The Scottish Parliament
Pàrlamaid na h-Alba

Official Report

FINANCE COMMITTEE

Wednesday 11 March 2015

Session 4

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FINANCE COMMITTEE
9th Meeting 2015, Session 4

CONVENER

*Kenneth Gibson (Cunninghame North) (SNP)

DEPUTY CONVENER

*John Mason (Glasgow Shettleston) (SNP)

COMMITTEE MEMBERS

*Richard Baker (North East Scotland) (Lab)
*Gavin Brown (Lothian) (Con)
Malcolm Chisholm (Edinburgh Northern and Leith) (Lab)
Mark McDonald (Aberdeen Donside) (SNP)
*Jean Urquhart (Highlands and Islands) (Ind)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Jackie Baillie (Dumbarton) (Lab) (Committee Substitute)
Bob Doris (Glasgow) (SNP) (Committee Substitute)
Paul Johnson (Institute for Fiscal Studies)
John Swinney (Deputy First Minister and Cabinet Secretary for Finance, Constitution and Economy)

CLERK TO THE COMMITTEE

James Johnston

LOCATION

The David Livingstone Room (CR6)

Scottish Parliament

Finance Committee

Wednesday 11 March 2015

[The Convener opened the meeting at 09:30]

Decision on Taking Business in Private

The Convener (Kenneth Gibson): Good morning and welcome to the ninth meeting in 2015 of the Finance Committee of the Scottish Parliament. I remind everyone who is present to please turn off any mobile phones or other electronic devices. We have received apologies from Malcolm Chisholm and Mark McDonald. I welcome their substitutes, Jackie Baillie and Bob Doris, and invite first Jackie and then Bob to declare any relevant interests.

Jackie Baillie (Dumbarton) (Lab): I have no relevant interests, convener.

Bob Doris (Glasgow) (SNP): I have no relevant interests other than the information that is already publicly available on the Parliament's website.

The Convener: Thank you very much.

Our first item of business is to decide whether to take item 7 in private. Is that agreed?

Members *indicated agreement.*

United Kingdom Budget

09:30

The Convener: Our second item of business is to take evidence on the forthcoming United Kingdom budget from Paul Johnson, director of the Institute for Fiscal Studies. I welcome him to our meeting—it does not seem like a year since he was last here—and invite him to make an opening statement.

Paul Johnson (Institute for Fiscal Studies): Thank you very much. I will make only a very brief opening statement.

I will start off with where we are on the economy. The economy is growing but, in terms of national income per head, we are barely back to where we were before the recession. We think that, although people's incomes are probably roughly back to where they were before the recession, they have still not reached the peak that they were at in 2009. For all that things are turning up, it has still been a seven or eight-year period that has been almost unprecedented in the sense of the slowness of recovery.

It is that slowness of recovery—and the slowness of growth in income and earnings in particular—that means that we remain in a difficult fiscal position. Our expectation is that this year the deficit will turn out to be around £90 billion, which is roughly what the Office for Budget Responsibility thought that it was going to be back in December, but more than the OBR thought that it was going to be at this time last year and in the order of £60 billion more than was expected back into 2010. That is driven entirely by the slowness of growth in incomes and the corresponding slowness of growth in tax revenues.

That does not leave the Chancellor of the Exchequer with a great deal of room for manoeuvre in next week's budget. There has been a bit of speculation that he might have money to spend, but I cannot see where that money would come from. Because inflation is extremely low, he will be spending less on debt interest over the next year than he expected, but if he is to behave in a way that is symmetric with how he behaved when things were getting worse, when he did not tighten the fiscal numbers, it would be very odd for him to loosen them in a year in which things look as if they might be getting just a little bit better.

As far as the sets of things that the chancellor could do in the budget are concerned, if he wants to give money away, he will have to take money away from somewhere. We are in the run-up to the UK general election, so it is worth thinking about a set of other options in the longer run. An issue that I am sure we will come on to is where the various parties' spending plans take them and how that relates to the figures in the autumn statement. The figures in the autumn statement clearly imply that there will be some really dramatic spending cuts over the next four or five years, but it is not clear that any of the main parties is properly signed up to those spending cuts. That creates a degree of confusion about where we will end up. If we go down that road, we have an awful lot of cuts to come. The numbers in the autumn statement are consistent with cuts of 40 per cent in unprotected departments over the period from 2010 to 2020; that is the scale of the change that they imply. My guess is that that is not what is going to happen, because it is not clear that anyone is fully signed up to that.

Whichever way we go after the election, it will be a difficult few years. All the parties seem to be signed up to the cuts in 2015-16. Exactly how deep those cuts will be is something that we will learn in the budget. Significant cuts were planned for 2015-16 in real terms, but because inflation has been so much lower than expected, real-terms cuts in public finances are currently less dramatic than originally planned. We should look out to see whether the chancellor decides to take some more cash away to achieve those cuts.

If we follow the minimum set of cuts that appears to be consistent with what the Conservative plans look like after 2015-16, it is clear that most departments would face substantial additional cuts. If we consider what Labour is planning, the cuts are significantly smaller than those implied by the Conservative plans, because the Conservatives are looking for an overall budget balance, but Labour is looking for a current budget balance, which gives it £25 billion or so of additional room for manoeuvre. The flip side of that is that, if we follow the Labour plans, we will end up with somewhat more debt and borrowing at the end of the Parliament.

That is where the big fiscal choices, and indeed the big political and general election choices lie. I am happy to follow up on any of that.

The Convener: Thank you. You have appeared before the committee before, so you will not be surprised that I will open with a few questions ranging across several areas, which my colleagues will no doubt want to explore in greater depth as we progress.

You touched on the issue of borrowing. You have basically said that only Japan will have higher structural borrowing than the UK in 2015, despite the UK having carried out the seventh largest fiscal consolidation since the crisis began. Is that because the Government has been unable to reach its growth targets? What is the reason for that state of affairs?

Paul Johnson: Essentially, it is because growth, over the Parliament as a whole, has been so much less than originally hoped for. The Government has responded to that not by imposing additional spending cuts or tax increases; it has kept to the spending and tax rates that it originally planned back in 2010—things have been moved around a bit, but the overall effect has been the same—in the face of a much worse fiscal situation. To some extent, the Government has kicked the problem down the road.

The other thing that we say is that, over the next four years, we have the biggest planned fiscal consolidation in the Organisation for Economic Co-operation and Development. Relative to the size of our original deficit, we have had a relatively restrained fiscal consolidation over the past five years but, because of that, we have the biggest planned consolidation over the next five years. That is all being driven by, as you say, lower growth, and the response of the Government, which has not been to tighten further in response to that but to say that it will tighten further later on.

The Convener: Yes, so it is postponing some of that pain, in effect.

Last year, we discussed productivity and you said that the key puzzle is why productivity has fallen so much. Do you have any more answers to the puzzle of productivity, which is a great concern? If productivity were to increase, that would resolve many of those issues, at least to some extent. Do you have any answers on the relationship between productivity and pay and on why productivity has not improved as one would expect at this point in the cycle?

Paul Johnson: I probably do not have any more answers than I did last year. You are right to raise the issue again. The very poor productivity performance has been behind the very poor level of earnings growth, which in turn has been behind the very poor level of economic growth and the fiscal situation.

We do not know more than we did a year ago about what is driving that. It is clear that there is a role for the financial sector and the way in which it remains difficult for new businesses to get hold of finance while it has been relatively easy for existing businesses. That is clearly related to some extent to the high levels of employment growth, because a lot of that employment growth has been in relatively low-paid or low-productivity work.

The labour force is significantly better educated than it was seven or eight years ago. The proportion of the labour force that is graduate has grown significantly. The overall distribution of where people are working shows that there has not been a shift to less highly skilled or less productive industry. Most of that shift appears to have happened within industries.

There has certainly been a fall-off in investment in machinery and technology and so on, which impacts on productivity. A lot of new people are moving into the labour market, which also impacts on productivity. What is happening in the financial services sector also has an effect. The fall in productivity is probably a result of bits of all those things, but there remains quite a puzzle on top of that.

The Convener: In your analysis of the global economy, you talk about a

"widespread retreat from risk by investors, resulting in a considerable decline in asset prices"

In looking at the UK, you also say that

"the biggest threat would be a widespread retreat from risk, which could push the UK back into recession in late 2015."

How big a threat to the UK economy is the reduction in people wanting to take risks and go forward with investment plans?

Paul Johnson: It is worth saying that those are the words of Oxford Economics rather than the IFS. The view of Oxford Economics is that the risk is relatively small; it does not see that as anything like the most likely outcome. Indeed, the revised Office of National Statistics figures show that investment looks like it has picked up during the past year or two.

We remain in an extraordinary world in which interest rates have been at their lowest level ever now for five or six years and we have hundreds of billions of pounds in quantitative easing. This country and most other countries have very big deficits, but the return on that debt is extraordinarily low, which itself indicates the desire of investors to invest at a relatively low-risk level. Even given the debt, they see Government gilts as low risk and worth investing in, despite the low returns. That tells us something about the extent to which they do not have confidence in what is happening in the rest of the economy. In an odd way, it will only be when we start to see a growing return on some of that debt that we will know that investors are becoming more confident in investing in the real economy. The fact that so much money is pouring into Government debt, even when returns ought to be high but are not, is an indication of the difficult position that we remain in.

The Convener: How much money do large businesses have in cash stockpiles? You have touched on that over the years, saying that a lot of businesses have got money but do not necessarily want to risk spending or investing it because of their concerns about the long-term economic future.

Paul Johnson: There is still a lot of money in the corporate sector. Some of the numbers that were being talked about a couple of years ago have been revised down a lot because of problems with ONS figures. Nevertheless, the figure is in the hundreds of billions of pounds. With respect to your previous question, that is evidence of the continuing relative lack of confidence in being able to invest that effectively. One of the difficulties with all this is that the situation is not as dramatic as it was thought to be a couple of years ago, because the ONS has pretty substantially changed its view of history in terms of the amount of money that the companies had and, in a positive direction, of the amount of investment that they have been making during the past few years.

The Convener: Of course, confidence is critical because people need to invest to stimulate growth, but if they do not think that there is going to be growth, they do not necessarily invest, so we end up with a non-virtuous cycle.

Paul Johnson: Yes. Who knows whether they will be right, but there is a remarkable degree of agreement among the economic forecasters that the UK will grow at the rate of 2 to 2.5 per cent during the next several years. That means that we have pretty much lost for ever everything that was lost in the crisis and the years following it. Nobody is really predicting 3 or 3.5 per cent growth for several years, which would enable us to catch up on what we lost.

09:45

Secondly, there is clearly a lot of concern about what might be happening in the international markets and the eurozone in particular, and the effect that that might have on the UK in the short run if things start to go wrong there. There remains a lot of risk out there.

My perception of the forecasts for the UK economy is that there is a remarkable degree of consensus about a reasonable and steady recovery over the next few years.

The Convener: I was quite interested in your comments about the perspective of the Institute of Chartered Accountants in England and Wales on the whole-of-government accounts. John Mason is an accountant, so I know that he will be particularly excited about that issue. In 2012-13, the accounting deficit of £179 billion was £94 billion more than the current deficit of £85 billion that is reported in the national accounts. Can you talk us through the implications of the change?

Paul Johnson: The ICAEW has considered the public finance figures in a different way from the standard national accounting framework. If you do that, you learn some interesting additional things about the level of commitments and the change in those commitments.

By far the biggest of those commitments concerns commitments to public service pension payments. Certainly, if you look at the overall debt in terms of the balance sheet, you see a very large number in there for future commitments to public service pensions. Those are legally binding commitments in some sense and, therefore, they ought to appear on the balance sheet. There are other things in theatre such as private finance initiative commitments and contracts and nuclear decommissioning. There is a set of things in there that we ought to be thinking about and worrying about. Those numbers change year by year, particularly on the pensions side, because of changes in expected longevity or in the discount rates. One ought to be taking account in some sense of how that level of future commitment changes.

One of the difficulties in interpreting the figures is that you have to put a brake somewhere on what you consider to be absolute commitments. Public service pensions are in those numbers, but state pensions are not. That is because the legal commitment to state pensions is of a different kind from the one that there is to public service pensions. PFI contracts are in there in full, although, in some sense, you could probably renegotiate some of those or chop them and pay people earlier. Elements such as the NHS budget or the education budget are not in there at all, yet, actually, the implicit commitment is so strong that they perhaps ought to be. On the other hand, Government is different from any company, in that it has a permanent capacity to tax its citizens as much as they will allow themselves to be taxed. You might want to put that in on the positive side of the balance sheet, but that is not how those rules work.

As long as one understands the limitations of the process and is clear where the line is drawn between things that are put into the balance sheet and things that are not, it is a useful piece of additional information.

