OFFICIAL REPORT
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Finance and Constitution Committee

Wednesday 16 January 2019

Session 5

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Pàrlamaid na h-Alba

Wednesday 16 January 2019

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FINANCE AND CONSTITUTION COMMITTEE
2nd Meeting 2019, Session 5

CONVENER

*Bruce Crawford (Stirling) (SNP)

DEPUTY CONVENER

*Adam Tomkins (Glasgow) (Con)

COMMITTEE MEMBERS

*Tom Arthur (Renfrewshire South) (SNP)
*Neil Bibby (West Scotland) (Lab)
*Alexander Burnett (Aberdeenshire West) (Con)
*Willie Coffey (Kilmarnock and Irvine Valley) (SNP)
*Angela Constance (Almond Valley) (SNP)
*Murdo Fraser (Mid Scotland and Fife) (Con)
*Emma Harper (South Scotland) (SNP)
*Patrick Harvie (Glasgow) (Green)
*James Kelly (Glasgow) (Lab)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Kate Forbes (Minister for Public Finance and Digital Economy)
Derek Mackay (Cabinet Secretary for Finance, Economy and Fair Work)

CLERK TO THE COMMITTEE

James Johnston

LOCATION

Committee Room 6

Scottish Parliament

Finance and Constitution Committee

Wednesday 16 January 2019

[The Convener opened the meeting at 09:30]

Budget Scrutiny 2019-20

The Convener (Bruce Crawford): Good morning and welcome to the second meeting in 2019 of the Finance and Constitution Committee. As I usually do, I remind everyone to put their mobile phones into a mode that will not disturb proceedings.

The first item on our agenda this morning is to take evidence on the Scottish Government's budget for 2019-20 from the Cabinet Secretary for Finance, Economy and Fair Work, Derek Mackay. He is joined by Scottish Government officials Aidan Grisewood, head of tax division, and John Nicholson, deputy director for public spending. I welcome all the witnesses to the meeting.

Before we move to questions from the committee, I invite the cabinet secretary to make an opening statement.

The Cabinet Secretary for Finance, Economy and Fair Work (Derek Mackay): The budget is comprehensive and I have given a statement to Parliament. I am keen to get straight to the committee's questions.

The Convener: Thank you. In its report "Scotland's Economic and Fiscal Forecasts December 2018", the Scottish Fiscal Commission states that

"it is not unreasonable to expect an average one-year ahead error in our tax forecasts of around £530 million",

and that,

"Of the 53 UK forecasts we looked at, there was an error of ... £810 million in a Scottish context, on 11 occasions."

Given that your borrowing powers for forecast error are limited to £300 million, does that concern you?

Derek Mackay: We have previously discussed the complexity of the system and the fiscal framework, and there will be a review of the fiscal framework. Of course, I want the forecast to be as close to actual as possible. As you have described, we have borrowing powers and reserves are available. With regard to the budget, I have said that I want to have adequate reserves to meet any requirement that arises, for example as a result of a forecast error. We want the forecasts from the SFC and, in relation to the block grant adjustment, the Office for Budget Responsibility to be as accurate as possible. We have a number of levers to deal with the situation, should the SFC forecast turn out not to be accurate: borrowing, reserves and then decisions that might be taken for the particular budget year.

That said, the further we go in the process under this system, the more data we have and the more accuracy the SFC and Her Majesty's Revenue and Customs have about the detail and the outturn numbers. As we get closer to each fiscal event, we have the most up-to-date reports. Of course, a finance secretary watches that closely. I am mindful of it and that is why we need a number of levers to manage the position in the event of forecast errors.

The Convener: To get a better understanding of the extent of the risk, the committee and I would find it helpful if we could explore one specific example. The most recent SFC and OBR forecasts show that income tax receipts are now forecast to be £43 million lower in 2018 than the adjustment to the block grant, when, previously, in December 2017, they were forecast to be £420 million higher. Therefore, to what extent should we be concerned about those revised forecasts and, building on what you have already said, do you think that the Government needs to take a strategic approach to dealing with potential shortfalls, rather than waiting for the publication of the final outturn figures in July 2020? Where do you see the Scotland reserve in that regard, given its current position?

Derek Mackay: We will give an update on the Scotland reserve at the next appropriate time. As you would expect, the situation remains fluid, and we present the figures when we announce the medium-term financial strategy, the budget and the budget revision.

On the strategy for dealing with potential shortfalls, the decision that Parliament makes from year to year on an annual budget is to determine the revenue that it raises and what it wishes to spend and, if there was a request from this committee or elsewhere to have a strategy of building up reserves to a particular figure, that would essentially be a budget decision. There could be a deliberate policy choice to put more aside in reserves—some members have mentioned that in the chamber as recently as the past couple of weeks—but putting more money into reserves would take money away from day-to-day spending. That would be a political choice.

What I am trying to do in this budget is provide stability, stimulus and sustainability to our public services. Of course, I acknowledge the risk that you flag up of forecast error—not on the part of the Scottish Government but in the processes involving the SFC and the OBR that we are bound by—and the material impact that that has for the resources that we have available.

Essentially, if there were to be a strategy to set aside further amounts for the reserve and to take that amount from day-to-day spending, that would affect the budget as proposed. Members should be mindful of that.

I have set out my ambition to ensure that we have adequate reserves. Of course, there are repeated calls from all sides of the chamber to use any reserves that we have. It would be appropriate to try to have reserves to account for some of the forecast error, if it transpires, but there are other levers, which I have described, and there are decisions that we can take from year to year in the budget.

It is important that the agencies that advise us give us the best forecast possible, so that there is not a high level of reconciliation, which might concern us all.

Alexander Burnett (Aberdeenshire West) (Con): My question is very much in the same vein. We heard in previous meetings that the finance minister in 2021-22, whoever that is, will be starting with a negative reconciliation of £472 million and that, with your proposal to draw down £85 million from the capital reserve and £203 million from the resource reserve, you will have drawn down the maximum that is allowed under the fiscal framework. The simple question is this: will you be writing a letter to your successor to say that there is no money left? If that is the case, is it true to say that your legacy will have been to have single-handedly bankrupted Scotland?

Derek Mackay: Absolutely not, and that is absolute and total nonsense. It is very colourful language for this morning. I know that there have been dramatic events in Westminster and Mr Burnett might be trying to replicate them here, but I am afraid that the answer is no.

As we get closer to each fiscal event, we have the most up-to-date advice. I am sure that members will be familiar with the situation, as we have had similar debates before. The forecast numbers will inevitably change. In the most recent report, the SFC has upgraded the outlook for economic growth. That is progress since the medium-term financial strategy that was published last year.

The Scottish Government has produced balanced budgets and will continue to do so. There is the flexibility that I have described in the arrangements.

As we have previously discussed in meetings of the committee, there should be room for further discussion with the UK Government about borrowing limits and caps. In light of some of the constraints that we face, it is right to have more fiscal and financial flexibility, taking into account some of the issues that have been raised.

On the point about spending money, we have consistently produced balanced budgets. If I were to follow the advice of the Conservatives, we would have less money from income tax to spend on our public services. That is the reality. I did not hear anyone say, at any fiscal event for the budget last year, that the revenue from income tax in the SFC's projections, which led to the budget decisions, should all be banked in reserves. The request that I got from Parliament was to spend the budget.

We want balanced, competent budgets and stability, but the financial arrangements that we have set out in the fiscal framework are what we are following, and there are provisions for how to deal with the situation in the event of forecast error.

I repeat that we are dealing not with the Scottish Government's forecast but with the forecast of the SFC, which I know the committee comprehensively probed and challenged. The catastrophic circumstance that Mr Burnett outlined will not come to pass.

Alexander Burnett: Colourful language or not, you said on Wednesday that other levers are available to the Government in the event of a negative reconciliation. Which levers are you looking at and, if you are not considering levers, why not?

Derek Mackay: I have already gone through some of the levers, which are the borrowing capacity that we have in the event of forecast error, the use of reserves and the decisions that the finance secretary can take when proposing the budget to Parliament in that year. I have also set out that it is my desire to ensure that we have reserves. If the Parliament wants to take more money out of day-to-day spending and put it into reserves, that is a choice that the Parliament should take. Just as I said in relation to the budget overall, if parties wish me to take money out of the national health service, local government, education, or something else and put it into reserves at this time, that is a legitimate alternative proposal. However, that is not the position that has been put forward by other parties in the Scottish Parliament—it is to have a balanced budget that stimulates the economy, provides stability and sustains our public services.

We are all familiar with the issues of forecast error if the SFC has got any of its numbers wrong. Of course, the SFC is just made up of economists who look to the future to try to establish what the tax takes will be. The most recent SFC report upgraded the economic performance of Scotland, as subdued as that forecast is—and we know that that is the case because of the uncertainty of Brexit, which has not been resolved as of last night, and some of the demographic challenges that our country faces. The Government is getting to work, trying to stimulate the economy to address those issues. However, we would be able to do more if we had more powers.

