



OFFICIAL REPORT
AITHISG OIFIGEIL

Finance and Constitution Committee

Wednesday 13 June 2018

Session 5



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Wednesday 13 June 2018

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FINANCE AND CONSTITUTION COMMITTEE

19th Meeting 2018, 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:

- Jo Armstrong (Royal Society of Edinburgh)
- Professor David Bell (University of Stirling)
- Amanda Burgauer (Community-Led Local Development Group (LEADER))
- Professor Sir Ian Diamond (University of Aberdeen)
- Jonathan Hall (NFU Scotland)
- Derek Mackay (Cabinet Secretary for Finance and the Constitution)
- Diane Milne (Dundee City Council)
- David Phillips (Institute for Fiscal Studies)
- John St Clair (Scottish Government)

CLERK TO THE COMMITTEE

James Johnstone

LOCATION

The David Livingstone Room (CR6)

Scottish Parliament

Finance and Constitution Committee

Wednesday 13 June 2018

[The Convener opened the meeting at 09:30]

European Union Competences (Funding)

The Convener (Bruce Crawford): Welcome to the 19th meeting of the Finance and Constitution Committee in 2018.

Our first item is to take evidence on the funding of European Union competences in a round-table format. We are joined by Jo Armstrong, Royal Society of Edinburgh; Professor David Bell, professor of economics at the University of Stirling; Amanda Burgauer, community-led local development group (LEADER); Professor Sir Ian Diamond, principal and vice-chancellor, University of Aberdeen; Jonathan Hall, director of policy and member services, NFU Scotland; Diane Milne, Dundee City Council, who is part of the East of Scotland European Consortium; and David Phillips, associate director, Institute for Fiscal Studies.

This session will differ from our usual formal evidence session. A round-table format is intended to be a more free-flowing discussion than our normal standard question and answer event. We have structured the discussion around five themes, as set out in the meeting papers, and I intend to allow around 20 minutes for each one. We may cut across the areas that we have laid down in the structure—that is inevitable—but we will try to keep to those areas.

I will invite a member of the Scottish Parliament to initiate each theme's discussion to allow the participants here to set out their views. If anyone wants to make a contribution, it will help if you catch the eye of myself or the clerk, Alan Hunter, and we will try to allow panellists in at the appropriate time. Whether I can keep to the 20 minutes in each bit of the structure is another story—we will see where we get to.

The first theme is governance issues around EU funding. Ash Denham will lead off.

Ash Denham (Edinburgh Eastern) (SNP): Good morning to everybody. How well the current system and structures for intergovernmental engagement, such as the joint ministerial committee on Europe, work in reflecting the whole of the United Kingdom has been questioned in a

number of areas, including in reports by this committee and Westminster committees. There is an opportunity here to look at what we might do post-Brexit and how those structures could be updated, and also to make sure that the mistakes that have hampered the current structure are not repeated. Do panellists have ideas on how we might move forward in that area, post-Brexit?

The Convener: I am looking at the two Davids to see who wants to volunteer first.

David Phillips (Institute for Fiscal Studies): I think that David Bell wrote more about the governance side in his response to the committee.

It seems to me that there are two elements to the governance arrangements for post-Brexit funding; those between the Scottish Government and the UK Government, such as the JMC, and those within Scotland, which are also important, such as the relationship between Scottish local government and Scottish central Government and the role of the voluntary sector. A question that arises is whether the British Government will want in some instances to have direct relationships with local government and organisations in Scotland—I am not saying whether that would be a good thing or not.

It is not clear to me whether the shared prosperity fund will provide money from the UK Government to Scottish Government to set up authorities in Scotland or whether there will still be an element in which individual city regions, local authorities or groups of organisations in Scotland will bid direct to the UK Government.

As well as thinking about the relationship between the Scottish and UK Governments, it is also worth thinking about the relationship between the Scottish Government and local government and the relationship between local and subnational things within Scotland and the UK Government, because it is not clear where those relationships will end up.

Professor David Bell (University of Stirling): I largely agree with that. In a sense, we have a mixture of governance relationships. For example, on the one hand, the UK and Scottish Governments work with local government in arranging stakeholders to set up city deals but, on the other hand, we are trying to merge everything, assuming that the shared prosperity fund in some way mirrors what the structural funds have been doing in the past.

We have been used to a system with the EU, with intercession by the UK Government, which I have mentioned in my submission. On the day-to-day administration, most of the relationship has been between the EU and the Scottish Government.

The structural funds have been based on the principle of areas of need, whereas the city deals are about getting together local stakeholders whether or not the area is particularly needy. If we are merging all that, with possibly the UK industrial strategy as an overarching strategy, we need to have really clear thinking about the governance arrangements. I do not know what the answer to that is.

I will switch the attention to agriculture, where there are similar problems. If we do new trade deals, because we will have a common tariff with whatever countries we do deals with, the UK Government will have a global interest in agriculture and the Scottish Government will have a local interest in ensuring that rural communities continue to thrive, so there is a strong need a greater level of intergovernmental co-operation in that area, which you will see in countries such as Canada.

Jonathan Hall (NFU Scotland): I will comment on the agriculture point and not the trade issue. In thinking about this issue, I am curious because, with the common agricultural policy and other EU funding that comes to the UK, the EU views the UK as the member state. However, when it comes to the audit and accountability processes, it looks at different paying agencies in each of the devolved Administrations. In governance terms, the Scottish Government is accountable to EU auditors of various forms on a regular basis—much to its annoyance—but I wonder what the situation will be post-Brexit, when we will have to have a centralised audit of agriculture and development spending. Who will take responsibility for doing the work of the European Commission and ensuring that the allocation of taxpayer funding is done fairly and is accountable?

I am not for a minute suggesting that the UK Government, or even the Scottish Government, becomes the European Commission mark 2; nevertheless, we must have in place something that says where funding that is allocated across the United Kingdom is being spent by different Administrations and what the governance or audit process is to make sure that that is being done in a fair and robust way, as we currently have at a European level. That suggests to me that we probably need a UK body, such as an enhanced JMC, that could oversee that across different Administrations within the UK.

Jo Armstrong (Royal Society of Edinburgh): My point, which probably follows on a little bit from that one, comes back to the principles of why we are spending the money and what the objectives of doing that are and therefore what the governance requirements are to make sure that the spending delivers the stated objectives. That would probably require greater clarity on the rules

about what the funding is being used for and, as was said, how that is then made accountable and auditable.

The spatial level at which that accountability or auditing is then done has to take account of economies of scale and local needs. If we are moving away from the current system, and we consider that what we have now is not necessarily fit for purpose, we need to start by asking why we are doing what we are doing and what the objectives are that we should set. The governance and accountability aspects would follow that.

Amanda Burgauer (Community-Led Local Development Group (LEADER)): I want to flag up what Jonnie Hall has said, but from a LEADER perspective. The funding is very much from the grass roots up and decision making is made at a very local level. LEADER is funded through the Scottish rural regional development programme. Twenty-one local development strategies have been made in concert with the grass roots. Each one of the local action plans reflects the specifics of that local community, and the plans vary greatly across Scotland. One of our fears is that, if the governance were to be moved even further away than Edinburgh, some of that local competence would be lost.

The Convener: In the overall scheme of things, there is a danger that funding streams such as LEADER get missed out. Although it may be a smaller bit of the pot, it is still worth £77 million over the life of the programme, which is a substantial amount of money. The model is different—it delivers at the rural level where local people are making decisions about what happens in their communities. I understand that almost 500 projects are funded through LEADER. The £31 million allocated to those projects has levered in another £47 million. We should not forget that that structure and that model of delivery are different from other funding sources, so I am grateful to you for drawing that out.

Ivan McKee (Glasgow Provan) (SNP): I have an observation to make. To row back from some of the comments, the position depends on whether the funding goes to the UK level and the objectives are set at that level, or whether the funding goes to the devolved Administrations, which set their own objectives, which might be different. I can envisage the scenario that Jonathan Hall mentioned in which it would get a bit complicated if the UK Government was involved in setting objectives, but if the funding was for Scotland only, do we not already have governance mechanisms in place, such as a regulator for charities and Audit Scotland? We have a whole framework of institutions that manage public money and where it goes and check whether it has been spent correctly.