The last thing that I would say on that is that the Office of Budget Responsibility's long-term finance forecasts, which consider pension commitments, health service commitments and tax receipts down the road, consider essentially the same kind of information but in a cash-flow, year-by-year way, which is another useful way of thinking about the scale of commitments that we have in the future and our capacity to fund them.

The Convener: Fascinating stuff, I must say. Of course, one of the things that form the meat, politically, in "The IFS Green Budget" is the option for further departmental spending cuts. You point out that

"Coalition government plans imply real departmental spending cuts of 9.5% between 2010–11 and 2015–16."

You go on to say that

"The 2014 Autumn Statement plans imply real cuts to departmental spending between 2015–16 and 2019–20 of 14.1%."

That basically means deeper cuts over a shorter period. What are the implications for Scotland of those cuts, assuming that they are rolled forward?

Paul Johnson: Most of those cuts flow directly to Scotland through the Barnett formula. Because of the way in which the Barnett formula interacts with revenues from business rates, until now the impact on Scotland has been a bit less than the impact on England. We have not worked through the exact Barnett consequentials of those changes but, broadly speaking, one would expect that they would have a similar effect in Scotland to the one that they have on the rest of the UK.

The Convener: The Office for Budget Responsibility has forecast that the cuts to departmental spending could lead to some 900,000 job losses in the public sector up to 2020. Obviously, that relates to the autumn statement. I take it that a number of scenarios could be painted. What is your view on those figures?

Paul Johnson: Our calculations, on the same basis as the OBR's, come up with similar results. It is hard to see how we can make cuts of such a scale in public spending—and public service spending at that—without making big cuts in the number of people employed. After all, the workforce is 60 or 70 per cent of spending on public services. We cannot make big cuts in public service spending without making cuts in the workforce, unless we can hold pay down to a remarkable extent. There is obviously a trade-off. If we have a certain amount of money, we can spend a certain amount on the pay bill, which means more people on less pay or fewer people on more pay.

One thing that will make all those figures even more difficult to achieve over the next five years than they have been over the past five years is that, over the past five years, pay in the private sector has done extraordinarily badly, which has made it relatively easy to hold pay down in the public sector. For the first few years of this Parliament, public sector pay was high relative to private sector pay, because private sector pay fell so quickly at the beginning of the recession. Public sector pay has fallen much more gradually. Public and private sector pay levels are now pretty much back to their relativity pre-recession.

If private sector pay continues to grow, as we expect and hope that it will, it will be quite hard for public sector pay to be held back indefinitely. That might be possible for another year or two, but not indefinitely, because then we would start paying public sector workers significantly less than what is available in the private sector, which is not easy to maintain in the long run.

We are then left with a world in which, if we need such spending cuts, the only option is to reduce the number of public sector workers. Large numbers of public sector job losses are the most likely outcome that is consistent with the scale of the cuts that the autumn statement suggests. I am sure that we will come on to the issue of whether those cuts are likely to happen. I suspect that they are less than 50 per cent likely to happen, even under a Conservative Government.

The Convener: Why do you feel that to be the case?

Paul Johnson: For two reasons—because the cuts are extraordinarily hard to achieve and because it is not clear that the Conservatives are fully signed up to the numbers in the autumn statement. They have said that what they want to achieve, in terms of their fiscal targets, is a budget balance, not a surplus of 1 per cent of national income. The chancellor said in front of the Treasury Select Committee words to the effect that he felt that he could use some of that planned surplus as a buffer for tax cuts or easing some of the spending cuts that are implied.

One difficulty in looking ahead is that I do not know exactly where the Conservatives are on that. I do not know exactly where Labour is on the speed at which it aims to achieve its current budget balance. However, we know that there is a difference between the parties.

The Convener: Indeed. We touched on productivity, and you have talked about the impact on pay in the NHS. Something like £30 billion is required for enhanced NHS productivity if we are to continue to deliver the services that will be required because of additional pressures and so on.

You are saying that an issue in the NHS—specifically in England and Wales—is that, if salaries are not kept relatively close to private sector growth, there could be difficulties in attracting and retaining staff who are well trained, well educated and able to deliver. Is that correct?

Paul Johnson: Yes—that is true across the public services. You cannot allow pay and conditions to get significantly out of line with those in the private sector and expect to continue to recruit and retain people of the quality that is wanted. That is one of the difficulties of funding public services such as the NHS into the long run, because we know that measured productivity in the NHS does not grow as quickly as measured productivity in the private sector, although we have to increase earnings consonant with earnings in the private sector if we want to continue to attract people of similar quality.

The Convener: And keep them motivated.

Paul Johnson: Indeed.

The Convener: You are looking at the options for reduced spending on social security, all of which appear to be fairly unpalatable, as I am sure most people would agree. There is an implied concern that the protection of social security spending on pensioners means a particularly disproportionate impact on people of working age. Will you talk us through some of your thoughts on that?

Paul Johnson: The Conservatives have said that they are looking for £12 billion of cuts in the social security budget. That could be thought of as £12 billion out of £220 billion, which is the entire social security budget, but they have also said that they want to fully protect pensioner spending, so it is actually £12 billion out of the £90 billion or £100 billion that goes to non-pensioners, and that is more than double the proportionate effect on that group.

There is an arithmetic effect. If £12 billion is taken from £220 billion, that is 5 per cent, but if £12 billion is taken from £90 billion, that is 13 or 14 per cent. Arithmetically, the change is more difficult to achieve if spending is taken from only one part of the budget.

In addition, the non-pensioner social security budget is more focused on those towards the bottom of the income distribution. The large majority of it is means tested or goes to people who are sick and disabled, so it is pretty difficult to take money away from anyone else through the social security budget, other than through what is left of child benefit.

The Convener: What is the logic for the Government's view on that, other than electoral reasons? Why has it decided to focus on one group of people who receive social security payments?

Paul Johnson: I cannot comment on the political element. Two things might be thought. One is that, once people are significantly past pension age and are retired, they cannot do much to change their income, so a cut that is imposed at short notice is not something to which people can respond easily once they have hit pension age. There is certainly a strong reason for not doing anything dramatic to the incomes of people who cannot do much to respond, particularly if they have arranged their affairs over a long period in order to meet what they are expecting from the state. However, policy has changed quite a lot in that area. If someone wanted a rational reason for protecting pensioner benefits, they would use that one.

With respect to those below pension age, two things are worth noting. Although there have been significant cuts under the current Government, for significant groups of the population the system is still much more generous than it was at the end of the 1990s. We still have a significant tax credit system that is much more generous to low-income families with children than was the case even back in 2001 or 2002. It is always important to be clear about the baseline that we are comparing things against.

We then have the difficulty of controlling budgets such as the housing benefit budget, in which, despite significant discretionary cuts in the generosity of housing benefit, real spending has continued to rise, because rents have risen and incomes have been so low. The truth is that the Government has found it difficult to reduce spending on social security over this period, because there are continued upward pressures.

10:00

The Convener: You say:

> "Giving exemptions from cuts for groups deemed more vulnerable can weaken work incentives and strengthen incentives for people to have children or claim disability benefits."

Paul Johnson: That flows from the nature of the system. If we have a means-tested benefits system, we increase the incentive for people to take those benefits and not work. How important those incentives are is open to considerable dispute. For most groups, they are probably not terribly important, but they are there in the system.

The Convener: You also say:

> "Many of the policies suggested by the Conservative and Labour parties—withdrawing winter fuel payments from higher- and additional-rate taxpayers, cutting housing benefit for young people, reducing the benefit cap, and increasing child benefit by 1% for a further year—would reduce spending by relatively little."

How much are we talking about, compared with the overall picture of social security?

Paul Johnson: This is an important part of the debate about cuts in social security spending. If we take as examples some of the things that the Government has done, the so-called bedroom tax or getting rid of the spare-room subsidy for social tenants saved a small number of hundreds of millions of pounds, and capping benefits at £24,000 per household has saved maybe £100 million. There have been £17 billion of savings, most of which have come through freezing benefits and reducing the rate at which they go up, first from the retail prices index to the consumer prices index and then to 1 per cent. An important part of the political debate is that the things that have got the headlines, such as the bedroom tax and the cap, have saved very little compared with the total savings, which have been spread across much broader sets of people and have been slightly more hidden.

If we are looking at having a sensible debate, it is odd to suggest that we would save a measurable amount of money by taking winter fuel payments from higher-rate tax-paying pensioners, because we would not. We would save at most £100 million or so, which would almost be lost in the roundings when we are looking at a £220 billion budget. Increasing payments by 1 per cent when inflation last September was 1.2 per cent clearly does not save very much. If we increased them by 1 per cent when inflation was 3 per cent, that would save a great deal more.

It is important to have a sense of scale. The Conservatives say that they want to save £12 billion. They have told us how they will save £1 billion or £1.5 billion of that—by the 1 per cent indexation—but they have not told us where they will get the other £10 billion from.

The Convener: It is interesting that you say:

> "Introducing a separate 'mansion tax' would be unnecessarily complicated when council tax could be brought up to date and refocused on higher-value properties."

Paul Johnson: There is a significant problem with the way in which council tax works, in that it is based on values back in 1991 and it is regressive, because the amount that people pay goes up less than proportionately to the value of their house and is capped.

In a sense, the proposed mansion tax would layer on top of that something that got rid of some of the regressivity for a group of houses at the top end of the distribution. That would help a bit, but we would have a more complete reform if we revalued all properties and charged council tax as a flat-rate proportion of the value of the house, rather than at a rate that falls as the house becomes more expensive. We could do that in all sorts of ways, and that would have a different distributional effect from simply sticking a mansion tax on top. In a sense, we can think of a mansion tax as sticking additional bands on top of the council tax system.

The Convener: I will ask a question about one more area and then let colleagues in. You say in your green budget:

> "while there are sensible ways to raise more revenue from the taxation of pension saving, the widespread

proposal to restrict income tax relief on pension contributions to the basic rate is misguided."

Why do you feel that to be the case?

Paul Johnson: There are significant problems with the taxation of pensions. There are extremely generous elements in what might be thought of as a neutral system, but the income tax treatment of pension contributions is not one of them. A long-standing view of most economists is that an appropriate way of taxing savings is to tax them once. In other words, people would save from their pre-tax income and pay tax on it later—say, in retirement.

To tax savings twice disincentivises saving and creates quite a lot of complexity. From that point of view, the income tax system treats pensions in a pretty sensible way. A lot of the numbers that are bandied around about the costs of that are somewhat misguided, because taxing money that goes in now means that tax revenue is lost in the future. The position also depends on what the system is being compared with.

However, two very big elements of the pension tax system are extraordinarily generous. First, if someone has enough money in their pension, they can take a lump sum of more than £300,000 tax free—and that is money that no tax has ever been paid on. Now that people do not have to buy annuities, it is hard to see why we would incentivise in that way.

The other extraordinarily generous element is the treatment of employer contributions, which do not attract any national insurance contributions when they go in or when they come out. They are entirely exempt from NI contributions; on the other hand, employee contributions are not. That is probably why about 70 per cent of contributions come from employers. People might well want to change that by, for example, putting an additional national insurance surcharge on pensions in payment that could be gradually increased over a long period or by putting the whole surcharge on up front.

However, our main point is that, if there is any problem with the taxation of pensions, it is probably not with the income tax treatment up front but with the income tax treatment of lump sums and the national insurance treatment of employer contributions.

The Convener: I had said that that was my last question, but I will exploit my position as convener and ask one more before I let colleagues in.

On additional fiscal consolidation, you talk about the proposal for about 2 per cent to come from net tax rises and 98 per cent to come from spending cuts while, in the current Parliament, the split has been 18 per cent from tax rises and 82 per cent from cuts. I know that you do not want to get too much into the politics of the issue, but is such a balance reasonable or sensible from an economic point of view?

Paul Johnson: There is a choice to be made. Up to a point, people can see why a significant majority of the consolidation would come from spending cuts. If, for example, the split had been 60 per cent from spending cuts and 40 per cent from tax increases, spending would have been ratcheted up as a proportion of national income. If the aim was to get back to pre-crisis levels of spending as a proportion of national income, the majority of that work was always going to have to be done through spending cuts.

Meeting all the plans in the autumn statement through spending cuts will bring us back not just to pre-crisis levels of spending as a proportion of national income but to very low levels of spending as a proportion of national income—indeed, perhaps the lowest since the last war. There is a big choice about the size of the state to be made. If a Government wanted to have a surplus of 1 per cent of national income, as the autumn statement numbers suggest, and to return the state to roughly its size in the 1990s and 2000s, it would have to do more through tax and less through spending than the numbers in the autumn statement suggest.

The Convener: Do you believe that the chancellor is planning a fundamental reimagining of the role of the state?

Paul Johnson: I do not know. I genuinely think that to impose an additional £50 billion of spending cuts, which is what the autumn statement numbers imply, will be extraordinarily difficult, particularly if spending on health, pensions, schools and so on is to be protected. For unprotected departments—those concerned with defence, transport, the environment, the police, justice and so on—that would imply average cuts of 40 per cent between 2010 and 2020. That seems like a set of very big cuts.