In respect of the complexity of the forecast, there have been revisions because of improved data, which is something that the committee has probed with the SFC and HMRC in relation to the tax take in Scotland. Increasingly, we are moving from forecasts of how much tax the UK agencies think they raise in Scotland, to more detailed forecasts of what they actually raise in Scotland. Those are the numbers that we have to wrestle with when determining the budget.

I have tried to set out the balanced decision that I have taken in presenting a budget to Parliament that is mindful of the needs of public services today, this year and going forward.

James Kelly (Glasgow) (Lab): The Scottish Parliament information centre blog on the taxation impacts of your budget states that anyone who earns less than

“£124,375 will pay less tax”

as a result of the budget. Do you think that that is a fair taxation policy?

Derek Mackay: What we have done on taxation overall has met our four tests for income tax: having a more progressive system, as a result of the recalibration last year; stimulating support for the economy; supporting lower earners; and raising more income. Those are the tests that we set out for the role of income tax in Scotland’s budget. There are changes to the personal allowance, but I think that the tax policy that I have put in place is fair and progressive. I have not increased the tax percentage rates, but we are not passing on the tax cut that arises from the increased higher-rate threshold in the rest of the UK to higher earners in Scotland. I think that I have taken balanced decisions that are fair and progressive, but it is true that, because of the change to the personal allowance and the fact there is no increase in the tax rates, a number of people will pay the same or less tax, so it is also not accurate to describe it as a huge tax hike.

James Kelly: So you think that it is entirely reasonable that cabinet secretaries such as you, who are scheduled to earn £111,000 in the next tax year, would pay less tax.

Derek Mackay: I would point out that cabinet secretaries such as me have had a voluntary pay freeze since 2008. I have been asked about my own situation and I have not been a cabinet secretary that long, but that is the position for cabinet secretaries.

09:45

The income tax proposals that we have made are fair because they meet the tests of raising the necessary income, protecting the economy—it is important to have that balance and give that stability—and protecting lower income earners. We have designed the system to be more progressive and we are not passing on the tax cuts for higher-rate taxpayers that the UK Government has made by raising the threshold in the rest of the UK. The rates and bands that we have proposed are fair and progressive and strike the right balance for Scotland at this point.

James Kelly: Do you think that it is fair that Government ministers, managing directors and chief executives on salaries of around £100,000 are paying less tax as a result of the budget?

Derek Mackay: The budget meets the principles that I have set out: it raises more money, it is more progressive and it protects lower income earners. It is far more progressive because it does not pass on the cuts from the UK Government that result from the increased higher-rate threshold.

It is interesting that James Kelly is asking that question when the shadow chancellor in the UK Parliament has said that he will emulate Tory policy and will not undo the Tory income tax cuts. I will not pass on the Tory tax cuts in Scotland. Our budget raises more money, protects lower income earners and is more progressive and fair.

I am also examining the evidence on potential impacts, which shows that, for example, if we increased the top rate of tax to the point that Labour has proposed, we would raise less revenue. That would be counterproductive, because that lost revenue would mean that we had less to spend on our public services.

The approach that I have set out is balanced and fair. In not passing on the Tory tax cut, that approach is right for Scotland as we try to deliver the society that we seek.

James Kelly: If you have looked at the evidence, have you taken account of the crisis in public services, which we hear about week after week in Parliament? Councils are facing the prospect of job losses and cuts in services. Why then have you set a taxation policy under which 99 per cent of taxpayers will pay less tax in the coming year?

Derek Mackay: I have tried to set out the composition and structure of the tax base in Scotland and, in following the evidence, I have met the tests set out for the role of income tax in Scotland. I wonder why the Labour Party is just photocopying the Westminster chancellor's tax cuts. I am told that in Scotland there will be no alternative proposals from Mr Kelly or any of the Labour Party. If it is not my income tax proposals, what is the Labour Party proposing? The budget is absolutely defensible and fair. For the tax that is paid in Scotland, we get a better deal.

It is true to say that, for the majority of people, Scotland is the lowest-taxed part of the UK. It is also the fairest-taxed part of the UK, because the beneficiaries of our policy include lower earners. It is a fairer, more progressive tax system that is based on the evidence on what optimises our income, rather than putting it at risk, which is what the Labour Party has proposed.

There is divergence from the UK tax policy. That divergence reflects what we wish to see in our country in respect of the social contract, entitlement and economic growth and stimulus for the economy.

There are challenges because of on-going austerity from the UK Government. I have covered the numbers in relation to the overall settlement for Scotland. If we put aside the health consequentials, there is a real-terms reduction in resource for the Scottish budget. That has put pressure on our public services. We have taken a balanced decision on tax. I am proposing a real-terms increase in resource and capital specifically for local government as part of the budget.

The Convener: As you might expect, cabinet secretary, several members want to speak on the topic. I expect we will now hear the opposite side of the argument from Adam Tomkins.

Adam Tomkins (Glasgow) (Con): Good morning, cabinet secretary. Do you agree that the highest 1 per cent of earners in the United Kingdom currently contribute more than a quarter of income tax receipts, for both the Scottish and UK Governments?

Derek Mackay: I would need to go through all the individual figures but, by the nature of the composition of the tax base, they pay more.

Adam Tomkins: Given your ambitions as Cabinet Secretary for Finance, Economy and Fair Work to grow the Scottish economy and to have more money to spend, invest in the Scotland reserve or save elsewhere, do you accept the imperative need to attract a greater number of additional-rate taxpayers into the Scottish economy?

Derek Mackay: At the Economy, Energy and Fair Work Committee, I referenced the fact that I value people irrespective of their tax band. We value people on a range of issues, and it is not necessarily just people's tax band by which they are judged. We want to attract people to live, work and invest in Scotland for a whole host of reasons. We need population growth, we want to stimulate the economy and we want tax support, too. I have not set a target just to attract top-rate taxpayers, but of course we want to attract as many people as possible to live, work and invest in Scotland.

As I said at the Economy, Energy and Fair Work Committee, I value nurses, carers, refuse workers and everyone else. Not just top-rate taxpayers contribute to society; everyone does.

Adam Tomkins: Indeed. I am sure that we all agree with that. However, the fact is that, for every additional 20 top-rate taxpayers we attract to Scotland, the Scottish Government accrues an additional £1 million annually in tax receipts, which is £1 million extra to spend or save. My question is, what is the Scottish Government doing to attract new additional-rate taxpayers into the Scottish economy?

Derek Mackay: As I have done at another committee, I am expressing the view that we need a whole host of people to support the economy.

Adam Tomkins: I understand that but, given the immense financial contribution that additional-rate taxpayers make, I am asking you to identify the specific policies that the Scottish Government is pursuing to attract additional numbers of such taxpayers into the Scottish economy.

Derek Mackay: I am just slightly interested in why the need for nurses, carers or people in other professions is not also important.

Adam Tomkins: It is. I am not saying that it is not important, but I am asking—

Derek Mackay: That is exactly what you are saying. You are asking me to target one band of taxpayers.

Adam Tomkins: Cabinet secretary, I am not saying that anybody is unimportant, but I am identifying that—

Derek Mackay: You are saying that some are more important than others.

Adam Tomkins: Some pay more tax than others. I am saying that 20 additional-rate taxpayers would contribute an additional £1 million annually for the Scottish Government to spend. Under the fiscal framework, that money would not go south to Westminster; it would stay in Scotland. Notwithstanding the importance of other people in the economy and society, I am asking you to identify what the Scottish Government is specifically doing to attract additional numbers of additional-rate taxpayers into the Scottish economy.

Derek Mackay: Convener, I question the premise of the question. I come back to my previous answer, simply because Scotland's economy needs a variety of people to make different contributions to our society. The premise of the question of what we are doing to target a specific band of taxpayers is somewhat strange when we know that the economy needs a range of people. We want to attract as many people as possible to come here to live, work and invest.

On the question of what we are doing to achieve that, we want a more welcoming migration policy and we want to build a quality of life that attracts people. We want quality jobs so that there is meaningful employment, and we want to grow the sectors of the economy that ensure that there are high-value jobs, which we are doing through our economic strategy. We have an education system that attracts people here because of its quality. Quality of life is important, too, which can be about the environment, the nature of our public services, the social contract or the prospect of living in a fairer and more socially just society. That should be attractive to all taxpayers, as well as those whom Mr Tomkins wants to pursue. The kind of society that we seek is more progressive and fairer, and of course we want to raise the necessary revenue as well.

Crucially, when the SFC looks at our tax propositions, it looks at behavioural effects and similar issues and ensures that those are factored into the numbers that it gives me. In our tax policy, we have to be mindful that we do not deter people from coming to live, work and invest in Scotland. Therefore, I take an evidence-based approach to ensure that we optimise the revenue that we can raise, attract people to come here and protect our public services.

We are building a better country, which is attracting people here. The UK Government has a far more hostile attitude to migration.

The Convener: Looking at the figures in the SFC forecast, I find it interesting that, without the Scottish Government having to do anything, the number of additional-rate taxpayers will go up from 15,800 in 2019-20 to 20,100 in 2022-23. I put that on the record as a fact from the SFC—no, it is not a fact, because it is a forecast; I have to get that right.

