Official Report
Aithisg Oifigeil

DRAFT

Finance and Public Administration Committee

Comataidh an Ionmhais agus Rianachd Phoblaich

Wednesday 25 November 2026

Session 7

The Scottish Parliament
Pàrlamaid na h-Alba

© Parliamentary copyright. Scottish Parliamentary Corporate Body

Information on the Scottish Parliament's copyright policy can be found on the website—
www.parliament.scot or by contacting Public Information on 0131 348 5000

Wednesday 25 November 2026

CONTENTS

	Col.
UNITED KINGDOM BUDGET (IMPLICATIONS FOR THE SCOTTISH BUDGET)	1
FISCAL FRAMEWORK REVIEW	21

FINANCE AND PUBLIC ADMINISTRATION COMMITTEE
12th 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:

Professor David Bell (University of Stirling)
David Phillips (Institute for Fiscal Studies)
Dr Eleanor Ryan (Scottish Fiscal Commission)

LOCATION

The Robert Burns Room (CR1)

Scottish Parliament

Finance and Public Administration Committee

Wednesday 25 November 2026

[The Convener opened the meeting at 09:30]

United Kingdom Budget (Implications for the Scottish Budget)

The Convener (Clare Haughey): Good morning, and welcome to the 12th meeting of the Finance and Public Administration Committee in session 7. I remind everyone to switch off or silence mobile phones and any electronic devices.

The first item on our agenda is to take evidence on the United Kingdom autumn budget implications for Scotland. I welcome our witness this morning: David Phillips, who is attending remotely. He is the associate director of devolved and local government finance at the Institute for Fiscal Studies. We will move straight to questions.

One of the key issues faced by forecasters is the uncertainty that the conflict in the middle east is causing across the world. In recent years, there have been several external political and economic shocks, as you will be aware. What is your assessment of the degree of uncertainty currently? Is the outlook in the coming years more volatile than we have been used to?

David Phillips (Institute for Fiscal Studies): One of the things about shocks is that they are shocks. If we could predict them with any degree of accuracy, then they would not be a form of uncertainty or shock—or, at least, they would not be a pure shock. Therefore, I am not sure that I would want to say concretely that you should expect more shocks to the economy and public finances over a given timeframe, or speculate on the nature of those, but I will point a few things out.

First, we do know from history—not just over recent years, but over a much longer time span—that shocks affect the economy and public finances. There can be upside shocks, where things turn out better, as well as downside shocks. However, as the Office for Budget Responsibility pointed out in its most recent fiscal risks and sustainability report, the major shocks have overwhelmingly been negative. When a particularly large shock has hit, it has been more likely to have been a negative shock to the economy that has worsened the public finances. The positive shocks that we have had have tended to be smaller, on average.

It is reasonable to extrapolate from recent shocks that the kind of shocks that we are talking about have a large impact on not only the economy but the public finances. That is because they tend not to have a purely temporary effect. The shocks that we have experienced recently—Covid, the financial crisis and the wars in Ukraine and the middle east that have impacted on energy costs—have not only caused a temporary slowdown, but have resulted in our having a permanently smaller economy than we were previously expecting, which has led to a permanent upwards shift in the stock of debt and in the deficit, which has required a fiscal repair job.

Although, as I said, I do not want to be looking into my crystal ball and saying which shock is going to happen when, or to be giving you the probable quantitative change in relation to a shock, I think that there are reasons to suspect that the coming years are going to be more volatile than was the case in the 1990s and 2000s. One of those reasons concerns geopolitics, and the fact that we are seeing the resurgence of great power competition, which can lead to uncertainty in relation to international events and international trade.

The fact that we cannot predict shocks or say with real confidence what the probability of those shocks is has implications for the behaviour of Governments and chancellors, and of course for that of the Scottish Government and the Scottish finance minister, too, with regard to building a buffer into your fiscal arrangements.

When those shocks hit, they tend to have a larger downside and permanent effects that will ratchet up your debt and potentially your deficit, so you need to build in some buffer so that, in the good times, you are running a tighter fiscal ship and are in a position to start to bring down debt. You then have the fiscal firepower to respond to those shocks and, as Governments, you can invest in things that make you more resilient to particular types of shocks. You might invest in things such as energy storage for energy shocks, or in pandemic preparedness or general responsiveness, which includes ensuring that you have good automatic stabilisers in the economy. So, it is about investing in measures that help to ease the shock to the economy and potentially avoid the deepening of shocks.

The Convener: You mentioned buffers specifically. Have you seen any evidence that either the UK Government or the Scottish Government are building buffers into their budgets to prepare for those unexpected shocks or changes in geopolitics?

David Phillips: The UK Government has a set of fiscal rules that are designed to prevent the

indefinite growth of debt. There is the rule on the debt and the rule on the deficit, which is to run a current budget surplus three years out in the forecast horizon. The OBR judges on whether those rules are met.

Governments try to meet those rules with a bit of headroom, as it is called. However, that headroom is pretty small—indeed, even between now and the spring, there is a 25 per cent chance that changes in the forecast will lead the UK Government to not meet its fiscal rules. When it comes to outturn data, given the degree of uncertainty about forecasting the economy three years out, there is a 40 per cent chance that it would not, in reality, have a current budget surplus in the year that it is required to.

The economy is not doing great. However, we forecast a recovery in the late 2020s into the early 2030s, and if we are only just stabilising and slightly bringing down debt—if we are only in the realm of a 60 per cent chance of our reaching a budget surplus on the current budget by that point—the question is whether enough headroom is being built in. If shocks hit, which we would expect them to, debt and borrowing will likely ratchet up again. Planning on that basis, the question is whether we need to build in more of a buffer so that we have more firepower to respond to future crises.

The UK Government sets the overall fiscal response, and the Scottish Government has fairly limited borrowing and reserve powers, which constrains stability to some extent. However, the Scottish Government has also gotten into some bad habits when upside shocks to the revenues have happened. When there has been, for example, a positive reconciliation or an instance of money unexpectedly coming through from the UK Government, such as a one-off compensation for local authorities for historic special educational needs and disabilities deficits in England, those revenues have often been used to fund recurrent spending—things that will go on—instead of for one-off purposes, such as being put into capital investment or the Scottish Government's reserves.

Of course, funding recurrent spending from a series of one-off bits of money means that there is a risk around how you fund that recurrent spending when those one-off bits of money are not there. In 2027-28, when instead of getting a positive reconciliation for income tax revenues, as has happened in the past, the Scottish Government gets a negative reconciliation and money is taken off its budget, the things that have historically been funded through those one-off reconciliations will need to be funded from a smaller budget.

The Scottish Government is not responsible for that, and it does not have the power to put aside substantial reserves or to really use borrowing to smooth things. However, I think that where it does have power, which is to decide how to spend the money that the UK Government gives, sometimes it has not taken the most prudent choice about how to allocate those one-off positive shocks to revenues.

The Convener: Thank you.

Pauline Stafford (Bathgate) (SNP): Good morning, David. Thanks for your evidence. I want to pick up on the work around breathing space for households, which was central in the UK Government's budget. The Chancellor of the Exchequer announced a range of measures to deliver breathing space, one of them being the £100 payment for about 80 per cent of households down south. Today, we have seen that the Office of Gas and Electricity Markets price cap will rise again, by £443, which will be the highest rate in four years. Do you think that the measures in the UK budget come anywhere near meeting the challenge of providing households breathing space, within the restraints of meeting the fiscal targets?

David Phillips: The cost of living package that was announced in the run-up to the budget is relatively small and it will partly offset the impact of higher energy bills for households. We estimate that the council tax rebate, the removal of VAT on electricity and the extension of the fuel duty cut and freeze will save households around £140 on average over the nine months from the start of October. That compares with an expected increase in energy bills of around £400 on average over that same period; as that is a nine-month period, it is not the full £440-odd for energy, which is calculated over a 12-month period. That is, obviously, partial compensation. In its October forecast, the OBR expected households to see a small fall in their incomes in real terms over this period, although not as significant a fall as that which was seen in 2022, when we had the bigger energy price shock.

It is worth saying that the October forecasts were for inflation to peak at just under 4 per cent early next year, and the impact on households will depend on two things: first, the level of inflation that comes through from those energy cost increases as well as more broadly, and secondly, the extent to which wages respond to that. The Bank of England more recently had inflation peaking at slightly over 5 per cent early next year. If that happens and there is no corresponding increase in wages, there will be a bigger squeeze on households.

All that I have said so far is, yes, the cost of living package is partial compensation. Households will still feel a squeeze, and the extent of that squeeze

will depend on the level of inflation. However, I would sound a note of caution around how much one could expect the Government to insulate households from higher energy costs. That is in part because the public finances are constrained, but also because, as I will come on to in a second, it can be difficult to distinguish between what is a temporary shock to energy prices and what is a permanently higher level of energy prices that we can expect to be sustained, to some extent, going forward.

One can make the case that the Government should do more to insure households against temporary shocks to energy prices or the economy or against unemployment and so on, but such insurance comes with a price tag. Taxes need to be paid to cover the cost of stepping in and providing support to households when a shock hits.

The pressure to insure against energy price rises or unemployment, et cetera, will be on top of a range of other spending pressures. I think that you have already touched on debt interest. There is the social safety net—health and pensions. New arms of the welfare state are being added at the same time—expansions of childcare, potential expansions of social care in England and so on. What we might need to be thinking about, given the fiscal constraints—including our high debt costs and the markets being quite sensitive to suggestions that we are losing control of the public finances—is how we trade off spending on different areas, such as support to households, the national health service, social care and, obviously, defence.

