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Finance and Public Administration Committee

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Wednesday 18 November 2026

Session 7

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FINANCE AND PUBLIC ADMINISTRATION COMMITTEE
11th 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:

Stephen Boyle (Auditor General for Scotland)
Dr Ben Cormier (University of Strathclyde)
Lénaïc Couderc (Moody's Ratings)
Melissa Davey
Angus Macpherson
Professor David McMillan (University of Stirling)
Professor Stephen Millard
Steven Whyte

LOCATION

The Robert Burns Room (CR1)

Scottish Parliament

Finance and Public Administration Committee

Wednesday 18 November 2026

[The Convener opened the meeting at 09:15]

Scottish Government Bonds Programme

The Convener (Clare Haughey): Good morning, and welcome to the 11th meeting in session 7 of the Finance and Public Administration Committee. I remind everyone to switch off or put to silent mobile phones and any other electronic devices.

Under the first item on our agenda, we will take evidence on the Scottish Government's bonds programme. I welcome Dr Ben Cormier, senior lecturer and associate professor in the department of government and public policy at the University of Strathclyde, and Professor David McMillan, professor in finance and accounting at the University of Stirling.

I remind the witnesses that they do not need to operate their microphones, as broadcasting staff will do that. If you wish to contribute to a discussion point, please raise your hand or indicate to the clerks.

We will move straight to questions.

Liam Kerr (North East Scotland) (Con): Good morning. The bonds plan will not raise more money, but it will raise money from a different source. Yesterday, it was reported that the bonds plan

"would be more expensive than using the National Loans Fund".

What is your view, Professor McMillan?

Professor David McMillan (University of Stirling): There are lots of pros and cons to the bonds programme. One of the cons is that it is likely that the issuing of the bonds will cost more than using the existing national loans fund. The question is whether the potential benefits are sufficient to outweigh the increase in costs. I do not know whether you want me to discuss any of that in more detail now or whether there will be other questions about that.

We should not consider whether to take forward the bonds programme purely on the basis of it costing more; we should consider, in the round, the collective benefits, the collective costs and the current market situations. A decision can then be made on whether it is worth proceeding now, in six months, in a year or whatever. That is the nature of the issue. I can go into more detail now, but there might be other questions on that.

Liam Kerr: I suspect that we will explore the details later, but please ensure that we do. You accept the proposition that issuing bonds would be more expensive, which is one metric. Dr Cormier, do you agree?

Dr Ben Cormier (University of Strathclyde): Yes, that sounds about right. Like most things in this area, it is a question of trade-offs. There are a lot of benefits to consider alongside the comparatively minor increase in costs.

Liam Kerr: The Scottish Government has said:

"In the right market conditions, a bond could represent better value-for-money than borrowing through the … National Loans fund in net-present-value terms."

However, the Government has been clear that it will not release the calculations underpinning that conclusion. Has either of you seen the calculations underpinning that claim?

Dr Cormier: No.

Professor McMillan: No.

Liam Kerr: Should the committee, the Parliament and/or the public be able to see those calculations?

Professor McMillan: This moves us beyond the economics and into the politics of the issue. Should there be full information about the launch of a programme that might or might not cost taxpayers more money? Yes. It is important, whether or not the Government decides to go ahead with the bonds programme, that the public are fully informed of the rationale for the plan—whether that rationale has an independence bent and what the rationale is excluding independence?

There needs to be a full and frank conversation with the public in which the Government says, "We're doing this for these reasons, and these are the costings that sit behind it." The costings might support or, arguably, not support the argument, but the Government should set out specific reasons for pushing ahead. When launching such programmes, it is always important to be open with the public, because what would sit behind the bonds and where would the money to repay them come from?

Liam Kerr: The Scottish Government's response would be that that sort of thing was commercially sensitive and its financial interest could be prejudiced. Does that stack up in your view, Dr Cormier?

Dr Cormier: For me, not so much. Estimating these things is pretty straightforward. I saw in the *Financial Times* an estimate that the bonds would

be 30 basis points above United Kingdom gilts, and I think that the NLF is 11 basis points all in. I do not see why, if the FT can get an estimate, we cannot. However, it also reflects how relatively marginal the difference is—it is not a big one.

Liam Kerr: I understand.

Alan Brown (Kilmarnock and Irvine Valley) (SNP): Dr Cormier, you said in response to my colleague Liam Kerr that there were benefits to the programme that should be weighed up against the additional costs. Can you outline what you see as the benefits of these bonds?

Dr Cormier: Sure. There are a couple of meaningful benefits, the first of which is that any debt management office would really benefit from diversification and from the flexibility that comes from developing a bond market, being able to issue strategically at certain points and across an investor base that could accept different tenors, and being able to manage a yield curve. Therefore, a willingness to begin a bond programme that could lead to bond market development would almost certainly bring long-term benefits. It would bring flexibility to public finances and debt management.

The diversification and flexibility bit is, from a debt management perspective, almost intuitive—or obvious—to me. Overall, costs will come down in the long term if the bond market is developed appropriately and if there is flexibility to issue more strategically than the Government can at the moment, given that there is no bond market for it to manage and use strategically.

There are also some potential knock-on benefits for the private sector. The fact that Scotland got the same credit rating as the UK means that any price differences between the NLF and the planned borrowing programme will, in the short term, be pretty minimal. I see a lot of almost market infrastructure benefits that would bring a lot of long-term benefit at the expense of relatively marginal short-term cost differences.

Alan Brown: Professor McMillan, would you agree with the benefits that Dr Cormier has suggested, and do you see any additional ones?

Professor McMillan: I would, and I wouldn't. From what has been laid out in the documents that I have read, the argument being made is about the diversification of funding sources, which I think is fair. There has been discussion in some of the official Government papers about the national loans fund mark-up and whether the UK Government can arbitrarily change that. That is a relatively moot, and weak, point to make, because politically that is very unlikely to happen.

The main benefits that have been argued for relate, as Ben Cormier has just said, to market structure, establishing credibility, the fiscal framework and those kinds of things. The more that I have been reading and thinking about this, the less I am convinced that those benefits actually exist; after all, the programme is very limited not just in money terms but in length. As far as I understand it, it is currently limited to five years, at the end of which there might be reflections on whether it continues or whether we move back, primarily, to the national loans fund.

That is where the credibility starts to fall down. If you are going to argue that this bond programme is a route into a wider range of funds and access to global capital markets, there are certain characteristics of such a programme that I would expect and want to see.

One of those characteristics is a range of maturities for the bonds. I would probably stay out of the money market, but there should, at minimum, be a two-year bond—I could make other arguments later for why having a two-year bond might be a good idea—and one for five years, 10 years and so on. It would also help to establish credibility not only to pay those bonds off but to have the ability to manage doing so over a longer period of time. There should be an ability to roll bonds over and manage them in that way.

In principle, the bond programme has a lot of sense in it. If there was an opportunity to renegotiate how it runs and its current structure, I would do that. If, after five years when the programme finishes, the market volatility is too high and the Scottish Government at the time decides to pause the programme and maybe reopen it again later, any benefits that have been established—about credibility, building up the market and making investors want to invest in it—will start to wane. If no more Government bonds are actively being issued, the benefits for credibility and managing fiscal discipline will wane.

To me, the main benefit would be in having a live programme that did not end after five years.

Alan Brown: Does the outline business case that the Scottish Government published not cover that? It highlights that there can be longer periods.

Professor McMillan: You can or you cannot. The point is that I would not design a programme that looks like this or one that says, “In five years’ time, we will think about it.” Investors are looking for permanence in the nature of the programme.

Alan Brown: Is there an argument for taking tentative steps? You are talking about credibility over the long term, but is a smaller step into the market not a way to build up credibility?

Professor McMillan: That is why I would look to issue a range of bonds. It would not be about having a five-year programme; the programme

would continue but have a range of different maturities.

Where does the credibility come from? It comes from repaying the bonds that were issued, managing the debt and rolling it over. No rollover is possible, as far as I understand it. There needs to be an ability to show that we can manage the programme continuously, rather than within a five-year framework—which may then disappear and issue no more bonds after five years.

It is all about the design. I am not saying that the programme is bad; I am saying that I would want to think about how to redesign it.

Alan Brown: Okay, but, in the worst case, the bonds are paid off after five years and the market is still happy because the Government has fulfilled its obligations.

Professor McMillan: You have—but then the bond market is asking what comes next. Say that the programme was paused for five or even 10 years. When you went into the bond market again, you would be starting from scratch. You would be starting from the place that you are in now.

Alan Brown: Okay. Dr Ben Cormier, do you agree with those comments? Is the position as fixed as that five-year period or is there still flexibility in how the Government goes to market?

Dr Cormier: I thought that it was interesting that, in some of the business case and financial case documents, different assumptions were made that did not match the five-year plan that seems to have been decided on. Obviously, there have been some discussions about having a different type of strategy.

Dipping the toe in the water is a useful starting point—you have to enter the market somehow and set up the market infrastructure. However, I agree that, although it is not meaningless, it almost becomes disappointing or beside the point if the programme does not become bigger and a robust market for Scottish debt. The hope and expectation for us all has to be that this is a dipping of the toe in the water leading to a bigger, more robust market that can develop into something that is well managed and stable.

My other point is that, if the programme will involve the standard thing in sovereign debt, which is bullet repayments, the anticipation is that the bonds will not be repaid. There will be rollover. That is how that tends to work, at least in the countries that I am familiar with—a long-term view is almost implied.

09:30

Alan Brown: Okay—so you roll it over and that allows the capital headroom to continue.

It has been estimated that the administration cost would be £2 million per bond. Does that seem realistic? What would that look like? Would it be £2 million per bond literally, or would it depend on the value of the bond? How does the administrative cost estimate stack up?

Dr Cormier: I know very little about the administrative costs, but that seems in line with standard operating procedure. I could comment on whether that is good or bad for the banking sector to do. Maybe David McMillan has more thoughts on that, but it seems pretty par for the course to me.

Professor McMillan: To be honest, I do not. Obviously, the investment banks will set their fees. Without looking into the detail, I presume that a lot of it will be fee based so, if the fee is £2 million, it is £2 million. That goes back to the earlier issue about being open with the public and explaining the position, which is that we are paying a set amount of money to investment banks, so that money is not being used for something else. If we are paying investment banks the money, we must have a clear rationale for why we are doing that and why it benefits Scotland in the longer term. Maybe because of the current mark-up in terms of the interest rate cost, we are paying that fee up front every time that we issue a bond, so there has to be a reason that we can articulate to the Scottish people.

Alan Brown: How do we quantify the benefits of the administration costs versus the revenue savings? If we are only paying interest and are not making capital repayments at the same time, how do we calculate the advantages of that?

Professor McMillan: Obviously, you can work out what you believe future cash flows would be, and you could do a kind of net present value calculation. Minus £2 million would be your initial investment, if you want to think about it in those terms—you can calculate those kinds of statistics. Instead, I would argue that it is about how the access to the bond market—as I said, that would be over a longer horizon, beyond five years—allows Scotland to raise capital for much-needed infrastructure projects, for example, around the country. That is the rationale to set out, rather than just saying, “Here are some figures that some people will want to understand and some people will not want to understand.” It is about setting out a clear rationale for a programme that is a step change from the way in which funding has been done.

Alan Brown: I have almost a repeat of Liam Kerr’s question about transparency in the calculations. How could the Government publish those calculations, given the market sensitivity? Because some of the calculations would be based

on the assumption of borrowing rates, we would be publishing what we expect the market borrowing rates to be. Would it not be a problem if we published those calculations?

Professor McMillan: Investment banks might say that you should not do that but, with projections, you can have a range—that is what you would typically do. That would show what would happen if the yield rose. Currently, we expect policy rates to rise over the next six months. Inflation is up this morning, for example. Last week, the US inflation figure was a big surprise, and we know that the Federal Reserve is going to put up its interest rate. We are in a higher interest rate cycle. You can have projections for what bond yields will look like in different scenarios. In a year's time, we will probably be sitting around talking about when policy rates will be falling—I hope so, anyway.

You can have different scenarios. You are trying to communicate to the population why you have this plan and set out the potential costs involved as well as the benefits, which are beyond just what you might put in an accounting balance sheet.

Liam McArthur (Orkney Islands) (LD): You have been very helpful so far to us in our efforts to navigate the issues. I will pick up on the themes that Liam Kerr and Alan Brown addressed. Last week, we heard from witnesses from the Office for Budget Responsibility. I do not want to put words into their mouths, but they came across as saying that dipping your toe in the water is all very well, but you would not want to start here.

