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Finance and Public Administration Committee

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Session 6

The Scottish Parliament
Pàrlamaid na h-Alba

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FINANCE AND PUBLIC ADMINISTRATION COMMITTEE

24th Meeting 2024, Session 6

CONVENER

*Kenneth Gibson (Cunninghame North) (SNP)

DEPUTY CONVENER

*Michael Marra (North East Scotland) (Lab)

COMMITTEE MEMBERS

*Ross Greer (West Scotland) (Green)
*Jamie Halcro Johnston (Highlands and Islands) (Con)
*John Mason (Glasgow Shettleston) (Ind)
*Liz Smith (Mid Scotland and Fife) (Con)
*Michelle Thomson (Falkirk East) (SNP)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Professor Francis Breedon (Scottish Fiscal Commission)
Claire Murdoch (Scottish Fiscal Commission)
Professor Graeme Roy (Scottish Fiscal Commission)

CLERK TO THE COMMITTEE

Joanne McNaughton

LOCATION

The Robert Burns Room (CR1)

Scottish Parliament

Finance and Public Administration Committee

Tuesday 3 September 2024

[The Convener opened the meeting at 09:30]

Scottish Fiscal Commission (Publications)

The Convener (Kenneth Gibson): Good morning, and welcome to the 24th meeting in 2024 of the Finance and Public Administration Committee. I hope that everyone had a good summer recess. Our colleague Ross Greer will be slightly late today—he is held up by public transport.

Before we start, I put on record our thanks to those who attended and participated so actively in our pre-budget scrutiny event in Dundee last week. In particular, I thank participants from the Scottish Youth Parliament, Young Enterprise Scotland, Dundee University Students Association and the Hot Chocolate Trust, all of whom shared their views eloquently with us. I know that members had lively and interesting discussions about young people's priorities and what would help Scotland to attract them to and retain them in the workforce. We will draw on those discussions as we continue our pre-budget scrutiny, and we will publish a summary note of the discussion at the engagement event in due course.

I also thank Professor Graeme Roy for coming along and participating in our business planning event.

Our first agenda item is an evidence session with the Scottish Fiscal Commission on its "Fiscal Update", "Forecast Evaluation Report" and "Statement of Data Needs", which were all published on 27 August, giving everyone on the committee a really exciting weekend wading through those reports.

I welcome to the meeting Professor Graeme Roy, who is the SFC's chair; Professor Francis Breedon, who is an SFC commissioner; and Claire Murdoch, who is the head of fiscal sustainability and public funding. I intend to allow around 75 minutes for the session. Before we open up to questions from the committee, I invite Professor Roy to make a short statement.

Professor Graeme Roy (Scottish Fiscal Commission): Good morning, and thank you for inviting us to speak with you today.

As you said, we published three reports last week, including the "Fiscal Update", which summarised economic and fiscal developments since our previous forecast and set out a timeline of what we can expect between now and the Scottish budget later this year. We also published our regular "Forecast Evaluation Report" and "Statement of Data Needs".

As the committee will recall, the 2024-25 budget was tight when it was set in December 2023, with funding needed for new and existing commitments, such as the council tax freeze and growth in social security spending. Since then, spending pressures have grown.

The main source of the recent pressure is public sector pay. Negotiations are—so far—leading to pay deals that are higher than the 3 per cent that was set out in the Scottish Government's pay policy published in May. The Government is also now under pressure to at least match recent United Kingdom pay review body awards, which are in the range of 5 to 6 per cent.

With pay accounting for more than half the resource budget, and a lack of clarity from the UK Government over the final funding settlement for 2024-25, decisions that are taken on pay can have a significant knock-on effect on the management of Scottish Government spending. In short, if budgets are set based on pay assumptions that are lower than those that materialise, that creates challenges with in-year management of the budget, with moneys needing to be freed up elsewhere.

Some additional funding for 2024-25 from further Barnett consequentials is likely when the Chancellor of the Exchequer delivers the UK budget on 30 October. However, we think it unlikely that those will fully cover the recent pay awards, in part because the UK Government has indicated that departments will be expected to absorb some of the pay increase from within current budgets.

A combination of a lack of certainty on potential Barnett consequentials and on past policy commitments here in Scotland are all contributing to pressure on the Scottish Government budget. However, this is the context in which the Government must set its budget and it should be prepared to handle different scenarios.

Our report concludes that there is a need for improved planning, so that decisions that are made today are sustainable. The UK Government's move to a regular cycle of spending reviews should mean that the Scottish Government is in a better position to provide multiyear spending allocations.

Beyond the pressures in 2024-25, our reports covered a number of other important issues. The latest outturn shows a positive income tax net position of £257 million in 2022-23. However, because of relatively slower growth in the Scottish economy since income tax was devolved, there is still a gap between the net position and where it might be based on policy differences alone. We estimate that the economic performance gap means that the net position in 2022-23 was around £624 million lower than it would have been had Scottish economic performance matched that of the rest of the UK.

We also now have outturn for social security spending for 2023-24. Overall, social security spending was £5.3 billion, and the latest estimate for the 2023-24 social security block grant adjustment is £4.4 billion. That gap is in line with our expectations and has to be funded by tax increases or reduced spending in other areas.

Finally, our "Statement of Data Needs" sets out how the data that we rely on to undertake our forecasts and analysis can be improved, and it includes several recommendations for the Scottish Government on how to improve the transparency and accessibility of its information on the Scottish budget.

We are more than happy to answer any questions on our reports.

The Convener: Given the volume of reports, we will try to ca cannie in terms of the questions that we ask.

One of the issues that you emphasised was that of pay. You talked about how, in the public sector, workers in Scotland earn around £2,400 a year more than workers in England, on average, which is £1,500 after taxes. Given that there are 548,000 workers in the public sector in Scotland, that amounts to an additional sum of about £1.3 billion, does it not?

Professor Roy: I have not done the calculation; I can get an envelope to back that up. [*Laughter*.]

In principle, what you say is correct. There are several issues that are important here. One is the fact that more than half the budget goes on public sector pay, so any decision that is made on public sector pay has implications elsewhere. You are right to say that the relative differential in public sector pay between Scotland and the rest of the UK is now about £2,400. That represents a significant increase from what the number was just a few years ago. In 2019, the difference was around £700, so there has been a big relative increase over a short period of time.

In addition, the totality of public sector employment in Scotland is bigger than it is in the rest of the UK. That means that, even for the same level of pay award, the call on the Scottish budget will be that much bigger.

The point that you make is entirely right. More of the budget is spent on public sector pay. That is important in the sense that public services depend on public sector workers—we can see why it is a circular process. However, because public sector pay represents a bigger call on the budget overall, reductions have to be made elsewhere.

Professor Francis Breedon (Scottish Fiscal Commission): There is also a caveat, which is that, although the pay bill might be higher, we have not worked out the composition of the various jobs that people do. It could be the case that the pay is comparable for comparable jobs. This is unlikely, but the differential could just be a result of the mix of jobs. For example, there could be more seniority in the Scottish case. It is very likely that the average pay for comparable jobs is higher in Scotland, but we cannot confirm that simply by looking at the total.

The Convener: I was going to come on to exactly that issue. I understand that one of the reasons for the differential is the fact that the Scottish Government is trying to boost pay for people at the lowest level. Has any work been done to look at comparative levels across the different jobs that people do in the public sector? I am not convinced that people in Scotland who have higher-paid jobs are paid the same as people in equivalent roles in England are paid—they are probably paid a lot more, I would suggest. I am talking about chief executives of local authorities, health boards and so on.

Professor Roy: We can share with you the latest real-time information data that we have, which looks at the mean pay growth across key areas over the past few years. Across areas such as public administration, education, health and social care, the mean pay growth has been bigger in Scotland than it has in the UK overall. That backs up the idea that we are not talking simply about an issue that the Scottish Government is facing this year. Several years of pay awards have backed up, which is now putting pressure on the budget this year.