The Convener: Jean Urquhart has some questions.

Jean Urquhart (Highlands and Islands) (Ind): There is a general feeling that we would like to get to a fairer society. Reading the submission, it does not seem to me that that kind of discussion has driven anything in the budget. You have just said that there was an "extraordinarily generous" approach to people who have more than £300,000 in a pension fund. It seems that that generous approach has been taken only to those who can afford things, yet the hardest cuts have fallen on the savings of others. We know that 20 per cent of the poorest people in the country have less than a week's income in savings to spend.

On the idea of increasing income tax, national insurance or VAT by 1 per cent, you say:

> "Increasing any of these would weaken work incentives".

Would you say that, currently, work incentives are already weakened for those who are on the lowest earnings, yet we see no concentration on any suggestion of increasing the minimum wage to compensate for the fact that we may be raising tax levels? Indeed, do you agree that the people at the lowest end should be exempt from paying any tax?

Paul Johnson: You raise quite a lot of issues. What you say about work incentives is correct. The biggest issues are for those on the lowest wages and the lowest incomes, because of the way that the means-tested benefits system treats people. It is hard to avoid such things. If you are going to give money to people when they are out of work, you can either take it away very quickly when they move into work, which has a significant work disincentive effect on a relatively small group, or you can take it away much more slowly, which gives you big marginal tax rates much further up the distribution.

We have shifted that quite a lot in the past 15 years, with the introduction of in-work tax credits, which give people a significant additional incentive to move into work. However, when the tax credits are taken away as their earnings rise, that gives them what is very often an extremely small incentive to increase their hours of work, which is why we see a lot of people working exactly 16 or exactly 24 hours, because that is exactly where the incentives bite. You can see very clearly that that is what people do.

If you look at the plans for universal credit—of course, I do not know whether it will come in eventually—you will see that a slightly different view is taken. Universal credit does not give people a clear incentive to move to 16 or 24 hours of work, but it gives some incentive to work 5, 10 or 15 hours, because it gives people an amount that they can earn before anything is taken away; it is then tapered away slightly more gradually than is the case under the income support system. There is a judgment to be made about whether that is the most effective way of handling work incentives.

With regard to fiscal consolidation overall, and thinking about the fairness issue that you raised, a particular pattern arises with regard to who has been affected by the changes since the recession of 2008.

There have been cuts in working-age social security benefits. People at the bottom end of the working-age distribution have lost out, whereas people in the middle to upper-middle part of the distribution have lost remarkably little. On the whole, they have been protected from tax and benefit changes, largely because a huge amount of money is being spent on increasing the personal allowance, which has largely helped people in the middle and upper-middle part of the income distribution.

There have been a series of quite big tax increases that have hit people at the top of the distribution. They have lost most, not just in cash terms but as a proportion of their income. I am talking about the top 5 per cent or so of the distribution. We have hit the bottom, through social security cuts; we have largely protected people in the middle and upper middle; and we have taken a large amount away from people right at the top.

10:15

Jean Urquhart: The understanding society policy unit at the Institute for Social and Economic Research revealed that, on average, the top 20 per cent have improved their wealth by 64 per cent. That is extraordinary; it is rather more dramatic than you suggest. They are currently much better off in terms of savings, job security, pay rises and so on. They may be paying slightly more in taxes, but they are still, since before the recession, gaining at an extraordinary rate.

Paul Johnson: What period does the 64 per cent refer to?

Jean Urquhart: That is from 2005 to 2013.

Paul Johnson: I am not familiar with that particular piece of work, but my guess is that that is largely driven by house prices over that period. Since 2005, there has been increase in asset prices, including house prices, which means that owner-occupiers who are holding assets will have seen significant increases in their wealth over the period. It does not surprise me that owner-occupiers and those who have wealth in individual savings accounts, pensions or what have you have gained from increases in asset prices. It means that that group will have been getting better off. Clearly, at the bottom end of the wealth distribution, the half—or so—of the population who have very little in the way of assets will not, in absolute terms, have seen the same growth in their wealth.

It is worth adding that if you look at wealth in particular but also income, there has been a real difference by age or generation. The groups that have gained most here are the older groups. Those over 60—and particularly those over 65—have seen their income grow since 2008, while everyone else has seen their income shrink. Wealth is very much concentrated, as you would expect, among those over 50 and 60 as they head towards retirement. Earlier cohorts will not end up with the same amount, unless through inheritance.

The number of homeowners in their 20s and 30s is much lower than a generation ago. We have halved the number of people in their 20s who are homeowners, relative to a generation ago. There are no occupational pensions, outside the public sector, for people who have entered the labour market in the past 10 years or so. The distribution by generation has changed, or is changing, quite significantly.

Jean Urquhart: Do you agree that, according to your analysis, there is not much hope for changing that?

Paul Johnson: For changing what?

Jean Urquhart: That situation.

Paul Johnson: For the different generations?

Jean Urquhart: I mean the situation in which the people at the top end of the earnings scale are getting richer and the people at the bottom are getting poorer.

Paul Johnson: I would not say that there is not much hope. If we look at the period since 2008, income inequality has not increased, partly because earnings have done so badly. Earnings at the top have done quite well—let us be clear about terms here: I say "the top", but we do not know much about the top 1 per cent, although we know that the earnings of the 9 per cent below that have grown less than average earnings over the period. Up until now at least, benefits have risen somewhat faster than earnings. That is mostly a reflection of how very badly earnings have done over that period.

In the UK, there was a massive increase in income inequality during the 1980s. From 1990 to 2008, not much changed across most of the distribution, as far as inequality was concerned, although the top 1 or 2 per cent continued to race away. Over the 2000s, inequality reduced a little bit, if anything, among the bottom 98 per cent, while the top 2 per cent raced away even further.

Since 2008, there has been a slight compression in distribution in the bottom 99 per cent, although it has essentially been flat. We do not really know what has happened to the top 1 per cent over that period. Inequality now, certainly across the 99 per cent, is roughly where it was at the end of the 1980s. There has not been much change in inequality other than for that top 1 per cent over the past 25 years.

Jean Urquhart: You said that hundreds of billions of pounds were resting with business, given the lack of confidence in investment and so on. What is the nature of the reluctance to spend some of that money on abolishing zero-hours contracts and increasing the minimum wage? Although businesses generate money, there is no obligation to pay people at the bottom end better salaries so that they can get over the 16-hour threshold or curb, at which everything kicks in and people are worse off if they work beyond that level.

Paul Johnson: The decision on the minimum wage is taken by the Low Pay Commission, which takes a view on how much it thinks the minimum wage can be increased by without having an impact on employment. It is incredibly difficult to make a judgment about the point at which raising the minimum wage starts to have an impact on employment. The minimum wage has risen more quickly over the whole period than average earnings, which, again, is a reflection of how badly average earnings have done. There may well be scope for further increases, depending on one's view about what impact that might have on employment levels.

Gavin Brown (Lothian) (Con): I start by referring to something that Jean Urquhart asked about late on in her questioning. In your response to a question about inequality, you said that, since 2008, inequality has not increased, and that, if anything, there has been a slight compression, but that it is broadly flat. That is slightly different from what we regularly read in the media. What is your data source or your back-up for that statement?

Paul Johnson: The information about the period 2008 to 2012-13 comes from data on households below average income and is based on a big survey called the family resources survey, which is produced annually by the Department for Work and Pensions.

We have forecast to the current day from the 2012-13 numbers on the basis of what we know from other surveys has been happening to earnings, to the distribution of earnings, to tax and to the benefits system. Therefore, we can give a pretty good sense of where things have changed over the two years since the most recent official figures came out. They show broadly what I have suggested.

Over the period to 2012-13, there was a significant compression in inequality, partly because benefits were rising quite a lot more quickly than earnings, and earnings were falling so much, relative to inflation. Over the two years since then, it has opened up a bit, as benefits have been doing worse than earnings. If we take the period as a whole, there is something close to not much change in the overall level of inequality, although there is perhaps a little bit of compression.

The broader story over 25 years, following the massive increase in inequality in the 1980s, is one of small ups and downs since then for most of the population, but the top 1 or 2 per cent have really been racing away. I cannot tell you much about what has happened to the top 1 or 2 per cent, partly because HM Revenue and Customs has not made available data for the past four or five years that would allow us to do that.

Gavin Brown: You said that you do not think that the chancellor has a huge amount of room for manoeuvre next week, but if you were a betting man—

Paul Johnson: I'm not. [*Laughter*.]

Gavin Brown: I am not suggesting that you are, but what sort of things do you expect to see next week? Is the IFS looking out for anything in particular?

Paul Johnson: As I have said, an awful lot is happening already, and I expect to hear some re-announcements of things that have already been announced. Some of the main things that are due to happen in April anyway include quite a big increase in the personal allowance to £10,600; 1p off the main rate of corporation tax, bringing it down from 21 to 20 per cent; the introduction of the transferable allowance between husband and wife in circumstances in which neither is a higher-rate taxpayer and one is not using their full allowance, which will represent a small gain to a small proportion of married couples; a freeze on fuel duties; and the Google, or diverted profits, tax. All those have been announced, so even if the chancellor said nothing next week, there would still be a lot of changes happening in the tax and benefits system in April.

What else might the chancellor do? As I have said, he might decide to impose greater cash spending cuts on departments for the next financial year than are currently planned, because inflation is so much lower than expected and therefore the planned real cuts are less than was initially intended. If he were to increase those cuts by, say, £1 billion or £2 billion, he might decide to give that money away in, say, a further increase in the personal allowance or what have you.

The coalition agreement explicitly says that there will be no cut in inheritance tax until the personal allowance reaches £10,000. The personal allowance has now reached that threshold, and given that the Conservative manifesto included a commitment to reduce inheritance tax, the chancellor might decide that this is the time to make good on that commitment. However, we should note that he previously made it clear that the inheritance tax threshold will stay where it is until, I think, 2017, so any move to reduce the tax would be a bit of a reversal. As an aside, I point out that although inheritance tax has gone up under this Government, in that the threshold has been held constant in nominal terms, it was very substantially cut by the previous Government, which one might describe as political topsy-turvy.

The chancellor might also decide to do something political. Labour has announced a £3 billion increase in pension taxation to pay for its cut in student fees, and the chancellor might say, "Well, I'm going to use that money to increase the personal allowance."

Those are the sorts of things that the chancellor might do, but no doubt he will do a bunch of other things that I have not thought of.

Gavin Brown: In response to the convener, you talked about borrowing for this financial year being, I think, £60 billion more than had initially been planned in the emergency budget back in 2010. Obviously, a number of things have happened since then. Some people will say that borrowing is higher because growth has been lower. Growth has certainly been lower, but some have said that that is because the Government is reducing spending too fast, too deep and too quick. On the other hand, others will point to the huge spike in commodity prices that happened around about 2011, or the euro crisis and the six quarters of retraction that most of our trading partners experienced. Does the IFS have an official view on or analysis of what happened, or do you just report on the figures? Do you have any reasoning that might explain why things are different from what was projected or hoped for in 2010?

Paul Johnson: We do not carry out our own macroeconomic analyses, but I can say that all the things that you have mentioned are part of the story. A big reduction in Government spending has clearly had an impact on growth in the short run; what was going on in the euro zone has clearly had an impact; and what happened to commodity prices has clearly had an impact, although one has to hope that things will move in the other direction now that oil prices are so low.

All those things have had an effect, but it is pretty clear that, had the Government imposed less austerity and had we had a little bit more growth our deficit would be bigger than it is at the moment. We might have had a slightly bigger economy, but I find it implausible that the multiplier would have been so big that we could have increased spending and reduced borrowing. We probably would not have increased borrowing by as much as we had increased spending, but we would still have increased it.

Going back to my initial answer, I think that a series of things created lower-than-expected growth, including the overhang from a financial crash, which tends to have longer-term consequences than I think people realised back in 2010. The Government is now borrowing more because it decided to put off the consequences of such austerity until later instead of making further spending cuts earlier.

10:30

Gavin Brown: You are clear that all those factors played a part, but has the IFS done any work on the relative impact of each of those measures?

Paul Johnson: No. I think that the OBR has done that work; in particular, it has done some quite interesting analysis on why it got its forecasts wrong back in 2010. I cannot remember the relativities, but that work gives some sense of what the OBR thinks were the important factors and highlights all the issues that you have raised.

Gavin Brown: I have dealt with the first couple of chapters of your green budget, but chapter 4 focuses on the prospects for the UK in the coming year or couple of years. The pattern of unemployment in the UK is very different from that of most countries in the euro zone—Germany is obviously an exception—and although it is higher than anyone would like, the rate of unemployment is still a lot lower than most of those countries. Why is unemployment in the UK so different from other European countries?