They pointed to what you have referred to, Professor McMillan, regarding high interest rates and energy costs and monetary policy expectations, not only in relation to the United Kingdom but internationally. The briefing from the Scottish Parliament information centre says:

> "While these higher borrowing costs largely reflect wider international economic conditions rather than Scotland-specific factors, they would increase the cost of servicing debt and could influence assessments of whether bond issuance offers value for money."

Does that suggest that, although there is value in exploring the options, the timing is critical? Given the volatility that we are seeing and the fact that levels of uncertainty are heightened, does dipping a toe in the water by issuing bonds at this stage come with a higher level of risk than the public might be prepared to tolerate?

Professor McMillan: That is an interesting point. Bond yields are rising and the market is volatile, and we can go through the reasons for that. As I said, there are expectations that policy rates will rise and I think that that is on the cards. We know what inflation looks like and we have projections. There are those issues, and geopolitical risk is another. It is waning at the moment, but who knows where that might go? That is important.

The other side of that is that there is a lot of demand for money. That is coming from Governments, which you might argue is bad because that would create a debt, but a lot of demand for money is coming from tech and artificial intelligence firms, which are issuing huge amounts of bonds. One of the reasons why yields are rising is that, for a variety of reasons, lots of parties want funds.

That takes us back to whether we should wait for six months or a year, but if not now, when? It is difficult to make future projections about what is going to happen to the bond market or to volatility. You could say—and it would be my view—that, in a year or 18 months, policy rates and inflation will be falling. If we also assume that there will be no more geopolitical risks, you could argue that that will result in a more stable market. The kind of demand for funds that we see from AI companies will always be there; notwithstanding the events of the past week, there will always be that push.

It is interesting that, when you look at real interest rates, as opposed to nominal ones, you see that the real interest rate is not particularly high and is sitting at about 2 per cent. I know that one of the documents mentions a 15-year Government bond. If you issue that right now at a real cost of 2 per cent then, although the nominal yield is higher, the real value is not at a historic high, which means that doing that now would not be out of line.

Related to that is the question of what interest rates are supposed to look like. If we go back to 2007 to 2009 and to the period of quantitative easing that lasted more or less until the beginning of this decade, when short-term rates were artificially pushed down, long-term rates did not go down by so much but were still anchored a little bit. However, that is what interest rates were like before 2007. Rather than asking whether we expect to move back to bond yields of 2 or 3 per cent, rather than the 5 per cent level we are at now, perhaps we should say that the past 15 years have been an anomaly and that we are now moving back to where we should be.

Briefly, to sum up, you can never wait for a perfect time because there is no perfect time. I fully see the argument for saying that we should hang on a bit, but you will always be sitting here wondering whether we should hang on for another six months because something has happened in the global economy.

Liam McArthur: This might be an unfair question, but I am going to ask it anyway. At the point at which the previous First Minister committed to the bonds, for reasons that I think we

all understand and accept, and set the train in motion, the volatility and instability that we have seen since was not predictable or predicted. If the former First Minister had had a crystal ball and been able to see what was coming down the track, do you think the same decision would have been made or that the bets would at least have been hedged a bit with regard to the timing and the structure?

Professor McMillan: You could easily make that argument: "Interest rates go in cycles. We're now in an up cycle, hopefully peaking in, say, the first six months of next year, so let's just wait." That is a very easy argument to make, because it is better to launch in an interest rate cycle that is kind of in the middle. You do not want to launch it when things are too high, but, at the same time, you do not want to launch it too low, because you know that interest rates will rise in the future, and that puts pressure on bond prices. Given the turbulence we have seen in the global economy, particularly in relation to geopolitical events, it is very easy to make the argument that we should wait and see what happens—but who knows what is going to happen geopolitically. That is the problem.

Liam McArthur: We probably would not all be sitting here if we could predict that. Do you have anything to add, Dr Cormier?

Dr Cormier: Yes, a couple of things. First, the most important thing is the context that David McMillan just gave, which is that, in a historical context, these interest rates are not high—they are normal. What has been going on since 2008 is the weird stuff. It is completely reasonable to issue bonds at these levels. It is also important to keep in mind that, as David also said, uncertainty goes both ways—things can get worse—so reasonable is good. There is a risk that is not quite letting the perfect be the enemy of the good but that is in that space. Looking back at the historically and worryingly low interest rates and saying, "We missed our opportunity" is not quite right, because these rates are, historically, where bonds should be.

Liam McArthur: The point about interest rates absolutely seems to be a fair assessment, but perhaps these levels have not previously coincided with debt levels being as high as they are. The combination of those two things seems to have an impact.

Dr Cormier: For Scotland in particular, I do not think that that is a major concern, given the legal limits on borrowing. The question was about whether now is the right time to dip a toe in the water. I think that it would be, because debt levels will be capped, at least for the foreseeable future, given the current arrangements.

The other thing is that not borrowing is not the alternative. It is not a case of a bond programme or nothing; it is a bond programme or the NLF, and UK bonds are subject to the same volatility and global rates as Scottish bonds would be. It is not as though not issuing the bonds would remove Scotland's exposure to bond market rates, because they are exposed through the NLF anyway. If you think of the situation not as bonds or not borrowing but as bonds or the NLF, it is almost a case of six of one or half a dozen of the other, so my view is: why not use this moment of reasonable interest rates to dip your toe in the water?

Liam McArthur: You talked about the equivalent credit rating being given to Scotland and the UK, which is predicated on the constitutional settlement. I think that S&P Global and Moody's have suggested that a move towards independence might apply downward pressure on Scotland's ratings. Albeit that S&P's assessment is that it considers

"the likelihood of Scottish independence to be low",

it said:

> "Material steps toward independence could affect monetary and fiscal arrangements with the UK government."

Without losing ourselves in a constitutional debate, that is clearly a factor that weighs on any assessment of taking bonds forward and what the implications might be. Is that fair?

Dr Cormier: Yes, that is actually the crux of the matter. Fundamentally, all the discussion of risk associated with Scottish bonds comes down to a constitutional question.

Liam McArthur: Like so many other issues.

09:45

Dr Cormier: Yes. As soon as I open my mouth, I am not really in a position to talk about it. However, from a debt management perspective, that is the one thing that could materially change the nature of the risk associated with Scottish bonds. The rating agencies have said that in their assessments when they have given the equivalent rating of UK gilts. That is the crux of it, because it is about explicit and implicit UK guarantees of Scottish debt. Investors are perfectly happy to see Scottish debt as equivalent to UK debt because, if anything was to go sideways—it certainly would not in the initial programme at relatively small volumes—the UK Government would be there, so the risk to investors is essentially nil.

Liam McArthur: If the Scottish Government proceeds, what assurance will it have to offer the market, given the narrative in a political context,

which we understand, that it is going to press quite vigorously for a referendum and independence?

Dr Cormier: At the very least, all of this is implied through the fiscal rules and debt rules that are part of the legal arrangements for devolution. A strong parallel would be a large American or Canadian city, province or state issuing debt. That debt is implicitly guaranteed by the Canadian or American Government, and investors know that, whether it is written down or not. Such implicit guarantees are pretty standard assumptions for investors to make in sovereign debt. That explains why the gilt-kilt spread is basically nil. What could make it grow and make Scottish debt more expensive and seen as more risky is really just the constitutional question and any changes in that regard, whether they are to do with polling or political events down the line.

Professor McMillan: Everything that Ben Cormier has said about credit ratings and so on is the case, but that leans heavily into how the bond programme will be issued and the maturity of the bonds. That is the key issue. If the Scottish Government came out and said that it was going to start issuing 40-year or 50-year Government bonds, the market would factor in a bigger constitutional risk premium. As I have said before, there is a need to have a range of maturities, but they should not get too long. If we end up with independence one day, bonds with shorter maturities will have been paid back. It is in the nature of the programme that the bonds will be paid back anyway, but that is obviously seen as a positive thing. That is the way in which the Scottish Government would try to avoid a bigger constitutional risk premium. However, I would certainly avoid having maturities that are too long.

Pauline Stafford (Bathgate) (SNP): Thanks for your evidence so far. Dr Cormier, you said that we are talking about relatively small volumes in the grand scheme of the Scottish budget. We heard evidence from Dr João Sousa from the Institute for Fiscal Studies, who said:

> "You could do a trial to see whether there will be a lot of demand for the bonds. That is not cost free, but it prevents you from issuing a lot of bonds that do not get subscribed afterwards."—[*Official Report*, *Finance and Public Administration Committee*, 9 September 2026; c 24.]

Is that a reasonable proposition? Is there a minimum scale or commitment that we would need to make to test that?

Dr Cormier: That is an interesting question. I do not know that I have a firm answer off the top of my head. The idea that there would not be demand for the bonds is strange, because there clearly is demand. How much trading there would be could be a function of how big the bonds were. In many emerging markets, countries are trying to issue fewer, larger bonds. However, this does not feel like an important question at the moment.

David McMillan might have more thoughts on the issuance plan and consolidation. Especially given that they will be the first such bonds, I see logic in issuing a handful of small to medium bonds just to dip a toe in the water and ensure that it is possible to manage the timing. If something happens, it would be possible to hold off on some of it.

I do not have firm thoughts on that question, but the idea that there would not be demand is sort of shocking to me.

Professor McMillan: Despite Government debt levels around the world, the demand for bonds is still there. No Government is issuing a bond programme that is not subscribed to. With a Scottish Government bond programme, the demand will be there, and it will be from the usual institutional characters—the pension funds and insurance companies—because they want the regular payments of interest, as that matches with their liabilities.

The issue with the programme being small is that, obviously, an illiquidity premium will be factored into the cost. You might argue that it is a good thing, because hedge funds will probably stay away. They will not get involved, because the issuance is too small and there is no derivatives market around it. Also, because of illiquidity, it might be hard for them to flip bonds in a short period. You might get a little bit of speculative demand at the beginning, depending on the exact pricing at issue, but I do not see a problem with those big institutions that need the regular income.

Pauline Stafford: We have heard a lot about our position on foreign direct investment, on which we have quite a strong track record within the UK. Does that have any impact on how investors see a potential bond programme?

Professor McMillan: I read the document that was circulated for this meeting, and one of the arguments in it is that Scotland would have greater access to global capital markets and therefore the programme would be seen as a signal that Scotland is a good place to invest. As you said, people know that anyway, and Scotland has a lot of good things going for it that signal to the market.

A well-functioning bond programme would add to that attractiveness as an investment destination, particularly as the bonds are to be earmarked for infrastructure projects rather than to cover day-to-day spending, which some other Governments issue debt for. From that perspective, if the programme runs smoothly, it will be a plus. However, as I said, there are things that I would change.

Dr Cormier: I read that section in the document as well, and I am actually a little dubious about that argument. I do not know how much Scottish capital coming into Scotland is crowded out because there is no Scottish bond market. That is an empirical question, and I am a little dubious about that point. However, I think that smart use of the bond proceeds would prompt further private investment. I do not think that the bond market itself would do that; it would be how the Government uses the £1.5 billion.

Pauline Stafford: That is helpful.

My other questions are about the structure of the debt. You have mentioned that it would be helpful to have a range of maturities. The Scottish Fiscal Commission noted that the bonds could be structured with a bullet repayment, so that there is a lower debt repayment at the beginning but that would accumulate later down the line. Is that flexibility a significant benefit, or is there more risk attached to that within the current fiscal framework?

Dr Cormier: Bullet repayments are standard for sovereign bonds. In a sense, there is the short-term benefit that you get all this cash and you get to use it. It is not like the way in which we pay our mortgages, in which you have equally large payments over time—it is not amortised. However, that means that, in all likelihood, the debt will be rolled over. Again, that is how sovereign debt works, and that is fine.

To me, it comes back to how the debt is used. If it is used productively and invested in productive purposes that lead to growth and increased tax revenues, there is absolutely no reason to fear a bullet repayment and rolling over, because leading to growth is the thing that debt is supposed to do. Sovereign debt becomes a problem when the debt is not used productively and the growth effects and increased tax revenues do not come to pass.

That repayment structure is very standard and nothing to fear. Again, David McMillan might feel differently.

Professor McMillan: If the Scottish Government is going to move into this market, it will want to issue what everyone else issues, so I would expect there to be standard bullet repayments.