The Convener: If Scottish public sector workers are better paid by an average of £2,400 and pay is increased by 5.5 per cent across the board, that alone will result in an increase of £132 per worker over and above what the figure would be south of the border. If we multiply that by 548,000 workers, we end up with quite a big number.

If, as you said, half the Scottish Government's budget—£25 billion—goes on pay and the Scottish Government ends up giving people pay rises of 5 or 6 per cent, even though they are already paid an average of 6.5 per cent more than people south of the border, that will cost about £1.3 billion or so.

Professor Roy: We were chatting about that on our way down the hill to the Parliament. If £25 billion is spent on pay, every additional percentage point will cost about £250 million on top of that. We come back to the broader conversation that we have had before with the committee. So much of the budget goes on pay that what the Government says on pay when it sets the budget is fundamentally important for the overall spending priorities and allocations across different elements of the budget, because pay accounts for more than half the resource budget.

The Convener: How important is it that the Scottish Government has a pay policy that it sticks to in the annual budget deliberations?

Professor Roy: It is really important for us, for two reasons. Having clarity about what the Government is planning on public sector pay is important for our forecasts, because it feeds into our income tax forecast and what we think might come through in revenue. It is also important for our ability to scrutinise what is happening across portfolios.

After the budget has been published, we have the budget scrutiny element, whereby there is a rich conversation about the Government's priorities. If they have to change halfway through the year because it is changing its pay policy, there are challenges around how we go forward with our scrutiny.

One thing that will help is the UK Government's announcement about moving towards multiyear spending reviews, which, in turn, should mean that the Scottish Government can move towards multiyear spending reviews. We hope that that means that it will be able to set a more regular pay award that lasts not only one year but multiple years, and that it will not have to do pay negotiations midway through the year and then look at the budget.

The Convener: The commission has made it clear that it believes that we should have short, medium and long-term financial projections in any case, whether we have multiyear pay settlements or not. Is that not the case?

Professor Roy: Yes. There are two parts to that. It is about anything that we can do to improve long-term fiscal sustainability. The key conclusion that we make—as I mentioned in my opening remarks—is that the decisions that we take now not only matter in this year's budget but build in implications for the medium to long term. We see that with social security, as well. That is not to criticise any of those policies; however, if we take a decision about affordability now, that will also have implications for affordability in subsequent years.

On pay, in particular, in one of our recommendations—recommendation 15, I think, on data needs—we state what, in an ideal world, the Government should set out in relation to public sector pay. That would include not only public sector pay awards but issues around the size of the workforce, trends and so on, which would let us consider the totality of the budget in a way that does not look at only one-year pay awards.

The Convener: Do not worry—I will come on to data needs in a wee minute.

I am interested in the sustainability of the growth in the public sector. In Scotland, since the second quarter of 2018, the public sector workforce has grown from 504,300 to 548,200. That is growth of about 44,000, or 8.7 per cent; 25,000 of those people are in the national health service, and I think that we understand the pressures there. In England, there has been even more growth: that workforce has gone from 4.269 million to 4.792 million. That is 523,000 people, or growth of 11.2 per cent.

How sustainable is the continued growth in the public sector workforce, given the level of productivity in the economy at the moment?

Professor Roy: That is a very big question. Ultimately, it comes back to what public services we want to deliver and how we deliver them. We should not separate out public services from public sector workers. If we want to expand and grow our public services, we need to think about what our public sector workforce looks like in order to deliver that.

On the broader point about fiscal sustainability, in order to afford public services over the long term, we have to think about not only what we choose to spend our money on but where the revenue comes from and how we get growth and productivity in the economy overall. Quite a lot of work has been done to look at public sector productivity and how it has been lagging behind. We have had a productivity puzzle in the UK overall, and productivity in the public sector is lagging behind in some key areas.

The answer to your question, which is a big question about the reform of public services and how we do things more efficiently, is about considering how, if there are pressures coming down the line, we can still deliver the high-quality public services that we depend on in a much more efficient way.

The Convener: I saw a few months back that, since the pandemic, productivity in the NHS has fallen by 25 per cent, which is astonishing. That is an English figure, but I imagine that Scotland will not be significantly different. Is that figure reflected in Scotland?

Professor Roy: I would need to double-check it, but we can get you that number.

09:45

The Convener: It seems like quite a huge number. I will move on in a second but, in the “Fiscal Update”, you talked about

“public sector pay offers in Scotland now coming in higher”

and the fact that

“There is significant uncertainty on the level of funding the Scottish Government will receive from the UK Government ahead of the UK Budget.”

I think that we are all aware of that, but what are the parameters? Where do you see the parameters for that? Do you have any hint, clue, idea or thoughts about where they would be?

Professor Roy: We have nothing concrete. The only thing that we know is what the UK Government has said, in passing, around public sector pay awards through public sector pay review bodies. Most of those awards lie between 5 and 6 per cent, and the Government has said that it is looking for departments to find some of that growth from within their budgets. The Government has used the figure of one third, so that gives you a rule of thumb that there might be additional consequentials to pay for two thirds of the equivalent pay awards in England, but that still means that awards will not be fully funded.

The Convener: That would be proportionately less for Scotland.

Professor Roy: Exactly—yes, and there are two parts to that. First, the pay awards will not be fully funded, even if you match the funding, because the UK Government will ask Whitehall departments to pick up at least a third of the cost.

Secondly, to go back to the conversation that we have just had, if you start from a higher point, a percentage growth will be harder to achieve, because you are starting from a higher level.

There is also some commentary about how easy it will be for UK Whitehall departments to make that contribution and whether, over the next few months, they have the capacity to make those savings in order to deliver the one-third contribution.

That is all speculation, and we will need to wait until October, when the formal consequentials come through. It might even be later on—well into the start of the 2025 calendar year—before we know everything, once all the departmental decisions are taken in Whitehall about actual spend.

The Convener: You said that productivity growth

“will remain subdued and will not return”

to the pre-global financial crisis average. What are the reasons for that?

Professor Roy: That gets into the long term. I will hand over to Francis Breedon in a moment, but it gets into something that has dominated discussions in UK economics for the past decade, which is the question of why we are at the bottom of the G7 league table for productivity.

There is a host of different stories. In the UK, we suffer from very low business investment, so investment is low in comparison with our competitors. There are challenges around skills gaps and there is a lot of regional imbalance in the UK economy. We have the powerhouse of London and the south-east but, unlike Germany and France, we do not have second-tier cities. The economy is all concentrated in one part of the UK, and that acts as a drag on growth.

There is a whole host of elements as to why UK productivity has lagged behind, and economists have thought for ages about how we can improve it. However, we have not yet found an answer and we are still thinking about it.

The Convener: At this point, I will not ask you exactly how you are doing that.

In your report, you spoke about

“higher spending on disability payments associated with higher demand than we forecast, a trend which has also arisen for disability payments in the rest of the UK.”

That has led to further pressure on our social security budget, which is higher by about 1 per cent than was anticipated. Obviously, a 1 per cent increase in a £5.3 billion spend is significant. Do you have any views on why that happened?

Professor Roy: There are two things to separate out, which are quite important in order to understand what is happening to social security.

First, you are entirely right—we are seeing a growth in inflows into disability payments across the UK. That is also flowing through into what we are seeing in Scotland. Of course, the block grant adjustment will also increase as a result of that. Any shared inflow into disability payments across the UK leads to higher spending, so that is why it is running ahead of our forecast. However, the BGA also increases.

