HOUSE OF COMMONS

Scottish Affairs Committee

Oral evidence: Coronavirus and Scotland, HC 314

Thursday 2 July 2020

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Watch the meeting

Members present: Pete Wishart (Chair); Mhairi Black; Deidre Brock; Wendy Chamberlain; Alberto Costa; Jon Cruddas; Sally-Ann Hart; John Lamont; Douglas Ross; Liz Twist.

Questions 265 - 310

Witnesses

I: Professor Alasdair Smith, Commissioner, Scottish Fiscal Commission, and David Phillips, Assistant Director, Institute for Fiscal Studies.

Examination of witnesses

Professor Alasdair Smith and David Phillips.

Q265 **Chair:** Welcome to the Scottish Affairs Committee and this one-off session in our Covid inquiry on the economic impact of Covid-19 in Scotland. We have two very distinguished guests with us today, who I am now going to allow to introduce themselves, who they represent and anything by way of a short introductory statement. We will start with you, Professor Smith.

Professor Smith: I am Alasdair Smith. I am one of the members of the Scottish Fiscal Commission. The commission was formally established in 2017 following the devolution of additional tax and social security powers to Scotland. We produce the official independent economic and fiscal forecasts for Scotland. We are accountable to the Scottish Parliament. Our role is slightly different from but parallel to that of the OBR for the UK. Our forecasts support the Scottish budget process and although we produce an economic forecast as part of that, it is not within our remit to comment on specific economic policy proposals.

We are also responsible for commenting on the reasonableness of the Scottish Government's borrowing plans as part of the fiscal framework between the two Governments. We published our last forecast in February 2020. Clearly that has now been overtaken by events, so in April we published an update on the Scottish budget position, which has been included as a background paper for the Committee. I am very happy to be here and to answer your questions.

Q266 **Chair:** Thank you very much for that. We are very grateful for your time and attention today. Mr Phillips?

David Phillips: I am David Phillips. I am Associate Director at the Institute for Fiscal Studies, or the IFS. The IFS is an independent research institute looking at macroeconomics and public finance issues. I lead our work on devolved and local government finance and I have particular expertise with issues around the fiscal framework. Colleagues of mine have been looking at broader aspects of the Covid-19 crisis on public finances more generally, on issues to do with the benefit system, tax system, incomes, the labour market, families and so on.

Q267 **Chair:** Thank you. That was very concise. To get things started, Scotland's Chief Economist has warned that Scottish GDP could shrink by a third during this lockdown and by 14% for 2020 as a whole. Do you share this assessment and what is your view about the impact of Covid on Scotland's economy?

David Phillips: I think at this stage we already have outturns for the UK that show around a 20% reduction in GDP during April. Clearly, that is a large hit to the economy. How the scale of that will differ in Scotland will depend to some extent on the scale of the lockdown. There were some additional sectors suggested to lock down in Scotland relative to the rest of the UK. I think parts of manufacturing were recommended to lock down

in Scotland. It will also depend on the sectoral composition of the economy. Scotland has a larger share of the economy in things like hospitality, which might mean it is more exposed to some of the effects economically, but also a larger share in the public sector, which might insulate the Scottish economy somewhat from the impacts.

What I would not want to comment on is exact figures. Very large magnitude declines are perfectly consistent with evidence we are seeing for the UK as a whole and other countries. Some parts of the Scottish economy will see much bigger falls in activity than that—hospitality, non-food retail—and other parts of the social economy will have held up better.

Q268 **Chair:** Professor Smith, obviously I would like you to answer that question, but is Scotland just that little bit more vulnerable than the rest of the UK and other comparative countries?

Professor Smith: I would agree with what David said, that there are some aspects of the Scottish economy— like exposure to the hospitality sector—that make it a little more vulnerable and others, like the larger size of the public sector, that make it perhaps a little bit less vulnerable. What is going on in the oil and gas sector may have a particular impact on Scotland, but the thing to emphasise is that the main thrust of what is happening in relation to Covid in the economy is fairly common across the whole UK. That is the first point.

The second point is that everything we are looking at has a high degree of uncertainty attached to it. We might say, "Scotland's economy looks more vulnerable than the UK economy for this reason or less vulnerable for another reason," but everything we say has to be qualified by the fact that there is a high degree of uncertainty and things might turn out that surprise us all.