Patrick Harvie (Glasgow) (Green): Cabinet secretary, you have mentioned a couple of times that one of your objectives on tax policy is to raise more revenue. This issue has been discussed in the chamber but, for the record, what is the Scottish Government's assessment of the amount of additional revenue in the budget for 2019-20 compared with a scenario of following UK tax policy?

Derek Mackay: The divergence between our policy as proposed and one that follows UK policy would amount to about £500 million. To be clear, that amount relates specifically to income tax.

Patrick Harvie: Given that that income tax policy was not your party's manifesto commitment but was the result of positive cross-party discussions after the election, and given that you would have said at the time that your party's spending commitments were fully costed and funded and that you have spent what you describe as health consequentials—Barnett consequentials, which you are free to decide how to spend—on health, I presume that the £500 million shows up in substantial increases in other spending areas. Where is it?

Derek Mackay: I publish the budget year to year, and it is in the budget, as proposed. To be clear on the £500 million and to address the premise of the question, there is divergence. There was divergence between the income tax manifesto proposition from the Scottish National Party and the Conservatives' tax policy. Some of the divergence is now driven by the UK Government's decision to implement its higher-rate threshold change earlier than planned, which has a material impact on us.

The extra resources that are generated by the divergence in tax policy are invested in the budget. In 2018-19, they were invested in the public services of Scotland, and if we were to take a contrary decision this year and follow the Conservative Party's income tax policy, we would have to take £500 million out of proposed spending. Where is the money from the tax divergence? It is in the budget, as proposed.

Patrick Harvie: I appreciate your answer at the extremely general level, but I am hoping for a specific answer. You say that there is additional money in the budget for the coming year because part of your intention in income tax policy was to raise more revenue for public services. I am asking you to identify specific budgets that have benefited by that order of magnitude from the additional resources that are available. As you know, you are being told by, for example, council leaders all over the country that they are having to strip services down to the bare minimum, so the additional money is not going there. It is not coming into health, because you have acknowledged that that was a pre-committed SNP policy that would have been funded from the resources that you expected to have, and the additional Barnett consequentials have gone to health from that source. What are the other areas of expenditure that have seen this substantial uplift?

Derek Mackay: Arguably, the uplift has gone to the rest of government, including local government. To refer to what I said earlier, which might be helpful, we do not generally extrapolate income tax alone and say where that element of revenue is allocated in the budget; we take a total approach of total revenue and then total spend. It is not hypothecated in the way that has been suggested.

To give further detail, with the health consequentials, Scotland was of course short-changed to the tune of £50 million. The tax changes that we are making make up that figure, to ensure that we can allocate to health services the resources that were committed by the UK Government in the uplift that it previously talked about. If we discount those health consequentials—we have said that we will pass those on—there would have been real-terms reductions in the rest of expenditure because of the UK resource allocation to Scotland and the offsetting of other budgets as a result of the UK Government's decision. The tax policies plus other decisions that I have made, have ensured that other portfolios will enjoy growth.

10:00

Local government is a pretty good example. If I had simply passed on that real-terms reduction to Scotland's resource budget—the fiscal departmental expenditure limit—local government would have had a real-terms reduction, but I am proposing real-terms growth for the local government budget in respect of resource and capital. We do not extrapolate that element, but the tax revenues fund the budget as proposed.

As I have said, the alternative, if we had not taken the decisions that we have taken, would have been a £500 million reduction in budgets. That would have been £50 million less for health services and reductions for other portfolios as well, to the tune of around half a billion pounds. That would have been the consequence if we had followed the UK's income tax policy.

Patrick Harvie: I know that other members want to come in on local government, so I will perhaps come in on the back of their questions.

The Convener: We will come back to that. There are still a number of areas to discuss. A number of members want to talk about tax.

Angela Constance (Almond Valley) (SNP): On tax, the cabinet secretary has said a few times in the chamber and elsewhere that UK-imposed austerity has led to a real-terms reduction of 6 per cent, or £2 billion, in our total Scottish fiscal budget over the decade from 2010 to 2020. Will the cabinet secretary remind us how, in his overall decisions on tax and borrowing—bearing in mind that he has many competing interests to balance—he has managed to mitigate the real-terms reduction in the Scottish fiscal budget, by how much, and what additional investment in public services that has enabled?

Derek Mackay: If we look at the figures that we have debated, we see that, in the period from 2010-11 to 2019-20, Scotland's discretionary resource budget allocation is £2 billion lower in real terms. It is down by 6.9 per cent.

I have covered the issue of health funding and the fiscal resource budget allocation. If we take out health funding, from one year to the next for 2018-19 to 2019-20, the figure is over £340 million or 1.3 per cent lower in real terms.

The decisions that we have taken on tax and borrowing have reduced the real-terms reduction in the total Scottish fiscal budget from 6 per cent to 3.8 per cent between 2010-11 and 2019-20, and we have generated an additional £712 million for investment in public services. That is £450 million from capital borrowing and £262 million from tax policy decisions.

In the budget for 2019-20 that we are proposing, compared with 2018-19, there is a difference of £2 billion of extra expenditure for our public services.

Angela Constance: I am interested in how particular investment choices can increase tax receipts. For example, there is record investment of £826 million in the affordable housing supply programme, which has to be good news. Will the cabinet secretary talk through how that improves income tax receipts, because it works its way through? Everybody knows that capital investment increases employment, and I know that the Scottish Government has done some work to crunch the numbers on what investment in housing means for income tax receipts.

Derek Mackay: Employment is, of course, created through the immediate work in the construction sector, which we want to stimulate. That applies to a whole host of Government spending decisions, whether on assets, infrastructure or supporting and stimulating the economy. The investment of £826 million in housing will, of course, help us to meet the target of providing more homes. That is a short, medium and long-term economic stimulus. Of course, that creates employment, too. If we have more people in meaningful employment paying tax, we generate more income tax as a consequence. When investing in the economy, there is the circular benefit of the supply chain, too.

There are a range of commitments to stimulate the economy in relation to manufacturing, and a competitive rates regime to support business growth. Housing is a good example of the short, medium and long-term multiplier effect of infrastructure investment. Providing more quality houses for people to live in is a good social outcome, too.

Angela Constance: Will you share the detailed numbers on the multiplier effect and what investment in housing means in terms of increasing tax receipts?

Derek Mackay: I can write to the committee with the details of the multiplier effect and the economic benefits that come from housing specifically.

Neil Bibby (West Scotland) (Lab): In the first sentence of your draft budget statement, you said:

"This Scottish budget prepares our economy for the opportunities of the future".—[*Official Report*, 12 December 2018; c 33.]

It is very important that it does.

You recently hailed a growth in Scottish gross domestic product, but that growth is not forecast to be sustained. The Scottish Fiscal Commission has said that it does not

"expect this stronger growth to be sustained beyond 2019",

and that it expects growth to average

"just over 1 per cent over the next five years."

You said that numbers and forecasts will change. I accept that, but it is not particularly reassuring. What evidence, if any, can you present that will give us confidence that Scottish growth figures will be higher than those of the rest of the UK over the next few years?

Derek Mackay: We have had five consecutive quarters of GDP growth and we have enjoyed higher GDP growth than the rest of the United Kingdom for at least two quarters. I am looking at the Fiscal Commission's press release right now. Its headline is "Improved outlook for Scotland's economy but long-term prospects remain subdued". As we know, we are already outperforming the SFC's previous forecasts for GDP growth. The commission has revised its forecast for GDP growth upwards, but the reason for the subdued nature of the growth, as I am sure that Neil Bibby is well aware, is Brexit uncertainty. It is also to do with some of the population challenges that Scotland faces, which have very specific reasons.

We want to grow our economy sustainably. We have an economic action plan, we are trying to create a competitive tax environment and we are trying to give stability to our country at this time when we are faced with the instability of Brexit and the UK Government's handling of it. The forecasts, although they are subdued, have been surpassed so far. Once the numbers are reconciled, it looks as though the GDP forecast for 2018 will be surpassed. Looking forward, we want to stimulate growth as much as possible.

It is important that the budget invests in the economy, infrastructure, digital, improved productivity and our areas of growth. There is an export strategy, to enhance our exports. To return to the benefits of people in employment paying more tax, our pay policy will have an impact, too. We are putting in place a range of measures to support, stimulate and give stability to the economy.

Some of the divergence between GDP in the rest of the UK and that in Scotland is down to population. We are much closer on earnings per head but, specifically on growth, the population challenge presents us with a disadvantage compared to the rest of the UK. I think that we will all work together to try to stimulate the economy. I say again that it is welcome news that we have had five consecutive quarters of growth and that, for some of those quarters, we were outperforming the rest of the United Kingdom.

Neil Bibby: You said that we need to stimulate the economy and that the budget provides an economic stimulus. That is an encouraging statement, but the proof of the pudding will be in the eating and the Scottish Fiscal Commission forecasts that income tax revenues will be down by £183 million. What is the value of the economic stimulus that you are providing in the budget? How will we judge the success of your economic stimulus in terms of growth, wages and employment figures?