The second, really interesting bit is that we now have outturn data for 2023-24, which shows that there is a confirmed gap of about £900 million between the funding and the commitments on social security. Some of that is coming through from things such as the Scottish child payment and the mitigation of the bedroom tax—for which there are no comparable flows—but there are also additional responsibilities for which the funding is coming through the BGA. In the report, we talk about £225 million coming through. That is about a higher uptake of disability payments in Scotland and payments that are running ahead of the forecast and predicted funding based on comparable benefits that are being delivered across the UK. That is a call on the Scottish budget—the Scottish Government has to find that additional £900 million, either from the taxes that it is raising or from spending cuts elsewhere.

The Convener: I was quite interested in the "Statement of Data Needs". You have written down 21 areas in which we can improve data, which are all very laudable, of course. How deliverable are they? What would be your three priorities for data delivery? What three areas must we have as an absolute priority?

Professor Roy: That is a good question. It is like our wish list to Santa—we are always going to ask for perhaps more than we want.

I will say two things, and I will ask Claire Murdoch to come up with the specific ones that are important. I should note that you will see in the document the progress that has been made on the data needs that we asked about two years ago. I thank the Government, and Social Security Scotland in particular, for responding to a lot of that. Although our list is quite long, they respond to it. A lot of the items are quite small recommendations on matters such as how the data is loaded on to websites to let people use it and so on.

The Convener: A lot of it is housekeeping as much as anything else.

Professor Roy: Yes, exactly, but there are chunkier requests. As I mentioned, recommendation 15 talks about what more we could have around public sector pay, which is really important.

In another set of recommendations, you will recall that, when we did our climate change work, we said that when it publishes its budget, the Government should set out much more about how much money is actually going on climate change mitigation and adaptation. The flipside of that is that, when it publishes its climate change work, it should be very clear about what the budget is actually being spent on to deliver on the targets.

I ask Claire Murdoch to pick the top three highlights.

Claire Murdoch (Scottish Fiscal Commission): For our ability to do our forecasts, the recommendations that are really important are on public sector pay. We also have recommendations on the labour force survey. There are challenges with the data that we have on labour markets in Scotland. If we can improve that data, that will directly improve our economy and income tax forecasts.

As Graeme Roy said, the other areas—if I can group them together as priorities—are around the data that the Government provides alongside the budget and alongside its climate change plan, and the data around the climate change assessment of the budget. There could be general improvements in the transparency and quality of the data that the Government is putting out, which would enable not only us but other organisations to better scrutinise the Government's plans, how it is instigating those plans and whether it is changing what it said that it would do.

In particular, when we look at the Government's funding and spending, one of our challenges is that, as you all know, the position changes during the financial year. Comparing what is happening this year, as it stands in the middle of the financial year, with what the Government plans to do next year and what it actually did last year is a more productive way of considering what is going on with public finances than comparing the budget position as introduced, when we know that it has changed significantly since then.

The Convener: I was looking at paragraph 2.11 as you were speaking, which talks about that. That is a very important point.

I also notice that the responses to labour force surveys have been declining over the years, so there is an issue or concern about accuracy.

Professor Breedon: Yes—that is a problem UK-wide. Once you take the data into smaller groups, such as for Scotland, that becomes a significant problem for us. Luckily, we have been able to supplement it with data from other sources, but we are almost not using that survey data at the moment, which is a real shame. It includes important issues such as inactivity, which is a big question. We do not really know what is going on with labour market inactivity, because that survey is the best source of that data. There is a UK-wide problem, but we feel it particularly in Scotland.

The Convener: You have said that Barnett consequentials are hard to reproduce.

Claire Murdoch: It sounds like quite a simple thing, but exactly how much money the Scottish Government is receiving after a UK fiscal event is something that the Treasury and the Scottish Government agree between themselves, and it is not published in a very transparent way.

The block grant transparency document is not published following every fiscal event, but it is agreed between the two Governments so, in theory, either it could be published or the Scottish Government could be clear publicly about what level of consequentials it is receiving. That would enable us to distinguish between what the Government has definitely confirmed that it will receive from the Treasury and what it might perhaps be assuming that it will receive at subsequent fiscal events. In previous years, that has been a legitimate thing for the Government to do, but it is important to make that distinction clear and transparent, so that everybody knows what is actually happening.

The Convener: As John Mason might recall, in session 4, we decided to look at the Barnett formula in some detail. In our naivety, we thought that it would be pretty straightforward, only to find out that how it functions in reality is quite byzantine. Therefore, any transparency that we can get on that is important.

I will touch on your forecast document. You have outlined the issues in great detail in the report, but I would like you to talk about the one area in which there was a significant difference from the original forecast, which is that of income tax receipts, which were some £1,498 million—about 11 per cent—higher than the forecast.

Professor Roy: That is a large error, and much larger than we would expect, but there is a good reason for that. The forecast was made in December 2021, which was before the war in Ukraine, the big spike in energy prices and the big spike in inflation, which in turn led to significant nominal pay growth and fiscal drag. The forecast for income tax was out by a large amount because there was a big growth in earnings relative to anything that we could have foreseen in that December. The same thing applied across the UK—there was a huge increase in nominal earnings as part of the response to the cost of living crisis.

The interesting thing that follows from that is that the net tax position is now projected to be positive, when we were previously expecting a small negative net tax position. That comes back in part to the conversation that we had when we previously appeared before the committee about the effects of fiscal drag.

We now understand a bit more about the relative positions of Scotland and the rest of the UK. Because our thresholds are lower, if there is high nominal pay growth, that should lead to an increasingly positive net tax position in Scotland, even if the Scottish Government does nothing on tax policy other than freezing the thresholds, because more people are moving into higher tax bands in Scotland than in the rest of the UK—people flip over into the higher-rate tax band in Scotland when they earn just over £43,500 but, in the rest of the UK, that does not happen until people earn £50,000. That explains quite a bit of the overall improvement in the relative tax position.

The final point, which is on a more positive note, is that, since tax devolution, there had been a negative gap in earnings between Scotland and the rest of the UK. However, in 2022-23 and through the start of this financial year, that gap closed and Scotland moved ahead of the rest of the UK in terms of earnings growth. We think that that has narrowed, and that Scotland and the UK are growing at the same rate again.

Those three effects are essentially why the income tax forecast has been revised up significantly.

The Convener: Thank you. I will now open up the session to colleagues, starting with the deputy convener, Michael Marra.

Michael Marra (North East Scotland) (Lab): All the coverage on transparency is key, particularly given what we are expecting this afternoon—hundreds of millions of pounds of cuts, with many people's livelihoods on the line. Do we know yet what the assumptions that the Government made on pay in the 2024-25 budget actually were?

Professor Roy: I will say a couple of things. You will recall that, when we did our budget forecast last December, we did not have a stated pay policy from the Government, so we made an analytical judgment that was based on inflation plus progression—I think that we used figures of 3 per cent for inflation and 1.5 per cent for progression, which came to 4.5 per cent overall. We then saw the Government's pay policy in May—its stated policy—which was also 3 per cent. However, since then, there have been pay awards that have been above that, particularly to local government and NHS staff. That is a very long way of saying that we do not have a stated pay policy just now. To be fair, that is partly because the UK Government has announced that it will have a revised pay policy this year, and we await the consequentials for that.

10:00

Michael Marra: However, we do not know whether the pay policy that was published in May matches the assumptions that were made in the 2024-25 budget.

Professor Roy: We would not be party to such discussions after we had made our forecast. We did not have a specific pay policy from the Government when we made our forecast, so we made our own assessment. That was it in relation to our setting out our budget forecast. The next bit was when the Government publicly set out its pay policy in May, but we would not go back and change what we had set out—well, we would have done if we had changed our forecast, but we did not publish a new forecast.