David Phillips: That is true. You are right that the requirements for governance, audit and management will depend on, for example, whether the money is being rolled into the block grant and the Scottish Government has complete freedom over how it spends the money, or whether the objectives are being set at the UK level and Scotland has freedom within certain bounds and parameters.

There are areas where you might want external assessments. David Bell mentioned agriculture. Even if the management is being done at the Scotland level, because agriculture interacts with UK trade policy issues, the UK will want to have a role in it.

I have been wondering about the issue of joint competences. Agriculture could, in effect, be a joint competence because it is a devolved policy measure that interacts with UK trade policy and needs to conform to certain UK-level rules for our trade agreements with, for example, the US and Canada. In those circumstances where it is a joint responsibility, could there be an arrangement whereby that joint responsibility would be between

Audit Scotland, the National Audit Office and the Wales Audit Office? They could form committees between them. You could even have someone from England, Wales and Northern Ireland or someone from Scotland, Wales and England and so on, so that there is external critique. The point is that everyone would be involved and it would not just be dominated by Westminster. Perhaps that could be an approach to take. I do not know.

The Convener: This is an area in which there are a lot of things that we do not know at the moment. However, the purpose of today's meeting is to get views on the table, so that we know what to look forward to.

09:45

Jonathan Hall: I echo the point that has just been made. Although no one can predict it with certainty, the likelihood is that, to replace the common agricultural policy for the UK, we are looking at having a commonly agreed regulatory framework that would be applied across it. It would cover all sorts of standards to protect intra-UK trade, as well as to enable the negotiation of trade deals outwith the UK and so on.

There are lots of governance issues on matters such as animal health and environmental standards, in relation to how finance is spent and penalties are levied on payments. Thereafter, there are issues to do with the delivery of support payments. Under the CAP system that we have now, there are four separate settlements across the UK, with each devolved Administration having its own payments agency that is ultimately

accountable to the European Commission. A framework in future would need to be a bit of a hybrid that looks at accountability across the UK, at how standards are being met and regulations enforced, and also at where funding is allocated and given to individual businesses to ensure that there is full traceability for how such money is spent. I could see Audit Scotland playing a very serious role in that, but probably alongside other audit administrations across the UK.

Diane Milne (Dundee City Council): My experience is very much at a local level. I work for a local authority, so I have experience only of the relationship between it and the Scottish Government. Even at that level, we see that the amount of transparency has decreased considerably in recent years. In previous programmes, there was a lot more peer review in the application process and in decision making. To be honest, we do not see that at all any longer. In Scotland, we rarely see any of the papers relating to the JMC; they are not regularly published on the Scottish Government's website. I do not think that I have seen a paper on there since about 2016.

Therefore, from our perspective, the issue is about having more transparency in the process, and having clearer rules. We were recently in Brussels, where they talked very clearly about possibly having what they called a single rulebook across all programmes. We would look for that as well, in that we would make sure that any governance arrangements were the same regardless of the programme that applied. At the moment, the governance arrangements for funding from, for example, LEADER, European structural and investment funds—ESIF—and the fisheries programme are all different. For anyone who uses those, the processes are different. Even within the ESIF process, every strategic intervention lead who manages money delivers it in a different way. If we are to look at governance, we need to do so from the bottom up as well as from the top down, so that process will need to be adapted.

Jo Armstrong: I agree with the point about transparency. I also agree with having clarity and rules. However, the downside of having rules is that there is less flexibility. A lot of the funding streams that are introduced typically come in to deal with a problem that has arisen, and therefore they may not be conducive to applying the exact rules that apply elsewhere.

The other issue that the microeconomist in me wants to bring out is displacement. The more local control we have, the greater the chance of having displacement activity elsewhere in the economy, at UK, Scottish or even local levels. That is not to say that we do not necessarily accept some level of displacement. However, if we do not have a

discussion about it, we will create activity that does not generate net overall economic growth or net social benefit.

The Convener: Are there any governance issues in the university sector that Ian Diamond would like to draw out?

Professor Sir Ian Diamond (University of Aberdeen): In the university sector, we largely apply for funding that we either get or do not, so the governance aspect is about whether we achieve a project. However, the non-European, UK-wide position, which is helpful, is that research is funded according to the dual support system, in which there is a particular project and also a block grant. The block grant comes from UK Research and Innovation to the Scottish Government, which chooses how to use the funding. The Scottish Government has a research excellence grant, which goes to each university. So far, so good.

A large and exciting programme called the global challenges research fund is funding research to alleviate poverty in low-income countries. Because that is a joint fund of the Department for International Development and the Department for Business, Energy and Industrial Strategy, the block grant that is associated with it must be for low-income country work.

Universities get two pots of block grant—one block grant that can be used in any way that we want, and which universities can show allows enormous leverage of other funds, and the other block grant, whose contribution to research to alleviate poverty in low-income countries must be audited.

I support that funding very much, but I fear that we could end up with all kinds of relatively small pots that must be used in particular ways. It is much easier to have a university-wide economy that tries to improve research in ways X, Y and Z, without having to think about which block of funds is being used for which project.

The Convener: One thing that we will know for sure after this morning's discussion is that there is a complex picture of arrangements for many programmes. I am glad that we asked the question, but I am not sure what the answers are.

Before we move on to structural funds, does anybody else want to make a point about governance issues?

Professor Bell: I reiterate Jo Armstrong's important point. There is an opportunity to decide whether all such funding, in aggregate, is delivering what we intend it to do. We are looking for sustainable economic growth. Are the initiatives that European funding encompasses delivering the objectives that we want for Scotland? We have tended not to evaluate the

structural funds and so on. It is tough to reach clear conclusions about whether the objectives have been delivered.

In agriculture down south, a strategic decision might be made—the question is out for consultation—that support from public money is only for public goods. We have not debated that in Scotland. I am not saying that I support such an approach, but we must think about what we want our agricultural funding to achieve. There is an opportunity to think about such issues.

Adam Tomkins (Glasgow) (Con): I will tie that back more directly to the conversation about governance and pick up on something that Ivan McKee said. In designing our governance arrangements, we must think about what we want the governance to govern. If we want it to govern joint policy making—to take the Department for Environment, Food and Rural Affairs example that David Bell just put on the table, if the UK-wide policy was that agricultural support should support public goods—the UK-wide policy decisions should be made through an institutional structure that enables the four Governments of the UK to come together and agree the policy outcome.

That is a different structure for governance arrangements from one in which a single set of broad objectives is filtered down and delivered by different Administrations in different ways. What determines the governance is not just what we want to achieve, but what we are trying to co-own or co-govern.

My reflection on the conversation is that we are much nearer the beginning than the end of a puzzle about how much we want to copy and paste EU structures into the UK post-Brexit. Do we want the UK to have a system of centrally imposed directives that enable each Administration in these islands to pursue common goals through separate means, which is what European directives do? We do not have anything like that in UK law at the moment, in England, Scotland or anywhere else. That is one question. If we do not want to do that, what do we want to do instead?

For me as a lawyer, the elephant in the room is that no one has talked about courts and dispute resolution. The big difference between the way in which EU law resolves disputes arising out of these issues and the way in which such disputes have hitherto been resolved in the UK is that the UK's JMC machinery—which Ash Denham talked about in her opening remarks—is entirely political. It is informal and does not use the courts.

We use the courts for funding disputes between local and central Government, but we do not use them for disputes between the UK and devolved Governments on funding or anything else, apart from questions of competence. There is no judicial

architecture attached to the JMC machinery, so one of the big questions is the extent to which, if at all, we want to make these issues justiciable—questions that can be litigated in court.

The Convener: That is probably a good place to move on to the next set of discussions. *[Laughter.]*

Adam Tomkins: You do not want any answers to that question.

The Convener: I do not think that anybody can answer it—we could spend all day asking. That question has to be answered. It is something that everyone will need to think about as we go through this journey.

We move on to funding mechanisms.

Murdo Fraser (Mid Scotland and Fife) (Con): We touched on funding mechanisms briefly in the previous discussion, but I want to open out the discussion a bit and look at what the most appropriate mechanisms are for the distribution of funding across the UK post-Brexit and what impact that might have in Scotland. David Bell wrote a lot about the issue in his paper.