Q269 **Chair:** In your view, how reliable are GDP forecasts now in the face of an unprecedented pandemic like this? What would be the margin of error?

Professor Smith: The margin of error on GDP forecasts would be quite large, not least because the very process of collecting statistics is affected by the crisis and also because there are things going on within the crisis the economic effects of which are difficult to assess. A very large proportion of the workforce being supported on furlough makes it hard to guess what the underlying economic forces are, but, on the other hand, various commentators have used things like universal credit application rates, the furlough rates themselves, all the different calls on the Government programmes that have been put in place. We have a broad picture. The number that David quoted is that it looks like an immediate hit of the order of 20%. It is 20% plus or minus a bit, but we have a broad order-of-magnitude sense of what kind of economic hit we are looking at.

David Phillips: I have managed to dig out some figures from a report colleagues put together. This was put out a couple of weeks ago. The Bank of England was expecting a 25% fall in quarter 2; the OBR had forecast or

projected a 35% fall. That shows there is a fairly wide margin in the numbers, but the point I was going to make is that I think all the evidence is pointing to a very significant fall. I would not necessarily become overly fixated on exactly what that fall is. What will be more important, certainly for the health of the economy and people's wellbeing in the longer term but also the public finances of the UK and Scotland, is what happens to the recovery of the economy. It is much more important whether in three years' time we are still 5% of where we would have been or we have caught up than it is whether the fall in this quarter is 25% or 35% or 15%. It is the long-run trajectory that will be much more important for people's living standards, and also public finances and the money available for public services.

Q270 **Chair:** I was going to come to what your views are in the last of my introductory questions. We are all hoping it is going to be what is referred to as a V-shaped recovery and that as quickly as it has gone down, it will return back to normal and we will all be living our lives as we were pre the Covid lockdown. Are you confident that is a model that you are seeing and observing now? What are your views about the long-term impact on our economy as we go forward and start to recover as we leave this?

David Phillips: I think initially there was the hope that this would be a V-shaped recovery. In what it called its coronavirus reference scenario in April 2020, the OBR had a sharp drop of 35%, then a very strong bounce back, so that by the end of the year we were back on track to the pre-crisis forecasts. More recent forecasts, which are more like forecasts than scenarios, have tended to assume there will be a longer-run hit to GDP. For example, in its scenario for June 2020, the OECD expected GDP to be about 5% to 6% below where we would have otherwise forecast it to be by the middle of 2021.

Colleagues have done some work alongside Citi and they have a persistent output gap as their scenario, so that even by 2024 the economy will be a couple of percentage points below where it otherwise would have been. Of course, there is a lot of uncertainty and it could catch up or it could fall behind even more. I think several factors will affect that. One will be whether or not we have a second wave of coronavirus, whether the numbers stay low or come back somewhat. That will impact on the lockdown measures that are needed, but also people's behaviour.

It will also depend on the extent to which the crisis generates structural changes in the economy. If the future economy is somewhat different in structure and there are more activities based around home working, IT and so on and less around hospitality, the processes of adjustment take time and can lead to a somewhat slower return to growth. How things evolve will depend on those different factors.

Q271 **Chair:** Coming to you, Professor Smith, obviously I want you to answer that question too, but is there anything specific that we should be looking to in Scotland that suggests it might be more difficult for us to recover as quickly as the rest of the UK or other comparative countries?

Professor Smith: As David said, I think the consensus now is that it would be over-optimistic to see a quick recovery. It is not a matter of the economy going to sleep for three months and then waking up and everything is unchanged. Not many people think that that is going to be the case. The reason is that during the lockdown some businesses—some areas of economic activity—will have suffered in ways that make it very hard for them to perhaps even get back into business.

There are areas that are particularly important to the Scottish economy, like tourism and hospitality, where months of shutdown may have effects that are very hard to recover from, so we will be looking at shifts in business over the medium run and those things take time. The more that is happening—businesses are suffering effects that they are not going to recover from quickly or at all—the more pessimistic we have to be about the speed of the recovery.