The tricky issue relates to the nature and structure of the programme. If there is a five-year programme and all the money needs to be paid back, future budgets will be impacted by what the Government issues now. If the Government has to pay back the money in five years, 10 years or whenever the bond matures—let us assume that the rules mean that the bond cannot roll over, although that position might change—the money must come out of the budget for that year. That is just the nature of the issue. Therefore, the Government must structure the bonds so that it does not need to make repayments over a sequence of years. It might go for a five-year bond, a 10-year bond and a 15-year bond so that there are years in which there are no repayments.

Last night, I was thinking about the Government issuing a two-year bond, which would mature within the five-year period, because, as I understand it, that bond could then be reissued within the five-year period, with the Government staying within its capital limits. I am not saying that there would not be problems with that, but it would be an interesting approach to consider. On the credibility argument, if we want to prove that Scotland can access capital markets and is able to successfully repay, doing that over a short period would be a big plus.

There would be other problems. For example, there would be a mismatch with the infrastructure for which the money was being used—the building would take longer than two years.

It depends on how we want to balance the arguments. If the Government issued a bullet bond and there was no rollover, it would need to be careful about how things were structured.

Pauline Stafford: You think that such a bond issuance programme would fit with the current fiscal framework and debt policy landscape in Scotland, so it would be entirely possible.

Professor McMillan: If I could wave a wand and change the position, I would, but such a programme would be entirely possible.

Pauline Stafford: I have a slightly unrelated question. You said that we should issue what people want to buy. Alongside what we have been talking about, is there an argument for considering retail bonds or green bonds, or would you begin with the standard bonds?

Professor McMillan: One of the arguments for a bonds programme is that we want to issue bonds that everyone in the market will want, so we do not want to put too many restrictions on what we can use the money for. Green bonds and other labelled bonds are fine, but they should not be issued first.

If I were designing the programme, I would not have a five-year programme, but I would issue regular bonds now to get the market interested in them and get them on the books. In the future, the Government could issue a particular bond for a green project—a hydro energy project or whatever—but, right now, I would just issue the standard product in the market.

Dr Cormier: The prices of labelled bonds, such as climate or social sustainability bonds, depend

on vanilla prices anyway. Labelled bonds would be step 2, but there are all sorts of complications with them. For example, how would you validate that the money had been used as intended? That would require a whole set of fiscal infrastructure, which would need to be figured out. Although such bonds are terrific and admirable, they should be used down the line. Setting the baseline benchmark is key.

Liam Kerr: I have a supplementary question based on Pauline Stafford's questions about rollover and bullet repayments. Professor McMillan, I accept what you said about such repayments being a standard mechanism—there is no doubt about that—but should the Scottish Government provide any safeguards or structures to ensure that Governments of the future can afford any repayments or obligations that arise?

10:00

Professor McMillan: That is a very difficult one, because nothing that I have seen suggests that that is in place. Say that the Government issues 10-year bonds now and decides that it will fully repay them in 10 years' time. That payment will come from that year's budget. There are two ways around that. One is the rollover, which I think both Ben Cormier and I would agree is something that perhaps even the market might think would develop during those 10 years. However, if we assume that it does not, a reserve must be put in place that increases over time so that the repayment can be made. Otherwise, when it reaches the 10th year, the Government will be taking a huge chunk of money out of that year's budget.

The only slight caveat to that is the 10 years of inflation over that period. The purchasing power of, say, the £300 million in 10 years' time will not be the same as it is today; it will naturally erode. You can argue that that is a reason to issue longer-term bonds.

That is the kind of trade-off that we are talking about. I would imagine that either you negotiate with the UK Government about a rollover or you put something else in place.

Liam Kerr: Understood.

Angela Ross (Edinburgh and Lothians East) (Reform): Good morning. Thank you for your responses so far. It has been very interesting.

I will touch on a few things that have been spoken about previously. The size of the Scottish Government's proposed bond issuance programme is fairly modest. Given that, do we have to make the kilt more competitive for investors, perhaps when compared with the UK gilt? How would we make it more competitive in the bond market? Would doing that create a symbiotic relationship between kilts and gilts?

Dr Cormier: I do not think that competition for capital is a major concern. It goes back to what David McMillan said when we were talking about this earlier. There is always demand for safe assets such as Government bonds, especially from a rich developed economy, especially now. The volume is not important for being competitive in the eyes of investors. In my view, what is more notable about the volume is that there is relatively minimal risk because the numbers are modest—you can get your hands around them.

In terms of the linkages between the kilt and the gilt, it is inevitable that they are tightly bound at this point. That is because the gilt is the natural reference point for investors, and that covers everything from getting the same rating to the fact that Scotland is a devolved nation. To go back to the issue of Scotland's status, if the discussion around constitutional change becomes increasingly relevant, that is the one thing that could change the tight, necessarily interwoven relationship between kilts and gilts. As long as that does not happen, the kilt and gilt will, in a way, be inseparable.

Angela Ross: Are there any additional costs, such as administration costs, involved with such a small issuance, or would those be negligible?

Dr Cormier: I would say that they would be negligible. I suppose that you could get more bang for your buck if you issue a larger bond—for the same operation, you get more money. However, for me, that would be far down the list of things to be concerned about.

Angela Ross: This might be slightly out of your remit, but I want to ask about the draw-down of money from a bond and its being assigned to, say, capital projects. If money is drawn down, where would it be held if it is not immediately invested in a project? Could it be placed in some financial vehicle to accumulate interest? I am aware that we would be paying interest on it. We do not want to have a mismatch whereby we are paying interest on a bond that is sitting somewhere unused. Is there any structure around that at all?

Dr Cormier: There are two things there. First, money sitting there can still collect interest, depending on how a finance ministry holds it and sets it apart.

The more interesting question, which is kind of a global challenge, is that bond money is fungible—it is hard to track. The vast majority of countries borrow money and put it in a consolidated fund with all other revenues, such as taxes, so it can be hard to decipher what got

funded with bond money rather than tax revenues and other resources.

Different accounting strategies or options are available, and the World Bank talks about three of them. You can deposit the proceeds into a separate account, which might collect interest until it is drawn down. Surprisingly few countries do that. You can have a sub-account, where you transfer funds when a project demands it. You can also not have anything, so there is just virtual accounting, in which you back-calculate, based on expenditures, where the bond money ended up going.

Drawdown is a hard thing to do, because the fungibility of revenues is a public financial management principle. It is a good governance thing. As a finance bureaucrat, you want to be able to respond to political priorities, shocks and surprises. That is an interesting question that a lot of countries struggle with.

As I say, there are different approaches. In theory, wherever the money sits—if it is waiting to be drawn down over the lifetime of the bond—it should collect interest.

Angela Ross: Professor McMillan, did you have any comments?

Professor McMillan: You talked about the competitiveness of the bond, which was an interesting point. I was going to ask what you meant by that. How do you make a bond more competitive? You can offer higher interest but, from the debtor side, you do not want to do that.

This is where the size of the bond issue can be more tightly tied to capital projects. If you are issuing a relatively small amount, in a global sense, you can say that it is earmarked for a particular project and present the accounting for the project and the investment costs of whatever it is, whether it is building a new rail line or putting in green energy infrastructure. That element is easier.

Your comment got the finance side of me thinking about what you could do, if you issued bond money, to invest to earn an interest rate that is higher than that rate that you are paying. I know that that is not what bonds are for, but that is my finance training coming out.

The Convener: That could be an interesting academic exercise. Maybe it is one that you could set your students this year as a final project.

Liam McArthur: To follow that up, linkage with particular projects seems sensible, particularly given our discussion about the market having confidence that the bonds will lead to beneficial growth and so on. In the infrastructure delivery pipeline, there is not a clear explanation of how bond debt might sit alongside the other sources of financing. From what you are saying, alongside everything else that would need to be done, there would need to be much greater clarity about how that bond debt would be utilised if it is to build the confidence that the Government wants.

Professor McMillan: It comes back to the question of why this is happening. A source of funding is available through the national loans fund, but the Government wants to do something different. Why is that? Even though the total amount of money is staying the same, the Government is doing it for a range of reasons that have been mentioned, such as diversification.

To go back to an earlier point about how we can tell the Scottish people what we are doing it for, we need to say that we are issuing this bond—for example, a 10-year bond—because the money that is raised from it will go towards, for example, an infrastructure capital project that has a rough life of 10 years. You describe the rationale for paying a slightly higher cost of borrowing and say that you are doing it for diversification, to get credibility in global markets or for a particular project.

There used to be big display boards that said something like, “Funded by X”, and I would have something like that to put the idea in people’s minds that it is a positive programme and that it is not being done just by finance people and all those investors that we do not necessarily like. It would show the tangible benefit of the programme.

Liam McArthur: Is it still possible to account for that within a consolidated fund?

Professor McMillan: It can be earmarked within the accounting.

Dr Cormier: It is possible, but there are a couple of issues. David McMillan mentioned messaging. It is hard to explain to people that the diversification of sovereign debt is a good thing, so it would be helpful to be able to say what it is going to fund. It is challenging to tie bond proceeds to outcomes, but it can be done with some effort and some interdepartmental communication. That would be the ideal.

Joe Fagan (South Scotland) (Lab): I will go back to the point about establishing credibility. You spoke about a robust market. Can you comment on any of the other factors that might change some of the assessments of the cost of borrowing or the assessments of risk? Are there any other factors that you think could usefully be highlighted to the committee? You have spoken about the geopolitical risk that is associated with the country that we are sitting in at the moment, but is there anything else that you think is important to highlight?

Professor McMillan: Bond yields are set by things such as growth rates and Scotland has its own growth rate, so we can publish that. They are also affected by inflation rates, but we do not have an inflation rate for Scotland, so that is a separate issue. Things like that would be good.

Prices in financial markets are driven by what people expect will happen. For us, that would include expectations about the level of growth in the Scottish economy, the level of spending on infrastructure as opposed to day-to-day spending, and what is happening with the constitutional argument. The level of Government debt would be another factor and I know that there are always arguments about "Government Expenditure and Revenue Scotland".

The Scottish Government needs to be able to establish credibility and to say that it has a programme and what that programme is. In some senses, the issue is not really whether investors completely like the programme; the issue is whether the Government sticks to the programme. If the Government says that it is going to stick to the programme for certain reasons and because it will have certain benefits, and if it does then stick to that programme, that will build credibility. The thing that would destroy credibility would be the Government saying what the programme is but then changing halfway through and doing something completely different.

Joe Fagan: I do not want to draw you too much into the realm of politics, because I am interested in the academic perspective, but would it be fair to say that the Scottish Government's position that Scotland will be an independent country by 2031 is not something that the markets are pricing in when assessing the value of Scottish bonds?

Dr Cormier: I think that it is priced in but that markets do not see a high likelihood of that happening. That is what the ratings agencies have said and that is what the really tight and minimal spread of assessments implies.

Joe Fagan: There are areas of potential risk. At some point during this session of Parliament, we will again assess the fiscal framework while remaining within the overall structure of the UK. Has there been any assessment of the risk around that?

Professor McMillan: What Ben Cormier said is true. The credit rating is based on the situation as it is now. You can have countries that have the same credit rating and different bond yields, and you can have a country that has a better credit rating but a higher bond yield, depending on the specifics of the circumstances. What would then happen? Is that priced in right now? Where does that difference come from? It comes from the fact that the market is illiquid, and from the fact that there is a bit of political and constitutional risk.

10:15

Let us say that there is an issue of a long-term bond of more than 10 years. If the constitutional risk increases, you would see that the gap that is currently projected to exist of about 0.3 per cent would widen and institutional investors would start to move out of the market. It would be revealed in the pricing.

Joe Fagan: If we set aside independence as a geopolitical risk, as we have discussed that, it is also the Scottish Government's policy that there should be a system of full fiscal autonomy in the relationship between Scotland and the rest of the UK. What would be the impact of that material change on the bonds programme?

Professor McMillan: That is an interesting question. The reason why the credit rating is set the way that it is and why the yield difference is what it is, is that, although this is not explicit, the UK Government stands behind. With full fiscal autonomy, if there was a worst-case outcome, would the UK Government still stand behind? The spillover effect of a fiscal problem in Scotland would inevitably affect the rest of the UK, so there is an argument that the UK would not let a sovereign debt crisis occur only in Scotland. Again, you might see a change in the spread, but not to the extent that you would see if there was a fiscal crisis in an independent Scotland.