09:45

The final point that I would make on that is that it can be hard to distinguish a temporary shock from a long-term high energy-price level. One thing that I would be cautious about is the temptation to see any upward movement in energy prices as a one-off shock, because, if those higher prices are sustained because we are in a more dangerous world where there are more constraints on supply and more fragility in supply of energy, for example, you will end up not with a position in which there is temporary insurance but a position in which you are permanently subsidising energy use. You can argue the pros and cons of that, but that is quite a different kettle of fish. Therefore, my view would be that, given the fiscal situation, and bearing in mind the risk that higher energy prices might become a permanent feature, providing partial support is not unreasonable. However, it is true to say that households will still be feeling a squeeze over this winter and into next year.

Pauline Stafford: Yes, I think that that is a really important distinction. We keep talking about a cost of living crisis, but households have been facing this crisis for years now, with sustained pressure.

The Resolution Foundation suggests that the Government is spreading its limited support too thinly across all households, with around four in five properties qualifying for it, meaning that vulnerable families are not being targeted, and it suggests that using council tax bands is perhaps not the best way to deliver it. My other question relates to that. Will the £200 million in Barnett consequentials that it has been suggested are coming to Scotland be sufficient for the Scottish Government to make a similar payment, and are there other models that could be used to target the support better?

David Phillips: I put figures on that into my notes—sorry about the delay while I am pulling them up.

Under the Barnett formula, Scotland gets a population-based share of the spending on the policy in England. There are two factors that will affect whether that money is sufficient for Scotland to replicate the policy, if that is what it wanted to do. One is the number of households per head of population. Scotland has a smaller average household size than England, which means that, given its population, it has more households, and that, if all else was equal, the Barnett population share would not be enough to cover Scotland. However, offsetting that is the fact that Scotland has a smaller share of properties in bands A to D—it is something like 71 per cent in bands A to D in Scotland, compared with 80 per cent in England. When you combine those two things—more households to cover, relatively speaking, because there are more single-person households and so on, but fewer households in bands A to D—the situation basically evens out. Therefore, I would expect that the money would be just about enough to pay for a similar scheme in Scotland.

On the question of targeting, the UK Government has taken a fairly broad approach to targeting. It means that the support that is provided to lower-income households is bigger as a share of their incomes, but is not bigger in cash terms. Energy costs scale a bit with income, but they are a bigger share of the budgets of lower-income households, so that approach does not really provide a bigger proportionate amount of support to those lower-income households relative to the energy costs that they are facing.

The Scottish Government could go for a more targeted approach if it wanted to. The main trade-offs are around complexity, and the extent to which targeting the support in a more focused way would require different administrative arrangements. For example, the support could be made available to those who get one of the Scottish benefits or one

of the UK benefits. It could be done automatically if you used one of the Scottish benefits, but you might need to liaise with the Department for Work and Pensions to get the details of those who get UK benefits if you wanted them to get the support automatically—they might need to apply otherwise. However, I guess that there is a political trade-off between the breadth of targeting and the degree of support that you give to certain households.

On the question whether council tax is the right way to deliver support, the issue that sometimes gets raised is that council tax itself is out of date, and therefore the bands are out of date. That is a big problem in itself, and council tax should be brought up to date. However, when we looked at this in England, we found that although property values had risen so much more in London than they had in the rest of the country, there were still quite a lot of low current income people living in London. If we were to revalue council tax, and if support for energy costs were still based on it, we might end up giving less support to some low-income households in London and more support to some higher-income households in the north of England, where values have not gone up so much.

That is not to say that we should not revalue council tax—council tax should be revalued to make it a good property tax. However, doing so will not make it a better way of targeting things like temporary income support. If you really want to target that sort of thing based on people's current financial circumstances, you will need to find some separate way of doing that.

Pauline Stafford: So, it is quite a blunt tool in what is a complex picture.

David Phillips: Yes.

Pauline Stafford: My other—

The Convener: Please be very brief. We have only an hour for this session. Mr Phillips, if you could perhaps give us—

David Phillips: Shorter answers.

The Convener: Yes, shorter answers. That would be really helpful, too, as we have a lot of members with a lot of questions.

Pauline Stafford: I am happy if you want to move on, convener.

The Convener: Thank you. I call Joe Fagan.

Joe Fagan (South Scotland) (Lab): I want to return to the issue of forecasting and the volatility that you mentioned in response to the convener's earlier question. We have just been through a period in which growth seemed to exceed market expectations but, obviously, that is not the outlook as we move forward. What do you see as the upside and downside risks in the near term with regard to economic growth?

David Phillips: In the short term, the main risks on the upside and the downside relate to the war in the middle east. As you have mentioned, the increases in household energy costs are now baked in for the coming months, so inflation will rise over the next few months. However, if the conflict were to be resolved in fairly short order, inflation would fall faster, and the Bank of England might not raise interest rates quite as much as expected. All else being equal, that could mean higher growth in the short run and certainly higher household real-term incomes, if wages did not respond and we saw smaller wage increases as a result.

On the downside, if the middle east conflict were to stay as it is or to intensify, or if we were to see further disruption, energy prices could stay high for longer. Indeed, they could increase even more. It is worth noting that, on the gas front at least, the increases even now are much smaller than those back in 2022. Higher energy costs would mean lower growth, lower real earnings, higher interest rates and so on. In the short term, then, I would say that it all comes down to energy costs and conflict in the middle east—and potentially conflict in Ukraine, if that were to flare up and start to affect energy costs again in a more significant way.

In the medium run, I would say that, aside from the normal risk of economic downturns, there are a couple of factors affecting risks to the economy, and two of the main ones are geopolitics and artificial intelligence. The increase in geopolitical tensions in recent years has been reflected in uncertainty not only in foreign policy, but in trade policy, and also in the push for defence spending, which is squeezing the rest of the budget.

As for AI, there is uncertainty about the direction in which it will go. On the one hand, if it leads to higher productivity without displacing existing activity and workers, that could be good for the public finances. On the other hand, if AI grows productivity mainly through the displacement of workers, if there is no increase in overall output, and if there is a shift in the composition of output from labour to capital, and from wages to profits, the fact is that profits are, on average, taxed at a lower rate than labour is, and that will hurt people, because there will be fewer jobs, and it will hurt the public finances, too. Therefore, the upside and downside risks relate to energy costs in the short term and, in the medium term, to geopolitics and AI.

Joe Fagan: I will return to another of the earlier questions, about the buffer that is built in and the security that we have. The Government is using a figure of £650 million in real terms, or thereabouts,

to describe the cut to its budget this year. If I am right, that figure relies heavily on that one-off special educational needs and disabilities money being baked into the comparison. Is there a healthier comparison that we can make, or is that the appropriate way to look at it? Should we do more to unpick year-to-year shifts in budgets to establish a firm baseline of where, structurally, the Scottish budget sits on the back of the UK budget and where those variations distort the budget picture?

David Phillips: I am pretty sure that you are right that the cut of £650 million includes the impact of the one-off SEND funding that was received for the historical deficits in England in 2026-27 not being replicated in 2027-28. It is a correct figure, because it is the actual real-terms change in the Scottish Government's budget; however, you are right that it includes, in the baseline year, some one-off funding that was used in England for a historical purpose—a one-off write-off of existing debts—rather than for recurrent spending pressures.

I think that it is legitimate for the Scottish Government to include it in its figures, because it has used most of that money for recurrent spending pressures, so it will need to find those recurrent spending items from its new lower budget next year. However, I also agree that it probably is a good idea, when looking through the budget each year, to identify the expected recurrent spending and the things that are temporary, such as reconciliation payments and one-off Barnett consequentials, and to see how the Scottish Government is using them. To the extent that it is possible to do so, the Scottish Government could use that temporary funding for one-off purposes, such as capital investment, or put it aside for a rainy day down the line.

Joe Fagan: My final question is about the outlook for earnings, which is quite important in how we construct a budget in Scotland. If we come back to that near-term forecasting, what is the outlook for earnings likely to be?

David Phillips: The OBR has earnings growth slowing down, even as inflation rises. That seems to have been borne out, at least in the data so far. There is the question of whether, if inflation moves towards 5 per cent, we will still see earnings growth in nominal terms slow down and an even deeper real-terms fall in earnings.

When you look to the medium term, there is a discrepancy in the OBR forecast for earnings growth. The OBR has it trending down to just over 2 per cent a year in nominal terms by 2028-29, and the Scottish Fiscal Commission forecast for earnings growth tends to be between 2.5 per cent and 3 per cent. That difference in the earnings forecast between what the OBR is saying and what the SFC is saying matters a lot for Scotland, because it is one of the big reasons why, in the medium term, it looks like the Scottish net income tax position is growing. If that was because the SFC thinks that earnings will grow faster in Scotland than they will in the rest of the UK, that would lead to a growth in the net income tax position, but that is not really what is happening. In essence, compared with the OBR, the SFC is just more optimistic about earnings growth overall, and it expects earnings growth to be higher across the whole of the UK.

The OBR thinks that earnings growth will go really low because, looking at the data, it looks like the labour share of national income is a bit higher than it has been historically. Therefore, the OBR thinks that wage growth will slow down for a period so that that labour share of income will fall back to a more historical level. The SFC says, "We do not think that there will ever be earnings growth as low as 2 per cent a year. Wage settlements and so on are anchored a bit higher than that, so we think that it will bottom out at 2.5 per cent to 3 per cent a year".