It seems that there are two broad approaches, the first of which is to replace EU funding mechanisms with UK-wide structures that will allocate funding on some agreed basis. The other approach is to take Scotland's share or the devolved Administrations' share—however that might be determined—and give it to them as part of the block grant. They will then have the flexibility to divvy it up as they see fit without having the UK-wide element. What are people's views on those two approaches?

If we take the second approach, how would Scotland's share be determined? Would it be done on the basis of the Barnett formula, which has been applied in the past only to changes in Scotland's budget allocations? If I am right, Scotland's share of UK spending has historically been much higher than our population share, so if Scotland's share was determined on a Barnett basis it would represent a reduction in the proportionate amount that we were getting. If we do not use Barnett, how else might it be done and what would the implications be? That is an easy question to start with.

The Convener: When the witnesses are answering that, perhaps they can explain something to us. There seems to be a difference of view about whether a Barnett formula process will be advantageous or disadvantageous to Scotland. I would like to understand that a bit more. It probably means asking the two Davids, Bell and Phillips, to kick off the answers again. I am not doing that intentionally.

Professor Bell: Does David Phillips want to go first?

David Phillips: Okay. The disagreement or uncertainty about whether the Barnett basis would be beneficial or costly to Scotland depends on what we think will happen to the level of funding once it has been set up initially. The Barnett formula will not tell us what the initial level of funding should be; that decision will need to be made in some other way. It could be based on existing allocations of EU funding or some other assessment of spending needs for the different areas that will receive the replacement funds.

The Barnett formula would be beneficial in effect if those allocations were to be reduced over time in cash terms. That is because, when we sum up agricultural and development funding, Scotland gets quite a bit more per head than England. Applying the Barnett formula would mean that any change in funding should be by the same amount of pounds per person. If Scotland started off with, say, £200 per head, England had £100 per head and the funding was reduced by £1 a year per head in England, England would get a 1 percentage point fall every year, but Scotland would get only a 0.5 percentage point fall. If funding is cut in cash terms, Scotland benefits from a Barnett-type per head arrangement. However, if funding per head increases in cash terms, a 1 per cent increase in England will be only a 0.5 per cent increase in Scotland. Therefore, Scotland loses out when funding is increased in nominal terms under the Barnett formula.

10:00

That is where the uncertainty lies. The messages from the Westminster Government on agricultural funding certainly suggest reducing direct payments to farmers over time, but it is not clear whether that means a reduction in the overall levels of funding for rural areas or the funding for direct payments being shifted into rural development and greening initiatives. I am not sure that there is any signal about the likely outcome for regional development.

A cash-terms freeze will be quite a significant reduction over time. If there was a real-terms freeze in England, which implies that the cash is still going up, Scotland would lose out because there would still be a cash-terms increase. That would be small in percentage terms in Scotland.

It really depends. If the budget is falling in cash terms, the Barnett formula is good for Scotland. If it is rising, it is bad for Scotland.

Professor Bell: That is exactly the point that I made in my paper, so I will not repeat it.

David Phillips is absolutely right: it all depends on what is happening with the cash budget—on whether it is going up or down. When it goes down, that is relatively advantageous to Scotland; although that might still mean a cut in its funding, it will basically be less of a cut than England gets. That is why I gave the example of pillar 1 payments in my paper. If they disappeared, Scotland would still have some money at the end, even if the spending in England diminished to zero.

I agree with David Phillips on the detail, but there is the question of principle. If the money went into the block grant, that would mean, in effect, that it would be in competition with health, social care, education funding and all the other forms of funding. We know that there are currently pressures right across the system.

In a sense, the Barnett formula does not help because it is not a measure of need. The EU structural funds principle is that they are allocated on the basis of need, and need is measured in terms of gross domestic product per capita. Currently, Scotland's GDP per capita is not that much different from that of England. Wales's GDP per capita—at least that of west Wales—is significantly lower.

There is the principle of whether need will be used as an indicator or whether some money will just be allocated to Scotland at the start and Scotland will be allowed to use it as it likes. Scotland could have its own indicators of need. Most money is already allocated on the basis of need within Scotland, of course. Education, local government and health funding take account of the number of pupils and the levels of disability in the population, for example.

The overall question is whether the UK Government should determine need with a global view across the UK economy. That would probably mean that even more structural funds money would go to Wales and less would go to Scotland. Alternatively, should a bunch of cash just be handed over to the devolved Administrations with the argument that they know best how to deal with their own patch? The devolved Administrations could be allowed to allocate money to the Highlands or deprived areas of Scotland, for example. There is not an easy answer. Again, we go back to the governance arguments. That is a critical question that we have to think through in a relatively short time.

Ivan McKee: Now that we have figured out the reverse Barnett squeeze, I want to throw a few more interesting things into the pot to get the witnesses' take on them. Clearly, the Barnett squeeze depends on relative population growth, although we start from a position in which Scotland has a higher per capita revenue through

the Barnett formula. If we were in the environment that we hope to be in where Scotland's population was growing faster in percentage terms than the UK's population—that may happen, given the differential attitudes to immigration—that would have an impact on the reverse Barnett squeeze. Certainly, it would have an impact on the quantum, if not the direction.

Another issue is that Barnett is not the only mechanism for allocating funds. There is a third option, which is to invent a new way of doing it. That is in effect what the fiscal framework does, because it has the IPC—indexed per capita—approach, which protects from the population growth impact. There is another way to do it.

On top of that, if I am correct, the more revenue that is devolved to Scotland—VAT could be on the table in a post-EU environment—the smaller the impact of Barnett, because the block grant adjustment will be bigger. It is protected through the IPC under the fiscal framework, at least until 2021. If I am correct in my assumptions, I would like your take on those points.

The Convener: I will let the witnesses think about that. While they are doing that, I will let in Ian Diamond.

Professor Diamond: I just want to make a point about the question that David Bell raised about, in effect, whether policy is best made on one's own patch. I want to point to the current example of higher education, broadly defined. In each of the four nations that make up the United Kingdom, higher education policy has been diverging at some rate. In Scotland, we have a very different policy from that anywhere else, which has been achieved by the Scottish Government taking a view that it wishes, for example, to fund fees and, in research, that it wishes to encourage in a Scottish way the interaction between universities and industry to drive the economy.

As has been said, the money for that could be spent on education, health or any other thing, but the bottom line is that the Scottish Government is taking decisions about what is best for Scotland on a block grant basis as opposed to those decisions being taken UK wide and then having to be enacted across the country. I would argue that that approach is working quite well in research at the moment in every way.

Jonathan Hall: I will pick up on some of the points that have been made. Murdo Fraser asked whether EU funding will be replaced with a UK-wide approach or whether Scotland's share will be allocated through the existing block grant approach. Our view on that is clear and, I guess, quite crude but, nevertheless, I hope that it gets the message across.

CAP funding, particularly pillar 1 funding, comes from the EU to the UK and then basically goes straight through the UK Government's hands and into the Scottish Government's hands, at which point it is also entirely ring fenced and cannot be spent on anything other than direct agricultural support and some other things. A significant amount of the pillar 2 rural development funding is of the same ilk. Therefore, the issue of what future budget the UK Treasury might allocate to replace current CAP funding is key to us. We argue that it has to be at least the same quantum.

Thereafter, the big question for us is how the funding is allocated on a UK-wide basis. Currently, we get 16.3 per cent of the UK funding from the CAP, which is a significant difference from the Barnett equivalent, which would be about 8 or 9 per cent. That immediately sets a few alarm bells ringing. The second question after that is, regardless of what the allocation to Scotland is, once it comes to Scotland, will it be ring fenced? The point has already been made about where it would have to sit and competition with other things. We all recognise that there are hugely competing demands on limited public funding. We have significant concerns about that.

I am intrigued by the comment about the Barnett formula not being based on need, which is absolutely right. That goes back to the earlier conversation about our objectives. Given that Scottish agriculture's reliance on agricultural support is significantly different from that in other parts of the United Kingdom, and given the terrain in which we operate, particularly with our beef and sheep producers in more marginal areas, where we need to consider the sustainability of communities and rural development as well as food production, I would argue very strongly that the allocation of future funding should be done in a very different way from how it is done under the Barnett formula. We have several different criteria for determining how funding should be allocated across the UK.