Paul Johnson: There are clearly one or two countries that have had an even bigger demand shock than we have had; the bigger economic shock that, for example, Spain and Greece have had has had a bigger effect on their employment levels.

Your question raises one of those issues in which it gets very difficult to sort out the direction in which causality is moving. The fact that wages have stayed low has made it easier for firms to hire people on relatively low wages, but equally the fact that there has been a big effective supply of labour has made it easier for those companies to keep wages low. It is quite difficult to determine which way that causality runs.

To some extent, we have a labour market that allows such changes more easily than the labour markets in some other countries do, and allows firms to reduce pay relatively significantly, particularly for younger workers. Firms have reduced younger workers' pay a lot, which is good in the sense that more people can get into work but bad in the sense that those who are in work are doing rather badly. Over the past 20 years, Governments of both complexions have changed the benefits system to help people into work through Jobcentre Plus and so on, to push them into work by ensuring that they can lose benefits more easily if they do not move into work and to give them incentives to go into work by giving them tax credits.

There are also more part-time jobs. As we say in our green budget, although the employment rate is back to where it was in 2008, the underemployment rate remains higher than it was. Quite a large proportion of people who are in part-time jobs are saying that they would like to work more hours, which is different from the position that we used to be in. Finally, there have been increases in self-employment at what appear to be low levels of pay.

As with all these things, there are multiple aspects to what has happened, some of which are to do with long-term rather than short-term Government policy, the structure of the UK labour market, the scale of demand shifts and the flexibility that individuals have shown in feeling that they have to, or in being willing to, take jobs.

Gavin Brown: In the same chapter, you talk about business investment. I think that there is a desire in all political parties for more such investment, as it will lead to a longer-term and more sustainable recovery than a reliance on consumer spending. What is your prediction? Do you think that we will see a big increase in business investment? I guess that it is one area that has been a little disappointing in the past three or four years. Are you more confident about that for this year?

Paul Johnson: We do not really make forecasts for that. One thing that is clear is that it has not been as bad as it looked. The ONS has changed its view of history dramatically in the past four or five years and business investment has not been quite as bad as was previously thought. Clearly, for the recovery to continue, business investment will have to grow somewhat faster, which will depend on a host of things happening in the economy, partly to do with the tax system. Some of the changes to the corporate tax system over the past few years have not improved incentives to invest. Reduction in investment allowances and so on will not help from that point of view.

Almost certainly, the most important thing in this context is confidence, which is difficult to measure, and the view about what will happen to the economy in the future. As confidence builds, hopefully business investment will move in the right direction. However, I am afraid that I do not have a forecast.

Gavin Brown: Chapter 5 includes a stat that has been put out there many times—you mentioned it again today—which is that we will reach the lowest level of public spending as a percentage of national income since 1948. That is what your report says; I assume that that is a matter of fact.

That is a significant statement, but I am keen to explore how significant it is. Is there a risk of overdramatising that by couching it in those terms? A graph that I saw—it might have been from you or one of your colleagues—showed the percentage of spend compared with gross domestic product over time. While it was the lowest, I think that there was a difference of something like only one percentage point between next year and 2001; I am going from memory. On reading the simple statement, one assumes that there has been a downward trajectory ever since 1948. However, is it one of those graphs that fluctuate? Is the figure as significant as that statement makes it sound?

Paul Johnson: A lot of issues are involved in that. First, we get to the lowest proportion since the war, not next year or the year after but by 2019, only if the kind of cuts that are implied by the autumn statement are imposed. There is a big "if" there.

Secondly, total public spending only just dips below its minimum at the end of the 1990s. If we are looking at public service spending—excluding pensions and welfare—it is more clearly below where it was at the end of the 1990s. We are not there. There is still a choice about what happens in the last two years of the next Parliament. As I say, it is not clear to me that anyone is really signed up to that.

Thirdly, total spending is not very different from where we were at the end of the 1990s. Public service spending is a bit more different.

How does one interpret that? One thing that it is rather important to think about over this long period is the composition of that spending. If we look back at 1948, something like a quarter of public service spending was on defence and not much of it was on health. That has flipped completely. I cannot remember what spending is on defence now—maybe 5 per cent—and spending on health is 20 to 25 per cent. The money is being spent on completely different stuff. When we compare the overall portion, it is not obvious quite how much that is telling us.

Looking into the longer-run future and thinking about total public spending, it is clear that there are big pressures on health and pension spending from a population that, even over this decade, is ageing pretty rapidly. To keep spending at relatively historically low levels, at a time when the demands on it are growing, is likely to be particularly difficult. At a time when the population is ageing in that way, we might expect spending as a proportion of national income to rise rather than to fall.

One can look at spending as a proportion of national income, but one can also look at it in terms of real pounds per head. In considering health spending over long periods, it is probably better to consider it as a proportion of national income, but for short periods, real pounds per head spending probably matters more.

Real pounds per head spending on public services grew very fast over the 2000s. Even on the numbers in the autumn statement, that real pounds per head spending will fall back to where it was in 2002-03 by the end of the next Parliament. That does not mean that it buys the same stuff—you have to pay more now for nurses and doctors than you did 20 years ago.

That gives the committee a different metric for thinking about such things.

Gavin Brown: I have one last issue. In chapter 7, you say:

"Real capital spending cuts have turned out much lower than originally planned (13.6 per cent rather than 25.9 per cent)".

Can you expand on that?

Paul Johnson: Back in 2010 the initial plans, which were inherited directly from the previous chancellor, were to impose very substantial cuts on capital spending of about 25 per cent, compared with cuts of about 10 per cent or less on day-to-day spending. Many of the budget and autumn statements since then have unwound that slightly. If we put them all together there is almost a halving in the rate of cuts that were planned.

It would have been preferable for that to have been announced at the beginning, because it is not easy to shift investment spending up and down in a relatively unplanned way. It is quite a dramatic change in the shape of the consolidation over the period.

Gavin Brown: Thank you.

John Mason (Glasgow Shettleston) (SNP): Good morning. On the question of the split between tax increases and expenditure reductions, the plan going ahead is that 2 per cent of the savings should be made from tax rises and 98 per cent of the savings should be made from spending cuts, whereas up to now it has been 18 per cent from tax and 82 per cent from cuts. Is there a right answer to that?

Paul Johnson: No, there is not a right answer. It is very much a political judgment.

As I said, it was always likely that most of that would happen through spending cuts if one wanted to avoid the recession resulting in a ratcheting up in the size of the state. The autumn statement numbers suggest a reduction in the size of the state and that is achieved by doing everything through spending cuts, rather than through tax increases.

As my answer to one or two previous questions implied, that is hard to achieve and will be hard to maintain in the long run, particularly given the pressures of demographics and other things on public spending. My expectation is that there will be more tax rises than are implied by those numbers, whoever wins, because we still have a large deficit. Every election since at least 1992 has been followed by significant tax increases, without us having been told beforehand that those increases were going to happen or what they were going to be. The numbers in the autumn statement imply the numbers that John Mason suggests, but I would be surprised if that were to be where we end up.

John Mason: Does that have an impact, or is the total amount of money in the economy just whatever it is? Does it matter how it is shared out and where it comes from? If we had £1 million as a result of taxing those on top more and being more generous with benefits, would that give the same result as cutting benefits by £1 million and leaving the tax at the top?

Paul Johnson: It gives a different distributional result. It may give a different economic result if we think that those on benefits are more likely to spend their money and those at the top are more likely to save their money, so that we end up with more consumption in the short term but less saving and investment in the long run.

John Mason: Is that proven or is it just a theory?

10:45

Paul Johnson: It is reasonably well known that those with not very much income are more likely to spend it all and those with more income are likely to save it, so there is that kind of effect. Depending on how far we take it, we start to have work incentive effects at both ends—at some point, taxes get high enough that people stop working or paying their tax, and at the bottom benefits get generous enough that people do not have the incentive to work. We need to get a balance.

Broadly you are right: if money is moved from one set of people to another set of people, that leaves the economy with the same amount. However, the second-round effects can be quite important.

John Mason: Your report mentions reliefs, and you make the point that cutting out some reliefs, which we have tried to do with our new taxes, results in a simpler tax system. Does having a simpler system have an effect on the economy?

Paul Johnson: Having an efficient and neutral system can have quite an effect. Not all reliefs are bad reliefs, by any means. Earlier, we talked about pension tax relief and my view is that there ought to be some tax relief for putting money into savings, otherwise savings are disincentivised and we end up taxing the money twice. Investment reliefs for corporation tax make a lot of sense, because otherwise companies are double taxed on investment. Research and development tax relief probably makes sense in principle, although it may not be at its best at the moment. Relief should not be a dirty word; an effective and neutral tax system may well have a bunch of reliefs in it, but we need to look at each of them to see whether it is doing the right thing appropriately in the tax system.

Clearly a bunch of things in the tax system create economic costs, such as running a national insurance system alongside an income tax system.

John Mason: I was going to ask you about exactly that, but on you go.

Paul Johnson: That creates all sorts of unnecessary complexity. The stamp duty system has economic costs beyond what it needs to have, and the VAT system is more complex and narrow than it is in most countries. All those things create costs, and moving towards a better-structured tax system would have positive effects on the economy, although it is hard to put a number on it.

John Mason: You have touched on what I was going to ask about next, which is pay as you earn and national insurance. First, we are running two systems and, secondly, at certain stages national insurance tends to be a bit regressive compared with income tax, which broadly is more progressive.

Playing around, you mention that the three main taxes that we could look at increasing are income tax, NIC and VAT. Do you believe that the economy would benefit if income tax and national insurance were combined and jointly became more progressive?

Paul Johnson: It would certainly make life a lot easier if you put the two together. It would also make it more difficult for politicians to hide increases. Over the past 40 years, we have not had any increase in the basic rate of tax—indeed, we have had an awful lot of cuts—and we have had consistent increases in NICs. There is no economic reason at all for doing it that way around. Indeed, given that for the same amount of money NI hits people in work more than income tax, it is a slightly curious way of doing it. In addition, next year or the year after we will have an entirely flat-rate pension system, in which the self-employed and everyone else will accrue full benefit of that system. There is now, in essence, no relationship between the amount of NI that someone pays and any benefit that they are entitled to, so it has become just another tax on income.

If you combined income tax and NI, you would get significantly more transparency, less capacity for fooling the electorate, and simplicity for employers, who currently have to deal with two entirely different definitions of income to work out what tax their employees owe.

Finally, we would presumably get away from the somewhat odd situation that we have seen over the past several years, in which income tax has risen and risen and the point at which people start paying national insurance has not risen, so there is now a £2,000 or £3,000 chunk on which we pay national insurance and not income tax. It is pretty hard to think why the system would be designed like that, given that the two were pretty closely aligned in 2009 or 2010.

John Mason: Could that have a negative effect on people who are wondering whether they could work more, because it is so confusing and people do not know where they are?

Paul Johnson: I do not know. I would not want to speculate about that.

John Mason: The three big taxes—income tax, national insurance and VAT—are mentioned in the green budget summary, which makes the point that

"Increasing any of these would weaken work incentives and hit the rich harder than the poor."

However, it goes on to say that

"the VAT rise would be less progressive".

Is the idea that it would hit the rich harder than the poor in absolute terms, because a rich person will pay more tax than a poor person, or in relative terms?

Paul Johnson: As you said, income tax is clearly a directly progressive tax. If you put 1p on all main rates of national insurance, that is directly progressive and hits the rich proportionately more than those on lower incomes. VAT is more complex. If we look at VAT relative to people's incomes, it looks as if people at the bottom of the income distribution pay a higher proportion of their income in VAT than people towards the top do. That is curious, given that things such as food, which take up a bigger portion of the budgets of poorer people, do not have VAT imposed on them. If instead people are ordered from the lowest spenders to the highest spenders, we get a much flatter distribution and one that is slightly progressive. Spending probably gives us a better sense of how well off people are over the longer term. It is often said that VAT as it is currently constructed is a regressive tax. It probably is not a regressive tax, but it is certainly less progressive than NICs and particularly income tax.

John Mason: The last area that it was being hinted that I should ask questions about is the whole thing about balance sheets, whole-of-Government accounts and so on. You have already made a few points about what is a real liability and what is not a real liability. Was I right in understanding that you are saying that it is not entirely clear? I am not sure that I understand a pension liability. If it is in a pension fund, there is an asset and a liability, so I understand that. However, any Government pension, be it the basic state pension or any others, is surely not a liability right now, is it?

Paul Johnson: As I said, there is a continuum of those things. The way that whole-of-Government accounts work is that what is owed to teachers, civil servants and NHS staff in public service pensions counts as a clear liability in those numbers, although presumably Government could decide to renege on its promises or change them. Indeed, it has changed its promises in the past, by moving from RPI indexation to CPI indexation, so those things are changeable, but the judgment is that, on the whole, the pension that is promised to a teacher is part of the remuneration package and will be paid, pretty much, come what may. Therefore, it is a liability, whereas the judgment made in those accounts is that the promise to pay me a pension of £7,000 a year, or whatever it is, when I retire is something that could be reneged upon and is therefore not a liability in the same way as a teacher's pension.