10:00

If it turns out that the OBR is right, the Scottish Fiscal Commission will need at some point to downgrade its forecast for Scottish income tax revenues. That will mean less money for the Scottish Government than it currently looks like having in 2028-29 or 2029-30. On the other hand, if the SFC is right and earnings growth is higher than the OBR thinks, at some point the block grant adjustment will be revised upwards, which will also mean less money for the Scottish Government down the line. The differences in earnings forecasts are important for the outlook for Scottish Government funding in 2028-29, 2029-30 and so on.

At the moment, those figures and the figures that the Scottish Government has to use for its planning purposes have, in effect, an optimism bias. They are building in a growth in Scottish earnings, relative to UK earnings, that we do not think will happen.

Liam Kerr (North East Scotland) (Con): Good morning. The UK budget offers various benefits, such as Barnett consequentials, as Pauline Stafford was exploring earlier. However, those necessarily interact with the Scottish Government delivering on its savings plans. In August, the IFS said,

"Tough decisions and ruthless prioritisation will be needed",

but it also described progress against those efficiency savings as

"disappointing",

and the cabinet secretary has acknowledged that the workforce reduction plans are

"off course",

with the head counts being higher than the planned trajectory. Is there any evidence of a credible plan to achieve the £1.5 billion of savings that are required? In any event, can the Scottish Parliament have confidence that they will be delivered?

David Phillips: That is a big question. What we saw last year in the fiscal sustainability delivery plan and the public service reform plan was the genesis of a high-level plan that was then fleshed out in some detail in the Scottish spending review. An annex set out the specifics of the efficiency savings that were planned for the different areas of Scottish Government spending. To be fair, the level of detail that was provided in that is about as much detail as we have had from the UK Government alongside its spending reviews. However, that is not a particularly high bar.

The two areas in which the information was most lacking are the two biggest areas of Scottish Government spending. One area was the NHS, which is by far the largest area of Scottish Government spending. That was the area with the largest efficiency targets, at 3 per cent each year, from a combination of genuine efficiencies and one-off savings that could contribute to those savings targets. There was very little detail on how those would be achieved or measured.

The other area was core local government, which is the second-largest area of Scottish Government spending: the amount that is provided to councils. I understand why the Scottish Government might not want to set out specific measures for councils to take, because, clearly, councils have their own democratic accountability to their local electorates and they can be in a position to make savings. However, there was not even a savings target for the improved efficiency that was expected of local authorities, to help them to deliver on the overall improvement in government efficiency.

I guess that what I am saying is that there is a high-level plan; it spells out a bit more detail for some of the smaller departments; however, for the two biggest drivers of Scottish Government spending, it gives little detail and, to my mind, not enough information on what is being counted or how calculations are done.

You mentioned the workforce. That was key. It is not just that the workforce has increased; it has gone in the wrong direction. When the target was made, the workforce was basically flat, and it has now started to increase, so it has made more difficult the further effort that is needed to get back to a trajectory of decline, because there has been a reversal of course, not just a failure to make the cuts that were required.

Alongside the budget or, potentially, as a separate publication, I would like to see something along the lines of the UK Government's assessment of its savings targets in the first year of its efficiency plans. Again, that did not always make clear exactly how some of those things were being counted. I would like to see more transparency from the UK and Scottish Governments on that. We should be hoping for a meaningful update that shows the good, the bad and the ugly in relation to where progress has, and has not, been made relative to the efficiency targets that were set out in that annex alongside the spending review in January.

Liam Kerr: In the current absence of the meaningful update that you talked about, is it possible to say to what extent the Scottish Government's lack of progress on that has reduced its financial room for manoeuvre ahead of the 2027-28 budget?

David Phillips: We cannot say, quantitatively, what the potential lack of progress is, because we do not know at this stage how much has been achieved and whether it has been through one-off savings or genuine efficiencies. That lack of information makes it hard to assess. However, it is clear that, if progress is falling short, or if more is relying on one-off savings as opposed to genuine long-term efficiencies, that will worsen the fiscal trade-offs in future years as money is cut back and efficiencies have not, in fact, brought improvements that will help deliver more with that smaller pot of money.

Liam Kerr: I am very grateful for that answer.

Alan Brown (Kilmarnock and Irvine Valley) (SNP): Good morning. After the UK budget, the IFS published an illustrative set of slides on the cost of living, one of which caught my eye, because it said that it is set to be the worst decade for real income growth since 1950. Would it be fair to say that a breathing-space budget does nothing to correct the long-term issue that living standards are not increasing?

David Phillips: You are right that this is currently projected to be the worst decade for growth in living standards since at least 1950, and probably since substantially before that as well. As it stands, after accounting for inflation, incomes this year are no higher than they were at the start of this decade. On current forecasts, after a small dip associated with the energy shock, they are expected to grow fairly slowly and end the decade around 2 to 2.5 per cent higher than they were at the start of the decade. That is growth of around

0.2 per cent a year in incomes, after adjusting for inflation. That compares to growth in the second-worst decade, the 2010s, of 12 percent, or 1.2 per cent a year. It is therefore a substantially weaker performance than the previous record low in the post-war period. It is a decade of stagnation.

I think that the breathing space is about temporary relief from a particular shock: the energy price shock that has hit over the winter, linked back to the war in Iran and the middle east and the lack of liquefied natural gas and so on coming through to Europe. It is temporary in relation to that. However, that sort of measure will never be what addresses long-term stagnation in living standards, which is about economic growth and productivity. I do not see tax cuts and cost of living measures as measures that can really change things so that, I hope, the latter half of the 2020s, and the 2030s, are stronger for living standards. That requires measures that sustainably boost underlying productivity growth and economic growth; namely, a different package of measures in relation to things such as skills, planning, investment, tax reform and so on.

Alan Brown: How does that stagnation in living standards over the decade—preceded, as you said, by the second-worst decade—compare to other developed countries in the G7 or G20? We continually hear about the UK having record growth in the G7, but I do not see how that is possible in that long-term outlook compared to other countries. I wonder whether I have that right.

David Phillips: This is an area where data has been moving around. The UK had been a laggard in productivity from around the 1950s to the 1970s. We had reasonably good productivity growth from the 1980s through to the 2000s. Data suggested that we did really badly from the financial crisis onwards compared with most developed countries. There was a much bigger slowdown in productivity and a slowdown in income growth here, although perhaps not to the same extent. We really suffered after the financial crisis.

There have now been revisions to the Office for National Statistics estimates of how many hours we have effectively been working since about 2010, and they suggest that, rather than being a laggard when it came to productivity growth after 2007, the UK was roughly middle of the pack, or slightly above average, albeit well behind the US, which outpaced the rest of the developed world after 2007 in productivity growth and earnings growth. The UK did reasonably well compared with continental Europe, however.

That leaves a bit of a conundrum in that, if our productivity has been revised up substantially, that makes our household income and our hourly earnings figures look a little bit more problematic. If our productivity growth slowed down—but not as much as we thought—why did hourly pay slow down quite so much? That conundrum still exists.

It is fair to say that income growth has been weak in the 2020s, across Europe at least. It has been particularly weak in those areas where there has been higher inflation because they especially rely on gas. The UK is one of the countries that are most dependent on gas for its energy use. Therefore, alongside other countries with high reliance on gas, we have had particularly poor performance in household incomes. Countries that have relied more on other energy sources such as nuclear, in the case of France, or renewables, in the case of Spain, have had an improved performance.

The short answer is that everyone has suffered, but the amount by which people have suffered across countries has been partly due to their reliance on that most expensive energy source at the moment: gas.

Alan Brown: To go back to the immediate UK budget and its possible future implications for Scotland, the IFS says:

> "Next year's Spending Review will be a crunch point, and looks very tough for many departments, whose budgets will be squeezed by higher inflation forecasts."

If there are further budget pressures in the UK spending review next year, does that have possible consequences for the Scottish budget?

David Phillips: Indeed—yes. Higher inflation has squeezed the settlements that have already been announced for 2026-27 and 2027-28. The higher inflation that is already there—which we had expected to see over the next few months—is squeezing budgets now. To some extent, the squeeze is more severe than it will look in the official figures, because the official figures that reflect the real value of public sector spending use a measure of inflation called the gross domestic product deflator, which concerns domestically generated inflation. The GDP deflator is a different measure from the consumer prices index or CPI, which we usually think about when we are considering households. The GDP deflator excludes imported inflation, which means that it excludes increases in the cost of imported energy. That matters. The public sector does use some energy, so it will experience some impact from that, which is not being picked up in the measure of inflation that is typically used to adjust public spending for inflation.

That will also have an impact on wage settlements. When unions are negotiating wage settlements, they will consider the rate of inflation facing households, which is very much affected by imported inflation drivers such as energy costs. I think that in the short term—that is, this year and

next year—the official measure of inflation that is being used to adjust public service spending is understating the inflation pressures facing public services. That is the first point that I would make.

10:15

Secondly, looking ahead to the spending review, I think that higher inflation will reduce the baseline level of spending, but the bigger pressure coming down the line is the fact that the overall increase in spending is only small. Budgets are, on average, projected to increase by 0.9 per cent a year above inflation. Increasing health spending will generate money for the Scottish Government, but any increase in defence spending to meet the aim of getting that spending to 3 per cent of national income by 2030 will not generate any money for the Scottish Government and will lead to a bigger squeeze in other areas.

Therefore, you might have a situation in which the Scottish Government gets Barnett consequentials from increases in health spending in England, but other areas have to be cut back, thereby offsetting most of the increases coming from health. The Scottish Government might find itself with a very tight budget after 2028, because of the combination of a low overall increase in spending and the lion's share—or a large share, at least—going on that defence spending pledge.

Alan Brown: Thanks.