Derek Mackay: The totality of the budget is significant—it is £42.5 billion. That is the—

Neil Bibby: That is not a stimulus—a stimulus is additional revenue that is put into the budget. I am asking about the value of the stimulus that you are providing in the budget. You cannot say that the whole budget is a stimulus.

Derek Mackay: I can say that, because it is perfectly credible to say that the budget provides stability and stimulus. New measures in the budget include those that I have mentioned in relation to the competitive tax regime, the growth accelerator and the proposed substantial investment in infrastructure. We are focusing on the growth areas. I have touched on exports, and we are maintaining our commitments on education and local services. I know that we will come back to this, but there will be a real-terms increase for resource and capital spend for local government, which will include the proposed town centre fund. Spending on public services stimulates the economy—I am surprised that a Labour member is questioning that.

Neil Bibby: It is not a stimulus.

Derek Mackay: Anyone who has read the SFC report will know that increased expenditure stimulates the economy, so it is perfectly fair for me to say that a £2 billion uplift in expenditure will stimulate the economy, as will the specific economic interventions that I am proposing. Austerity has meant reduced spending in the public sector, which has subdued the economy. Again, I would expect a Labour member to understand that.

I have been asked a question. The budget proposes more than £5 billion of capital investment, which will stimulate the economy. I am also proposing an expansion of early years and childcare provision, more work on energy efficiency and innovation, the creation of the national manufacturing institute, support for agriculture and work on digital, enterprise and skills. We are providing support in a whole host of areas. The totality of the budget will help to stimulate the economy. The SFC recognises that, given what it has said about the positive impact that public expenditure has on the economy.

Neil Bibby: Will there be £2 billion in additional revenue? Is that the value of the economic stimulus that the budget provides?

Derek Mackay: I was asked about the quantum of the economic stimulus, and I am saying that the total budget of £42.5 billion is an economic stimulus. The difference between the budget in 2018-19 and the proposed budget for 2019-20 is £2 billion. That is the extra resource that I propose to spend as a consequence of the budget.

The Convener: Tom Arthur wants to come in on taxation, but we have covered that area pretty well and we need to move on. He should feel free to come in after Murdo Fraser asks about underspend.

Murdo Fraser (Mid Scotland and Fife) (Con): Over the past couple of years, we have become used to a pattern of activity around the budget: the cabinet secretary publishes his draft budget in December, he tells us that that is all the money there is and then, when we get to the stage 1 debate, which is usually at the end of January or start of February, he miraculously discovers a lot more money lying around that he did not know about in December, which he uses to lubricate his budget deal, usually with the Scottish Green Party. How much money has the cabinet secretary got hidden away this year that he has not told us about yet and which he will suddenly produce in a few weeks' time?

Derek Mackay: Again, it is a morning of colourful language. As the First Minister said, I have fully allocated the resources that are at our disposal. I have set out how the budget is funded. As a minority Government, we want to get the budget passed, which is important for the stability of our country and the sustainability of our public services. Therefore, my door is open for Opposition parties to provide me with alternative proposals, if they wish to amend the budget. If that means that additional resource would be required in one area, they will need to set out how it will be funded—either by taking resource away from another area or through an alternative tax proposition. I am open to engagement on that.

Murdo Fraser: Thank you for that answer, but it would help Opposition parties in that regard if they were fully aware of what additional sums you have not told us about that might be lying around. I have just checked the *Official Report* from a meeting last year, so I know that, in the period from 15 January 2018 to 31 January 2018—12 working days—you came up with an extra £110 million. Is it reasonable for us to expect that you will, by the time we get to stage 1—which is in, I think, 15 days—have found some additional funds, or is that absolutely it and there is not a single penny available that we do not know about?

10:15

Derek Mackay: I am telling the committee that I have fully allocated the resources. Last year, there were very specific circumstances, which I know cheered up the whole Parliament, in which I was able to identify specific changes—through Barnett consequentials, forecasts and tax changes that were suggested at the time.

I am answering the question genuinely. I have fully allocated the resources that are at my disposal, in such a way as to present the best possible budget that takes into account the requests, demands and issues that are of importance to the people of Scotland. I have answered Mr Fraser very clearly.

Murdo Fraser: I am not sure that you have specifically denied that there will be more money available in 15 days' time. However, let me ask you about underspend—

Derek Mackay: I say again that I have described that I have fully allocated the resources that are at my disposal. If they want to bring alternative proposals to me, I will engage with any constructive and reasonable Opposition party representatives—among whom I would count Murdo Fraser, of course.

Murdo Fraser: I am entirely reasonable, as you know, cabinet secretary. However, all the Opposition parties would be better informed and better able to do that if we had the totality of the financial picture.

Let me ask you specifically about the underspend. Last year, in the budget for the current financial year £70 million I believe, of the £110 million that you produced came from the underspend. Where are we in relation to the underspend, and what additional underspend might you be able to discover and allocate to the budget for next year?

Derek Mackay: The underspend is factored into the budget as published.

Murdo Fraser: So nothing extra will be produced over the next two weeks.

Derek Mackay: Again, I say that I have made it perfectly clear that I have fully allocated the resources in the budget, as I have set out. Changes that have been requested through the budget process review group have been taken into account. At the outset of the budget, I have set out how it is funded, including use of the budget exchange reserve.

Murdo Fraser: Thank you, cabinet secretary. As you have said, we will find out in 15 days who is right.

Tom Arthur (Renfrewshire South) (SNP): Good morning. If it is passed, the budget will come into effect a week after the UK is scheduled to leave the European Union. Will you outline the consequences if the budget is not agreed to?

Derek Mackay: If the Scottish budget is not agreed to, that will be devastating to the sustainability and stability of our public services. Given the chaos at Westminster at the moment, we know that Brexit will be damaging to the UK's economy and to Scotland's, so we are trying to avert that. However, if the budget is not passed, there will be very specific arrangements for what we would revert to. As I mentioned earlier, the difference between the budget for 2018-19 and the one for 2019-20 is £2 billion.

If the budget is not passed, that will create a great deal of uncertainty and alarm in all parts of the public sector. The budget represents growth for our national health service, an increase for local government and other parts of the public sector, and investment in the social contract of our country. Its not being passed would have profound effects, which is why we must work very hard to ensure that we find the necessary compromise so that the budget can be passed and we can release the £42.5 billion spend to our public services and provide the economy with the stimulus that it desperately requires right now, particularly in view of the mishandling of Brexit by the UK Government. It is for all of us to find that necessary compromise.

Tom Arthur: I want to clarify my understanding and, I am sure, that of many of my constituents. Am I correct to say that specific policy commitments—for example, on Frank's law or investment in early years—will be at risk if the budget is not passed?

Derek Mackay: Of course. Some elements of policy are driven by statute, but we must have the necessary resources to pay for them. If we are not providing the necessary revenue, the commitments that I have outlined in the budget cannot be paid for. Therefore, when parties ask us to deliver policy commitments, the onus is on them to ensure that the budget is passed. The extension of free personal care is a very good example of that. I therefore encourage all members to engage constructively with the budget.

If the committee wishes, I can provide more technical detail on what would happen were the budget not to be passed. In essence, if a budget does not pass, we would revert to the previous year's budget, but that assumes that we would have the necessary income to pay for it. A Scottish rate resolution and non-domestic rates element would have to have been passed.

With the chaos and calamity that is going on south of the border, we in the Scottish Parliament should show a constructive, progressive, pragmatic, positive and engaging approach in order to ensure that our budget can pass, so that we can support our vital public services, give economic stimulus and sustainability to public services and deliver a fairer tax system. However, in order to raise the revenue, the revenue-raising legislative requirements have to be passed.

Patrick Harvie: Given that Tom Arthur and the cabinet secretary both made the connection and a comparison with the Brexit process and the rather reckless "my deal or no deal" approach that the UK Government has taken, will the cabinet secretary acknowledge that that catastrophic approach would be entirely the wrong one, especially in the context of the Scottish Parliament, in which my party and Murdo Fraser's party—I mention this to aid his recollection—have voted for SNP budgets on precisely the same number of occasions since the cabinet secretary's party came to power.

Derek Mackay: I am a constructive and reasonable finance secretary. As I have set out, I have found compromise on my previous two budgets: I hope to find a compromise, going forward. My door is open for engagement with others, and I hope to meet with success in so doing. It is vital that we do that, for the reasons that I have given. I will continue to engage constructively to try to find the necessary compromise. I do not think that I can be any clearer than that.

If we check the record, we see that the SNP voted for Scottish Executive budgets for a number of years while in opposition. It is responsible to vote for the Executive's or the Government's budget, because of the alternative, which Tom Arthur touched on. It will be very damaging to our public services and our economy if the budget is not passed. However, it is our job to make sure that we find the necessary compromise.

Patrick Harvie: Thank you.

Emma Harper (South Scotland) (SNP): Will you clarify what you said about the Barnett consequentials for health that are now not coming to us? At the Health and Sport Committee yesterday, Jeane Freeman was asked questions about the budget and the funding gap of—I think—£55 million that the NHS is now not getting. However, am I correct that the tax decisions that you have taken in the budget will help to fill that funding gap? Will you clarify how that has been managed?