It does not strike me that there is an absolutely clear dividing line between those things. That is the convention in whole-of-Government accounts, and it is the convention in international accounting standards. That is why it is useful to look at three things. It is useful to look at the standard national accounts cash flow money that we normally look at. It is useful to look at it in the way in which the ICAEW chapter in the green budget looks at it, using whole-of-Government accounts and international accounting standards. It is also useful to look at it on a cash flow basis going forward, which is what the OBR does when it looks at the long-term financial situation and how much we might be spending on state pensions, public service pensions, the health service and so on in 20 or 30 years' time, under a set of assumptions about how those things change with the population and with productivity in the health service.

None of those things on their own gives us a full picture, but if we look at them together, we get a useful picture. They all show pretty clearly, looking a little further forward, that we will be spending a higher proportion of national income on state pensions unless we reduce them, and on health unless we increase productivity extraordinarily or reduce the quality of existing provision. By simple logic, that means that either we will spend less on other services and presumably be offering less, or we will be increasing taxes to pay for all that.

John Mason: Okay. I have to say that I like the idea of balance sheets because they reassure me that we have taken everything into account. I wonder, however, whether there is a danger in focusing on all the liabilities. Historically, one of the ways out of that has been to encourage—or at least to allow—inflation, because one can whittle away liabilities in that way. When I was at university I spent most of my time studying accountancy and how we deal with inflation. At that time, we just lived with quite high inflation. Is it a temptation for any future Government to let inflation get going in order to take away some of those liabilities?

Paul Johnson: Many of the liabilities are pretty much inflation-linked anyway. The pension liabilities, for example, assume indexation largely with CPI inflation, so higher inflation does not reduce them. The same is true for spending on the health service: if we want real health spending going forward, what John Mason suggests would not help.

There are bits in the tax system particularly in which high levels of inflation could be used the other way round, in a sense, to bring more money in. It is rather odd that we now have significant parts of the tax system that are not indexed at all. For example, there is no procedure for indexing the point at which child benefit starts to be withdrawn—that is fixed at earnings of £50,000 a year. We estimate that the number of people losing child benefit will double in the next 10 years as a result, because we are beginning to get to quite a thick bit of the earnings distribution.

The point at which the 45p tax rate comes in is fixed at £150,000 a year. This Government says that it does not like that top rate of tax, but it has reduced quite significantly in real terms the point at which people start to pay it. Earnings between £100,000 and £120,000 have a 60 per cent rate of tax. That £100,000 has been fixed in cash terms since the rate was introduced in 2010, so inflation is bringing more people in and therefore raising more tax.

With regard to the pension tax system, the maximum that one can put in at present is £40,000 each year and £1.25 million over a lifetime, which will be reduced under Labour plans and is, again, fixed in cash terms.

Inflation helps to bring in money in all those ways, which are slightly hidden and inappropriate. Most bits of the tax system are indexed to inflation, but the fact that some bits are not is rather bizarre.

The Convener: I am glad that we have covered that area, because I was going to ask about fiscal drag, so that is one less question to be asked.

Bob Doris: I want to follow up on the theme that Jean Urquhart and Gavin Brown asked about. Is there greater inequality as a result of the UK Government’s economic strategy and austerity programme? You said that there have been marginal differences in the past few years. You also used the expression “a slight compression”, and even suggested that things are perhaps not as bad as newspaper reports have described.

However, life is not a balance sheet, and I would not be representing my constituents if I did not talk about disabled people in Scotland, of whom 100,000 will lose about £1,300 a year as a result of UK welfare reforms, or about single parents and how the fiscal situation has disadvantaged them, or about the constituents whom I see weekly who have been sanctioned by the DWP and Jobcentre Plus.

I know there is a balance sheet by which you produce a matrix and work out whether things have become more equal or more unequal. However, would it be reasonable to say that there is a group within society for whom things have got a lot more difficult and unequal, irrespective of what the economic balance sheet says?

11:00

Paul Johnson: Yes—there is a group who have been sanctioned for benefits. The number of benefit sanctions has grown substantially over the past four or five years, and that group will clearly be significantly worse off as a result. The group numbers in the low hundreds of thousands, so the impact on overall measured inequality is relatively small, but for those people there has been a significant change in how the benefits system is administered, which has had a significant effect on their experience. There are also groups who are losing various disability benefits, largely because of the way in which the system is being administered. Those individuals, too, are being made significantly worse off.

My point about the overall situation is that across the 60 million people in the population the average experience of people in the bottom 10 or 20 per cent has not been any worse than the average experience of people in the top 10 or 20 per cent. The proportional hit may be felt harder, of course, by people in the bottom 10 per cent than by those towards the top. Within the bottom 10 or 20 per cent, there will be people who are doing very much worse than the average, and within the top 20 per cent there will be people who are doing better than the average. However, if we take a snapshot of incomes across the distribution in 2008 and a snapshot of incomes across the distribution in 2015, there has not been much change in the overall level of inequality.

Bob Doris: I am grateful to you for putting that on the record. I hope that you will appreciate that the lived experience of many of my constituents is dramatically different from the average experience as is it shown in certain figures. It is important to look to see where inequality is within society.

Mr Mason spoke about austerity being 18 per cent based on tax rises and 82 per cent based on spending cuts, whether they are cuts to public service spending or the withdrawal of benefits. In the future, it is going to be 2 per cent tax rises and 98 per cent spending cuts. Is that shift in the balance likely to lead to additional inequalities?

Paul Johnson: I do not know whether that is what the distribution looks like, but those are the numbers that are implied in the autumn statement.

I think that the answer is yes in two respects. First, what I have said about inequality has just been about income inequality, but the public services that people receive are also part of their welfare. We do not, when we look at inequality, measure the loss of social services—for example, the loss of social care that some people might experience. The fact that the library, or whatever, has closed makes people worse off. Public services are, on the whole, more important to people on lower incomes, so cutting public services has a real effect on welfare and, potentially, on inequality, if we measure it in a broader sense.

Secondly, if we are not going to do much more on tax but are going to cut benefits, it is clear that that will hit people towards the bottom of income distribution. If we do not raise taxes, we do not hit the people who are towards the top of income distribution. So, cutting spending without doing anything on taxes will make the overall distribution of income and, in a more general sense, economic welfare less equal.

Bob Doris: Thank you for that. In chapter 9 of the green budget, you discuss how the social security system can be used as an incentive or disincentive to work. My experience of the social security system has been that it is a one-trick pony. As you said, there has been a general attrition of benefit levels. There seems to be a feeling that compressing—to use your expression—benefits and sanctioning may be an incentive to people to become economically active, but the policy is a stick rather than a carrot. Is the social security system just not sophisticated enough to deal with that?

I will give you a couple of examples. I have two constituents in north Glasgow who are now unemployed because in order to get tax credits they would have had to work additional hours that their employers did not have available for them. They had understanding employers who said that work was no longer available, so they were not sanctioned by the Benefits Agency when they went to make a benefits claim. However, some people are going to be worse off in work because of tax credit changes. I see things like that all the time.

You mentioned how the tax credit system works—there is a cut-off point, so that people can focus on whether it is worth their while to work. Does that suggest that it would be helpful if there was more flexibility in the tapering of benefits? That might affect how long people can receive benefits for. More discretion could be used because local economic circumstances are very different around the country.

I have another example. When I first came into politics, I was told about something called the 104-week linking rule. I am not an expert on it, but I think I understand how it works. A disabled person may not have the confidence to get into work—they may not be sure that they can hold down a job or whether they even want to try because if they do, they might be considered fit for work and their benefits would be cut, whether or not they are in employment. The 104-week linking rule said that they would have two years of trying to sustain a job. If the job broke down for certain reasons, they would be put back on to their original level of disability benefits. It was seen as a supportive way of getting people back into work.

Should there be more flexibility and imagination in the social security system in terms of how we support people to get into work? What is happening at the moment is the stick effect. As you would expect me to say, being from the party to which I belong, I think that Scotland could support vulnerable people into work much more imaginatively. We have what I feel is a draconian strategy of austerity at the moment. Would there be benefit in being more flexible in how we operate the social security system?

Paul Johnson: You are absolutely right to draw attention to the way in which the system is administered. We know for sure that that matters in all sorts of ways. In the early 1980s, for example, the system was administered very loosely and people were given very little support and encouragement to get back into work. Lots of people ended up on disability benefits and unemployment benefits in the very long term, which did not have much to do with the financial incentives; it had a lot more to do with the way the system was administered.

The way the system is administered has changed a lot since that period to provide a stick, certainly, and some carrot. One of the differences between the UK and a number of other European countries—it may be a surprise—is that we have more sophisticated administration of the system.

On tax credits, it is true that if the person is not working the full 24 hours, it is not worth their being in work, under the current system. There will be lots of people for whom there is little or no incentive to work anything between zero and 24 hours—if you cannot get 24 hours work, you are in the position that Bob Doris described.

As I said earlier, if universal credit comes in, it will be different in the sense that it will not have that clear hours point at which things change. First, it will allow people to earn a bit before they lose anything, and there will be a less severe taper after that. It is very hard for us to model ex ante what effect that will have on people's behaviour because there will no longer be the clear 24 hours work point and there will be some incentive to work five, 10, 15 or 20 hours. In a world where that is all that is available, it may be that your constituent would be able and willing to take that kind of work. For other people, because there is not that clear focus point, it may be less clear to them that working is worth while. It would have been nice to have trialled and evaluated the impact of universal credit, but that has not been possible.

Beyond that, the way in which the system administered matters. I would like to see more trialling of different ways of providing flexibility in local delivery, or of different ways of delivering benefits to see which ones work. We do not do anywhere near enough of that kind of testing in this country. It is very much the case that we make a big change and just say, “Here it is.” That is what is happening with universal credit, without our really knowing what the effect will be. It would be very good to see areas doing things differently, looking at the effects and learning from each other. With the centralised system that we have, that does not happen anywhere near enough.

Bob Doris: Thank you very much. I have two more questions, convener. Do I have time for them?

The Convener: Aye, on you go—as long as they are shorter than the answers. [*Laughter*.]

Bob Doris: There is possibly time for only one more question then, convener—or half a question, perhaps.

I looked at pay levels and real-terms pay. I think that the OBR said that pay in Scotland is down 4.1 per cent in real terms since 2008—that was the figure that I took down from other notes that I had. Average earnings are well below the pre-crisis levels. In your paper, you speak about some people having done okay because they have sustained their jobs, moved through pay increments and got more experience, and things will have kicked in to assist them. Is an even more severe real-terms pay deficiency being masked because of that group?

Paul Johnson: We did that analysis because a number of people said that people who have stayed in work over the period have not seen real-terms cuts; rather, their incomes or earnings have risen over the period. That is true, and that is one of the reasons why it is sometimes hard to get across the idea of what is happening across the population as a whole.

Let us consider people in their 20s. Average earnings of people in their 20s now are about 10 per cent less than they were in 2007. However, most people who are in their 20s now were not in the labour market in 2007, of course, and most people who were in their 20s in 2007 are now in their 30s. Therefore, we are not comparing the same people over time. Most people in their 20s will see their pay rise, because they will be early in their careers. Looking at the average person in their 20s now is very different from looking at the average person in their 20s in 2007, so we try to be very careful about how we describe that—using the average of one cohort relative to the average of another cohort, for example.

Similarly, people have suggested that earnings are not so bad because the earnings of people who have stayed in work over that period will have grown. That is true, but it has always been true that if a person has stayed in work over a five-year period, their earnings will have grown more than average earnings. Young people come in at the bottom end of the labour market on less than average earnings. As people go through their career, they will, we hope, see an increase in their earnings.

Our analysis showed that there is that gap, but it has not really changed over time. The gap post-2008 is essentially the same as it was pre-2008. Median earnings have fallen or have not increased. That is real, and it is not hiding something different in what has been happening to other people. As Bob Doris said, that means that some people are seeing increases in their earnings, and the big thing that we see is the fall in earnings of people in their 20s. As I said, most people in their 20s now were not in the labour market in 2007 and they are being offered significantly lower pay than people of a similar age in 2007 were, so that group is significantly worse off than it might have expected to be.

Bob Doris: Thank you. That is helpful. My final question will be very short, convener.

I am deputy convener of the Health and Sport Committee, which is keen to map out how other policy decisions impact on the national health service, for example. In considering its economic strategy, austerity and cuts, does the UK Government do modelling work on the increased strains that are put on our public service sector, which is receiving significant cuts? For example, is work being done on whether there are more mental health issues, on whether carers are feeling greater strain, or on pressure on families and how that manifests itself? Is any social impact assessment of the UK economic strategy done?

