The Scottish Parliament
Pàrlamaid na h-Alba

Official Report

FINANCE COMMITTEE

Wednesday 18 June 2014

Session 4

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FINANCE COMMITTEE
20th Meeting 2014, Session 4

CONVENER

*Kenneth Gibson (Cunninghame North) (SNP)

DEPUTY CONVENER

*John Mason (Glasgow Shettleston) (SNP)

COMMITTEE MEMBERS

*Gavin Brown (Lothian) (Con)
*Malcolm Chisholm (Edinburgh Northern and Leith) (Lab)
*Jamie Hepburn (Cumbernauld and Kilsyth) (SNP)
*Michael McMahon (Uddingston and Bellshill) (Lab)
*Jean Urquhart (Highlands and Islands) (Ind)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Professor David Bell (University of Stirling)
Chris Curry (Pensions Policy Institute)
Ann Flynn
John Swinney (Cabinet Secretary for Finance, Employment and Sustainable Growth)

CLERK TO THE COMMITTEE

James Johnston

LOCATION

The Robert Burns Room (CR1)

Scottish Parliament

Finance Committee

Wednesday 18 June 2014

[The Convener *opened the meeting at 09:30*]

Decision on Taking Business in Private

The Convener (Kenneth Gibson): Good morning and welcome to the 20th meeting in 2014 of the Finance Committee of the Scottish Parliament. I ask everyone present to please turn off mobile phones and other electronic devices.

Our first item of business this morning is a decision on whether to take items 6 and 7 in private. Do members agree to take those items in private?

Members *indicated agreement.*

Scottish Fiscal Commission (Nominees)

09:30

The Convener: Our second item of business is evidence from John Swinney, the Cabinet Secretary for Finance, Employment and Sustainable Growth, on the nominees for appointment to the Scottish fiscal commission. The cabinet secretary is accompanied by Alison Cumming, the head of tax policy at the Scottish Government. I welcome both of them to the meeting and invite the cabinet secretary to make an opening statement.

The Cabinet Secretary for Finance, Employment and Sustainable Growth (John Swinney): I am pleased to discuss with the committee my nominations for appointment to the Scottish fiscal commission. Scrutiny, review and discussion of the nominations is an important process in establishing the commission's credibility and independence. I believe that the process is very much in line with what the committee envisaged when it included the suggestion in its report on the fiscal commission in February. It is also in line with what I envisaged in accepting that proposal.

I believe that there is widespread consensus across the Parliament that the Scottish fiscal commission will be an important and welcome addition to Scotland's fiscal framework. The commission will play a key role in scrutinising and reporting on tax forecasts that are prepared by the Scottish Government. I am strongly of the view that the commission will be able to fulfil that role effectively only if it is independent of the Scottish Government and is seen and understood to be so. Given that view, I take the independence of the prospective members of the commission very seriously.

As I confirmed in my letter of 6 June, I gave full consideration to the potential for conflicts of interest to arise, or to be reasonably perceived to arise, between membership of the commission and other roles and offices that are held by the nominees. Those include membership of the Council of Economic Advisers, to which the committee made specific reference in its letter to me of 4 June. I will set out why I am satisfied that no conflicts of interest exist between membership of the Scottish fiscal commission and membership of the Council of Economic Advisers.

My first point relates to the status of the Council of Economic Advisers, which is an independent group that provides advice to the First Minister on the Scottish economy. The political and professional independence of individual members of the council is protected and fully respected. Susan Rice and Professor Hughes Hallett have each provided assurance on that point in their written evidence to the committee and during their pre-appointment hearings. Susan Rice demonstrated to the committee that the CEA has put appropriate procedures in place to protect her independence. She and the Bank of England were satisfied with the procedures to address any actual or perceived conflict of interest between her membership of the Council of Economic Advisers and her role on the court of the Bank of England.

My second point relates to the roles of the Council of Economic Advisers and the Scottish fiscal commission. I strongly believe that they do not conflict. The Council of Economic Advisers and the Scottish fiscal commission have entirely different roles and remits. The commission will engage in the technical scrutiny of revenue forecasts, which will draw on the members' understanding of economic and financial data, trends and assumptions. The work of the CEA focuses on recovery and jobs, internationalisation and economic levers. The CEA will have no role in the forecasting process, which will be undertaken exclusively by the Scottish Government and will be scrutinised exclusively by the Scottish fiscal commission. There is no intention that the commission will review work that is undertaken by the CEA or vice versa.

To further ensure the independence of commission members, I have proposed that the chair and members should be subject to a code of conduct that is based on the "Model Code of Conduct for Members of Devolved Public Bodies", which was approved by the Parliament in December 2013. The code deals with all aspects of conduct, including the registration and declaration of interests. That should provide the committee with further assurance that the chair and members will be held to the highest standards of conduct. I would, of course, be happy to share that material with the committee for its consideration.

I have nominated three highly respected, skilled and authoritative individuals to serve on the commission. I believe that Susan Rice and Professors Leith and Hughes Hallett would bring a strong set of skills and experience to bear on the work of the commission. The committee has direct evidence of the calibre of the nominees from their written evidence and the hearings on 28 May and 4 June. I am pleased to have the opportunity to discuss my nominations with the committee this morning and to answer any questions that the committee may have.

The Convener: Thank you for that, cabinet secretary. I will start by asking a couple of questions and will then open the session up to colleagues around the table. In his response to questions, Professor Hughes Hallett said:

> "it is difficult to imagine how somebody who is independent can have a conflict of interests, because they would not then be independent. The council is not beholden to anybody, nor do I imagine the commission would be—anyway, I would not want to be."—[*Official Report, Finance Committee*, 4 June 2014; c 4312.]

He also talked about the two organisations being "sequential" and their roles being "complementary". Is that how you see them?

John Swinney: I see the roles of the Council of Economic Advisers and the fiscal commission being entirely distinct and separate. When I came to the committee on previous occasions, both prior to and after the publication of the committee's report on the subject, I established what I hope was a very clear line of argument that the Scottish fiscal commission would, in essence, look at the forecasting of taxes that are being devolved as a consequence of the Scotland Act 2012.

As part of the committee's evidence taking on the whole process, there was a debate on whether the Scottish fiscal commission should have a wider remit than that. I acknowledge that there were different voices—some outside the Parliament and some within the committee—who thought that the Scottish fiscal commission should have a broader remit than undertaking scrutiny of the forecasting of new taxes. However, that was not my view. I did not set the Scottish fiscal commission up to rival or compete with any other sources of economic discussion or deliberation.

I said to the committee on 8 January:

> "If we give the commission too broad a remit beyond the forecasting of the taxes that have been devolved to Scotland as a consequence of the Scotland Act 2012, we will create the opportunity for intrusion into the responsibilities of other bodies."—[*Official Report, Finance Committee*, 8 January 2014; c 3518.]

My view has been crystal clear that the role of the fiscal commission is to scrutinise the forecasts that I bring forward to this part of the budget process. That is the extent of its responsibility, and the Council of Economic Advisers will have no involvement in that process.

The Convener: Thank you for that full answer.

In his response to questions, Professor Hughes Hallett said that he did not foresee that there would be a conflict of interest but that, if there was, that would lead to

> "a parting of the ways."—[*Official Report, Finance Committee*, 4 June 2014; c 4312.]

In terms of the code of conduct, would you agree with that?

John Swinney: It is clear, from the different experience of and the different responsibilities that have been undertaken by all three nominees for the Scottish fiscal commission, that all of them have undertaken a range of projects, developments, initiatives, roles and responsibilities for a variety of organisations—some of them at the same time. Given that they have been able to undertake all those roles in the past, the three very distinguished individuals whom I have nominated to serve on the fiscal commission have demonstrated the ability to handle properly any issues that might arise or might be perceived to arise in relation to potential conflicts of interest. To put it bluntly, you do not get a CV like the CVs of the three individuals who have been nominated without being able to manage properly the independence and integrity that they bring to the work that they undertake. That is exactly what I would expect of them in their participation in the Scottish fiscal commission.

The Convener: Professor Hughes Hallett talked about being approached by representatives of all four main Scottish political parties to provide impartial advice. All the witnesses talked about integrity and independence of mind and the ability to give advice in that manner. However, colleagues on the committee have raised the issue of perception, because two of the three members whom we met are members of the two different bodies—the CEA and the Scottish fiscal commission. How do you deal with the issue of perception? That is very much at the heart of the deliberations this morning.

John Swinney: The issue of perception is dealt with by the fact that I have made it absolutely clear that the roles and responsibilities of the Scottish fiscal commission and the CEA are entirely separate. There will be no discussion at the CEA that will encroach on the remit and the responsibilities of the members of the fiscal commission, which will be to scrutinise the forecasts that I make in relation to the devolved taxes and non-domestic rates income. Part of the remit that I have set out for the commission will be a technical evaluation of the estimates that I have put forward for the commission to consider and, I hope, to endorse. Clearly, if the commission did not endorse the estimates, I would have to reconsider the forecast that I had made.

The Convener: I open up the discussion to colleagues around the table.

Jamie Hepburn (Cumbernauld and Kilsyth) (SNP): In her written response to the questions that the committee sent to her, Susan Rice said:

"I was asked to join the Council of Economic Advisers in 2011 and agreed to do that only if my political independence would be protected at all times ... This restriction was accepted willingly".

Andrew Hughes Hallett said:

"I am a member of"

the Scottish Government's

"Council of Economic Advisors on the condition that my independence would be protected".

Do you think that we should take that in good faith and accept that Susan Rice and Andrew Hughes Hallett will also act independently as members of the Scottish fiscal commission?

John Swinney: Those are fair and representative statements by Susan Rice and Andrew Hughes Hallett. The CEA has been established to provide advice to the First Minister on the Scottish economy, and its members participate willingly and voluntarily. They do so with the very clear proviso that their independence is utterly protected and respected, and, in all my observation of the CEA, that is the approach that has been taken.

Jamie Hepburn: That leads me neatly on to my next point. In response to Gavin Brown, Professor Hughes Hallett said something that the convener has already highlighted:

"The council is not beholden to anybody, nor do I imagine the commission would be—anyway, I would not want to be."—[*Official Report, Finance Committee*, 4 June 2014; c 4312.]

Is that your understanding of how the CEA works, and is that how you envisage the Scottish fiscal commission working?

John Swinney: Of course. In establishing the fiscal commission, one of the factors that I weighed in my mind when making my recommendations to the committee was that I wanted a group of individuals with very strong technical expertise who would be able to challenge effectively the work that is done within Government in forecasting new taxes.

I did not want to establish a general commentary body; I wanted to establish a body of people who would have the correct perspective to be able to challenge what the Government was setting out and reassure the Parliament—if they were endorsing my estimates—that the estimates were made on a sound and justifiable basis. If they were not endorsing my estimates, I wanted them to be able to marshal to the Parliament the reasons why my estimates and forecasts were not sufficient. The three nominees were chosen to reflect that essential requirement, which Parliament would expect of a Scottish fiscal commission.

I have told the committee that I have set out my initial thinking on the resources that will be available to the fiscal commission. I have established the commission away from Government, under the auspices of the University of Glasgow, in order to put distance between the

Government and the fiscal commission. I have also included the caveat—I think that the committee has gone over this ground with the nominees—that, if the figure of £20,000-worth of resources that I have allocated is not sufficient, that figure will be revisited. I must have an open mind on that question and I will advise the committee if it becomes necessary to change that figure.

In all those respects, the commission is being set up to exercise independent judgment—judgment that is independent in itself and independent from any other work that any other individuals may be associated with.

09:45

Looking at the CVs and biographies of the candidates, I see that Professor Leith is one of the principal individuals who have explained and argued in their academic work the rationale for setting up independent fiscal bodies. That approach is reflected in the biography of Professor Hughes Hallett, whose work on the role of fiscal commissions and how they must be robust in challenging Government is extensive around the world. Susan Rice has served in a variety of public and private sector roles, most recently on the court of the Bank of England, so she is able to exercise a degree of independent judgment and challenge. We should have a great deal of confidence that these individuals can exercise the distinctive judgment that the Parliament expects of them as members of the fiscal commission.

Jamie Hepburn: You have talked about the different roles of the Council of Economic Advisers and the fiscal commission, and in a letter to the convener you said:

> "The CEA will not have a role in the forecasting process. Furthermore, nor will it, or the Commission, take a view on setting rates for the devolved taxes."

How will that protect the independence of both bodies and prevent a conflict of interest from arising?

John Swinney: I am exploring those questions at the moment in relation to the 2015-16 budget. I will make a decision on the tax rates and tax bands that will be applied, and that will be my judgment—there will not be any input from the Council of Economic Advisers or the fiscal commission in that process. I am the finance secretary and I have to exercise that judgment—the Parliament expects that of me. Those judgments will be signed off by the Cabinet as part of the budget process and we will make estimates of what we think will be generated as a consequence of those rates and bands. The estimates will be submitted to the Scottish fiscal commission and it will have due opportunity to scrutinise them, in its own time and with its own responsibilities, and tell me either that I have made a reasonable set of assumptions or that I have to go back and think again. Adequate time will be given to the fiscal commission to enable it to come to either conclusion.