Derek Mackay: First, I say that the health consequentials are welcome. The issue is that Scotland will receive less than was committed to it, because of offsetting elsewhere. The £55 million figure that Emma Harper mentioned is correct. I have said that we will reinstate that amount in the total spend on health services, which will ensure that health resource funding will be increased by £729 million. That is quite a significant increase. Jeane Freeman will have gone through the detail at the Health and Sport Committee, but that will take total resource spending on health and sport to £13.9 billion and will mean more support in mental health, which is an area that is of interest to many members. As has been touched on, there have been requests for more expenditure in many areas. That is one, and I think that providing that support is absolutely the right thing to do.

Through our tax decisions, we have reinstated the short-changing by £55 million of health consequentials. As I have outlined, that is to do with the nature of the Barnett consequentials. There has been an increase for health, but it has been offset by cuts elsewhere because of the construction of the UK Government's decisions.

Emma Harper: I refer back to Tom Arthur's question about Frank's law. If the draft budget is approved, an investment package of £120 million will be transferred from the health portfolio to local government to help with integration of health and social care. That is a really important contribution to supporting local government in managing our integration process.

Derek Mackay: As well as the specific resource for free personal care, it is true to say that the integration journey is important in ensuring that people get the support that they need. In the discussions that I had with local government, there was a request for more support for social care, and I was able to meet that request.

Willie Coffey (Kilmarnock and Irvine Valley) (SNP): I asked the Scottish Fiscal Commission last week why the forecasts for revenue are going up significantly at the same time as growth in sales is slightly behind the UK as a whole. The increase in the forecast is not entirely attributable to the policy change on the additional dwelling supplement—it was roughly double the amount of revenue we would get through that. What is your take on that, and why will we see such good performance in relation to land and buildings transaction tax over the next few years?

Derek Mackay: I would want to take credit for the policy change: the intention is to raise revenue while giving that degree of stability. The SFC can answer for its own forecast. Some transaction taxes can be volatile, based on the nature of the market—its composition and the sensitivities within it. However, through our policy changes, we will raise more revenue. Some of the fears about the more progressive structure of LBTT in relation to residential transactions were unfounded, in that we have raised the necessary income.

Commercial transactions are even more volatile because they depend on the nature of property in the commercial sector that happens to be selling at a given point in time. While recognising the volatility of forecasting and the market sensitivities, my proposed policy changes will continue to raise revenue. That is a pretty sound basis on which to continue.

The market will be affected by any shock to the economy that might come from UK macroeconomic policy and Brexit. The forecasts are made based on, and the budget is contingent on, there being a deal between the UK and the European Union. I say that because the SFC forecasts are based on its economic forward look, which recognise the volatility. However, on LBTT, as Mr Coffey has suggested, we will generate more money through our tax policy over and above the block grant adjustment.

Willie Coffey: That can be seen from the Fiscal Commission's five-year forecast, which is very positive.

Derek Mackay: Of course, the Fiscal Commission's forecasts might change.

Adam Tomkins: I have a couple of questions about business rates. On page 17 of your budget document, you say that our high streets and town centres

"are facing challenges as retail patterns change and evolve and it is essential that we support them to become more ... sustainable."

What is your reaction to the Scottish Retail Consortium's take on your draft budget? It has stated that

"the large business rates supplement remains twice that which applies in England",

which means that businesses in Scotland pay "a total of £65 million extra each year"

compared with what they would pay in the rest of the UK. In the words of the SRC,

"This higher rate simply makes it more expensive to operate on our high streets and retail destinations and raises the hurdle for attracting commercial investment."

What is your response to that?

Derek Mackay: Mr Tomkins is looking only at the large business supplement, and not at business rates or non-domestic rates in their totality. The overall approach has been welcomed by business representative organisations in relation businesses and, I think, to town centres, as well.

There are the decisions that I have taken more widely and, of course, there is the Barclay review recommendation to reduce the large business supplement. I have said that I will do that when resources allow it.

However, we are confirming the decision about the poundage uplift going down from the retail prices index to the consumer price index. We are going below that to make sure that the vast majority of businesses—including all the medium-sized businesses in Scotland—are paying less tax than they would if they were south of the border.

There is actually a slightly below-inflation increase in non-domestic rates, and that has been welcomed by the business representative organisations. We are continuing with the small business bonus, and I am proposing a town centre fund. As I said, there are also the city deals, which support economic growth.

10:30

If you consider business rates and non-domestic rates in their totality, you will see that there is support for businesses, including in retail. We are also continuing the transitional relief. In the north-east, for example, there is a cap for offices in Aberdeen and Aberdeenshire, and there is a cap for hospitality over the piece, in recognition of the particular challenges that that sector faces. We have lifted 100,000 properties out of rates altogether and, as I said, the poundage uplift is less than it is in the rest of the United Kingdom.

All in all, that is a supportive package for businesses and takes our relief package to about £750 million. There has been an increase in relief. If you look only at the large-business supplement, you discount everything else that we are doing through non-domestic rates to support the economy and, in particular, local economies.

Adam Tomkins: You said that you hope to be able to implement the Barclay review recommendation that the large business supplement's Scotland-only surcharge should be eliminated when resources allow, but, as I recall, the Barclay review set out a specific timeline in its recommendations. What is your forecast for when resources will allow you to take that necessary step?

Derek Mackay: I am not proposing to do it in this budget because I do not think that resources allow me to. However, I think that the other decisions that I have taken will absolutely help stimulate and support the economy and will provide a lifeline to our town centres and businesses across the land.

It is significant that Mr Tomkins has quoted the SRC. He should look at the totality of its comments. It was very much in the Christmas spirit that David Lonsdale of the SRC said:

"With Scottish retailers feeling the pinch after a difficult year, we are glad the finance secretary has more Christmas Elf than Mr Scrooge in this year's Budget."

Those are his words, not mine; I might not have worded that in exactly the same way. He went on to say:

"moves to protect ordinary workers from income tax rises and investment in infrastructure, housing, and skills are positive which should support the economy."

Adam Tomkins: I am happy to say that I missed that particular fancy-dress party.

Derek Mackay: Well, you should have looked at those quotes as well as the ones that you touched on.

Adam Tomkins: I would like to talk about the operation of business rates in the hospitality sector, which is an issue across Glasgow, the region that I represent, that has recently been brought to my attention.

As I understand it, in the hospitality sector, business rates are assessed by reference to a formula that focuses on turnover as opposed to profitability, floor space, the number of employees or any of the other factors that are used in other sectors. That has led to what can only be described as eye-watering and punitive increases in business rates across the hospitality sector in Glasgow. For example, the owner of a much-loved local restaurant around the corner from where I live in the south side of Glasgow is faced with a 411 per cent increase in business rates.

Are you aware of the issue? Have you examined the formula for assessing business rates in hospitality? Could that be considered in the forthcoming bill on business rates that, I think, we were promised in the most recent programme for government, or do we need to take it forward separately?

Derek Mackay: Mr Tomkins asked whether I am aware of the issue. I have reported to Parliament a number of times on the issues around non-domestic rates and the specific issues around hospitality. In my rates decisions, I proposed a cap of 12.5 per cent so that we could limit the increase that hospitality businesses would endure from year to year. I have committed to that.

Members should be mindful of the fact that the decisions about the methodology of assessing value are a matter for the assessors, not Government. Scottish Government ministers do not direct assessors on their methodology. That is a matter for them, and they are ultimately answerable to the courts in that regard.

However, I agree that the assessors should engage with the sector on the methodology that they use, and I encourage them to do that. They are working through various for a to engage with hospitality. My decisions capped the increase for individual hospitality businesses at 12.5 per cent, which is within the state aid limits, but it is for local authorities to make sure that that approach is implemented, because they collect the non-domestic rates. I need to make it really clear to the committee that it is not for ministers to direct assessors as to how they change their methodology; that is the assessors' independent function. However, they are engaging with the sector on that.

There are different choices. It is not about turnover or profitability; there are other factors that, arguably, should be taken into account. I am aware of the issue, but, as I say, I cannot direct assessors. With my decision-making power, I have capped the increases, including for hospitality, for the whole country. It has to be done within the state aid limits. Therefore, an amount of relief can be attained, although it is limited.

I have implemented that transitional relief and committed to it for everyone who pays non-domestic rates. I have lowered the poundage to a below-inflation increase and moved from RPI to CPI. That is significant because it means that every small and medium-sized property in Scotland that does not get any other relief is paying less than it would if it was south of the border. Everyone, not just the hospitality sector, benefits from that.

As for the non-domestic rates bill, in which I am sure that members will have a great deal of interest, and whether there is room for an amendment, let us discuss that when we get to it. However, we need to be careful not to jeopardise the independence of the assessors in making their decisions. I encourage Mr Tomkins to engage with them on the matter, as I have encouraged the sector to engage with them; there are on-going discussions between the hospitality sector and assessors. I cannot leave anyone with the impression that it is a ministerial decision.

Adam Tomkins: That is very helpful.

The Convener: Neil Bibby has a question on local government issues.

