



OFFICIAL REPORT
AITHISG OIFIGEIL

Finance and Constitution Committee

Wednesday 29 November 2017

Session 5



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FINANCE AND CONSTITUTION COMMITTEE
28th Meeting 2017, Session 5

CONVENER

*Bruce Crawford (Stirling) (SNP)

DEPUTY CONVENER

*Adam Tomkins (Glasgow) (Con)

COMMITTEE MEMBERS

- *Neil Bibby (West Scotland) (Lab)
- *Alexander Burnett (Aberdeenshire West) (Con)
- *Willie Coffey (Kilmarnock and Irvine Valley) (SNP)
- *Ash Denham (Edinburgh Eastern) (SNP)
- *Murdo Fraser (Mid Scotland and Fife) (Con)
- *Emma Harper (South Scotland) (SNP)
- *Patrick Harvie (Glasgow) (Green)
- *James Kelly (Glasgow) (Lab)
- *Ivan McKee (Glasgow Provan) (SNP)

*attended

THE FOLLOWING ALSO PARTICIPATED:

- Dr Jim Campbell (Glasgow Caledonian University)
- Naomi Clayton (Centre for Cities)
- Jonathan Hall (NFU Scotland)
- Jim Harra (Her Majesty's Revenue and Customs)
- Michael Russell (Minister for UK Negotiations on Scotland's Place in Europe)
- Sarah Walker (Her Majesty's Revenue and Customs)

CLERK TO THE COMMITTEE

James Johnston

LOCATION

The James Clerk Maxwell Room (CR4)

Scottish Parliament

Finance and Constitution Committee

Wednesday 29 November 2017

[The Convener opened the meeting at 09:02]

European Union (Withdrawal) Bill

The Convener (Bruce Crawford): Good morning and welcome to the 28th meeting in 2017 of the Finance and Constitution Committee. The first item on our agenda is evidence on the Scottish Government's legislative consent memorandum on the European Union (Withdrawal) Bill, which is currently being considered by the United Kingdom Parliament. We are joined for this item by Michael Russell, the Minister for UK Negotiations on Scotland's Place in Europe, who is accompanied by Scottish Government officials Ian Davidson and Luke McBratney. The minister gave evidence on 20 September, and since then we have taken evidence from a range of witnesses, including lawyers, academics, UK ministers and other stakeholders. The minister does not want to make an opening statement, so we shall get straight down to questions.

Ash Denham (Edinburgh Eastern) (SNP): We know that the Scottish Government and the Welsh Government put forward joint amendments to the UK Government with regard to the European Union (Withdrawal) Bill. Can you give us an idea of what progress has been made on those amendments?

The Minister for UK Negotiations on Scotland's Place in Europe (Michael Russell): The issue of devolution in the withdrawal bill is due for debate on Monday next week in the House of Commons. We will have to see how that goes. I should make it clear—and I know that the Welsh Government's position is the same, because I had a meeting with my Welsh counterpart, Mark Drakeford, in Dublin on Friday morning—that we cannot agree to move forward unless the bill is amended. I will talk later about the progress that we are making with the frameworks and the formal discussions, but a sine qua non of this situation is for the bill to be amended and for clause 11 in particular to be either removed or amended. Without that, we cannot complete the progress and we cannot pass a legislative consent motion. That is where things are, so we will know next week.

There are, of course, other opportunities for amendment. The proceedings of the House of

Commons are a little arcane compared with those of our Parliament, so there are other ways to do that and perhaps the amendment will come at a later stage. However, Monday is crucial and we need to have a clear, categorical assurance from the UK Government that change will come.

Ash Denham: You are probably aware that the Secretary of State for Scotland, David Mundell, appeared in front of the committee a couple of weeks ago. He said that very detailed discussions were taking place between officials to look in particular at the amendments. Are you able to confirm that that is on-going, or to comment on it at all?

Michael Russell: Discussion has taken place. There has been a detailed and, I think, positive discussion, but the ball is very much in the UK Government's court. It knows the position that the two Administrations have taken and the changes that we require to see. If it wants to make other changes that are consistent with those objectives, of course we will discuss them. I am endeavouring to keep the political parties informed, by means of discussions with individuals from all the parties; Mr Tomkins has been at some of those. We have never made any secret of the fact that there have to be changes.

Ash Denham: Progress has obviously been made on the common frameworks. Is that overshadowing the fact that no progress has been made on the bill?

Michael Russell: Those matters are conjoined, but they are operating on two different timetables. The opportunity for change comes at the amending stages of the bill, and we are getting close to the first such opportunity. I am happy to accept the assurances that I have had from a range of people that that work is on-going, but we have to see some fruits of it. Damian Green will be in Scotland tomorrow to meet the Deputy First Minister and me, and we will make that point to him very clearly.

The Convener: How likely is it that the amendments that will be debated in the House of Commons on Monday will be successful? If they are not successful, what will the Scottish Government's strategy be thereafter? We are all keen to find a solution. There is a general view that clause 11 has to be amended in some way, if not disappear entirely. Therefore, any information that you can give the committee would be useful, so that we can help with that.

Michael Russell: That is now a matter for the UK Government. We have made our position entirely clear. If the UK Government has alternative amendments that it thinks will serve the same purpose, we are absolutely open to those discussions. I cannot speak for the Welsh

Government, but I am confident that it will have the same position on that.

We can view what might happen to those amendments on Monday as a branch diagram. If the amendments are accepted by the UK Government, that will conclude that matter and we will move on. If the amendments are not accepted but are put to a vote and pass, the matter will be done. If the amendments are put to a vote and defeated by the UK Government, we need to know what it intends to do next. Will that be the conclusion of the matter? Will the UK Government proceed with the bill unchanged, or table further amendments? Does it have a view on what those amendments should be?

As is ever the case with Brexit, we are taking a step at a time, testing the ground and seeing what is next. I hope, because I am an optimist, that the UK Government will see the sense of those amendments and accept them. Do I expect that to happen? I would like it to.

Adam Tomkins (Glasgow) (Con): Good morning. I want to focus on solutions to what I am going to call the clause 11 problem. Everybody around the committee table fully understands the Scottish Government's position and, as you know, we have taken evidence from UK ministers in two different departments to try to understand the UK Government's position as well. Rather than going over that ground, I want to peer a little more—one might even say do a deep dive—into what the solutions are.

Can I take it that the Scottish Government agrees that there is likely to be a solution in and around common frameworks?

Michael Russell: I am hesitating, because there cannot be a solution if clause 11 remains unchanged. Frameworks in and of themselves are not going to produce a solution. They are a necessary part of the solution, but they are not sufficient to produce the solution.

Adam Tomkins: That is helpful. Will clause 11 need to be amended to reflect the existence of such frameworks?

Michael Russell: That would be a possibility, but the main objection to clause 11 is that it changes the devolved settlement. At least, that is our objection to it. We do not accept that change. If the Secretary of State for Scotland is to be believed—and I am sure that he is—when he says that it should be done by agreement, not imposition, clause 11 will have to be changed, as it still has an element of imposition in it.

Adam Tomkins: The Secretary of State for Scotland has made it clear both in the House of Commons and here that his position is that all 111 of the powers identified in that Cabinet Office list

will be exercised after exit day either by this Parliament or subject to a common framework to which the Scottish Government is a party. I am speculating, but if clause 11 were to be amended to reflect that position, would that satisfy you?

Michael Russell: I do not want to be difficult with you, but I would want to see the wording on that. It would be a step forward from where we are now. We have one means of amending the bill, which essentially expunges the issue of clause 11. If there is another solution that accepts that any changes take place by consent, that is something that we would be willing to discuss, and always have been willing to discuss.

Adam Tomkins: Professor Rick Rawlings took part in our previous evidence session. In his written evidence, he suggested that in place of clause 11 there might be included

“a power to add, remove or modify reservations in the devolved settlement(s) to reflect frameworks”.

That would presumably be done by a procedure under section 30 of the Scotland Act 1998, which would require the consent of not just Scottish ministers but the Scottish Parliament. Is that the sort of thing that you would be prepared to look at?

Michael Russell: I can see the way in which that might operate successfully and would meet our objections in terms of imposition, and that is the key issue. It has to be negotiated and agreed; it cannot be imposed. If any amendment or set of amendments were to come forward that removed the imposition and made sure that that was done, and could only be done, by agreement, we would be more than willing to discuss those amendments. Of course, I cannot give a hard and fast acceptance, but there is an opening there. However, I would counter that by saying that we would prefer the route that we are taking on this with our amendments.

Adam Tomkins: I have to say that I am still not entirely satisfied in my own mind that I will know what a common framework will look like when I see one. I have not seen one. Can you help the committee to understand your thinking on how the frameworks will be constructed and how they will be policed and enforced in the event of there being what looks to one party like a breach of a common framework somewhere down the line?

Michael Russell: That is precisely the work that is under way. There is not one standard common framework. There will be a degree of different arrangements, some of which will replicate what we already have in some areas, which is the ability to work together. A slightly unusual example that I dredged from my memory the other day, going back to my time as Minister for Environment, is the solution that was found to the Solway and Esk

issue, in which two different Administrations administer rivers that cross the border. I am not saying that that is a template; it is simply one way in which a contentious and difficult situation was solved at the time of devolution.

Different types of arrangements will be arrived at. The work of the deep dive—Ian Davidson has just surfaced after more deep diving—has been first to identify the proof of concept and whether it could be done, based on looking at the specific details of one or two areas. Then we ask whether we could devise a system of governance around that that accepts the co-decision making—that phrase would need to be fleshed out—that we would have to be involved in. There would have to be confidence that we could reach decisions in a way that would be binding on all of us. That work has been moderately successful.

Having gone from principles to proof of concept then to governance and dispute resolution, we need two more stages: political agreement on the subjects covered out of the list of 111 and, finally, their conversion into legislation, should that be required, through embedding them at either the macro level—solving the clause 11 problem—or the micro level; for example, in the proposed agriculture bill.

Out of those five pieces of progress that we need, we are probably reasonably well down the road on three of them. The other two require action. Damian Green is here tomorrow, so perhaps we will make some progress on them. They will then need to be converted to action.

I am moderately confident that the matter is going in the right direction, but we need to resolve the clause 11 issue. Either it is all agreed or nothing is agreed.

09:15

Adam Tomkins: I understand that. Your fifth point is the legislative issue. Are you content in principle—of course, you will want to see the detail—that a number of the common frameworks might need to be reflected in legislation?

Michael Russell: I have always said that there will be a need to reflect one or more of the common frameworks in legislation. Agriculture is the obvious one, because an agriculture bill is proposed. Let us see how it happens. It would not be automatic. I can imagine the common frameworks operating without legislation, but there is a potential for them to be legislated on.

The Convener: I will pick up some of the nuances of the discussion that you just had with Adam Tomkins. In relation to the evidence from Rick Rawlings, your answer was quite interesting. The Scottish Government's position is rightly

centred on consent and agreement. When the Scottish Government consents and agrees to things, you can move forward. I understand that, but Professor Rawlings talked about other circumstances in which you could countenance alterations to schedule 5 to the Scotland Act 1998 that expand the scope of reserved competence. That is what Adam Tomkins was referring to in his question. Does that mean that the reality behind the scenes—the nuance of this is important—is that the UK Government will be able to legislate in areas that are devolved if we agree them rather than powers being reserved?