Jamie Hepburn: You mentioned in your opening statement that the members of the commission will be subject to a code of conduct. Will you tell us a bit more about that and say how it will deal with conflicts of interest, in particular?

John Swinney: The code of conduct is the "Model Code of Conduct for Members of Devolved Public Bodies", which was approved by the Parliament in December 2013. It provides guidance for members of devolved public bodies on their general conduct, on the registration and declaration of interests and on things that they have to watch out for in relation to perceptions of influence from external factors, lobbying and access to members of public bodies. It goes through all those questions.

The code has been subject to parliamentary scrutiny, so I am confident that a very robust standard of scrutiny has been applied to it, and it would be used to regulate any issues connected with membership of the Scottish fiscal commission.

Jamie Hepburn: You believe that it enhances transparency. Crucially, the code has been subject to parliamentary scrutiny.

John Swinney: The Parliament approved it very recently, so I can only believe that the Parliament considers it to be the appropriate code to be in place at the present time. The code provides further guidance and reassurance to the Parliament that the highest standards are being applied in the constitution of the Scottish fiscal commission.

Michael McMahon (Uddingston and Bellshill) (Lab): Cabinet secretary, I preface my question by accepting absolutely the credentials of the three nominees whom you have put forward. They are estimable figures in the field in which they operate, and we should have the utmost confidence in their ability to do the job.

However, do you agree that that is not really the question that we are here to consider? The crux of the problem is that, in all the evidence that the committee has taken—we have taken extensive evidence on the establishment of a fiscal commission—the commission's independence seemed to be a given. It seemed to be a given that the individuals concerned would be independent of the Government and that we could rely on that fact.

You gave the example of Lady Rice's being on the court of the Bank of England and also on your Council of Economic Advisers, but do you concede that the two entities in question are entirely separate, with different auspices and that the appointments are different? Do you also concede that we have a concern that the Council of Economic Advisers and the independent fiscal commission are both appointed by the Scottish Government and that that is where the perception of a potential problem comes from?

John Swinney: I welcome what Mr McMahon said at the start of his question, which is a helpful contribution to the discussion, as it puts it beyond peradventure that the individuals are of significant strength and capability. That is important in the process, as those individuals have not quite volunteered for parliamentary scrutiny, but I have certainly invited them to go through it, and they have been prepared to make a particularly welcome and willing contribution. I therefore welcome what Mr McMahon said at the outset of his question.

On the second part of Mr McMahon's question, throughout all my evidence to the committee, I have made clear the importance that I attach to the Scottish fiscal commission's independence. I have gone to significant lengths to establish that in its whole founding ethos, where it will be located, how it will be supported, and its distance from Government.

I have also said that the members of the Scottish fiscal commission will only ever be appointed for one term. Therefore, they will never have to come back to me for reappointment, and nobody will be worried about saying, "Well, what if I say this this year? I might not get reappointed." That is one of the founding parts of what I have put into the organisation of the fiscal commission, and that step is entirely correct.

The Scottish fiscal commission's role is completely different and separate from that of the Council of Economic Advisers, which will have absolutely nothing to do with the scrutiny of the forecast tax receipts for the land and buildings transaction tax, the landfill tax or non-domestic rates income. If the committee requires further reassurance on that point, I shall make it crystal clear that the Council of Economic Advisers cannot consider any issues in relation to that. That might help the committee in making that distinction.

In a discussion on 8 January, Mr McMahon and I had an exchange in which he in essence invited me to confirm that the fiscal commission would have a very tight remit that was focused entirely on the forecasts. I was able to confirm that in our exchange, and I stand by that. The individuals will undertake a distinct task, to which they must apply themselves irrespective of any other perspectives and interests that they may have.

My point, which I made to the convener earlier, and which Mr McMahon has accepted with his generous remark, is that the individuals have built up biographies by protecting their independence utterly while working for different bodies and institutions. There is absolutely nothing in the arrangements that I wish to put in place that will jeopardise that.

Michael McMahon: I thank the cabinet secretary for his answer. I recall our discussion in January, which took place in a certain context. It never occurred to me that we would be talking about the same people sitting on two different bodies appointed by the Scottish Government, or I would have raised that issue at the time.

When Lady Rice was asked a question about a potential conflict of interests or the perception of such a conflict, she said—as did Professor Hughes Hallett and you, cabinet secretary, when you wrote to us and again this morning—that she would deal with the issue should it arise.

Surely the point is that there should be no potential conflict of interest. If we can foresee a potential conflict of interest, the perception already exists; that is the crux of the problem at the outset.

John Swinney: I do not see how a conflict of interest can arise. First, I have nominated three individuals with significant independent credentials, as Mr McMahon has accepted in his remarks this morning. Secondly, I have indicated that the Scottish fiscal commission's role is completely separate from the role of the Council of Economic Advisers, and I will not tolerate any fusion of their remits. Thirdly, the members of the Scottish fiscal commission are appointed for one term only. If the Parliament approves their nominations, they are not beholden to me in any respect, and they are free to say what they like about my forecasts. They will never have to come back to me for reappointment, because that would interrupt or undermine their independence.

Given those three points, I say to Mr McMahon and the committee that I see no potential for a conflict of interest to arise. I accept the caveat that, if a perceived conflict of interest was to arise, we would have to remedy it, but I do not foresee how one could emerge.

I make it absolutely clear that the Council of Economic Advisers has no involvement in forecasting or scrutiny. It will certainly have no involvement in forecasting, because that is my business as the finance minister, and no involvement in scrutiny of the forecasts, which is the exclusive preserve of the Scottish fiscal commission.

I will highlight one other point—to which I have referred already this morning—from my earlier evidence to the committee. By giving the fiscal commission a very clear and focused remit, I wanted to avoid the opportunity for intrusion into the responsibilities of other bodies. That is a significant point of reassurance for the committee that the fiscal commission will not have its responsibilities or its territory intruded on by anybody; equally it will not do likewise with any other body.

Michael McMahon: Do you not concede that having two distinct and separate remits is not the same as having two distinct and separate people on each of the bodies? That is where the perception becomes a problem. The only way in which you can guarantee that there is no potential conflict of interest is to have different people on the two different bodies.

10:00

John Swinney: I do not accept that point. As I have said to the committee already, if you look at the biographies of the individuals whom I have nominated, you will see that they have all managed to work for a variety of bodies. The convener made the point that Professor Hughes Hallett, for example, has advised all four main political parties in the United Kingdom. He therefore must be able to provide advice in a fashion that commands confidence among various political parties. As I have said already, Susan Rice has successfully managed any circumstances in which there may have been a perceived conflict of interest in the different roles that she has taken on as part of a wide and varied career. Individuals of that calibre are perfectly capable of managing any potential issues that could lead to the perception of a conflict of interest.

Gavin Brown (Lothian) (Con): I agree entirely—100 per cent—with the cabinet secretary about the high calibre and skill levels of all three of his nominees. The issue is the perception of a conflict of interest. The cabinet secretary has said clearly that he does not think that a conflict exists, but he sounded a little less clear on the question of perception.

Is it your view, cabinet secretary, that there is no perception of a conflict of interest in serving on a body that is advising Government on economic levers and serving at the same time on a body that is scrutinising Government on the use of and the forecasts for those levers?

John Swinney: I see no grounds for a perception of a conflict of interest in that respect, because those are two entirely different things. The fiscal commission will not provide me with advice on how I might exercise the fiscal levers. It will provide the Parliament with an assurance that my estimates on the calculation of tax receipts from land and buildings transaction tax, landfill tax and non-domestic rates income are soundly based. That is a technical process that involves economic modelling, and the modelling of tax take and the assumptions that we use in that process. It is not in any way, shape or form related to policy development or the manner in which economic levers have been exercised.

Gavin Brown: Has the Council of Economic Advisers at no time given you advice or suggestions on how tax levers might or might not be used?

John Swinney: That is not what I said. I am saying that the fiscal commission has a very specific remit, which is to consider technically the tax forecasts that I am making for the relevant taxes. That is the commission’s function, and at no stage, under any circumstance, will the Council of Economic Advisers be involved in that process in any way.

Gavin Brown: But has the Council of Economic Advisers given you, or could it potentially give you, advice on the use of taxes?

John Swinney: I cannot recall any instance in which the Council of Economic Advisers has given the Government any advice on the exercise of tax powers.

Gavin Brown: At no point?

John Swinney: Never. I cannot recall that happening. There may well be something that I cannot recall today in response to that question, but at this stage I cannot recall it happening.

Gavin Brown: I want to explore what the Council of Economic Advisers does. Although the fiscal commission may well be set up as an independent body, if there are individuals who are simultaneously serving on both bodies, there is, in my view, at least a question of a perception of a conflict.

How regular are the engagements between the Council of Economic Advisers and the chief economist’s office, outside formal meetings?

John Swinney: There will be discussions from time to time between the chief economic adviser and members of the Council of Economic Advisers in between meetings of the council. The council generally meets a couple of times a year.

Gavin Brown: Obviously, the minutes of those meetings are put online. When you say that there will be meetings from time to time in addition to the formal meetings, do you have a rough idea of their regularity?

John Swinney: They will happen from time to time. There is not a set programme, but when the Council of Economic Advisers is working on issues it will take forward the discussion with the office of the chief economic adviser or other officials within Government.

When the council is involved in an issue—as it was in relation to childcare, for example—it interacts with Government officials who are nothing to do with the chief economic adviser's function but are policy specialists in the area concerned.

Gavin Brown: When you discussed the draft budget at the Council of Economic Advisers, how in-depth was the discussion?

John Swinney: It would be at the level of me setting out that the Government's priorities would be around maximising capital investment to support economic recovery, the focus on the person-centred approach that the Government is taking to the reform of public services and our actions to fulfil our commitments in relation to climate change, equalities issues or issues of that type.

Gavin Brown: Did business rates feature at all in that discussion? Did any member of the council discuss them?

John Swinney: No.

Gavin Brown: I turn to the Organisation for Economic Co-operation and Development rules, because the committee has obviously signed up to all 22 OECD rules. Rule 2.1 refers to avoiding

"even the perception of partisanship."

Is it still your view that there could be no perception whatsoever of a conflict between the two roles if they are held at the same time?

John Swinney: I do not accept that argument.

Gavin Brown: I have a question on another issue that has cropped up in relation to the perception of a conflict or a lack of independence. Some comments have been made about the OBR and its lack of independence from the Government, as I suspect happens in other countries. You said specifically when you gave evidence to the committee in January that the OBR

"is an example of the more limited number of cases in which the independent fiscal commission constructs the forecast itself. However, given that that arrangement operates on the basis of secondment from the Treasury to the OBR, there is a justifiable degree of scepticism about how far from Government the office is."—[*Official Report, Finance Committee*, 8 January 2014; c 3515.]

Do you not think that you have, in effect, challenged the independence of another fiscal body by making that statement?

John Swinney: No, I have not. The issue about the OBR is that it is in essence staffed by secondees from the Treasury. The Scottish fiscal commission will not be staffed by secondees from the Scottish Government. I have set it up away from Government. I have set it up in the University of Glasgow and in such a way that we send it the forecasts that we make, which are worked on by my finance officials and by the office of the chief economic adviser. Ultimately, I will make a judgment based on those forecasts and we will send them to the Scottish fiscal commission, which will be independent and removed from Government.

The fiscal commission is empowered as a result of being staffed by individuals who will never have to come to me for reappointment. They are not civil servants who would have to come back and work for me later on and would think, "What will it be like if I have to go back and work for him later?" They will never have to do that and they will never have to come back to me for reappointment. They get their single term to exercise this independent function.

Gavin Brown: Finally, you have publicly expressed scepticism about the independence of one fiscal body, although members of that body are not simultaneously providing advice to Government through another body. Can you at least understand why some questions are being raised by the committee, and by other outside commentators, about a perception of a conflict when members—not staff but members of the body—will be serving on both bodies?

John Swinney: I understand it because I am here to respond to questions from the committee. Of course I understand it, but I do not accept it, for all the reasons that I have gone through already this morning. The commission has been set up with single-term appointments so that nobody will have to come back for renomination or reappointment. People can say what they like about my fiscal forecasts because they will never have to come back and ask me to reappoint them.

The fiscal commission will not be staffed by the Government. There will not be a single secondee from the Government in the fiscal commission. It is away in the University of Glasgow.

In preparation for today, I looked through all the evidence of my line of argument throughout this process, and it has been that the Scottish fiscal commission should have a tight remit to judge my fiscal forecasts. There is not to be remit creep into other areas of policy and activity. I have specifically and consistently ruled that out during the committee's inquiry.

All those reasons should give sufficient reassurance that no conflict of interest arises.

Malcolm Chisholm (Edinburgh Northern and Leith) (Lab): Cabinet secretary, you said just now that you do not see how a conflict of interests could arise, but Lady Susan Rice clearly gave a great deal of thought to that and therefore could envisage the possibility. Her implication was that, were that to be the case, she would choose, and she implied that she would pick the fiscal commission. Given all that, do you think that you are right to be so absolutely sure that it is not possible for conflicts of interests to arise?

John Swinney: Yes—I think that I am correct.