Neil Bibby: Cabinet secretary, last year you said that local councils were getting a fair settlement, but the Convention of Scottish Local Authorities and others disagreed and you ended up giving them more money. This year, local authorities are again clear that you are cutting their core budgets by £237 million. Are they getting a fair settlement this year?

Derek Mackay: I believe that they are. The chancellor had the opportunity to end austerity, which he did not take. If I had simply copied the chancellor's cuts, the public sector in Scotland would have seen a real-terms reduction. That is not what I am proposing for local government. I am proposing a total core-funding package amounting to £11.1 billion.

The 2019-20 local government finance settlement increases day-to-day spending for local services by £195.7 million in cash terms and delivers a £207.6 million increase in capital spending. That is a real-terms increase in both revenue and capital settlements, and there is an increase of more than £210 million in the overall settlement. Local authorities can also use their council tax powers—a function that not every other portfolio has. If they increased council tax by 3 per cent, that would generate a further £80 million. I have gone over that in great detail with the Local Government and Communities Committee, but I am happy to do so again today. However, those are the figures that I have set out to Parliament.

Neil Bibby: You have said before, and you said it again this morning, that if we exclude the Barnett consequentials for health, the Scottish Government budget has been cut in real terms. Councils are saying that, if we exclude the money for additional childcare and social care responsibilities, their budgets elsewhere have been substantially cut in real terms. However, you told councils that the additional funding for childcare and social care is for core services and that they need to see it in the round. Do you not see the contradiction in your position?

Derek Mackay: I happen to believe that early learning and childcare and the integration of health and social care are core to the local government function. That is the debate that I had at the Local Government and Communities Committee. I see those not as separate from local government, but as part of it.

Neil Bibby: But you were complaining about the UK Government budget allocations, excluding the

Barnett consequentials for health. It appears that there is one rule for you and another for councils. With respect, you are not the sole arbiter of what core services are. As we know, Scotland's councils are facing increasing pressures. The outstanding issue of teacher's pay is set to be a significant cost, and if it is not fully funded, it will result in even more council cuts. Will you, therefore, fully fund the eventual pay settlement for teachers?

Derek Mackay: The negotiations are live. There are tripartite arrangements for teachers' pay involving the Scottish Government, local government through COSLA and the teaching trade unions. Given that the discussions are live, it would be inappropriate for me to set out any detail on something that has not yet been agreed. I hope that there is agreement and that we find consensus with local government and the teachers' representative trade unions. We will then look at the funding of that.

The Scottish Government is trying to be as constructive and helpful as possible, as am I. It is hard to outline the funding package when agreement has not yet been reached, but I hope that we reach agreement.

Willie Coffey: At last week's Local Government and Communities Committee meeting, two of COSLA's spokespeople described councils in England and Wales as "collapsing", so thank God that a different approach is being taken in Scotland.

Page 86 of the budget proposal shows quite clearly an increase in local government finance from £10.6 billion last year to nearly £11.1 billion this year. Is that not an increase on anyone's terms? I do not understand why members continue to claim that that is a cut.

Derek Mackay: I have set out why it is an increase—it is real cash going to local government. We can debate the priorities within that, but it is real money and a real-terms increase in resource and capital. This is the third budget that I have proposed to Parliament, and it proposes a third year of a real-terms increase to local government.

The financial circumstances have been really challenging. To go back to my answer to Mr Bibby's question, if I had simply photocopied the chancellor's budget, there would have been real-terms cuts to all portfolios, including local government. That is not what I am proposing; I am proposing a real-terms increase for local government.

On the policy choices and priorities, when I watched the evidence from the COSLA spokesperson for resources, I noted that she described our priorities as "excellent". There is partnership working with local government.

I do not underestimate the challenge for any part of the public sector because of the UK Government's on-going austerity, but I am proposing a real-terms increase.

Patrick Harvie: I suspect that everyone understands why there are different interpretations being put on the figures. It does not necessarily mean that we disagree with the new policy commitments that the Scottish Government is telling local government to deliver if we are still concerned about the core funding of services that are outwith the new national commitments that have ring-fenced money attached.

I want to share some comments that have been sent to me by a council leader:

> "There is, quite simply nowhere else to go. That is why we are now in a position where, like our fellow Scottish local authorities, we must seriously consider the unthinkable—stripping services right back to the absolute bare minimum, delivering only statutory duties and cutting absolutely everything else that, while much valued by the people we serve, we are simply no longer able to continue to deliver".

I have spoken to people in council leadership and in the trade unions that represent council workers, and they tell me about whole council functions that are in danger of being shut down and about budgets, such as for supply teaching, that are in danger of being devastated. You know that that is happening, cabinet secretary, because those councils are speaking to you as well.

Derek Mackay: As I have said, I do not underestimate the challenge in any part of the public sector. However, what I am proposing is a real-terms increase. If Opposition parties wish to amend the budget and take more money away from another portfolio to give it to local government, it is for them to set that out and say how it should be done. If that is what Opposition members wish to do, I encourage them to bring those proposals to me.

I have tried to give local government the best possible settlement in the circumstances of the UK Government's on-going austerity. I have tried to ensure that we give local government a fair settlement. What I am proposing is a real-terms increase, notwithstanding the fiscal challenge that I have been presented with. In addition, local authorities have the power to raise council tax to supplement their income.

I have set out the public sector pay policy. This is not meant as criticism, but local authorities are offering non-teaching staff a pay award that they must believe is affordable. We have also mentioned teaching staff. I recognise that there are financial pressures on local authorities, just as there are financial pressures on the Scottish Government. Parliament has set out a number of commitments, including on free personal care, that it wishes to be delivered. It is a significant task to ensure that there is the necessary resource to fund that.

10:45

If members wish not to do certain things, whether that is free personal care or the expansion of what we are doing in education with the pupil equity fund, they can say so. We set out our educational, social and other commitments as part of the budget. What I am proposing represents a real-terms increase. If other members wish to propose more for local government, they have to set out where that resource would come from.

Patrick Harvie: I hope that others will do that in a positive way—just as I and my colleagues are trying to do.

There is a great deal about the UK Government's policy and economic philosophy that I profoundly disagree with. However, when a tax is devolved, the UK Government at least has the decency not to say that it will cut our block grant if the Scottish Government sets tax rates that it disagrees with. It does not put your arm up your back and constrain you in that way.

You talked about the extra resources that are available because Scotland is now able to set its own tax policy. Should not local council leaders also have the ability to make fiscal choices at local level that are right for their circumstances, rather than being constrained in the way that they currently are by the Scottish Government? At least when Thatcher did rate capping, she had the decency to do it on a statutory basis, not by bullying.

Derek Mackay: Patrick Harvie knows fine well that his analysis is not accurate, because the UK Government caps council tax increases in England. The basic premise of his analysis is inaccurate, because the UK Government—

Patrick Harvie: I was talking about the UK Government's relationship to the Scottish Government and the ability that we now have to make tax choices that are right for Scotland. Should that same respect not go down from the Scottish Government to the local government tier?

Derek Mackay: In the 2016 Scottish Parliament election, people voted for our council tax proposition, which, ultimately, is what we are discussing here. They voted to cap council tax increases at 3 per cent, which is the Scottish Government's position. It is not a surprise to many households—indeed, I think that it is a great relief in these difficult times—that council tax increases are capped. It is hardly underhand when we put it in our manifesto and were elected on that basis.

The Convener: We are into the area of local government and I suspect that that might draw out a few more questions. There are still some supplementary questions.

Murdo Fraser: I never thought that I would see the day that Patrick Harvie delivered a compliment to Margaret Thatcher. That is a first for this committee.

Patrick Harvie: It was damning with faint praise, if anything.

Murdo Fraser: I want to follow on from Patrick Harvie's questions on local government and finance and tie them back to Angela Constance's line of questioning.

Cabinet secretary, do you accept that the Westminster block grant to Scotland in its entirety, including resource DEL, capital DEL and annually managed expenditure, is higher today in real terms than it was in 2010?

Derek Mackay: I have tried to specifically draw out the fiscal DEL—

Murdo Fraser: It is a simple question. Yes or no?

The Convener: Let him answer the question.

Derek Mackay: We do this every year. I am very clear that the analysis that I use is the fiscal DEL—the day-to-day expenditure on resourcing our front-line services. We have this debate every single year. The reason why I focus on that is that it is what funds education, local government and the health service. I have done it repeatedly because of how significant it is to our budget, as Murdo Fraser knows.

Murdo Fraser: Thank you, cabinet secretary. I think that we will take that as a yes—we know that the overall budget has increased in real terms since 2010. Your argument, which is a reasonable one, is that resource DEL has reduced since 2010, albeit that there are arguments about how much it has been reduced, and the Fraser of Allander institute would dispute the figures that you have quoted to the committee.

Derek Mackay: It is very kind of Murdo Fraser to make that compromise for the first time.

Murdo Fraser: Do you not see the parallel between the approach that I have just outlined in relation to the UK Government's overall settlement and the settlement that you are giving to local government? You are arguing that local government is getting more money in real terms, but COSLA argues that, although that might be the case, because the additional money is being allocated to particular areas, the amount of money for core spending on resource has been reduced. That is exactly the same argument that you deploy about the block grant from Westminster, is it not?