Angela Ross (Edinburgh and Lothians East) (Reform): In your submission, you refer to the allocation of funding to the English mayoral authorities and how it might impact on the devolved nations, and you propose two models in that respect. Can you give us a high-level view of the models and set out the benefits of and the restrictions in each?

David Phillips: This relates to the plans for mayors in England to start to receive a share of the income tax revenues that are collected in their areas as well as the plans to move from 50 per cent to 100 per cent of business rates being retained by local areas in England. That matters because, at the moment, the 50 per cent of business rates that are not retained locally goes to central Government, which then feeds through via the Barnett formula. Similarly, all income tax revenues are retained by central Government, which, again, feeds through via the Barnett formula. Therefore, those changes in England will have implications for Scotland, Wales and Northern Ireland.

The business rates issue is quite easy to address. The Barnett formula is designed so that the spending that is funded by business rates and the revenues from the rates both go through it, and they just offset each other. Because of those perfect offsetting mechanisms, even though all the money goes through the Barnett formula, it has zero effect on the Scottish, Welsh and Northern Irish Governments' budgets. Therefore, the business rates aspect can be dealt with relatively easily; although the money goes through the Barnett formula, it does not really have an impact on the funding for the Scottish and Welsh Governments. The exception is where money from central Government is used to reduce business rates in England, which can still happen, even if all of the resulting revenues and the knock-on effects of any business rates policies are borne by local government in England.

The bigger issue is income tax, and in that respect, there are two approaches that can be taken. First, even if, say, 10 per cent of the revenues raised in England were to go directly to the English mayors of the regions, rather than to central Government for reallocation back out again, that money could still be put through the Barnett formula. It is still money that is being raised and spent in England, and you could say, "Well, in that case, we can still put it through the Barnett formula, and Scotland, Wales, and Northern Ireland will still get their consequentials based on any spending funded by those income tax revenues." Such an approach is most similar to the one being taken now to Scotland, Wales and Northern Ireland, and it is probably the one that is most generous financially to Scotland, Wales, and Northern Ireland, too.

However, it would mean that, if the mayor of Manchester were particularly good at encouraging economic growth in his area, which led to an increase in income tax revenues in Greater Manchester, yes, Liverpool, Sheffield and so on would share in some of the proceeds of the growth that central Government retained from that but not in any of the proceeds that the mayor of Greater Manchester retained, which would get to be spent in Manchester. However, the Welsh and Scottish Governments would get a share of the growth that the mayor of Greater Manchester retained.

In effect, that could be seen as allowing Wales, Scotland and Northern Ireland to benefit from some of the growth that England's regional mayors retain, which other parts of England cannot benefit from. That is the trade-off with the first approach. The question is whether the UK Government wants a system that is most similar to the current system for Scotland, Wales and Northern Ireland, at the risk of it looking as if those three nations are getting more of a share of the growth in England's regions than is shared between those regions.

The alternative approach is to take the money out of the Barnett formula and adjust how the block grant adjustments work for income tax in Scotland and Wales. The Barnett formula gives a population

share to Scotland and Wales of any change in spending that is funded by income tax revenues in England, but the block grant adjustments are based on the tax revenue capacity of Scotland and Wales, which is lower than the population share of England's tax capacity—revenues per person are lower in Scotland and Wales. When running the maths, it becomes clear that, with that approach, compared to the current situation, Scotland would lose a population share of revenues but save less than a population share on the block grant adjustment size.

With those two offsetting adjustments, Scotland would lose more than it would save. If fiscal devolution in England went ahead, Scotland and Wales would lose out a bit compared to the current situation, which could of course be seen not only as financially bad for Scotland and Wales but as against the principle of devolution, which is that changes to arrangements in England should not have adverse consequences for Scotland and Wales, given that they are not involved in the decision making on those changes. The one advantage of that second system is that it would mean that, when there was growth in Greater Manchester, Scotland and Wales would be treated in the same way as, say, Liverpool is.

That is probably quite complicated. The write-up is probably more straightforward, because I thought about how to put that down on paper. In short, there are two choices: the first is more consistent with the current situation and financially advantageous for Scotland and Wales but risks being seen as unfair when you compare Scotland and Wales to, say, Liverpool or Manchester; the second deals with the unfairnesses between Scotland and Manchester or Liverpool but is potentially unfair compared to the current situation for Scotland and Wales.

The judgment on which approach is taken is a political one. However, if I were the UK Government, I would use the first approach and continue to put that money through the Barnett formula. That is the simplest way and the most consistent with the idea that Scotland and Wales should get a share of all spending in England, not only that which still flows through central Government.

Angela Ross: Thank you for explaining that in such detail. It is important, because we have to choose or consider the right model and examine the financial impact and the fairness of the system.

Do those models put an unnatural reliance or focus on the relative performance of areas of the United Kingdom, and would that be a disadvantage when, surely, there might be simpler ways of doing things, which would not necessarily link different areas?

David Phillips: You are right that basing a system on relative performance adds a degree of complexity. It can also mean that, at least in the Scottish context, if Scotland's revenues grow but do so less quickly than revenues in the rest of the UK, Scotland's budget could be reduced, even though its revenues have gone up. Given the current fiscal architecture, though, it is the system that makes sense. Let me explain why.

Under the Barnett formula, Scotland gets a population-based share of any change in spending in England that is funded by England's income tax revenues. If it was based on the absolute performance of Scotland's revenues and not on their relative performance, Scotland would get a Barnett share of the increase in spending in England, funded through England's higher income tax revenues and, on top of that, its own revenue growth. It would be getting both its own revenue growth and a share of England's revenue growth, which could be seen as double dipping, if you like—it would get twice the share of growth.

Basing the system on relative performance means that Scotland gets its population share of England's growth but, if Scotland's growth is a bit slower, some of that will be clawed back, so that the funding that Scotland gets depends more closely on its revenue growth than on revenue growth in England.

You could move to a system that was not based on relative revenue growth, but that would require removing the Barnett formula and a completely new system. Given that the Barnett formula is there, and that the Scottish Government has said repeatedly that it should remain in place, it needs to be based on relative revenue performance to stop not only double dipping when revenues are going up but a double whammy when revenues are falling.

The Convener: I will bring in Liam McArthur.

Liam McArthur (Orkney Islands) (LD): The issue that I was going to raise has been covered. Liam Kerr might have a couple of other issues to raise, so I am happy to leave it with Liam.

Liam Kerr: I am grateful.

When David Phillips was talking about income tax with Angela Ross, he said that Manchester is growing particularly quickly. Could a similar analysis be done in respect of business rates? England is moving to local retention of business rates—I think that it is 70 per cent next year and 100 per cent the following year. To the best of my knowledge, Scotland is not proposing anything similar. Taking into account your example of income tax, what are the consequences of Scotland not doing something similar? For example, could councils in England that

experience stronger business growth use the additional revenues to attract further investment and employment? That would be great for them but would have a detrimental impact on councils that were not in a position to do that.

David Phillips: There are two facets to that. As it stands, the plan in England is that, by the end of the decade, instead of central Government getting any share of the growth in business rates revenues, local areas will retain all of the growth in business rates that they generate. If more properties are built in their area, or there are improvements to properties, they will retain that growth. The idea is that it is a financial incentive to areas to support growth and improvements to business property. It can also be a source of funding, in that councils can borrow against it for enabling works that can support that growth.

In the Scottish context, you are right that local authorities cannot do that. The Scottish Government retains the lion's share of any growth in business rates. I am not sure whether the small business rates incentive scheme still operates in Scotland. If not, the Scottish Government gets all of the growth. If it does, local authorities get a little bit of it. However, the incentives lie with the Scottish Government. Partly, the question comes down to who the incentives matter more to. Do they matter more to local authorities? Are they in a position to drive local business growth, or is it the Scottish Government that can do more to drive growth? There is a case that it is not 100 per cent either way. You might say that some of it is for the Scottish Government but some of it is for local authorities, not least because of the planning regime.

The other thing that potentially matters in the Scottish context is that, if the Scottish Government retains business rates revenues and any growth in them, that does not enable the Scottish Government to borrow against the proceeds of growth, because the Scottish Government's borrowing powers are limited in that respect. If local authorities could retain some of that growth, it could enable some of them to access preferential rates of borrowing from the private sector, because it would give them a more buoyant revenue stream.

The fact that there is no local retention does not mean that there is no incentive to support economic and business property development in Scotland. The incentives just lie elsewhere, and the question is: where are the incentives most powerful, and where could they create the most leverage to invest in the things that can drive business growth?

The Convener: Thank you for your evidence, Mr Phillips. I know that you are joining us on the next panel, so I briefly suspend the meeting, not least to allow you a comfort break.

10:30

Meeting suspended.

10:41

On resuming—

Fiscal Framework Review

The Convener: The next item on our agenda is to take evidence on the fiscal framework review. I welcome our witnesses. We are joined in the room by Professor David Bell, professor of economics at the University of Stirling, and Dr Eleanor Ryan, commissioner at the Scottish Fiscal Commission. We are also joined remotely by David Phillips, associate director of devolved and local government finance at the Institute for Fiscal Studies. Mr Phillips, if you wish to speak or come in, please type RTS in the chat window and clerks will acknowledge your request.

We will move straight to questions.

Pauline Stafford: My first question is for Dr Ryan and Professor Bell, and I will then ask a follow-up question to David Phillips. Since 2023, the limits on borrowing and the reserve have risen in line with inflation. Have those rises been sufficient to manage the risks that now face the Scottish Government budget?

Dr Eleanor Ryan (Scottish Fiscal Commission): There is definitely a question to be asked about indexing in line with inflation. The borrowing limits and things such as the Scotland reserve rising in line with inflation result in them rising more slowly than the overall block grant. That means that they also rise more slowly than the risks that need to be managed, which leads to challenges in managing the budget. That definitely needs to be considered.