Malcolm Chisholm: In a sense, however, you want to reinforce your position. You suggested that you would make it explicitly clear to the Council of Economic Advisers that it would have no role in forecasting. I do not know how wide that exclusion will become. Surely it is very restrictive for such a body not to be allowed to consider matters of fiscal policy that are so crucial to economic and financial policies. You said that you thought that the council has not given advice on taxes, but surely it could, and it might think that that is very relevant to its role. You are almost being put in a position in which you have to constrain the council's remit in order to protect your statement about a hard separation of the two roles.

John Swinney: I will quote from the *Official Report* of the Finance Committee's meeting on 8 January. This is territory on which Mr Chisholm and I had an exchange. Mr Chisholm raised with me the issue of clear demarcation between Audit Scotland and the Scottish fiscal commission. In my answer I said:

"I am simply saying that uppermost in my mind will be the need to avoid creating the conditions in which the body can move into territory that is properly the responsibility of organisations that we all accept have been properly constituted."—[*Official Report*, *Finance Committee*, 8 January 2014; c 3518.]

What I meant is that I am anxious to avoid the Scottish fiscal commission's responsibilities extending into those of other bodies, and to avoid the responsibilities of the Council of Economic Advisers creeping into the areas of responsibility of other bodies. I was trying to set out as clearly as possible that I do not want bodies to intrude on the responsibilities of others. I make it expressly clear to the committee that that cannot be the case.

Malcolm Chisholm: You said that there could be some blurring at the edges if the Council of Economic Advisers wanted to talk about fiscal policy and the consequences of certain taxation decisions.

John Swinney: My point is about the remit of the Scottish fiscal commission, which is to forecast the taxes that have been devolved to Scotland as a consequence of the Scotland Act 2012 and as a consequence of decisions that I have taken on domestic rates income. That, and no more than that, is the remit of the Scottish fiscal commission.

10:15

Malcolm Chisholm: My fundamental puzzlement about the issue is that, although there are many eminent economists in Scotland—there are some eminent professors sitting behind you in the gallery—and you could have chosen any from a large number of figures, you picked two, of the three, who are already fulfilling particular roles. I am genuinely baffled by that, because many others would have been equally acceptable because of their competence but would not have stirred up controversy. I have no doubt that you will be able to push this through with your parliamentary majority, but you know that a lot of people outside Parliament are already questioning it, which does not get the fiscal commission off to the best possible start. I am genuinely puzzled as to you why you would seek to move into controversial territory when you could have picked other experts. We have had several before our committee in the past two months who would be eminently suitable for the role—Jeremy Peat, for example. Why did you choose to move into controversial territory by picking two who were already serving instead of casting the net wider?

John Swinney: It certainly was not my plan to move into controversial territory. I have taken care, throughout the inquiry, to build as much consensus and agreement as possible around the establishment of the Scottish fiscal commission. I do not think that anybody could look at the evidence that I shared with the committee, at the approach that has been taken to the handling of the issues, or at the response to the Finance Committee's report and say that the Government has done anything other than work in the spirit of the Finance Committee's approach to establishing the Scottish fiscal commission as a body that is entirely independent of Government.

I will go through the individual candidates and what informed my judgment of them. Susan Rice is an individual of significant distinction in the business community in Scotland who has exercised a number of independent and challenging roles. In particular, it was uppermost in my mind that her experience in the court of the Bank of England required a very strong element of independent thinking. Professor Campbell Leith was nominated because he has been one of the key academics who have considered, explained and set out the basis on which independent fiscal commissions can operate. Professor Andrew Hughes Hallett is another key academic who has been involved in the design of independent fiscal commissions around the globe. I judged that, if we had that experience available to us and those people were willing to participate, their appointments were a reasonable conclusion to arrive at.

Of course, many of our eminent academics and commentators could have been put on an independent fiscal commission. However, I made my judgments entirely to ensure that the fiscal commission is established on an independent footing and that it includes people who have significant records and who can contribute to the process. I could have chosen other nominees but, after exploring all the territory, I tried to get individuals who have absolutely no connection to anything that has gone on, and of whom people could not say that they might be conflicted in certain circumstances, which would be impossible to rule out in relation to a range of other possible nominees.

Malcolm Chisholm: There are only two bodies—one at present, which is the Council of Economic Advisers, and there will soon be a second one—that have a direct link to Government economic and financial policy. Given the controversy, which you obviously think is unjustified, what would be the problem with asking their members to choose? The implication of what Lady Susan Rice said is, I think, that she is so committed to the role on the fiscal commission that she would choose it. I do not know what Andrew Hughes Hallett would choose. However, I do not really see why asking people to choose would be such a big problem, because you would certainly have other people to fill whichever vacancy arose.

The controversy has arisen partly because, I suppose, certain people feel that the Government has its favourite economists, that too cosy a relationship can develop with one or two individuals and that it is better to spread such relationships as far as possible. We know from the evidence that we have taken over the past two months that there is a range of views and that it is better to let that range of views be reflected in the different bodies.

John Swinney: I will deal with that in two ways. First, the fiscal commission will have a very tight and focused remit, which is about challenging the forecasts that I make for tax take from the various taxes. As I said already, it will not range across other questions.

On the Government having its favourite economists, I need only to recall First Minister's question time a week past Thursday, I think, at which the leader of the Conservative Party used Professor Hughes Hallett's contribution to suggest that he was somewhat at odds with the Government. I cannot see how we can have it both ways.

Malcolm Chisholm: I think that you will remember what answer the First Minister gave to that, but I do not want to pursue that line of questioning.

Would it not be better to have a fiscal commission that was independent not only of the Government but of the Council of Economic Advisers?

John Swinney: I have proposed three eminent candidates who have built their reputations on being independent figures.

John Mason (Glasgow Shettleston) (SNP): In that last exchange, you touched on the kind of people that we want. I jotted down some of the things that have been said about the people whom we are looking for that I do not think anyone disputes. We have had: "independent credentials", "significant records", "highly respected", "skilled", "authoritative", "expertise" and "perspective". The bar is quite high.

Will you give us an idea of how big a pool you think we are drawing from? I presume that it is not thousands of people. Another point that I thought of is that they would have to know the Scottish economy quite well, which restricts the pool further. How big a pool are we talking about?

John Swinney: There is a reasonably comprehensive pool of individuals. It is not in the thousands.

John Mason: Are there dozens?

John Swinney: Yes—the number is probably in the dozens. However, we also have to think about what those other people are doing. Because of other projects that they are involved in, some of them would not be able to commit the time to be involved in the fiscal commission. There is a variety of considerations in relation to whether individuals would be prepared to be nominated. However, the pool is certainly substantial.

John Mason: To be in that pool—I assume that it numbers dozens, scores or something along those lines—those people could not have empty lives and zero history outside their current role, could they? I presume that they all have complex histories and, at present, a wide range of roles.

John Swinney: That is one of my core points. Individuals do not amass the biographies and CVs of the character that the three nominees who are before the committee have amassed if they have not done lots of things for lots of people and lots of bodies over time. The crucial point is that they have done that while preserving their independence. That is at the heart of the nominations that I have made.

John Mason: The committee has concentrated on the Council of Economic Advisers in relation to a possible conflict of interests, but other words have jumped out at me from CVs, among them “Calman commission”, which immediately sets orange and red lights and all sorts of things flashing for me in terms of potential conflict. It makes me ask whether the person is too close to the Labour Party. If somebody says that they have had links with four of the parties, I am not to know which ones. They might have stronger links with the Conservatives, the Labour Party or anybody.

It seems to me that we are not looking at a blank sheet of paper here and that it is very much about how we manage the situation. Michael McMahon referred to there being no potential conflict of interests and Gavin Brown referred to perception, but perception is very subjective, is it not? Anybody could perceive anything about anybody, if we take it to the extreme conclusion.

John Swinney: That is undoubtedly possible. However, I return to the answer that I gave to Malcolm Chisholm about why I arrived at the choice of the three individuals concerned. I chose Susan Rice because of her significant business leadership capability, and particularly because of her role in the court of directors of the Bank of England. I chose Andrew Hughes Hallett and Campbell Leith because of their technical expertise and the fact that they have been so instrumental in the design of fiscal commissions around the globe. Those are important contributions that I want to make sure are available to Scotland as we embark on an entirely new area of activity in the management of our public finances.

John Mason: I am sure that the Bank of England is up for criticism, but it is also quite respected. In some ways, I was surprised that the bank allowed Susan Rice to be involved in the Council of Economic Advisers, but she said that the bank is quite positive about that as long as proper safeguards are in place. She said that that situation is an example that could be replicated. Is it your contention that that can be replicated, because it is almost inevitable that someone will have a conflict of interests somewhere along the line?

John Swinney: I made the point about the “Model Code of Conduct for Members of Devolved Public Bodies” in my letter to the committee. I have also made it clear to the committee that I see a very clear and firm distinction between the remit of the Council of Economic Advisers and the remit of the fiscal commission. There is sufficient distinction between those remits to ensure that there will be no conflict of interests. However, I return to my fundamental point that the individuals concerned have worked for a variety of organisations and projects with different perspectives, for different political parties and so on, and have protected their independence throughout. That is the nature, calibre and strength of the candidates whom we have in front of us.

The Convener: Thank you. That has exhausted the questions from the committee. I thank the cabinet secretary and colleagues for their contributions. I suspend the meeting for a minute to allow a changeover of officials.

10:27

Meeting suspended.

10:28

On resuming—

Subordinate Legislation

Public Appointments and Public Bodies etc (Scotland) Act 2003 (Treatment of Revenue Scotland as Specified Authority) Order 2014 [Draft]

The Convener: Our next item of business is to take evidence from the cabinet secretary on the draft Public Appointments and Public Bodies etc (Scotland) Act 2003 (Treatment of Revenue Scotland as Specified Authority) Order 2014. Mr Swinney is joined for this item by Colin Miller and Greig Walker of the Scottish Government, both of whom are familiar to committee members. Agenda item 4 is to approve the motion on the order, but before that we will hear evidence on it. I invite the cabinet secretary to make an opening statement explaining the order, and I remind him not to move the motion at this point.

John Swinney: The purpose of the draft order is to facilitate the appointment of the chair and members of revenue Scotland in good time for the new body to take up its full powers before the devolved taxes come into being on 1 April 2015. The order does so by providing that the appointments can be regulated by the Commissioner for Ethical Standards in Public Life in Scotland. The legal mechanism for achieving that is an order under section 3(3) of the Public Appointments and Public Bodies etc (Scotland) Act 2003, which is what I have laid before Parliament.

The effect of the order, if it is approved, would be to allow revenue Scotland to be treated, for the purposes of any public appointment, as if it was already a "specified authority" for the purposes of the 2003 act. That, in turn, will mean that the appointments would fall within the jurisdiction of the Commissioner for Ethical Standards in Public Life. In this case, the relevant appointments would be the chair and members of revenue Scotland. This is a well-established and—I hope—entirely uncontroversial way of facilitating the making and regulation of appointments to a new public body.

The Convener: Thank you, cabinet secretary. I have no questions and nor do committee members, so we will move to agenda item 4 and the debate on the motion. I invite the cabinet secretary to move motion S4M-010325.

Motion moved,

That the Finance Committee recommends that the Public Appointments and Public Bodies etc. (Scotland) Act 2003 (Treatment of Revenue Scotland as Specified Authority) Order 2014 [draft] be approved.—[*John Swinney.*]

Motion agreed to.

The Convener: The committee will publish a short report to Parliament setting out our decision on the order. I thank the cabinet secretary.

10:30

Meeting suspended.

10:38

On resuming—

Scotland's Public Finances Post-2014

The Convener: Our next item of business is to continue our consideration of Scotland's public finances post-2014. Our evidence today will focus on pensions—although not exclusively, if colleagues want to bring in other issues.

I welcome Professor David Bell, from the University of Stirling, who of course is no stranger to the committee; Ann Flynn, a pensions consultant; and Chris Curry, from the Pensions Policy Institute. Members have copies of the written submissions from the witnesses, so we will go straight to questions.

For the witnesses who are not familiar with the committee, I point out that I will ask some opening questions and then colleagues round the table will ask questions. I might ask a question directly to one individual, but other panel members should feel free to comment on those points, although you do not have to if you do not wish to.

I will kick off with a question for Professor Bell, as he is a kind of battle-scarred veteran of the committee. Paragraph 12 in your submission states:

"The Scottish Government opposed the increase in contribution rates, but was threatened with a loss of grant if it failed to implement them."

Will you expand on that a wee bit and on the impact on the Scottish Government of being unable to make changes for Scottish circumstances?

Professor David Bell (University of Stirling): That was an outcome of the realisation that a lot of public sector pension schemes in the United Kingdom were in considerable deficit and that one way of correcting the deficit was to increase contributions from employers and employees.

I think that you are referring particularly to the increase in contributions from employees. In effect, the Treasury insisted that the Scottish Government apply the same adjustments to employee contributions as were happening in the rest of the UK. In a sense, the UK Government has insisted that the Scottish Government follow its preferred method of partially righting the deficits that the public sector schemes were in. That clearly limits the course of action of the Scottish Government. I do not have at my fingertips the sums that were involved.

Taking the whole idea forward a bit, Scotland has current liabilities of around £85 billion in public sector pension schemes. With pay-as-you-go schemes, the people who are currently employed pay for those who are retired. If the public sector is shrinking and the number who are currently employed is declining, that becomes more and more difficult. In other words, the size of the contribution has to increase in order to meet the pension payments, which are guaranteed.