Dr Cormier: How I think about it is that, whether it is debt laws, fiscal laws or percentages of GDP or budgets—however this is measured—what investors are looking at right now is that the devolution framework and fiscal rules are all robust and adhered to. As long as that is the case, investors will trust that really bad outcomes from the debt programme are unlikely. Material changes in that would change the yield, because that would change the risk. I have no idea whether that is likely, but it would, and should, change the risk.

Joe Fagan: That suggests that, even with full fiscal autonomy, there would have to be a strict set of fiscal rules. I do not want to get too off track.

Professor McMillan: There has to be.

Joe Fagan: Yes, exactly.

I want to come back to a question that Pauline Stafford asked. Something occurred to me during the meeting, which is about the opportunity cost. You mentioned that the two options are the bond programme and the national loans fund. In a broader sense, we know that there is demand for capital spending and that the Government has

certain capital spending requirements, but arguably—actually, there is no argument about it—it does not have enough resources to meet those capital spending requirements. Are there other financial products or mechanisms that, from your experience and that wider academic perspective, the Scottish Government should give more consideration to alongside the national loans fund and a bond programme?

Dr Cormier: I would say no, I guess. The development of a bond market in which you can issue at different maturities and strategically engage with investors to get more of what you want, because you can issue at two, five and 10 years and you have a lot of flexibility, is so helpful and important that anything that I could conjure up would be secondary, given those significant benefits of developing a bond market.

Professor McMillan: The question that I would ask—and which I think goes to the heart of the issue—is, why is this happening? Why are we doing this? A source of funding is already available, so what ultimately lies at the heart of this? It is impossible, I think, to extract the argument for it from the independence argument. Why does Scotland want a bond programme that essentially replicates what it has through the national loans fund, but at higher cost?

Ultimately, the only reason for doing it is that the benefits in the long term—say, in 25-plus years—will outweigh the current costs. However, the structure of the programme means that those 25-year benefits are never going to arise, because it is supposed to end in five years with no rollover. As I have said, that could change, but that is the way in which it is structured now. The question, really, is, why do it?

Also, as we discussed, there is turbulence of the market right now, which might carry on for another five years. Perhaps interest rates will fall, and the market will calm down, or perhaps another geopolitical risk will arise. Given the many other things that could happen, there has to be some reason for doing this when you think about the opportunity cost and the fact that you have something sitting there that costs less. You have to be clear about the tangible benefits; my view is that those benefits will only ever emerge in the longer term, and, as of now, the programme is not designed for the longer term. There are, as we have discussed, other ways of structuring the bonds, but unless the programme becomes a permanent feature, whatever the perceived benefits are now will wane when it ends in five years' time.

Pauline Stafford: I have just a final question. Where would you look internationally for a comparator country in the same situation—that is, as a sub-sovereign issuer of bonds? I took a look at Quebec, which has quite a well-established bond programme and has had to deal periodically with quite significant constitutional questions. Could that serve as an example of how the constitutional question might affect things, or are there other comparators that you would recommend?

Dr Cormier: As I said earlier, the parallels for guidance on how this might go are not the emerging market sovereigns. I just think that Scotland is in a different position. For a start, it is much wealthier, and it has, through the UK, an existing, even if relatively indirect, relationship with markets.

The parallels would be subnational entities such as Quebec and even big urban centres such as Chicago that issue a lot of sizeable bonds that generate investor interest, and which are backed by some superior authority that implicitly, or explicitly, guarantees them. A big city, or a province such as Quebec, would be the appropriate parallel.

Professor McMillan: Yes, and I think that the German states are able to issue bonds, too. As far as I understand it, though, the key difference in Canada and Germany is that those regional authorities are able to roll over their debt, so they are not stuck in some five-year cycle in which they have to pay the money back. The nature of this bond programme is that it ends in five years, and then we will be forced into paying the money back.

If we wanted to take those countries as comparators, we could look at what happens in terms of yields and so on. However, they are a different market, so we have to be a little bit careful in that respect.

Pauline Stafford: That was helpful. Thanks.

The Convener: I call Liam Kerr.

Liam Kerr: Thank you, convener. I will be honest—I was not expecting to be brought in. However, given that I have been, I want to go back to Dr Cormier's point about US and Canadian Governments implicitly guaranteeing the debt. Is that actually what happened? I am thinking of Detroit, for example, which effectively went bust in 2013.

Dr Cormier: That sounds about right, yes.

Liam Kerr: What happened then? Did the federal Government step in, or not?

Dr Cormier: I will not be able to tell you the story accurately, but I would assume that the state of Michigan and/or the US federal Government backstopped the default. I do not know what sort of workout they had—you are going to make me

go back and read about it now—but that would have been the idea.

Indeed, thinking about the parallels that you could look at, I would say that what is unique about this situation is that such a backstop exists and that investors really believe that, as is implied through how tight the yield is compared with gilts. Detroit might have been paying a huge amount, because investors did not really believe the Michigan and American guarantee, but I will have to go back and read about it.

Liam Kerr: I will, too. Thank you.

Professor McMillan: I was also thinking about Orange County, but I cannot remember that one, either.

The Convener: It sounds as if we have set the both of you homework as a result of the session. Thank you for your interesting evidence.

I suspend the meeting briefly for a comfort break.

10:25

Meeting suspended.

10:34

On resuming—

The Convener: We will now continue our evidence taking on the Scottish Government's bonds programme.

I welcome Stephen Boyle, Auditor General for Scotland; Angus Macpherson, former co-chair of the Scottish Government's investor panel; Lénaïc Couderc, assistant vice president in the sovereign and sub-sovereign group at Moody's Ratings and acting lead analyst for Scotland; and Steven Whyte, former head of resource and finance at Aberdeen City Council.

We will move to questions. Liam Kerr will be first.

Liam Kerr: My first question is addressed to Stephen Boyle, the Auditor General, but if anyone else wishes to come in, please indicate that to me. Stephen, we heard evidence from the first panel about the lack of information that has been provided on what is going on. Given the potential financial implications of issuing Scottish Government bonds, do you consider the current level of information that is available to Parliament to be sufficient?

Stephen Boyle (Auditor General for Scotland): Good morning. Thank you for your question. As you will know, we have not audited the arrangements so far. You will know from much of our work that it is important that there is effective scrutiny, including in the work of this committee and other parliamentary committees, and that there is a clear narrative and transparency. That will be formed with the right balance between commercial sensitivity and confidentiality, and transparency, to support scrutiny and effective decision making.

Our perspective as the auditors of the Scottish Government, which I am happy to go into in more detail if members wish, is that we welcome the engagement that we have so far had from officials as the Government has explored the accounting, financial reporting and disclosure arrangements that will accompany any Government borrowing. I believe you touched on some of those issues with the previous panel.

One factor in relation to Government borrowing is that there is currently a mismatch between accruals accounting and receipts and payments accounting. The Scottish Government's consolidated accounts set out its assets, liabilities and so forth. Alongside that is the Scottish consolidated fund, which is a receipts and payments account.

However, a welcome development, which supports scrutiny and transparency, is the Scottish ministers' intention and plans to explore the creation of another account that would be known as the Scottish ministers' borrowing account. That potential development is important as it allows for any listed debt bond to be seen alongside other borrowing arrangements, and it will have a clearer position in its own right along with the other two accounts.

Transparency matters. It is part of the work that Audit Scotland does, and being transparent is clearly part of my role when I report to Parliament on public finances.

Liam Kerr: Angus Macpherson, do you want to come in on that?

Angus Macpherson: I am not completely aware of issues relating to what has or has not been told to the Scottish Parliament, so I am not sure that I can add anything.

Liam Kerr: In which case, Stephen Boyle, in your answer, you talked about intentions and exploring future accounting arrangements. The Scottish budget is due on 3 December, so what additional details about the expected costs, benefits, risks and financial trade-offs should the Scottish Government provide to the committee and the Parliament in its budget so that we can assess whether the programme represents good value for money?

Stephen Boyle: It is difficult for me to be entirely specific on that, Mr Kerr, because judgment can vary between one user of financial information and

another as to whether the information is sufficient and completely transparent.

However, as the committee explored with the previous panel, the Scottish Government has set out three broad aims for its bond programme, and it is important that those three aims are accompanied by appropriate detail.

Much of the narrative in our reporting—on whether there are clear intended outcomes as well as adequate tracking, monitoring and governance arrangements—is set out so that both the Parliament and potential investors will have a clear understanding of the aims and objectives, as well as the anticipated outcomes and usage, of what is a new type of Government debt. I am not giving you additional very clear specifics, because they are a matter for the Government to explore and to set out for the Parliament as part of the Government's own arrangements, and it is then for the Parliament and others to take a view on whether those things remain adequate.

Liam Kerr: Presumably, that should be done with the overriding principle of transparency and openness.

Stephen Boyle: Transparency and openness are absolutely fundamental, bearing in mind that, after all, the issue concerns public debt and public money that will be used to repay that debt—and new assets, presumably, that will be created alongside that. Transparency alongside existing arrangements and, potentially, new enhanced arrangements to support transparency are important and welcome.

Liam Kerr: I will put my final question to Angus Macpherson. How important will that independent scrutiny, the transparency that we have heard about, and robust financial governance be in building investor confidence in the Scottish Government's bonds programme?

Angus Macpherson: Evidently, financial competence and transparency are the hallmarks of a credible issuer of bonds, so, yes, they are important.

Alan Brown: Good morning. Angus Macpherson, you were a co-chair of the investor panel that made the recommendation about bonds. At great risk to myself, I assume that you have not changed your mind and that you still think it a good idea.

Angus Macpherson: I have not changed my mind. I still think it a good idea. I have not had the opportunity of speaking to the other members of the panel, even though some time has passed, but I am reasonably confident that they remain of the view that it was a good idea, for the reasons that we outlined in our recommendation.

Alan Brown: The outline business case that the Scottish Government put forward drew on your recommendations. One of the advantages that was detailed related to making Scotland more attractive for additional foreign direct investment. Is there any way of measuring that? How would you measure the additional attractiveness of the market, and, possibly, the additional investment in it, that might be generated?

Angus Macpherson: That was one of 31 recommendations that we made. It has probably had a disproportionate amount of attention relative to the others. However, taken together, all had the objective of either increasing the quantum or reducing the cost of capital that was available to Scotland on an ongoing basis. The recommendations were, to a great extent, interrelated. We can perhaps touch on that later. It is very difficult to isolate the impact of any one measure, but the text of what we said is,

> "Although it will involve additional costs, Scotland's profile could be significantly raised in the international capital markets by using existing devolved powers to issue debt. This will provide a motivation for regular engagement by investors and an opportunity to market Scotland's investment story. It would also allow the development of relationships with providers of debt, a track record and credit rating".

The one bit that is very visible at this stage is the credit rating, and if that surprised anyone in the investment community to the up side—there is quite a lot of research about the correlation of credit ratings and the cost of capital—that would be empirical evidence of a beneficial impact to the programme.

Alan Brown: I think that you were in the public gallery during the first session.

Angus Macpherson: I was.

Alan Brown: One of the witnesses—Professor McMillan—said that he felt that it would be better to release bonds of a different duration initially, rather than the Scottish Government's proposed five-year window. Do you have a view on that?

Angus Macpherson: I do not. Well, I have personal views. The panel, which I am here to represent today, did not have a view on it.

I cannot remember the exact list of the various book runners who have been appointed, but, from memory, some of the best names and most significant underwriters of government and corporate debt are on the list. I imagine that they will have provided very good advice about the best way to access the market to achieve the Scottish Government's objectives, so what Professor McMillan described did not immediately concern me.

10:45

Alan Brown: Aberdeen City Council has been through the process of issuing bonds. Steven Whyte, in making a business case and highlighting the benefits against the cost, how much granular detail did Aberdeen publish?

Steven Whyte: We were in a unique position at the time. We already had a significant capital programme, and an additional project for the exhibition and conference arena, TECA, was being progressed. Our problem was that there was a three-year build-out period before TECA would be open and providing an income stream, so we needed to look at how we funded the construction cost. That was about £300 million to £350 million in the first three years, which would have put pressure on the revenue account. The reason why we considered the issuance of a bond was that it allowed us to raise the finance initially and not have to start repaying it until the income-generating asset was generating income.