Michael Russell: I can conceive of that happening, but let us be straightforward: I am not willing to undermine the principle of devolution. The core principle is that there should be clarity between what is reserved and what is devolved. We are in a different set of circumstances. They are unexpected and unwelcome circumstances, so it is incumbent on us to negotiate and discuss, but we will not undermine the devolution settlement. We will not accept anything—again, Wales has found itself in this position—that means that we are unclear about what is reserved or devolved or that means that new reservations are imposed on us. That is clear. The rest of it is for negotiation because we are trying to find a legislative solution to a complex problem.

The Convener: I wanted to make sure that that nuance was drawn out.

Patrick Harvie (Glasgow) (Green): Good morning, minister. The question that still seems unanswered is whether the UK Government asserts, or the Scottish Government implacably rejects, a belief that a common framework requires a single decision-making level.

Some of our witnesses used the example of marine planning, in which there is a mixture of reserved and many devolved areas, there was a consultation process at both legislative levels—stakeholder engagement and parliamentary scrutiny—and there was separate legislation in the two legislatures. Does that deserve to be called a common framework, given the fact that it would be permissible for there to be divergence in the future? It would not be something that Adam Tomkins called a breach—it might be unfortunate or unhelpful, but it would be legitimate divergence within the current arrangements.

Michael Russell: I absolutely concur with your view that agreeing the common frameworks is not, and should not be seen as, a means of imposing uniformity on the agreed devolved settlement. That is not what it is about. It is about dealing with the interfaces that have been created as a result of the Brexit process, which have not occurred before and require resolution.

In the established example that you gave, only in those areas where EU competence is presently being exercised and where there is a dispute about where that competence should lie after Brexit—should it take place—would the question arise of whether there should be a framework. If the existing operation works well, I do not think for a moment that there should be a framework there. Marine planning is a good example of that: there is a clear set of arrangements, a range of organisations are involved and there are established ways of dealing with any dispute or conflict that arises.

Patrick Harvie: Therefore, if Mr Mundell is still saying to you what he said to us, which is that he wants to have a process to agree where there will be common frameworks, but not necessarily agreement on the contents of common frameworks, we have a problem.

Michael Russell: Let us start with the list of 111 points. If something is not on that list, it is by definition out of scope and consideration. If things were to start being added to the list of 111, this whole thing is doomed—we could not make any progress. Indeed, we should pare that list back. We do not accept that anything should be on that list, to be blunt—all those competences should come back here. In the process of negotiation and discussion, if items were to fall off the list because there is no interest in them, there is no reason why they should be included in any of the frameworks.

An example that was used by Adam Tomkins in his article—I am a keen student of his writing—was aircraft noise, if I remember correctly. It is perfectly possible to exercise the competence on aircraft noise under existing legislation and powers; we just have to say that the competence that is coming back goes directly to Scotland. Therefore, we could take that sort of example out of the list and we would be left with a range of issues that will require further resolution. Our initial approach is that those competences should all come here; the UK Government's initial approach is that they are all reserved. The solution may be somewhere in the middle in shared frameworks operating under co-decision making. We recognised that last year in the "Scotland's Place in Europe" paper. We have not changed our position.

Alexander Burnett (Aberdeenshire West) (Con): Good morning, minister. I want to go back to the common frameworks and the statement of principles that was agreed by the joint ministerial committee on European Union negotiations. I will not read the principles out in full, but they include the principle that there should be common frameworks to

"enable the functioning of the internal market ... ensure compliance with international obligations ... implement new trade agreements"

and

"enable the management of common resources".

Will you talk a bit more about how the principles were arrived at? Were they co-produced by the UK Government and you or were they just presented to you?

Michael Russell: We were presented with an initial list, which was unacceptable to us. In essence, it did not recognise the principles of devolution. There was then a classic process of negotiation: officials undertook heavy-duty negotiations to come to a set of principles that we could agree—those principles are in front of you.

When we agreed those principles at the most recent JMC, on 16 October, I made it clear that they should be published. It is quite interesting that they were appended—to the communiqué, I think—by agreement of the meeting, so that they were clear. We will try to keep doing that as we go forward. The next JMC will meet on 12 December and I will want to ensure that we are entirely clear about what we are doing. We have established that those are the principles to which we are working. We need to be clear that we are illustrating the proof of concept that has taken place and I hope that, by then, we might be able to illustrate the governance issues. We will build on the process, partly to build confidence between the partners who are negotiating and also for the public, so that people understand that firm, clear foundations are being put down.

Alexander Burnett: Would you go so far as to say that the JMC is much more constructive than it was previously?

Michael Russell: It depends what you measure from; the baseline was quite low. We worked hard last year to try to get the JMC up and running, and it was disappointing when it stopped meeting. The UK Government broke the agreement to meet monthly and broke the agreement on the means of seeking agreement on the article 50 letter.

Previously at the Finance and Constitution Committee, I have paid tribute to Damian Green and his effort to get the JMC going again. One of the things that has changed is the membership. The JMC is a very unwieldy instrument. I never tire of telling the story of the JMC on Europe that I attended in 2009 at which there were 21 UK ministers, me and Rhodri Morgan—it was not exactly balanced. The most recent JMC was attended by the First Secretary of State, the Secretary of State for Exiting the EU and the three territorial secretaries of state—that was it—and I sat on the other side of the table with Mark Drakeford. That was a better dynamic and Damian

Green also chaired the meeting in a way that created a better dynamic. That was one of the factors that allowed us to make some progress.

We are committed to the process and so are the Welsh, and it is good if the UK Government is committed to the process. I was sorry that the Northern Ireland Administration was not there—that is a major loss to the process. I was in Northern Ireland on Friday and Saturday last week and it is clear that there is a need for participation. I had a meeting late on Friday afternoon with cross-community organisations and businesses and their very strong view was that they should be represented at the JMC and that their voice should be heard.

We will endeavour to continue to build confidence in the process.

Ivan McKee (Glasgow Provan) (SNP): Thank you for coming to talk to us this morning.

Patrick Harvie touched on the issue of common frameworks and I want to follow up on that. When the Secretary of State for Scotland was here he spoke about the LCM and said that if we got to the stage of agreeing what the process for agreeing was, that would be sufficient progress—rather than actually agreeing to agree it. Using your five steps, I think that takes us to about step three and a half. Do you agree with that perception of how we will reach agreement?

Michael Russell: The words “sufficient progress” have a different meaning in the lexicon of Brexit, so I will be careful about how I use them. It is not the case that the process moves forward because we have sufficient progress; they are discussions in which we need to reach a conclusion—there is an end point, both in time and as an objective. The end-point objective is to get the bill passed in a way that can be given legislative consent, so that we can move on. The objective in time is to do that before the bill completes its passage.

That is what we have to achieve, so I do not accept that we are simply talking about talks or seeking ways to agree about agreements. We have an objective to meet and the question is how we get there. We have done it methodically, which is the right way to do it—we have done it by agreeing principles and we are now doing it by proof of concept. We suggested that we look at a number of areas to see if we could work out how the frameworks would work, and we are now looking at governance and dispute resolution. Then, we will need to look at the wider context of how we relate to each other through the bill and the changes to the bill. Finally, that will have to be expressed in legislation.

I am keen for us to keep moving along that path. Tomorrow’s meeting with the first secretary and

then the next JMC will be further aspects of that. We will reflect on the experience of Ian Davidson and his colleagues of the deep dive process and I hope that we will be able to cement something in. Our objective is to take it step by step towards an agreement.

Ivan McKee: If we have agreed what common frameworks look like and have agreed the process for agreeing, but have not yet nailed down the details or specifics, would that be considered sufficient?

Michael Russell: If we have confidence that we can see how the frameworks would work—that would be proof of concept, governance and dispute resolution—that would be fine. However, nothing is agreed until all is agreed. The key that turns the lock is quite complex. We have to have trust and believe that the frameworks will work, but there must be actual changes to the bill—both those things must happen. If, at the end of the process, those things have not happened, there will not be an agreement. That means that there will be no legislative consent motion and it might mean that we introduce a continuity bill. We have options. However, we are committed to the process.

Ivan McKee: My final question is on that point. If there is a failure to agree, where does that leave us?

Michael Russell: We have made it clear—as have the Welsh—that the less desirable option is to have continuity legislation. That will be hard work and there are some difficulties in that, but if it has to be, then it has to be.

We can resolve this, as long as there is an understanding that the bill has to change, and as long as we continue to make progress on the discussions that we are having. The official discussions have been positive, and progress is being made in them. That is a good thing, because there were periods this year when the official discussion was producing nothing of any description.

09:30

Ivan McKee: Thank you.

The Convener: Can I tease that issue out a bit, minister? At the end of the process, a final piece of the jigsaw will have to fit into place before agreement can be reached—nothing is agreed until everything is agreed, as you said—and I guess that the final piece of the jigsaw will be the conflict resolution issue. The secretary of state said that agreement should be reached by consent in relation to the process, but that is different from agreement on the content of the frameworks, as Patrick Harvie said. That final piece of the jigsaw

needs to be in place, to give not just the Scottish Government but this committee some assurance that the issue is resolved. Where are we getting to on conflict resolution?

Michael Russell: My view is that we build our way towards agreement by building confidence and trust in the process, so that as we discuss these things, we do so on the basis that we trust each other and will get an outcome that is acceptable. That process is on-going. There have been discussions this week on dispute resolution and governance, and we will reflect on the outcomes of those over the next few days and certainly in our discussions with Damian Green tomorrow.

I will be happy to have a further conversation with the committee when we know where we are. I suppose that the next key date is the JMC on 12 December, at which we will seek to make progress on those issues. If we can come out of that meeting with some agreement on the next steps, I will be happy to report that to you—but we are not there yet, so I will not overclaim what the situation is. You are right to say that conflict resolution is a key element, just as the principles and proof of concept were key elements. All those things fit in, step by step.

The Convener: Yes, but conflict resolution will probably be the last piece of the jigsaw to fit into place.

Michael Russell: The last piece of the jigsaw will be to convert all that into legislation—into an amendment to the bill that is acceptable to all of us. I say all that without prejudice to the outcome of the negotiations; we are doing our best and we are very happy to talk about the issues—we do not think that they should be secret—but equally I cannot identify the precise moment when that will happen.

The Convener: Let me go a bit further on that, if you do not mind. This is the question that I really want to ask—I am not sure that I should ask it as directly as this, but I am going to do so. If, at the end of the process, there is no resolution on how we sort out the fine wording of the frameworks and on conflict resolution, will that mean that you cannot recommend a legislative consent motion to the Parliament?

Michael Russell: Yes.

The Convener: That is important. This committee needs to know that, because we will have to take a view on how important that last piece of the jigsaw is.

Michael Russell: I am happy to put it on the record that we absolutely will not recommend an LCM unless we are convinced, first, that we have frameworks and a structure that will work and,

secondly, that the amendments to the bill will meet our objectives.

The Convener: Thank you.