That is not a specifically Scottish issue—it is a consequence of where the UK and Scotland have got to. At one point they had quite a large public sector, and they are now moving to a somewhat smaller public sector. Therefore, a smaller number of current public sector employees are contributing to a relatively larger number of public sector retirees.

The Convener: From memory, the sum involved was about £108 million a year. Unless the other panel members have any comments on that, I will move on to another point.

Ann Flynn's written submission states:

"I believe that there will need to be change for pensions"

in an independent Scotland. It continues:

"The opportunity is for Scotland to build on the current framework to develop a socially inclusive and progressive approach to pensions provision. In fact, independence will facilitate the fixing of some of the issues of the current system."

It goes on to say that independence

"opens up the opportunity to fix some of the problems we live with today."

Will you expand on that?

Ann Flynn: My key focus is on workplace pensions. I have lived and breathed the auto-enrolment legislation for the past 10 years since it was first mooted, while working for large providers and helping to influence policy.

In the past year, through my independent consultancy, I have worked at the coalface with significant UK employers and have seen the auto-enrolment process being put in place. In that year of working closely with employers and providers, I have noticed the complexity of the auto-enrolment regulations and what they are already doing to mid-size and large employers, so I know what the legislation will do to micro employers. That is a particular issue in Scotland, as a lot of the commercial interests here lie in that area. Smaller employers with 20 or fewer employees will be faced with complex rules to deal with, which will distract them from their business purposes.

I honestly feel that there is an opportunity, whether in an independent Scotland or by remaining part of the UK, to carry out the reform that is needed on the auto-enrolment regulations as they stand. They have been overcomplicated—for the right reasons, I believe, as I have watched the regulations develop over the past decade—but we have now learned real lessons that we need to apply, whether through the Westminster Government or in an independent Scotland.

10:45

We already have more UK-wide pension reform being mooted, and collective defined contribution pensions will have a significant impact across the UK, whether Scotland is still part of the UK or not. That needs to be considered because it is an interesting concept that is already starting to lose favour on the continent—where it has been followed for a number of years—because of its lack of fairness to members.

Professor David Bell's point about the working population shrinking in the UK and Scotland and the retired population growing, and how to fund that population either with public or private pension provision or through the state, is the big challenge for any country in the western world at the moment. We need to look at that and ask how we can do things differently.

The Convener: How would we do those things differently, assuming that Westminster and Scotland have different views on how to take the matter forward?

Ann Flynn: There could be a lot of challenges if, for example, Westminster decided to go down the collective defined contribution path and Scotland decided not to do that.

The first thing that we could start with is reviewing the auto-enrolment legislation and simplifying it from a Scottish perspective. Some of the rules and regulations for record keeping are so onerous that I cannot see how small businesses are going to manage it in future. If we have an equivalent to the Pensions Regulator, which will start to police firms and could fine them, a lot of firms will not comply, although the larger firms have the infrastructure to be able to do it.

The first thing that I would recommend is certainly a review of record-keeping rules and of the regulations on who employers have to auto-enrol or treat differently. There are 38 different classifications that their workers could fall into, so from that perspective it is just too complex. It needs to be simplified and made easier for employers and for employees.

The system has been successful in some places. Some of the companies that I have worked with have had good take-up rates, with very few people opting out. People are more than happy to start paying pension contributions if employers get the engagement right. Auto-enrolment is working on that level, but we need to help employers to manage the whole issue.

The Convener: If Scotland voted yes and took control of pensions, how would it gain through the changes that you are suggesting?

Ann Flynn: Scotland could quite quickly develop a framework that is simplified for employers and could make it easy for them to engage with pensions regulation.

There could be opportunities to incentivise employers. I know that Ros Altmann published a paper this week about things that she had recommended in the workplace, and I am an advocate of some of the things that she has said. You could increase the tax reliefs for employers on providing pension or savings education in the workplace from £150 a year per employee upwards. There are different levels of incentivisation that Scotland could introduce for employers to better engage in the whole process and to help Scottish citizens prepare for their retirement.

The Convener: How would that help not just the employers but the workers?

Ann Flynn: One big thing that I have found as I have done research with different organisations is that people at the receiving end of pensions—the people in the workplace, on the factory floor or on the shop floor—really do not understand the system. It is shrouded in a kind of language that nobody can really break through. If you break it down into much simpler language and help people to understand what it means for them, it makes a huge difference.

During the past two years, I have seen that happening. The level of engagement between the employer and individual employees has been much greater and has involved thinking about what employees want and aspire to, rather than simply saying, “You have to contribute to a pension and it's coming out of your pay packet.” Before, the stance was prescriptive, based on what the legislation said, but now I am starting to see a shift towards a more engaging approach that encourages people to take personal responsibility for their futures.

The Convener: Chris, do you wish to comment?

Chris Curry (Pensions Policy Institute): I would like to make a general observation. The conversation that Ann Flynn has been leading about collective defined contributions and automatic enrolment highlights the fact that pensions policy never stands still. It is important to think about that in the context of the UK or of an independent Scotland, or even internationally.

I will give an example. In relation to automatic enrolment, we know that a review of the policy in the UK is planned for 2017 to see how things are working. Opposition parties are already putting forward proposals to simplify the existing UK system. The Labour Party has suggested that it would automatically enrol a much larger group of people by reducing the initial earnings threshold.

On collective defined contribution pension schemes, Ann Flynn made the pertinent point that, at the same time that the UK is considering introducing such schemes, Holland, which has had them for quite a while, seems to be moving away from that model of collective provision. However, there is a wide range of collective defined contribution schemes. For example, there are also such schemes in New Brunswick in Canada, which work in a slightly different way from the way in which the Dutch schemes work. Although it is possible to borrow from international examples, it can be helpful to build a specific scheme, whether a collective DC scheme or some other type of scheme, that best provides the features that are sought.

Professor Bell: I have a couple of general points to make.

Auto-enrolment is one of the great success stories for behavioural economics, which we study at the University of Stirling. In general, given the high level of take-up, one would hope that it will reduce pensioner poverty in the future.

To pick up on what Ann Flynn said, financial literacy is an important topic and one that is not given sufficient attention in our education system. That is why a large number of employees find it difficult to understand what they might get out for what they put in by way of pension contributions—the complexity of the current regulations aside.

The Convener: Thank you.

I turn to Chris Curry's submission. In paragraph 30, you say:

> "The principle informing future changes to the SPA is that on average an individual should spend 'up to a third of their adult life in retirement'. For this purpose adult life is defined as starting at age 20."

If we look at chart 1, "Year in which SPA would increase if the principle as set out in the Pensions Act 2014 were applied", we see that, if the new state pension age were 67, the year in which that would happen would be 2019 for England but 2033 for Scotland. Will you talk us through that?

Chris Curry: Yes, gladly.

The principle that we outlined in our submission is the principle in the Pensions Act 2014, which sets out the framework under which future state pension ages in the UK might increase. As you said, the principle is that people should spend up to and no more than a third of their adult life in retirement. Given the definitions in the 2014 act, it is possible to use life expectancy projections to calculate when, on average, people in the UK will start to meet that level of one third. Those are the figures that we put in chart 1.

The figures also highlight the fact that there are various differences in life expectancy across a number of dimensions. The ones that we highlighted in the submission are regional dimensions. In most of the papers that I have read that talk about state pensions in Scotland, the demographic situation in Scotland—whereby an increasingly large proportion of the population will be older but those older people will have shorter life expectancies than the rest of the population—means that, as you can see from the chart, the Scottish population as a whole would reach that one third tipping point much later than people in the rest of the UK would do. That would happen on a consistent basis; it would not apply only to people reaching the age of 67. By the time the state pension age goes up to 68 and 69, Scotland will be roughly 11 to 12 years behind the rest of the UK throughout the period that we looked at.

That is not necessarily the only thing that ought to be taken into account in considering the state pension age. There are other criteria in the Pensions Act 2014 that will be used, such as labour market impacts and the impacts of healthy life expectancy.

It will not be a case of describing precisely what the formula says and what will be implemented. There will be reviews at regular periods, which will try to take into account other factors, too. The chart highlights the point that, if the policy was used in an independent Scotland according to the same basis, the tipping point for state pension age increasing would be much later in Scotland than in the rest of the UK.

The Convener: So basically you are saying that an independent Scotland should wait 12 years after England before implementing that policy, all else being equal.

Chris Curry: That is what that part of the equation would suggest, but other factors would need to be taken into account in determining exactly when state pension age should increase.

There are other external factors around the Pensions Act 2014. One issue would be affordability and how much it would cost to pay pensions earlier in Scotland compared with the rest of the UK. Even just considering other impacts in Scotland, there is an increase in benefit expenditure, as Professor Bell has highlighted in his work. There are changes in income tax receipts as a result of people having different spending patterns. The UK Government has estimated that there is quite a big difference in economic growth because of the labour market impacts of people being able to take a pension earlier and therefore being less likely to continue in the workplace.

You would need to consider all those different factors before deciding exactly what the state pension age increase should be, and when.

The Convener: I am tempted just to ask you, “But what do you think it should be?”

Chris Curry: I wish I was qualified to answer that question.

It is important to consider why the state pension age is increasing and what you would like to achieve with an increased state pension age. Then, it is a balancing act. The underlying demographics in Scotland, the UK and the world as a whole suggest that state pension ages will need to increase over time. The question is how quickly they should increase. That is a subjective decision, in the same way that a lot of pensions decisions are subjective. There are always trade-offs involved between how much is paid to people, how early they are paid, how much it costs and what the contribution from the working-age population is to fund that. For Scotland, you would need to consider those aspects separately in order to come to a conclusion.

The Convener: That was a very political answer, I must say. I was very impressed by that.

Professor Bell, you are desperate to contribute. I know you are—you have been jumping about like a hen on a hot girdle for the last few minutes. I will come to you on this issue. You touch on it in paragraph 16 of your submission. You state:

> “on average state pension costs are around 6 to 8 per cent less per pensioner in Scotland due to lower life expectancy.”

To be fair, however, you go on to say:

> “payments for incapacity benefit, severe disability allowance and disability living allowance are well above Scotland’s population share.”

You provide a helpful graph on the following page, on “Scotland’s Share of State Benefit Payments in Great Britain 2012-13”, which covers a whole host of benefits. For example, the share of incapacity benefit is higher, but those of discretionary housing payments, housing benefit and council tax benefit are lower. Do you accept that, overall, social protection in 2012-13 was a lower proportion of gross domestic product in Scotland than it was in the UK as a whole?

Professor Bell: The difference between spending per head on Department for Work and Pensions benefits in Scotland and that in the rest of the UK has been narrowing quite significantly over the past 15 years or so: 15 years ago, spending per head in Scotland was markedly higher, but the difference has been narrowing. Therefore, if you take geographic share of North Sea oil as your metric for the denominator, I think that it is correct that welfare benefits would be a lower proportion of GDP. Do not ask me what the exact difference is, but I think that that is correct.

The Convener: In paragraph 18 of your submission, you say:

> “Discussion of the relative costs of the state pension for Scotland and RUK ... has tended to focus on the accuracy of the migration assumptions which underpin these population projections.”

You will know that the IFS has talked about a 4.4 per cent increase in the Scottish population through migration over the next 50 years. Is it not the case that there has been a 4.4 per cent increase in Scotland’s population through inward migration in the past 10 years?

11:00

Professor Bell: I was sitting behind the cabinet secretary during the discussion about forecasting, to which I listened with interest. I spent some time in an institute that assessed different bodies’ forecasts of the economic future. During that time, I became extremely sceptical about long-term forecasts in relation to the economy.

Migration is particularly difficult to forecast. Scotland has had very significant net inward migration in the past decade, preceded by decades of low to high levels of net emigration, rather than immigration. The net immigration of the past decade was driven primarily by the A8 migrants who came to Scotland, with a much closer balance between migration from the rest of the UK into Scotland and emigration out of Scotland into the rest of the UK. It is true that the past decade has been particularly favourable in respect of increased immigration to Scotland.

Partly for the reasons that I have already given, I would hesitate to project that into the future. It seems to me that there is nothing on the horizon that would have the same effect on immigration as the A8 migrants did in the noughties. There is considerable uncertainty as to where UK immigration policy is going to go over the next decade anyway.

The Convener: I am sure that you would accept that the zeitgeist in the UK is to reduce immigration, but if Scotland had the powers of independence it might take a different view. Would that not mean that there would be a different impact in Scotland relative to the rest of the UK?

Professor Bell: There are complications. Clearly, Scotland could set out a more liberal immigration policy if it was independent—there is no question about that—but could it have a more liberal policy within the existing UK? That is possible. We had the fresh talent initiative, for example, and Quebec runs a somewhat different policy from that in the rest of Canada.

One complication is that presumably we would want to be part of a common travel area with the rest of the UK, as Ireland is at the minute. We would have to take cognisance of whether the immigration policy that the rest of the UK was following would be compromised in some way if people migrated to Scotland and then moved on to England and Wales, which might be feasible within a common travel area. Therefore, there is a question about whether there would be negotiation around Scotland's independence to set its own immigration policy if it also wanted to be part of the common travel area.