Q272 **Sally-Ann Hart:** Good afternoon, Professor Smith and Mr Phillips. I want to have a look at some of the main sectors in the Scottish economy to see which ones will be worst hit by Covid and how significant they are to the overall health of the Scottish economy. I want to look at the tourism and hospitality sector first, as you have both highlighted this as an area of concern. We know that they are facing significant disruption during the pandemic. How will the economic impact of this be felt in Scotland in comparison to the rest of the UK in the tourism and hospitality sector? Does Scotland have enough flexibility to support these sectors or is it reliant on the UK Government to support them? I do not know who would be most appropriate to ask first. You can probably both answer it, so I will go to Professor Smith first.

Professor Smith: We have both mentioned tourism and hospitality as areas in which the Scottish economy might be vulnerable, but it is worth making the point that tourism and hospitality are a very important part of the UK economy. There are big parts of the UK where tourism is important; hospitality is very important throughout the whole of the UK. In many respects, the most important effects are not going to be differential effects between Scotland and the rest of the UK as between different parts of the economy, so the different effects on tourism and hospitality, which are very strongly impacted by the shutdown, and, on the other side, health and social care, for which demand has increased during the shutdown. That kind of difference across sectors of the economy is much bigger than differences between Scotland and the rest of the UK economy.

David Phillips: To illustrate that point, the share of jobs in accommodation and food services is higher in Scotland than it is in England. It is 7.5% in Scotland compared to 6.9% in England, so it is higher but it is not massively higher. Where you might see particularly large impacts is at a more localised level. When colleagues looked at this for England rather than the UK as a whole, given the data that was available, the hospitality share was very high in rural and coastal areas. In Scotland, parts of the Highlands and Islands and places like that are particularly reliant on these

sectors. The within-Scotland impacts might be more variable than the difference between Scotland and the rest of the UK in the hospitality sector.

At this stage at least, the short-term impacts have clearly been very negative for the hospitality sector. We have seen a very large share of workers furloughed and output in this part of the economy fall very substantially. I think the medium-term impacts are less clear. As discussed, it depends on how consumer behaviours evolve over the long run. You can see more than one scenario there. One scenario is that people are travelling less and avoiding crowded places into the medium term and, therefore, these sectors continue to suffer, especially if there is a second wave.

On the other hand, there have been reports of surges in demand for domestic holidays in England in particular as the lockdown has ended. If you saw a rise in staycationing, that could potentially have some upsides for this sector. It is a little bit early to say how all these things will pan out sector by sector for the longer term, but sectors that have been hit in the short term are also those with more uncertainty about what the long-term impacts will be.

In the oil and gas sector, there has been a very big hit to oil prices and that will potentially impact on investment and other things going forward. How that evolves will very much depend on what happens to energy demand going forward. Again, you can see that remaining depressed if the economy is depressed. You can see it going up if everyone is scared of using public transport and are using more petrol in cars. I know in China there is evidence that road use has gone up after lockdown. The effects you can see—where there have been big hits so far—are also the ones where there is a lot of uncertainty going forward.

Q273 **Sally-Ann Hart:** Picking up on oil and gas, do you have an assessment of the economic impact that can be anticipated in this sector? You talk about an increase in car usage, which is not so great for the environment I suppose, but do you think there can be an assessment of the economic impact, or is the uncertainty just too great at the moment?

David Phillips: That is not something that we have done at the IFS, but there may be economists who have looked at the oil and gas sector in more detail and will be able to talk about those issues. I know in Scotland there are academic economists who look in particular at the prospects for the oil industry in Scotland. It could be worth talking to them.

Q274 **Sally-Ann Hart:** Thank you. I wonder if Professor Smith might be able to give more information on that. Is it something you have some expertise in?

Professor Smith: I am not sure I would claim expertise. The Fiscal Commission does not have particular expertise on the oil and gas sector, or indeed on sectoral analysis, but we know that in the five or six years after the global financial crisis of 2008, which was associated with a big

decline in the world oil market, there was a significant impact on the Scottish economy because the offshore oil and gas industry declined and that led to a decline in, essentially, high-paying jobs in the Scottish economy. A chunk of the disappointing productivity performance of the Scottish economy over the last decade or so is due to the decline in oil and gas after 2008, so a further hit to oil and gas would probably have a further impact, particularly on the Scottish economy.