Another concern, which relates to the issue of intra-UK agricultural trade or competitive advantage, is that, if there is a significant change in the current allocations—in other words, a Barnettised approach—and if we assume that the Treasury continues to fund to the same extent as the EU does, there would be a rush of funding into English agriculture, which arguably does not need it, and a rush out of marginal areas in Scotland, parts of Wales and possibly Northern Ireland to a degree, although it is in a slightly different place. At a funding level, that is one thing, but it would almost immediately cause some sort of collapse, particularly in our red meat sector. That would put us in a very difficult competitive position within the UK agricultural market, let alone within Europe.

In our approach, we need to recognise that discussions have already started at a European level about the next programme for the CAP, and there are already suggestions of significant funding cuts to that programme. I suspect that we will follow the sort of model that the Treasury sets, although we might go further with some cuts. We need to be mindful that whatever happens to the CAP is likely to influence decision making by the UK Treasury.

Diane Milne: I am not sure whether I am answering the committee's questions; I am probably just raising more.

I think that I was invited here because I have hands-on experience of managing structural funds. I have had 20 years of experience from the 1997 programme until now, so I have seen significant changes in the level of information that is required, the audit process, the bureaucracy and so on. It got to the stage at which we received an invoice from the Scottish Government for 16p, because we had rounded up two of our invoices in a claim. I thought that I would just give that to the Government out of my pocket, because surely that would be cheaper.

From a local authority and an East of Scotland European Consortium perspective, a number of issues need to be considered, one of which is match funding. We can be given all the money in the world, but if we do not have any match funding—if that is a requirement for delivering projects—we cannot deliver anything. Aberdeenshire Council raised the issue and was awarded a pot of money from the European structural funds for delivering employability programmes. However, the council did not have the required level of match funding to draw down all that money, so it could not do so. The council was given a rurality index that set out what money it might need to deliver a programme. That meant that Aberdeenshire, with an unemployment rate of about 3 per cent, was awarded more money for employability than Dundee City Council was awarded, because Dundee is an urban area and we therefore did not have that rurality index.

We need to look carefully at need versus opportunity. The levels of funding are determined by Europe through NUTS 2, which is far too large to address local versus regional disparity. We also need to think about who is making regional or local policy, and money needs to follow the levels of opportunity.

The timing of any replacement funding that comes from the UK Government, whether that comes via the Scottish Government or directly from the UK Government, is critical. That work is not being developed quickly enough. We have only until 2020 to identify what our future will be like.

The Convener: That is very helpful. Professor Bell, do you want to address Ivan McKee's general question? You might not remember what it was—I cannot.

Ivan McKee: I can repeat it, if you would like.

10:15

Professor Bell: I was thinking about areas, too. If we are thinking about how to measure need, we will probably need an agreement at a UK level about what the areas are, so that they are not gerrymandered to provide the level of need that generates the support.

My other point is that Scottish farmers should not be terrified about the Barnett formula. As David Phillips has said, in the first instance, Scotland would probably get 16.3 per cent of the funding and Barnett would then apply only to the changes. As I have said, Scotland benefits slightly, in relative terms, when the money is going down and it loses out slightly when the cash budget goes up. However, if the budget does not change very much, the 16.3 per cent also does not change very much.

Professor Diamond: As need has been mentioned, I will make a plea. If we are making indices or measures of need, it is incredibly important that we take rural areas into account. Too many such measures simply take a multiple deprivation approach and are often heavily biased towards urban areas, meaning that rural deprivation—which, in Scotland, is hidden but important—is lost completely. If we are to measure need, we really need a sophisticated measure.

David Phillips: I want to follow up Ivan McKee's questions and some other points related to them.

Mr McKee is right in saying that, if there is more rapid population growth generally, the Barnett formula becomes less advantageous to Scotland, because it takes account of population growth for the increment but not for the baseline funding. He is also right in saying that the IPC method would avoid the issue of convergence either because of population or because of the difference in pounds per head, as it is based on percentages rather than on pounds per head.

Returning to some of the bigger questions, we can separate the issue of whether funding is ring fenced from the issue of whether it goes via the Barnett formula. We could have a form of needs assessment that was based on certain characteristics such as agricultural need or deprivation—I guess that “economic disadvantage” is a broader term that could be used in relation to need—and such an assessment could still give discretion as to how that money was spent. For example, we might look at the

relative levels of deprivation or disadvantage economically in order to decide how much funding to give to Scotland or areas within it, but the Scottish Government would then have discretion over how to spend that funding.

Perhaps the best way to tackle such deprivation is not a traditional economic development type of policy but better social care and education that let people back into work and improve human capital in the longer term. We can separate out the way in which funding levels are determined from what they have to be spent on, although we should bear in mind that there will be issues about whether certain sectors feel that they might be squeezed if there is no ring fencing.

In relation to regional funding, how need is currently defined in the UK for, say, local government funding is quite different from how it is defined for EU funding. For local government funding the definition is based on deprivation, whereas for EU funding it is based on GDP per capita, and the pattern of those measures differs quite significantly across the country. A lot of the areas with the lowest levels of GDP per capita are rural ones and a lot of the areas with the highest levels of deprivation are urban, although urban areas have quite strong economies overall.

We must determine what need is and how progressive the funding should be according to need—currently, it is very progressive. There are a lot of decisions to be taken about that.

I have probably taken up enough time with that answer.

The Convener: If I have interrupted your flow, please forgive me. I was just thinking that we are dealing with very big questions here, and I was saying so to Adam Tomkins. I was not reflecting on something that you were saying.

David Phillips: Okay—I am sorry. I thought that I had taken up too much time.

At the moment, EU funding is very progressive and there is a big cliff edge, with areas in which GDP per capita is less than 75 per cent getting much more money. That is why west Wales, the valleys and Cornwall get much more than places such as South Yorkshire and some parts of Scotland, which are just above that threshold. It creates an incentive to gerrymander, as David Bell said, when places that are just below the threshold get three times as much funding. That has happened in Wales and in inner and outer London. Outer London is classified as a transition area because all the inner sections have been taken out.

As well as thinking about need, we should think about what role there is for outcomes and for competition in the bidding. Within local areas,

there is competition between projects although, when applications are made, there is not necessarily a formal competitive tendering process; a judgment is made about the cost benefits of different projects and certain criteria are used to decide which ones should be funded. At the regional level, the process is based on measures of need. Should outcomes or competitiveness be taken into account at that level, too? I am not saying yes or no, but that is an important decision. City deals and growth fund deals, for example, have an element of that.

The Convener: So does LEADER, because it is about competition for resources.

Professor Diamond: At the risk of appearing to disagree—in fact, I am disagreeing—I suggest that, too often, we engage in discussions about need in a historical way, because the data allowed us to look only at a big area. Using data that are available from administrative and other sources at a local level, we now have the ability to take local levels of need and build them up in whatever way we want to without encountering the problems that we get if we take a big area, which is when we lose people and have cliff edges. It is not rocket science. It is perfectly possible to do that, and Scotland is better than just about anywhere else at doing it.

The Convener: That is a strong point.

Patrick Harvie (Glasgow) (Green): I hesitate to make the discussion even more complicated. Once upon a time, not so very long ago, we had just the Barnett formula, which people thought was complicated enough. On top of that, we built a fiscal framework to deal with the devolution of tax, social security and other issues under the Scotland Act 2016. That additional level of complexity is due to be reviewed under the agreement between the Scottish and UK Governments by 2020-21, and recommendations for change will be made towards the end of that period. That may or may not be at the end of what seems to be quite a stretchy transition period in relation to the EU. Is there a danger that, if that process and the design of new funding mechanisms that may or may not be based on Barnett are carried out in isolation, we will make a mess of both? How much of a challenge would it be to combine those two processes?

Emma Harper (South Scotland) (SNP): I have a quick point to make. When David Mundell, the Secretary of State for Scotland, was here, he said that farming would not be Barnettised. Is he ahead of the game? Will some other fiscal framework be set up that will be completely separate? Scotland has a disproportionate need for support for our rural economy. Given that 73 per cent of the land in Scotland is agricultural holdings and that 85 per cent of our agricultural land has less favoured area

status, we need a different solution to how things are looked at for Scotland.