Neil Bibby (West Scotland) (Lab): We have heard evidence that, despite assurances to the contrary, the Scottish Government routinely relies on UK subordinate legislation in the transposition of EU obligations, without this Parliament being kept informed, let alone asked for its consent. If the UK Government concedes that the consent of the Scottish ministers is to be sought before the UK ministers amend the Scotland Act 1998 or other legislation within devolved competence, what assurance can you give the committee that the Scottish Government will inform the Parliament before it consents to such amendments and will consider seeking parliamentary approval?

Michael Russell: I gave that assurance at the last meeting of the committee at which I gave evidence, Mr Bibby, and I am happy to give it again. That is what we will do. Not only did I give that assurance but I said that we want to set up a mechanism to ensure that we do not exercise our own powers until we have consulted. I understand that that discussion with the Parliament is on-going and I am keen that it reaches a conclusion. I have no wish to take on powers that are allocated to us and then exercise them in a way in which I think that they should not be exercised at Westminster.

There are amendments to the withdrawal bill that will give effect to changes at the UK level on that. We will, at the very minimum, mirror those, but I intend to go further and to make sure that there is an agreement between the Parliament and the Government about how we do that.

Neil Bibby: Thank you for that assurance, minister.

Willie Coffey (Kilmarnock and Irvine Valley) (SNP): Clause 7 protects the Northern Ireland Act 1998 but there is no such protection for the Scotland and Wales acts. In your discussions, has there been any progress on that issue, or is that in the basket of asks that we can look forward to in amendments?

Michael Russell: It is in the basket of asks for the amendments. There are particular difficulties with regard to Northern Ireland, as we know. We should always be conscious not to draw an exact parallel with Northern Ireland, and we do not draw an exact parallel with Northern Ireland. Clearly, however, protection for the Northern Ireland Act 1998 and no protection for the Scotland and Wales acts is not equitable treatment, and there are issues that need to be addressed with regard to that fact.

It should not be assumed that we approve of all the parts of the withdrawal bill that we have not sought to amend. That would be a misreading of our position. We have been very careful about saying what we want to amend, because the process of amendment is for Westminster members of Parliament to undertake. They are the people who will discuss, for example, the European charter, as that is a Westminster issue, although I would want to see it maintained and I am sorry that the vote did not follow through on that. We have focused on the areas that we believe produce a threat to the devolved settlement and that we, therefore, want to change, but we look to Westminster MPs to object to and amend the other areas. Our Scottish National Party MPs have done that, Labour and Liberal Democrat MPs are doing it, and some Tories are doing it from time to time, so there is fairly widespread opposition to some parts of the bill.

Willie Coffey: When the Secretary of State for Scotland came to see us, he said he was quite happy to talk about extending the Sewel convention to cover secondary legislation—he is on record as saying that. How should that commitment be put in place if it is a genuine offer?

Michael Russell: I think that that exists in Wales, because of the legislative processes there. We would be very happy to enter into constructive discussions with the secretary of state at any stage about changes to that process. That would involve this Parliament very heavily, I think, rather than the Scottish Government, but of course we should have those conversations.

Emma Harper (South Scotland) (SNP): Good morning. Minister, you mentioned that you were in Ireland over the weekend. I know that the border in Ireland continues to be a huge sticking point. My area includes Cairnryan, which is the third-largest ferry port. Is there any progress on the border and, if there is, how will it help or hinder us in Scotland?

Michael Russell: We have to be careful in discussing that issue. Again, we are clearly not drawing exact parallels of any description. I was in Dublin on Friday morning to speak at an event in the very beautiful Royal Irish Academy in Dawson Street. I had a series of meetings, including with the British Irish Chamber of Commerce, which on Monday published an excellent report about trade and the fact that a customs union needs to be secured in order for the chamber of commerce to continue the work that it does, which is very important for trade between the UK and Ireland.

After speaking at the event in Dublin, I was driven to Belfast for a meeting with cross-community leaders, and then I presented an award and spoke at the Aisling awards ceremony, which is a big cross-community event. On Saturday morning, I was given a tour of the peace

walls by Professor Deirdre Heenan, who is pro-vice-chancellor of the University of Ulster and an expert on community and community issues. I was very struck by the sensitivity and the importance of the border issue there.

I was in Brussels last week, too, where I was struck by how the dialogue there on the question of “sufficient progress” on that issue had changed utterly in the two or three weeks since I was last there. It had moved on from issues of finance and citizens’ rights to a focus that was almost entirely on the border issue and how it would be resolved. That will be up to negotiators and others, but it is a very difficult conundrum. It is obviously utterly unacceptable to Ireland and to many people in Northern Ireland that there should be any impediment on the border. If you drive the border, you know precisely why that is. It has 257 crossing points. Only 20 of them were open before the single market, so that has transformed the position.

There is a wonderful statistic, which I cannot remember exactly, about border crossings in Europe: there are far, far fewer crossing points—the number is in the teens, I think—on European frontiers from the Arctic circle to the Black Sea than there are on the border with Ireland. It would change things in a very damaging way were there to be impediments on crossings. That needs to be resolved, but the UK Government is resolving it in the context of its political agreement with the Democratic Unionist Party, and you have heard what happened at the DUP conference this week. It is up to them to resolve it.

As I said in an interview in Ireland on Friday morning, there are issues that arise for the Scottish ports of Ardrossan, Stranraer and Cairnryan with a border down the Irish Sea. The physical issues would have to be coped with, of course, because of the capability of those ports. If customs checks had to be introduced, that would create a big difficulty. I have met representatives of the British Ports Association and the UK Chamber of Shipping to talk about the physical infrastructure of ports, which would take some time to deal with. There are also security implications that will have to be dealt with too. That is clearly unacceptable in parts of Northern Ireland, and it could be problematic.

The solution lies in what the Scottish Government’s position is now and has been for the past year, which is that we should not be leaving the EU but that we should definitely not be leaving the single market and the customs union. That is crazy, because it will create all those difficulties and there are no advantages to leaving them. The “boasted advantages”—if I may use that Burnsian phrase—of Brexit in that regard are absolutely untested and fall to pieces when you

look at them closely. Where are the free-trade agreements that are to be held with lots of other countries and are going to compensate us for the front-page story today about the Fraser of Allander institute report about the loss of jobs and trading income that will result from our leaving the customs union? We need to be clear that the best solution is undoubtedly continuation of the customs union and the single market—certainly of the customs union—and if that is to take place for Scotland, it should also take place for rest of the UK, because that avoids those issues and allows the trading relationships to continue.

It is not simply the Scottish Government that is saying that. It is being said widely, for example by the British Irish Chamber of Commerce. It is the position of business and industry, which are saying that, if we impose new barriers because we have removed ourselves from the customs union, we will do nobody any favours of any description. The French ambassador to the United States pointed out, rather memorably, about a month ago that it is not in the interests of free trade for us to remove ourselves from the largest free-trade block on the planet and from 53 free-trade agreements, which is precisely what is happening. That needs to be reconsidered.

Emma Harper: Thank you.

The Convener: The minister mentioned the Fraser of Allander institute. I think that Patrick Harvie wanted to ask about sectoral impacts, so this is probably as good a place as any for him to come in.

Patrick Harvie: I wanted to ask when an impact assessment is not an impact assessment. You wrote to the UK Government yesterday, after being given what I think you described as material that is

“shallow and contains no policy options still less assessment of impacts.”

Am I right in thinking that you have agreed to accept that information from the UK Government on the basis of secrecy, and that you will not be sharing it with the committee?

Michael Russell: You are right to say that the material was given to us on the understanding that we would not publish it, and in those circumstances we are certainly not going to publish it. However, we have urged the UK Government to publish it, as the material belongs to it, and we have supported the Exiting the European Union Committee’s position that it should be published. We have to be careful about what we do—what any Government does—when given material by another Government, just as we want others to be careful with material that we would give on intergovernmental terms. I am not going to publish it, but I am urging the UK

Government to publish it, and I am urging it to publish the material that clearly is not in what we have been given, which is in the form of standard templates that have been filled in and which is pretty thin. Some of it I recognise from papers that may have come to the joint ministerial committee when it was meeting, so some of it is a rehash of other material.

Patrick Harvie: I do not think that any of us should be surprised that you are unimpressed by the quantity and quality of what is there, given that the UK Government has variously described the impact assessments as existing, non-existing, sketchy and “in excruciating detail”. The assessments cannot be all those things simultaneously. I am slightly disturbed by the implication of your decision to accept the information on the basis that you will withhold it from parliamentary scrutiny and from public scrutiny. Surely you agree with the basic principle that, if Westminster parliamentary scrutiny has access to that information, so should Holyrood parliamentary scrutiny. Surely you would not provide information to the UK Government on the basis that it would keep it secret. Why agree to the same thing in reverse?

09:45

Michael Russell: Let us just be clear about that; I might well provide a letter or information to the UK Government on the basis of confidentiality. That would be a reasonable thing to do. If the—

Patrick Harvie: Earlier this month in the chamber you said to me:

“The Scottish Government believes in the need for transparency in the Brexit negotiations”.—[*Official Report*, 2 November 2017; c 5.]

The Convener: Patrick, please let the minister finish his answer.

Michael Russell: The Scottish Government does believe in the need for transparency. You asked me whether I would provide material to the UK Government on the basis of secrecy and I indicated that, in the course of negotiations, I would provide, say, a letter or information to the UK Government that was confidential. It might not be confidential for ever, but that could be the basis for an exchange of letters. I have exchanged letters with members of this committee on a confidential basis and I am sure that I will do so again. However, if the material is provided publicly to every MP, for example, I would regard us as being no longer bound by any condition and would therefore think that every MSP should have it, too. We are not at that stage yet, but I do not think that we are far away from that material being in the public domain and I will be very comfortable about that.

I have to be very careful that I am not simply receiving material or information and automatically publishing it. My inclination is to make everything public that I can, but on this occasion the material was provided to us and the Exiting the European Union Committee in a confidential way. I think that it should be public and that it will become public, but I cannot make an ex cathedra decision on that. It is parallel to what happens with freedom of information requests., which is that, if you seek a document, you should seek it from the person from whom it originates. The Scottish Government has done that before and we have to be mindful of it.

Patrick Harvie: I will just express surprise that you have agreed to accept information on the basis that you will withhold it.

Michael Russell: Just to be absolutely clear, I have not “agreed” to accept it—

The Convener: We are getting miles away from the bill now.

Michael Russell: Convener, I just want to make it clear that I have not “agreed” to accept it—it was provided to us. I would not want to be misrepresented on that matter.

Patrick Harvie: So—

The Convener: Patrick, you have had enough.

James Kelly (Glasgow) (Lab): I am interested in the Ireland-Northern Ireland aspect. I totally agree with what you said earlier about it being regrettable that there is no elected representation from Northern Ireland in the discussions with the devolved Administrations. You clearly had extensive discussions in meetings across there during your trip at the weekend. Have you picked up any sense that there is a chance of that impasse being broken—perhaps by ensuring that there is an election—or that elected officials will become involved? This is a crucial time for Northern Ireland in relation to Brexit, but the table is empty of elected officials from there.