Apart from the social justice aspects, in simple economic terms, if in five years there is an explosion of mental health issues or even more of an increase in multimorbidity in older people because of what they had to go through during this period, society and the Government of the day will have to pick up the cost of supporting those people. Has the UK Government done any modelling work on that?

11:15

Paul Johnson: I am not aware of any such work. Some of it will happen in individual departments, but my guess is that the overall strategy for the cuts has not been much informed by it. My experience is that Westminster finds it quite difficult to make decisions in the way that you are describing.

Bob Doris: Thank you.

Jackie Baillie: Good morning, Mr Johnson. I suspect that it might well be the afternoon before we are finished here.

I want to explore the UK budget in relation to Scotland. You have been quoted in this morning's papers as saying, first, that the Conservatives would spend £25 billion a year less than Labour over the Parliament and, secondly, that there is not a huge amount of difference between Labour and Scottish National Party spending plans. Assuming that both those observations are correct, I wonder whether you can talk us through some of the headline numbers on what that would mean for Scotland's budget.

Paul Johnson: Let me first explain precisely what I meant about the various differences between the parties. If you take at face value the Conservatives' claim that they want to achieve budget balance by the end of the Parliament and Labour's claim that it wants to achieve current budget balance, that means that there is a difference between them of around £25 billion to £30 billion. If you then take at face value the SNP's claim that it wants to increase public service spending by 0.5 per cent a year over the Parliament, that means that it is looking to spend something like £7 billion more than at present by the end of the Parliament. I am doing this from memory, but I think that that gives us a difference of the order of £10 billion to £15 billion between Labour and SNP and a £25 billion difference between Labour and the Conservatives. Those are the orders of magnitude that we are talking about. As I have suggested, the knock-on effects on Scotland would be proportionate to that. It would largely flow directly through the Barnett formula to have a similar set of consequentials for Scotland as for the rest of the UK.

Jackie Baillie: I wonder whether I can tease that out slightly. In a major economic speech that was delivered in London, the First Minister suggested that, under the SNP's proposals, there would be £180 billion of investment while at the same time debt would be reducing. Apparently, you have said somewhere that the Treasury is right that, if public spending were to be increased by 0.5 per cent, debt would in fact rise, not decrease. Is that correct?

Paul Johnson: Yes. In a sense, it is a simple arithmetic point. Even under this Government's plans, debt barely falls in 2015-16, and that is with quite big cuts in public spending. If you are looking to increase public spending over that year, debt will rise slightly. On those numbers, debt at the end of the Parliament will be similar to or maybe slightly more than debt at the beginning of the Parliament. Economically, I do not think that it makes very much difference if it is up or down 1 per cent but, arithmetically, increasing public service spending by 0.5 per cent a year will lead to an increase in debt for the first couple of years, with a slight decrease in the last couple.

Jackie Baillie: That is helpful to know.

Let me move on to my second question. After all, in politics, timing is everything and while we have been speaking the "Government Expenditure & Revenue Scotland 2013-14" figures have been published.

Paul Johnson: I have not seen them, then.

Jackie Baillie: I see that the news has caused a frisson of excitement around the room. Those figures point to a continuing budget deficit that we believe, given the falling price of oil, will get worse in the next year for which we will have figures. What assessment has the IFS made of the impact of full fiscal autonomy in light of the indication of a deficit in GERS?

Paul Johnson: I presume that, by full fiscal autonomy, you mean having all of your spending and taxation in your own hands.

Jackie Baillie: Yes. I believe that that is the proposal that the Government has advanced. It is that Scotland would raise all its taxes for all its expenditure.

Paul Johnson: In a sense, that involves a simple piece of arithmetic. Aside from North Sea oil, tax revenue per head in Scotland is very similar to average tax revenue per head in the rest of the UK, but spending per head in Scotland is substantially higher than spending per head in the rest of the UK. Therefore, oil revenue apart, the deficit in Scotland with full autonomy would be significantly higher. In years up until last year, oil money has broadly made that up; indeed, in some years it has more than made it up. When oil revenues are falling at the levels that I imagine are set out in GERS this year, or at the levels that will certainly be in GERS next year, the deficit in Scotland will be higher than in the rest of the UK. As I said, that is simple arithmetic.

Jackie Baillie: That is helpful to know. GERS suggests that the gap is £4 billion this year, and people are predicting that it will be higher next year. In that context, do you agree that, if we have full fiscal autonomy, we cannot also have the Barnett formula? It is one or the other. Otherwise, it would be a bit like stopping paying into the kitty but still wanting the kitty to pay out to us.

Paul Johnson: There is a political decision there. You can have fiscal autonomy with subsidy from the rest of the UK—that is a choice that the Scottish and UK Governments could make about how we distribute resources. In a sense, that is how the UK Government has chosen to distribute resources over a long period.

Jackie Baillie: If we are raising our own taxes and keeping all of them, would it be practical or reasonable to expect the Government to say that it will give us some extra?

Paul Johnson: That seems to be a political choice.

Jackie Baillie: Indeed.

To develop that a little, in the past year, when the Barnett formula was threatened by English MPs, various members of the Scottish Government have said that ending it would result in a £4 billion cut in Scotland's budget and something of the order of 70,000 job losses. I believe that the current First Minister and Deputy First Minister have said that. Is that a reasonable assessment of the impact?

Paul Johnson: I would not like to comment on the specific numbers, but the issue is pretty clear. Spending per head in Scotland is 17 or 18 per cent higher, or whatever, than in the rest of the UK. If that was unwound, there would be a big impact on Scottish public finances.

Jackie Baillie: The way of closing the gap would be, as the UK Government is doing, either to cut services or to raise taxes.

Paul Johnson: Yes.

Jackie Baillie: There has been some suggestion that we could grow our way out of the deficit. Economic analysis published by the Scottish Government—in two papers that were published within days of each other—looks at factor productivity growth, exports increase and narrowing gaps in investment so that we get closer to international standards. In total, taking all that together, it suggests growth that would normally be over a 12-year period squeezed into four years, with a growth rate higher than China's in its heyday. Is that realistic on any level?

Paul Johnson: I am not familiar with those numbers, but higher growth than China in its heyday sounds quite optimistic. Clearly, the analysis that you describe is right in the sense that higher economic growth, whether in Scotland or the UK as a whole, helps to get out of a fiscal hole. For the UK as a whole, if it turns out that we have lost less permanently of the economic output that it looks like we have lost, we will need a lot less austerity over the next Parliament. If it turns out that we can grow at 3 per cent per year for the next five years without any inflationary problems, a lot of what we have been talking about will not be a problem. The same is true for Scotland.

The truth is that Governments, whether UK or Scottish Governments, find it difficult to create growth in the short run. There are policies that most economists would agree would be good for growth in the long run, but things that are at worst neutral in the long run and which really impact on growth in the very short run are pretty hard to come by.

Richard Baker (North East Scotland) (Lab): I have some questions on oil and gas taxation. Gavin Brown asked you earlier about what you thought was coming up in the budget in a whole range of areas. There has been a lot of speculation about what might happen with the oil and gas taxation regime. Do you have a view about what is likely to happen? Does the IFS have a view about what should happen? What impact do changes in oil and gas taxation have, not only on the industry but on the broader picture of Government expenditure and revenue?

Paul Johnson: I am afraid that you are taking me off the areas where I feel expert. The broad economic principle for oil and gas taxation is that we need a consistent and certain regime that taxes the economic rents that are being earned. We have not had that consistent regime over recent years, and it is not clear that we have a regime that only taxes economic rents. If we did have that, it would be a system that did not impact on people's incentives to invest in oil and gas. That is clearly not where we are.

The broad-principle picture is that it would be good to move towards a more neutral regime that taxes rents in that way. Given that we do not have that system, and that the system that we have impacts on incentives, some of that might change in the budget, in terms of either structure or rates. I do not know, and I will not speculate any more on that.

As for the impact on the budget, oil and gas taxation clearly has an impact on the overall UK public finances. In the context of the £600 billion or £700 billion or whatever it is that the UK raises in taxes, the numbers here do matter, but they are relatively small. They would clearly be a much bigger issue for Scotland by itself, were it to have full fiscal autonomy.

The other side of it for the UK is that prices are reducing across the economy, particularly road fuel prices. That may allow the Government to raise road fuel duties for the first time, certainly since 2010, at least in line with inflation.

One of the reasons why economic growth is looking relatively positive over the next year or two is low oil and commodity prices. The long-run effect of that will be fiscally positive for the UK as a whole, but presumably it will be fiscally negative, at least in the short run, for an autonomous Scotland.

Richard Baker: The key issue there is the size of the UK economy. Because it is that much more diverse, is it fair to say that the Government is more able to consider changes to the tax system that might reduce income in the short term while also stimulating the industry?

Paul Johnson: For a net importer of oil, a fall in the oil price is a good thing economically and, in the long run, fiscally.

Richard Baker: That is not really very good news for my region in the north-east, but I understand that that is one of the benefits that we have of being part of that larger economy—there is more that can be done to address the situation.

Mr Mason was interested in the issue of whole-of-government accounting, as we knew he would be. You have mentioned nuclear decommissioning. Presumably offshore decommissioning would be part of those accounts as well. The Government has made a commitment of £20 billion of funding for offshore decommissioning. That figure will be in there somewhere, too.

Paul Johnson: I presume so.

Jean Urquhart: I wish to return, to some extent, to Jackie Baillie's comments, which would open up a huge political debate—which Scotland has of course enjoyed for the past couple of years—and to challenge some of that.

Going back to the very black-and-white presentation of oil revenues and fiscal autonomy for Scotland, you would also have to consider things such as VAT. Because we are one nation in Europe, there would be adjustments on VAT returns, with services bought and sold and shared, which of course may well see a Barnett formula still in place in order to make those adjustments.

Paul Johnson: I am not sure that I follow the question—sorry.

11:30

Jean Urquhart: I do want to make this point, so I will labour it, if I may. Every economy, including the UK and Westminster, will adjust to a rise or fall in oil prices; indeed, oil prices have in recent years been as low as they are now, and everybody expects them to increase again at some point. The fact, though, is that economies adjust. I take the point that oil would account for a greater percentage of the Scottish economy than it would in a much bigger economy such as the UK's, but the point is that full fiscal autonomy, including the oil, would have other benefits. There has already been discussion about the fact that decisions about jobs in the oil industry should be taken in the north-east rather than in London, and there are so many other aspects to this that some black-and-white declaration that full fiscal autonomy will lead to a huge deficit in Scotland is quite wrong. It is just wrong to give such an impression at this committee without having much greater debate and discussion about Scotland's economy. Do you agree?

Paul Johnson: It is clearly the case that if Scotland were to have greater autonomy, independence or what have you, a series of different decisions could be made that could have long-run effects on the growth of the economy. It might well be that a more locally controlled economy could grow more or could make different decisions, and in the long run that could make a very big difference to growth and therefore to the fiscal situation.

My point was a short-run arithmetical point. In the short run, the arithmetic would dominate. As for the long run, however, I agree with the general proposition that one does not quite know what would happen and that it is at least possible that behavioural change, additional growth and so on would dominate.

The Convener: That has exhausted questions from the committee, but I have a couple more to wind up on.

During the discussion, you referred to the lack of information on the top 1 per cent of earners and said that HMRC has not made any data available for the past five years. What is the reason for that?

Paul Johnson: I was referring to the survey of personal incomes, which is based on income tax data. From conversations with HMRC, I think that the problem is a lack of resource. I slightly exaggerated the lack of information from the "Annual Survey of Hours and Earnings"; we have reasonably decent information on what has been happening to earnings, certainly in the top 1 per cent if not the top half per cent of earners, and we can see some of that information when we look at tax data and the impact of the 50p tax rate. However, it is disappointing that the survey of personal incomes, which is an annual survey based on income tax returns that had been available for a large number of years, has not been updated recently. I cannot remember when the last one was; it might have been as far back as 2009-10 or 2010-11, but we have certainly not had anything for the past three or four years.

The Convener: Given all the discussion and debate about the top rate of tax and so on, it seems remarkable that HMRC does not seem to have the resources available to do that work. One would have thought that it would.

On an issue that has not been raised by members, I note that, even with Government proposals to reduce Government borrowing and debt in order to have a 1 per cent surplus by 2020, there would still be a deficit amounting to about 54 per cent of annual income—assuming, of course, that everything went to plan. How does that 54 per cent stack up in historical terms with regard to the UK's debt?

Paul Johnson: I guess that you are asking about where we might end up in 2030 if we ran 10 years of surplus, but I have to point out that we have never had anything even approaching 10 years of surplus. That would be a wonderful world to be in.