Jo Armstrong: I will pick up on several points. I reiterate David Bell's point that we should capture the money now rather than put it over to competition elsewhere. A simple approach would be to put it in the block grant and work with the Barnett formula. That picks up Patrick Harvie's point about whether we should come up with a new system when Barnett already exists. Whether we like it or not, it has worked.

The issue of whether the funding for agriculture should be ring fenced is extremely important and needs to be debated. Agriculture is important, but it is not as important for growth purposes as other sectors in the UK economy. It is clearly important for rurality and rural sustainability. Are we funding agriculture for its rural sustainability value or for its growth, trade and economic benefits? We need to have that debate rather than just assume that we will continue to ring fence agriculture as is. We do not do that for any other industry.

My other point is about setting a needs-based approach, which is extremely difficult to do. If we open up this level of funding to a needs assessment, what will we do to the rest of the Barnett formula? We will open that up to a needs assessment, because the Welsh would certainly argue that the Barnett formula is not fair to them on a needs basis. Opening up a needs assessment for this area would create leverage for doing that for the rest of the block grant.

The Convener: I sense a Welshman wanting to come in.

David Phillips: Emma Harper is correct in saying that it is unlikely that the Barnett formula will be used for agriculture. There was talk of using it for public goods purposes, but there is no necessary relationship between the size of the public goods that can be delivered and the size of the population. If Scotland has the potential to deliver more public goods because its larger rural landscape and the historical degradation of farmland, moorland and forests offer more scope for that, Scotland should get a much bigger than population share, which should increase if it does more to deliver on those things. Emma Harper is correct in saying that the rhetoric suggests that Barnett will not be used for that.

Jo Armstrong asked a more general question about whether needs should be used more widely to replace the Barnett formula. I am sure that Wales would try to use that argument as leverage, but the Scottish Government would push back against that. I am not sure that Wales has greater leverage on the issue than the Scottish Government or that it would be a threat to Scotland's relatively high level of funding under

the current arrangements. However, applying the Barnett formula to development funding would have a big impact on Wales—I am not just saying that as a Welshman—and, for that reason, it is unlikely that we will go simply by the Barnett formula. Regional development funding is currently about six times higher per capita in Wales than it is in England. In a few years, the Barnett squeeze on that would bring it down from 600 to 400 to 300 per cent. Because of the size of that squeeze, it would be very challenging for the Government to roll that into Barnett and not be seen as penalising the poorest region of the UK.

Amanda Burgauer: I will pick up on a couple of points. First, measuring need is incredibly difficult in the rural context. We have learned, through LEADER and other programmes, that the Scottish index of multiple deprivation is not fit for that purpose. Although there have been efforts to look at how we can measure need, there are problems with measuring it in rural communities—issues to do with privacy and shame that mean that people do not come forward. We have seen that with rural homelessness and poverty. Those issues are hidden and are very difficult for us to use as metrics. I just wanted to flag that up.

Secondly, we tend to think about CAP as farm payments. This goes back to Jo Armstrong's point about rural sustainability. The money that agriculture receives does not just sit on the farm but trickles through the rural economy, helping to provide jobs and livelihoods for a lot of people in rural communities. That is really important together with LEADER, which is the other source of funding that enables a lot of rural communities to put together projects, whether those are about the rural economy and creating jobs or about the social aspects of rural life. LEADER has the advantage of additionality, and in lots of places it is used to bring other external money into the rural economy. Rural communities consider that they are being hit everywhere at the moment. Farm payments are going, and they will not be able to use LEADER money for match funding, which means that we will have to take another look at community benefit funds, most of which include clauses that insist on communities finding match funding at a time when such opportunities are few and far between.

10:30

Jonathan Hall: A rough estimate is that, for every £1 of direct support that Scottish agriculture receives, it spends—through farmers and crofters—about £5.30, which is a multiplier of more than five. Although not all of that money is being spent in the local economies, a lot of it is. It sustains a whole host of upstream suppliers, trades, businesses, hauliers, vets and

contractors—you name it—and it filters through the local and national economy throughout the year.

The downstream effect is key, too. Agriculture is not a huge employer in its own right, with 65,000 full-time jobs in the sector, nor a huge part of the Scottish economy if you look at it in isolation. However, its contribution to Scotland's food and drink sector is significant in employment terms and to the economy overall. It is the producer of the primary product, and what we do with that primary product is significant.

The Scottish Government's target is to grow the food and drink sector's turnover from £14.5 billion to £30 billion a year by 2030, but I suspect that the Government will fall far short of that target if we do not keep an eye on how funding is allocated to agricultural businesses. Agricultural businesses are not just about food production; we need to take account of everything that they do for local communities and economies and for the management of our environment.

The Convener: The next topic that we were due to discuss is agricultural funding, but we have already gone into that a fair bit. Does anybody have any other comments or questions on that topic?

Professor Bell: I will add to the previous comment. It is perfectly defensible to argue that agricultural funding is there to support the provision of public goods, which is mainly about environmental improvement and sustaining rural communities.

To go back to the start of the discussion and the governance of all this, the UK Government will not want to be in a trade negotiation in which the other side—the US, Canada or whomever—is saying, “Nothing much is going on in England, but you are supporting the incomes of farmers in Scotland, and we will use that against you in these trade negotiations.”

How agriculture is currently being supported is probably allowable under World Trade Organization rules because that support is decoupled from food production. Nevertheless, the Scottish Government will have to make a good case about how it supports agriculture and, in a sense, be in a position to participate and to help the UK Government when it is in the trade negotiations, because apparently many of them will occur within a relatively short time.

David Phillips: I have a question. Do we know how much agricultural land is rented as opposed to owned by the farmers in Scotland? You might expect that agricultural subsidies could get capitalised into land values and, ultimately, the beneficiary of the subsidy would not be the farmer but whoever owns the farming land. If the farmer is

the owner, they will benefit; if they are not the owner, it could be that a bunch of lairds are living it up.

Ivan McKee: That would never happen.

The Convener: Which one are you, Mr Hall?

Jonathan Hall: I can answer that. The ballpark figure for tenanted agricultural land is about 30 per cent, but that land is let in a whole host of different arrangements, whether they are secure tenancies or even annual, farmer-to-farmer grass lets, through which fields are let here and there.

It is absolutely right to make an assumption about agricultural support being capitalised into land values. That has happened since the repeal of the corn laws in the 1800s. Under Ricardo's theory of rent, the price of corn is not high because rents are high, but vice versa. It is exactly the same now.

An absolutely clear and unequivocal flaw of the common agricultural policy is that it is an area-based payment with no reflection on how people farm; it is about the occupation of land. Having the occupation of land as the means to unlock a payment is a very blunt, crude and inefficient way of supporting an agricultural industry or, indeed, deriving environmental benefits or anything else.

We want to see a move away from the common agricultural policy and how CAP payments are made, but the challenge, as David Bell pointed out, is that, once we move away from a decoupled area-based payment, there could be, depending on how that is done, the challenge from trading partners that we are directly supporting production. We think that we have solutions that involve saying that it is not about directly supporting production or tonnes of wheat or head of cattle, but about how people manage their land. That is one of the arguments that DEFRA will use if it pays farmers for the delivery of public benefit or for driving productivity gains rather than for production. That is the right direction, and we think that we can overcome that issue.

The CAP has without question incentivised inertia in Scottish agriculture. For the past 45 years, we have farmed in a way to unlock a payment rather than in view of what the market or society wants. We believe that there is now an opportunity to move away from that, but we need to do that very carefully. We are not saying that the funding that goes into Scottish agriculture should be reduced—far from it. Rather, we are saying that how we spend money on Scottish agriculture has to change. That is the clear distinction.

The CAP has long been ready for reform and, arguably, Brexit is a catalyst to move the process on quickly. Obviously, we must avoid cliff edges

for our more vulnerable beef and sheep producers in certain areas in particular, because they need to manage the change process. The Scottish Government, other Administrations and NFU Scotland have the same view. There will be a difficult and challenging time. We want to get to a place where we have clear objectives for what we want farmers to do and how we will support them, but we cannot race to that place very quickly because the collateral damage could then be significant for rural areas and the rural economy.

The Convener: That is helpful. The committee is about to undertake a more substantial piece of work on common frameworks, what they look and feel like, and how they are negotiated. Obviously, what Jonathan Hall has just described will be in front of our minds as we consider what the arrangements will look like.