Michael Russell: Yes, and that is deeply to be regretted. It is a matter for the Northern Irish parties and I would not want to interfere in any way, but I do not get any sense that change is imminent. That is problematic. It is axiomatic that we are at a crucial stage—we are always at a crucial stage with Brexit—but there is a lack of representation. At the JMC, the presence of an official, no matter how senior, is not the same as having the political parties represented.

At the start of this process, Northern Ireland chose that its membership of the JMC should be the First Minister and the Deputy First Minister, so Arlene Foster and Martin McGuinness were the original representatives. That showed the seriousness with which the matter was taken and

the difficulty of the issue in Northern Ireland, because Northern Ireland voted to remain but its principal political party voted to leave. Martin McGuinness was very focused on squaring that circle. I do not think that the process has moved on in any way, which is to be regretted.

We keep our dialogue going and I have always tried to meet all the political parties. I was not able to see anyone from the DUP this weekend, because it was in conference, but I hope to see them at some stage. We try to keep a dialogue open so that conversations can take place. For example, the issue of the withdrawal bill is one that needs some focus in Northern Ireland, because it affects the Northern Ireland Assembly just as much as it affects the rest of us, but it has not had that focus. A number of the parties regret that and have had conversations with me and Mark Drakeford about it.

The Convener: Because we had time, I gave members a bit of latitude to cover areas beyond our primary purpose today. I think that we have asked all the questions relating to the legislative consent motion and the European Union (Withdrawal) Bill. Thank you for coming in front of the committee, minister. I will suspend the meeting to allow a changeover of witnesses.

09:50

Meeting suspended.

10:12

On resuming—

Budget (Impact of Brexit)

The Convener: Item 2 is to discuss the impact of Brexit on the Scottish budget. We are joined for this item by Dr Jim Campbell, reader in economics at the women in Scotland's economy research centre at Glasgow Caledonian University; Jonathan Hall, director of policy and member services at NFU Scotland; and Naomi Clayton, policy and research manager at the Centre for Cities. I thank the witnesses for coming along today and for their written submissions. Adam Tomkins will ask the first question.

Adam Tomkins: Good morning, everyone. My question is really about cities so I direct it at Naomi Clayton in the first instance—the other witnesses can chip in, by all means.

I am an MSP for the Glasgow region so I have a particular interest in the impact of Brexit on the Glasgow economy. A paper on that was published in October 2016 by Glasgow City Council, Glasgow economic leadership board and Glasgow Chamber of Commerce. On the publication of that document, the then leader of Glasgow City Council, Councillor Frank McAveety, said:

“Brexit will confront Glasgow with major economic challenges”

but

“these can be overcome if special action is taken by the Scottish and UK governments. If that happens then the problems associated with Brexit can become an opportunity for economic growth”.

What are the opportunities for economic growth for Scotland's cities, including Glasgow, that Brexit represents, and how can we ensure that we take those opportunities?

Naomi Clayton (Centre for Cities): In our work on the potential impacts of Brexit in terms of the change in the UK's trading relationships, we found that every part of the UK, including every city, is likely to be impacted by exiting the EU, whether that is under a hard Brexit or a soft Brexit. Therefore, we definitely need to look at ways of mitigating the impacts of Brexit.

10:15

First, we must ensure that we secure the best trade deal with the EU for the UK, so that our cities and the businesses in them are able to continue to trade with their main trading partners. We also need to look at ways of supporting businesses, by ensuring that they are able to access the skills that they need. There is a key need for cities and city regions to understand the role of business and

businesses' skills needs, and to ensure that education and training providers respond to those needs. It is absolutely vital that we mitigate the impacts on migration through education and training providers, and that we continue to ensure, at a city level, that businesses are able to thrive through investment in infrastructure and skills.

There are still opportunities, as regards how we ensure that our businesses are able to trade not just with the EU but around the world. However, there are key ways in which our cities can support businesses to do that.

Adam Tomkins: Is it your sense that the Scottish Government and the UK Government are doing enough to help cities in Scotland and in the rest of the UK to mitigate—as you put it—the effects or impacts of Brexit? Councillor McAveety said that he was calling for assistance from both levels of Government in Scotland—from both the Scottish Government and the UK Government—to assist Scottish cities to do exactly what you describe, which is boost infrastructure and investment and invest in skills training.

Naomi Clayton: The two city region deals for Glasgow and Edinburgh represent fairly significant funding agreements. What they do not represent is any devolution of powers and responsibilities or any fiscal autonomy. It will be important that the UK and Scottish Governments work with our city authorities and city regions to look at the powers and responsibilities that they need to be able to respond to their unique challenges.

Adam Tomkins: You are the expert on that. What is your view on the powers that cities in Scotland need, but do not currently have, to mitigate the effects of Brexit? I am glad that you mentioned the Glasgow and Edinburgh city deals. The interesting thing about those is that the Glasgow city deal is pre-Brexit and the Edinburgh city deal is post-Brexit. In your judgment, do the most recent, new-generation city deals adequately reflect the fact that we are going to leave the EU?

Naomi Clayton: There is always an argument for more investment in areas such as skills and education. There is also an argument for looking at ways in which Scottish cities can gain more fiscal autonomy and the ability to gain from land value uplift in their cities—for example, from planning permissions and housing developments. If they are able to retain and capture more of that value, that will enable them to invest further in infrastructure and initiatives that help to support better economic and social outcomes in those cities.

Adam Tomkins: Thank you.

The Convener: Neil Bibby has a question on a wider issue around Glasgow. Perhaps he could deal with that just now.

Neil Bibby: I am an MSP for the West Scotland region, which borders Glasgow and covers a number of the local authorities around the city. I note that the Centre for Cities report said that non-urban areas would not be as badly affected as urban areas by the Brexit impact. A number of local authorities are not in cities but have densely urban areas. It appears from the map that came with the report that local authorities such as Renfrewshire, Inverclyde and East Renfrewshire would be as badly affected as Glasgow by Brexit, whether it is hard or soft. What would be the impact on employment and living standards in and around Glasgow? Would the same policy solutions that you outlined to mitigate the effects of Brexit and make a difference in Glasgow also work in the neighbouring local authorities, such as those that I mentioned?

Naomi Clayton: Those areas are obviously important parts of the wider city region and although our report finds that the cities and primary urban areas in Scotland would be likely to be hit hardest, we predict that every local authority would see a loss of economic output as a result of Brexit, relative to the what the position would be if we stayed in the EU. That means that jobs may be lost and wages could continue to stagnate, which would obviously impact on living standards. The impacts are not just confined to cities, but we need to look at how we can support cities to continue to drive economic growth through the policy initiatives to which I referred. We also need to look at how the Scottish Government and cities can continue to support inclusive growth, so that people in the wider areas surrounding our main economic growth poles are able to access employment opportunities in those areas.

The Convener: Before we move on to other questions, I will bring in the other two witnesses. I noticed that Dr Campbell's paper talks about areas where the Scottish Government would need to concentrate some of its activity and spending. It says that, for small to medium-sized enterprises in Scotland,

"the Scottish Government should be looking at ways in which their spending can contribute to faster growth in the short term and medium term".

Obviously, that is also true for cities. I ask Dr Campbell to expand on how that approach might help activity in the cities. At the moment, the questions are concentrating on Naomi Clayton and, to be frank, I want the other two witnesses to take up the burden.

Dr Jim Campbell (Glasgow Caledonian University): The point that my paper was trying to make is that we do not really know what Brexit will look like—whether it will be a hard Brexit, a soft Brexit or something in between. Trading relations between us and the EU will be different from what

they are now. There is no doubt that there will be barriers, which will be much more of an issue for small and medium-sized firms to deal with. The Scottish Government needs to provide support for companies that already export to mainland Europe so that they can continue to do so after Brexit.

The Convener: What might that support look like? Your ideas would help members to formulate our response.

Dr Campbell: At a practical level, it is about filling in the forms. After Brexit, we will have border controls and goods will be checked as they enter and leave the country.

Jonathan Hall (NFU Scotland): In the question that Mr Tomkins posed and in Naomi Clayton's response, there is a striking parallel. There are major economic challenges from Brexit, but then again there are significant opportunities and potential for growth. That applies equally to cities and rural areas—particularly rural areas that are driven by an agricultural industry that underpins the food and drink sector, which is so vital to the wider Scottish economy. There is a huge parallel there.

I was struck by Naomi Clayton's comments about trade, labour and migration issues being to the fore of her thinking because they are very much to the fore of our thinking. The added dimension from an agriculture and rural development point of view is the role that current European support plays. I am sure that we will come on to that. I was intrigued by the comment on non-urban areas. Does non-urban mean rural? Define, please. Of course, the definitions are very academic, but they are also very interesting.

We are in danger of falling into the trap of looking at issues as being particular to cities, small and medium-sized enterprises or a more industrial base and then considering agricultural and rural issues separately. We need to bring those things together.

The Convener: Do not worry, you will get to say your bit about your particular area. Several committee members represent rural constituencies—in the widest sense.

Ivan McKee: I thank the panel for coming to talk to us this morning. I want to lift the discussion to take an overview. My question follows on from Adam Tomkins's question about opportunities, because Naomi Clayton's answer was very illuminating.

Having read the your submissions and all the data that they include, we see a gross value added impact that ranges from bad in the case of a soft Brexit to very bad in the case of a hard Brexit—we see a public sector finance impact, an EU funding impact and a whole bunch of negative

impacts. The narrative is all about how we mitigate, rather than maximise, the impacts of Brexit. There seems to be no upside. It has been described as the first time in history that two sides have sat down to do a trade deal that will make them both worse off. Can you comment on that? Do you see any silver linings, or do you think that, based on the economic analyses, everything will range from worse to a lot worse?

The Convener: Who wants to take that on?

Dr Campbell: I will. You are right, Mr McKee: the economy would be better if we did not leave the EU. There is a consensus on that among most economists—the disagreement is about how much worse off we will be and whether it will be to a significant degree. That is up for debate—it relies on forecasts, so it all needs to be taken with a pinch of salt.

If you are looking for a silver lining, you may find it in public procurement. At the moment, that area is heavily regulated by European directives. For example, when the Scottish Government wants to give out the contract for the island ferries, it has to go through a whole procedure, which involves inviting tenders from across Europe and ends up with only one tender, which is from CalMac Ferries. That means that an awful lot of time and money is spent on something that is perhaps unnecessary. The Government might be able to take more control of public procurement, which it can then use to mitigate some of the problems that will result from Brexit. That is one upside.

Jonathan Hall: I support that point. Public procurement has a huge impact on the sourcing of food and food products. We have pushed hard on that issue for a number of years. There is an opportunity to look at that and at how local authorities, schools, hospitals, prisons and so on can be enabled to source local food from Scotland, which would be a boost to local producers, rather than that all being based on price, contracts and so on.

There are huge challenges; I am sure that we will come on to those and—do not get me wrong—we are very concerned about them. However, there may be a silver lining, given the way in which the common agricultural policy has operated in Scotland. To be brutally honest, although the CAP may have provided a degree of certainty and security for the past 43 years, it has not necessarily done Scottish agriculture and rural areas any great favours. There is a clear opportunity right now to recast how we support rural areas and agricultural businesses to deliver more of what we want in terms of quality food production, protection of the environment and sustaining rural communities. That opportunity will revolve around funding—I am sure that we will

come on to that—and, equally, how the Scottish Government delivers in that regard.

