in that I own a business. I have run it for eight years, but I no longer take any money from it. The business included an artificial intelligence component; we built a large language model that included a kind of closed AI system. Those are, I think, the key things that I should cover.

Joe Fagan (South Scotland) (Lab): As my entry in the register of interests shows, I am a councillor in South Lanarkshire and will be so until May next year.

The Convener: Thank you, and I welcome both of you to the committee.

I also want to take this opportunity on behalf of the committee to thank Michael Marra MSP and Kim Schmulian MSP for their valued contribution to the committee's work.

Finally, before we move to the next item of business, I want to make everyone in the room aware that I will be suspending the meeting for the two-minute silence at 11 am to mark remembrance day.

United Kingdom Budget (Implications for the Scottish Budget)

10:31

The Convener: The next item of business is an evidence-taking session on the implications of the United Kingdom autumn budget for the Scottish budget. I welcome to the meeting our witnesses, who are all from the Office for Budget Responsibility: Jonathan Haskel, chair; Tom Josephs, member of the budget responsibility committee; and Callum Bridge-Adams, senior official for the OBR's October economic and fiscal outlook.

Before we begin, I remind the witnesses that they should not worry about controlling their microphones—broadcasting will do that. If you wish to contribute to a discussion point, please raise your hand and indicate as much to the clerks.

We will move straight to questions. I call Pauline Stafford.

Pauline Stafford (Bathgate) (SNP): Good morning. To start with, I draw members' attention to my own entry in the register of members' interests as a sitting councillor on West Lothian Council.

I want to start with the OBR's assessment of energy prices. A lot of the assumptions in your forecast, including those on inflation, growth and household income, are underpinned by energy prices, which have been incredibly volatile recently. You say that you expect the recent shock to be of a limited size and duration and that, after it peaks, it will begin to fall. What have you based that view on? I know that you set out two scenarios—a severe shock scenario and an orderly recovery scenario—in your forecast, but is it too optimistic to expect energy prices to return to anything like normal? Indeed, do we have a normal to return to?

Professor Jonathan Haskel (Office for Budget Responsibility): Thank you very much indeed for the question. I will start and then pass over to Callum Bridge-Adams to give you a little bit of detail.

First of all, convener, thank you for your welcome. We are very pleased to be up here.

Our central forecast is, as your question has indicated, predicated on energy prices at the end of August and the start of September. Of course, the reason for the quite long lag between that and the session that we are having now is that we have to go through the various stages of costing the various programmes, which involves other

Government departments coming in with their assessments of tax revenues and so forth. That is why the window for energy prices that we have used now seems, in some sense, quite a long time ago. I will say something more about the central forecast that has come out of all of that, and then I will ask Callum to tell you about the scenarios that you have kindly referred to in your question.

The central forecast, as you will know, is for gross domestic product growth to go down a bit next year—we have, if anything, strengthened that figure this year—and for inflation to be much higher next year than we had thought. Previously—I am just looking at my notes—we had thought that next year's inflation would be around 2 per cent, but in our central forecast, we are now focusing on around 3.5 per cent. That will give you some sense of how sensitive the forecasts are to energy prices.

In order to get some purchase on the fact that energy prices go up and down, we have laid out in the report a series of scenarios. If it will be helpful, Callum will tell you a little bit about them.

Callum Bridge-Adams (Office for Budget Responsibility): Thank you, Jonathan—likewise, thank you, convener, for the invitation and the question.

To start, I definitely agree with the premise of your question: that energy prices drive a lot of the forecast. They are what we call a conditioning assumption in the forecast, so we do not take our own view on what is going to happen to energy prices—we take the market pricing for the future path of energy prices. As Jonathan Haskel said, we take a window for that at the appropriate time, and that is what drives the path. In mid-August, when we took those energy market-based futures, the path was a reasonably steep decline back to above the mid-2026 levels by the end of the forecast—the end of the decade. That is what the central assumption is based on.

As Jonathan said, because energy prices are so volatile, we then look at scenarios. We have a more severe scenario in which energy prices both peak higher—so, oil prices peak at $115 a barrel and gas prices peak at closer to 275p per therm, which is significantly above where they are both now and in the central scenario—and also stay higher for longer, so they are more persistent in those scenarios as well. That obviously has a significant impact on inflation, growth and the public finances.

Pauline Stafford: Thank you for that. You mentioned the gap, or the lag, that has arisen even since the budget was published. Have there been any movements in oil and gas prices since the budget was produced that would move us more towards the severe shock scenario rather than the orderly scenario?

Callum Bridge-Adams: With regard to how the market has moved, energy prices moved up after August; they were certainly higher than they were in our central assumption, for example, towards the middle of October, so that has underpinned some subsequent forecasts, of which the Bank of England's forecast is the most recent. In recent weeks, however, energy prices have come down again. Again, therefore, the key takeaway is that there is a lot of volatility rather than a consistent move towards one scenario or another.

Professor Haskel: I will add to that, if I may. In the media, there is rightly a lot of attention to the daily movements in the spot price, which—as Callum Bridge-Adams said—have been up and down. As far as the economics, and understanding what the consequences are for Scotland and for the rest of the UK, is concerned, what really matters is the persistence of those prices. As I said, I do not want to dismiss the fact that people are conscientiously monitoring the price every day and that kind of thing, but, in thinking about what the medium-term effects are, what matters is how long the price stays up for, and we have tried to reflect that a little bit in what we have said.

Pauline Stafford: To add to that, over the longer term, there is obviously a prolonged squeeze. If that continues, what will the impact be on household finances and tax receipts, and on public spending pressures? What would be the result of that prolonged pressure, even if there is volatility within that?