I saw Jo Armstrong nodding her head vigorously.

Jo Armstrong: I was nodding in agreement.

The Convener: Does Alexander Burnett want to pick up on anything?

Alexander Burnett (Aberdeenshire West) (Con): My question was about the WTO, but it has already been covered very well.

Jonathan Hall mentioned the next CAP round. Are there early indications that it will go the way that we think the WTO is going in moving away from production support?

Jonathan Hall: On the direction of travel at the European level, the CAP shifted a gear in 2005 with the decoupling of payments. In 2013, that was taken a step further with the introduction of things such as greening measures in pillar 1. I cannot see the direction of travel changing at all at the European level; I think that things will continue down the same route.

A major proposal has come out of the early discussions and papers from the European Commission. The European Commission is looking at the capping of payments to individual businesses. That is partly a budget management issue, as the CAP is a huge expenditure issue for Europe. It is also about how funding can be rebalanced from the old member states of western Europe, such as Germany, France and Spain, to the newer member states, and how to move to more converged payments across what will be 27 member states once the UK leaves the EU. That is the broad direction of travel. However, built into that will be an increasing expectation that farmers should deliver more in terms of public good at the same time as producing food of a certain standard and quality, with traceability and so on as well.

The Convener: We have covered agriculture adequately. Does anybody have any other points that they want to make?

Professor Diamond: I hope that we take that expectation on board and move to a system of funding that incentivises both agricultural production and environmental protection. That can be done: about 10 years ago, there was a very good piece of work that the Economic and Social Research Council evaluated, which showed how incentivising farmers to reduce their impact on the environment worked very well. That could be seen as part of what Jonathan Hall was saying about the public good. It is about making the goals a little bit more complex, but it seems a good thing that we have goals that impact not only on agricultural production but on environmental protection.

The Convener: That might help with WTO rules as well.

Jonathan Hall: On the direction of travel, we believe that the future is not about area-based support—or direct income support, if you like—but about combining improvements in productivity with tackling the big issues around the environment in terms of climate change, water quality and biodiversity. Those two things should not be separate, parallel exercises, which they have been to date, but complementary and overlapping.

The more efficient you are in your production system, the less input there is, and so on. To use a cliché, there are win-wins all over the place, but we just have not grasped them. Now we have an opportunity to do that. We have already produced proposals to try to bring that agriculture support approach into play and mainstream it.

The Convener: We are moving into the area of research funding now. Willie Coffey will kick off on that. Ian, I know that you might have to go soon—

Professor Diamond: No, I will stay. I am having too much fun. [*Laughter.*]

The Convener: Too much fun? It is actually good fun—I am learning so much.

Willie Coffey (Kilmarnock and Irvine Valley) (SNP): We know that the research funding pot, through things such as horizon 2020, is worth about €80 billion over the period up to 2020. Our universities in Scotland have been particularly successful at winning research funds; we think that they have gained about 11 per cent of the total UK allocation of those funds. What will the impact be on Scotland, including on Scottish universities, if we no longer have access to that European funding stream? Presumably the UK has a decision to make about whether it will continue to contribute to that fund to allow Scottish universities to apply for the funding. What are the implications if the funding stream is withdrawn?

Professor Diamond: In the Prime Minister's Jodrell Bank speech, she was very clear that it is the wish of the UK Government to remain part of the European funding stream. That requires negotiations that I am certainly not able to comment on, but I think that, throughout the discussions, there has been a consistent view that we would wish to remain part of the European research enterprise, not least because European research is much better with the UK being part of it rather than not part of it, given the UK's strength in research. I believe—without in any way trying to sound arrogant on behalf of the UK—that Europe needs the UK in research as much as the UK would like to be part of the European research enterprise.

Scotland is extremely good at competing for those funds. Indeed, Scotland outperforms other parts of the UK in terms of percentage of population. That said, your question was about what happens if the wishes that have been expressed thus far do not happen and we as a nation do not have access to those funds. Clearly, it would then be for the UK as a whole to decide how much funding to allocate to research. It is worth saying that the current UK Government has increased the funding for research and innovation by £7 billion in this parliamentary session, and I expect Scottish higher education to be successful in bidding for much of that funding. There is already a commitment to research and innovation.

10:45

If we are not able to access European funds, I hope that there will be an increase in funding. I would then expect that Scottish universities would continue to outperform, or do very well against, the existing competition. If there was such an increase, it is important to recognise that the dual support system that I described earlier is enshrined in the Higher Education and Research Act 2017. An increase in funding would therefore lead to an increase in the block grant to the Scottish Government, which would then be able to take whatever decision it wanted to take about the block grant part of funding research in Scotland.

I will make one further point. Whereas in the 17th century, say, research was done by individual scholars who were locked away in garrets for long periods of time, research these days, particularly on the big challenges that the world faces, is undertaken by multidisciplinary teams. Because knowledge knows no nation-state boundaries, those multidisciplinary teams cut across nation states. We therefore need to find ways to enable the best researchers in Scotland to collaborate effectively with the best researchers elsewhere in order to really be able to address some of the

magnificently difficult but important problems that the world faces.

David Phillips: In part because of what collaboration opens up, Scotland's average success rates are better than the UK's, and the UK's are better than the EU's. Scotland is performing well within a country that is performing well, and there could be financial benefits and benefits from collaboration through remaining in EU-wide schemes, such as horizon 2020, and the European Research Council.

That will require the UK to make a contribution to the EU. The rules on setting the priorities for what a research stream looks like are somewhat different for non-EU members. I think that it is the case that, if a country is outside the EU, it does not have as much influence over the design and allocation of horizon 2020 funding, for example, as it would if it were a full member of the EU. That could have implications for how much funding we get back if funding shifts towards priorities that other universities and countries have comparative advantage in. However, if the contribution is based on population or GDP, the UK and Scotland would expect to get more than that back, unless there was a substantial changing of priorities and allocations post-Brexit.

If we cannot be in the EU schemes, there is then a question about how much of the funding comes back and can be allocated at the UK-wide level through the research councils, such as the ESRC or the Engineering and Physical Sciences Research Council, and how much of it goes into the block grant to be allocated by the higher education and research bodies of Scotland, Wales, England and Northern Ireland. I am not sure whether any proportions are set by the 2017 act.

There could be a trade-off with regard to how much control the Scottish Government has over the priorities that govern how the money is spent. Clearly, it has more control if the money is something that the Scottish Government can allocate as part of its research funding than if the money is allocated in a competitive way at a UK level, but that potentially brings more scope for collaboration and getting a higher share of the money than the population share would dictate.

There are also decisions to be made about the criteria for allocating that funding. Is it based purely on the quality of the research proposals or are there other objectives that the funding is aimed at meeting? For example, would the funding be partly seen as being an element of regional policy, whereby it would be aimed at supporting innovation not only in general but in more deprived or less advantaged areas? I am not saying whether that is a good or bad thing.

Being in the EU research programmes gives the most scope for collaborations and, potentially, the highest levels of funding if the highest levels of success were to be sustained. However, devolving things down to Scotland would give the Scottish Government the most control over the objectives and the type of research and innovation that the funding goes towards.

Professor Diamond: Scotland has always been clear about the fact that it sees the competitive nature of funding across the UK as desirable, and there is considerable evidence to demonstrate that the UK's competitive funding scheme has led to the UK being one of the very best countries in the world for research. That approach has been partly based on the view that excellence is the key thing. One of the things that have been said about our potential participation in European funding after Brexit is that we would still like funding to be based on excellence. We believe that we can do very well if it is so.

I deliberately did not talk about third-country models of participation in European research funding because I could be here for three days talking about them. There is the Norwegian model, the Swiss model, the Israeli model—I could continue, but they are all different. It seems to me that this is one area in which, if both parties wish to participate—as the UK and Scotland certainly do—there needs to be a sensible conversation about how best to ensure both excellence and influence.

Professor Bell: Quite a lot has been said about the flows of funds, but I want to make a quick point about the flows of people.

We can try to organise some kind of deal in relation to horizon 2020, but it has been vitally important for higher education institutions in Scotland to have people from Europe spending time here. That kind of interaction, which Ian Diamond talked about, helps to develop excellent research. I am one of only three British—two Scottish—people in my department. We benefit from all the international linkages that are brought about by the fact that we have people from Mexico, Belgium and wherever in the department. Aside from any funding issues, that helps the research itself.