Michael Marra: It is incredibly difficult for us as parliamentarians to judge the variance with the initial budget and whether the Government has made a mess of the whole situation with the governance of public pay when we do not know, you do not know and, as they have said, the Fraser of Allander Institute and the Institute for Fiscal Studies do not know what the assumptions on public pay were in the budget. There has been no attempt from the Government to give you any clarity. I understand that you are not going to make revisions on the basis of those assumptions, but you have had no conversation in which the Government has said, "The global figure that we reached in our budget was based on this figure."

Professor Roy: No. We saw the public pay policy that was published in May. That is the publicly stated position.

Michael Marra: That is all that you have had.

Professor Roy: There is an important broader point about, when the budget is set, what the Government's public sector pay plans are and what they mean for the workforce. As we said in our conversation back in December, that is a crucial part of the budget for our forecast. I get that there is uncertainty and that negotiations have to take place but, in some ways, the Government needs to plan for that and set out scenarios. For example, if public sector pay is higher in some areas or if the Government changes its workforce assumptions, what will be the implications elsewhere in the budget?

Michael Marra: When I raised the issue with the finance secretary at the committee in January, she said:

> "it would not be right"—[*Official Report, Finance and Public Administration Committee,* 16 January 2024; c 35.]

to publish such a policy. Surely it could not be anything other than right to publish such a policy. You need it.

Professor Roy: Yes—we need it. In our "Statement of Data Needs", we set out what we need to make our forecasts and to scrutinise the budget and spending portfolios throughout the year.

I sympathise with the Government's challenge, because pay deal negotiations through the year can come after the point in the cycle at which the budget is set. One solution is to have multiyear settlements, with negotiations on pay over multiple years. A second is for the Government to be clear on its starting position on pay and to set out, if it changes its position on pay, the workforce or any other part of the budget, the scenarios that it would have to work to in order to balance the budget at the end of the year.

Michael Marra: No such scenario planning was set out. Nothing about contingencies was expressed to you.

Professor Roy: Not to us—no.

Michael Marra: That is a huge issue, given that we hear that pay is the single biggest pressure that we face.

I will move quickly on to social security payments. The report that you submitted to us showed that there was a very big spike after the allocation of adult disability payments in comparison with the awards for personal independence payments across the UK. That gap seems to have closed quite substantially in relation to the new awards that have been made. Are you confident about that data? Does it feel real? In relation to applications, has there been a short-term behaviour change?

Professor Roy: I will say a couple of things about that. First, based on the volatility, I am reluctant to make a big judgment call, because we have seen delays and processes taking time. The data shows that the situation is quite volatile. In the most recent data that we have published, the gap has come back down again, but it could bounce back up quite easily. In our "Forecast Evaluation Report", we have a chart on successful applications, but we also have a chart on actual applications, and it is quite interesting that there is still a gap in relation to actual applications.

In the run-up to the budget, we will keep an eye on and work on three things. First, we said that we thought that there would be a spike in the number of initial applications once the new payments were made. That is quite clear from the data. That means that the level is now higher, so that is baked in.

The second thing that we have to think about is whether we will have faster growth continuously from that higher level. We thought that we might have some of that but, despite the volatility and despite our moving back closer to the growth of the UK, there is nothing yet to give us full confidence that we need to revise that. However, even if we revise it, that level effect will be there in the system.

The third bit, where we do not have much data at all, but we are beginning to get emerging signs, is the outflows. We have the spike and the growth in inflows, but there is also the issue of how many people are flowing out, which is another important aspect. We made a judgment call that all three of those elements would add pressure—that there would be an initial spike, higher growth and fewer outflows. We just need more time to wait and see the effects of that.

Michael Marra: That is comprehensive. Thank you.

Liz Smith (Mid Scotland and Fife) (Con): Good morning. I have a point of clarification that follows on from Michael Marra's question. You made it clear that the Scottish Government has not provided you with a public sector pay policy. Have you expressed concern to the Scottish Government about that? If so, when was that?

Professor Roy: On public sector pay, we have, as you will recall, a timeline for when we ask for information from the Government on key elements and policies. In that, there is a timeline for when we would expect to have a policy from the Government on public sector pay. We published that in our budget report back in December, and as you will recall, we did not get that policy. At that point, we made our own forecast and moved forward with our budget analysis.

I would not say that we would formally express concern, in the sense that we need that material to make our forecast. If we do not get it, we make our own forecast. Again, we have been transparent about how we do that. I do not think that that, in any way, has an impact on our ability to make a forecast—our forecast is robust—but if you are asking whether it would be better if we had clarity from the Government on pay so that we could build that into our forecast, I will say that that would be really helpful.

Secondly, from a budget scrutiny point of view, it would also be really helpful if we had an overall setting out of what the public sector pay strategy would be and the scenarios for what would happen if things were to change. You get that in May, when the Government publishes its public sector pay policy, but that is well after we make our forecast in December.

Liz Smith: Thank you—that was helpful.

I want to turn to what we can try to do about the challenges in the Scottish Government's finances. In the summary of your budget report, you set out some of the demographic trends, which I have to say are some of the most concerning aspects for the longer run, particularly the issues around economic inactivity in the labour force. Given Claire Murdoch's point that there is some incompleteness in the labour market survey, does your data give you a good understanding of the behavioural changes in the group of people who are able but are unwilling to work?

Professor Roy: I will maybe ask Claire Murdoch to say a bit more about that. Across the UK, a lot has been written about inactivity and what has been happening in that respect post the pandemic. The data on inactivity is quite noisy, but the really interesting bit is the increase in people flowing into disability payments, which is linked to the point about inactivity. There have been a lot of discussions about things such as the spike in mental health issues and the collapse in wellbeing that we are seeing, particularly across different key aspects of the demographics. Among young people and people at the tail end of the labour market, in terms of age profile, we are seeing quite a significant increase in that respect. That is where the potential long-term effects are quite concerning.

All the evidence points to the fact that, once people move into such payments, it is very difficult to come back out of them, because the conditions that people have are really quite concerning. That is very much about something that is upstream. It is showing up in social security at the end, but the problem lies much further upstream and is about what is happening to people's wellbeing and mental health.

Liz Smith: Yes, it is obviously putting considerable pressure on the social security budget. What about people who are economically inactive and do not have disabilities or health issues? Do you have any idea of the policies that will make a difference to getting them back into the labour market? Obviously that has a huge implication for increasing productivity and, in the long run, economic growth.

Professor Roy: I do not think that we have done too much work on specific policies.

Professor Breedon: One thing that we know has made a difference is raising the state retirement age. Inactivity tends to increase as you age, and the evidence from the UK shows that the steady rise in the state pension age has raised activity in that cohort. That might or might not be a good way to do it, but it does have that effect. On the other hand, policies for younger inactive people are a very open area.

Claire Murdoch: The other cohort of people who are inactive and not working is people with caring responsibilities. That is probably the third category that we have not talked about. Those policies relate more to childcare or to caring for—

Liz Smith: —the older generation.

Claire Murdoch: Yes.

Liz Smith: Which is obviously increasing as a percentage share of the total population.

What I am driving at is the policies that the Scottish Government needs to enact to try to address the big black hole in public finances. Some of that can be done through public sector reform, which you have set out, and some can be done with tax-and-spend policies. However, addressing economic inactivity in the Scottish population is a crucial element of your longer-term forecasts; indeed, it is a major issue. Do you have any indication from your analysis as to the policies that might be most effective in bringing those people back into work?

Professor Roy: We can write to the committee about where the evidence is on inactivity. The key thing is that the group relating to inactivity is a big one. It is not like unemployment; that is when you are actively in the labour market looking for work, which is quite a defined thing. People can be inactive for a host of different reasons. They might be in full-time education, as we have heard, or they might have caring responsibilities, so childcare could be a key policy responsibility. Health issues can also stop people looking for work.

The policies for each of those will look quite different. It is about understanding the cohort; we should not see it just as one cohort but understand that the people in it have potentially complex needs to which we cannot rely on the creation of more jobs as the solution. The policy recommendations will have to be much more nuanced.