Professor Haskel: The answer to that is that it is in our severe shock scenario. I will turn to exactly the right page and Callum Bridge-Adams, who probably knows this off by heart, can say a word about it.

Callum Bridge-Adams: Energy prices both rise higher than they have and stay persistently higher for longer. That means that inflation peaks higher, at closer to 6 per cent than to 4 per cent as in our central forecast, and that reduces growth.

In bringing out the key uncertainty with regard to the impact on the public finances, we have tried to set out the channels of impact. Essentially, there is a negative impact on the public finances from higher interest rates as a result of those higher energy prices, but the key uncertainty is the extent to which higher inflation feeds through into higher wages and, more broadly, a larger nominal economy. That increases receipts, so that factor alone reduces borrowing.

There are some impacts on the public finances that offset those higher energy prices, so it is about the balance between higher interest rates; the

knock-on effects in moving to a larger nominal economy; and any secondary impacts on public spending pressures as the real value of cash settlements is eroded by that higher inflation. We set out quite a few different channels in the scenarios.

Professor Haskel: Having outrageously landed Callum Bridge-Adams with having to answer that question, I can now look up the answer; it is around paragraph 7.36 of our economic and fiscal outlook, if members are interested. I will give you some numbers that relate to what Callum said. If you layer all those factors on, we are talking about an increase in borrowing by around £6 billion in 2031-32.

The other point, as Callum mentioned, is that the implied increase in inflation puts pressure on the real-terms value of the cash spending, and we document that. There is erosion of £13 billion in real-terms spending power.

Pauline Stafford: To continue on inflation, the OBR has said that the current energy price shock is not expected to trigger a sustained inflation spiral. You mention 3.5 per cent as your estimate, but some commentators say that it might peak as high as 5 per cent, or 6 per cent, as Callum Bridge-Adams said. Aside from energy, what are the main risks to your assumptions on inflation?

Callum Bridge-Adams: Energy is the clearest immediate risk, and then the key judgment for the persistence of inflation concerns the extent to which any inflation that is directly driven by energy prices feeds through into what we call second-round effects in the economy.

There is an immediate impact on inflation from energy prices, which comes through petrol prices at the pump and the Office of Gas and Electricity Markets price cap, feeding through to household electricity. There is then a set of more indirect channels whereby high energy prices will feed through to higher food or transport prices because those goods and services have a component of energy in their delivery. The least certain of the channels involves the second-round effects. Because inflation is higher in the economy, workers try to bargain for higher wages in order to prevent the erosion of their real spending power and their real wages. That is the key judgment with regard to how persistent an energy-driven inflation shock will be.

In this forecast, we expect those second-round effects to be reasonably moderate. That is basically because, especially when we compare the situation with 2022, when we had the last big energy price shock, the labour market is much looser, monetary policy is much tighter and the output gap is larger, so we think that there is a bigger amount of slack in the economy. All those things will make it harder for nominal wages to keep pace with inflation. That is a key judgment, and it drives the economic forecast and very much drives the fiscal forecast as well.

Liam Kerr (North East Scotland) (Con): Callum Bridge-Adams, you talked in your remarks to Pauline Stafford about oil and gas, so I would like to explore that quickly. The OBR forecasts that UK oil and gas production will decline by around 10 per cent a year to 2031. However, you go on to say that that is 14 per cent if no new fields are developed. Which new field developments are included in your forecast? Do you have commencement dates for those fields? In particular, what assumptions have you made around Rosebank, given that regulatory consent for that field remains outstanding?

Callum Bridge-Adams: I might pass that over to Tom Josephs, if that is okay.

Tom Josephs (Office for Budget Responsibility): I am happy to take that—thank you for the question.

We produce our oil and gas revenue forecasts using projections for production and investment from the North Sea Transition Authority. It produces a detailed set of projections and uses various assumptions on what proportion of currently undiscovered or undeveloped fields will be developed in the future. In its main projection, which we use for the tax forecasts, production is, as you say, expected to decline by around 10 per cent a year. That includes an assumption that both Jackdaw and Rosebank will be developed over that period. I stress that that is a forecasting assumption and it is completely separate from the Government's actual decision on whether to go ahead with Rosebank. There is also a projection that assumes that no further fields will be developed over the forecast period, in which case production falls by around 14 per cent a year.

10:45

In both cases, we forecast a very significant fall in revenues from oil and gas production. They are currently at a relatively elevated level because oil and gas prices are very high, as we have just discussed. This year, we expect revenues of around £5 billion, but we expect that to fall to close to zero by 2030-31, which is the end of the forecast period. That is because, based on market pricing, we are expecting oil and gas prices to fall and production to decline. It is also the case that a lot of companies are able to use losses from the past to offset future tax liabilities. That is why we forecast that very sharp decline in revenues from the sector.

Liam Kerr: I want to press you on that second point. The revenues this year are projected to be

£5.1 billion, and that is forecast to go down to £300 million by 2030-31. To what extent is that decline attributable to the decline in production, to what extent is it attributable to the changes in the forecast oil and gas prices and to what extent is it attributable to the anticipated expiry of the energy profits levy?

Tom Josephs: It is a combination of all those things. We assume that the energy profits levy will expire in 2029. That will lead to a significant decline in receipts, because the levy is driving quite a lot of the receipts that we are receiving at the moment. However, the lower prices and lower production make a significant difference as well.

There is also the factor that, as I mentioned, companies can use losses from the past to offset tax liabilities. We have some analysis of that in the report. The sector is consolidating as it declines in size and companies are merging with smaller producers, which allows them to offset losses against future profits to quite a considerable extent. That has been suppressing receipts recently compared with our previous expectations. It has been happening more than we realised that it would.