10:30

The Convener: Murdo Fraser will ask about that. We will get on to the area.

Jonathan Hall: I am just being impatient.

The Convener: No, no—we are all impatient in this Brexit world, I assure you.

Naomi Clayton: There is also a chance to look at the funds that will replace European structural funds, which provide important support to different parts of the country. There is a chance to improve the process, so that any replacement funds are managed and distributed in a way that reduces bureaucracy for local partners and improves outcomes.

Ivan McKee: On procurement, surely that is fine until we do a free-trade deal with another country, because the first thing that the other country will say is, “If you want to trade with us, we will have to have some rules about access to markets”, which means that we will be back to square one again.

Dr Campbell: I think that you are right. It is all in the detail—which we do not know.

Alexander Burnett: I am sorry to put Naomi Clayton back on the spot about the Centre for Cities’ report, but as the member for Aberdeenshire West it would be remiss of me not to ask about the finding that Aberdeen is an outlier. I think that there are three reasons for that. First, in the north-east we probably consider ourselves to be linked less to economic performance in the EU and even the UK, and more to economic performance in the oil sector. Secondly, when you mentioned the city deals you missed out the Aberdeen deal. Thirdly, in the summary of your findings you say:

“Cities predicted to be most negatively affected tend to be more productive and have highly skilled workforces, which means they may find it easier to adapt in the longer term.”

Given those three points, how accurate do you think your methodology is in relation to Aberdeen?

Naomi Clayton: Our work is very much a first look at the potential local impacts of a change in the UK’s international trade relationships. There are a number of caveats, the first being that we are looking just at the impact on trade and are not factoring in the impacts of changes to migration or the impact on foreign direct investment, for example. Once we start to add in other factors, we find that the impacts at national level are likely in some cases to triple. That is my first point.

My second point is that the report is a static analysis. We have not, to date, been able to model

how different areas are likely to respond to the economic shocks that Brexit is likely to bring. We know from the experience of the 2008 financial crisis that parts of the country that had higher wages and more productive and highly skilled workforces were better placed to adapt over the slightly longer term, and recovered much more strongly as we came out of the recession. To some extent, we expect that to be the case again. Cities such as Aberdeen and Edinburgh, which have highly skilled workforces and very productive economies, are better placed to adapt to changes.

A particular challenge for Aberdeen is its dependence on oil and gas and the potential impacts of Brexit on the sector.

Patrick Harvie: I want to ask whether something that Naomi Clayton just said has a connection to a point in Jim Campbell's paper. Page 12 of the Centre for Cities' key findings says:

"Even though the immediate negative impacts are predicted to be smaller in poorer regions, households in those areas start off poorer and may experience considerably more difficulty in adapting to those negative changes."

Jim Campbell's paper talks about the role of the care sector—social care and childcare. We have heard evidence from others that there is a multiplier effect—that there is an additional economic benefit from investing in that social infrastructure. Is it fair to say that it is likely that in poorer areas—where dependence on the care sector is perhaps higher—the multiplier effects will be stronger and investment in social infrastructure might have the potential to mitigate the effect that the Centre for Cities mentioned in relation to poorer regions, where households that start off poorer will be less able to adapt?

Naomi Clayton: The levels of disparity between different parts of the country represent a long-term challenge in the UK. As I have said, our research found that it is likely that everywhere will be impacted by Brexit. Although the initial shocks may be smaller in less-affluent parts of the country, we know that unemployment rates tend to be much higher and wages tend to be much lower in those areas, so the initial shocks might have longer-term impacts on those economies, which are likely to be less able to adapt in the way that some of the stronger-performing parts of the country will be able to adapt.

Investing in social infrastructure—education, ways to improve school performance, retraining schemes and other ways of supporting individuals in the less-affluent communities to access employment opportunities and to progress—is a fundamentally important part of helping those places to adapt to the changes that Brexit is likely to bring.

Dr Campbell: If you are looking to generate employment, investing in the social economy will create more employment than will investment in construction, for example. All the evidence tells you that. The one caveat to that, of course, is that employment in the care sector is low paid, both in childcare and in social care in general, so there also needs to be a move towards professionalisation of the care sector through education, qualifications or whatever. Its wages need to go up: childcare and social care are very important, but the market economy does not value them as they should be valued.

Patrick Harvie: Does the investment need to be in raising quality, and to be not just about scale?

Dr Campbell: Absolutely. All the studies on the social and economic benefits of childcare include the caveat that it needs to be high-quality childcare: it is not just about sticking a kid in front of a video for a couple of hours and thinking that that is them being looked after. Childcare has to be stimulating and in some sense educational.

Ash Denham: It seems to be the trend this morning for members to say where they represent, so I will stick to that. I am an Edinburgh MSP, so I will ask a question about Edinburgh. Naomi Clayton's paper states that

"Cities with large shares of employment in private-sector knowledge-intensive services"

are likely to be particularly impacted by Brexit. Obviously, that includes Edinburgh because it has a large financial services sector. One impact there could be reduced employment, which I think you said in your paper.

For the first time, Scotland is going to be responsible for income tax. If there is reduction in employment, particularly in well-paid jobs—of which there are quite a lot in Edinburgh—that would affect the Scottish tax take, which would affect public services in the future. Is that what the Scottish Government should be preparing for? Are you able to put any numbers on that, or to say what the scale of the impact would be?

Naomi Clayton: I repeat the earlier point about caveats that we highlight in the paper: it really does represent a first look at the potential impacts of Brexit under different scenarios. Also, the paper is based on very detailed models of trade flows and impacts on various sectors. We find that financial and business services are likely to be particularly hard hit under a hard Brexit because of the impact that the increase in non-tariff barriers will have on those sectors. If those impacts play out in loss of employment and earnings, of course that will impact on tax take. That is particularly significant, given that per capita levels of tax take in Edinburgh and Aberdeen are among the

highest, so that might well have an impact on Scottish finances overall.

However at this point, there are so many uncertainties with regard to the nature of the deal that will be agreed with the EU. Therefore, in terms of the reality post-Brexit, and the elements that we have not been able to model as yet that will show us how places are likely to adapt, it is difficult to put firm numbers on the overall economic impacts, and therefore on the impacts on tax take.

Dr Campbell: I have one additional point to make. Naomi Clayton is right that the biggest impact will be seen over time. On the impacts of our membership of the EU, the biggest impact occurred not when we joined, but as businesses changed how they behaved because of the change in the environment: they had access to a much bigger market, which encouraged investment and so on.

It is to be expected that if we leave, it will be another massive change to the business environment and businesses will react. The financial sector might react by leaving the UK because companies will not have the access to the European market that they currently have.

Murdo Fraser (Mid Scotland and Fife) (Con): I have a couple of quick questions on cities and then I want to ask about agriculture.

I am curious as to why the Centre for Cities' report covers only four Scottish cities in its analysis. There are seven, as I am sure you know.

Naomi Clayton: The Centre for Cities looks at the 63 largest urban areas in the UK, which includes the four largest urban areas in Scotland.

Murdo Fraser: Is it not a slight to Inverness, Stirling or Perth that they are not included?

Naomi Clayton: No, but we have produced figures for every local authority in the UK, including those authorities.

Murdo Fraser: My second point follows the question that Alexander Burnett asked about Aberdeen. I was quite surprised to see Aberdeen at the top of the table of cities that are most likely to be impacted. Most people's understanding of the Aberdeen economy is that, because of its connection to oil and gas, it is connected more to the dollar economy and to oil-producing countries around the world than to the Eurozone, and that those connections impact much more on Aberdeen's economic performance than the Eurozone does, with which it trades much less. Is that because you have looked at the question of shares of employment in private sector knowledge-intensive services as a generality, rather than digging below that headline to look at local economies?

Naomi Clayton: In our method we took the national model, which looks at all the imports and exports for all the industries in the UK, and applied it downwards using employment shares for local authorities and cities. Aberdeen stands out as the city where the initial impacts of Brexit are likely to be largest, partly because of the oil and gas industry and partly because of employment in the business services that support that industry. The model predicts that the oil and gas and business service sectors are likely to be hardest hit, which is why Aberdeen stands out as being one of the hardest-hit areas.

10:45

Murdo Fraser: Thank you. I take it from that that you applied a general model rather than specifically examining the make-up in individual cities.

Naomi Clayton: We examined the employment profiles of individual cities.

Murdo Fraser: Thank you.

I will move on to questions on agriculture for Jonathan Hall. I was interested in what you had to say about the common agricultural policy's impact in Scotland and the opportunity that presents itself to devise a system of agricultural support that is tailored to the needs of Scottish agriculture rather than its being handed down from Brussels. As things stand, we are due to leave the EU 16 months from now. What is your sense of the work that is being done in Government to devise that new system of agricultural support, which will need to be in place when we leave the EU?

Jonathan Hall: I will have to choose my words carefully—"sluggish" might be an appropriate word.

You see 2019 as being the point of departure: to be honest, it needs to be further ahead than that—say, 2021. We will need some sort of transition. On the day of departure, we need to continue to operate under a system that looks, tastes and smells very much like the CAP. We cannot afford to go off any sort of cliff edge. People talk about cliff edges all the time in relation to Brexit; if we go over the cliff edge in March 2019, Scottish agriculture and the food and drink sector that it supports would be in a difficult position because there are still some huge outstanding questions around the operating environment that we will find ourselves in on trade with Europe and non-European countries. It is anybody's guess how long it will take for those trade deals to emerge and solidify.

In the short to medium term, we will continue to need the CAP, whether we like it or loathe it. That said, between now and 2019 and in any transition

period, we must work very hard with the UK Government and the Scottish Government to secure the right framework for an agricultural policy throughout the United Kingdom that will cover the regulatory elements. There is clearly a need to maintain something of a level playing field within the UK if we are going to have intra-UK trade, movement of animals, pesticide use and environmental standards. Thereafter, the ability to deliver a new system of support that is tailored to Scottish circumstances must be devolved to the Scottish Government.

There are one or two clear and important landmarks or milestones on the near horizon. A UK Government white paper on agriculture will emerge in the near future and there will be a UK agriculture bill sometime in the spring. Our main focus right now when we talk to the Department for Environment, Food and Rural Affairs is on ensuring that the toolbox has the tools that will enable the measures that will be required to support agriculture and rural development in Scotland to be put in place. Today, we have four devolved applications of the common agricultural policy—four different delivery mechanisms—and we need to ensure that that approach continues in the future.

We also need the funding to underpin that. Any significant reduction in funding would be catastrophic: as well as needing to be able to do the right thing for Scotland, we need the funding to deliver that.

Murdo Fraser: Thank you. I will summarise what you have said to me. You expect a transition period so, come 2019, we will not have a new system. We will mirror the CAP support, whether we are in it or not, for two years, maybe. I am sorry, I am putting words in your mouth; I am surmising.

Jonathan Hall: No—that is fine.

Murdo Fraser: Thereafter, we will need to move to a new system. There will be something of a common framework in the UK, but most of the system will actually be devolved to the Scottish Government. What I am trying to get at is whether you are aware of any work that the Scottish Government is currently doing to create the new system of agricultural support that we need to have in place and that your members want.