Q275 **Sally-Ann Hart:** We heard evidence in one of our Select Committees, I think last week, about the devastating impact of Covid-19 on the food and drinks sector in Scotland. Could either of you highlight or give us some information about what the long-term economic impacts of Covid-19 on that sector might be?

Professor Smith: That is a good example of the high degree of uncertainty because we can look at what has happened to the hospitality sector in lockdown. It has been the most affected. What is the recovery going to be like for it? We see in some quarters excessive enthusiasm about getting back into demand for hospitality, but the hospitality sector is going to have to cope with keeping customers socially distant from each other and with a reluctance from some demographic groups to get involved in activities even when they become available to the population at large. It is quite hard to judge how rapidly that sector will recover. It will recover; whether it will recover fully depends on lots of uncertainties. How much it recovers is a bit uncertain. We can be pretty certain it is not going to recover fully and that it is going to have longer-term problems to deal with.

Q276 **Sally-Ann Hart:** Mr Phillips, do you have anything to add to that?

David Phillips: No, I think that covered all the points I would have made.

Q277 **Alberto Costa:** Good afternoon, Professor Smith and Mr Phillips. Thank you for appearing before the Committee. I would like to turn to the issue of the impact on employment in Scotland. The employment and income support schemes that have primarily been put in place by the UK Government have been viewed as very successful, certainly in comparison to other western nations, but clearly these arrangements cannot continue indefinitely. The Chancellor has indicated a tapering off of many of these support schemes.

What are the current indications, in your opinion, of expected levels of unemployment in Scotland compared with the rest of the UK? For example, in your view, does the fact that there is a higher proportion of employment in sectors such as public administration in Scotland shield the Scottish economy from the impact of Covid-19?

Professor Smith: As David and I have already said, the public sector is protected to some extent from the impact of Covid. Other sectors like hospitality are particularly exposed and that economic exposure will translate into employment risks, without any doubt. The higher proportion of the labour force in the public sector will help Scottish employment

relative to the rest of the UK. Oil and gas, to take the example we have already talked about, will pull in the other direction.

If I may hang another point on that, as we look forward and also look back at the experience of the last 10 years, there have been problems for Scotland specifically and the UK as a whole, but one of the positives about the performance of the UK economy, including in Scotland, was the buoyancy of employment and the way that employment recovered faster from the global financial crisis of 2008 than most people expected. We ought to take the message from that in looking at recovery from the Covid crisis, different though it is from the global financial crisis. We should be looking very carefully at the post-2008 experience and asking, why did employment in the UK economy do so well during that period and are there lessons from that period that will be relevant for the post-Covid period?

Q278 **Alberto Costa:** Before we move to Mr Phillips, are there any lessons that you might share at this stage? Do you think there is anything that might assist in understanding the lessons to be learned from the 2008 crisis?

Professor Smith: Yes. Having a flexible labour market—by international standards, the UK labour market has been very flexible during this period—is a good thing for the creation of jobs and that has been a positive. Less positive has been the fact that productivity has grown slowly. Translating that into jobs means that high-paying jobs have not grown as fast as lower-paid jobs. One of the big questions for the medium run is that in recovering from the Covid financial crisis, can we get the same recovery of employment as we had over the last decade but with better performance at the higher-paying job end of the spectrum—that is to say, better productivity as well as employment performance?

David Phillips: If I might follow on from what Professor Smith was discussing there, it is important to consider that there can sometimes be trade-offs between different objectives—for example, when it comes to productivity and employment. On the one hand, it certainly reduces productivity if companies that otherwise would have been viable go to the wall due to the coronavirus crisis. With measures like the loan schemes, the furlough scheme, the business rates holidays, you can provide a real support to long-term productivity by keeping businesses that are viable going through the acute phase of the crisis. But there have been some concerns that one of the impacts of the very loose monetary policy during and after the financial crisis is that it allowed a tail of relatively low-productivity firms to remain in operation, effectively, and that the lack of creative destruction that you sometimes see meant that employment held up very well but workers were not being reallocated to more productive parts of the economy.