The Convener: Does Ann Flynn have any comments to make on the points that have been raised?

Ann Flynn: Yes, although they are off on a slight tangent. Immigration to Scotland has increased, which has obviously strengthened the Scottish economy and allowed it to grow. That has an impact on pensions, too. The pensions issue is starting to emerge quite strongly for a lot of employers, who have migrant workers who might stay here for the rest of their lives but who might move on. What will those workers do with their UK pension pots if they leave the UK's shores? There is almost a need for pan-European pension reform to help with all that, because the situation is becoming more and more complex as people become much more mobile. An independent Scotland could consider how to treat such people.

The Convener: The committee has developed a wee bit of a self-denying ordinance, because some of our meetings have lasted more than three hours. I do not want to put the witnesses through that, so I will not ask more questions. I open up the session to other members.

Jamie Hepburn: I want to return to what Mr Curry said about the impact of the raising of the state pension age and how, on average, Scottish pensioners do not benefit as much as pensioners in the rest of the UK. You made the interesting point that Scotland is consistently 11 or 12 years behind—I think that that was the essence of what you said. According to the formula in chart 1 in your submission, whenever Scotland catches up, the UK as a whole will be ready to increase the state pension age again. Will we always be 11 or 12 years behind if we carry on operating in the UK context, given current policy?

Chris Curry: I think that that is right, if current projections of life expectancy in Scotland and the rest of the UK are correct. I echo what Professor Bell said about long-term projections in the context of migration: the track record on life expectancy projections is not great in the UK—or anywhere else in the world, for that matter. If we take the current projections as being the best estimates of where things are likely to go, you are right that there is a continual problem.

It is worth bringing out a number of different issues. When we consider the averages for regions, we should bear in mind that Scotland, the rest of the UK, England and so on are quite big areas and there is a lot of variation even within those areas. We included evidence in our paper that there is not a massive difference between the areas with the lowest life expectancy in Scotland and those in the rest of the UK: in Glasgow city, life expectancy at age 65 is just under 15 years, whereas in Manchester life expectancy at age 65 is just under 16 years. In the best performing places—if we think about the issue in performance terms—life expectancy at age 65 is just under 20 years in the Orkney Islands, whereas it is just over 20 years in Harrow, in England. There is wide variation within regions, as well as there being differences across regions. That is not to say that the differences across regions are not important—obviously, they are important.

There is an issue to do with whether we look at state pension age as a means of trying to treat the symptoms or the cause. There is an underlying issue in there being variations across regions, in any case, and to my mind a potentially bigger policy issue is what can be done to try to reduce the inequality in life expectancy across different places. Inequalities could be down to health, lifestyle and behaviour. In recent years, smoking has been highlighted as an important cause of differences in life expectancy, and there are new treatments through the health service and so on.

Although having a fixed state pension age at any point has implications for regions where life expectancy is lower, and changes in the pension age have a bigger proportionate impact on such areas, an important feature of any policy discussion should be consideration of how to narrow the inequalities, so that the state pension age changes—if we used the same basis—would have less impact on certain parts of the UK and Scotland.

Jamie Hepburn: I accept your point about regional variation. However, this inquiry is about Scotland's finances post-2014, so we are considering Scotland as a whole. I absolutely accept your point about improving people's health; I hope that we will do that and that people will live longer in Scotland.

Chart 1 in your submission shows that the new state pension age will rise to 67 across the UK in 2021, while Scotland would reach the average level that the chart details only in 2033. In 2033, the UK would be seeking to increase the pension age to 68, while in Scotland the pension age would not reach 68 until 2045. In 2046—the very next year—the UK would be seeking to increase the pension age to 69.

Given the trends that you have identified, one could argue that Scottish pensioners are getting a bit of a rough deal.

Chris Curry: The trends show, as you clearly state, that if life expectancy were to stay the same as the projections, Scotland would always have a lower life expectancy and therefore there would be an expectation that the length of time for which people would receive the state pension would be shorter than in other parts of the UK, if the UK raised the pension age as set out in chart 1.

As I mentioned in my discussion with the convener, other factors, rather than just the formula, would be used to set the state pension age in the UK. Regional variations might be one of the factors to be taken into account, but that will depend on who the Government appoints to undertake the review at the time and how the Government considers the outcome of that review.

Professor Bell: We also came to the conclusion that, on average, the state pension costs per person are cheaper in Scotland for the reasons related to life expectancy that Chris Curry has just discussed. In an earlier answer, he mentioned the very important issue of healthy life expectancy, which is how long people can expect to live in good health rather than just how long they can expect to live.

Scotland is also somewhat behind the rest of the UK in the sense that the gap between healthy life expectancy and life expectancy is bigger in Scotland than it is in the rest of the UK. That is reflected primarily in figure 3 in my paper, which shows that, on average, more is being spent on incapacity benefit, severe disablement allowance and so on.

Surely we want Scotland to increase life expectancy, and healthy life expectancy in particular, so that people spend more of the third of life in which they may be retired in good health. That could have a beneficial effect on Scotland's finances because it would reduce the relative spending on the benefits that are associated with disability and ill health.

Jamie Hepburn: I think that we all accept, as Professor Bell says, and as paragraph 37 of the Pensions Policy Institute's submission states, that on average

"individuals in Scotland, Wales and Northern Ireland, who retire at SPA ... spend a greater proportion of their retirement in ill health than individuals in England."

I turn to population trends, which Professor Bell mentioned in his submission and in discussion with the convener. His paper states that any predictions about population trends, which are a key part of the debate about state pensions and the ratios involved,

"must be subject to large margins of error."

Chris Curry, throughout most of his submission, operates on the assumption of the low migration scenario that the Office for National Statistics has described. I am not necessarily criticising him for that, as I know that the OBR and the UK Government have chosen to operate on that assumption, too. However, I understand that the ONS estimate is way below the actual migration trends in recent years.

Paragraph 84 of Chris Curry's paper is quite interesting. He describes how, in the mid migration scenario, "pensioner benefit expenditure" for working-age people will, by the mid 2050s, be more or less the same as that in the UK, while in the high migration scenario, pensions will become more affordable in Scotland.

I imagine that most people would accept—although you may not—that the Scottish Government's ability to influence those matters is somewhat limited at present. Would you accept that?

Chris Curry: It is very important that, whenever we produce any such estimates, we highlight the sensitivities that are involved. We identified, as others have, that the migration assumption is quite important in enabling us to think about what the population and demographics might look like in future, particularly for Scotland.

Migration is not the only key factor. Scotland also has a lower fertility rate than other parts of the UK, which has an impact on the population. A smaller proportion of the population in Scotland is aged under 44, and a greater proportion is aged over 44. That starting population will have an impact for a large number of years.

11:15

As chart 13 in our submission shows, we have, along the same lines as the Department for Work and Pensions, looked at spending on pensioner benefits per working-age person in Scotland as a way to try and gauge affordability. We recognise that pensioner benefits will be funded by the working-age population.

A better measure, if we had it, would be to look at the working population rather than the working-age population, because there are all sorts of interactions—as Professor Bell mentioned—with levels of disability, different employment rates over time and people working beyond state pension age who could contribute to the economy. However, we have to work with what we have.

We decided to look at how the spending would vary under different migration assumptions. We are not able to project which of those particular sets is the most likely outcome, but, as Jamie Hepburn says, we have used as our main projection throughout our analysis—which is shown in chart 13—the low migration assumption. The OBR uses that assumption, which is our rationale for using it.

If we were to use alternative projections, the mid migration scenario that the ONS has outlined would show, in comparison with the low migration scenario, an increase in the working-age population of 3 per cent by 2030 and of 10 per cent by 2050. By the end of the projection period, that would bring Scotland much closer to the levels of aggregate spending and spending per individual in the working-age population in the UK.

If we were to go further and use the high migration assumption, it would mean, in comparison with the low migration scenario, a 6 per cent increase in the working-age population by 2030 and a 20 per cent increase—which is very significant—in the working-age population by 2050. Even then, we would start to see expenditure per working-age individual being lower in Scotland, from about 2040 onwards, than it would be in the rest of the UK, specifically because of that growth in the working-age population.

The assumption implies quite rapid growth in the working-age population, which is not apparent from the fertility figures and would have to come through migration. As has been discussed, there is a wider range of issues around immigration, which include not only the ability of any Government to influence migration but the impact of migration on other parts of the economy.

Jamie Hepburn: That is very helpful—it is the bit that I am probably more interested in. I accept that projections are very difficult; that was the top line of your answer, and I take it on board.

I am aware that I have not yet directed a question at Ann Flynn. Her submission mentioned the opportunities with independence. In my view, one of the opportunities would be that we could have greater influence over migration trends and policy. Perhaps she has a view on that.

I was interested in Professor Bell's comments on the potential for a degree of difference in migration policy within the confines of the UK, but that is entirely dependent on the UK Government's willingness in that regard—it is not in the hands of the Scottish Government. With independence, the context would be different. My point is that we could at least try to achieve that influence. Would you all accept that?

Chris Curry: As I said in my long answer to your previous question, the Pensions Policy Institute focuses on pensions issues and not on migration issues, so I do not feel suitably qualified to say whether an independent Scotland would be able, or should be seeking, to achieve that, especially as there are much wider implications. If Scotland could achieve that, it would have potentially positive implications for the affordability of pension expenditure.

Jamie Hepburn: Professor Bell, you seemed to indicate a hypothesis with regard to students.

Professor Bell: Overseas students are more important to Scotland than they are to the UK as a whole, so it would certainly be in the interests of Scottish universities and the Scottish economy—because a certain proportion of those students will always find Scotland so attractive that they want to stay—if it were easier to attract students to Scottish institutions. Over the past couple of years, we have suffered somewhat as a result of current policies.

Jamie Hepburn: Does Ann Flynn have anything to add?

Ann Flynn: Yes. You are quite right: an independent Scotland should try to shape migration policy to make an impact on the economy. I believe that the more that we can increase the working population, the more revenues will increase and so on, and the costs of benefits will reduce.

With the impact of auto-enrolment and people saving for private pensions, the reliance on state pension changes a little bit. Another option is to incentivise healthy people who are still working to delay withdrawing their state pension. Various aspects can be looked at.

Jamie Hepburn: There is one final area that I want to cover. Again, it is an issue that is dealt with in Mr Curry's very helpful submission.

In paragraph 18, you say:

> "a low earning woman with career breaks, aged 44 in 2014 and reaching SPA"—

state pension age—

> "at 67 in 2037, who is automatically enrolled in a workplace pension at the minimum contribution level when she is in work, could have an income from state and private pensions £14 a week higher under the Scottish Government proposals than in the current UK system".

I make that to be £728 per annum, in 2014 earnings terms.

In paragraph 20, you say that, under the Scottish Government proposals,

> "the median earning man could be entitled to Savings Credit less than 5 years after reaching State Pension Age. This would increase his state and private pension income

further under the Scottish Government proposals, compared to in the current UK system."

What did you factor in there? Does it include both the single-tier pension starting point of £160—I notice that in your paper you started at £159 for 2014 prices—and the triple lock uprating?

Chris Curry: It does. It includes the £160 starting point for the single-tier pension. The figure is £160 in 2016, but in the paper we converted all the figures to today's earnings terms, so it looks slightly lower. However, if you roll it forward to 2016, it will be £160. We have assumed that it will be just over £1 a week higher than the figure that is used in the UK, although that will be subject to what is determined by the UK Government in the run-up to April 2016. There is nothing on the face of the Pensions Act 2014 that says exactly what the level will be.

We have assumed that the single-tier pension would be triple locked in both those scenarios on the basis that there is a commitment from the Scottish Government to do that for at least the first five years. Although the UK Government has not yet made such a commitment, some political parties are starting to get there, and the impact assessment in the 2014 act also uses that assumption, which is why we used it. We have also included—and this is one of the potential differences—the retention of savings credit beyond 2016 for individuals who reach state pension age after 2016, which is another proposal that the Scottish Government made last year.

Savings credit is a very interesting issue, which has two impacts. We felt that it was important to highlight that savings credit being in place means that people who reach state pension age will have higher pensioner benefits, which drives some of the figures that we have seen elsewhere on pensioner benefit expenditure per individual of working age. That is partly because people who reach state pension age in Scotland would retire under a more generous system and have higher incomes in retirement, all other things being equal. That is particularly important for lower earners, who are only entitled to a single-tier pension and very small amounts of other pension. Savings credit could be a very important top-up to their income, above and beyond the single-tier pension level, if that is retained in the future. The individuals that we are talking about will reach state pension age in the mid-2030s—2037 or so.

Interestingly, the median-earning man illustrates the other side of savings credit, which is that after a period of five years or so he would become entitled to savings credit, which would provide a further boost to his income. Under the single-tier proposals that have been put forward by the Scottish Government, there is a difference of around £1 a week for that individual, but it goes up to around £2 to £3 a week because of savings credit, once savings credit kicks in.