Professor David Bell (University of Stirling): I broadly agree. Over the past couple of days, I have looked at the forecasting errors for the block grant adjustment and Scottish income tax. In the past eight years or so, both forecasting organisations come out reasonably well on average; the total forecast error over that period was not big. However, the year-to-year fluctuations were huge, and the consequence is that the fluctuations were of such magnitude that they well exceeded the limits that were originally set.

The simple answer to your question is that indexing in line with inflation is not sufficient to cover the risks that are associated with the way in which the fiscal framework works at the moment.

Pauline Stafford: We covered that point in the first evidence session, when Mr Phillips talked about the short-term pressures and long-term patterns.

The independent report that was published for the Scottish Government at the time of the previous fiscal framework review—you were an author of that, Professor Bell—recommended that the Scottish Government be granted powers to borrow a small sum of money to cover shocks other than those that relate to tax and social security forecasting errors, including shocks in public service spending, which I guess includes the things that you outlined. Do you still see a case for that?

10:45

Professor Bell: Yes. The Scottish budget faces a number of risks post-2016. For the fiscal framework review that David Phillips and I were involved in writing, we concentrated on the economic issues and the question of whether Scotland could grow its income tax per capita faster than England and Wales could. We perhaps did not properly take into account other important risks, one of which concerns forecasting and the implications of forecast errors.

We also did not pay all that much attention to timing. For example, the Government might introduce a policy to enhance economic growth, which would certainly be of benefit to the Scottish economy and, if that growth were increasing faster per capita than was the case in England, that would be of net benefit to the Scottish budget. However, you would only find out about that about three years later, so the connection in the mind of the public between enhanced economic growth and better outcomes due to the Scottish Government's greater ability to spend seems to me to be lost.

Pauline Stafford: That seems to be the case. For example, it is difficult to explain to the public how the large income tax reconciliation this year, based on very small forecasting errors, came about.

My other question is for Mr Phillips. The IFS submission suggests that there is a case for indexing borrowing and reserve limits not to inflation but in line with the revenues and spending risk, and that annual borrowing limits could be removed entirely for forecast error while retaining a cumulative cap. Are the current fixed limits becoming progressively less effective in the current situation?

David Phillips: I will address that question and then circle back to the question that you put to Professor Bell.

The current limits are not only not keeping pace with the block grant but, even more importantly, are not keeping pace with the income tax revenues, which, because of threshold freezes, are going up much faster than inflation, or disability benefit spending, which, because of rising claimant numbers, is also going up much faster

than inflation. Therefore, you might say that we should link the borrowing limits, if we still have them, to growth in income tax revenues and disability benefit spending in the rest of the UK—you might not want the limits to depend on exactly what is happening in Scotland, because that might lead to the Scottish Government increasing spending to get higher borrowing limits.

However, it is the SFC and the OBR that are making the forecasts, and they are independent forecasters, which means that there should not be any bias and you could expect the forecast errors to offset each other, on average. In that case, given that we are talking about errors in independent forecasts that cannot be manipulated by the Scottish Government to get access to more funding, you might say that, effectively, there should be no limits. However, there might be a different position if there were a series of negative reconciliations. Given the recent discrepancy in the forecasts of earnings, it looks as if there could be a series of overestimates of the Scottish net income tax position, and you might therefore raise a concern in relation to the possibility that, if that situation persisted and there were no cap on borrowing, the Scottish Government could just keep deferring the reckoning on that, as there would be an overall cap rather than an annual cap.

Circling back to the question that you asked Professor Bell, what he said is right. When we looked at the limits for forecast errors, we looked at the correlation between outturn revenues, and we did not think as much as we should have about the forecasting process, and that has put some more volatility in the system. However, beyond that, all the issues around current borrowing powers for day-to-day spending concern forecast errors for income tax and social security that happen once the budget has initially been set. Sometimes, you know even before the start of the year that it is going to be a bad year for income tax. If you know that there is a downturn in the economy, you might want to be able to borrow to smooth that downturn, even if you know about it a bit in advance.

There are also pressures that can affect other areas of spending, including in the public service budget. It might be a year in which inflation turns out to be higher than expected, which puts pressure on your public sector wage negotiations. In Westminster, if that happens, they can say, "Okay—we will borrow a bit more money to pay for this wage increase, and next year, we will adjust some spending or raise taxes down the line."

The Scottish Government cannot do that. That is why we said that giving the Scottish Government the equivalent of maybe 1 or 2 per cent of its public service spending as discretionary borrowing, to smooth out those revenue effects that are forecast in advance or to deal with pressures on public service spending, is not a big fiscal risk and it is not a big issue in terms of the equity position across the UK. That would provide meaningful additional flexibility to respond to other forms of uncertainty and risk in the Scottish Government budget.

Pauline Stafford: Thanks for those answers. I have a follow-up question on the social security spending mechanism, but I will maybe come back in later if there is time.

Liam Kerr: Good morning. Professor Bell, I will pick up on Pauline Stafford's question on borrowing. Your submission goes into borrowing in some depth. Given the Scottish Government's existing fiscal pressures and the difficulties that the Scottish Government has encountered in delivering its efficiency and workforce reduction targets, which David Phillips highlighted in the earlier evidence session, how important is it that any additional borrowing powers are accompanied by much stronger requirements for financial discipline and transparency?

Professor Bell: I guess that the Treasury ensures that borrowing is repaid in a way that accords with whatever rules there are. I think that what you are getting at is the current fiscal position, which is very difficult. My feeling is that we should see how the Scottish Government responds in a week's time to those pressures. However, the pressures are fairly severe at the moment. I suspect that there will not be any short-term changes to the borrowing rules as they stand. We are between a rock and a hard place in that regard. As I say, let us see how it evolves.

Dr Ryan: You would never get the Scottish Fiscal Commission arguing against having more transparency. Transparency is the key to fiscal discipline because, once everyone properly understands what is being done, you can ask questions and scrutinise.

In this discussion, we are focusing on borrowing—quite rightly, as it is a huge tool—but I encourage the committee to think about the entire package of measures that allow the Government to manage risk and its finances effectively. For many years, we have had very tight budgets; therefore, naturally, there are not large surpluses around. However, the size of the Scotland reserve also matters, as does the Government's ability to carry forward money from year to year, not just from one year to the next, and potentially to set aside surpluses for investment in future.

You need to see this in the round, with borrowing as one part of the story and the other part being the other flexibilities that the Government has to use the money effectively within the rules, with more transparency then allowing the Scottish

Government to be properly held to account when it does that.

Liam Kerr: I accept that. The committee will certainly be scrutinising those other measures.

I will stick with borrowing. Dr Ryan, I will come back to you, but my question is about something that Professor Bell said in his submission, which is that he does

"not support general borrowing to finance recurrent spending."

Professor Bell may wish to come in after Dr Ryan. Do you have any suggestion for how we ensure that any flexibility is used to manage genuine volatility and unforeseen circumstances, rather than to allow the Scottish Government to defer difficult decisions about recurring spending commitments?

Dr Ryan: The challenge there is about what is deferring a difficult decision and what is borrowing to invest. We have rules about capital borrowing, which we understand. The regime could be different. The idea of a prudential borrowing regime for capital has been floated, and that could be thought about.

When it comes to borrowing on the resource side, I agree entirely that you would not want the Government to be running up a significant deficit and deferring difficult decisions. However, there might be a case. For instance, as Professor Bell mentioned, measures to stimulate economic growth could involve capital investment, but they might not. You could conceive of a regime in which it was possible to borrow to invest through resource.

Professor Bell: My position is that borrowing for resource is not a good route to go down. Having flexibility for volatility seems to me to be appropriate, but the question is how to define what things are part of that volatility.

One interesting development in the UK budget, on which David Phillips may have touched, is the greater ring fencing of preventative spend. Budgets that are capital in a sense but not recognised as such could, to an extent, be ring fenced and therefore included in the spending review and have greater protection than they have at the moment. For many years, when things got tough, the tendency was that everything went to either front-line services or statutory duties, for local authorities in particular. The trouble is that there are no hard-and-fast rules by which we can identify exactly what is preventative, what is volatility and so on. The review should look into that and try as best it can to come up with a coherent and transparent understanding that the Parliament can examine.

Dr Ryan: I agree with that. Preventative spend, which is another way of coming at the sort of thing that I was talking about, would be very interesting. However, in my experience, it is very difficult to define it tightly enough.

Liam Kerr: I am grateful.

The Convener: Mr Phillips, do you want to come in?

David Phillips: Yes, briefly. I agree with what Professor Bell said. My point was that the current way of using borrowing powers only to address temporary shocks is really quite restrictive. The form of the shocks is narrow—it is just tax and social security. There can be shocks elsewhere. It is really difficult to get a set of rules that mechanically defines what is a shock, what is discretionary and what is, as you said, kicking the can down the road. What it requires is a culture of the Government using those powers responsibly, transparency on the financial situation and effective scrutiny from the Parliament.

11:00

Joe Fagan: For safety's sake, I declare an interest as a serving councillor.

I go back to the point about borrowing for resource and preventative spending, which you briefly moved on to. I understand the difficulties. In the case of capital, there are some pretty strict rules on how we construct borrowing and the case that we make for borrowing. However, is there some potential on that? Across the four nations, different Governments are thinking of developing preventative spending disciplines and approaches in their own ways. With preventative departmental expenditure limits—PDEL—becoming part of the future spending review, does the fiscal framework review give us an opportunity to do what Dr Ryan was talking about, with a clearly defined approach, almost akin to the Treasury green book, standing behind good business cases for preventative spending? Would that be a constructive way forward, albeit a way forward that would require a change to the fiscal framework?