Jonathan Hall: I do not think that anything concrete is being constructed on what that system might look like, either at Westminster or by the Scottish Government. There is a lot of rhetoric about where we might want to get to, but we are still lacking action on the steps that will take us there. We have set out the NFU Scotland's position very clearly, which is that we want ultimately to move away from an area-based

payments system, whereby occupation of land is pretty much all that one needs to unlock a support payment. We want to move to an activity-based approach in which action is supported—whether that is action to enhance environmental qualities or action to invest in agricultural businesses that can focus on new market opportunities. That is where we want to be. We are pushing both the Scottish and UK Governments hard and saying that that might be the vision that everybody keeps talking about, but asking how we will get there.

Murdo Fraser: At the moment not much is happening, but the NFUS and its members are bringing forward ideas.

Jonathan Hall: Absolutely. There is an increasing sense of frustration across the industry. The Scottish Government has recently produced a report from its so-called agricultural champions, and we have been quick to highlight what we would like—there is a lot of overlap—so there are lots of thought lots of and ideas about where want to get to, but we still need to work very hard at the mechanics of moving away from the common agricultural policy and how we will deliver what we all aspire to deliver. That is where it gets really difficult, because we have to take into account the fact that we still want to trade with Europe and other requirements and legislative issues. It becomes a very tricky road to walk, but we need to start taking some steps in that direction pretty quickly.

The Convener: What comes first: the agricultural bill and a framework, or the policy?

Jonathan Hall: That is a very good question.

The Convener: Of course it is. We need to get some priorities about what has to be tackled first.

Jonathan Hall: The agriculture bill setting out the broad framework should come first, but that bill has to include the scope to enable Scotland to do what is right for Scotland.

The Convener: Agreed.

Jonathan Hall: That is the danger at the moment. If it is too narrow—I will be slightly cheeky here and say, if the view of the world is that everything looks like Cambridgeshire—it is not going to do us any great favours. We need the scope of that bill to enable the Scottish Government to put in place measures that will work for Scottish agriculture and everything that it underpins.

The Convener: Although “sluggish” was the term that you used to describe policy development, it is a bit difficult for a Government to develop policy until it knows where the starting point is.

Jonathan Hall: I agree. There are definitely things that we can start to think about and plan for, but it is difficult if we do not know the parameters within which we have to work. The focus has to be on DEFRA at the moment, to ensure that the parameters are set in such a way that Scotland can be accommodated within the UK approach and that delivery is within the gift of the Scottish Government.

The Convener: We can have a great policy, but unless we have money to support it, delivering it will be even more challenging. In your written submission you say that you have had some assurances on the situation up to 2019. However, at paragraph 7 you say:

“Post-2022, the amount of money the UK decides to spend on farming and farming-related matters will have major consequences for Scotland. NFUS is clear that agriculture must continue to receive the same quantum of funding as it currently does under the CAP post-2022. This budget must be ringfenced to agriculture and rural support.”

What assurance have you had from the UK Government?

Jonathan Hall: We have had only the assurance of the Tory party manifesto of May this year. We have sought further assurances as to what that commitment to funding of farm support to 2022 or for the lifetime of the Parliament actually means. We have written to Mr Gove, as has the Scottish Government. We have not yet received a reply, although we wrote to him some months ago. We need clarification on what that commitment means.

I would go further than we do in our submission and say that we need at least the same quantum of money as we currently receive under the CAP, given that Scotland already has a budget disadvantage, in terms of the amount of money coming to Scotland via the CAP compared to the amount that goes to rest of the UK and to other EU member states, and that Scotland's reliance on that funding is critical.

The important point to note is how effective that money is once it comes to Scotland. Once it is channelled into Scottish agriculture, farms and crofts, it generates and drives the rural economy to an extent that is very difficult to quantify, although our calculations suggest that for every £1 that Scottish agriculture receives via the CAP, Scottish agriculture spends about £5.30. That supports a host of allied industries and enables the primary product that is going into the fastest growing part of the economy, which is food and drink.

The Convener: The purpose of today's meeting is to gather evidence on Brexit and the budget. In paragraph 10 of your submission, you mention the funding streams that might be used to support

agriculture in Scotland in the future. You have some concerns about future funding going through the Barnett formula. Would you like to tell us about those concerns?

Jonathan Hall: Under the current CAP arrangements, Scotland receives about 16.3 per cent of the UK's allocation. That is based on historical production across the United Kingdom. If we were to move to a simple Barnett formula approach, potentially we would be looking at 8 or 9 per cent of any budget that the Treasury might find in the future, instead of 16.3 per cent. That would immediately put us in a difficult position. Even if the budget was maintained in total and the Treasury committed to the same funding as the CAP, if Scotland were to receive only 8 or 9 per cent of that, it would effectively be a 50 per cent reduction.

That would be extraordinarily challenging for Scottish agriculture as a whole, but particularly for areas and regions that are more reliant on support, such as our uplands, and our more disadvantaged areas, which are heavily reliant on sheep and cattle, because those businesses are the most reliant on support payments through the CAP. The socioeconomic consequences of knocking that out of the system might be unquantifiable, but nevertheless extremely damaging.

Emma Harper: You mentioned the different parts of our less favoured areas, but 85 per cent of our land in Scotland is less favoured areas. I am reading here that there are 52,000 farm holdings in Scotland. What we are talking about is massive, with current funding of £520 million potentially being reduced to £253 million.

Scott Walker expressed a “desperate need” for progress, rather than saying that it was “sluggish”.

Jonathan Hall: I was being polite when I said that.

Emma Harper: We need to make progress and there are only 485 days to go. I am really concerned. How do we express those concerns to rural farming businesses and convey them to the UK Government?

Jonathan Hall: That is partly our job and partly your job. In a way, it is everyone's job to highlight how important it is that we get it right. Places such as Dumfries and Galloway, which is in your region, are highly reliant on a productive agricultural industry in so many ways. As you say, if that funding is stripped out, the damage could be untold. We must all make that case.

Scotland's agricultural profile is fundamentally different from the rest of the United Kingdom's. You have highlighted the fact that we are 85 per cent less favoured areas. It is the mirror image in

England, which is 15 per cent less favoured areas. In many ways, we will always be at the margin of agricultural production and financial viability. That is why that support remains critical. It is not just about underpinning farmers and crofters; it is also about underpinning everything that they deliver. The key message that we must get through—to the Treasury, in particular—is that investing in agriculture and rural areas is money well spent in the public interest. It is about return on those pounds through what agriculture then does.

11:00

Murdo Fraser: I want to clarify something that you said in response to a question from Bruce Crawford about money. You talked about ring fencing agricultural support. Will you elaborate on what you mean by that? Do you mean ring fencing it within the devolution settlement?

Jonathan Hall: Ideally, that is exactly what we would like, because right now CAP money is allocated to the UK by Europe. The UK Government cannot touch that and neither can the Scottish Government. If it is a pillar 1 payment, it has to be channelled into agricultural support payments. If it is a pillar 2 payment, that funding from Europe is then co-financed by the Scottish Government. Therefore, if it is coming into Scotland, it has to be channelled into agriculture or wider rural development measures. We want a ring fence to be put around a budget that protects it from being eroded. Otherwise, there might be a notional, nominal allocation for rural development spend, or whatever it might be, but by the time it percolates down to actual spend on the ground, it could go in any direction.

The Convener: Dr Campbell, in your submission you mention issues around the CAP, and you rightly tie them to EU structural funds. On the last page, you say:

“However, one of the most important impacts of EU Structural Funds has been its promotion of gender mainstreaming.”

You then look at the issue of EU leadership and the dangers that might arise without that. Will you expand on that, please, for the record?

Dr Campbell: One thing that European regional policy tried to do was to support other actions, which included equal opportunities and particularly gender mainstreaming. If someone received funding through the European regional development fund or the European social fund, they had to show how the project would contribute to gender mainstreaming or to equal opportunities. For a lot of the time, that was a tick-box exercise in which people said, “Yeah, of course it is,” and carried on. However, there is evidence to suggest that that requirement might have had an impact on

the type of economic development policies that have been pursued in Scotland.

When people invest in projects, we assume that the economic activity will be shared equally between men and women. However, without that requirement that will not necessarily be the case, so we need to think about what the gender impact of the spend will be. I am not saying that it happens all the time, but the requirement has made projects and funders think about the gender consequences of economic policy, which they had not really done before.

The Convener: What procedural and legal frameworks do we need to put in place to help to achieve that?

Dr Campbell: One of the problems with gender mainstreaming is in its name. The requirement was put in place in the period of European regional funding from 2000 to 2006. Thereafter, it was assumed that gender mainstreaming was happening and that projects would automatically think about the gender consequences. I am not sure that that has been the case.

There may well be an opportunity now for economic development policies that include such a requirement. Earlier, we mentioned public procurement. We could use that approach in public procurement policy to ask, “What will the gender impact of this spend be?”

The Convener: Thank you. That is helpful.

Willie Coffey wants to touch on matters of technology.

Willie Coffey: I am hoping to broaden the discussion to talk about digital and technology issues. Jim Campbell, in your submission you mention the potential impacts on research and technological development. Naomi Clayton touched on the issue that Ash Denham raised about the knowledge economy and knowledge-based services, particularly in cities. What effect would it have on the Scottish economy if there were to be a serious impact on the free movement of people with such skills working in the UK or, indeed, in Scotland?

Dr Campbell: It could have quite a serious impact, particularly in the university sector. The UK has done really well in the various European research and development frameworks, and we currently have horizon 2020, through which universities get funding and work with colleagues in other European countries. My own institution has received a number of research contracts in that way. However, that avenue is now going to be cut off, and we do not know whether it will be replaced by a Scottish or a UK version, because the loss of CAP and structural funds will be a problem. There will be lots of competition for

limited resources, given the latest forecasts about where the economy is going.

You mentioned the digital economy. A lot of interesting developments are taking place at the European level in relation to regulation to open up the digital market. At the moment, many businesses use geo-blocking. If you try to book a hotel or an airline ticket in another EU country, the price will differ depending on where you are booking that service from. There are currently discussions about removing geo-blocking so that the prices will be the same irrespective of where someone buys the service, which will mean a single online market such as we do not have currently. British businesses and consumers will lose out as a result of that market once we leave.

Willie Coffey: That is an interesting point. On the one hand, we will leave the single market but, on the other hand, we will stay in the digital market.

Dr Campbell: Not really.

Willie Coffey: It will be like being in and out at the same time.

Dr Campbell: We cannot turn back the clock on technology and say, "Let's not invent the internet."

Willie Coffey: Naomi Clayton made a point about knowledge services and specialist skills, in particular. What will be the likely impact if we lose lots of those skills in Scotland through restrictions on freedom of movement?

Naomi Clayton: The migration element is an important consideration. We do not yet know what migration policy will look like post-Brexit, but we know that, as a result of the impact of policy change and the economic impact, the flow of migrants into the UK is likely to reduce and there will be implications for businesses' access to the specialist skills that they require. It is a fundamentally important consideration, particularly at a time when a great deal of investment is going into supporting the digital and technology sectors in the UK and Scotland.