The only difficulty with savings credit is the impact of means testing on private pension saving. That has been debated heavily in a UK context over the past 10 years, especially with the introduction of automatic enrolment. There is a concern that, historically, people have found any reason not to save, which is why automatic enrolment has been introduced. However, if you look at the issue in economic terms, there are probably two different impacts: an income effect and a substitution effect. The higher the income that people get from the state, the less likely they are to save on top of that. However, the lower the additional benefit of saving, the less people will save. The issue that we are discussing works in both those areas. It means, for example, that, if the median earner did not save and opted out of automatic enrolment, he would not lose all the value of his pension saving, because he would receive £15 a week of pension credit instead. He could get almost half of what he gains from saving from not saving, so that reduces the incentive for him to save.

It is difficult to say, in aggregate terms, what impact that would have on levels of saving. You could argue that, given that the number of people who opt out of automatic enrolment at the moment is low—across the UK, it is less than 10 per cent of all the individuals who have been automatically enrolled since October 2012—the issue might have only a relatively small effect. However, with regard to the way in which individuals make saving decisions, as other research that we have done has highlighted, saving the minimum amount through automatic enrolment is not enough, and people will have to find some way of putting more into pensions saving. That could be more difficult in a situation in which savings credit exists, as it reduces the extra value of saving.

There is a definite bonus in terms of getting a more generous income on retirement or during retirement for people who go on to savings credit later in their life, but there is a potential impact on the level of saving that people make.

Jamie Hepburn: Could I just clarify something? In your comparison, you included some of the Scottish Government's commitments on uprating pensions for the rest of the UK. Is that what you said?

Chris Curry: In both scenarios, we have assumed the triple lock for the single-tier pension.

Jamie Hepburn: But as there is no equivalent commitment, the differential could be even greater. You say that people could have an income that is £14 a week higher under the

Scottish Government proposals, but the figure could be higher than that.

Chris Curry: Yes. If, in the UK, an earnings link—that is the minimum that is required by legislation—were used instead of a triple lock, there would be a bigger difference between the two.

Gavin Brown: My first question is for Ann Flynn; it is on a fairly narrow issue.

In your paper, you say that Scotland does not need an equivalent to the national employment savings trust scheme. The white paper talks about a "Scottish Employment Savings Trust".

Ann Flynn: I do not think that the Scottish Government understood why NEST was branded in the way that it was, but that is another issue.

Gavin Brown: Your view is that, if there were a yes vote and Scotland became independent, we should not set up SEST, if we may call it that. What would you propose in that scenario?

Ann Flynn: Watching what has happened with automatic enrolment and with NEST in particular in the past two years, we can see that NEST has been reasonably successful—I think that it now has more than 1 million members. However, we have also seen more of the less-established providers—the master trust providers, as they are known—stepping up to the mark and taking a lot of the population that NEST was originally designed to deal with. I believe that, rather than creating a Scottish version of NEST, whatever it would be called, you could negotiate a Scottish automatic enrolment scheme design with one of those other providers that would offer a savings vehicle for people who are not automatically enrolled into private workplace pension schemes, where employers feel that that is the only option that they want.

The point that I was trying to make was that, given the infrastructure costs of setting up SEST, you could deliver the same solution in a different way.

Gavin Brown: In your paper, you talk briefly about the cross-border issue in relation to private pensions. In the work that you do, you must see some of the issues that can come from that. How onerous do you view those issues as being and how would you solve them, should they arise?

11:30

Ann Flynn: The question of a solution is an interesting one. In the past couple of years, particularly in the arena of defined contributions, I have considered the situation that pertains with regard to UK employers that have operations throughout the UK and in, for example, Éire. Their UK employees can all be put into a registered UK pension scheme, but their Éire employees are put into a pension scheme that is registered in Ireland. Those are quite distinct bodies.

My concern is that an independent Scotland could really disturb some UK employers with Scottish operations that are used to having one arrangement. They will have all their administration and so on set up and then they will suddenly be faced with a different set of rules that they need to adhere to, and they will need to contribute to a pension scheme that is registered in Scotland.

My simple solution—I do not know whether it is possible, but I am sure that the legal people will tell me whether it is—would be to work with pension providers and administrators to create sections that could accommodate Scottish operations of UK companies. As I say, I do not fully understand the legal implications of that, but it is a case of minimising the impact on UK employers that currently have operations in Scotland rather than forcing them to change to a whole different regime.

There will also be an issue if the basic rate of income tax changes in Scotland. At the moment in the UK, the principle of pension saving is that people get basic rate relief on their personal contributions. If that rate changes in Scotland, it could have a severe impact.

From my experience of working with providers, I know that a few of them have thought about the issues and have already parameterised their systems so that, if the tax rate in Scotland is different from the one in England, they will still be able to run pension schemes on the same basis but applying the right tax reliefs. The situation becomes quite complex, and the impacts and possible solutions need to be carefully thought through. I think that there are solutions, although I do not know whether they could be legally validated.

The other big issue is salary sacrifice, which is a very common form that employers use to make pension contributions. They agree with their employees to do it on that basis because it saves them national insurance contributions—I do not know whether people would want that, going forward—but it also helps individuals to make pension contributions more efficiently. Salary sacrifice is currently written into primary legislation in the UK, so the question is how we would move that into an independent Scotland to ensure that it could continue to work here.

Gavin Brown: Professor Bell, in paragraph 17 of your submission, you mention an issue that has occasionally cropped up in discussion and debate. You talk about the age-dependency ratio being the ratio of the number of people who are over the age of 65 to the number of people aged 16 to 64.

In much of its work—whether in its pensions paper or, indeed, in the white paper—the Scottish Government compares the ratio of those people of working age to those over 65 and those under a certain age; I cannot remember whether it is 16 or 18. If that ratio is used instead of the one that you used, Scotland's position looks more similar to that of the rest of the UK than the graph in figure 4 of your submission suggests.

Can you explain the difference between those two ratios? If we are being objective about it, which ratio is more commonly used and more useful for working out the viability of pensions and so on?

Professor Bell: In effect, we are trying to calibrate the number of people who are dependent in some measure on state support and how that relates to the number of those who provide taxes and contributions that will support those people. Clearly, it is true that people under the age of 16 receive a significant amount of state support, primarily through the education budget. We have already discussed the fact that the fertility rate in the rest of the UK is higher than the fertility rate in Scotland, so Scotland has a smaller share of the zero to 15 age group relative to the rest of the UK and a larger proportion of people aged 65 and over relative to the rest of the UK.

If we are thinking about pensions and support for older people in relation to the working age group, the graph that I have shown is probably more relevant. Having said that, it is a pretty rough and ready measure, because it assumes that people might retire at 65. In the 1990s and the following decades, many people retired before 65. However, since the beginning of the recession, the number of older workers has increased dramatically, whereas the number of young people getting jobs has suffered somewhat. We have had high levels of youth unemployment but, at the same time, we have had large numbers of older people—many of them self-employed—in the workplace. That has happened in the UK as a whole as well as in Scotland. If you are trying to get an idea of the costs of dealing with the older population in relation to the capacity of the economy to generate taxes, I think that the measure that I have used would be the more appropriate one, but it is not a perfect measure.

Gavin Brown: That is helpful. In paragraph 10 of your written submission, you say:

> "To establish efficient bond trading, the Scottish Government would have to set up a bond market. This would be the major priority immediately after-independence."

I think that you are one of the first people to make that point to the committee, unless I have missed it. Are you aware of any work that is being done on that? I have read the white paper and other documents, and I am not aware of a huge amount of work being done on that issue.

Professor Bell: I do not know of any at the moment, but that work would have to be done in the period before the final agreement. Depending on what arrangement there was for Scotland to take over a share of the debt, whatever that share might be, and even if it did not take over some of the debt, there would be a need to borrow almost immediately and that could not happen unless the Government did some deal with another sovereign state that had a large wealth fund. There would have to be a market in Scottish debt—that would have to be established straight away.

Gavin Brown: Paragraph 9 of Chris Curry's paper makes a point about pensions. It states:

> "This does not mean that it would be unaffordable. Rather the Scottish Government would need to ... raise higher revenues ... reduce spending in other areas ... or have higher Government debt levels."

We have heard that argument before. Are you aware of any work that is being done, or has your institute done any work, to quantify the pension commitments or possibilities? Is any work being done out there to put some numbers to the point that you make in paragraph 9?

Chris Curry: That is not something that we have done at the Pensions Policy Institute. The issues in that paragraph came up in the previous question that you asked Professor Bell about how the dependency ratio is defined. In Scotland, because a smaller proportion of the population are of school age, lower levels of relative expenditure may be required for that group and you may be able to afford to spend more on the older generations. Such trade-offs are involved in determining whether a particular level of spending is affordable. However, it is not something that we have done any particular work on. We focus purely on the pensions side, and I do not think that we would be able to look at the economy-wide implications.

As we show in the paper, there is an increasing gap or divergence between the UK and Scotland in the expenditure on pensioner benefits per head of the working-age population. That is driven mainly by the old-age dependency ratio, but it is also driven partly by some of the different policy decisions that the Scottish Government has proposed. By the time we get to the 2050s or thereabouts, the difference will be around £150 a year per person of working age, of which around two thirds will be due purely to ageing.

Malcolm Chisholm: I will start by following up some of the issues that Gavin Brown asked about. Professor Bell, although you do not go into pension companies buying bonds in great detail in your written submission, that issue relates to other discussions that we have had with earlier panels. The interest rate charged would be very relevant to that issue. You say that—it is a throwaway remark—were there a higher interest rate, leaving the currency union could then impact on that rate. I am interested in what effect a different interest rate and currency arrangements could have on pension companies' resources.

Professor Bell: This is a very complicated area. It is not yet clear how a Scottish bond market would develop. If there were no currency union, there would clearly be a bond market dealing in a different currency; if there were a currency union, I guess that you would not have any currency risk.

However, there is what is called the redenomination risk. The white paper says that the Scottish Government reserves the right to go its own way on the currency post-independence, although its wish is to continue to form a currency union. If you were buying bonds, you might try to price in a premium based on how realistic or unrealistic you think that that particular statement might be.

As I say in my submission, there is a set of pension funds out there that expect to pay Scottish pension scheme members in the future and, implicitly, given that pension wealth per person probably is not much different in Scotland from what it is in the rest of the UK, the value of the commitments is very substantial. Indeed, they are worth around the same as the future worth of North Sea oil.

How the commitments to Scottish pension scheme members in funds that are held by both Scottish and UK companies would be paid out to those pension members were there no currency union is an extremely difficult problem. It might be that people would want to retain a sterling relationship, so that they are paid in pounds and they convert the payment afterwards. Much of this would be much simplified if there were a currency union. I guess the question then would be whether Scottish pension companies dealing with Scottish pensioners would want to buy Scottish or UK bonds if both were priced in sterling. The question then would be which of those would be the more attractive. It is an interesting question whether a premium would have to be offered or whether the markets would take the view that Scottish bonds were more trustworthy than those of the rest of the UK.

11:45

Malcolm Chisholm: That was very interesting.

I had better move on to something a bit more straightforward, although perhaps it is not. Most public service pensions are pay as you go. I think that that is the case for all of them apart from the local government scheme—you can correct me if I am wrong. What are the implications of that for the payment of pensions post-independence, if such a thing were to happen?

Professor Bell: The obligations do not change. Independence does not have that effect. The public sector net debt, which is what discussions about how the overall Scottish debt might be allocated focus on, does not include public sector pension obligations. They are included in the even more esoteric whole-of-Government accounts, and I think that they amount to about £85 billion. One would assume that they are cast-iron commitments that will have to be met in future. The question is whether the capacity of the Scottish economy within the UK economy is better able to meet those commitments compared with a Scottish economy on its own.

That brings me back to a point that I make in my submission, which is relevant to a number of these discussions. The extent to which pension commitments, welfare commitments and so on cause problems for the economy really depends on how much they are in relation to GDP. Do they amount to 20 per cent of GDP? If so, that will tell us something about the level of taxes that we will have to levy and/or the amount of public spending other than those commitments that we are able to make.

What is critical, therefore, is not only the population projections and the level of migration, but the GDP projections. The Institute for Fiscal Studies and the Treasury are basically making an assumption that productivity growth in the Scottish economy will continue into the future at 2.2 per cent. If we vary that downwards just a little, it is a disaster; if we vary it upwards, it becomes relatively easy to meet the commitments to the kinds of things that we are discussing today.

In my mind, the discussion seems to have focused an awful lot on the demographic issues rather than on whether Scotland's economic prospects—in terms of growth—are better with independence or without it. I am not offering a view about that; I am just saying that I feel that the argument has skated over that vital issue.

Malcolm Chisholm: I am interested in the seeming contradiction between pay as you go and national insurance. Ann Flynn's paper implies that there is some national insurance fund that pays for pensions, but that is a fiction, is it not? Is the state pension not a pay-as-you-go pension?

Ann Flynn: What I mean by that is that the level of state pension that is paid to someone is based on their national insurance record, as opposed to there being a national insurance fund. I was not saying that it is funded; I was saying that a person's national insurance contribution history drives the amount of pension that they are paid.

Malcolm Chisholm: But you also say that the UK Government would "make this available". I do not know what you mean by "this". Do you mean that it would make the information available?

Ann Flynn: The entitlement to the state pension does not change. If somebody has paid their national insurance contributions as part of the UK and we then move into an independent Scotland, that commitment remains, but the question is how it is funded.

Malcolm Chisholm: The Government in Scotland has to deliver that commitment.

Ann Flynn: Yes.