At the moment, debt is sitting at around 80 per cent of national income, which is the highest that it has been since 1967. Looking over a much longer period, however, you will see that debt goes in big cycles. At the beginning of the 19th century, it was at 100 to 150 per cent of national income after the Napoleonic wars; it gradually came down to really quite low levels of maybe 20 per cent of national income, and then it shot up to 150 or 200 per cent over the period covering the first and second world wars. There was then a fairly sharp decline right through to the 1980s. We passed through 80 per cent in 1967 and came down to 30, 40 or 50 per cent in the 1970s or 1980s and 20 or 30 per cent at the beginning of the 2000s. The figure was heading up to 40 per cent in 2008, which was the cap that the previous Government said that it wanted to put on it, but it has essentially doubled to 80 per cent between 2008 and this year. In short, if we look at relatively recent history, we see that 80 per cent is the highest figure in 50 years but, looking over a much longer period, we see long periods of paying down much higher levels of debt following wars.

The Convener: So Governments have long experience of dealing with similar deficits for many years.

Paul Johnson: That is right.

The Convener: Finally, coming back to a point that Jackie Baillie raised, I note that Jonathan Portes, the director of the National Institute of Economic and Social Research, has said:

> "there is quite a lot of room for manoeuvre in terms of plans to get the deficit down over the next Parliament. Even what Nicola Sturgeon is proposing, which would involve spending quite a lot more and borrowing quite a lot more than what the Conservatives are proposing, would still result in a falling deficit and falling debt over the Parliament, so it would be fiscally sustainable."

Given your comments about the size of debt historically in the UK, would you share that view?

Paul Johnson: With all of these things, there are trade-offs, and the big trade-off here is that, although you will have significant debt wherever you are in 2020, it will not be debt that you cannot cope with. Two things will then happen. First, we will get another recession; I do not know when, but the fact is that we are not going to get rid of boom and bust. One of the questions that you need to ask yourself is this: had we gone into the last recession with debt at 80 per cent of national income and it had gone up to 120 per cent, would that have been sustainable? I do not know, but there is clearly more risk associated with going from 80 to 120 per cent than there is in going from 40 to 80 per cent.

The Convener: But of course we do not know when or whether another recession is going to come along or what the extent of it would be.

Paul Johnson: Absolutely, which is why I am not sure that economists can really help. There is an incredibly difficult judgment about risk to make here.

Secondly, the pressure on public services is only going to grow over the next 20 or 30 years, particularly because of demographic change, and it is easier to deal with that if you start with a lower deficit and lower debt. However, I am now going to duck your question. It is great that the electorate has these choices; they are real, and I do not think that any of them are stupid. They simply take different views about where the risks lie.

The Convener: You mentioned boom and bust. When Gordon Brown said that he would bring an end to both, do you think that he was half right?

Paul Johnson: No.

The Convener: He ended the boom.

Thank you very much. Do you wish to make any other points before I wind up the session?

Paul Johnson: I think that I have said plenty, convener.

The Convener: To be honest, I have to take my hat off to you. Every year, you come up here and give us a sterling show for more than two hours, answering questions across a huge spectrum of issues. Thank you again for coming before the committee—we very much appreciate it.

Given that we have been in session for more than two hours, I am going to call a 10-minute suspension. We will reconvene at about 11.49 or 11.50.

11:38

Meeting suspended.

11:49

On resuming—

The Convener: I remind members to switch off all electronic devices, please.

We have 10 minutes before the Cabinet Secretary for Finance, Constitution and Economy is able to come to the committee, due to other engagements. With the committee's agreement, I would be happy to go into private session now and deal with our draft report on land and buildings transaction tax subordinate legislation, under item 7. Are colleagues happy to do that?

Members *indicated agreement.*

11:50

Meeting continued in private.

11:57

Meeting continued in public.

Subordinate Legislation

Budget (Scotland) Act 2014 Amendment Order 2015 [Draft]

The Convener: The next item of business is evidence from the Cabinet Secretary for Finance, Constitution and Economy on the Budget (Scotland) Act 2014 Amendment Order 2015.

The cabinet secretary is joined by Scottish Government officials Joe Welsh and Martin Bolt. I welcome our witnesses to the meeting and invite the cabinet secretary to make an opening statement.

The Deputy First Minister and Cabinet Secretary for Finance, Constitution and Economy (John Swinney): The spring budget revision provides the final opportunity to amend formally the Scottish budget for 2014-15. This year's revision deals with three types of amendments to the budget. First, it deals with a number of technical adjustments that have no impact on spending power; secondly, it deals with a small number of Whitehall transfers; and, thirdly, it deals with budget-neutral transfers of resources between portfolio budgets, including a modest budget redirection to ensure that we maximise our available budget. The net impact of all the changes is an increase of £475.1 million in the approved budget, from £36,431.4 million to £36,906.5 million.

Table 1.2 on page 6 of the supporting document—"Scotland's Budget Documents: The 2014-15 Spring Budget Revision to the Budget (Scotland) Act for the year ending 31 March 2015"—shows the approved budgets following the autumn budget revision as realigned to reflect the new portfolio structure that the First Minister announced on 21 November 2014 and the changes that are sought in the spring budget revision.

The supporting document and the brief guide prepared by my officials provide background on the net changes.

The first set of changes comprises a number of technical adjustments to the budget. The technical adjustments are mainly non cash and budget neutral and have a net positive impact of £452.2 million. It is necessary to reflect the adjustments to ensure that the budget is consistent with accounting requirements and the final outturn that will be reported in our annual accounts.

In my letter of 2 February to the Finance Committee, I provided information on the Scottish Government's response to updates to relevant

Eurostat technical guidance on accounting, applied from September 2014 in relation to non-profit-distributing hub projects.

In the interests of clarity, I advise members that the contingency arrangements that I have agreed with Her Majesty's Treasury do not impact on the spring budget revision, as those relate to HM Treasury budgeting at a UK level. That should not be confused with the routine Scottish budget adjustments that are made each year in relation to revenue financed projects.

12:00

The Scottish budget aligns with the accounting requirements under the Government's financial reporting manual. Accordingly, budget provision is included within the Scottish budget for the financial year to reflect the recognition of relevant health and transport assets within revenue finance infrastructure schemes in accordance with the accounting requirements. In numerical terms, that is the most significant technical adjustment at the spring budget revision, with an adjustment to the budget of £253.4 million. With regard to Whitehall transfers and allocations from HM Treasury, there is a net positive impact on the budget of £22.9 million.

The final part of the budget revision concerns the transfer of funds within and between portfolios to better align the budgets with profiled spend. There are a number of internal transfers as part of the revision process that have no impact on overall spending power. The main transfers between portfolios are noted in the spring budget revision supporting document and the guide to the SBR. In line with past years, there are a number of internal portfolio transfers that have no effect on portfolio totals but which ensure that internal budgets are monitored effectively.

As I have said previously, the committee will wish to note that as part of our robust budget management process and in line with good practice, we have taken the opportunity at the spring budget revision to deploy emerging underspends to ensure that we maximise public expenditure in 2014-15, in particular to support capital investment where possible.

The spring budget revision records the deployment of some £115 million of redirected budget, which represents around 0.4 per cent of the fiscal departmental expenditure limit budget. Details are provided at annex C of the brief guide prepared by my officials.

The spring budget revision also reflects the proposed transfer of budget from resource to capital in respect of the Scottish budget. Members should note that the Scottish budget records capital that scores in the Scottish Government's consolidated accounts or the accounts of our directly funded bodies. In the context of our HM Treasury budget, the planned resource-to-capital transfer is £190 million. The switching is managed within the total DEL available to the Scottish Government. That approach takes into account the latest profile of the Government's overall capital programme.

As in previous years, once we have provisional outturn figures, it is my intention to write to the Finance Committee with a table setting out the actual resource-to-capital transfers by portfolio and programme in a similar format to the table that was provided in my letter of July 2014 in respect of financial year 2013-14.

As we approach the financial year end, we will continue, in line with our normal practice, to monitor forecast outturn against budget and wherever possible we will seek to utilise any emerging underspends to ensure that we make optimum use of the resources available in 2014-15 and that we proactively manage the flexibility provided under the budget exchange mechanism agreed between HM Treasury and the devolved Administrations.

I confirm that, in line with past years, it is my intention to make a statement to Parliament on provisional outturn in respect of both our Scottish Parliament budget and Her Majesty's Treasury budget.

The brief guide prepared by my officials sets out the background and details of the main changes that are proposed. I look forward to discussing the issues with the committee.

The Convener: Thank you very much, cabinet secretary. I will ask a few questions and then open up the session to questions from other committee members.

The autumn statement 2013, the UK budget 2014 and the autumn statement 2014 allocated an additional £158 million to the Scottish budget. The 2014-15 budget bill allocated £90 million in Barnett consequentials, and in the autumn budget revision another £53.3 million of Barnett consequentials was allocated. Therefore about £15 million in Barnett consequentials appears to be unallocated. Has that been carried over into 2015-16 using the budget exchange mechanism?

John Swinney: It is correct that there are remaining consequentials totalling £15 million that have not been put into budget measures so far. We intend to carry those forward. Of that £15 million, £13 million will be allocated to support the delivery of free school meals in 2015-16—that was part of our long-term planning for that policy. After those provisions are taken into account, £2 million will remain unallocated.

The Convener: Are any other funds being carried over? If so, have they been allocated?

John Swinney: I expect there to be a budget underspend of the order of £140 million to £150 million. That has been factored into the spending plans for 2015-16.

The Convener: Thank you.

You said a lot about the technical transfers. The brief guide says that they

"are essentially budget neutral and do not provide additional spending power for the Scottish Government."

What is the word "essentially" doing in there? If you say that the transfers are "essentially budget neutral", there is an implication that they are not quite budget neutral. Can you clarify whether they are completely budget neutral?

John Swinney: In the overall statement that I just made to the committee, I made the point that there was essentially a net positive impact on the budget of £22.9 million. In every other respect, all the other transfers are budget neutral.

The Convener: They do not have any practical significance.

John Swinney: No.

The Convener: Okay; I just wanted to clarify that.

What resource budgets have fallen to accommodate the capital increases, and what changes have taken place since the plans were set out in the draft budget for 2015-16?

John Swinney: Our expectation is that the resource-to-capital transfer will be of the order of £190 million this year. At the draft budget stage, our plan was for the transfer to be £120 million. Essentially, what we are doing is working the totality of the budget available to us to ensure that we can fulfil a broad range of capital investments across the country.

Some investments will be affected by timing, such that we are able to make more progress on particular projects than we envisaged when the budget was set in 2014-15. We are trying to find the headroom within the budget to enable us to undertake more capital investment work in 2014-15 than we had previously planned. That will be a product of operational decisions within the capital programme. Therefore, where we find opportunities to undertake more activity, we will try to establish the funding mechanism to do that. One of the options available to us is to undertake a greater resource-to-capital transfer than was planned.

The Convener: Do you have specific details on that?

John Swinney: I can provide the committee with a range of areas where we will do that. Also, we will formally write to the committee once we have reached the end of the financial year, when it will become clear whether we have in fact undertaken all the transfer activity that I have suggested will be undertaken.

The Convener: Table 3 in our the committee's briefing from the financial scrutiny unit shows the sources of emerging underspends. What are some of the reasons for those underspends? They cover quite a significant area of the infrastructure, investment and cities portfolio, but the education and lifelong learning portfolio also has a £13.4 million underspend, the Scottish Prison Service has a £12.3 million underspend and the Scottish Parliamentary Corporate Body has a £1.5 million underspend. Can you talk us through some of the underspends? Will the money be restored to those budgets in the future?

John Swinney: I can go through some of the underspends.

On rail services, we have identified a number of savings through a combination of a reduction in forecast inflation and the published control period price list, which is relevant to Network Rail access charges. We estimate what we think is likely to be required in terms of budget provision when we set the draft budget, but of course we do not have to hand the detail of how the costs will crystallise. That means that, later on, we can reallocate to support other provisions.

On Scottish Water—we have gone through this territory before in committee—the infrastructure programme will change its shape and character, depending on particular projects that are taken forward. Essentially, the Government will have to provide a net funding requirement. We expect that net funding requirement to reduce voted loans to £106.6 million, which will remove a requirement for £40 million of borrowing by Scottish Water.

On motorways and trunk roads, there are in-year savings from the Queensferry crossing, which is continuing to make very visible progress and is delivering savings because of low inflation. The project is taking its course—I think that I have gone through this with the committee before—but the contract is structured such that there is a fixed price for the whole project, with a contingency element running alongside that, which is for variables that are outwith the contractor's control. That contingency is accessed only if there is a proven need to access it. When it is not needed, it comes back to the Government, and that is what we are gathering back.

With regard to the Scottish Further and Higher Education Funding Council, there are savings because of changes to the timescale for the delivery of certain programmes that the funding council is taking forward, as a consequence of some of the activity around carbon reduction and other projects.

In the Scottish Prison Service, the savings have come from changes to the costs of energy supply and energy usage, court custody contracts coming in at a lower price than was anticipated, and improvements in estates maintenance, which is being delivered more efficiently.