Liam Kerr: I understand. I am grateful for your answers.

Liam McArthur (Orkney Islands) (LD): Good morning. In response to Pauline Stafford's questions, you talked about the range of effects that energy prices are having, as well as the inflation situation and interest rates. You have also drawn attention to the increased cost of Government gilts across the G7, but that factor has been more keenly felt in the UK, for reasons that have been set out.

The Scottish Government has announced plans to pilot Scottish Government bonds. Do you have any assessment of the prudence or the affordability of issuing Government bonds in the current market, particularly if that borrowing would be used for investment in long-term growth? Do you have any observations on that initiative?

Professor Haskel: It is not for us to comment on a specific policy proposal such as the one on Scottish bonds. We do not have a view on that. However, on the first part of your question, both Callum Bridge-Adams and I were at a big conference in London yesterday on exactly that issue: why are bond yields so high? It is a tricky area, and there seem to be lots of different alleged problems with it. That is the backdrop.

As your question indicated, that increase in borrowing costs is a severe upward pressure on Government spending: it is the biggest upward pressure among the pressures that we have looked at. It is something to take very seriously. As we say in our report, the increase in borrowing costs means that the Government must find an extra £14 billion per year on average, every year over the forecast period, before it will have done anything at all. It is important to bear that in mind. Although it sounds like a rather small number when expressed as some number of percentage points, it is a big and important factor in terms of money and the stress on the public finances.

Liam McArthur: What are your observations about the pressure that those debt interest payments put on Governments—both resource spending and capital investment? Are you able to offer any advice or make any observations in light of that rising component of debt interest payments?

Professor Haskel: To repeat, there is upward pressure on money that would otherwise be spent elsewhere. If we look at the figures that we have reported on, we see that, in 2019, before the pandemic, interest rate payments were 1.7 per cent of GDP—not very much. By the end of our forecast period, they will be 4.2 per cent of GDP. That upward pressure is material in terms of demands on Government spending.

Liam McArthur: There has been quite a bit of debate in the Scottish context concerning a fiscal gap of approximately £5 billion across resource and capital. Are you seeing detailed plans for bearing down on or closing that gap, as part of Government policy at either Scottish or UK level?

Professor Haskel: I will bring in Tom Josephs, who is wanting to respond.

By way of background, I note that, as the Government wants to stick to the fiscal rules, any source of upward pressure means that, other things being equal, there is less room.

Tom Josephs: I will add a couple of things.

Mr McArthur, you were asking why countries around the world have seen the cost of borrowing rise. We had a bit of discussion about that in our report. Generally, the view is that there are a few factors driving that. First, there is higher inflation, with more concern about future inflation, which pushes up the cost of borrowing. Secondly, there are concerns about fiscal policy around the world, with debt levels increasing in many countries and borrowing at relatively high levels. The third factor is something that we have done some analysis on in our reports on longer-term fiscal sustainability: there have been some quite big changes in the structure of the gilt market in the UK. In particular, there has been a decline in the defined benefit pension sector, which has historically comprised big buyers of long-term UK gilts, and that means that there is less demand for those gilts than there used to be. Those buyers are probably being

replaced by buyers who are a bit more price sensitive, and that is an upward pressure on the cost of borrowing.

On the question about what that means for the future, one important point is that, although the cost of borrowing—the interest rate—has risen very significantly over the past few years, that is only taking it back to a level that is closer to the historic average that Governments have been paying in order to borrow. The very low levels that we saw during the decade following the financial crisis look like the outlier. Therefore, it would not be wise to assume that interest rates will necessarily fall back to the levels that we saw in that period and that that will automatically reduce the pressure.

Liam McArthur: In light of the signals that are being sent on the increased cost, is there not a risk that, if Governments continue to increase debt levels, the market response will be to crank up interest rates significantly higher? I presume that there is a degree of discomfort with the level of indebtedness and then, given the repayment requirements that are already being borne, there would be further alarm if those were to continue on an upward trajectory.

Tom Josephs: Yes, that is certainly a risk. I mentioned the long-term report that we produce every summer in which we look at the longer-term outlook for fiscal sustainability and fiscal risks, and make longer-term projections of the public finances. Those generally show that, due to demographic pressures and other factors, pressures on public spending will increase in future, and that, if Governments were to just allow that to happen, that would obviously lead to higher borrowing and debt. We have modelling that shows that that could potentially put further upward pressure on the cost of borrowing, as you say, with a risk that that could quickly push the public finances on to an unsustainable trajectory.

Liam McArthur: Thank you.

The Convener: Before we move to the next question, I suspend the meeting to allow members to observe the two minutes' silence for remembrance day.

10:56

Meeting suspended.

11:06

On resuming—

The Convener: Welcome back. We will move on to further questions.

Angela Ross: I thank our witnesses for the OBR's economic and fiscal outlook. Considerable effort and input have gone into it, and I enjoyed going through it and finding out more. We have talked about inflation, higher interest rates and borrowing costs, and we seem to be painting quite a negative picture. On productivity growth, your report says that, if productivity growth were just 0.5 percentage points higher, forecast borrowing would be around £50 billion lower. Does that indicate that productivity growth is one of the most important determinants of long-term fiscal sustainability in the UK?

Professor Haskel: I will pass that to Callum Bridge-Adams but, before I do that, I thank you for those kind remarks. It is a team effort, so I will pass that on to the team back in London, but thank you for saying that.