On the level of detail, we had a significant amount of detail through financial modelling, as well as from the presentations that we had to give to Moody's and S&P Global to get an initial credit rating. That was all presented to the committee to look at the pros and cons. We looked at borrowing directly from the Public Works Loan Board, which is where we would normally fund capital projects or capital programmes from. We compared that with the issuance of a bond and the estimated cost of that bond. We graphed that together, which showed that the bond would be cheaper for the first seven to nine years. The savings that we had made allowed for any additional costs from the bond, taking us up to about year 18 or 19.

The other thing that we had to factor in was our existing debt portfolio and the repayments that we had to make. We did not want to have a spike of repayments in a particular year, but, given the way that our existing book was structured, the bond slotted in quite nicely. We took all that and presented it to the committee for it to decide whether it wanted to go down that route.

Alan Brown: Was the bond project specific to fund that one major project?

Steven Whyte: Local authorities cannot borrow against a specific asset. The bond, and the raising of other PWLB debt, was to fund the entirety of the capital programme, but front loading that programme was one project. Although a lot of people probably assumed that the bond was to fund TECA, we could not borrow against a specific asset in strict accounting terms, so it was to fund the entire programme.

Alan Brown: We were just speaking about different bond durations. Has Aberdeen City Council considered that? Are there a range of bonds? Are you looking at rolling over now, or is it a case of "We've done that and that's it"?

Steven Whyte: From memory, the bonds were all issued for 35 years. They are all standard. They are listed on the London Stock Exchange, so they can be bought and sold by other investors. If an investor decided to sell, we could buy it back ourselves. That was another attraction; if we found ourselves in a position in which a bond was being traded, we could look to buy it back ourselves at a future point. The bonds were all for a fixed duration; I am pretty certain that it was 30 or 35 years. However, I have been retired for three years now, and it was 10 years ago, so I am working from memory.

Alan Brown: Auditor General, on transparency and following the money that is drawn down, we heard from the first panel of witnesses about the advantages or merits of linking it to specific infrastructure projects. Are there any risks for the Scottish Government in relation to the fiscal framework and the allowable money—the amount that the Government is allowed to hold? The Government might draw down a bond to fund a three-year project, for instance. Is there any risk in relation to what can be held in reserve, as it were, and how would that be managed?

Stephen Boyle: You are right to note that the Scottish Government has a new complexity to manage, if it draws down funds and there is a delay in the intended capital projects.

As well as the new complexity, there is already some understanding of and sophistication within the Scottish Government regarding Treasury management arrangements. It will be an added requirement to manage the transparency and the boundaries of the fiscal framework with new bond issues, if the Scottish Government gets to that stage. I refer back to the point that I made to Liam Kerr in respect of the appropriate accounting and transparency.

None of that is insurmountable, but it will require additional focus, reporting and preparation, so that the measures satisfy two main groups. First, they must satisfy the existing audience of the Parliament and the public. Alongside that, there are the new requirements to meet institutional investors' expectations on accounting, transparency and disclosure.

Liam McArthur: Good morning, and thank you very much for your evidence so far. Sticking with the same point but also going back to a point that you raised earlier about the creation of a ministerial borrowing fund to provide a degree of clarity on where funds sit and what they would be utilised for, we heard from the previous panel about the linkage with infrastructure projects and the importance of accounting for that. I assume

that the Scottish Government would not be as constrained as local authorities are, in the way that Mr Whyte identified, when it comes to attaching the revenues from the bonds to specific infrastructure projects. Do you view such a fund as a way to provide transparency on what the revenue from the bonds would support?

Stephen Boyle: That is a really strong option. The Scottish ministers' borrowing account can build on the financial reporting developments that we have seen over the past few years in the Scottish Government's consolidated accounts. Our audit of the 2025-26 Scottish Government consolidated accounts is essentially complete, and the accounts will be laid before the Parliament imminently, so I will not get ahead of myself by commenting on those. However, aspects such as transparency, connections and linkages to particular projects, and the way in which the infrastructure investment pipeline aligns with Government borrowing requirements, all form part of the opportunity around the consolidated accounts, alongside the consolidated fund—which is more limited in terms of its financial accounting, as it is a receipts and payments account.

The new Scottish ministers' borrowing account presents more opportunities to satisfy the requirements of Parliament for transparency, and the requirements of institutional investors. Ultimately, it is about how well the money is managed. If it does not go through that account itself, there could be some other important vehicle that supports transparency as to the money that is borrowed and what it is used for.

There are real opportunities to enhance the existing arrangements for how money is used, the additional money that is being borrowed and what it is used for.

Liam McArthur: On another point that I explored with the previous panel, the infrastructure delivery pipeline does not, at the moment, knit together how bonds might provide support or how that would sit with the other financial models that may be available. It sounds like quite a bit of work would need to be done in that area before we could have confidence that transparency was likely.

Stephen Boyle: Up until now, it has not been easy to link specific borrowing that the Scottish Government has undertaken to individual projects. Steven Whyte has set out the local government context.

I am happy to correct this if I am wrong, but I think that the Scottish Government has more flexibility in relation to its borrowing and accounting arrangements. In due course, value-for-money considerations will be made on borrowing through bonds relative to more traditional borrowing through the national loans fund, especially if it is tied to a particular asset or project. That is one of the factors that will be considered when comparing institutional borrowing with borrowing through the national loans fund. I am sure that the Government will give careful thought to that as it sets out to the Parliament and other stakeholders the case for borrowing through bonds and how it relates to particular uses.

Liam McArthur: We have heard quite a bit about the diversity of available options. To most people, using different options would seem to be a way of mixing up the different risks. However, given the evidence that the committee has taken on the Government's efforts to close the fiscal gap, there might be concern that the bonds model is a way for the Government to push things down the road, with debts having to be repaid later, rather than taking fairly difficult decisions now, whether through public service reform or another mechanism, to get on top of the fiscal deficit. Is that concern valid? Do you share it?

Stephen Boyle: As you know, we have not yet done any direct audit work on the bonds programme, but we will do, through the audit of the Scottish Government and, in due course, through annual audits of the borrowing account. Alongside that, as the committee will be familiar, we undertake a programme of value-for-money and performance audits. We are giving careful thought to how and when we might best undertake that range of activity. We are in the throes of undertaking our first dedicated public service reform audit, which we will publish in May. Audit Scotland will provide the Parliament with a programme of assurance on any new activity on bonds, alongside our standard value-for-money audits, given the importance and prominence of public service reform.

Liam McArthur: Mr Macpherson, I do not want to try to interpret your body language, but I know that you were listening to the previous evidence session when I raised the evidence that we heard from the OBR last week about current market conditions, including high inflation and high energy costs, and the large sustained fiscal deficits in many developed and advanced economies. It has been suggested that the bonds programme might be an exercise in dipping our toe in the water. I heard your response to Mr Brown about the investor panel's view on its recommendations. Over the interim period, has anything altered your perception of the level of risk of dipping our toe in the water now? Had you known then what you know now, would you have slightly altered any of your recommendations?

Angus Macpherson: No. The previous answer that was given was a good one. The choice is not between borrowing or not borrowing, but we have a choice of where we borrow from. Most of the

impacts of what you have described will be built into gilt prices anyway, so it is a case of thinking about the difference between the 11-point spread above that and the higher spread that we would anticipate with Scottish bonds. As I understand it, it is anticipated that tranches of £300 million would be issued in separate years for the next five years, across the cycle.

I echo the observation that interest rates are probably at a more normal level now than they were previously. The bond market's great asset is that it is a very good pricer of risk. With the pricing of gilts at any one time, there is an equilibrium between buyers and sellers—there is literally a divided opinion about whether interest rates will increase or decrease over certain periods.

It is quite brave of the OBR to move into market timing, although I have not seen the specific context of its observations. There could be timing and tactical considerations, but, if the choice was to go for gilts plus 11, the volatility would be shown in the gilt price.

11:00

Liam McArthur: For the record, I do not want to put words in the OBR's mouth. I do not think that it gave a view on the advisability or not of bonds but, rather, made an observation about where the market is at the moment and what has happened to yields.

Angus Macpherson: There is no question but that borrowing costs have moved significantly. Real interest rates have risen quite a bit, certainly since we made the recommendations, and a considerable amount since the Aberdeen bond. However, in the very long term, real interest rates will be around the levels that we see at the moment.

Liam McArthur: Do you share that view, Auditor General?

Stephen Boyle: That is probably not a question for me at the moment. There will be a premium, but the market will dictate the cost, and it will be up to the Government to decide, case by case, what to borrow and from what source.

Pauline Stafford: I have a question for Mr Couderc. Some market commentators have suggested that, despite the fact that we have been given the same credit rating as the UK, Scottish bonds are initially likely to attract a higher interest rate. Is that a reasonable proposition? What would drive the spread that we have heard about between kilts and gilts?

Lénaïc Couderc (Moody's Ratings): It is not for us to comment on what the likely spread would be, which will be decided by the market. What I can say is that, looking at what Scotland currently pays in interest costs, we assume that, even if there was a spread, it would not have a big implication. Based on the metrics that we look at, the interest costs are about 0.5 per cent of the Scottish budget, so even if you assumed a higher spread, the impact would be relatively limited in terms of the additional interest costs that would arise from any spread.

Pauline Stafford: Do you have any thoughts on how those might diverge either way over time?

Lénaïc Couderc: Again, it is for the markets to decide. We just look at the implications for the rating. As things stand with the low interest bill, the implications are limited. Based on the plan to issue £300 million a year, the impact would be limited, given the size of the Scottish budget.

Pauline Stafford: My next question is for Mr Boyle. I go back to the point that we raised with the first panel about how the bonds fit within the fiscal framework and the wider borrowing landscape. We heard from Mr Whyte that the risk is always that repayments might spike in a particular year. We have also got other debts. If we issue the bond programme, are there any safeguards that we should be looking for to prevent that from occurring?

Stephen Boyle: The limits on the arrangements of the fiscal framework between the Scottish and UK Governments are set out. As the committee knows, no additional borrowing is available within the existing limits.

It is not for me to disagree, but I note carefully the comments by Professor McMillan on the previous panel that if there are no rollover arrangements, the money will have to be repaid at the end of the original term, and that will have to be managed. In recent years, we have seen increasing complexity in the Scottish Government's budget arrangements, particularly with budget reconciliations and volatility that have to be accounted for. This would be another new complexity. It is definitely not insurmountable, but this goes back to Mr Brown's question, in that Treasury management, forecasting and repayments will all have to be factored in, either within the existing arrangements or through preparations in the event that any of the boundaries of the fiscal framework change.

Pauline Stafford: Looking ahead, will there be implications for the fiscal framework review in 2028 if a bond programme is in place?

Stephen Boyle: Yes, very much so. If bonds are operating, that is a new factor to be taken into consideration and there will be additional complexity to be negotiated and managed between the two Governments.

Pauline Stafford: I have a final question for Mr Macpherson. There are different structures that the Scottish Government can call on, such as the Scottish National Investment Bank, and we are now talking about mutual investment models. Did you look at how the bonds might interact with those and where a bond programme would be better placed to fund infrastructure capital projects?

Angus Macpherson: We did not look specifically at whether the bond programme would be better placed for particular projects, but we were very focused on the opportunity that it gave to improve the dialogue between the Government and investors. If you look at the panel report, there are a number of observations both about the responsiveness of the Scottish Government to what investors need and about how unintended consequences could play out.

Also, in the research that we did, which involved speaking to a lot of investors, what came over was a lack of understanding or knowledge on the part of many of the international investors about what investing in Scotland actually involved. In our experience, neither the devolved settlement nor the investment opportunities of scale are well understood by investors. We were very much focused on the international capital markets. I spoke to the head of infrastructure investment banking of one of the major international banks and he said, "Of course we know Scotland—I'm based in London." However, when I challenged him on what he was interested in in Scotland, his response showed that he had only really heard of ScotWind and Edinburgh Airport and, when I challenged him on his understanding of how the devolved settlement worked, he had a very limited understanding.

This programme gives an opportunity to engage with international investors who will want to hear the Scotland story. There is a reason to understand how devolution works in the United Kingdom if you are buying a bond that is issued on a sub-UK national basis. That is a real opportunity to improve the Scottish Government's understanding of what investors want from long-term investments into Scotland, to improve investors' understanding of what is actually involved in doing that, and to price in the risk of the devolved settlement.

Pauline Stafford: That is very helpful.