It is important that we think about how we can maximise the impact of that investment to support the wider economic and social infrastructure. Migration and businesses' ability to continue to attract and retain international talent are an essential part of that. Some of the impacts of migration are starting to play out. For example, over the past year, there has been a significant reduction in the number of national insurance registrations by EU citizens in the UK. It is difficult to attribute that specifically to the referendum and Brexit, because a number of factors are at play, but that marks a trend change rather than just normal fluctuation.

Willie Coffey: Does the soft Brexit model in your paper assume that freedom of movement is gone? Does that account for the biggest impact on those negative figures in the model?

Naomi Clayton: We looked primarily at the trade impacts. In a soft Brexit scenario, the UK would join a free-trade area. We looked at the impacts of tariff and non-tariff barriers rather than freedom of movement within that.

Willie Coffey: If freedom of movement does go under a soft Brexit, that would make your soft Brexit forecast even worse.

Naomi Clayton: Yes, if you start to factor migration into the model.

The Convener: I am not sure whether Jonathan Hall wants to touch on that. We did not get much of an opportunity to talk about migration issues in agriculture.

Jonathan Hall: I echo what has been said. The movement of people and migration issues are hugely important to agriculture and, downstream, to the food processing sector. We are very concerned about losing seasonal and permanent workers—on farm and off farm—and their skills and competence. Without those folk coming to Scotland to underpin agricultural production and the processing thereof, we will be in a bad place.

That issue has some low-hanging fruit for the UK Government, because we could reinvigorate or reignite the seasonal agricultural workers scheme that existed a few years ago, when Bulgaria and Romania were not full member states. We have already seen an impact in some sectors, with vegetable and soft fruit growers on Scotland's east coast having struggled to access labour for the season just gone and struggling to access labour for next year. For some workers, the problem is exchange rates and the value of coming here on a seasonal basis, but they also have less inclination because of the messages that the EU referendum outcome has delivered to them.

The Convener: I genuinely do not know the NFUS's position on the customs union. Given the issues around trade and the export of quality Scots beef, lamb and so on, and given the issues around the freedom of movement of people, what sort of Brexit would the NFUS like to see, if it goes ahead?

Jonathan Hall: We are probably being overambitious, but we still argue for access to the single market and retention of the customs union to provide protection.

You are right to identify that our red meat sector—sheep meat and beef products—would be massively exposed if we were not covered by the customs union. That sector is extremely vulnerable in many new trade outcomes. It is

massively important to Scotland but it is heavily reliant on agricultural support. That situation would expose Scotland in ways in which the rest of the United Kingdom may not be exposed. We have a far greater interest in those products, because of their importance to our agricultural economy.

James Kelly: Dr Campbell, your paper addresses the issue of inflation post-Brexit. Where are the pressure points in the forthcoming Scottish budget as a result of the recent changes to inflation, and what options are open to the Scottish Government to address those pressure points?

Dr Campbell: Last week's UK budget forecast that inflation would not get below 2 per cent for the next few years, so it will potentially be above that level and could rise further depending on what happens in the Brexit negotiations. If it looks as though it will be a hard Brexit, without continued membership of the single market and the customs union, the pound could depreciate further, which would cause more inflationary pressure.

That would mean that the Scottish Government's budget would buy a lot less and it would have to make tough decisions, especially given the pressure on public sector wages, which have been flat—or declining in real terms—over the past 10 years. There is now pressure to increase public sector wages, but the Government's ability to do that would be constrained because services would have to be cut. By 2021-22, given the pressures that there could be on budgets, would the Government be able to afford to subsidise agriculture in the way that it has been subsidised in the past? The outlook for the economy, at both UK and Scottish levels, is not particularly good, to put it mildly.

James Kelly: Do you think that the Government will have to look seriously at taxation options to alleviate those pressures?

Dr Campbell: A problem for the Scottish Government is that it does not have access to all the fiscal tools that the UK Government has. To raise revenue significantly, it has only income tax, and I think that it is looking at whether income tax rates should increase in Scotland. If the Government wants to continue to provide the same level of services, the bottom line is that it will probably need to raise income tax. Whether it does that for high earners or across the board is a political decision.

The Convener: I thank our witnesses for coming along today. We are very grateful. I suspend the meeting for a couple of minutes to allow a changeover of witnesses.

11:15

Meeting suspended.

11:20

On resuming—

Draft Budget 2018-19

The Convener: Item 3 is a discussion on the administration and collection of Scottish income tax with Her Majesty's Revenue and Customs. We are joined by Jim Harra, who is director general, customer strategy and tax design, and Sarah Walker, who is deputy director, devolution.

Alexander Burnett: I thank the witnesses for joining us. Let us get straight into the costs of running our new tax system. In a response to a parliamentary question from my colleague Bill Bowman last week, the Cabinet Secretary for Finance and the Constitution said that the system would cost about £1.5 million a year to run if bands and rates were kept consistent with those in the rest of the United Kingdom, but admitted that increasing the rates would cost the public purse more. The finance secretary said:

"A more significant divergence between the rates and bands that apply in Scotland when compared to the rest of the UK may lead to an increase in costs of up to £5m."—
[Written Answers, 22 November 2017; S5W-12712.]

Will you comment on the finance secretary's response and give more information about differences in the costs of the Scottish Government's proposals?

Jim Harra (Her Majesty's Revenue and Customs): Yes, those are the estimated costs; I will explain them. First, while rates and thresholds do not diverge very much, we expect very low levels of contact from Scottish taxpayers about Scottish income tax issues and their Scottish taxpayer status, but if there is more divergence we can expect, first, more contact from people who have queries, and secondly, to have to consider what compliance work we need to do to manage the risks that arise from divergence. That is where the estimate of £5 million comes from.

Those figures are just estimates. What kind of compliance plans we would put in place and what costs we would formally estimate at the time would depend on the nature and level of the divergence.

Alexander Burnett: Do you have different estimates for the different proposals?

Jim Harra: We have been looking at the proposals in the discussion paper that has been published and working out our responses. We have not yet come to or shared any conclusions in that regard. Obviously, the greater the divergence between Scottish rates and thresholds and UK rates and thresholds, the more likely we are to see behavioural effects, some of which will be non-compliant and will require a compliance response.

Alexander Burnett: Thank you.

Patrick Harvie: None of us would expect HMRC to offer a policy view on the preferable position in relation to tax policy in Scotland, but I am sure that we are all interested in hearing about the practical implications for you of the various options in the Scottish Government's paper and about whether the efficiency of tax collection would vary under the different scenarios.

The word "divergence" has been used. So far, it is only the UK Government that has created divergence, by changing the threshold for the higher rate south of the border—that is where the only divergence has originated. Why do we have the notion that only Scottish changes create divergence? We have two different jurisdictions, which are responsible for tax policies in two different areas.

Jim Harra: Yes. I did not intend to imply that only decisions of the Scottish Parliament create divergence; different decisions will result in divergence and give rise to different behavioural effects. Some of those behaviours will be perfectly compliant and will not involve us in extra costs in monitoring compliance, but some might not be compliant.

On the different options in the discussion paper, we can deliver any of them, in administrative terms, and stand ready to do so. You are right to suggest that different options have different administrative implications and therefore different cost implications. In particular, if new bands were to be added at the bottom—for example, if the basic rate band was split—we would have to think through some policy and administrative changes to cope with that, because various reliefs are given at source at the basic rate, and some things that currently happen automatically might require intervention to make them work in the future.

Similarly, if there are lots of bands, there is greater scope for people's tax affairs in year—for example, in pay as you earn—not to be quite right, so when we do our reconciliation at the end of the year, there are likely to have been a higher number of underpayments and overpayments than there would have been if there were just a few rate bands.

However, all those options are capable of being administered.

Patrick Harvie: At an organisational level, have you looked at other countries that have different income tax regimes across different parts of single states? In other European countries there are a number of areas in which people pay a different rate of income tax in different sub-state jurisdictions. Have you looked at that?

Sarah Walker (Her Majesty's Revenue and Customs): Yes, we look regularly at the position in other countries. A lot of other countries are different in that they expect everybody to submit a tax return every year, and we do not. We have a PAYE system that is very sophisticated and which tries to get most people's affairs right at the end of the year without them having to complete a tax return. That is a difference, in administrative terms, between how we work and how other countries work.

We study the behaviour of taxpayers in reaction to different tax rates in different parts of the country, or even between different countries, and we learn from that and make our plans in the light of that experience.

Patrick Harvie: Is there any further evidence that you could give us in writing after this meeting that demonstrates what you have learned about those comparisons with other jurisdictions?

Sarah Walker: I am not sure that there is anything specific in writing. We can have a look and see whether there is.

Patrick Harvie: That would be helpful. The debate over potential behavioural effects is one that rattles back and forth every once in a while. Most of the evidence that I can find is pretty thin about the extent of those behavioural effects, but if there is more out there, it would be useful to see it.

Jim Harra: Ultimately I would expect the Scottish Fiscal Commission to have to make some judgments and assumptions about what those behavioural effects would be.

The Convener: It is interesting and curious. If we know how much it is costing the Scottish Government to make some of these changes, how much did it cost when the UK Government changed the higher-rate tax threshold from £43,000 to £45,000?

Jim Harra: I do not have a figure for that. We cost all the policy changes that the Treasury asks us to make. We have, within our baseline, a certain amount of funding that we are expected to use for regular changes such as uprating.

With regard to specific policy changes, our advice to ministers ahead of a budget includes what money we will need to implement those measures and whether we can implement them within our existing baseline funding.

The Convener: It would be helpful for us to get an understanding of the cost of that change. If we have to make a judgment in the future about whether the Scottish Government and the Scottish Parliament are getting best value from HMRC, seeing the whole picture would be helpful to us. If you could write to us with that further information, if it is available—

Jim Harra: I will certainly see what is available and give you it.

The Convener: Thank you.

Willie Coffey: Good morning. I have had a look over the service level agreement several times, and I want to ask about the role of scrutiny. I do not see any direct mention of opportunities for members of Scottish Parliament committees to scrutinise the process. Does that need to be further developed in the agreement on this area that has been reached between HMRC and the Scottish Government?

Sarah Walker: One of the papers that we sent to the committee for this meeting is our first annual report on our performance against the service level agreement. It is fairly limited at this stage, because we have had only one year of operation and we have not had a full cycle of the income tax, but we would expect to produce that report once a year and send it to the committee. That would be an opportunity for scrutiny.

Willie Coffey: Do you have a formal role in appearing before, say, the Public Accounts Committee at Westminster on matters relating to tax, although there is no equivalent requirement or expectation for you to appear before the Scottish Parliament's Public Audit and Post-legislative Scrutiny Committee?

Jim Harra: I have appeared before the Public Audit and Post-legislative Scrutiny Committee.

Willie Coffey: Yes, but that is by invitation, is it not? As I understand it, that is not a formal part of the scrutiny process.

Jim Harra: I am formally HMRC's accounting officer for Scottish income tax. Therefore, I account to the Scottish Parliament for that in the same way that my chief executive accounts to the Public Accounts Committee at Westminster for the UK income tax.