Professor Breedon: It is worth going back to that point, which we have made already. Our data on that is not really at the standard that you would want to answer the questions that Professor Roy has just raised. It is quite hard to tease out inactivity by group if you do not even know what the overall number is with any great certainty.

Liz Smith: The nuancing of that will be very important with regard to the policies that might help us in the future. The statistics for the longer term that you have given us are pretty grim, and we need to do all that we can to try to address the issue.

I want to raise one point of clarification. Your report contains a very short piece about the UK Government's raising of VAT on independent schools. Am I correct in thinking that, if that amount of money were to be positive, it would be spent in England and Wales and that, as a result, there would be Barnett consequentials for Scotland?

Professor Roy: Yes, but it comes back to how you follow through on particular things.

Liz Smith: Indeed.

Professor Roy: All that we will see is the UK Government choosing to spend money in Whitehall departments, which then generates Barnett consequentials. As for how they get that money and where it comes from, it goes into the Treasury and comes back out again. My understanding is that it is not ring fenced; it is not that there will be an exact amount that the UK Government gets from VAT on private schools, which is then ring fenced exactly for the education budget and then ring fenced to come to Scotland—that is not how it works. If the Treasury raises taxes through a new policy for raising revenues, funds will flow in and—

10:15

Liz Smith: Assuming that the amount is positive—I know that there is a lot of debate about that—if the money was spent on teachers or on improving resources in the state sector in England and Wales, am I correct in thinking that Barnett consequentials would flow from that?

Professor Roy: Yes. As I have said, if we ignore everything else in the world and the only thing that happens is a change in the taxation of private schools—that is, if VAT is charged—that will deliver a certain amount of money, which will then lead to a certain amount of expenditure in education and Barnett consequentials.

Liz Smith: Thank you. That was helpful.

Professor Roy: Everything else happens in the round, and we would never be able to unpick that, but the principle is correct.

The Convener: When we took evidence at the University of Dundee, Dundee City Council mentioned that 22,000 people were economically inactive in the city, around 11,000 of whom could, it believed, be encouraged or persuaded back into the workforce. There is a huge pool of people who could perhaps rejoin the workforce; I know that a lot of focus is being given to that in Dundee, and I am sure that other areas are doing the same.

John Mason (Glasgow Shettleston) (Ind): Early on in the "Fiscal Update", you make the statement that

"Decisions by the Scottish Government have played a role in these budget pressures."

I would like to explore a little what that means.

We could have spent our budget in different ways, but the fact is that we must spend all of it. If a hard year comes along, we have to make cuts. In one sense, the Scottish Government does not have a lot of control over that.

Professor Roy: I will say two things about that. First, the budget is set and the Government has a funding envelope. You are right to say that it wants to spend all of that; our point is that certain decisions that have been taken over successive years will naturally eat up a bigger share of the funding envelope, which then means that other decisions must be taken to free up resources to follow through on those commitments.

Take, for example, the £900 million of additionality that is going into social security. We are not saying that the decision to do that was right or wrong; it is just a matter of arithmetic that

that amount must then be found from elsewhere in the budget in order to balance it. Similarly, on public sector pay, if awards made over successive years are greater than those made in the rest of the UK—people will have views on whether that is right or wrong, but that is an entirely legitimate decision for the Government to make—that builds pressure into the overall budget envelope, because such a decision needs to be committed to and the money spent, which then leads to adjustments having to be made elsewhere in the budget.

That is the example that we are using. That is not to say that the budget is under pressure to be cut; instead, we are saying that the budget needs to be spent and that, if more commitments are being made in some areas, commitments in other areas will have to be reduced.

John Mason: If that £900 million had been spent on, say, the health service instead of on social security, that would not make the budget any easier now. We would just have to cut health instead.

Professor Roy: Exactly. It is all about prioritisation within the budget that is being set. We are making the point that once certain decisions and commitments are made—particularly on social security, which is demand led, and on public sector pay, which is more than half the budget—they are baked into the overall budget. That means that really tough decisions have to be made elsewhere.

The simplest example is pay. If pay accounts for half the budget and the Government chooses to increase expenditure on public sector pay by more than the total budget is increasing, everything else has to be reduced by that amount. That is the general point that we are making about pressures on the budget.

John Mason: You used the phrase "baked in". Are other parts of the budget not baked in? I presume that a one-off payment could be given to somebody, but it would have to be taken away the following year.

Professor Roy: Yes. That speaks to the point about the Government's prioritisation of spending. You will see that the Government has, in some areas, to scale back from what it had projected to spend. Some things will be cut from what was projected because of decisions that have been taken elsewhere, particularly on measures that are demand led and on public sector pay, which gradually take up more and more of the budget.

It is about expectation management in relation to what the budget is being spent on when the budget is introduced, then debated and discussed. That might look quite different if decisions that have been taken on some areas of the budget start to increase the pressure and lead to a squeeze elsewhere.

Professor Breedon: The initial point is that if you have a completely fixed amount of money, it is really important that your plans are realistic. If you suddenly realise halfway through the year that what you planned was wrong, that is difficult when there is a fixed cap on what you can spend. The UK Government can always say, "Well, we'll ask to borrow some more", but that is not available to Scotland. The importance of being realistic in planning is greater for Scotland than it is for the UK.

John Mason: I do not want to labour the point, but it seems to me that, whatever the Scottish Government did, we were going to have to face a similar problem. We cannot underspend the budget, can we? Some people have suggested that, if we had underspent last year, we could have saved the money up, but we are not really allowed to do that.

Professor Roy: I take your point and I am not disagreeing with you, but it is about the language that we are using. If we take the funding that is associated with social security, for example, we are saying that the Scottish Government is choosing to spend more on social security than the funding that is flowing in. A decision has been taken to put pressure on elsewhere in the budget to make up for that commitment. Similarly, with public sector pay, if you choose to pay public sector workers in Scotland £2,400 more on average than they are paid in the rest of the UK, that creates a pressure elsewhere in the budget.

The point that we are trying to make is that the Government is having to make really difficult choices just now not because it just wants to cut expenditure but because decisions taken elsewhere, whether rightly or wrongly, are using up more of the budget.

Claire Murdoch: It is also worth distinguishing between different types of spending. In social security, you have people who are eligible for payments who are receiving those payments, as in the case of disability payments. You have to pay those people: you cannot cut that spending in-year. Politically, it is very hard to cut other parts of your budget, and it is hard for an NHS health board to manage a reduction in its budget, but you can reduce the amount of money that you give to the NHS in-year. That is not to say that that is the right thing to do. That is for others to decide.

However, a larger chunk of your budget can be spent on things that are much harder to cut in-year, and you might also have pay pressures. You have to decide how big your workforce is and whether you can pause recruitment or start making redundancies, but if you are not making redundancies, you will have a pretty fixed workforce, so you will have quite large chunks of the budget that you cannot cut in-year. The areas that you will then have to cut will have to take proportionally larger cuts than the reduction in funding that might be needed for the overall budget.

John Mason: Okay. I think that I have spent long enough on that angle. Thanks very much for your answers.

On the question of multiyear spending plans or medium-term financial statements and how possible they are, I am frustrated, and the committee is frustrated, that we have not got to that sooner. Things always seem to come up as a reason for not forecasting three, four or five years ahead, or whatever it might be. We have already covered pay: we thought the UK policy was 2 per cent, Scotland came in with 3 per cent, then the UK went to 5.5 per cent. Are we just unrealistic to hope that we can make forecasts because all those outside things can come in and destroy them?

Professor Roy: We did this better in the past; the movement to single-year budgets and things like that is relatively new. If you go back to the early years of devolution, multiyear spending reviews, rather than single-year spending reviews, were very much the norm.