Steven Whyte: To follow up on Mr Macpherson's comments, when we were doing the pitches to potential investors, one of the biggest challenges was getting them to understand the context of a local authority in that instance, the relationship between the local authority and the Scottish Government, and the relationship between the Scottish Government and the UK Government. What took us by surprise was how much of the pitch time we had to spend going through the institutional structures that are in place, because the investors had not looked at that aspect at all. That surprised me, and that backs up what Mr Macpherson said.

Pauline Stafford: It is really helpful to hear that there is that opportunity, but I understand that it is quite difficult to quantify the benefits over the long term.

Angus Macpherson: Perhaps we can look at it the other way round. When you look at the incremental costs of issuing the bond, there has been an awful lot of chat about how expensive that is. To put it in context, I think that I am right in saying that the 10-year gilt is trading at 5.33 per cent this morning, so, to borrow £1 billion, it would cost the UK Government £53.3 million a year in interest. From the loan fund, it would cost us 11 basis points more, so that would be £54.4 million each year. If we use the 30 basis points spread over gilts, as referred to by the witnesses in the first session, and which was reported in the *Financial Times* as an investor's view, that would take you up to £56.3 million, so the increments that we are talking about are very small—a couple of million a year. The Scottish Government's business case argues that it would require only £40 million of incremental investment to pay for those costs, and that is the quantum of capital.

With regard to the cost of capital, the Scottish Parliament's figures are that £20 billion-plus of private investment takes place in Scotland every year. Just changing the pricing of that, through a better understanding of the risks, by 15 thousandths of a per cent would pay off all of the incremental costs for the bond programme. Therefore, the bar to make this a very good value for money project is relatively tight when it is looked at in the context of attracting international investment, in relation to both its quantum and its cost. Is that helpful?

Pauline Stafford: Absolutely—that is great.

Liam Kerr: I have a quick question for Lénaïc Couderc. The Scottish Government has Aa3 and AA ratings from Moody's and S&P. How much of Scotland's favourable credit rating is attributable to its position within the UK?

Lénaïc Couderc: The rating relies on the framework as it stands. We look at subnational and regional Governments through a methodology that uses a set of indicators, both quantitative and qualitative.

One of those indicators is the institutional framework, and we look at the arrangements between the UK and Scotland. The rating is based on the current circumstances and reflects a lot of

the strengths that are inherent to Scotland and have been mentioned already, including the diversification of the economy, wealth levels and the very low debt levels that are, in part, driven by an institutional framework that restricts the Government's ability to borrow.

The rating is also based on Scotland's access to UK Government financing. Some of that is regular, through the block grant, but there are also mechanisms that we call extraordinary support measures, which come into play in the second layer of the rating. We look hypothetically at what the UK Government would do if Scotland were to get into trouble and at the likelihood of the UK Government stepping in to repay the Scottish Government's debts, and we rate that on a five-point scale. We assigned Scotland "very high", which is the highest level of support, because borrowing from the national loans fund is guaranteed by the UK Government. We also looked at what happened when the Northern Ireland Assembly was closed and the UK Government stepped in to pass budgets and to write off some overspend. All of that gave us comfort in assigning Scotland with the "very high" level of support, which takes you to the Aa3 rating.

Liam Kerr: I understand.

I have a follow-up question, which I will put to Angus Macpherson, although Stephen Boyle may also wish to comment. Steven Whyte spoke earlier about tiers of reassurance when the Aberdeen bond was issued. That bond contained something that was, at that time, a debt market first and was described by lawyers as unprecedented: an independent event clause that would require early repayment on such an event.

Would you expect to see something similar being required in Scottish Government bonds? What impact would constitutional uncertainty have on interest rates and what provision would you expect to be made in either or both of those situations?

Angus Macpherson: That is not something that the investor panel discussed, but I can offer a personal opinion, if you are happy to accept that.

I would hope for no such provision to be made. You would be getting £20 billion of investment every year. Within every investment decision—whether Scotland-based private companies decide to invest here or whether overseas companies are investing here for overseas investors—the same risk is built in. I would prefer to call that the risk of constitutional change, rather than of independence, because devolution also has implications, but that is costed into every investment decision that is made.

Having an instrument that is trading and that has the potential to consider the probability of independence does not, in and of itself, strike me as being anything other than useful. It is a transparent and freely traded instrument with a price. Some of that spread premium will come down to liquidity and some will come down to the constitutional settlement.

It is important to appreciate why I am stressing the idea of devolution. As things currently stand, there are restrictions on the quantum that the Scottish Government can borrow, which is a little over £3 billion. I think I am right in saying that section 66 of the Scotland Act 1998 means that there is, essentially, a first call to service debt before any expenditure is undertaken elsewhere. Scotland can borrow £3 billion against a block grant of more than £30 billion, which means that the actual risk under the current framework, relative to the risk for countries that are borrowing 100 per cent of their gross domestic product, is really very small. You would anticipate that if there were changes in the future, or the expectation of changes, that would be priced into the spread in due course.

11:15

On whether that is a bad thing, people really understanding the devolved settlement and the probabilities is likely to be helpful for getting the cost of capital down because, to be frank, it feels like more devolution might be coming, given the cities initiatives that are going on in the United Kingdom. What powers are being passed on is a dynamic, constantly changing process and investors have to react to that.

Liam Kerr: Stephen Boyle, do you have any thoughts on that?

Stephen Boyle: I do not have a huge amount to add. It is captured under the themes of variability that Angus Macpherson described and increasing complexity in the Scottish Government's arrangements.

To go back to your original point, transparency does not get squeezed out with the additional complexity. In the reporting and auditing of the arrangements, how geopolitical events are reflected in the disclosure and accounting of the cost of borrowing is still clear to Parliament, users of the accounts and institutional investors. In due course, through our own work, we will take a view on the disclosures and auditing that come from the new arrangements.

Liam Kerr: Understood.

The Convener: To state the obvious, Scotland is not isolated in being affected by geopolitical events. I assume that geopolitical events are

reflected in the interest rates and bond costs in every country or region across the globe that issues bonds.

Angus Macpherson: Yes. Nor is the gilts price isolated from such events. You get geopolitical volatility and risk in the pricing of both instruments.

The risk of constitutional change is unique to Scotland, but you have seen how the ratings agencies have assessed it in the estimate of probability. That is extremely valuable. In its current form, we live in a devolved settlement and we need to attract investment on the most competitive terms if we are to be able to achieve the ambitions that we have for the economy of Scotland.

Liam McArthur: As we said to the previous panel of witnesses, Moody's and S&P describe the expectations of independence in the short term as low. However, S&P adds that material steps towards independence could affect monetary and fiscal arrangements with the UK Government, which is the point that you made, Mr Macpherson, in relation to changes to devolution and the fiscal framework.

We operate in a political environment in which politicians say things to shape a narrative. To what extent will the market be able to distinguish between the bold promises and assertions that are made about independence being on the horizon and the reality of the likelihood of a change in the constitutional settlement?

Angus Macpherson: This has to be a personal opinion rather than anything else. In my experience, bond markets are extremely adept at reading through and they understand the politics of individual countries extremely well.

At the moment, there is not a particular focus on Scotland's settlement. We are fighting for airtime in attracting investment. One of the observations that we made in the panel report is that there are 16 cities in China that have populations larger than Scotland's. Everyone is out there trying to attract interest. The bond provides an opportunity in that it is worth people understanding exactly what the devolved settlement is and why the rating is what it is. We hope that that will inform other decisions. Most groups that will invest in the bonds have multiple different arms of investment, including equity, infrastructure and other things in which we are interested.

Liam McArthur: Mr Couderc, would you suggest that politicians need to understand the consequences of the statements and assertions that they make in this area? As Mr Macpherson said, the markets will interrogate what they believe to be the substance behind such statements, but they have an influence on the way that markets view constitutional arrangements. That is particularly the case with statements from ministers. We all have a responsibility, but ministers have a unique responsibility, given their decision-making responsibilities.

Lénaïc Couderc: It is not my place to say what politicians should and should not do but, as I said, for now, the rating is predicated on the existing framework. The framework might change, so Scotland might evolve within the devolved framework, which could have implications. Some of the metrics, such as the debt, are bounded by the current framework, so if those were to be lifted and debt was to increase materially, that could have implications without independence coming into question. However, as we have said, it is not a baseline scenario. If it was to happen—and there are different ways and timeframes in which it could happen, as it could be from a referendum all the way to independence being enacted—that could have implications for the rating.

There is the issue of the difference between the current state and the independent state, and also the way that you get from A to B. The rating of state A and state B might not be the same, but also the way that you get from A to B can have implications, which I think is the point that you made in relation to uncertainty. We mentioned the risks to financial stability from that.

That is what I can say on the independence question, but it is not to advise on anything that politicians should or should not do.

Liam McArthur: Mr Macpherson, do you want to add anything?

Angus Macpherson: The only point that I would add is on the comment that we make on page 8 of our recommendations, which plays to your point. It states:

> "It is not apparent that the Scottish Government considers the impact of its actions on investment appetite from the outset".

That was not in relation to anything to do with devolution or the constitutional settlement; it was actually a broader point, which is that the reality is that investors look at all the actions of Government in the context of whether those are investor friendly. Where investors want to invest, they want to build meaningful relationships with serious Governments that understand that they need to make a return. There is a very big capital market out there to tap if we can achieve that.

Liam McArthur: I presume that that includes the tax regime, the budget scrutiny that we have been discussing and the need for tax reform and the support for economic growth that needs to flow through that.

Angus Macpherson: It is very broad. That is not to say that the actions of Government should in any way be driven by what investors want, but what needs to be understood is the implications of individual policy measures for investor appetite if it is anticipated that we will need significant investment to make the progress that we want to make as a country.

Liam McArthur: That is helpful.

Joe Fagan: I will go back to the Moody's assessment. You might have heard that I asked our previous witnesses about full fiscal autonomy. The point was about a constitutional change that is not independence but is not far off that, because it would largely mean fiscal independence within some continuing relationship with the United Kingdom. Full fiscal autonomy would have profound consequences for the Scottish budget and for anyone who holds a Scottish Government bond. When Moody's conducted the assessment, was it aware that that was the Scottish Government's policy?

Lénaïc Couderc: As I said, rather than comment on potential policies, we look at how things stand and assess the implications of what is currently the case. If there were to be material changes to the devolved settlement, that would be reflected in the rating.

What we have said is that the fiscal framework, and devolution in general, have evolved progressively on the basis of consensus between the Scottish Government and the UK Government. Obviously, we would assess whether that sort of thing would be realised, but we would not comment on policies of certain Governments ahead of their being implemented.

Joe Fagan: I might bring Angus Macpherson in on this, too. I do not want you to repeat what you have just said, Mr Couderc, but you have made an assessment of likelihood and have set out a five-point scale of risk. This brings me back to a previous question, but the fact is that, at some point, we are going to have reassess the fiscal framework operating in this parliamentary session. I see from reports that the markets are making assessments of the likelihood of Scottish independence, but what I think would be useful would be to understand whether an assessment is being made of the consequences, and implications, of further fiscal devolution.

I do not want you to repeat yourself, but have I managed to land that point? Is further fiscal devolution a risk? There is no question but that full fiscal autonomy is at the upper end of the risk window, but has that been explicitly disclosed by the Scottish Government to you?

Lénaïc Couderc: It has. We had meetings with the Scottish Government ahead of assigning the rating at which we discussed all of these points.

Joe Fagan: But you do not explicitly mention full fiscal autonomy in your assessment of risk.

Lénaïc Couderc: We have not mentioned it, because, although it might be a policy of the Scottish Government, it is not part of the current framework. When—and if—it happened, we would assess its implications.

We rate about 200 subnational Governments, and there are some countries whose regions have full fiscal autonomy, or a lot more fiscal autonomy than Scotland has. Some are rated higher than the sovereign, and others are rated lower. It really is more about the outcome. In other words, what would such autonomy mean for the Scottish Government in terms of the strengths that I have mentioned with regard to the debt levels? We assess what the Government would do with that fiscal autonomy, not the framework itself.

Joe Fagan: Angus, you picked up on the point about constitutional change not necessarily meaning independence. Is there anything you want to add to that?

Angus Macpherson: Investors like a degree of certainty, and any change is volatile from that perspective. Given the process of continual change that we have been in to date, it would be quite heroic to assume that there will be no change in future.

We did not ask people specifically about the constitutional question when we were looking at the relative attractiveness of Scotland; indeed, relatively few people brought it up, partly because we were relatively tight in the definition of what we were looking for. Any change from what is a very stable position is going to have implications, but they will be assessed on the nature of the plans, the credit assessment of the entity and the changes at that time. When it comes to ratings, it is very difficult to assess a hypothetical without the detail being there.