The Scottish Parliament Corporate Body has been able to release £1.5 million of savings. That is not a budget that I control, but such savings are always welcome when they come.

The Convener: Will any of those funds be restored to those budgets, or will they be put into other things?

John Swinney: The funds are reallocated to meet other provisions in the 2014-15 budget. However, if, for example, a project has not happened this year but will happen the following year, we will restore the budget accordingly.

The Convener: Excellent. Thank you for that clarification, cabinet secretary, which I sought in a more ham-fisted way than you put your eloquent reply.

I have one further question on infrastructure, investment and cities. There are four proposed reductions, totalling £74.1 million, in the rail services budget. One reduction involves a £23 million transfer to ferry services for contract commitments. Can you tell us a wee bit about that?

John Swinney: I have shared the origins of the saving with the committee. The lower price inflation on contracts and the changes in Network Rail access charges have been the source of that particular change.

The transfer into the ferries budget takes account of additional budget cover that we are putting in place to support and sustain ferry commitments. Of course, ferries are vital for many communities around the country—not least for Arran in your own constituency, convener. The transfer is designed to provide the support that is necessary for our essential ferry services.

The Convener: Thank you for that. Members are keen to ask questions now.

Gavin Brown: Cabinet secretary, the Scottish Water saving is £43.5 million less than was anticipated for 2014-15. Does that impact at all on what you will need to lend to Scottish Water over the longer term, or is that likely to pop up in future years?

John Swinney: Is “pop up” a technical term?

Gavin Brown: They were the first words that came into my head.

John Swinney: They make the point, Mr Brown. Yes, that will pop up at a later stage.

Gavin Brown: You referred to your 2 February letter to this committee. I just want to double-check that I heard you right. Did you basically say that nothing from your letter is actually captured in the spring budget revision document?

John Swinney: That is correct.

Gavin Brown: You have explained some of the underspends quite clearly. Do you encourage any departments to underspend?

John Swinney: Yes.

Gavin Brown: Okay.

12:15

John Swinney: I do so for two reasons. First, I have to underspend. I defy anyone to believe that it would be possible to spend precisely the amount of money that is allocated to us in any given financial year. The arrangement that we have with the UK Government allows us to carry forward a very small proportion of our budget. The numbers used to be ingrained—around £150 million of resource and around £40 million of capital can be carried forward. I think that we are talking about roughly 0.6 per cent of our resource departmental expenditure limit budget.

That is a sensible arrangement, because it means that we have to plan to balance our budget. I think that it would be very risky to plan to hit it on the nail. The arrangement that we have with the UK Government that allows us to carry forward a modest underspend without any loss to the Scottish public purse enables us to manage the process in an orderly fashion, and I am entirely satisfied with it.

Secondly, different things happen during the year, when I have to find resources for particular priorities. It helps to have portfolios that can identify savings and are prepared to offer them for deployment elsewhere. It is one of the strengths of the Administration that portfolios are obliged to offer such resources to my office for consideration of whether they can be deployed within the portfolio or on corporate priorities.

Gavin Brown: I refer to page 65 of the supporting document. In answer to the convener, you said that there was a bit of an underspend in rail services, which was partly due to a reduction in inflation. You gave a couple of other reasons. The table on page 65 shows that the original budget for rail services was £842.8 million. Following the autumn budget revision and the spring budget revision, the actual budget will be

£757.4 million, which is quite a drop from the original budget. Is all of that explained by inflation and other reasons, or are services being affected or projects delayed?

John Swinney: It is explained by a combination of a reduction in the level of inflation that was forecast and the published control period price list relevant to the Network Rail access charges.

Gavin Brown: That explains the whole difference—okay.

Schedule 3.4 on page 68 of the same document includes the heading "Technical budget adjustment in respect of Transport revenue financed infrastructure projects". It is described as a technical adjustment, but I want to dwell on it because of the size of it—£201.8 million. Can you give a bit more detail on that?

John Swinney: Yes. It is a technical adjustment in connection with the provision for the Aberdeen western peripheral route and the M8, M73 and M74 improvement projects. The figure for the AWPR is £66.7 million, and the figure for the M8, M73 and M74 projects is £135.1 million.

That has arisen as a result of our response to a point that Audit Scotland raised with us. Previously, when a project that was revenue financed was completed, we would have used what is called ODEL—outside DEL—which is a provision to recognise that in our asset base. Audit Scotland indicated to us that it thought that we should show that piece by piece as the construction proceeds. Therefore, the figure that you see represents our response to that point from Audit Scotland. It will not be the case that a complete number crystallises on those projects at a later stage; it will be an incremental process.

Gavin Brown: I am grateful for that—thank you.

On the same page, there is an emerging planned underspend of £17.8 million. In response to the convener's question, you suggested that that was down to inflation and savings from the Queensferry crossing. I am just looking for a bit more explanation. According to the spring budget revision in the table just below the one I mentioned, the Queensferry crossing has a figure of £250.2 million attached to it. When I looked at the draft budget, that figure was £241 million for the financial year 2014-15. On the face of it, £9 million more is being spent on the Queensferry crossing than is shown in the draft budget. How does that work out at an underspend?

John Swinney: We might have to write to the committee about all the transactions in the spring budget revision. I suspect that there might well be an issue about how much of what we show in that crystallises on to our balance sheet. I think that I had better write to the committee on the detail of that question. Other elements of funding might also form part of the equation so, for completeness, I will give the committee all that detail.

Gavin Brown: Okay. On page 75 of the revision document, there are two entries on schedule 3.11, and I am looking at the top two lines under the heading "Summary of proposed changes", which are:

> "Transfers from portfolios to support corporate procurement functions
>
> Deployment of emerging/planned underspend to support corporate procurement functions".

The figures are £6.2 million and £12.4 million respectively. I am just seeking an explanation of what is meant by transferring to support corporate procurement functions.

John Swinney: That is essentially crystallising in one place the Government's activity to operate a shared service for the delivery of procurement activities across the public sector. That is us identifying in one place the budget that is required to ensure that we operate a shared procurement service across the public sector.

Gavin Brown: Thank you.

John Mason: On page 37, under the heading "Justice", there is a line for the on-going legal case on annually managed expenditure provision. We have notes that say that that is something to do with pensions. I realise that, as it is an on-going legal case, you probably cannot say very much about it, but it seems to be quite a large amount for a legal case. Can you say anything about it?

John Swinney: I cannot say an awful lot. It is an issue in relation to the provision of pensions, which is the subject of a case involving the Government Actuary's Department. The Treasury has advised us that we should make AME provision so that it is available should it be required, and we have done so.

John Mason: I accept that; thank you.

John Swinney: I will happily share more information with the committee when I am in a position to do so.

John Mason: That is great.

My other questions are about the Whitehall transfers allocation from HM Treasury, which is not a huge amount. The £22.9 million that you referred to earlier is made up of some relatively small amounts. Is there negotiation with you or individual departments on the process of that, or is it just something that is decided and you are told about?

John Swinney: Essentially, UK departments will make a number of points from time to time and

I can give the committee a flavour of some of them.

John Mason: The one that I am most interested in, although it is quite small, is the G8. Is that £0.8 million really the cost? How was that decided?

John Swinney: That reflects the final outstanding costs in relation to mutual aid and the agreement that was reached at the G8 summit in Northern Ireland in 2013. I assume that it will involve a transfer to us for the support that we provided from our resources to assist with security at the summit.

John Mason: Right—I had not clicked that it was the Northern Ireland summit.

John Swinney: Yes. It will be the cost of Police Scotland's contribution towards the combined security operation for the G8 summit in Northern Ireland.

John Mason: Do we send them a bill, or do they just give us a figure? Perhaps you do not know that off the top of your head.

John Swinney: The resources that were deployed, and what we will be paid for, will have been agreed.

John Mason: Okay—thank you.

Richard Baker: I have a question on the education and lifelong learning budget. On page 25, the transfer from health of £2.3 million is specified as being

"in relation to Calman Report".

Can you give us some more details of what that means?

John Swinney: That is the additional cost of extra medical students in Scottish medical schools, resulting from commitments to implement the Calman report.

Richard Baker: That is helpful—thank you.

Finally, we have discussed the underspend in the SFC budget already—there is a total net reduction of £19.5 million. Is that all for deferred projects? In addition, there is a transfer to the learning budget of £9.9 million. Why has the decision been made to transfer money to the learning budget from the SFC budget?

John Swinney: As a result of the agenda that we are now pursuing with regard to implementing some aspects of the Wood report, there is a need to ensure that we take a focused approach to how we use our resources to support the cohort of young people in that age bracket. The funding council will be involved in supporting projects in some areas that will take forward some of the work that is envisaged in the Wood report. Some of the lines will be blurred in terms of where the resources should come from.

There will be other aspects of the SFC underspend on which we will have to make good in later years. For example, there is an underspend on the Rosslyn centre project—we have agreed to fund it but we have not been presented with the financial requirements at this stage.

Richard Baker: On the transfer to the learning budget, there has been a deliberate decision to transfer funds from universities or colleges—I guess we do not know which—to other aspects of learning provision and providers in relation to the Wood report.

John Swinney: It is simply about trying to ensure that the agenda is able to take its course with appropriate support.

Richard Baker: Thank you.

The Convener: We have now exhausted questions from the committee. We move to item 4, which is the debate on motion S4M-12552. I invite the cabinet secretary to move the motion.

Motion moved,

That the Finance Committee recommends that the Budget (Scotland) Act 2014 Amendment Order 2015 [draft] be approved.—[*John Swinney*.]

Motion agreed to.

The Convener: We will have a short suspension to change witnesses before agenda item 5.

12:28

Meeting suspended.

12:29

On resuming—

Scottish Landfill Tax (Administration) Amendment Regulations 2015 [Draft]

Scottish Landfill Tax (Exemption Certificates) Order 2015 [Draft]

The Convener: Our next item of business is to take evidence from the Cabinet Secretary for Finance, Constitution and Economy on two statutory instruments relating to the Scottish landfill tax.

The cabinet secretary is joined for this item by David Kerrouchi and John St Clair of the Scottish Government. I invite the cabinet secretary to make an opening statement explaining both instruments.

John Swinney: The Scottish Landfill Tax (Administration) Amendment Regulations 2015 primarily utilise powers in section 15 of the Landfill Tax (Scotland) Act 2014, which relate to how material disposed of is weighed. Scottish landfill tax will be chargeable by the weight and type of material disposed of. The instrument sets out that a weighbridge must be used to weigh disposals, if a working one is available on site. That will help to ensure the accuracy of tax returns and that the Scottish landfill tax is applied fairly and equitably across all sites.

Failure to use a weighbridge may result in a penalty for an inaccurate return under section 182 of the Revenue Scotland and Tax Powers Act 2014. Alternative arrangements will be made available on application to Revenue Scotland for weighbridge breakdowns or when an alternative weighbridge is not available in close proximity to the landfill site.

The remaining amendments address drafting recommendations that have been identified by the Delegated Powers and Law Reform Committee and help to provide clarity on the role of approved bodies in relation to the communities fund.

The second landfill tax instrument for the committee's consideration today is the Scottish Landfill Tax (Exemption Certificates) Order 2015. The instrument stems from powers in section 11 of the Landfill Tax (Scotland) Act 2014, which allow for the Scottish ministers to vary what is categorised as a taxable disposal, what is not a taxable disposal and what is exempt.

The order provides Revenue Scotland with the ability to grant authorities that exercise removal powers under the Environmental Protection Act 1990 and similar legislation with an exemption certificate. That applies to any landfill tax liability that may arise from the clear-up of a site following an unauthorised disposal—for example, in cases of illegal dumping and fly-tipping. The exemption applies to the subsequent correct disposal by the authority.

The Scottish Government envisages that the exemption will be used by authorities that are unable to recover their costs from the responsible person who made the original unauthorised disposal, and where landfill is the only practical destination for the material. The instrument will prevent local authorities from being penalised financially for the remediation of sites, which would divert resources from other core services.

The proposal was consulted on last year, and 96 per cent of those who responded to the question were in favour of the Scottish Government providing an exemption of that nature in order to facilitate the speedy remediation of sites.

The Convener: As no members have any questions, we move to item 6, which is the debate on the motions. I invite the cabinet secretary to move motions S4M-12550 and S4M-12551.

Motions moved,

That the Finance Committee recommends that the Scottish Landfill Tax (Administration) Amendment Regulations 2015 [draft] be approved.

That the Finance Committee recommends that the Scottish Landfill Tax (Exemption Certificates) Order 2015 [draft] be approved.—[*John Swinney*.]

Motions agreed to.

The Convener: I thank the cabinet secretary and his officials.

Meeting closed at 12:32.

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e-format first available
ISBN 978-1-78568-142-4

Revised e-format available
ISBN 978-1-78568-141-7

Printed in Scotland by APS Group Scotland