The first mover in this is ultimately the UK, because it sets the bar on consequentials. We will see the practice, but there has been a welcome statement from the Chancellor of the Exchequer that the UK Government plans to have budget settlements that run beyond a single year and to have a spending review in the spring. All else remaining equal, that should give the Scottish Government much greater certainty in order for it to be able to do something similar.

You are right that stuff always happens. Who can predict what is going on? The point is that, as long as the baseline is relatively stable and there is a solid plan, you are looking around in the margins for that stuff. At the moment, we are quite far on from the most recent UK spending review. A lot has happened since then: inflation has eroded budgets and consequentials have come in, and all that makes the whole process quite messy and not very satisfactory.

John Mason: Thanks for that. You mentioned bonds and you said that, if the Scottish Government is going to issue bonds, it will have to do it fairly soon. Does it make much difference? We have a limit on what we can borrow, so it does not really matter where we borrow from, does it?

Professor Roy: No. It might matter just with regard to the cost of borrowing and where you get the cheapest rate. Currently, all borrowing is done through the Treasury, so you go through the Public Works Loan Board, which is quite cheap. You can issue a Scottish bond. The question should be what advantages that will give in terms of cost and flexibility. We will need to wait and see all that information from the Government.

Professor Breedon: I think that it is the national loans fund.

Professor Roy: The point is that the cap is the cap, so the Government cannot do more than that.

John Mason: We talked earlier about public sector employment and the fact that it is 22.6 per cent in Scotland and 17.6 per cent in the UK. Are we comparing like with like? Things such as Scottish Water and ScotRail are in the public sector in Scotland, but the equivalents in England are not in the public sector.

Professor Roy: It is pretty much of a muchness. The statistics try to adjust for reclassifications and the like, but the situations are pretty comparable and the Government has similar figures in its analysis.

Claire Murdoch: One of the things about the data on public sector employment in Scotland is that not all of that workforce comes under the devolved Government—some will be in the reserved workforce. There are armed forces in Scotland and some UK departments, including the Department for Work and Pensions and the Department for International Development, are based up here. Those people will also be counted, but the broad story of there being a larger public sector workforce is very true.

John Mason: Is it that there are more people doing the same things, or are there people doing different things that are not being done in the public sector in England?

Professor Roy: The majority of it is more people doing the same things. That relates to levels of public spending per head in core public services in Scotland, which is above the rate for the rest of the UK. For example, the programme for international student assessment data, which looks at public services and public spending, shows that that expenditure is higher in Scotland than in the rest of the UK. Some of that is historical stuff and some of it just reflects the cost of delivering public services across, for example, rural areas—there are just more people employed in such areas. So, there are good reasons for it; it is not just that there is a bigger public sector.

John Mason: The ScotWind money was not spent when it was expected to be spent. Is there a time pressure to spend it, or is it like a reserve that can just sit there?

Professor Roy: The Government did not spend ScotWind money last year, so that is still a pot of money that the Government is earning interest on and could use to support public spending in any given year. We might get an update on that today.

John Mason: The ScotWind money does not count as part of the Scotland reserve.

Professor Roy: No—it is completely separate.

Jamie Halcro Johnston (Highlands and Islands) (Con): I want to follow up John Mason's questions and come back to the size of the public sector, before we move on. I represent the Highlands and Islands, so I understand that costs to deliver public services could be higher there. Is there a comparator for those figures for the size of the public sector in Wales, Northern Ireland and similar countries across Europe?

Professor Roy: We can write to you on that and get you that information. We can definitely get those figures for the UK, but it starts to get a wee bit more ropey once you start moving across countries because of the issue that John Mason raised about the definitions of "public sector", "quasi-public sector" and the like.

There was a time when the data got really messy because the banks were included under public sector employment during the financial crisis, when the Government became the majority shareholder, so we had to strip all that out in order to make comparisons. However, we can certainly get you comparisons across the UK.

Jamie Halcro Johnston: What size is the public sector in Wales, for example?

Professor Breedon: I think that it has a larger public sector than Scotland, but that is largely because there has been more of a push to base national services in Wales. I am not sure whether the data exists with that stripped out from Wales to say what is left once—

Jamie Halcro Johnston: When you say "national", do you mean "reserved", in effect?

Professor Breedon: Yes. There are a lot of departments in Wales, including the Office for National Statistics, the Driver and Vehicle Licensing Agency and others. Those are national services, so you would, ideally, strip those out and look only at the comparable services.

10:30

Jamie Halcro Johnston: On the spending commitment, I think that the position is that the Scottish Government cannot overspend its budget, but can overcommit its budget, to some extent. There are a number of areas that we can look at—social security is one of them. You said that the gap between income from the block grant and spending is, essentially, baked in. That could lead to serious issues, especially if the gap continues to grow. Even its just continuing to sit at the current level could have serious implications for budgets in the future because, as you said, that will be baked in—every single year we will have to find that additional money.

Professor Roy: As I mentioned, we now have outturn data that shows that the gap between the block grant adjustment funding for social security and the actual commitment is £900 million in the past financial year. In our latest forecast, we project that that will rise towards the end of the forecast period to about £1.5 billion. As Claire Murdoch explained, that is almost like the first call on the budget, because you set the policy and then demand flows in, which means that the spending is going out. Resources then have to be found from somewhere else within the budget.

That is not to say that it is wrong to have that policy—it is about tackling child poverty and all the commitments that go alongside that. It is just that it is a draw on the budget. As we spoke about with Mr Mason, the budget's being fixed means that you have to free up resources elsewhere in order to meet those commitments.

Professor Breedon: It is a good point, because obviously we are very focused on this year's settlement, and even on next year's budget, but that sort of pressure means that we are going to continue having this conversation for the foreseeable future. There will be many tight budgets to come and the pressures, including the demographic pressures that have been mentioned, will be accumulating. The decisions will be tough for the foreseeable future.

Jamie Halcro Johnston: The Scottish Government—both in correspondence with us and publicly—has said that, in relation to the winter fuel payments, the decision of the UK Government has meant that the Scottish Government has no choice but to replicate the UK Government's position. That is not true, though, is it? There are choices and options. What are they?

Professor Roy: You are right—it is almost the flipside of the conversation that we just had about the Scottish Government choosing to do something different with the adult disability payments, child disability payments and Scottish child payments, and setting a different policy because those areas are now devolved.

It is up to the Scottish Government to decide what it wants to do in terms of the policy on winter fuel payments. Of course, what happens under the framework is that, because the UK Government is now going to means test the winter fuel payments, the block grant adjustment—the funds flowing in—reduces by an equivalent amount.

Therefore, the Scottish Government has a challenge—it is exactly the conversation that we just had. It could continue with its pre-planned policy, but it would then face a funding gap of between £140 million and £160 million because the block grant adjustment will flow through. The Scottish Government faces a choice. Should it implement the same policies as exist in the rest of the UK, which balances out the funding gap, or continue with its intended policy, which would mean that it has the funding gap to fill? Ultimately, it is a choice.

There is the wrinkle about how this all works in the fiscal framework, in relation to the decision that has been taken and when it flows through into the actual budget, which we can chat about. There is a technical issue about when changes score in the budget.

Jamie Halcro Johnston: So, would that be about deferring the block grant adjustment?

Professor Roy: Yes—exactly.

Jamie Halcro Johnston: So the Scottish Government could defer it. Is it just for one year?

Professor Roy: Two years.

Professor Breedon: Yes—for the next two years.

Claire Murdoch: Technically, because the policy changes happened in-year, the Scottish Government could delay the reconciliation, which is the reduction in the block grant. It would then go into not the next financial year but the following financial year, so you would be looking at the 2026-27 budget.

Jamie Halcro Johnston: So, the money would still have to come out but, in theory, the Scottish Government could deliver the winter fuel payment as it currently is to the people whom it currently goes to—or would have gone to—but there would have to be reconciliation in two years, or within the two years.