Derek Mackay: No, it is not.

Murdo Fraser: It is.

Derek Mackay: It is not, because the fiscal resource that is available for local government—the fiscal resource is partly what the discussion is about; that is what local government is pursuing and interested in—is exactly what I am describing that the Conservative Government has reduced over the 10-year period and, excluding the health consequentials, will reduce in the next financial year, too. It is not the same argument whatsoever, but I am delighted that, for the first time, Murdo Fraser has conceded my figure—

Murdo Fraser: No, I deliberately did not. You heard me deliberately not concede your figure.

Derek Mackay: —and the point that I have been making repeatedly that the UK Government has reduced our resource fiscal DEL since 2010-11.

Murdo Fraser: For the avoidance of doubt, convener, I did not concede that figure, and the *Official Report* will show us that.

The Convener: I shall read that *Official Report* with great interest.

Tom Arthur: I will follow on from Patrick Harvie's analogy about the relations between the Scottish Government and local government and the UK Government and the Scottish Government. Will you confirm that the money that the UK Government has withdrawn, for example through reductions in social security spending and around areas to do with the welfare fund, is ultimately being found out of Scottish resources; that that is made possible through our income tax policies in Scotland; that it is a Scottish Government decision to mitigate the effect of the withdrawal of that money by the UK Government; and that, obviously, committing that resource has an impact on the budget?

Derek Mackay: Yes, there are areas in which we are mitigating from our resources, because of reductions in the UK Government's spend on those areas. The total reduction in welfare spend is, however, an even more sizeable figure, so there is that which we can mitigate, but the overall pernicious effect of the UK Government's welfare policy is having a profound impact on individuals and, for that matter, the economy.

There are various budget lines to do with welfare and poverty that we are supplementing in order to mitigate the damage from Westminster decisions.

Tom Arthur: Will you confirm that we do not get the savings that are made by the UK Government when it takes such policy decisions?

Derek Mackay: No, we would not make savings—it is a cost to the Scottish Government. However, it is a necessary investment in order to support the most vulnerable in society.

Tom Arthur: Thank you for clarifying that.

James Kelly: If I leave aside the debate about figures and cuts, I am sure that the cabinet secretary accepts that local councils have been under pressure in recent years. They have had to look closely at individual departmental spend and identify any reasonable efficiencies.

How does the Scottish Government look at its own departmental spend to eradicate any inefficiencies? I will give an example. At the weekend, a story in the press showed that the Scottish Government had spent £1 million on taxis. The figure seemed a bit high to me. How do you go through each of your departments and eliminate any wasteful spend?

Derek Mackay: The question on the Scottish Government's general efficiency is a good one. We, like all parts of the public sector, have to be efficient. I go through each cabinet secretary's portfolio and their budget requests, efficiencies and savings. I expect every single part of the public sector to be mindful of value for money and efficiency and to try to find those efficiencies, whether that is in procurement and productivity or in their assets and estates. We go through it methodically.

We also share experience. The Scottish leaders forum brings together all parts of the public sector to share good practice. Yes, I expect efficiency to run right through Government, and not to be the preserve of any one part of it, and for there to be a focus on value for money. That is an expectation. As we go through the budget, that is something that I challenge every portfolio to do.

James Kelly: You said that good practice is shared. Are there any published examples of efficiencies that have been identified?

Derek Mackay: We certainly produce information on efficiency savings. Local government does that, too. Authorities provide reports on the overall efficiencies that they have made.

I can look further at what more we can publish on efficiency savings, but I think that there is a lot in the public domain on the efficiencies that Government and the public sector make. I say again that the totality of expenditure is massive, and it is expected to be managed at a local and Governmental level.

James Kelly: You said that some of that information is shared. It would be useful if you could indicate to the committee where we could go to see examples of that methodology being followed through.

The Convener: When you do so, cabinet secretary, I think it would also be useful to understand what the scale of reduction in the administration of the Scottish Government over the years has been, compared with local government. That would be an interesting comparison.

Derek Mackay: We do have some information on the website in relation to efficiency savings but I am happy to look at any further information that we may have and that the committee might find helpful.

Angela Constance: I have two quick questions on local government. Given the uncertainty and chaos around Brexit, can the cabinet secretary remind us of the certainty that he has given local government with respect to resource planning assumptions for capital investment in housing, not just for this year, but for future years? Could he also share his thoughts on how we could improve the fiscal autonomy of local government? I am very much in favour of that dialogue, provided that increased autonomy is matched by increased accountability. As we have seen all too often, it seems that the Scottish ministers are held to account for decisions that are taken at a local level.

Derek Mackay: The question about resource planning assumptions, specifically for housing, is an excellent one. The commitment for this financial year is substantial: £826 million. I can provide more information to the committee about the commitment for future years—there is of course some £3 billion committed to achieve the housing target. We have set out some of the figures to local government on a multiyear basis, so that they have the certainty to allow them to plan and get on with the job, on the premise that the budget is passed. If it is not, they will not have the certainty required to release the resource in order to build the houses. I know that Angela Constance is aware of the detail of the figures and I am happy to share the information with the committee; it relates not just to one budget but to a multiyear budget. Therefore, in relation to the housing aspect of capital spend, local government can get on with it and meet the housing commitment.

In relation to the second question, I have said repeatedly that I am open to the fiscal autonomy of local government and to engagement on that issue. However, I ask that, in that spirit, people bring along a proposition: what is their request and how can it be progressed? I am open-minded on more fiscal autonomy for local government. At the moment, we are having a national discussion about a transient visitor levy. I have shown that I am open-minded and happy to engage on the issue, if people can present constructive suggestions to further empower local decision making.

The Convener: That brings us to a conclusion. I thank the cabinet secretary and his officials for their evidence on the budget. We will have a short suspension to allow a changeover of witnesses.

10:57

Meeting suspended.

11:04

On resuming—

Subordinate Legislation

Land and Buildings Transaction Tax (Tax Rates and Tax Bands etc) (Scotland) Amendment Order 2018 (SSI 2018/372)

The Convener: The next item of business is consideration of subordinate legislation relating to the land and buildings transaction tax. We are joined by Kate Forbes, the Minister for Public Finance and Digital Economy, and James McLellan, who is head of the fully devolved taxes policy unit in the Scottish Government.

Before we come to the formal consideration of the minister's motion, we will take evidence on the order. I welcome our witnesses to the meeting and invite Kate Forbes, if she wishes, to make an opening statement.

The Minister for Public Finance and Digital Economy (Kate Forbes): Thank you, convener. I will just say a few words and then I will be very happy to take questions from the committee.

The order provides for changes to land and buildings transaction tax rates and bands as set out in the budget of 12 December. There are a series of changes to the rates and bands for non-residential LBTT and an increased rate for the additional dwelling supplement. I will take those two aspects in turn.

On non-residential LBTT, the changes will ensure two things. The first is that Scotland will remain a competitive place for those who wish to buy business premises. In two thirds of all non-residential transactions under £350,000, less tax or no tax will be paid, and in all transactions, no more tax will be paid than elsewhere in the United Kingdom. The second thing is that the LBTT will raise vital revenue for Scotland.

The changes to the additional dwelling supplement will raise revenue but, equally important, they will also support first-time buyers and home movers, helping them to compete with buy-to-let investors and those who are buying a second home, which is a particular challenge in rural areas. The rate will increase from 3 per cent to 4 per cent.

On process and timing, the proposals have been made following discussion with Revenue Scotland, and I understand that its evidence makes that clear. In our timing, we have sought to balance the clear risk of forestalling that would have existed if the introduction of the changes had been delayed until 1 April 2019, as per the Scottish Fiscal Commission, and as the committee will appreciate. The timing also allows the Parliament the full 28-day period to scrutinise the legislation, taking the recess into account.

We have also included transitional provisions so that the increased rates will not be paid for any transactions that were concluded prior to 12 December. That is an important principle of fairness.

I look forward to the committee's questions.

The Convener: Thank you, minister. We will start with questions from Murdo Fraser.

Murdo Fraser: I remind members of my entry in the register of members' interests that relates to my property investments.

I want to ask about the increase in the additional dwelling supplement from 3 per cent to 4 per cent. I appreciate that, from the Government's point of view, it is a revenue-raising measure. The committee has received evidence from a number of interested bodies including the Scottish Property Federation, the Scottish Association of Landlords, ARLA Propertymark and NAEA Propertymark, and they have expressed some concern about the potential impact of the increase on investment in the private rental sector.

They all make similar points, stating that investment in private rented property is less attractive than it was to potential landlords, due not only to the additional dwelling supplement but to a number of other legislative changes at Westminster and Holyrood, including changes to taxation. They argue that, as a result, there is a contraction in the market and a knock-on impact that leads to higher rents, so there is a social impact from making the private rental sector less attractive to investors.

In the light of that, what consideration did the Scottish Government give to those issues when it decided to go for an increase from 3 per cent to 4 per cent? Will you explain to us why the 4 per cent figure was arrived at? Was it plucked from the air? Did it just seem a reasonable increase or was there a more scientific approach to reaching that figure?