Callum Bridge-Adams: Essentially, I agree with the thrust of the question. Medium-term growth is vital for the sustainability of the public finances and, within that, productivity is one of the most important drivers, if not the most important one. There is an old quote that, in the long run, productivity is not everything, but it is almost everything.

As you said, we set out scenarios that show what will happen if productivity grows. In our central forecast, it rises gradually to around 1 per cent growth by the end of the decade but, obviously, there are many uncertainties around that. AI is an important one, and we can talk more about that if you want.

Angela Ross: AI is indeed potentially a significant factor in ensuring that we have productivity growth. The issue is the utilisation of the technology and how we drive it in a fair and consistent manner across the workforce to achieve those figures. Do you refer to other countries to see how they are faring on AI implementation? What sources of evidence do you look at to inform a judgment on the issue?

Callum Bridge-Adams: We have used a wide range of evidence and have definitely used literature from across other countries.

The core element in our central forecast is a judgment that AI will increase productivity growth by 0.2 percentage points a year by the end of the forecast period. That is based on work that we published this time last year looking at the proportion of UK jobs and tasks within those jobs that can be complemented by AI; we took a US-focused approach and used a large language model to apply it to the UK workforce structure. There is a lot of uncertainty and disagreement between eminent economists about the size of the ultimate impact as well as the timing, and we discuss that a bit more.

That is what is in our central forecast at the moment. We look at the most recent data and some of the sectoral breakdowns and find, essentially, that there is nothing to cause us to change that central estimate now. Obviously, the GDP data comes with a bit of a lag, so it is hard to get a firm steer on exactly what impact AI is having already, but that is our central forecast. Jonathan Haskel might want to say more.

Professor Haskel: I would like to come in to add a little bit of colour. This is potentially a completely transformational technology and, from a productivity point of view, it might be incredibly good news for the economy, as opposed to a lot of the bad news that we have just been discussing.

As your question indicated, there are two aspects to the AI issue. One is about how we think about it, and the other is about what evidence we take on it.

How we think about it is exactly as referenced in your question. There is an AI-producing sector that is producing hardware and writing all the software that we are downloading and using, and then there is an AI-using sector, which is made up of companies, airlines, the health service and whoever it might be, that will use all that software in providing the services that we all want.

Callum Bridge-Adams was referring to our sectoral analysis, and I will add a bit of colour to that. If you look at the industry breakdown, you can somewhat identify what makes up the AI-producing sector and the AI-using sector. The AI-producing sector is the information and communication services industry. It is writing the software; it is writing all the clever bits of code that the lawyers are using to automate their opinions and all that kind of thing. The AI-using sector is the health service, the retailers and all that kind of thing. That is stage 1, which is how to think about it, and that is exactly in the way that your question indicated.

Stage 2 is to look at the data, which we do in table 2.2 of our report. I will say a couple of things based on that data, if I may. One is that we have in the UK—I include Scotland, obviously—a pretty strong AI-producing sector. We have a very strong university sector; I do not need to tell you that the University of Glasgow, the University of Edinburgh and other excellent universities are here. Our university sector is strong on computer science, maths and so forth, so the AI-producing sector looks rather large in the UK relative to other countries. It also has pretty high productivity growth—we have numbers around 7 per cent and 8 per cent for the AI-producing sector broadly defined, which are very large numbers. The issue is that, in order for that to have a material effect on overall productivity, everybody else has to use the AI. That is the dilemma, I think, for Europe as a whole.

If you look at the numbers showing how much the software is being used in the AI-using sector in America, you see that AI use is booming in the retail sector, the health system and so forth. If you look at the numbers for Europe, you see that they seem to be rather lower. There are lots of measurement difficulties around all of that, which the Office for National Statistics is looking at. I hope that we will be able to say more about the use of it as time goes by and we get better data and better indications from that.

I am sorry if that was a rather long answer to the question, but it is a crucial technology. That is how we are trying to think about it and to monitor what its knock-on effects might be.

Angela Ross: That is very interesting to know and understand.

Other than AI, what policy measures could we use to potentially make the greatest contribution to output and productivity growth more widely? Have you thought about other options and opportunities?

Professor Haskel: We talk about a number of different policy areas in the report, one of which is planning. Callum, do you want to say a word on the planning side?

11:15

Callum Bridge-Adams: Broadly speaking, we analyse Government policies once they are announced, rather than analysing hypothetical options or giving advice.

Planning is one example of a previous policy that we thought would have a material impact on potential output. When we made the forecast a few years ago, we thought that the increase in housebuilding as a result of the planning policy framework would increase the potential output by about 0.2 per cent by the end of the forecast period.

When we think that policies will have a significant, additional and sustained impact on potential output, we incorporate those, but none of the measures at this event crossed the threshold.

Angela Ross: I found it interesting that your forecast shows an improvement in public sector receipts. To what extent does that translate into additional fiscal capacity for public services once the higher debt servicing costs and other spending pressures are taken into account?

Professor Haskel: I will hand over to Tom Josephs to answer that.

Tom Josephs: In this forecast, we are forecasting an increase in receipts compared to our previous forecast in March. That is largely driven by the higher inflation that we have seen since then and by the assumption that Callum Bridge-Adams mentioned that some of that higher inflation will feed through into higher wages, which is an important driver of tax receipts. We also think that there will be slightly higher corporate profits, which again drive higher receipts.

However, that higher level of receipts is broadly offset by the fact that higher inflation has also driven up costs in other areas of spending. That applies particularly to spending on welfare, which is typically uprated in line with inflation, but also to some other areas of spending that are closely linked to inflation. Broadly, in this forecast, those higher receipts from inflation have been offset by higher spending caused by inflation. You are then left with the higher debt interest costs that are caused by higher interest rates, which are driving the overall increase in borrowing that is shown in the forecast.