As we leave the acute phase of this crisis and move into recovery, given the huge amounts of Government support that have been provided to certain parts of the economy, they will be very careful to unwind that in such a way that you do not then tip viable firms over but you do not keep zombie firms going. That is a challenging thing to do.

Q279 **Mhairi Black:** Thank you to both the witnesses for joining us. One of the things that we have noticed—so far at least—is that, for instance, the Scottish Parliament Information Centre says that it reckons the most deprived groups within Scotland are being hit the hardest by Covid. Similarly, the House of Commons has found that workers who are from a BAME background will be more likely to suffer disproportionately. If you take that into account and also the figures that 90% of the top 50% of earners in the country can work from home while 90% of the bottom 50% of earners cannot work from home—so, the practicalities involved and the reality of this pandemic—are they being created right now or are we seeing existing inequalities being exposed?

David Phillips: I am glad you raised the issues of the impact of Covid-19 on inequalities. Colleagues of mine have been doing a lot of work looking at the impact of Covid-19 on inequalities between different groups, between ethnic groups, the health and the economic effects of working in lockdown sectors, between income groups and between age groups, with younger workers much more likely to be working in lockdown sectors. I think new research will be coming out soon that shows that the prevalence of employment in lockdown sectors among young people has been increasing over time. Also, with education and the future generation, younger people from poor backgrounds are getting less support and are more likely to fall behind in their education, so I think there is a big impact on inequalities.

I saw that 90% number quoted in Mr Higgins's report. I have not been able to find that figure elsewhere, so I would not want to comment on it specifically, but colleagues have looked at this issue. They found a very strong gradient between incomes, education and so on and the ability to work from home. There are opportunities from the crisis in inequalities. We know that commuting costs and commuting time can be a big hold-up for women working. When you look at access to jobs, women are less likely to commute long distance and that means opportunities for women can sometimes be lower. If there is more home working, could that help boost women's opportunities? Could it help level up between the cities and more peripheral and rural areas if you can work from home and you do not all have to be in London to get the top jobs?

There are opportunities as well, but I think what we need to do is make sure that those opportunities are there right across the income distribution and the skills distribution so that it is levelling up not just high-skilled, high-income women and people in the countryside who can now work from home, but lower-skilled, low-income people as well.

Professor Smith: I do not think I have anything to add to that. I agree with what David has just said.

Q280 **Mhairi Black:** Following on from that, it seems to me that certainly when it comes to economics, the most radical ideas often come at a time of crisis. If we are talking in the context of learning lessons from 2008, do you think that this pandemic in many ways is an opportunity to change what our

economic priorities and economic policies are? If so, what would your recommendations be? David, you hinted at that. If you can have more people working from home, that could be more inclusive for a lot of communities. Following on from that, are there any other kinds of policy that you think would help?

David Phillips: I will say two relatively narrow ones, but they are important to consider. One thing that has been exposed by this crisis is that the welfare system in the UK is very much about keeping people out of absolute penury, and you can debate whether it does that or not. It is like a bare-bones welfare system. It is means-tested. The levels of support you get are on the breadline level, effectively. One thing that has been exposed is that compared to many other countries, it means that for people who suffer big shocks—they lose their job, they become unwell—there is not the insurance element in our welfare system that you get in many European systems and even the American system, where the unemployment benefit pays a percentage of the wages you had, at least for a period, so that you can have some cushion to deal with the shock. It is considering whether there is a greater role for social insurance in our benefit system. It is not just about social assistance; it is also about social insurance. That is one thing.

Another is that, for a long time, colleagues have been emphasising that we have a system where the tax system treats employees, the self-employed and company owner/managers massively differently. Employees are taxed much higher than the self-employed and company owner/managers. We had issues around the support of the self-employed and company owner/managers during the coronavirus crisis. Are they going to get access to the same sort of support that employees got via the furlough scheme? I think this can be used as an opportunity to try to fix our tax system so that it more fairly treats different kinds of worker, people on employment contracts, zero-hours contracts and so on.

Those are two relatively narrow areas, but look at the benefits system and tax system to see if they are fit for purpose for the changing world of work and the risk of shocks.

Q281 **Mhairi Black:** Professor Smith, would you like to add anything?