Professor Bell: It probably would require some kind of change to the fiscal framework. The annually managed expenditure and departmental expenditure limit classifications—AME and DEL—are worth thinking about in relation to the Scottish budget, particularly in relation to social security, which is really demand-led spending in the same way as annually managed expenditure is.

Preventative spend is motherhood and apple pie to an extent, in that everyone agrees that there is a case for preventative spend that reduces front-line spending later. The key is to understand the evidence that supports a particular thing, and that

often requires much better data than we have available.

I will pick one example from Ireland. Evidence from a longitudinal survey of ageing indicated to the leader of the survey, a geriatrician, that it would be in the interests of Irish society generally for fall prevention clinics to be set up around the country. They were set up, and they had a marked positive effect, reducing fractures, particularly among older women. That was built on a very clear evidence base. There are areas where you might make such a case, but the case must be made very clearly before the measure in question can be ring fenced.

In the past, local government has been badly affected by resources being moved towards front-line and statutory services where spending further back in the system would have led to better outcomes.

Dr Ryan: I absolutely agree. The rigour with which you define what preventative spend is will always be a difficult issue. Preventative spending can be absolutely transformative, but we have yet to understand how the PDEL idea will work. My concern is that it could become part of the game—that is, managing the public finances—and people might try to get things classified in a particular way, rather than approaching them with a rigorous business case and so on, as Professor Bell was discussing.

It comes back to transparency, as we were talking about a moment ago. If you are going to spend money that has been classified as preventative, that needs to come with an expectation that you will eventually publish data on what was achieved with that spending.

Professor Bell: Before the meeting, I was writing down the different risks that the Scottish budget faces. As I said, for the previous review of the framework, we concentrated on economic risk. We have talked about forecasting and timing and things coming later. We have also discussed, to an extent, transparency—one issue with the previous review is that very few people, especially people not called David, understand what is going on.

The final risk that I wrote down is policy. If the UK Government decides to change its policies in respect of areas that have been devolved to Scotland, you end up having to deal with a complex series of issues in trying to figure out what would have been the spend in England had the policy in England not changed. That is incredibly difficult, and it overlaps with the issue of prevention because, to an extent, the Milburn review, which was published last week, argues that earlier intervention and greater employment support are, in effect, preventative spend that might result in a reduction in social security spend over a long period.

What are the knock-on effects of that kind of policy, which was not envisaged? When we discussed the previous framework review, we had in mind that policies were almost permanent, but they are not. It is perfectly legitimate for the UK Government to change the way that it spends and taxes. At some point, one Government will perhaps grasp the nettle of dealing with taxes on property, which could massively change the way that both Governments deal with taxation of land. Obviously, that is another subject, but if that happened it would be difficult for the framework to keep on keeping on as if the situation was as it was in 2016. It is a bit like the fact that we are still dealing with valuations from back in 1990, as far as council tax is concerned.

Liam McArthur: I step into this debate with trepidation, as I am not called David. Our predecessor committee raised concerns about transparency during its deliberations on a review of the fiscal framework. You have touched on some elements that will need to be considered as part of that process. Do you have any observations about how the process of reviewing the fiscal framework could be improved? I presume that transparency is key to that. Do you have any observations about how the UK and Scottish Governments should manage that process?

Professor Bell: Some time ago, David Phillips and I were involved in a separate exercise in which issues relating to the Scottish budget were discussed with a set of citizens. I am not suggesting that that format be followed, but it seems essential that the upcoming review includes greater engagement with wider society, because, in general, people have very little understanding of how this all happens. The review provides an opportunity to engage more and to let the Scottish population better understand what is going on. I might come back to the mechanics of that.

Dr Ryan: As another non-David, I note that I was not involved in the previous review. I agree that it would be highly desirable to have a wider debate about the fiscal framework, but that would not be straightforward, given how complicated the existing framework is and how challenging it might be for people to get their heads around it.

We should take a step back from the existing framework, go back to the principles and think about mechanisms. We have talked a lot about borrowing—rightly so, because it is a huge part of the framework—but I would consider the package in the round and think about how, if this is the spending and these are the powers to be devolved, we can make them all work effectively to create all the right incentives to manage the finances well in Scotland.

I know that I keep coming back to the very limited reserve, but it is a huge issue. To some extent, the constraints on borrowing and the difficulty of managing reconciliations are not necessarily creating the environment that you would want for the Government to take a long-term view of managing the public finances. Therefore, I want the review to go back a step and think about what would create the right set of incentives, and the right tools, to allow the Government to do what it wants to do in its long-term planning.

Liam McArthur: I find it interesting that you have talked about general principles, because another concern that our predecessor committee raised was about spending too much time on the front end—the debate on what the debate should be—with the nitty-gritty of teasing out the revised framework being truncated or taking longer to resolve. Do you get the sense from what you are hearing from the UK and Scottish Governments that reaching an agreement on, and having discussions about, the general principles would be relatively straightforward?

Dr Ryan: I will be totally honest: I have no insight into that, but it is a fair enough point. All the nitty-gritty issues need to be addressed. I was not envisaging spending months and months arguing about principles, but we should not necessarily start from exactly where we are. We could take a step back and think about how things could be better.

Professor Bell: I hope that David Phillips will agree with me on this. We spent a lot of time talking about the principles that were laid out by the Smith commission, and we found that they were not consistent with one another. That caused considerable angst, and it enabled different parties to take different positions, because the implications for the Scottish budget were quite different, depending on how one interpreted the different principles that the commission had laid out. Therefore, there is a case for going back to that.

As for the objective, I agree with Dr Ryan that we want a framework that delivers stable spending and allows us to have a proper medium-term financial strategy.

Liam McArthur: I will bring in Mr Phillips, because the IFS has gone further in saying that some of the Smith commission's high-level principles are impossible to reconcile. I draw attention, in particular, to the principle of no detriment from the decision to devolve and the principle of taxpayer fairness. Mr Phillips, you touched on that in our earlier discussions on the UK budget and some of its devolution implications. Is it your sense that the compromise that has been reached is a reasonable place to land, or can we look to improve on that in the next review?

David Phillips: I agree with the comments that have been made so far. If we want to assess the fiscal framework, we need to take a step back, and away, from the Smith commission principles. Given when they were put together, they were an impressive set of principles to work with, but we need to think about the incentives that the Scottish Government should have; the risks that it should bear, and, conversely, which should be borne by the UK Government; and what that means for the Scottish Government's budget in relation to predictability, stability and so on.

11:15

We can consider where we started from, with the current fiscal framework having been negotiated around the Smith commission principles, two of which, in particular, conflict. Prior to devolution, a share of income tax revenues from England would come to Scotland through the Barnett formula, given that Scotland has a lower tax capacity. The no-detriment principle says that that should continue following devolution. However, that conflicts with the principle of taxpayer fairness, which says that, following devolution, revenues that are raised in England should stay in England and revenues that are raised in Scotland should stay in Scotland. We cannot fully reconcile those two principles, hence the conflict.

We have ended up in a situation in which, in effect, the UK Government acceded on the block grant adjustment in order to prioritise the no-detriment principle. Using the index per capita method for updating the block grant adjustment accounts for Scotland's lower tax capacity and lower population growth. Revenues still come to Scotland, because it gets a population share based on the Barnett formula, but the money that is clawed back through the block grant adjustment is less than Scotland's population share, because of Scotland's lower tax capacity. Therefore, the no-detriment principle is prioritised.

Clearly, compared with Scotland not getting an ongoing share of English revenues to offset its lower tax capacity, that is a better outcome for Scotland. However, framing the debate in that way—questioning that aspect of the fiscal framework and focusing on the block grant adjustment—allowed the UK Government, in the 2016 and 2023 negotiations, to get more of what it wanted in relation to broader fiscal flexibilities. The fact that the Scottish and UK Governments were arguing about the no-detriment and taxpayer fairness principles allowed the UK Government to place more constraints on the Scottish Government's borrowing powers, because

attention in the negotiations was on the block grant adjustment mechanism.

The situation might be different in the next negotiations on the fiscal framework. I think that the index per capita method is now the settled position, because it would be very difficult for the UK Government to reopen that can of worms. In the next negotiations, there might be more focus on the fiscal flexibilities. Although those have always been of importance to the Scottish Government, there has not been quite so much focus on them, because issues relating to the block grant adjustment and the taxpayer fairness and no-detriment principles have been sucking out the oxygen a little bit.

Liam McArthur: This might be an unfair question; it is probably more for the committee to consider this. However, the make-up of the Smith commission gave cover to the UK and Scottish Governments to behave in the way that they did in those negotiations. Do we need another commission similar to the Smith commission in order to provide that cover, or can there be direct negotiations?

Professor Bell: There is a question about the timing of all this. If we were to start from scratch, I suspect that there would be a very long period before we came to a significant agreement. I was not involved in the negotiations in 2016, but I share David Phillips's view on what happened in 2023—the negotiations about which rules should prevail gave the Treasury cover on the borrowing aspects.

To some extent, we need to go back to first principles, but I would need to give further thought as to the ideal mechanism for that. As the committee can see, there are fundamental issues that should be taken on board in the review. It is not simply about housekeeping.

Angela Ross: I was glad to hear Dr Ryan talk about reform of the fiscal framework to provide a better balance. The papers on reform that I have read have focused on protection from risks and potential increased borrowing flexibility. That was echoed in the UK budget, with its reliance on borrowing. I want to push you even further. If you were designing a fiscal framework entirely around incentivising economic growth, what would look different?