To answer your question, we have seen higher receipts but have also seen higher spending driven by the same factor, which is higher inflation.

Angela Ross: Fiscal drag also comes into that picture. It is a nice way for the Government to present the higher tax receipts that come through from inflation and wage increases, but that is not preferable to growth in productivity. What is your assessment of that?

Tom Josephs: Because income tax thresholds are currently frozen for most—for the first four years—of the forecast period, that means that higher earnings drive even higher receipts than would normally be the case. A lot of that additional revenue is, essentially, being driven by fiscal drag and by people being pushed up into higher income tax brackets.

Liam Kerr: My question follows on from Angela Ross's questions. The Scottish Fiscal Commission has identified a tax base performance gap of £800 million in 2026-27 and suggests that there are several explanations for that, including slower growth in earnings and employment compared to the rest of the UK. I believe that the OBR has done some pretty detailed work on the differences in income tax performance between Scotland and the rest of the UK. Has the OBR analysed to what extent the underperformance reflects structural differences in the Scottish economy, such as its industrial composition and its relatively large public sector, and how much is it to do with behavioural responses to different income tax bands and rates?

Tom Josephs: We have looked at that question in the past. A couple of years ago, we produced quite a long report looking at the structure of income tax performance in Scotland and the UK. That essentially found that differences in the sectoral composition of the economy in Scotland versus the rest of the UK did not appear to be the main driver. Instead, the gap appeared to be driven by lower growth in income tax revenues per person, which, if I recall correctly, was attributed to factors such as demographics, with Scotland's population ageing more quickly than that of the rest of the UK in relative terms. Also, over that period, slightly lower earnings growth seemed to be driven by lower overall productivity levels rather than sector-specific issues.

As you said, the Scottish Fiscal Commission has conducted more recent analysis. My recollection is that it showed a decline in relative earnings in Scotland compared with the rest of the UK, driven by the decline of the oil and gas sector and weaker earnings growth in that region, particularly around Aberdeen. We have not replicated that analysis ourselves recently.

Liam Kerr: I am grateful for that response.

Pauline Stafford: To pick up on Angela Ross's point about AI and productivity, I am sorry to say that my question brings us back to the downside. AI is a transformational technology, but you have highlighted the risks that are associated with the pace of its adoption when it comes to achieving those productivity gains. In your central forecast, you note that the "World Economic Outlook" publication projects global GDP growth of 3 per cent. A lot of that is linked to the momentum in the technology sector due to growth in AI. We have also heard that the UK economy has shown a bit more resilience than was expected after the Iran war, because of strong expansion in AI.

How exposed is your forecast to a downturn in the technology markets? Is there a risk that we are underestimating an AI bubble, and what implications would it have for the UK and Scottish economies if one were to materialise?

Professor Haskel: Let me have a go at answering that very important set of questions. To get to the heart of it, the notion of an AI bubble means different things in different contexts. If one thinks that AI will not deliver any meaningful productivity gains, that it is merely a passing fad and that people will not use it productively, in that sense it is a bubble, if you see what I mean. I do not think that anybody thinks that it is a bubble in that sense. People genuinely take the view that AI will revolutionise not only the uses that we were just discussing in response to Angela Ross's question but also the scope for scientific discovery, technological advancement, the development of new products and so on. That is one side of the bubble.

However, the other side of the bubble is the financial bubble around equity markets and all that. We talk about that as a risk, because consumer confidence depends on those things. When it comes to the risk of the world economy slowing down, the global growth rate has not fallen below zero in the past half-century, so the world economy has proved astonishingly robust in the face of all the gyrations that one might imagine over such a long time. If it were to slow, that would have a knock-on effect on us.

You are right to point out that there are various risks from all that, which we talk about a bit in our scenarios and sensitivities analyses. Callum Bridge-Adams is looking at me because he is more on top of that than I am.

Callum Bridge-Adams: Thank you. You have given me a chance to get to the right page, which shows that, in March and previously in November, we produced scenarios around equity price corrections. Again, this is simply to illustrate the potential impact of a global equity market crash, because such a crash could have significant effects on economic growth and tax receipts. One of the scenarios showed that if there were a fall of 35 per cent in equity prices in the UK and globally, that could increase borrowing by £26 billion—0.8 per cent of GDP—in 2027-28. That spells out that large equity price corrections will have important fiscal impacts, but it does not consider the likelihood of that happening.

Pauline Stafford: Yes, but it is built in. Thank you.

Professor Haskel: Forgive me, but, just for the record, Callum, which report was that from and what page was it on?

Callum Bridge-Adams: The box was in the November 2025 economic and fiscal outlook, and it was summarised on page 98 of the March 2026 EFO.

Professor Haskel: So it is not in the current EFO.

Callum Bridge-Adams: No, not the current one.

Professor Haskel: In case it is helpful to the committee to clarify that, it was in the March EFO, not the current one. Thanks, Callum.

Tom Josephs: On your question and Angela Ross's question about the potential impacts of AI in the labour market, that is a very important issue for the public finances in the future, because Governments, including in the UK, get a lot of their tax revenues from labour income—income tax, national insurance and so forth. In the long-term report that we published in the summer, and which I mentioned, we did a bit of analysis of the issue, to make the point that, if you get an AI productivity boom that goes alongside higher productivity for workers, it complements what workers do and, therefore, improves their productivity and drives up earnings. In that case, it is potentially very positive for the public finances.