Professor Roy: Yes. Also, if the Scottish Government continued to deliver the current policy in the future, there would be the reconciliation, but you would also have the funding gap to make up, because a block grant adjustment would not flow through in subsequent years, either.

Jamie Halcro Johnston: As you suggest, it is a question of priorities and what the Government chooses to do. I am not necessarily commenting on that, but there are options.

Do you feel that there is a slight contradiction there? The Scottish Government says that it has no choice but to remove the payment, at the same time as it announces policies on council tax freezes, for example, at political conferences. Those choices exist—it is about what the Government decides in making them.

Professor Roy: I would not pass comment on the Scottish Government's decisions in that regard, other than to restate that it is about choices. This goes back to the conversation that we had with John Mason. The Government's total budget is going up by roughly 3 per cent in cash terms this year, which has not really changed from when it was set out in December. This is about how the Government prioritises that budget.

This is the first year in which we have seen a significant in-year adjustment to social security at UK level, which has had quite significant implications for the block grant adjustment. The numbers are big: there is a reduction of £140 million or £160 million in the block grant adjustment. The Scottish Government could make a choice to subsume that gap within its overall budget, but it would have to prioritise what other areas would pay for it.

Jamie Halcro Johnston: Finally, as John Mason highlighted, there is the ScotWind money. We might hear in the next few days whether that is going to be used, but it is, nonetheless, available to plug some of the gaps.

Professor Roy: Yes, that money is available to be used. There is a question, however, given that that money is clearly a one-off payment that is tied to the sale of renewables leases, which feeds into the conversation that we have had in our climate change work about how the Government supports the transition to net zero. Back in March, we made the point that, on average, an extra £1.1 billion a year over the next 30 years would be needed in order to hit net zero. There is a question in that regard. You could use those resources, but you would be getting a one-off payment, rather than regular payments, to fund day-to-day services.

The Convener: I call Ross Greer, to be followed by Michelle Thomson.

Ross Greer: Thank you, convener. Apologies for the delay in getting here—my train was so delayed that I just gave up and found a different way to get to Edinburgh.

To follow up on the point about deferring the block grant adjustment, that is presumably a lever that can be pulled only once—you cannot keep delaying it in perpetuity.

Professor Roy: Yes, exactly. As Claire Murdoch said, you can delay it until the outturn—that is the nature of the framework. If the UK Government changes the block grant adjustment in-year, the Scottish Government essentially has the option to delay that adjustment until the final point, which is the outturn. It can have conversations with the Treasury about whether it can manage the change before that point in time, but it can delay it only until the outturn, and then the reconciliation must hit.

Ross Greer: To follow up on John Mason's line of questioning about issuing bonds, I recognise that we have not done that before, so it would be uncharted territory. Do you have any expectations about the relative value for money in issuing bonds versus going through the national loan fund?

Professor Roy: It is probably largely for the Government to tell us that, rather than for us to do an assessment of it. What we say in the "Fiscal Update" is that we still wait for the Government, if it is going to issue bonds, to set out the strategy for that. What is the likely cost that the Government would face, and what are the flexibilities in there? It might cost the Government slightly more, but it would potentially have more flexibility in the type of investment that is being secured. Ultimately, however, that is more for the Government to set out. Our role is to comment on the transparency of that, and then comment on the reasonableness of the borrowing assumption. However, we would not do a market assessment, for example.

Ross Greer: If I recall correctly, that was an Scottish National Party conference announcement this time last year. Have you had any discussions with the Government since then, and has it given you any indication of how it is progressing with that policy, or whether it is still doing so?

Professor Roy: Yes, we had a discussion last year around budget time. We were asking questions because we knew that the Government was looking at this policy, but, again, we would not comment too much on the policy per se and how it was developing. Our asks are really, "Where are you? Are you going to announce something? What is the plan? How much are you going to borrow?" Those are the bits that we are interested in. We are interested in the public finance aspect, rather than in the policy per se.

Ross Greer: On that point, what was the last thing that the Government told you in answer to that question, and when was that?

Professor Roy: The last conversation that I can recall would have been in the run-up to the budget. We were just asking for the timeline, and we were told, "It's not in this budget—it will be for something in the future," so I guess that the conversation will be picked up again in the run-up to the budget in December. I am sure that officials will have side conversations about how that is all progressing, but in the last decent conversation that we had, the Government said, "We'll get back to you."

Claire Murdoch: We are highlighting that this was something that the Government had flagged would be likely to happen in 2025-26. As we are thinking about the 2025-26 budget, we will be asking the Government those questions.

Ross Greer: That is a useful point. Thank you.

I have a question on public sector pay transparency. Going back to the discussion that we had last week, Graeme, I will put some of that on the record and follow up on Michael Marra's line of questioning. You mentioned recognising that the Government cannot be completely transparent without beginning to undermine its negotiating position with the unions, which is perfectly understandable—the more transparent the Government is, the more the unions will see whatever figure is there as the floor from which to work up, which just takes the Government back into that space of having to find money from elsewhere.

You mentioned, though, the benefit of illustrative scenarios. Could you detail what you mean by that? Is it essentially to say that the Government can put one sum up front and say, "This is what we are looking at in terms of the cost of public sector pay," or, "In terms of the pay strategy, we are looking at 3 per cent, plus 1.5 per cent for pay progression, but if it were to be more than that, here are the areas where that money would have to come from?" Are you talking about that kind of scenario, where there is a list of other areas of public spending that would be the first up for announcements like this afternoon's?

Professor Roy: We would not want, in any way, to try to influence the pay negotiations. Ultimately, that is for the trade unions and the Government. Our general point is that, with so much of the budget going to public sector pay, clarity about the Government's strategy on public sector pay, as well as on the workforce, would mean that the Government can have a conversation about what is happening with public services.

The SFC has been one of the first to articulate the scale of the public sector budget relative to the overall budget. We are just making people aware of that. The convener was doing a calculation earlier of what would happen if public sector pay were increased by an extra percentage point. What is the potential scale of other resources that the Government would have to free up? What might happen if additional consequentials were forthcoming, and what might happen if they were not forthcoming? Transparency on those sorts of things, throughout the whole budget process, would be really valuable.

We end up back again another year into a budget process in which the Government is announcing quite significant, and potentially chunky, decisions on a budget four or five months into the financial year, with a budget that was debated and discussed from December last year through to March. From a budget scrutiny point of view, that does not feel right in terms of the whole decision-making process. It affects our ability to support committees such as this one to understand where the money is being spent and how some areas are being prioritised. Ultimately, if we are not progressing toward outcomes as fast as we should be, or if some key projects on climate change or net zero are being delayed, there will be questions about why that is happening. We will not know why, because of the big adjustments that are taking place within a year.

Ross Greer: To clarify, is your suggestion with the point about using scenarios in planning that, at budget time, the Government should indicate that, if it spends more than it has allocated on public sector pay as a result of negotiations, the likely excess will have to be drawn from X, Y and Z areas of other spend?

Professor Roy: I do not think that it has to be just about public sector pay. That is the key point, and I would not want to make it only about a focus on public sector pay.

There is a broader point about the Government being much more transparent by saying ,“This is the totality of the budget envelope that we have at this moment and this is what we plan to spend.” Then it should be much more transparent about how money is actually being spent through the year. That comes back to the conversation that we have had repeatedly about the difference between budget—which is what is planned—and outturn, and about being able to track all of that back.

I am not saying that we would want to have scenarios about what happens if there is 1 per cent here or 1 per cent there. It is about reframing the whole conversation to say, “This is the projected budget and these are the choices that we have to make. If we choose to change those choices through the year, what are the implications elsewhere in the budget?”