Dr Ryan: That is a very good question. I am not an economist, but it has always bothered me that we are still very tied to annuality. I completely understand why there needs to be annual fiscal discipline and that Scotland sits within a wider UK framework, but having more flexibility between years is important, not just for economic growth but for managing public spending in general.

Being able to borrow or to build up reserves for capital investment is important. To me, having a tiny reserve and a large capital borrowing limit just seems wrong. Why should we not have more flexibility in both ways?

We have talked about resource borrowing and prevention. We want it to be possible for the Government to set a longer-term goal and to manage the money needed to achieve that goal, without always having to hit a number in the current financial year. There should be more scope for the Government to say, "We want to do this over five or 10 years, and we want to be able to manage our resources so that we can make that investment." That is not only about borrowing but about how annuality is managed.

Professor Bell: The agreements that have been set thus far are based on the idea, in principle, that Scotland can keep the benefits from economic growth through increased revenues from income tax, land and buildings transaction tax and other taxes. However, it seems that the message that there are incentives to the Scottish Government enhancing tax revenues is not clearly understood. There should be understanding that, if Scotland promotes growth, it can keep the rewards from that growth, although the risk is that Scotland might not achieve that growth.

The other risks that we have talked about have clouded the whole issue around growth, so we have lost that focus. For example, we do not talk very much about private investment; that does not seem to enter the discussion. What can be done to enhance the amount of private investment in the economy?

I am all in favour of finding mechanisms to enhance growth, but it is important that we understand where the fiscal framework sits in relation to that enterprise.

David Phillips: Under the current Scottish fiscal framework, in relation to how the block grant adjustments work for income tax, LBTT and disability benefits, although there was initial equalisation at the point at which the powers were devolved, Scotland did not gain or lose if its spending or its revenues were higher or lower than average. However, subsequently, it gains in full if its revenues grow more quickly and it loses in full if its revenues grow more slowly, and the same is true on the spending side. That provides quite a big incentive, but there are also risks at the margin, depending on the performance of the economy.

Therefore, the framework focuses quite a lot on growth, particularly if we compare it with the planned income tax sharing arrangements in England, which will include much stronger guardrails. There will be a safety net if revenues fall too far and a levy if revenues grow too quickly.

Some incentives will be provided, but the arrangements try to prevent things from getting too far apart.

The basic architecture is already quite incentives focused and there is perhaps a lack of understanding about that, as Professor Bell said.

However, a couple of things could be done to further improve things, which link up a bit to what Professor Bell said about investment. First, one thing that is not devolved to Scotland with regard to income tax is savings and dividends income. Devolving that would, first, allow more alignment of tax rates on savings and dividends income, as well as on the earned income, so you would not have that avoidance opportunity. Secondly, as dividends income is closely related not only to the profitability of companies in which you own shares but to that of small owner-manager or privately held companies in Scotland, you would get a bit more of a return on investment from dividends, if the company was profitable.

Given the complexities of operating at a devolved level, I am not sure that I would consider devolving corporation tax, but you could have a revenue-sharing arrangement on it, which happens in some countries.

In summary, the existing basic architecture is quite growth focused. However, you could think about what is devolved to Scotland and whether that could bolster growth incentives. Is the Scottish Government using the powers that it already has in ways that could generate growth? To go back to a point that David Bell made, an area where the Scottish Government has really significant powers is property taxes, and it has basically tinkered. If it wanted to, the Scottish Government could reform property tax to abolish LBTT, reform business rates and reform and revalue council tax to have a much fairer and more growth-enhancing property tax system.

Angela Ross: I am glad to hear that the architecture has that economic growth incentive within it. We need to highlight that to people better.

Alan Brown: To pick up on that point, David, you mentioned other possibilities for growth incentives. As far as the reality goes, with regard to risk and reward, do we need to have a wider debate about what other powers and revenues should be devolved, instead of a really tight review of the fiscal framework, as happened the last time round? As you have said, you get additional income tax revenues as an incentive for growth, but employment support for people who are out of work is reserved to Westminster, so you do not get that circular reward of extra job growth and benefits of reduced social security spending. Should we look at that type of things?

David Phillips: It would be in the scope of the fiscal framework review and you might want to consider it as part of a wider review of the overall devolution settlement, including not only powers but the risk and reward associated with a wider range of devolved revenue and spending streams and so on.

Although there is scope for stakeholder engagement in the fiscal framework review, it is envisaged as a fairly technocratic exercise. That particular review, which might focus on the BGAs, will not go back to the taxpayer fairness principle, but I think that the Scottish Government is trying to negotiate it so that it is not only based on the overall growth rate in income tax, for example, but accounts for Scotland's different income distribution, a bit like what the Welsh system does. One of the reasons why Wales is gaining financially from income tax devolution despite not increasing rates is that it has a different block grant adjustment system. BGAs, fiscal flexibilities, borrowing, reserves, capital-resource split and various other things will be in scope, and the review will link those things up, as well as consider questions such as how any changes on PDEL, if there are any, interact with Scotland's powers.

11:30

When it comes to the scope for devolution, I would probably restrict the framework review to thinking about tidying up the existing powers. That could include whether we can devolve income tax in full—at least in terms of rates and bands, including savings and dividends income. However, if it were to be made a broader thing that also considered aspects of currently reserved social security, VAT, corporation tax and national insurance contributions, that would be inherently a much less technocratic process and would require a much more politically focused approach. If that is where the fiscal framework review ends up, that would be appropriate. However, if the fiscal framework review is an intergovernmental and largely technical exercise, I do not think that it would be the right mechanism for such big changes in the devolution settlement.

Alan Brown: I suppose that that is my point.

I think that Professor Bell wants to come in. Do we not need to have a wider-ranging debate, rather than, as was described, a technocratic review of block grant adjustments? Otherwise, we will just continually be tinkering and will be in the same position in a few years' time, give or take minor changes.

Professor Bell: As David Phillips said, that would move us to a more political argument. However, as you imply, we are left in a position in which there are strange anomalies around the

areas in which the UK Government has control and the Scottish Government has control.

I will throw national insurance in to add to what David said, because that sits in an unusual position as a separate tax that the UK Government applies but that interacts with income tax to a significant degree. However, that is likely to happen only when the UK Government takes it in mind to reform national insurance and income tax, looking at them in the round. I suspect that that would be too big a political step to be caught up in the review.

I am not saying that there should not be a wider scope of review; I am just saying that, for it to be manageable at this moment—to be able to move on into next year's budget, and so on—there will probably have to be some technocratic limits.

David Phillips: I was not saying that we should not have the review, either. There is a case for a technocratic review, which would address things such as whether borrowing and reserve limits should be increased; whether they should be linked to revenues at risk rather than just inflation; and whether there should be some way to account for the fact that Scotland's income distribution is different, so we cannot expect the same growth in income tax revenues. If that were to be held up because of arguments about whether the scope should include NICs, the devolution of VAT and so on, that would be a problem. If people cannot look at all those things in the round, we should split them up and have one technocratic review and then a separate political process that might happen a bit further down the line, so that the technocratic stuff, which needs to happen, is not held up.

Liam Kerr: David Phillips, on exactly that point, you mentioned various taxes and possibilities. Last session's Finance and Public Administration Committee recommended that the next fiscal framework review should abandon VAT assignment, given what it said were serious concerns about how that would work in practice. The Scottish Government previously supported full VAT assignment, and I do not think that I have seen anything that changes that position, although I note that, in its 2025 "Fiscal Framework Outturn Report", the Scottish Government notes that VAT assignment would expose the Scottish budget to "substantial uncertainty and volatility".

Given those positions, do you agree with the previous committee that VAT assignment should be abandoned in any fiscal framework review?

David Phillips: As it stands, given the approaches that have been developed to assign VAT revenues, I think it makes sense to put that to one side and to say that the benefits would not outweigh the costs at this stage.

One reason is that one of the key data sources that was going to be used to assign VAT to Scotland was the living costs and food survey, which is a survey of household expenditure. The sample size across the whole of the UK is between 5,000 and 7,000, with a sample size in Scotland of well under 1,000. If you use a sample of that size when the largest component of VAT is the consumer-facing part, a lot of year-on-year volatility will be caused not by underlying economic variation but simply by sampling variation. If you asked a few more rich people, or a few more poor people, in Scotland in a particular year, that would move the revenues up or down. You could address that by looking at multiple years, but you would be weakening and delaying the signal from genuine underlying performance. As it stands, and given the existing data in the UK, I think it makes sense to leave VAT assignment on the back burner.

VAT assignment could be more feasible if we started collecting more data directly from firms and asking them about production or the location of their sales. It has, traditionally, been expensive to administer and comply with that process, but if AI and technology made that easier to do in future, that could change the calculus. Another thing that could change it would be to say that we want to vary the VAT rates across the country. If you think that there is a case for that, it might be worth the rigmarole of splitting companies' sales more appropriately. However, if we stay where we are now, it makes sense to put that idea on the back burner.

Professor Bell: I agree with David Phillips. The living costs and food survey creates too small a data set to be the basis of such a large calculation. Researchers increasingly use available data sets on private sector spending, with Amazon's data set being one example, but I do not think one could rely on a private sector source for such an important calculation and there would be serious concerns about doing that.

Dr Ryan: I agree. Unless we can calculate VAT assignment accurately, that would not make sense.

The Convener: We will move to questions from Pauline Stafford. We are quite close to the end of the meeting, so I would be very grateful for succinct questions and answers to allow everyone to have their say.