Yes, you could have a scenario, such as some people are worried about, in which AI is substituting for rather than complementing labour. That is very uncertain, but, in that scenario, there is potentially a bit of a downside risk to the public finances, if it means lower wages and more corporate profits rather than more wages. Currently, profits are taxed at a lower rate than earnings, so that is a potential risk to the public finances that we look at in the long-term report.

Pauline Stafford: Thanks, that is helpful.

Alan Brown (Kilmarnock and Irvine Valley) (SNP): Good morning. I will start by asking about one particular tax policy that was outlined in the devolved tax and spending forecast. It sounds a bit niche: the reclassification of carried interest, which is income received by fund executives relating to the performance of investment funds. You have documented that the UK Government's change to make that income subject to income tax, rather than capital gains tax, seems to have a consequential impact on the Scottish block grant adjustment of £250 million a year. Is that right—that the Scottish Government will have to be able to collect a quarter of a billion pounds a year extra because of that change in taxation policy?

Tom Josephs: Yes. As you said, the UK Government decided to reclassify carried interest revenue—in essence, revenue that executives of investment funds receive—from being subject to capital gains tax to being subject to income tax. From the point at which that starts, in a couple of years' time, UK-wide income tax receipts will be higher by that amount. The analysis by His Majesty's Revenue and Customs is that virtually all taxpayers who pay tax on carried interest are located in England, predominantly in London and the south-east, where those investment funds tend to be located. Therefore, as you say, that revenue will mean that the block grant adjustment is higher than it would otherwise be. That pushes down on the Scottish net tax position by, we project, about £250 million a year.

Alan Brown: Thanks for that. The economic and fiscal outlook says that that will be from 2026-27, so that is basically £1 billion over the remainder of this parliamentary session. That is the cumulative amount of additional tax that needs to be collected by the Scottish Government to make up for that adjustment. Am I right in thinking, from what I have read, that the Welsh fiscal framework

is different and that Wales is therefore slightly more insulated against that change?

Tom Josephs: That is correct. In essence, the way Welsh devolution of income tax works means that Wales is less exposed to changes in revenue from higher-rate taxpayers. Again, nearly all the taxpayers who are paying tax on carried interest are higher-rate taxpayers, so it affects the Welsh net tax position much less.

11:30

Alan Brown: To go back to a point that you touched on earlier, Scotland's population is ageing a bit more quickly. Therefore, by default, if there is no population growth through immigration, the size of the working-age population will shrink more quickly here than in the rest of the UK. Is it correct that that will increase pressures on the block grant adjustment by driving the relative growth comparison?

Tom Josephs: That is right. Some projections of the net tax position in our report suggest, based on our forecasts, that the net tax position will fall from the positive £0.7 billion where it sits now to a positive £0.3 billion by the end of the forecast period.

Our analysis suggests that that is driven by three things. One is the change to carried interest that we have just been discussing and another, as you say, is the relatively faster ageing of the population in Scotland compared to the rest of the UK. The third factor is the change to property income tax rates that was announced in the recent budget from the UK Government—and in its previous budget—which does not apply to Scotland and, as with carried interest, will push the block grant adjustment up by around £60 million a year from 2027-28 onwards. That change is contributing a relatively small amount of the decline in the net tax position.

I stress that those projections, like all our medium-term projections, are uncertain because they depend on what happens to earnings growth in the UK and in Scotland, both of which are subject to quite a lot of uncertainty. Projections from the Scottish Fiscal Commission assume stronger earnings growth in Scotland and, if that were to be the case, it would improve the outlook for the net tax position compared to what is in our projections.

Alan Brown: You said that the £60 million property tax was a relatively small amount, but if you add that to the £250 million of tax paid on carried interest, it adds up to £310 million and you are quickly getting to 40 per cent of the maximum that can be held in the Scottish fiscal reserve. Am I correct? The fact that the Scottish budget does not allow overspending means that that £310 million is relatively significant when compared to the maximum reserve.

Tom Josephs: The overall decline is definitely material. I meant that the £60 million makes a relatively small contribution to that overall decline when compared to other factors.

Alan Brown: In the overall UK budget, there is a budget line to close the tax gap, which is estimated at £12 billion. At the same time, it is confirmed that, in keeping with the fiscal rules, there will be predicted headroom of £15 billion in 2029-30. In many ways, three quarters of that £15 billion headroom depends on closing the tax gap. How credible is that?

Tom Josephs: As you say, our projections are currently based on the tax gap falling reasonably sharply from where it currently is. We have done some sensitivity analysis that shows that, if that were not to happen, and if the tax gap were to remain roughly at the level it is at now, that would imply lower tax revenues of around £10 billion. Our report highlights that the projection of a declining tax gap is a particularly uncertain part of the forecast.

The decline would take the tax gap back to mid-2010s levels, so it would not be an unprecedentedly low level. The tax gap has been down at those levels in the past, but getting there relies, in essence, on the success of a large number of HMRC initiatives on closing the tax gap. That includes a very significant increase in the number of staff that HMRC employs to tackle non-compliance and tax debt. We assume that that will reduce the tax gap fairly substantially.

We do a lot of work to make sure that those estimates look reasonable. We make various assumptions around, for example, the fact that each additional member of staff is likely to be a bit less productive than the previous one, only because they are having to tackle more and more difficult areas of non-compliance. We also make various assumptions around the fact that non-compliant taxpayers are quite likely to find different ways to become non-compliant when HMRC blocks a route.

We put a lot of effort into trying to ensure that those projections and assumptions are reasonable, but there is definitely a lot of uncertainty around them.