Joe Fagan: I have one more question, but it is perhaps more for the Auditor General. It is not just about the introduction of bonds, but about the fact that there is more evidence that markets and credit rating agencies are making judgments about the policy making and decisions that are happening in Scotland. Surely that will have implications for fiscal discipline in Scotland and your assessment of that. I know that you said that you have not undertaken any specific audit work on the bond programme, but are you looking ahead at your work programme and how this might change it?

Stephen Boyle: We are indeed. As the committee will know, I do two main things. First, I

appoint the auditors of public bodies and public accounts, some of which we have talked about already, and, secondly, we undertake a programme of value for money audits.

11:30

In recent years, we have done a lot of work on the Scottish Parliament's new financial powers, and specifically on bonds. I draw to the committee's attention our recent reporting on the interaction between the Government and private finance, specifically in the context of renewables. Recently we reported on the management of the ScotWind leasing round, and in the past few weeks we reported on the offshore wind investment programme, both of which are examples of the Government interacting extensively with private businesses and private investment. There is a lot of terminology about "crowding in" private finance from the "anchor investment" of the public sector. We are thinking carefully about how and when we might report further on that aspect.

Joe Fagan: I suppose—

The Convener: Please be brief, Mr Fagan.

Joe Fagan: What I am getting at is that, every time a chancellor sets a budget, we immediately look for the market reaction. It is a far more market-sensitive event than a Scottish budget has ever been or is likely to be. I am pricing in some scenarios there. However, the issuing of bonds could create a material change with potential for further development and much more scope for borrowing in the future. That could involve significant changes in the discipline that finance ministers have to exercise and indeed how the Scottish Parliament scrutinises the Scottish Government.

Stephen Boyle: I absolutely understand the point that you are making. This involves a new context with new complexity, and new stakeholders are involved. I echo the position that colleagues from Moody's are taking. It is not for me to advise ministers on what they might say and how, but I recognise that there is a new audience for fiscal events and fiscal statements.

Angela Ross: Thank you for your evidence. It has been very interesting. I want to focus on something that you have just touched on. The Scottish Government is looking to diversify its borrowing mechanism, but it needs to borrow for the right reasons. We have heard that it is looking for more inward investment and a better relationship with investors in order to attract investment. However, is there a slight conflict here? The £300 million limit is not a target but a ceiling, so is there an issue with attracting investors in that we might max that out? Selling more bonds would create more relationships.

Angus Macpherson: I see those as two distinct things. The issuing of bonds is, in a sense, an opportunity to interact with investors to tell Scotland's story. It will be necessary to do a road show and prepare a presentation describing the Scottish economy and how the devolved settlement works. The investment that various entities are trying to crowd in or attract is entirely separate from the bonds, but the bonds are the hook to get the engagement to start with and to deepen the market's understanding of the devolved settlement.

Angela Ross: We are spending an awful lot of time in the committee on diversifying the borrowing mechanism, whereas I would prefer to spend more time on improving the underlying fiscal capacity. However, I see that the two might not be totally disconnected. What tests should the Parliament apply when determining whether the issuing of Scottish Government bonds represents value for money in a wider economic growth sense?

Stephen Boyle: It is a test to be met with events to come, particularly with regard to budget information. It is important that the Parliament has the opportunity to have a clear understanding of the aims and objectives, the scale of the investment programme and the diversification of borrowing arrangements.

I have listened carefully to the evidence from the previous panel and colleagues on this panel. Auditors will certainly not be able to make an immediate judgment—and parliamentarians will probably not be able to do so—as to whether the programme has represented value for money compared with the counterfactual or alternative. However, if there is clarity about the aims and objectives and the opportunity costs of different sources, we will have a better chance of being able to make those judgments with real transparency. We accept, of course, that there will be commercial sensitivity and a need for confidentiality about certain aspects at appropriate points.

The more that that is laid out before Parliament, the better Parliament—especially this committee—is able to scrutinise and form a view, not for scrutiny's sake but to support Government in the choices that it makes.

Angus Macpherson: As I said in response to earlier questions, quantifying that is difficult and will require a lens looking backwards. However, the margins of increased investment or reduced costs that we are talking about are small relative to the size of the opportunity.

There has been a lot of discussion about bonds. The issuance of bonds will, as the witnesses on the previous panel said, be classified as subnational. The UK has half the level of subnational issuance of most Organisation for

Economic Co-operation and Development countries, or half the average for OECD countries. Finance is very centralised in its current form, and there are many advantages to that. I am not challenging that. However, what is lost is the ability to set out your stall for the specific advantages and opportunities that exist in a particular region, rather than taking a blanket approach to the UK as a whole.

Angela Ross: Mr Whyte, I want to ask you about the bonds that Aberdeen City Council issued and the associated fiscal and project discipline. Was there any difference between that and other forms of borrowing? Did you have to undertake more admin or additional steps, and did it improve project outcomes because there was perhaps a level of discipline that was not required in other situations?

Steven Whyte: There are probably two answers to that. First, obviously, the bonds were traded on the London Stock Exchange, so we had to comply with its rules. That required a complete review of all our governance arrangements. We had to have an insider list, for example. We had to provide mandatory training for a whole raft of staff, including pretty much all elected members. We had to examine the processes that we went through in order to release financial information, because we have to release it to the London Stock Exchange before releasing it to the general public. We had to review all our governance arrangements to ensure that we were in compliance.

In terms of the governance around the project, yes, that did bring a sharper focus to the multidisciplinary team. Our project was quite complex, and we had to ensure that we had the right people around the table because of the need to report on the wider programme and release information to the London Stock Exchange, as it contained financial information.

We had to create an insider list of those people who had access to financial or commercially sensitive information. As part of the terms and conditions of the bond, we must obtain an annual credit rating. Moody's scrutinises us each year, reviewing how we are delivering and managing the project and how we are complying with the governance arrangements.

Angela Ross: Do any of the witnesses have an assessment of how a change in the borrowing mechanism might result in greater project discipline? A lot of capital projects in Scotland go over budget or are delayed. Could it help in that respect, or is there no connection? Is there a link at all?

Stephen Boyle: Whether that is a factor remains to be seen. I appreciate that members will be aware of the complexity of some of the capital projects in which the Scottish Government and public bodies are involved. You are right that some projects take longer and go over budget, but not all of them do. I guess that it will be a case of the Scottish Government and public bodies taking a view, perhaps in due course, on whether the presence of institutional investment led to different and better programme and project management arrangements. That judgment will come in due course.

Liam Kerr: I have a couple of questions for Steven Whyte on the Aberdeen City Council bond. When the bond was issued, how did the interest rate compare with the borrowing rate that was available to you through the Public Works Loan Board? When the overall transaction costs were added in, was it still worth while?

Steven Whyte: I suppose that you could say that we struck gold, because there was an inverted gilt curve when we issued. If we could have issued the bond at that rate, the investors would have had to pay us interest, so, in effect, the investors paid a premium to take the coupon rate—from memory, it was 0.1 per cent. We would have had to borrow from the PWLB up front, so we would have had to start repaying that from day 1, whereas we had a three-year holiday period before we started paying. We undertook modelling, which showed that there was a significant saving against the PWLB, including the costs of issuance. The break-even point was in around year 8 or 9. However, factoring in all the savings that were made added on another eight or nine years. That is dependent on how the consumer prices index moves. It is three years since I retired, but certainly before I retired, the bond was still more favourable than the PWLB option that would have been available.

Liam Kerr: I understand. The obvious question that arises from the Aberdeen bond situation is whether, with the benefit of hindsight, the Aberdeen experience is genuinely transferable to what the Scottish Government is proposing in terms of scale, creditworthiness or borrowing arrangements.

Steven Whyte: As I mentioned earlier, there was a specific project that tipped us into a situation in which we needed to look at significant revenue savings. Our medium-term financial planning showed that we had significant savings to make, and factoring in a project of that scale would have significantly increased the level of savings that we would have had to make in those early years. Given the difficulty in achieving those savings before the project, the fact that we were able to use the bond meant that we did not have to take the hit up front; it smoothed it out quite considerably.

It was quite a unique situation that led us to the issuance of a bond. A bond has a big advantage if it is for a specific project and you know what return you are looking to get from the project, because you can factor that in when making a comparison. As I say, it was a unique position that led us to that situation.

The Convener: I am very impressed that, after three years of retirement, you are still able to remember such levels of detail. I would not want to be quizzed three years post-retirement.

Steven Whyte: It was quite a brutal experience, I can tell you.

Alan Brown: My colleague Joe Fagan asked quite a few questions on constitutional considerations. If I understood him correctly, Angus Macpherson said that, even if you issue bonds, the market will, in effect, assess risk and build that in. I assume that the principle is the same for the other constitutional question, which is the European Union. The constitutional change could be the UK rejoining the EU, the UK joining the single market or something different. Nobody argues that the UK Government should not issue gilts. Is it the same principle that the market will assess what it thinks the risks are and factor those in accordingly?

Angus Macpherson: The issuers of all bonds are subject to being assessed for the risks on repayment of those bonds, and that is true for the UK Government. On the Scottish bond, I note that the first issuance of £300 million—this was alluded to previously—is a very small amount of money in terms of the international bond markets. There is a risk that there is very little trading in it and nothing is reflected.

We discussed how to get the critical mass and depth of liquidity into the marketplace so that there is an active market and you are able to see the spread in real time. I suspect that, at least initially, the spread will not show an enormous amount, as is the case with the Aberdeen City Council bond at the moment. As the issuances increase and the liquidity increases, you will probably see, as was alluded to, that the issuance costs that are associated with illiquidity, which always commands a risk premium, will go down, and you will get a better look through to what is perceived as being general geopolitical risk, as well as Scotland-specific risk.

Alan Brown: To reiterate my point on market assessment, I was trying to draw an analogy with the constitutional change that might or might not happen with the EU. The UK Government will continue issuing gilts.

Angus Macpherson: Absolutely—that is right. The UK Government has to fund itself, so it will be in the gilt market irrespective of constitutional changes, threatened constitutional changes or advantageous constitutional changes.

The Convener: I thank the witnesses for their evidence. It has certainly been interesting and helpful to committee members. I briefly suspend to allow for a changeover of witnesses.

11:46

Meeting suspended.

11:51

On resuming—

Scottish Fiscal Commission (Appointments)

The Convener: The next item of business is to take evidence on two nominations for appointment to the Scottish Fiscal Commission. The Cabinet Secretary for Finance and Local Government recently wrote to the committee nominating Melissa Davey and Professor Stephen Millard for appointment as commissioners at the Scottish Fiscal Commission.

Members have received copies of the nominees' CVs and the person specifications for the roles. We will hear first from Melissa Davey, followed by Professor Millard.

I welcome Melissa Davey to the meeting. I remind you, Melissa, that the microphone will be operated by broadcasting, so you do not need to press the button.

We will move straight to questions. Just to kick things off, Ms Davey, can you tell us why you are the best person for this job?

Melissa Davey: I think that my background makes me very well suited for the role. I started my career as an economist, and I am an economist by training. I spent several years providing high-quality analysis and forecasting to the monetary policy committee of the Bank of England.

Later on, I specialised in communications. I ran the bank's inflation report, and I was involved in that throughout periods of intense uncertainty—the financial crisis, the euro area crisis and then Brexit. One particular thing that we did during my time on the inflation report was to think about broadening our audience. We worked on our communications—not just communicating with a business audience or economists in the City but thinking about how to get our messages to the general public. I know that the Scottish Fiscal Commission is also focusing on that, following its OECD review.

Since I did my jobs on the economics side, I have been working as director of the independent evaluation office in the bank. I report directly to our court of directors, and I help its members in their role of keeping the performance of the bank under review. We do in-depth evaluations of different aspects of the bank's policy. That experience of providing independent challenge to a large organisation is very relevant to the role of commissioner, and it has given me really good insights into governance. An important aspect of the role is that it is not just about the economics, the forecasts and the communications; it is also about running the commission. I think that, overall, I bring a good package of skills and experience for the role. Furthermore, I have a lifetime of commitment to public service.

The Convener: Thank you for that comprehensive overview of your CV.

Do you see a difference in the role of commissioner, given that it has a Scottish context, while your experience has been with the Bank of England in the main?