Malcolm Chisholm: I am sorry; I asked that just for clarity on that point. Good—we are all agreed on that.

It has been well discussed already, but it sounds as if there is some agreement on considering pension expenditure per working-age individual—Chris Curry and Professor Bell presented the same view on that; I do not know whether you have a view on it—which is why we have had a long discussion about demographics, because the only way we can shift the ratio is by increasing the working-age population. Is there general agreement that that is the best way to look at the affordability of the state pension?

Ann Flynn: I definitely agree with increasing the working population. The next stage on from that is getting more and more of the younger working population to contribute to private pensions, which auto-enrolment is encouraging.

Malcolm Chisholm: So, in a sense, a discussion about pensions easily morphs into a discussion about immigration, as we have already seen.

Ann Flynn: Absolutely, yes.

Malcolm Chisholm: Certain people, including the Scottish Government, place too much faith in immigration. There seems to be a contradiction between having a significantly different immigration policy and the wish to remain part of the common travel area. For example, I do not think that the Republic of Ireland has a significantly different immigration policy from the UK; otherwise there would no doubt be no common travel area. That probably takes you out of pension territory, strictly speaking, but that is where the argument seems to have proceeded.

Professor Bell: To a large extent, net migration is not controllable. You cannot stop people leaving if they want to leave.

Actually, there were high levels of immigration to Ireland in the 1990s and early 2000s, which were mainly driven by high economic growth. Economic growth creates opportunities for people to come to an economy that is attractive to join. Those things are not unrelated. You cannot just have a liberal immigration policy and expect people to roll up unless there are economic opportunities for them to engage in work.

Malcolm Chisholm: However, we could have differential migration from the European Union or the rest of the UK in the event of independence.

Professor Bell: It is quite possible and it could be driven just by differences in economic growth.

Malcolm Chisholm: Chris Curry, do you want to comment on any of the things that I have said? I have been agreeing with you, which is why I did not ask you any hard questions.

Chris Curry: That is always good to hear.

I have a final thought about the pension expenditure per working-age individual, which we have agreed is the best measure that we have of affordability. There are two ways to change it. One, which we have just been talking about, is to increase the working-age population; the other is to change the level of pension benefits—how much you pay pensioners and the relative generosity of the system.

There are two ways of increasing the relative size of the working-age population. One is migration, which we have been talking about; the other is increasing the state pension age. If we increase the state pension age, we increase the working-age population and reduce the pensioner population.

It is worth bearing in mind the fact that there is a range of things that could be done to change that measure.

Malcolm Chisholm: Are there any issues with cross-border pension schemes apart from the one that Ann Flynn raised in her paper and her comment?

Professor Bell: The only one—to which I have no solution whatever—is how overseas pensions are dealt with. The DWP provides retirement pensions to large numbers of UK pensioners who live abroad. I have forgotten the figure, but it is possibly about 1 million. How many of them are Scots and how many of them generated national insurance eligibility while working in Scotland might be a test too far for the national insurance records, so I have no idea how that would be solved.

Michael McMahon: I will move on to the pension protection fund. I am not sure who would be best placed to answer the question; I will leave that up to you. My understanding is that 16,000 people in Scotland are receiving the pensions that they were previously entitled to under the pension protection fund. The highest-profile case that I can think of is Waterford Crystal. I see Ann Flynn nodding, so I assume that she is aware of it. In that situation, as I understand it, the employees in Ireland are still fighting to recover their pension fund, but employees in the UK have been paid out of the pension protection fund. Who would pay in a similar situation in an independent Scotland?

Ann Flynn: That is another one of those quite complex situations. To date, UK companies have been paying levies to fund the pension protection fund to help schemes that have got into difficulty to pay the pensions. That has covered UK citizens.

In an independent Scotland, the question is whether we would have a Scottish pension protection fund and collect levies from Scottish companies. As I mentioned earlier, an awful lot of UK companies operate in Scotland, so how will we treat them in terms of pension protection? Will they contribute to the main UK pension protection fund while an allowance is made for the fact that they have employees who are citizens of Scotland who need to be looked after?

It is a complex area. Michael McMahon is right about the Waterford Crystal example, in which the Irish pensioners are still trying to get their benefits. I am acting for someone who was a member of a Scottish defined-benefit pension scheme. In their mid-80s, they are being told that they are having £13,000 clawed back because their scheme has gone to the pension protection fund. I would therefore argue that the pension protection fund is not ideal as it stands, but I agree that it is a complex situation and I am not sure that we have got the right solution yet.

Michael McMahon: At what level does the business tax levy come in in relation to this? What type of companies pay the levy? What obligation do they have to pay it? Is there anything in the Scottish Government's white paper that deals with how to resolve those types of issue?

Ann Flynn: I do not recall seeing any such detail in the white paper. Currently, Scottish companies will pay a levy towards the pension protection fund through their registration with the pensions regulator. I cannot remember the exact levels of levy. I think that it is per member. There is a per capita, per member type of levy that they pay every year. That is then held by the PPF and, if a pension runs into difficulties, it is assessed to see whether it can be taken into the PPF and pensions subsequently paid.

Michael McMahon: Can you give us a ballpark figure for how much the PPF is paying out to those 16,000 Scots at the present time?

Ann Flynn: I am afraid that I do not know that, but I can certainly find out for you.

Michael McMahon: If you could do that and inform us, it would be helpful.

John Mason: We have covered quite a lot of ground already. On a factual point, Ms Flynn, on the front page of your paper, you say:

> "I would argue that the existing legislation could be replicated to redefine the classifications for iScotland."

Am I right in thinking that, if we get independence, all existing UK legislation will still apply to an independent Scotland, and that we will not need to replicate anything in the sense of re-enacting legislation? We would only need to do that if we wanted to change something.

Ann Flynn: I was maybe being a bit bold in my submission but, having spoken to some legal people, I believe that some of the primary legislation that was written in the UK would have to be re-enacted in Scotland. That was my understanding of the situation at the point of writing my submission, but it might have changed. The example that I used earlier was salary sacrifice, which would have to be re-enacted for an independent Scotland.

John Mason: I am interested in that. Do the other witnesses have a view on it?

Professor Bell: No.

12:00

Ann Flynn: In a debate that I took part in a wee while ago, all the lawyers advocated that that would have to be the case.

John Mason: Perhaps we could look at that again. I think that other countries have left the UK and kept most of the same legislation.

Ann Flynn: I think that it would just be replicated. It would be re-enacted, but replicated.

John Mason: Okay. That is fair enough. I will leave that issue for now.

I turn to the concept of a person spending a third of their adult life, which starts at the age of 20, in retirement. If I am correct, if people are expected to live for 60 years after the age of 20, they will basically spend 40 years working and 20 years retired. Where does the one third come from?

Chris Curry: That is really based on observation of what has happened in the UK over a number of years. We have found that the state pension age has not increased, but life expectancy has. To go right back to the early part of the 20th century, it was somewhat unusual for people to live to receive a state pension, as the state pension age was set higher than life expectancy. Obviously, it has become more frequent that people spend more of their adult life in retirement compared with the amount of time that they work.

We have done work on the issue in the past. I am afraid that I cannot remember the precise figures, but we have roughly got to the figure of a third with the state pension age changes that are going through in the UK. The idea is to try to keep it at that level and ensure that any future increases in life expectancy are shared out in that way. Therefore, two thirds of any extra year would go on to the amount of time that a person spends working and one third would go on to time in retirement.

I do not think that there is any detailed research on the ideal split between the time that a person spends working and in retirement. It is probably a function of a number of different features, such as the figure not being far from where we are, or at least where we have been in the recent past. There are also affordability issues. The ratio between the two has a big impact on how much is spent on pension benefits and how much is collected in national insurance and taxation.

John Mason: Is it a rough-and-ready figure that has appeared, or is there a detailed mathematical model behind it?

Chris Curry: I do not think that there is a detailed mathematical model; rather, I think that it is simply based on experience. That is roughly where we are.

John Mason: The UK or Scotland could therefore vary it a bit—by 1 or 2 per cent or whatever.

Chris Curry: Yes. Other countries do not always use the same type of ratio. Denmark springs to mind. There, a fixed number of years in retirement has been set as the basis for changing the state pension age. As a consequence, Denmark's state pension age is increasing much more rapidly than it would do here, on the basis that people should expect to spend around 14 years in retirement at the end of their life. There are different ways of looking at the matter.

John Mason: So if people lived to 100, they would work until they are 86.

Chris Curry: If the average was up to 100, the state pension age would be 86. I think that it is expected to reach the mid-70s by the middle of this century.

John Mason: Okay. That leads me on to my next point, which is that people have a range of jobs. It is one thing for us to sit round a table and talk to one another, but nurses, teachers and firemen have very physical jobs. Is it fair to have an across-the-board theory, policy or age? Should we vary the approach more?

Chris Curry: In a way, that is a big philosophical question, but it is also an important practical question that relates to the discussion that we had with the convener at the start of the session about there being a fixed pension age rather than one that is based on average life expectancy. Those options have different implications depending on people's particular characteristics and life expectancy. As you quite rightly point out, there are many variations around the average life expectancy; in fact, probably very few people end up having exactly the average life expectancy. Most people are above or below it.

One rationale for having a fixed pension age is the simplicity of people understanding when they are likely to receive a state pension. That goes back to the rationale for having a state pension. In its starkest terms, a state pension exists as an insurance against people living to old age and not being able to provide for themselves. There have been other definitions in the past, particularly when the state pension was introduced in its current form, with national insurance. Although national insurance tries to highlight its insurance element, it was also felt to be a right that a person who has paid their national insurance contributions should get a return on them.

You highlighted the important fact that any fixed state pension age gives different outcomes for different people. The difficulty is in finding an alternative that would be simple enough to allow people to have certainty about when they will reach their state pension age and be able to claim a state pension, and which they could then use in planning their other affairs, such as the levels of savings that they might need or how long they might or might not be able to work for.

John Mason: Ms Flynn, I do not know whether you have a view on that from a practical perspective. Is it just that, from a practical point of view, we have to have a uniform system even if it means, for example, a nurse working until she is 70 and having to lift people, which would be quite difficult in practice?

Ann Flynn: That is a significant issue for employers—whether they are local authority or private company employers—who have employees who are involved in physical work. The age discrimination legislation means that people cannot be forced to retire. It is an issue if their health is not good enough for them to continue to work but they are unable to get their state pension.

I agree that it would be good if we could have some variation depending on people's occupation and allow flexibility in the state pension. We would have to look at the complexity of that and the cost of administering it. I advocate doing that, though, because I believe that some people must finish their working lives earlier than others and they should be entitled to some form of state pension at an earlier age.

John Mason: On the bigger picture, we are looking at what is happening now and what might happen in the future, but we should look at the past as well. When I was growing up, a lot of people worked for a company or a business and my impression is that they usually had a pretty good company pension scheme that had defined benefits. My father worked his whole life for Scottish Power and my mother seems to do okay off his pension. Was that a bad model that we have happily moved away from and should never think of going back to, or was it a good model from which the UK system has deteriorated? If so, should we try to improve the UK or the Scottish system?

Chris Curry: It is certainly a different model. There are certain things that we must bear in mind. First, although there have been very good defined-benefit pension schemes in the past, outside the public sector they have never covered the majority of the people in work. Even at their peak, probably only about 50 per cent of the working population was covered. That is in a UK context; I do not know the Scotland-specific figures. However, you are right in that, where people were covered, they were covered very well with what, looking back, now appear to be relatively generous pension schemes.

Having said that, they changed significantly during the 1970s, with a number of regulations coming in over time to increase the security and add to the value of those benefits. For example, they allowed for pensions not to be eroded by inflation and for the provision of spouses' benefits. In addition, equal treatment regulations came in during the 1980s. All of that means that there was never a particular point in time when the system was stabler, because it has been continually changing. Over the past 20 or 30 years, those types of pension scheme improved the security and increased the value of the benefits on offer.

John Mason: Does the cost of that mean that many people who would have had a pretty good pension 30 years ago now have a poorer pension, in practice?

Chris Curry: It means that people who had a good pension 30 years ago still have a good pension because the legislation has protected it, but it also means that far fewer people are now being offered those types of pensions, because not only has the protection increased but the cost to an employer of providing those pensions has increased. The cost has more than doubled over that period, at least in the overall UK context, and that has driven employer behaviour because employers have found that they can no longer afford to make those contributions.

The increase in global competition has meant that labour force costs are a real issue—not just wages, but also the additional benefits that are paid. There has been a transformation over a period of time. As the Public Sector Pensions Commission pointed out, it probably started about 15 to 20 years ago, when employers started to move away from the type of pension provision that was then current and to take on provision that holds less risk for them, is potentially less expensive and shifts the risk and cost on to the individual.

That is where we are at the moment in a UK context, and also in an international context. Much more responsibility for private pensions is being placed on the individual. Even if employers make a contribution, they are no longer responsible for the investment performance and they are no longer taking on the risk of individuals living for a long time. That is now being passed to individuals, who have to deal with it themselves.

John Mason: It sounds to me as if the individual is getting a poorer deal than they used to get. I accept that that is not the case for every individual, but it is for some.