Alan Brown: Closing the tax gap is clearly a good thing. Nobody would argue otherwise. The budget allows for 670 additional compliance officers for HMRC to do the work that you outline. Is there any risk to the block grant adjustment arising from where the target is to bring in that money? The largest earners are in London and the south-east, so if you go for the largest earners for

tax compliance and bring in more money from them, could where the receipts are allocated have a consequential impact on the block grant adjustment for Scotland?

Tom Josephs: That is a good question. We have not looked at the regional distribution of non-compliance, and I am not sure whether HMRC has good data on that. It is the case that the sector with the biggest tax gap is small business. I am not sure how that is distributed across the UK, but I imagine that it is evenly distributed rather than focused in a particular area. As I say, we have not done any analysis on that.

Alan Brown: But detailed analysis would need to be done to understand that.

Liam McArthur: I want to come back to the point that Alan Brown raised on carried interest. I assume that the application of income tax as opposed to capital gains tax is likely to increase the liability for those who would fall within that bracket. Is that right, given that income tax rates would be higher than capital gains?

Tom Josephs: It was part of a set of reforms that also increased the rates at which that income is taxed, and we classified it as income tax. We assumed in the costing of that measure when it was first announced that there would be a reasonably large behavioural response, whereby the taxpayers would find ways to reduce their liabilities because the rate has risen.

Liam McArthur: On the discrepancy that Alan Brown was talking about between Scotland and Wales and the impact of that, is that a reflection of differences in the fiscal arrangements between the UK Government and Scotland and Wales, or is it a reflection of differences in the demographics of Scotland and Wales in terms of higher earners and liabilities?

Tom Josephs: It is a bit of both. HMRC's analysis is that virtually all those taxpayers are located in England, and that something like 95 per cent are in London, so it is an important factor, but it partly reflects the fiscal framework arrangements. I go back to the point that was made earlier about the fact that Wales is less affected, because the Welsh income tax devolution framework means that changes to the revenue that is received from higher-rate taxpayers have much less effect on the Welsh block grant adjustment than they do on the Scottish BGA.

Liam McArthur: Thank you—that was helpful.

Liam Kerr: The UK budget provides additional business rates relief for hospitality and retail businesses in England, which will generate Barnett consequentials of £37 million and £60 million, respectively. Does the OBR's economic forecast make any assumption about the Scottish Government using those consequentials to introduce an equivalent business rates relief? Does it take account of the possibility that, if the Scottish Government does not introduce an equivalent relief, Scotland's hospitality and retail businesses might face a higher relative tax burden than their competitors in England?

Tom Josephs: The short answer is no. We do not make any assumptions about policy decisions that the Scottish Government may or may not take in response to UK budget decisions.

Liam Kerr: That is a straight answer. It is an interesting answer, because one would have thought that, in preparing its forecasts, the OBR would make projections about what the outcome would be if, in response to an injection of £97 million, the Scottish Government did X, and what the outcome would be if it chose not to do X. Therefore, I am quite surprised by your answer.

Tom Josephs: Our legislation says that we must base our forecasts solely on announced Government policy, so that is what we do. Basically, we look at announced Government policy—announced policy of the UK Government, as well as any policy that has been set out in Scotland, Wales or Northern Ireland or, indeed, at local government level in England—as it is at the time of the budget.

Professor Haskel: I add that the effect of the measure will presumably depend on at least two things, one of which is the affected sectors' share of value added in the Scottish economy. I do not know how big or small that might be. The other is the extent to which the measure is permanent or temporary. If I remember correctly, I think that it is a temporary measure. Is that right?

Tom Josephs: Yes.

Professor Haskel: It might be the case that the effects of a temporary measure are quite attenuated relative to those of a permanent structural change.

Liam Kerr: I am very grateful for those answers.

Joe Fagan: I had intended to ask about an issue that has been quite well covered—earnings growth. In that context, I am particularly interested in your relationship with the Scottish Fiscal Commission. As part of the budget process, the Scottish Government is heavily dependent on the forecasts of both the OBR and the SFC. Will you expand on the difference in the forecasts in relation to earnings growth? If I have followed what you have said, there has, up until this point, been an underperformance, but that is about to change, albeit gradually. Is that the case? To what extent do you have a relationship with the Scottish Fiscal Commission before you produce your forecasts?

Does that relationship become more apparent after you have produced them?

Tom Josephs: We work very closely with the Scottish Fiscal Commission, in particular on some of the forecasts for the Scottish devolved taxes. The SFC produces a lot of analysis and forecasts, which we work with them on. We generally share analysis as much as we can, where it is useful for us to do so. Ultimately, however, we take independent judgments on our forecasts, which is what our legislation requires us to do.

The area in which the interaction between our forecasts has been most important for the Scottish fiscal position is the outlook for earnings and what that means for our forecast of income tax receipts in the rest of the UK, which drives the block grant adjustment, and the forecast that the Scottish Fiscal Commission produces of income tax receipts in Scotland, which drives the decisions that the Scottish Government then makes in its budget. There is a very close link between those two forecasts.

11:45

In recent years, we have projected lower earnings growth than the Scottish Fiscal Commission forecast, and we have a section in our devolved forecast report in which we compare our forecasts. That difference reflects the inherent uncertainty around the outlook for earnings. It is an uncertain area because it is driven by some of the factors that we have discussed in this meeting, such as productivity, AI and inflation, which are very difficult to forecast.

Typically, our forecasts have been relatively similar to those of the Scottish Fiscal Commission in the short term and then diverged in the medium term. Our forecast is generally for lower earnings growth than that projected by the Scottish Fiscal Commission. In terms of the impact on the Scottish budget, the fact that the forecasts are relatively similar in the short term is quite important, because the Scottish budget is typically set one or two years ahead. The medium-term divergence is quite a useful illustration of the risks that the Scottish Government will face over the longer term.