Pauline Stafford: I have one final question. The previous Social Justice and Social Security Committee highlighted the different way in which social security payments are managed in Scotland. There is a fixed budget here, whereas England and Wales have annually managed expenditure. Does that asymmetry present an increasing material risk for the Scottish

Government and should how we manage social security be something that we should look at in the next review?

Dr Ryan: The Scottish Government has to manage significant demand-led spending within a cash-limited budget and that does create a challenge, but it is not obvious how you would get round that. If you were to allow payments to be completely demand led, how could you account for policy differences or for the Scottish Government changing the entitlements to benefits? That is definitely something to look at.

Professor Bell: I agree. Social security competes directly for funding with other front-line departments such as education and health, which is not the case to the same extent south of the border and creates difficulties for the Scottish Government's budgeting.

David Phillips: I agree with the points that have been made. The key point is that you are right that benefits spending in England and Wales is annually managed. If the spending turns out to be higher than expected, the UK Government borrows more money to cover that. It could not be the case that the UK Government just covers the spending in Scotland; it would have to be that the Scottish Government, likewise, borrows to cover such spending. That comes back to the point about whether the current borrowing limits are big enough to manage the risks for things such as disability benefit spending. Should we increase those borrowing limits, or should we decide that, although there are no limits to forecast errors, there should be some kind of cap on overall borrowing in order to stop the can being kicked down the road indefinitely if the spending is consistently being underforecast?

Pauline Stafford: Thank you.

Joe Fagan: I will be quick with my questions. I have put a couple of questions together, and the first is about the frequency of reviews of the fiscal framework. Should there be more reviews? Do they happen too frequently or not frequently enough? Are we in a Goldilocks zone in which the number of reviews is just right?

There has been a lot of comment about how protracted the process is. Do you have any views on that? Depending on the time that we have available, I may come back and ask a broader question, but what is your initial reaction to that question?

Professor Bell: There has been a sufficient number of unexpected changes to Scotland's budgetary situation since 2023 that a review is now certainly merited. We might get to a more stable situation, which would allow us to extend the gap between the reviews, but there is certainly a strong case for having one now. It would not be ideal to have a protracted review, but it would be all to the good if we could be as transparent as possible, consult as widely as possible and get more people involved in and understanding the importance of a particular review. However, we have a timetable that we must deal with, so there is an absolute limit to the timescale. There is a bit of to-ing and fro-ing to find the best Goldilocks position, as you said.

Dr Ryan: I have nothing to add.

David Phillips: It makes sense to assess fairly regularly—whether that is every three, five or seven years; I am not sure which would be best—whether the framework is working for the current devolution settlement. It makes sense to keep under fairly regular review whether the system is fit for purpose, whether the block grant adjustments, borrowing powers, reserves and flexibilities are working as expected and whether there are any little wrinkles with the exact definitions of devolved powers compared with what we thought would be the case.

However, broader questions about the overall devolution settlement—about what should be devolved and reserved and which risks should be devolved and reserved—are different and are more fundamental questions rather than technical questions. I come back to the point that there would be a benefit to separating the technocratic from the political, to the extent that that is possible, and to having regular technical reviews, while the political reviews are driven by political timetables. There will be a problem if the broad picture of the devolution settlement constantly changes, because that will impose costs on Governments, businesses and taxpayers to adapt to the changes and learn how the system is working.

Joe Fagan: That leads on to my next question. When we look around Europe and the world, we see that there are lots of different ways in which multilevel government—or however we want to put it—can be organised. What are your perspectives on any international experiences that can be used to compare how we operate the fiscal framework here with how things operate in other countries? Is there a better way of doing it?

11:45

Dr Ryan: In two minutes?

To add to what David Phillips said, I acknowledge the point about the technocratic versus the political, but it is important to recognise that you cannot completely separate those. The political settlement in the UK determines to some extent what options are available for a fiscal framework. Countries that have different constitutional and federal structures have different options open to them.

I cannot in two minutes describe what would be better, but we have to recognise that we cannot divorce the issue entirely from the political and constitutional set-up.

Professor Bell: We have a relatively centralised system of governance. That is true of the UK as a whole. You have to think about the criteria by which you consider whether other countries are doing better. One is stability and not needing to constantly change the arrangements. Another might relate to promoting better outcomes for the populace, whether that be higher incomes, better quality of life or whatever. That would require a little more than a couple of minutes to address.

Previous finance committees have tried to learn by exploring how other countries—different parts of Europe, in particular—deal with the challenges that they face. However, there is always something specific in those different countries—it may be the constitution or the structure of the economy—that makes comparisons not always as easily enabled as you might hope.

David Phillips: On that, I would distinguish between two areas that are worth looking at internationally. There is the constitutional side of things, such as how decisions are taken on frameworks and how decisions are taken on policies on an annual or ad hoc basis. Although the UK has devolution to Scotland and Wales, the Parliament is sovereign and can intervene and make decisions unilaterally. That is often not the case in other countries. There are benefits to having a more federal or codified constitution that gives explicit powers to devolved Governments and requires genuine consent for certain types of policies.

David Bell and I did some work during the Covid pandemic that suggested that in some countries that requirement, in certain circumstances, leads to a lowest common denominator situation. In Germany, the feedback that we had was that in order to get agreement on the actions to take on Covid, the approach ended up, after the initial crisis phase, being driven by the Länder that wanted to do the least, because the agreement needed to be bought into at the federal level.

Constitutionally, there can be advantages but also disadvantages to systems that give individual subnational territories veto rights on certain issues. Economically, on the technocratic side, one thing that is different in the design of the Scottish and Welsh systems is that, once the system is set up, all upside and all downside risk for devolved things is borne by the devolved Governments. That gives very strong incentives at the margin, but if risks hit and Scotland's economy does poorly for reasons that are entirely outside its control, or if the economy does really well for reasons that are entirely outside Scotland's control, there is no system to update the initial equalisation.

Other countries tend to have some sort of ongoing update that, a bit like the system in England, puts in guardrails to stop areas going too far from or falling too far behind the average. That weakens incentives, but it means more redistribution and assurance across the country. We can learn different things by looking at different countries, and we find that there are distinct disadvantages to our systems, but there are also some advantages.

The Convener: I want to ask the reverse of Joe Fagan's question. If we started with a blank sheet of paper, would you want to use the current system?

Dr Ryan: No.

Professor Bell: If we were starting with a blank sheet of paper, I would completely redesign the UK tax system and then work out how we would devolve areas based on the way in which we had changed the tax system.

The Convener: I am not asking you to redesign the whole system; I am asking what you would do if you had a blank sheet of paper and were considering the fiscal framework. What would you want to put on that paper?

Professor Bell: I would do some of the things that we have discussed. The obvious and immediate issue to consider is how borrowing powers are managed. There could easily be a wider discussion, outside of the fiscal framework review, about whether the powers are adequate.

I have talked about the risk that comes from changes to UK policy that affect the way in which funding comes to Scotland. That creates challenges in relation to whether Scotland should follow suit. Those are some of the things that we might think about if we had a blank sheet of paper.

The Convener: I will take that as a qualified no.

David Phillips: If I were starting with a blank sheet of paper, I would not start where we are now. There are a few elements that I would think about.

First, I would consider which risks and incentives were to be borne at the UK level and at the Scotland level. As it stands, any macro shocks that affect the whole UK are entirely managed by the UK Government—at least in relation to devolved matters—and any shocks that affect the Scottish Government's revenue or spending are entirely managed by the Scottish Government. Most countries are not like that. In most countries, subnational Governments bear some of the overall macro risk, but they also bear only some of the overall risk for their own revenues and spending,

because there are guardrails and they do not have entirely relative performance systems. If I were starting from scratch, I would think about that.

This probably would not benefit Scotland, but the second thing that I would think about is how funding is allocated to different parts of the UK to begin with. The Barnett formula's historical base allocations have little relation to the needs of the different parts of the UK. The evidence that we have from the Holtham commission and the Northern Ireland Fiscal Council, which have looked into such issues, suggests that Northern Ireland—which was, historically, substantially relatively overfunded—is now roughly funded in line with its needs; Wales is a little bit overfunded; Scotland is substantially overfunded; and the poorer regions of England are underfunded. Considering not only which parts of the system could be reformed to benefit Scotland but those that might adversely affect Scotland would be part of any objective first-principles look, but that probably would not get much support north of Hadrian's wall.

Like Professor Bell, I would also think about which taxes were to be devolved. What I am going to say is controversial, but it is worth saying. If I were rethinking the devolution settlement, I am not sure that I would devolve 100 per cent of the rates and bands of income tax. I might devolve rates and bands powers, but there would still be some UK-wide income tax powers, including in Scotland. Currently, income tax rate changes that are made in Westminster do not affect Scotland, but they do affect England and Wales, and—in effect—they affect the block grant adjustment. That has led to some policy distortions and has made the system more complex.

I mentioned a litany of things there, but I would do so many things differently that I would need not only a blank sheet of paper but blank sheaves of paper.

The Convener: I thought that I had asked a simple yes or no question, but evidently not.

I thank the witnesses for their evidence. At our next meeting, on 2 December, the committee will hear evidence from the Scottish Public Pensions Agency on the McCloud remedy and from witnesses on the risks and opportunities of private finance initiatives ending. That concludes the public part of this week's meeting.

11:55

Meeting continued in private until 12:22.

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

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

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

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

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

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

All documents are available on
the Scottish Parliament website at:

www.parliament.scot

Information on non-endorsed print suppliers
is available here:

www.parliament.scot/documents

For information on the Scottish Parliament contact
Public Information on:

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



The Scottish Parliament
Pàrlamaid na h-Alba