Professor Diamond: You asked me about research, convener, so that is what I talked about. However, given David Bell's helpful interjection, I should also say that some of those European scholars in his department might have first come here on an Erasmus undergraduate visit to spend a semester in Scotland. We need to recognise, as the Scottish Government has always done, that encouraging Scottish students to spend a semester outside Scotland and encouraging European students to continue to study in

Scotland is good for higher education in the long term as well as the short term.

Diane Milne: With regard to what Ian Diamond was saying about the third-country models, it is important to say that, whatever model we end up with, we are likely to get out only what we put in. As the UK, we will not gain more money than we have now. As Scotland, we will still have an opportunity to try to gain more money out of the UK pot, but it really is the case that what we put in is what we get out. It would be a very difficult negotiation to try to get any further.

A point was raised about how we will engage in the future programmes and what the priorities are. We are still in the negotiations and many of the programmes for the next multiannual framework are being developed right now. We need to make sure that our priorities are put into those programmes, because they will be there for the next seven years, regardless of whether we are there.

Finally, we have talked about the research, the people in Erasmus+ and horizon 2020, but there are a host of other transnational programmes that are not being talked about. The universities have a powerful lobby in relation to horizon 2020 and Erasmus+, but local authorities engage in hands-on research through a host of other programmes—particularly Interreg—that allow us to learn from best practice and experience elsewhere in Europe and to do the same things that universities do through horizon 2020 and Erasmus+. That is not being talked about as strongly at the national level.

The Convener: Will you say a wee bit more about what Interreg is and which other programmes local authorities are involved in? I think that it would help everyone to understand that.

Diane Milne: Interreg is a structural fund for interregional collaboration projects, which we go into with, usually, between three and 13 partners across Europe. Most of the projects are about us learning from best practice, exchanging experiences and collaborating, and we develop new policies as a result. We are involved in a couple of projects at the moment. We are the lead partner in one called create converge, which is looking at how people in the digital industries such as the film and games sectors can use their skills to develop other economic sectors. For example, how can we use underwater filming skills to help to develop the oil and gas industry? The project is about the convergence of those industries.

Other partners are involved in a project that is just about to start on cultural and creative tourism. For Dundee as a city that is about to start developing—we hope—a stronger tourism

product, participation in such a project and learning from others about how they have done it are key.

In addition to Interreg, we have engaged in many other programmes that will probably be rolled into bigger programmes in the future, such as the intelligent energy Europe programme and URBACT, which is the only EU programme that focuses solely on urban issues. We would like to continue to be able to participate in such programmes because, from a local government perspective, they are much easier for us to access than programmes such as horizon 2020.

The Convener: That is helpful. David, do you have another point to make about research before we move on?

David Phillips: It is just a quick point on collaboration. I think that the consensus is that it is good to be in the EU scheme, but if we are not in that, it will be worth while for both the Scottish funding body and the UK funding bodies to do more to set up collaborative programmes with other research bodies, whether that is with the European Research Council and other European organisations or directly with the ones in individual countries. For instance, the Economic and Social Research Council has collaborations with the equivalents in the Netherlands, Germany and France under an initiative called the open research area, and they are really successful in bringing teams together. As a fallback option, pushing forward that side of things could be very beneficial.

Professor Diamond: I agree with that. For example, Scotland could join the NordForsk collaboration of the Scandinavian countries. The approach is not optimal, however, and one would need to be imaginative, think laterally and work quickly.

The Convener: We have had another good discussion about that theme. Thank you.

James Kelly is going to lead on the next theme, which is structural funds. We have already touched on that a fair bit, but there is probably a bit more to tease out.

James Kelly (Glasgow) (Lab): I was going to ask about match funding, but Diane Milne and Amanda Burgauer made some really good and practical points about that. There has also been a lot of discussion about how funds are allocated, the role of the block grant, the Barnett formula and some of the different iterations of that, which apply in relation to structural funds.

I want to bring that all together and give the discussion a better focus. The current tranche of structural funds coming to the UK is €10.8 billion, of which Scotland gets €476 million. Going forward, the issue is how we ensure that, in what

replaces the structural funds, Scotland receives a fair and adequate level of funding and how we deal with the competing bids in the UK.

The Convener: That is helpful. In a sense, it brings us back to the beginning and to the governance issues that we talked about earlier.

11:00

David Phillips: You are right in saying that one of the first questions that the UK Government will need to consider—although I am sure that the Scottish Government, the other devolved Governments and local government will want a say as well—is about the level at which the strategic objectives and broad structures of the programme will be defined. Will the shared prosperity fund involve a UK framework? How detailed will it be in setting rules, objectives and aims? Will it involve simply assessing the level of funding to give to each area and then leaving complete discretion over how to spend it with the areas? For instance, will it be based on a needs assessment, as happens in determining local government grants, which local government can then spend as it wants, or will it be more like the current approach for EU projects, in which there is an assessment at regional level and the money has to be spent on fairly well-defined areas: labour markets and personal development on the one hand and competitiveness, greening and communications on the other? Those are the two main strands of regional funding.

Once that decision has been made, there will be a whole bunch of questions to consider. The first is about how granular the assessment of needs should be. I think that Diane Milne said that, currently, the approach is too high-level and does not pick up pockets of deprivation. We need to consider whether the funding is about picking up pockets of deprivation or about broader areas such as the Highlands and Islands, which are more remote and so perhaps do not have the same opportunities as the central belt, which is less remote and has more scope for agglomeration effects. We need to think about whether the funding is about dealing with deprivation or broad economic city region-type issues.

Once we have determined what it is about, the next question is about how targeted the funding should be, and then there is a question about how frequently the funding should be updated. If the funding is updated regularly to account for changes in local characteristics, that can end up reducing the incentives for areas to improve their economies. If an area's funding will be reduced if it has got richer after five years, that could have a negative effect. On the other hand, if the approach is not updated and if some big factories and

industries close down in an area, the funding will not reflect the fact that an area is more needy, so it could really fall down. There is a trade-off to think about there.

In my submission, I list the key questions to think about. Some of those will be thought about at the UK level but, depending on how much discretion the Scottish Government has, a lot of them will come down to the Scottish Government and the committee to think about. The key questions are about how to target, how targeted the approach should be, how frequently it should be updated and how much discretion there should be. Then there are questions about evaluation and whether it should be based on outturn. For example, if an area has not met its previous objectives, should it get less funding in the future? There are dozens of questions. We have touched on some of them but, at some stage, they will require much more debate.

Professor Bell: That takes us right back to the start of the discussion. It is good to think about the issue in the context of the UK's industrial strategy and how it is developing. It is partly about equity and partly about efficiency.

When the industrial strategy was dreamt up initially, the ideas that lay behind it were about efficiency and getting growth as quickly as possible. The Prime Minister then noticed that there were a lot of left-behind areas. We are now rebalancing the strategy a bit, with the discussion of the shared prosperity fund, although it is not clear how that money will be allocated. We have had the city deals to improve efficiency at a local level, and it will be interesting to evaluate those deals ex post. Some of the work that is aimed at sectors, including the automotive sector, has been quite successful, and it has brought research and innovation into the industrial strategy.

That sits somewhat oddly with the existing structural funds whereby money is paid out to an area if it is able to prove that, in some sense, it is deprived. That might be an equitable system, but it might not be an efficient use of funding. If we assume that we do not care too much about the efficiency aspects but we are really concerned about equity, we need to think about how we determine to whom we give the funding and how much we give to the community—or however we define the area. All of that is up for grabs. As David Phillips said, the existing model probably sets up a lot of wrong incentives, partly because of its cliff-edge nature whereby areas in which GDP per capita is less than 75 per cent get more money.

I think that the shared prosperity fund is out for consultation at the moment. However, we are largely in the dark about the quantum of resource that will go into that fund and exactly how it will be

designed. It is important that such issues are addressed. There needs to be something quite explicit about equity, as we need to decide how much of this is about trying to get the left-behind areas to catch up with the rest of the country and how much is about driving economic growth.

Professor Diamond: As David Bell says, left-behind areas are really important, but such areas are often, for example, fading seaside towns that might be quite close to good economic areas but have lost their economy. I give that example because the left-behind areas are not large economic areas.