Melissa Davey: Yes. There are lots of specific aspects of the Scottish economy, particularly the fiscal framework, on which I would get up to speed. I have started my revision already.

Although I worked in the UK central bank, I ran the bank's agency network for a time. We have offices all around the country, in the regions and devolved nations. One of the great things about that job involved getting out and about around the country. I used to visit my colleagues in Scotland regularly. I would get out and meet businesses and talk to audiences, which helped me to get an understanding of the different challenges that are faced in different regions and devolved nations of the country. I bring that background.

Overall, although it is indeed a different role, lots of my skills are relevant to this role, and I would use them to the best of my ability to carry out the role in the SFC.

The Convener: A couple of other members would like to ask questions.

Liam Kerr: Ms Davey, your role at the Bank of England involved independently evaluating the performance of what is a major public institution, providing challenge and making recommendations for improvements. If you were appointed to the Scottish Fiscal Commission, how would you approach challenging the Scottish Government if you thought that its economic expectations or spending assumptions were overly optimistic, particularly if those findings would be politically uncomfortable?

Melissa Davey: That was a necessary part of my job in my IEO role, and it would be a necessary part of my job if I was lucky enough to be appointed to the SFC. It is important to be clear on your remit and role. The SFC has a role in challenging the Government, when appropriate, and in being clear on the challenges with the fiscal position. It is important for independence to be clear in your remit, as I said, and to be clear in the judgments that you make and in the analysis that you undertake, because you must be able to explain where your judgments have come from when providing challenge. I take an analytical and technocratic perspective on the challenges that I

see, and there is a need to be clear in that regard. It is important to have such roles.

In relation to communications, it is clear to me that the SFC's role within the framework is to provide challenge to the Government. It is not a case of saying, "We think that you should do this," but it should set out the challenges that the Government faces based on the nature of the data, the forecasts and the fiscal framework. It is important to take a clear, technocratic and analytical approach to that. It is not about saying what we think should happen; it is about explaining the implications of the data and the other factors that I mentioned.

Liam Kerr: I understand.

Angela Ross: The SFC's forecasts can have major implications for public spending and can often be highly technical. What more could the commission do to make its work understandable to the public, without sacrificing analytical rigour?

Melissa Davey: I have experience of that from my time at the Bank of England. It is important that your communications do not all face the same audience. We should think about how we can tailor our communications to different audiences.

Obviously, I have been reading a lot of the SFC's material, which includes some very good, detailed analysis of its forecasts. It already produces a front page that draws out the main messages, and the insights that it has produced over the past year, following the OECD review, are really good in providing an explanation to a non-technical audience. More might be able to be done through the use of simple infographics and so on to engage with people.

One of the challenges when trying to explain things to a more general audience is finding the sweet spot between what people are interested in and what we think they need to know. People are probably not interested in the intricacies of some of the tax decisions that have to be made, but they are probably quite interested in our analysis of income tax or our view on what will happen to wage growth, for example. We need to think about what we can provide to draw people in, and then we might be able to explain to them something else that would be useful for them to know about the state of Scottish finances.

Angela Ross: That sounds good. I appreciate a front page with all the infographics and information.

You stated that one of your priorities would be developing a deeper understanding of Scotland's fiscal framework. What aspects of the framework present the greatest fiscal risks?

Melissa Davey: The challenge of the fiscal framework is the need to have a view on not just the outlook for Scotland but the outlook for the UK and not just the Scottish Government's decisions but decisions that are being taken in Westminster. I suspect that bringing all those things together means that there is more uncertainty about projections than you would have in a country that does not have that complex framework.

12:00

We saw that very recently in the tax reconciliation news that the budget will be lower because of forecast errors by the SFC and OBR going in different directions. There is more challenge in relation to uncertainty in the forecast because of that, which is obviously a feature of the work. It will take time for me to get up to speed on exactly how that works, but I have a lot of confidence that I will be able to do that, and I have spent the past eight years turning my hand to completely different topics every nine months and having to get up to speed very quickly on those.

Angela Ross: I appreciate that. If it helps, as a new politician, I am doing the same thing.

Liam McArthur: Good afternoon. I am interested in your point about expanding audiences and the work that you have clearly been doing on that at the Bank of England. Is that simply about making the information that is produced more accessible generally to the public and anyone who might have an interest, or is it a case of targeting particular stakeholders whose engagement with the SFC has perhaps not been as regular as it might have been?

Melissa Davey: I think that it is about both of those, and it is something that I would like to explore with colleagues in the SFC, were I to be appointed. One of the things that I learned when I did my job running the regional agency network is that it is good to get out and talk to people. The agents will regularly do round-table meetings and presentations at different forums. During my time running the network, we broadened from a business audience to include people in the third sector, for example. Going out and presenting your information to a different audience and receiving a different sort of challenge helps you to develop your own thinking, but you also get a lot of good will from being seen to be out and about. That struck me when I did the agency job, because so many people would come to us and say, for example, "It's really good that you've got these people out in Scotland, coming and talking to businesses, taking messages back to policy makers and then coming to tell us what you made of them and how that has affected your policy decisions."

I am interested in exploring whether presenting to different audiences is something that the SFC could do more of. At the moment, it talks to tax specialists and so on, but there might be something to the idea of broadening that out with business audiences. However, I would have to explore that, were I to get the job.

Liam McArthur: I will not speak for the committee, but I have seen that in action with the Bank of England in visits that were made to Orkney over the years, and I know how well received those were and how beneficial it was for those who engaged with the process. I certainly support exploring that with the SFC, if possible.

Melissa Davey: Policy members always love a trip to Orkney, too.

Liam McArthur: Who wouldn't?

The Convener: There are no further questions, Ms Davey, so I thank you for your evidence. I will briefly suspend the meeting to allow for a changeover of witnesses.

12:03

Meeting suspended.

12:04

On resuming—

The Convener: We will now continue our consideration of appointments to the Scottish Fiscal Commission. I welcome Professor Stephen Millard, who has also been nominated as commissioner. We will move straight to questions, and I pose the same question to you as I did to Melissa Davey: why do you feel that you are the best person for the role?

Professor Stephen Millard: Like Melissa, I have three decades of experience of doing economics and economic research in a policy-making context. I started off by doing a PhD at Northwestern University, which was about using macroeconomic modelling to understand labour market policy. I then spent 26 years at the Bank of England working on monetary policy, financial stability policy and financial market infrastructures. All that work was about using economic models to evaluate and assess policy.

For the past four years, I have been working as the deputy director for macroeconomic modelling and forecasting at the National Institute of Economic and Social Research in London. We are the UK's oldest independent research institute, and our quarterly macroeconomic forecasts are widely respected among UK journalists and the UK policy-making community.

In addition, for the past two years, I have been a member of the Irish Fiscal Advisory Council, which, in essence, is the Republic of Ireland's equivalent of the Scottish Fiscal Commission. There are slight differences between what the Scottish Fiscal Commission does and what the Irish Fiscal Advisory Council does, but, in essence, the jobs are very similar. I am the vice-chair of the Irish Fiscal Advisory Council, and I will be able to bring that experience to the role in Scotland.

I should also say that, in my work on economics and forecasting, as well as in my role in Ireland, I have put forward an independent view. NIESR, in particular, prides itself on being independent of any political party or special interest group. Such independence is, of course, crucially important for the Scottish Fiscal Commission.

The Convener: Thank you. I turn to colleagues who have questions, starting with Angela Ross.

Angela Ross: In the light of your work with the Irish Fiscal Advisory Council, what similarities and differences do you see between the fiscal risks that Scotland faces and those that Ireland faces?

Professor Millard: The risks are very different in the sense that, if you were to take a bird's-eye view of the Irish fiscal position and of the Scottish fiscal position, you would think immediately that the Scottish fiscal position is quite tight and that it is difficult to find the resources that are needed for improving public services, dealing with the green transition and dealing with demographic change in Scotland. In Ireland, on the other hand, the public finances are in exceptionally good health. The Government is running a fairly hefty budget surplus and is putting aside money for the future to deal with demographic change and climate change.

However, there is a big risk in that the fiscal position in Ireland is based on the tax revenue that comes from just a handful of very large US companies. If that tax revenue were to move back to the States, the Irish fiscal position would look a lot worse—it would move from there being a surplus of 3 per cent of GDP, roughly, to there being a deficit of 3 per cent of GDP. The position is that risky. The job of the Irish Fiscal Advisory Council always seems to be to remind the Irish Government of how risky that position is and why it needs to put money aside while the going is good. Although the Irish Government is doing that to a degree, it might not be doing it to the extent that we would like.

That is the position in Ireland, whereas, in Scotland, it is more a question of making choices about how to use the relatively scarcer resources that are available here.

Angela Ross: Thank you. Do you believe that the current Scottish fiscal framework gives enough flexibility for long-term investment, or does it impose constraints that concern you, as an economist?

Professor Millard: To be quite honest, I would really need to get into the detail of the current fiscal arrangements before I would be able to answer that question.

Angela Ross: That is no problem. Do you know enough about the Scottish Fiscal Commission's forecasts to say how you might challenge or scrutinise them in particular detail, or is that still to come?

Professor Millard: The detail is very much still to come. As Melissa Davey said in her evidence, the big challenge for the Scottish Fiscal Commission is that its forecast interacts with the forecast that is produced by the Office for Budget Responsibility in London, and forecast errors in both places can add up to create a headache for the Scottish Government. It will be absolutely key—to a degree, I hope to be able to do this, given my existing contacts with the OBR that I acquired through NIESR—that we work on developing that link and ensure that those forecasts are compatible with each other and as good as they can possibly be.

Angela Ross: Thank you. How could the SFC better or more effectively communicate uncertainty to the Parliament and to the public?

Professor Millard: Communicating uncertainty is very difficult. The traditional approach has been to produce fans around forecasts. The evidence suggests that the public understand that, if you have a wide fan, you are very uncertain; if you have a narrow fan, you are much more sure of your forecast. That is useful.

A lot of the uncertainty that is associated with forecasts relates to the particular effects of things that might happen, such as the oil price suddenly jumping to $150 a barrel and staying there for a length of time. Alternatively, the war in the middle east might suddenly stop, everything might be wonderful again and oil prices might fall to $70 and stay there for a long time. You cannot really capture such scenarios in those fan charts. You have to explain to the public that, "Here is a possible story. If that were to happen, then this would be the effect on Scottish GDP and the Scottish budget position. If this other thing were to happen, this would be the effect." You have to concentrate on explaining situations to the public via stories rather than necessarily providing a technical picture, which would not capture what you wanted it to.

Angela Ross: I appreciate a good story. Thank you.

Liam Kerr: Good morning. My question relates to Angela Ross's third point. As you know, the Scottish Fiscal Commission has confirmed that the 2027-28 Scottish budget faces a £720 million negative reconciliation, which largely reflects stronger than expected income tax receipts in the rest of the UK. Given your experience at NIESR and the Irish Fiscal Advisory Council, do you yet see a way in which the SFC could improve its forecasting of Scotland's income tax performance relative to that of the rest of the UK?

Professor Millard: I will repeat what I said earlier: the mistake was made by both the Scottish Fiscal Commission and the Office for Budget Responsibility in London. The two mistakes added together created the real problem.

Can we improve our forecasting? We are always looking to do so, whether that is at NIESR, the OBR, the Bank of England or wherever. At the end of the day, forecasting is very difficult; there are no two ways about it. The one thing that you know about any forecast is that it will be wrong, but you hope that it will not be wrong by too much and that, if it does go wrong, you will understand exactly why it went wrong.

The answer is not so much to improve the central forecast per se, because we are always trying to do that, but to ask yourself, in the context of the Scottish budget, "If I were wrong by an average amount or something like that, and the OBR were wrong by an average amount, what is the worst that that could mean for the Scottish budget?" You could then make it clear, as you do the forecast, exactly what range of possible outcomes could happen, and plan for that accordingly.

In some senses, that is the best that we can do, but, as I said, you are always looking to improve your forecasting performance.

Liam Kerr: Understood.

The Convener: No other members have indicated that they have any further questions for you, Professor Millard, so thank you for your attendance at the committee today.

The committee will consider in private whether to agree to the nominations and will report to the Parliament on our decision thereafter. At our next meeting on Wednesday 25 November, the committee will hear evidence on the UK budget implications for the Scottish budget and on the fiscal framework review. That concludes the public part of today's meeting.

12:15

Meeting continued in private until 12:27.

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