11:30

Willie Coffey: I am looking at paragraphs 37 to 40 of the service level agreement, which are about review, monitoring and reporting. They are all about exchanges between directors and accountable officers; there is no mention of the elected members of the Parliament and what their formal role in the process might be. Would you welcome the opportunity to come to this committee or the Public Audit and Post-legislative Scrutiny Committee to give more evidence as the process develops?

Jim Harra: Yes. The document is a service level agreement between HMRC and the Scottish Government. It sets out what we have agreed with the Scottish Government and what it can expect

from us with regard to service levels and data exchange. The Scottish Government will hold us to account on that, but I am quite happy to be scrutinised by a committee of the Parliament about how we are performing against the agreement. As Sarah Walker said, we will produce an annual report that summarises our performance.

Ivan McKee: Thank you for coming to talk to us this morning. The main questions that I want to focus on are about data availability, but I might want to come back later to do a wee bit more digging on the cost of changes to the tax bands.

There is a complex situation with the tax structure vis-à-vis the Scottish Government's policies and the outturn from that relative to what happens in the rest of the UK, and what that means for the fiscal framework. At one level, we will get complete outturn data at some point several months after the final deadline in January for self-assessment forms being submitted, when you will do some number crunching and we will get something back. That means that, for 2017-18, it will probably be the end of, or well through, 2019 before we get the full picture.

I am keen to understand what data we can or do see at Government level at the moment on the monthly performance of the tax. At that stage, you only know what is happening with PAYE—although, to be fair, that will be the biggest part of the tax take—and you will be looking for variations between what you thought was going to happen and what is happening on a seasonally adjusted basis. Where are we with getting that data? Is it being delivered month by month to the Scottish Government?

Sarah Walker: Yes. We are working with the Scottish Government, and the statisticians have done a lot of work to make sure that we understand that data. We now have an arrangement with the Scottish Government to provide the monthly data for Scottish taxpayers. As you say, that is of limited value because it is only a partial picture and there might be some lags in the identification of Scottish taxpayers, but it is the best way we have of establishing any trends or divergence from the forecasts. Those figures are being looked at by HMRC and the Scottish Government each month as they come through. We hope to publish that series in the future, but we want to get a bit of experience of the figures and make sure that we understand them before we make them a public document.

Ivan McKee: It is great to hear that. Following up on the scrutiny aspect, my next question would be to ask at what point this committee will get to look at those figures, but I understand what you are saying about wanting to establish confidence in the process. The committee might follow that up, probably directly with the Scottish

Government, to see what we can get on-going access to.

Jim Harra: Over time, as you get a data series, it will be more valuable. We will do the final reconciliation about 15 months after the end of the tax year and, as time goes on, we will be able to identify much more closely where the correlations do and do not exist between the monthly data and the final picture. I expect that, initially, there will be some concerns about how you can really tell what the figures are telling you, because of the limitations in the data.

For example, as you say, the data does not include self-assessment data, which accounts for about 14 per cent of Scottish income tax. Furthermore, someone can appear to be a Scottish taxpayer at a certain point in time, but the test is for the tax year as a whole, so you can know if they are a Scottish taxpayer only after the end of that tax year. In addition, our PAYE codes include adjustments for certain reserved matters, which would not flow through to Scottish income tax. It will take us a bit of time to gain confidence in what that data does and does not tell you and the level of confidence that you can have in it. That will grow over time.

Ivan McKee: I want to do a bit more digging into the potential costs of policy changes that the Scottish Government is considering. I understand that you will not want to give us a number, but I am keen to understand the magnitude of such costs. If you cannot give us an indication now, when would you be able to tell us that? If we are going to make a tax change and the Scottish Government expects to raise £100 million, but you are going to charge £20 million for implementing the change, clearly that is significant. However, if it will cost the Government only £1 million to implement the change, that is a different kind of decision. Is there any sense of the magnitude of such costs?

Jim Harra: We could give a reasonable amount of certainty around the information technology changes; as the convener said, we already make IT changes for the UK Government, so we should be able to get some confidence around those costings. What is less known is how customers will respond to changes—how many of them will ring or write to us with queries or requests for explanations about what is happening. It is fair to say that, to date, we have probably overestimated the costs of administering Scottish income tax in that we have not seen the levels of contact that we had planned for on a contingency basis. There is quite a lot of estimation in that area, so it could turn out to be significantly wrong over time.

Ivan McKee: So even at the point at which we take the policy decision we might not know the answer to that question.

Jim Harra: It will always be an estimate.

Murdo Fraser: I want to ask about Scottish taxpayer identification, which is an issue that the committee has considered previously. You have given us quite a lot of information about the work that you are doing in that area. What do you estimate the margin of error to be in working towards accurately assessing people with an S code?

Jim Harra: We have a high level of confidence that we have identified Scottish taxpayers on our systems. Having put that flag on our systems for people with Scottish addresses, we have carried out work to corroborate the accuracy of our address database against a number of other data sets. We have been able to have a high level of corroboration—we have corroborated about 98 to 99 per cent of those addresses. That does not mean that the other 1 to 2 per cent are wrong; it just means that they have not been corroborated. In several instances, we have found that the address data that we hold is more up to date than that in many of the data sets to which we have compared ours.

It is a never-ending job. We have to improve on that accuracy all the time and maintain it, because people move all the time. However, we have that good level of corroboration.

The other work that we are doing is comparing the flags on our systems with payrolls—for example, the Scottish Government's payroll, because it is among the large employers—and against a set of different scenarios, in order to identify whether there are people for whom we do not hold a Scottish address but who live in Scotland. Again, we have found very low levels of non-corroboration.

We are currently working with employers to ensure that the flags on our system have fed through to S codes that they are operating in their payrolls, as some payroll software does not pick up all of that. That would not impact on the Scottish Government at a fiscal level, as we would calculate the correct amount of tax because we have the flag on our system. However, it could mean that those taxpayers would have an underpayment or an overpayment at the end of the year and, as Sarah Walker said, the aim of pay as you earn is to get people's tax affairs right as the year goes on. We are carrying out those checks over the course of this year as part of our employer compliance checks to ensure that everyone's payroll is working as it should.

Our estimate of 2.6 million Scottish taxpayers is staying firm.

Murdo Fraser: From your paper, I see that you have a wealthy taxpayer unit—that sounds like a happy place to work—and you are giving that

extra attention. Have you had any cases of individuals disputing whether they have an S code?

Jim Harra: So far, we have not had a single dispute from a taxpayer arguing that they are not a Scottish taxpayer when we have said that they are. However, I am aware of one case of someone having expressed disappointment that they had not been flagged as a Scottish taxpayer. Unfortunately for Scotland, when we looked into it, they were not a Scottish taxpayer. [*Laughter.*]

Ash Denham: I am interested in that issue in the context of possible future divergence and behaviour change. I understand that there is no legal obligation for people to make HMRC aware of their correct address. If somebody tells the agency that they have moved away from Scotland, how will it ensure that they are genuine? What checks will be carried out to ensure that that information is correct?

Sarah Walker: We carry out matching exercises. At a macro level, we take our entire database of Scottish addresses and compare it with the address lists that others such as retailers hold or with the electoral roll and so on. If that highlights a discrepancy, we contact the taxpayer to follow that up and make sure that we know where they really live. We have a much more personal relationship with high earners. For instance, we have started reviewing the people who we think might have more than one residence or home, and we are thinking about how we would tackle such cases. We have two levels—one for the mass market and one for the high earners.

Jim Harra: At the moment, there is a low risk that people will game the system, which gives us the opportunity to establish a baseline. We are doing a lot of work to understand that baseline so that we can monitor trends in the future against it as rules change.

Ash Denham: I envisage a scenario in the medium term whereby the agency identifies someone who should have been flagged up as a Scottish taxpayer but was not. If staff felt that the agency had been given the wrong information on purpose, would HMRC seek penalties to dissuade such behaviour?

Jim Harra: Absolutely. Although you are correct in saying that there is no legal obligation on anyone to tell us of a change of address, if someone tells us their address and claims that they live there but that is untrue, that is tax evasion. Existing powers both to go back to earlier years to recover the tax and interest but also to penalise them apply.

Patrick Harvie: I would like to double-check the cut-off point of the two levels that Sarah Walker mentioned—for the mass market and the high

earners. Are you talking about the additional rate, or is there a different cut-off point between those two levels?

Sarah Walker: There is a personal relationship with people who are looked after by our high-net-worth unit.

Jim Harra: We have two levels of people, and the affluent level, who earn more than £150,000, get an extra bit of attention. I cannot remember the exact figure for the high-net-worth individuals, but they are wealthy people. That judgment is not necessarily based on their income, as it can be based on their capital wealth. A compliance manager is appointed to them who is expected to get to know their affairs individually, to keep track of what they are doing, their attitudes to tax compliance and the advisers whom they engage, and to manage them on a case-by-case basis. I do not have the exact criteria for that with me, but I can get them for you.

Patrick Harvie: That is fine. That helps me to get the picture. Thank you.

The Convener: Paragraph 16 of the summary in the National Audit Office report that was published earlier this week states:

“The biggest challenge facing HMRC is maintaining accurate address records of Scottish taxpayers.”

Paragraph 17 then states:

“Neither taxpayers nor employers are legally required to tell HMRC of changes of address.”

That might not have been necessary previously in the tax process, because we were all in the same jurisdiction, but the Scottish Government has no devolved powers to deal with that issue. Is HMRC considering whether there should be a legal requirement for it to be informed about tax changes? If not, why not?

11:45

Jim Harra: We will keep that under review. There are obligations in a few areas. Employers are obliged to give the addresses of new employees, and people who self-assess are required to confirm their address, which is populated on their return. Nevertheless, you are right in saying that it has not been necessary to place a legal obligation on people until now.

The level of corroboration of our address data to date suggests that we do not have a problem. Any legal obligation, including the penalties and everything that would flow from it, would have to be proportionate to the problem. However, we are in a new situation in which where someone lives in the UK will be relevant to the level of tax that they will have to pay, so we will keep the situation under review. At the moment, we feel that we have

good processes for keeping track of where people are.

Ivan McKee: The high-net-worth individuals whom you are talking about will work through an accountant or an agent who submits returns on their behalf. What guidelines have been issued in that regard? What conversations have been had with agents?

Jim Harra: They have been quite extensive, particularly on the need to keep us up to date with where people live. Apart from the day-to-day engagement that we have with agents, we issue about six bulletins a year to them in which we remind them that it is important that they keep us up to date with where their clients are living. We expect our compliance managers to have one-to-one dialogue frequently with the agents of the most wealthy of them. It is likely that high-net-worth individuals have more than one home and use several addresses.

In our early work to establish the identity of Scottish taxpayers, we identified 2,000 cases in which people had a correspondence address and another address that was outside Scotland, which they said was their main home. We looked into all those cases and found that they were all fine and that the address that they had identified as their main home was, indeed, their main home. We do monitor that.

The Convener: Thank you, Jim and Sarah, for coming along today. It was helpful in beginning our process of scrutinising the budget, which will eventually be published on 14 December.

Meeting closed at 11:47.

This is the final edition of the *Official Report* of this meeting. It is part of the Scottish Parliament *Official Report* archive and has been sent for legal deposit.

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