Kate Forbes: There were three questions there, and I will take each in turn. The first was on investments, the second was on rents and the third was on the evidence for the increase of 1 per cent.

On ADS, it is worth bearing in mind that there is another policy objective as well as the ability to raise revenue, which is to support first-time buyers. The SFC's evidence on that is important. Its analysis shows that the majority of the decline in ADS transactions has been made up of first-time buyers and home movers. In other words, where there is a loss of ADS-related transactions, the majority is absorbed by the market when it comes to first-time buyers and home movers. That is part of the policy objective of the change.

On investment, we recognise the role that the private rented sector plays. In the evidence that has been provided, tax is seen as just one of a range of financial, regulatory and other considerations. The Scottish Property Federation is clear in its evidence to the committee that other changes have more significance than the changes to ADS. The sector remains at a steady 15 per cent in Scotland. Although an increase in ADS might mean that some people in the property sector will take other decisions, other people will see new opportunities.

When it comes to investment, we recognise the role that the private rented sector plays, and when it comes to the creation of affordable housing, people often choose the private rented sector as a form of affordable housing. That is why we have the exemption from ADS for six or more properties, in order to get that balance right.

I move on to rents. It is perhaps obvious, but I think that it is worth saying that the changes have no bearing on landlords with existing properties. They apply only to new purchases. I cannot comment on decisions that individual landlords might take in specific circumstances but, as I said, tax is only one of a range of concerns. The Office for National Statistics has shown a 0.5 per cent annual increase in rents to November 2018 across all private tenants in Scotland. That compares with annual increases of 1 per cent in England and 0.9 per cent in Wales, which suggests that, while ADS has been in place—albeit at 3 per cent—it has not resulted in a significant increase in rents.

On the reason for the increase from 3 per cent to 4 per cent, we were keen to strike the right balance, as highlighted in the question, between supporting the private rented sector and achieving the policy objective of supporting first-time buyers. The SFC evidence makes it clear that we have got the balance just about right because the majority of ADS transactions that are lost will be made up of first-time buyers and home movers. There is an important point about fairness. In the budget process, we looked at different rates, and a judgment was made that a 1 per cent increase would strike the right balance between supporting the sector and supporting first-time buyers.

Murdo Fraser: On the last point that you made about the increase, would it be reasonable for the Scottish Government to monitor the impact on the market? Should the evidence show a detrimental impact on the private rental sector, will the increase be reviewed?

Kate Forbes: Absolutely. That will definitely be kept under review because of the twin aims of supporting first-time buyers and raising revenue. It is important that, in discussion with the various representatives that have written to the committee with evidence, which I appreciate, we track whether the sector continues to be a solid 15 per cent, track rent increases and, perhaps most important, examine the appetite and demand from first-time buyers and home movers. We have a range of initiatives to support first-time buyers, of which this is one. Our key concern is to ensure that, if someone wants a home in Scotland, they are able to get an affordable home in Scotland.

Murdo Fraser: I have another question on a different but related subject. KPMG makes the point in its submission that the period within which people can claim back ADS if they are inadvertent second home owners is 18 months in Scotland, compared with three years elsewhere in the UK. Given the increase in ADS, KPMG asks whether the Scottish Government is considering increasing the period from 18 months to three years.

I have had cases where constituents have inadvertently been caught in that situation because they have been unable to sell a property and have ended up being hit with ADS, which was never the policy intent. Will the Scottish Government consider that?

11:15

Kate Forbes: We recognise that there are concerns about the application of ADS in specific cases. As Murdo Fraser will know—I think he welcomed it at the time—we have legislated for a minor change to make it fairer for people such as a couple who are moving in together, whose previous house was in only one of their names.

Although I am sympathetic to some of the suggested changes, they are significant in scope. There are no plans to undertake a review at this time, but we will shortly consult on a new approach to the planning and management of devolved taxes, which will provide a more structured and efficient means of making some of these changes.

I am mindful of the particular challenge of the period being 36 months in the rest of the UK compared with 18 months in Scotland, but I would argue that that affects only a small minority of cases. In most situations, people have been able to sell properties within the 18 months. Most of those who have indicated a desire to claim back the ADS do so within the 18 months. It is extremely rare for that to prove a challenge.

Patrick Harvie: The minister mentioned fairness as one of the objectives of the Government policy. We are frequently told that fairness is a general goal of the Scottish Government's tax policy. The problems with the proposals do not relate to the changes that are being proposed today; they go back to the conclusions of the Mirrlees report of 2011, which said that there was no sound case for maintaining what was then stamp duty and recommended that it be abolished.

Notwithstanding the proposed changes, does the Government recognise that LBTT remains a tax that a great many people who are on ordinary incomes and live in typical-value homes will pay several times in their lives but that someone such as the Duke of Buccleuch will probably never pay?

Kate Forbes: Patrick Harvie makes an important point about fairness. Without touching specifically on the changes that we are discussing today, I note that our aims in making the changes are to make the tax fairer and to make sure that we do two things when it comes to LBTT—that we protect as much as possible those at the lower income levels and that, as a policy objective with ADS, we protect those who are trying to get on the property ladder for the first time.

No tax is perfect, and that includes LBTT. The one change that we have made so far, since the tax was introduced, shows that we are willing to try to make these taxes as fair as possible, but we recognise that there will always be scope to do more.

Patrick Harvie: LBTT was a slight improvement on what went before and the changes that we are discussing are a slight improvement in their own right, but is the Government still open to the wider argument that the tax base needs to include a modern approach to asset wealth values such as land and property, rather than merely to transactions?

Kate Forbes: Certainly, in terms of the way that the Scottish Government has taken on more tax powers over the past two years in particular. We are always looking at ways to make current taxes fairer and to ensure that, if there are improvements to be made more generally to the tax take, we consider those as well.

It is worth recognising that, if the order is approved today, it will raise almost an additional £40 million, which will go directly to supporting people who live and work in Scotland and rely on our public services.

Willie Coffey: Last week, I asked the Scottish Fiscal Commission for the reason behind its forecast of fairly healthy growth in LBTT revenue over the next five years. The answer was that the growth was not entirely attributable to the policy changes. They are yielding a net revenue gain for us, but the gain in LBTT revenue exceeds that. Why is that? I asked Derek Mackay the same question earlier and, of course, he took the entire credit for that gain being due to policy changes. However, there seems to be an additional element of gain for us in LBTT that is not quite attributable to the policy change.

Kate Forbes: I am more than happy for him to take the credit for that, and not me.

It is true to say that, for all years from 2018-19 onwards, LBTT is forecast to raise more than is removed through the block grant adjustment. The SFC was clear that the reduction in the forecast for this year relates to flatter house prices and transaction growth, which are common features across the entire UK housing market. The forecasts demonstrate that the tax works and will raise valuable revenue. Given that our taxes are so contingent on the performance of the rest of the UK, LBTT is vital.

Willie Coffey: Is one element that property values are moving through the thresholds and, therefore, more revenue is being yielded? The Fiscal Commission alluded to that being a potential explanation for part of the forecast growth.

Kate Forbes: The changes reflect the unique aspects of the Scottish property market, which is slightly different from the market in the rest of the UK.

The Convener: As no other member has indicated a desire to ask a question, we move to agenda item 3, which is consideration of the motion on the order. I invite the minister to move motion S5M-15215.

Motion moved,

That the Finance and Constitution Committee recommends that the Lands and Buildings Transaction Tax (Tax Rates and Tax Bands Etc) (Scotland) Amendment Order 2018 be approved.—[*Kate Forbes*]

The Convener: Do members have any further comments?

Murdo Fraser: I do not intend to oppose the order, but I think it is worth putting on the record some of the issues that stakeholders raised in our previous evidence session about the potential impact of the tax changes on the private rented sector. We will need to keep a close eye on the market impact of the tax changes, because the jury is still out on the likely impact.

The Convener: We can note that in the report.

The question is, that motion S5M-15215 be agreed to. Are we agreed?

Members: No.

The Convener: There will be a division. I have missed saying that.

For

Arthur, Tom (Renfrewshire South) (SNP)
Bibby, Neil (West Scotland) (Lab)

Coffey, Willie (Kilmarnock and Irvine Valley) (SNP)
Constance, Angela (Almond Valley) (SNP)
Crawford, Bruce (Stirling) (SNP)
Harper, Emma (South Scotland) (SNP)
Harvie, Patrick (Glasgow) (Green)
Kelly, James (Glasgow) (Lab)

Abstentions

Burnett, Alexander (Aberdeenshire West) (Con)
Fraser, Murdo (Mid Scotland and Fife) (Con)
Tomkins, Adam (Glasgow) (Con)

The Convener: The result of the division is: For 8, Against 0, Abstentions 3.

Motion agreed to,

That the Finance and Constitution Committee recommends that the Lands and Buildings Transaction Tax (Tax Rates and Tax Bands Etc) (Scotland) Amendment Order 2018 be approved.

The Convener: The committee will produce a short report on the order. I thank the minister and her officials.

As previously agreed, we will take the next item in private. I close the public part of the meeting.

11:22

Meeting continued in private until 11:54.

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