Michelle Thomson (Falkirk East) (SNP): I have a couple of wee questions to finish off. First, on the question that Liz Smith raised earlier about VAT on private schools, I want to make sure that I have all my ifs in a row. If that policy is enacted, if the money is spent on education in England and Wales and if it goes on public sector education spend—in other words, if it is not used to enable private companies to set up education-type bodies—only at that point could it result in Barnett consequentials. I accept that we would not know the detail of that, because of what you said in your earlier commentary. I am trying to flesh out all the ifs. There would be Barnett consequentials only if the money that is raised is spent on publicly tractable public sector funding for education. There could be a scenario in which the money that is raised is nominally spent on education provision or services, but it cannot be Barnett consequentialised, if there is such a word.

10:45

Professor Roy: That is why I was trying to say that there are lots of scenarios that have to arise for that money to come through. Ultimately, the only thing that we know is that, if the education budget goes up, we will get Barnett consequentials as a result of that. You are right to say that lots of ifs need to arise before we can read through from that one policy change to the education budget changing. For the purposes of the Scottish budget, all that matters is whether the education budget in Whitehall goes up and we get Barnett consequentials.

You are right in the sense that, if those ifs arise, that will lead to more money being available, which in turn would lead to more spending.

Michelle Thomson: As things stand as regards our understanding of those ifs, we are light years away from being able to definitively state that there will be Barnett consequentials as a result of that UK Government policy. That is what I am trying to get at.

Professor Roy: Yes—exactly. It is not as though, if anything happens to VAT, Scotland gets Barnett consequentials. That is not the way it works. VAT is a UK tax. Anything that happens to VAT changes VAT revenues. I am sure that the imposition of VAT on private schools will be one of a multitude of changes to VAT. As a result of those changes, money will flow into the Treasury. At that point, the total revenue pot that the chancellor decides to allocate across different Whitehall departments will be revealed. As you said, that will lead to specific policy announcements that will lead to comparable spending, which will then lead to Barnett consequentials. A lot of steps are involved in that whole process.

Professor Breedon: That is one of the reasons why the current position is tricky for Scotland. We are waiting for a very big budget. It is not only the total tax and spend of that budget that matters; the details of where the money actually goes matter to Scotland. A great deal of uncertainty is caused by that. The upcoming UK budget will be a big budget that could potentially involve lots of changes that could have very difficult implications for Scotland, depending on where the money is spent.

Michelle Thomson: You illustrate the complexity of the issue, which can probably go only one way. To counter that complexity—I think that my colleague Ross Greer was getting at this—assumptions should be stated, where that is possible and feasible. The more planning, the better, even though we all accept that the only certainty is that, ultimately, all plans will be wrong. However, from a behavioural perspective, we need to try to track things.

On that point, I note that we will not have a medium-term financial strategy, and we do not anticipate that we will have an updated infrastructure investment plan. That seems to me to be counter to the dawning realisation that everyone has had that we are in the position that we are in because of a failure to plan—or, rather, to scenario plan. Given that pay policy informs the MTFS, what are your thoughts on planning and what we need to do in that respect?

Professor Roy: I will make two points about planning. The first is that the outturn data helps us to look back and see what has happened and where things have been done.

My second point is about moving to multiyear settlements and providing much more transparency on the budget. A lot is going to happen over the next few months, following today's statement. A lot of the discussion that we have had has been about the 2024-25 budget, how it is managed and how we make sure that it lands and that the Government delivers it.

However, everything that we are going to discuss next will be about what happens next year and beyond. We should get a lot more information in the UK budget about the UK Government's plans, the fiscal rules that will set the overall envelope and the Barnett consequentials that will come through.

The next part will be the spending review, which we will have to wait until spring for. To be fair to the Government, it is really only after that that it will be able to say, "We now know what the spending review is saying. We now have multiyear settlements." At that point, it will be able to start to plan ahead on a more medium-to-long-term basis.

There is quite a bit of water to flow under the bridge before we get to that point but, at that point, there will be no excuses. Once the Government has multiyear settlements, it will need to start to plan and to set out the range of scenarios that it might face.

The Convener: Thank you. That has exhausted questions from colleagues, but I have a couple more to finish off with. One of the issues is that we have had six-month spending reviews rather than multiyear or even annual spending reviews, with the budget having to be revisited in an emergency context every summer.

Professor Roy: It just does not feel right for how the budget is being set, does it? There are good reasons for it. Challenges and other things come from left field, but these are ultimately public services that we all depend on. It is about stability for vulnerable people in some areas and for vulnerable organisations that rely on funds flowing through from the Government.

If we take a step back from that, we want to be in a period in which we have the ability to plan. Whether we agree or disagree with the decisions, we need to embed much more certainty into the process.

The Convener: Yes. It seems to me that the autumn and spring reviews will become increasingly important if the current situation continues.

Ross Greer pointed out that one of the issues with pay policy is the fact that it is considered a floor for negotiation. Is that not because, in effect, the Government decides to make it a floor? What happens every year is that we have this dance whereby the Government ministers stand up in the chamber and say that there is not a single penny left and it is a matter for the employers, whether it is the Convention of Scottish Local Authorities or colleges or whatever. Then, lo and behold, it ends up deciding to hand over a bigger settlement than it might initially have hoped to. The people on the other side of the table are well aware that that is going to happen year in, year out, and we end up with this cycle every year. Is that not the situation that we are in?

Professor Roy: It is not for me to comment on pay negotiations and strategies and all that, other than to say that public sector pay and the structure of employment are big components of the budget, and being really clear about plans for them is fundamental to setting the budget.

The Convener: But if the Government set a pay policy in the budget and then stuck to its guns for once and did not suddenly find additional funds from somewhere, other than perhaps through consequentials, would it not be in a much better position in terms of the sustainability of the budget?

Professor Roy: Again, it is not really for me to comment on the attractiveness of different Government strategies.

The Convener: Go on. I am just talking about it from a sustainability and scrutiny perspective, not necessarily from a policy point of view. If we knew where we were and what was going to happen come May, because money had been allocated to certain budgets and the organisations to which that money had been allocated—whether it be the NHS, local government or the culture sector—knew that that was the money that they had to spend, would that not be much more sustainable than having to keep going back to find additional money from somewhere in the budget?

Professor Roy: If the Government set out a multiyear policy and did not change it, it would not have to make revisions through the year. The general comment that I would make is that, although we have spoken quite a lot today about the driver of pay in all this, there are clearly other pressures in the budget. We have talked a bit about social security, but I guess that, in general, public services are putting real pressure on the overall funding envelope. It is about how the Government manages that over the course of a year, when it gets to the point where it might be projecting an overspend. However, if those pressures kick in on the delivery of day-to-day public services, that also eats into the budget.

The Convener: Finally, on the winter fuel payment, if the Government decided that it would pay the winter fuel payment, not only would it have to pay the £140 million to £160 million back next year, if it continued to make the payment, it would have to find £140 million to £160 million next year on top of that, and every other year. We could end up with a situation whereby, over five years, the Government could have to find £700 million to £800 million, and possibly more, from an ageing population.

Professor Roy: Yes. The block grant adjustment being cut means that, although you can adjust for inflation in the sector, going forward there will be a gap between the funding flowing in and how much would be going out to the tune of about £140 million to £160 million, year on year. The issue with delaying it this year is that, although you might be able to delay it for a year or two years, you would have a double payment at that point. However, you are right that that additional payment would have to be made from somewhere else in the budget.

The Convener: It would have to come from the NHS budget, policing, local government or whatever.

Professor Roy: Yes, or higher taxes

The Convener: Or higher taxes. Thanks very much. Do you want to make any further points before we wind up the meeting?

Professor Roy: No, thank you. I enjoyed that.

The Convener: I thank Professor Roy, Professor Breedon and Claire Murdoch for their contributions today. No doubt we will see you in the not too distant future.

10:55

Meeting continued in private until 11:46.

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