Callum Bridge-Adams: I will add a bit of colour on the medium-term wage outlook. As Tom Josephs said, the short-term forecasts have been similar to those of the Scottish Fiscal Commission. At the moment, it is quite hard to make that comparison because the latest Scottish Fiscal Commission forecast is from January. A lot has happened since then that affects the near-term wage outlook, which is reflected in our report.

As Tom Josephs said, there are more sustained differences in the medium term, for which we are forecasting a slightly slower rate of wage growth than the SFC by about half a percentage point a year in the back end of the forecast for 2028 to 2030. The reason why our wage growth forecast is reasonably subdued by that point is that we think that firms will seek to slightly rebuild their margins after a period in which they will have absorbed quite a lot of cost pressure into their margins. Between 2020 and 2025, there was a reasonably significant reduction in the profit share of the economy, because firms basically absorbed some of the energy price increases into their profit margins. We think that, especially given that they have already done that to some extent and that the labour market is now a lot weaker, there is less scope for that to continue. We think that, in the medium term, real wages will grow a bit less quickly than growth in productivity, which will allow firms to rebuild their margins and the rate of return on private capital. That is exactly the sort of forecast judgment that the SFC might take a different view on.

Joe Fagan: With the convener's indulgence, I wonder whether it might be possible to come back to what the witnesses said in response to Liam McArthur's question about interest rates and borrowing. You talked about demand for public services. That is becoming quite topical as we look to address public service reform in Scotland and try to address failure demand in the system. I am wondering about the extent of your work to quantify such demand for public services. Your paper identifies housing, social care and the welfare bill. Is that an area to which you should apply more rigour and attention in the future? Could you do more work in that area, or are you quite confident in your content as we start to change the way in which we think about public finance and public spending and do more in a preventative space, which is an emerging theme even in the UK budget?

Professor Haskel: Let me come in for a second—I will be happy to turn to others.

That is a fascinating set of questions about what the public want from their public services. I mentioned the conference that Callum Bridge-Adams and I were at yesterday. There was very interesting evidence from the world values survey about how people from different countries feel and their attitudes to public ownership. That speaks to the demand side.

My initial reaction—although my colleagues should come in on it—is that, although that is a fascinating question, at the moment it is probably beyond the remit of what we should be doing. Maybe my colleagues will want to come in on that.

Tom Josephs: It is definitely the case that, in our medium-term forecasts, we take the UK Government's assumptions for departmental

spending as given. Spending on health, education and transport is set by the UK Government. That is what we forecast at spending reviews and we plug that into our numbers.

In our longer-term report—the same one as I mentioned earlier—we look at the pressures that might emerge on the public finances over a longer time horizon. We go out 50 years. There, we take a different approach, which goes to your question about demand: if we assume that the demographic trends that we see at the moment continue, particularly in relation to the ageing population, we look at what that implies for future demand for public services. The answer is that there is increasing demand for health and pensions in particular and, at least over the next decade or so, reduced demand for education because, based on current demographic trends, there will be a declining number of kids.

Overall, that suggests that, unless Governments take decisions to change the structure of public spending, there will be a big increase in public spending and, therefore, significant pressure on the public finances. Quite quickly, debt will be on an unsustainable trajectory in the face of those demographically driven demand pressures.

Joe Fagan: There was enough in your latest outlook to make me think that you are already looking at those issues. That is something for the committee to reflect on.

Tom Josephs: You are right—as I said before, we take the Government's departmental spending allocations as given, but we do analysis over the medium term on pressures within those allocations.

In the report, we highlight in particular higher inflation, which is driving pressures on departmental spending across the board. The Treasury sets departmental spending in cash terms at spending reviews, so higher inflation reduces the real value of those cash settlements. We also look at pressure from the Government commitment on defence spending, which has to be accommodated within those overall totals. We highlight that there is significant pressure on those departmental spending totals, even over the medium term.

Liam McArthur: I am just coming in on the back of that—as you say, it is a fascinating concept that the committee will have to wrestle with. I understand entirely why you need to take at face value the departmental spending limits but part of that, across all departments, will involve an element of what is called preventative spend. What approach does the OBR take to assessing the validity of that prevention and whether it may, over time, bear down on demand—or are the tools for doing that not yet sophisticated enough for you to be able to come to any firm conclusions?

Tom Josephs: I do not know whether you are referring to this: in the budget, the Chancellor of the Exchequer announced a new classification of spending called preventative departmental spending. That was a very early-stage announcement so, in the report, we did not make any adjustments to the way in which we did the forecasts. For future forecasts, we will discover more about what that will mean in practice, when the Government has finalised its announcements on it. Then, we will consider whether to take it into account in the forecast.

Professor Haskel: I will repeat something that might be helpful, which goes to Joe Fagan's question and emphasises something that Tom Josephs has just said: we have a projection of what protected and unprotected departmental spending will look like. In other words, for the last three years of the forecast, assuming that the Government gets to its announced amounts for defence and school spending per pupil and assuming that health spending carries on as it has done previously, we have asked what the implications would be for the other departments were those demands to be characterised by that trajectory of spending. That adds a bit of colour to the explanation—that is a sense in which we do project those demands.

The Convener: I thank the witnesses for their attendance. It has been an absolutely fascinating session.

That concludes the public part of our meeting. The next meeting of the committee will take place on Wednesday 18 November, when the committee will hear evidence on the bonds programme.

11:56

Meeting continued in private until 12:14.

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