On David Phillips's point about things changing, we are in the position—in Scotland in particular, but in the UK as a whole—of being able to use data at a much more granular level and in real time better than people can do just about anywhere else. Therefore, it is wrong to continue to use the model that involves big areas for five years. We can be much more flexible. It would be really nice if there was an algorithm that told us exactly how to answer all the questions that David Phillips beautifully set out. Sadly, there is not, which is why we have politicians.

The Convener: I thought that it was for you guys to sort out an algorithm.

Professor Diamond: We can identify the questions and the data, and we can provide the evidence, but, at the end of the day, political decisions need to be made about how much money should be available, how it should be allocated and what the priorities should be. That is why your job is harder than mine. The research community can provide politicians with the evidence, but you have the harder job—you make the decisions.

Jo Armstrong: I am not going to make it any easier, I am afraid.

I feel quite aged sitting here, thinking through some of the economic development issues that I discussed or was involved in when I worked at the Scottish Development Agency. Issues of additionality and displacement are absolutely germane to the discussion about the new funding arrangements. If we are spending money that we are taking from taxpayers in places where that spending would happen anyway, there is no net good. If, by spending money in certain areas, we are displacing it from contiguous areas, that is, equally, not good. Additionality and displacement are not easy to discuss or debate, particularly when there is a target of getting money out of the door to ensure that it gets spent, but I would argue that they need to be part of any debate about how we allocate funding under any new fund or funding arrangement for the type of approach that we are discussing.

That raises the question whether the allocation should be made at a UK, Scottish or regional level—or at a sub-regional level, as we can, apparently, now do that with the data. It is not easy at a UK level—the Treasury green book shows that—let alone at a sub-regional level. If we are talking about good governance and why we are spending the money that we take from taxpayers, we must start asking such questions and have some clarity around how we are going to justify one area, one sector or one region getting money.

The third and probably most difficult issue concerns the areas that are left behind. We can talk about what those areas are now, but they were left behind when I worked at the SDA. The issue is not about turning the tap on or off when the data start to tell us something; it is about thinking about why those areas have been left behind and how long it will take to make a difference, and it is about making a lasting, long-term commitment.

Ivan McKee: I have a couple of observations to make on our discussion of economic efficiency versus the areas that have been left behind. There is a separate issue about agglomeration and where we focus city deal money, but I will leave that to one side. The growth commission's report is big on the inclusion agenda—those things are not necessarily opposites. If we focus the money where we want to drive inclusion and participation, that gives a huge boost to the economy as a whole. Those things need not be opposites, depending on how the funding is configured.

The Convener: I think that we have come to a natural conclusion.

From my perspective—and, I am sure, from that of the rest of the committee—it has been an excellent morning. There has been some fantastic input from around the room, and there has been a lot of learning going on, although turning politicians into algorithms will be interesting. What we have been discussing is complex, challenging and compelling, and it is time pressured. I will leave the final word to Ian Diamond, who said that it is also “fun”.

I thank everybody for coming along. It is most appreciated and will help us in our deliberations.

11:12

Meeting suspended.

11:19

On resuming—

Subordinate Legislation

Land and Buildings Transaction Tax (Group Relief Modification) (Scotland) Order 2018 [Draft]

The Convener: Our next item of business is consideration of subordinate legislation in relation to the land and buildings transaction tax. We are joined by the Cabinet Secretary for Finance and the Constitution and supporting officials Ewan Cameron-Nielson and John St Clair from the Scottish Government.

We must consider each statutory instrument separately, so we will have a short evidence session on each instrument before formal consideration of the relevant motion. First, we will take evidence on the draft Land and Buildings Transaction Tax (Group Relief Modification) (Scotland) Order 2018. I welcome the cabinet secretary and invite him to make a short opening statement, should he wish to do so.

The Cabinet Secretary for Finance and the Constitution (Derek Mackay): Members of the committee will be aware that the laying of the draft order follows our engagement with stakeholders, who highlighted a small but significant divergence of approach between land and buildings transaction tax and stamp duty land tax in relation to the group relief provisions. That divergence related to scenarios in which share pledge-type arrangements were in place. I considered the matter and accepted the need for change. In March, I announced my intention to launch a consultation on draft legislation to make it clear that group relief should be available where such arrangements are in place.

I am grateful to everyone who took the time to respond to that consultation and to Revenue Scotland for their considered and valuable input to the Scottish Government's thinking. All consultation respondents were in favour of the decision to amend the LBTT legislation, and that view seemed to be echoed across the chamber during the recent consideration of the Land and Buildings Transaction Tax (Relief from Additional Amount) (Scotland) Bill.

The focus today is on the draft order, but the committee will be aware of the widespread calls for any change to be made retrospectively. Indeed, two members of the committee explicitly raised that issue during the recent stage 3 consideration of the aforementioned LBTT bill. It is not normal practice to make changes retrospectively, so the matter requires careful thought. However, after detailed consideration, I

can confirm that if the order is approved by the Scottish Parliament, the Scottish Government intends to introduce legislation to make the change in question retrospective in effect at an appropriate future opportunity. I note that that position is informed, in particular, by the Scottish Government's original policy intent with regard to group relief.

I am happy to take questions.

The Convener: I am glad that you clarified the issues around retrospectivity.

As members have no questions, we move to item 3, which is consideration of motion S5M-12474. I invite the cabinet secretary to move the motion.

Motion moved,

That the Finance and Constitution Committee recommends that the Land and Buildings Transaction Tax (Group Relief Modification) (Scotland) Order 2018 [draft] be approved.—[*Derek Mackay*]

Motion agreed to.

Land and Buildings Transaction Tax (First-Time Buyer Relief) (Scotland) Order 2018 [Draft]

The Convener: Under item 4, we have a further piece of subordinate legislation on LBTT to consider. Do you wish to make an opening statement, cabinet secretary?

Derek Mackay: Yes please, convener. I will be very brief.

Members will be aware that, last December, as part of the draft Scottish budget, I announced my intention to introduce relief from LBTT that would be focused on supporting first-time buyers in Scotland. The proposed relief is intended to complement our progressive approach to the setting of LBTT rates and bands, which has prioritised support for first-time buyers. We have taken a range of other measures to support first-time buyers.

As a result of consultation, a number of changes have been made to our proposed approach. I believe that the approach that we have taken to setting the eligibility criteria for the relief is sensible and appropriate, and that it will minimise complexity as much as possible. As far as the impact is concerned, as members of the committee will be aware, raising the nil rate threshold for first-time buyers to £175,000 will mean that an estimated 80 per cent of first-time buyers will pay no tax if the relief is agreed to. In addition, those who purchase a home above the threshold will benefit from a £600 reduction in their tax, regardless of the purchase price of their home. The Scottish Fiscal Commission has

independently estimated that the policy will benefit around 12,000 first-time buyers each year.

I am happy to answer any questions.

The Convener: Murdo Fraser has a question.

Murdo Fraser: How is the term “first-time buyer” defined in the order? How will that be policed?

Derek Mackay: The policing and monitoring of that will be for Revenue Scotland, as the appropriate tax collection agency. It has established procedures for that. I know that Revenue Scotland has communicated with the committee on its general approach and some specific matters.

The consultation was really important in obtaining a full understanding of the issues surrounding the eligibility criteria for first-time buyers. An example of one of the considerations is whether, in the case of joint prospective ownership, just one partner should be eligible or both partners should be eligible. We have set out a range of criteria. I could go through the detail, which I think is set out in the order. That is what we consulted on, and that is what is in the order. I can read out the criteria, if the member wishes me to.

The Convener: I do not think that he does.

Murdo Fraser: I am happy for you not to.

Derek Mackay: That is a relief for us all.

The Convener: As there are no further questions, we move to item 5, which is consideration of motion S5M-12473. I invite the cabinet secretary to move the motion.

Motion moved,

That the Finance and Constitution Committee recommends that the Land and Buildings Transaction Tax (First-Time Buyer Relief) (Scotland) Order 2018 [draft] be approved.—[*Derek Mackay*]

Motion agreed to.

The Convener: In the coming days, the committee will publish a short report setting out its position on both orders. I thank the cabinet secretary and his officials for their attendance.

Meeting closed at 11:25.

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