Professor Smith: I could pick out one example where the current crisis has highlighted an aspect of inequality that has been particularly distressing to a lot of people over the last 10 years or so, which is the growth of street homelessness. That had to be dealt with. Is it conceivable that over the next few months we are going to toss thousands of formerly street-homeless people back out on to the streets? At the moment, it is not clear how that issue is going to be addressed, but it is hardly conceivable that we can just go back to where we were a year ago. That is a particularly striking example of what I think you are talking about—that a crisis does create opportunities to tackle issues that somehow have been not sufficiently high up the priority list to deal with before.

A completely different issue, but one highlighted by the Higgins report, is that lots of economists have been saying for many years that we need to do more investment. We have been in a low interest rate climate for some time. We are now in a particularly low interest rate climate and the general attitude towards how much investment, especially public investment, we ought to be doing may change as a result of the current crisis.

Q282 **Jon Cruddas:** Good afternoon, everybody. I want to come back to the question of the nature of the recovery that the Chair touched on in some of his opening questions. You both emphasised the similarities with the rest of the UK and continuously referred to the uncertainties in anticipating what recovery is going to happen. Less uncertain was Andy Haldane this week in a quite widely reported analysis of a V-shaped recovery, I think driven from data that he had seen of consumer expenditure. Do you detect similar data from what Andy has seen and can you add more about the possibilities of a V-shaped recovery in Scotland, which the Chair touched on in his initial question?

Professor Smith: I do not have any data to add to what Andy Haldane said, but it is important to be clear about what he was talking about. What he indicated was that demand may be recovering faster than some forecasters had anticipated. That is obviously good news. However, it is important to understand that this is an economic crisis unlike previous economic crises. There is a mix of supply effects and demand effects, so it is different from what we normally see if the financial system collapses and firms are unable to undertake investment that they were planning. The big thing that happened here was, in a sense, a deliberate shutting down of the economy.

As we begin to recover from that, it may well be that demand is going to recover quite fast, but to go back to things that David and I were talking about earlier, if in the meantime the businesses that are going to respond to that demand have been seriously damaged by the shutdown, the economy is not going to recover in the same way. We may see demand recovering very healthily, but unless the economy can respond to that increase in demand, it is not necessarily a bright story. One of the things that Andy Haldane was talking about was his fear that a growth in demand might lead to inflation. It is important not to misinterpret what Haldane was talking about.

Q283 **Jon Cruddas:** That was going to be my second question about the structural problems that would mean that we could not meet some sort of upsurge in consumer spending or demand here. Before that, David, do you want to touch on this? I am trying to push you a bit further in trying to define the nature of the recovery, given the comments of the Deputy Governor.

David Phillips: I should say that my expertise is not in the area of macroeconomics, so I will refer again to the report my colleagues did with Citi. What they said is that they had increased their expectation of the short-term effects. They thought the short-term outlook was rosier than

had been the case when the OBR and the OECD had made their forecasts in the month or two months prior to that. They were forecasting a reduction of 20% in Q2 2020 compared to the 25% or 35% forecast by the OECD and the OBR. I think there is evidence that there has been a stronger rebound in consumer spending during this second quarter. Whether that persists going forward is a great uncertainty. I think it is uncertain what the changes in the structure of the economy mean for reallocation, which will slow down the supply side to provide that.

Q284 **Jon Cruddas:** I will give you a final opportunity, given that you hear this sort of alphabet soup of a W-shaped recovery, an L-shaped recovery and a V-shaped recovery. You are more than welcome to align with any of those letters that are thrown into play. I assume neither of you will want to suggest that it will take the form of a letter. Your lack of response signals that you do not want to suggest it will take the form of a letter.

Going back, I was touched by what you talked about, David. I think you mentioned the creative destruction that this pandemic will allow for in structural effects on the economy. Do you want to say more about the medium or long-term effects and the scarring on the Scottish economy and, therefore, an inability to meet any upsurge in demand?

David Phillips: The issue about business destruction is one that offers very significant risks of scarring, as you mention. The extent to which we see viable businesses go under during this crisis—especially given that there will be some geographical concentration of these businesses in areas, for example, particularly reliant on hospitality and tourism and so on—is a risk we need to guard against. That is why having schemes of support through the crisis is very important.