Ann Flynn: I can see exactly where you are coming from. I go back long enough in the industry to have started off in what was known as final salary pensions, where people got a pension that was based on the salary that they were earning in their last year. There were then repeated changes to the legislation, as Chris Curry mentioned, which layered on complexity and cost to those pensions, and as a result many employers stepped back from them. However, many employers enjoyed what were called contribution holidays in the 1990s under advice from actuaries. That could be pinpointed as a significant turning point in the provision of that type of benefit. I would say that the overcomplexity of the legislation and regulations was the death knell for defined benefit pensions.

I refer back to the example that I mentioned earlier. If what was a good pension scheme 30 years ago is now within the PPF, its pensioners are actually having money clawed back from them, which is quite concerning. There is a switch to defined-contribution provision, and the onus sits on the individual. I agree that passing that risk on to the individual is a significant matter. That is why I advocate the whole aspect of engagement and education, because it is so important that people make the right choices and end up in the right place. At the moment, our industry is not very good at helping people with that.

John Mason: Is it too simplistic to say that, if someone is in some kind of pool—in what used to be a company scheme or a local authority scheme—where the risk is pooled, that will generally be better for them than just having their individual pot? We have moved to a very individualistic system, have we not?

Ann Flynn: Yes, it is a very individual system at the moment, although if you lift the lid on it, you will find that a lot of people invest in the same fund. There is already a level of pooling, to some extent, and the latest reform proposals are to make the pooling of risk more overt. That makes it safer. However, that runs the risk of having a with-profits phenomenon with people benefiting from being cross-subsidised by others within the pool, so there are downsides, too.

John Mason: Professor Bell, you make a point about what is funded and what is unfunded. If I read your paper correctly, Scottish local government is considerably better funded. You show a figure of £25 billion of assets, I think, and £78 billion in the UK, so we have about a third of all the local government assets. I was quite taken aback to see that. Is that the case? Does it matter whether we are doing funded schemes or unfunded schemes? The UK has a mixture. Do we just live with that, or should we be changing it?

Professor Bell: It is not an easy thing to change. To go to a funded scheme from an unfunded scheme is really difficult. The question is who is bearing the costs. The pay-as-you-go arrangement involves current employees and employers paying the pensions of those who are currently receiving them. In funded schemes, the pensioners have made contributions in the past and, when invested, they generated a fund that, broadly, and perhaps with some support from the taxpayer, repays their contributions, in effect. In general, funded schemes are to be recommended.

You need to think about what the returns on the invested funds are. We have lived through a period when interest rates have been very low, and funds invested in cash or near cash have not done all that well. It is a bit of a trade-off, but the UK turns out to be one of the countries that have done the most towards funding. Early in my paper, I state that the UK has the second largest pension asset funds in the world, following only the US. There is a considerable level of saving—that is effectively what it is—by the UK population, and the Scottish population, in pension funds, which will generate future income.

12:15

John Mason: It used to be the case that Scottish local authority pension funds were better funded as a percentage of their liabilities than the English ones were. Can you confirm whether that is still the case?

Professor Bell: I am not sure what the current position is.

John Mason: That is fair enough.

The final area that I want to touch on is equality between rich and poor. Your paper states that 55 per cent of people in Scotland are saving adequately, which sounds like good news, but I am a wee bit worried about the 45 per cent who are not saving adequately. Where is current UK pension policy going? Is it helping the people at the bottom or are we actually helping the people who have both income and financial education to do better for themselves while the people at the bottom get left behind?

Professor Bell: I am sure that my colleagues will have views on that. Auto-enrolment, which is a major innovation, is bringing more people into the ambit of having an investment in a pension than was previously the case, so that helps the relatively poorly paid to some extent.

Going back to previous questions, it seems to me that at the bottom of the income distribution, where people are not earning high salaries—through globalisation or technical change or for whatever reason—pension provision reflects the level of inequality that exists in Scotland and in the UK as a whole. People in that group are unlikely to be able to save sufficiently to have an adequate pension after retirement, so they will be dependent on the state pension and other benefits.

We should not forget that, in terms of benefits, the past 10 or 15 years have seen the balance of DWP spending move more and more towards pensioner benefits and away from working-age benefits. It tends to be working-age benefits that are really being squeezed. For example, working-age benefits fall within the benefits cap, which the Chancellor recently talked about, whereas benefits for older people have tended to increase. Things such as the triple lock, which some view as unaffordable, will protect those relatively poor pensioners who may not have had the opportunity to save during their working lives, at least post retirement.

John Mason: I understand what you are saying. There has been a bit of a move towards pensioners as a whole. Will the other two witnesses comment on that? Could present pension policy in the UK lead to a widening gap between those who have and those who have not?

Ann Flynn: I have observed over the past two years that there is a specific group of workers who fall within the auto-enrolment regulations—women, and there are not many of us in the room. It is interesting to note that it is mainly women who are part-time workers. They are on lower salaries and they quite often fall below the earnings benchmark for auto-enrolment, so they are not participating in that saving. Employers are obliged to offer them the opportunity to join if they want to, but without the element of compulsion that would make it happen.

I have a genuine concern that we will see a growing problem with women who work part time or who take career breaks still having big gaps in pension provision. I am not sure of the solution, but I definitely think that, if somebody is falling below a certain earnings level, their employer should be asked to consider contributing on their behalf, at least to get them started on the savings pattern. That is an issue that is close to my heart at the moment, as I have witnessed a number of large employers auto-enrolling their staff and seen that the majority of exclusions are women.

John Mason: That is helpful. Thank you.

Chris Curry: To put the matter in context, pensioner poverty in the UK as a whole has dropped significantly in the past 15 years or so, initially mainly as a consequence of pension credit, which helped people who had not done well from either the state pension system or the private pension system. Pension credit was good at bringing those pensioners up out of poverty, at least to a level close to the current guarantee credit level. The single-tier pension that is being introduced and is being set above the guarantee credit level is also likely to maintain that poverty prevention part of the UK pension system. If we look at who really loses out most from the introduction of a single-tier pension, we see that it is people who are relatively consistent high earners throughout their working lives and have built up high second-tier pensions.

The thrust of policy, at least in state pension terms, is to focus resources among lower earners to ensure that they stay out of poverty and to give everybody a flat base. If what you are trying to achieve is everybody having a relatively good standard of living in retirement relative to the standard that they had while they were working, you can get low earners much closer to that goal through the single-tier state pension policy than through the continuation of the previous policy.

However, as both Ann Flynn and David Bell have said, there are gaps. Interestingly, it is probably not the very low earners who are likely to find it hardest to get a decent income in retirement, but people just above that. Work that we have done suggests that they need to save more than the minimum 8 per cent of band earnings contributions in order to have an adequate retirement income. Interestingly, the higher a person’s earnings are, the higher the contributions they need to make, because the flat-rate pension does not reward higher earners in the way that the previous system did. However, higher earners are more likely to be able to afford that. It is probably people who are on high earnings in the middle who will struggle to make the additional contributions that they need to make and will be unable to build up other forms of savings that they can rely on in retirement, so they may have to find other ways.

It could be that, in households containing a couple where one partner is automatically enrolled and one partner is working part-time and is not automatically enrolled, the result will be a reduction in the amount that they have saved. The policy is focused on keeping low earners out of poverty, but there may be more to be done by people just above that level to ensure that they have a decent retirement income.

Jean Urquhart (Highlands and Islands) (Ind): I have two quick questions. One is about the relationship between national insurance contributions and pensions being paid out. Is there, in fact, no relationship there at all? We talk about some people contributing more NICs than the maximum needed to achieve their pension because they work longer, and other people being invited to pay more because they are behind by £3.50 or something, but is that all a bit of a myth?

Professor Bell: There is no fund. There are issues around eligibility. The IFS has criticised national insurance, which has become an income tax in all but name, and the politicians who are unwilling to raise the headline rate of income tax but are willing to make adjustments to national insurance. You might attempt to simplify the way that income tax is set—for example, by making the personal allowance £10,000, which is part of UK Government policy—but the national insurance system, on the employers’ side, is complicated. I hope that someone, whether in an independent Scotland or in the UK Government, might find a way of trying to stop the charade that it is, in some sense, a contribution to people’s national insurance, and present it instead as part of their overall income tax liability.

Jean Urquhart: Small employers would welcome that enormously if it would make their lives much easier than they are the moment, because they have to deal with two different tax deductions.

Professor Bell: I think that that is true. Politicians underestimate how concerned smaller employers are about all such issues, including national insurance and income tax.

Jean Urquhart: Do you have any observations to make on companies that register overseas and are therefore not liable to pay national insurance contributions, despite employing people in this country?

Professor Bell: I am not quite sure what category of company you are thinking about. There have been some well-publicised examples in recent months, when the issue of local taxation liability has come up. It seems to me that the only way to solve that is through a cross-national approach. There must be an agreement whereby tax havens or jurisdictions that are, in effect, being used to create what might appear to most people to be fictional transactions, are outlawed in some way or other, but I am not a tax expert, so I cannot tell you how that might be done.

Jean Urquhart: It seems that in an independent Scotland, difficult though it may be, there would be a real opportunity to redesign the tax system to counter some of the defects that exist and to make it much simpler, despite the complications that are mentioned in various papers, which relate to current practices and the difficulty of extracting responsibilities from the UK system. The present system is not working particularly well. Do you agree that an opportunity exists, even though there would be complications?

Professor Bell: It is clear that there are difficulties with the structure of taxation at the moment. I recommend that people read the Mirrlees report, which was produced by the Institute for Fiscal Studies, although it is a bit technical. It looks at the UK tax system and points out some of the difficulties with it. It considers aspects such as taxation of property, which is rather strange. It also examines how the tax system sets up incentives for individuals and companies to take actions that are about taxation rather than being of economic benefit to the country.

In principle, there would be an opportunity to redesign the tax system. The only thing that I would say is that it could not happen in the short term and that, inevitably, there would be transitional costs in moving from the current system to one that was radically different. It must be borne in mind that a redesigned system would have to pay attention not only to the kind of incentives that would be set up in a Scottish economy, but to any incentives that might affect, for example, migration between Scotland and the rest of the UK. If it appeared that taxes in Scotland had been designed in such a way that they were advantageous, large numbers of people might come to Scotland, which might or might not be a good thing. Alternatively, there could be a flow in the opposite direction.

I guess that I am saying that, in principle, a redesigned tax system might be a good idea, but there would undoubtedly be transitional costs and attention would have to be paid to the tax regimes that close neighbours were operating.

12:30

The Convener: That concludes questions from committee members, but I have a couple of short questions for Professor Bell. In your paper “Funding Pensions in Scotland: Would Independence Matter?”, which was published in February, you point out—as we have discussed—that the UK Government has no plans to vary the state pension age by country and you say that that is “actuarially unfair” to Scotland. Should we have the ability to set our own state pension age?

Professor Bell: That goes back to a question that Chris Curry was asked. In an ideal world—actually, I do not know whether it would be an ideal world—we might like to design pensions so that everyone got an individual assessment of their life expectancy and paid contributions accordingly. That would have to take in a huge amount of issues.

The Convener: You are ducking and diving. I asked you a pretty straightforward question and I was hoping for a pretty straightforward answer.

Professor Bell: The state pension age could be varied by location, but the question would arise whether the pension age should also differ within Scotland. Based on current statistics—as Chris Curry said—that the pension age should, I suspect, be much higher in Orkney than in Glasgow. Other factors also determine life expectancy. Ethnicity tends to be reflected in differences in mortality rates.

The case for what the convener describes can be made, but it is not overwhelming, because it could equally be argued that the state retirement age could be varied in other ways than by territory in the UK. That is my ducking and diving.

The Convener: In that case, why did you say that the position is “actuarially unfair” to Scotland?

Professor Bell: In a sense, it is. An actuary would look at everyone’s individual circumstances and design a pension that was appropriate for each person. A more generous pension might be available to a smoker than to a non-smoker, for example. The statement was correct. The question is whether such a policy would be desirable overall or whether it is simpler for people just to know when they can expect to receive the state pension following their working life.

The Convener: You have done a lot of work on demographic challenges, which we have talked about quite a lot. Scotland does not have a lot of the tools—in relation to immigration, fiscal incentives and so on—to address those issues. If Scotland cannot tackle those issues directly, will the ageing population situation get worse in Scotland relative to the rest of the UK?

Professor Bell: It is true that, when taken at face value, the demographic projections suggest that Scotland will devote a higher proportion of its GDP to supporting older people. That is the case made by the Institute for Fiscal Studies; it involves a raft of assumptions, many of which we have discussed and many of which are contestable.

One of the things that I wonder about and have mentioned before is that the UK is in the most favourable position in Europe, along with Ireland, with regard to the challenges that are associated with an ageing population.

The Convener: Other countries are much worse.

Professor Bell: Yes. Germany, Italy and Greece will face much greater challenges. The long-run projections for the German economy are actually fairly poor, on the basis that, by 2040—I think—for every working person, there will be half a pensioner.

The Convener: Would Scotland be in the better half—the upper half, rather than the bottom half—in terms of demographic projections?

Professor Bell: Yes.

The Convener: Okay—we will leave it there.

I thank our witnesses for their evidence, which has been helpful, and I thank colleagues for their questions.

As we decided earlier, we will take the next two items in private.

12:36

Meeting continued in private until 12:43.

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