The point I was making about creative destruction is that there will come a stage where maybe some of the changes in behaviours and economic activity have taken place—for example, the shift to home working, people maybe eating out a little less but spending more on their homes and their gardens and other things—but if we are still propping up businesses in the hospitality sector to the full extent, we will be slowing the reallocation of capital and workers to meet the opportunities.

I do not think it is just allowing the destruction to happen, because a lot of that would be viable businesses that would go under and then would slow down recovery, but I think it is not a failure of policy if there are some job losses and some businesses going under, especially further down the line, because they could be indicating that the economy is responding to the changed environment. Support in the acute phase, but make sure that support then does not change the reallocation and the changes in the economy in the medium to longer term.

Q285 **Jon Cruddas:** Professor Smith, do you want to say anything more about the medium and long-term effects?

Professor Smith: No, I do not think I have anything further to add.

Jon Cruddas: Chair, I will leave it there. Thank you very much.

Professor Smith: I am sorry not to be able to offer you an alphabet letter.

Q286 **Chair:** If things have been said, it is all right not to say them again, so thank you for that.

One little point, and it is something from the remarks of Mr Phillips: we are discussing Scotland as some sort of homogenous nation where everything happens the same, but obviously there are going to be regional impacts right across Scotland. I represent an area with lots of hospitality and tourism in Perthshire. We are one of the biggest-impacted areas in the whole of Scotland when it comes to a proposed GDP fall. Is this something that we are likely to see more of, that areas like mine with a higher dependency on hospitality and tourism will be more impacted than other parts of Scotland with a different emphasis on the local economies?

David Phillips: It is definitely the case that different areas have experienced the impacts differently so far and will continue to experience them differently. Colleagues of mine have done work—again, this is England only, I am afraid, but similar work could be done for Scotland and it may be worth doing—to look at the vulnerability of different local authority areas to different dimensions of the Covid-19 crisis: issues related to health, family vulnerabilities and economic vulnerabilities. They have seen quite different patterns in different parts of the country. Some of these patterns do not align well with our traditional concepts of needy and less needy areas.

On the economic front, it is often some of the less deprived areas, which are often more rural or suburban, that rely more on hospitality industries. With the health impact, it is often more rural areas where the population is older. The impacts on children's education, family wellbeing, housing situations are more concentrated in deprived areas. I think there will be different impacts that will need different targeted approaches in different kinds of area. There is a very strong role for local government in this response, as well as the UK and Scottish Governments.

Chair: I was just interested to see if there had been any work done on that. Maybe you could share from your studies in England. That would be very interesting to this Committee.

Q287 **John Lamont:** Good afternoon, Professor Smith and Mr Phillips. My question is similar to the last couple but from a slightly different perspective. I would like to know whether you think the rate of recovery for the Scottish economy will be impacted by the slightly different lockdown restrictions that we have had in Scotland compared to the rest of the United Kingdom.

I will give a couple of examples. In my constituency in the Borders, I had tradesmen—plumbers, electricians and similar—who might work on either side of the border and were unable to do work on the south side of the border in England. They lost that work to competitors because of the restrictions that they felt had been imposed on their businesses in

Scotland. Similarly, larger-scale businesses and factories that were producing things were losing contracts to competitors south of the border, again because of the variation in the restrictions that they felt they were working under in Scotland compared to the rest of the United Kingdom.

Do you think that these variations are going to have a lasting legacy on the Scottish economy's ability to recover from this pandemic?

Professor Smith: I will have a go first on that. Obviously, there are some differences in the relaxation policies between Scotland and England and it is perhaps not surprising that they have had some particular effects on businesses in the Borders. Nevertheless, they are relatively modest differences seen against the scale of the issues that we are looking at here. I think those are relatively small issues compared with the risks associated with Governments on both sides of the border getting the lockdown decisions wrong. If there is a second wave of the pandemic, the impact on the economy across the whole of the UK is a way bigger issue than the economic effects of differences between Scotland and England in the current lockdown policies.

Q288 **John Lamont:** Just to pursue that before I go to Mr Phillips, I accept that in the UK-wide national or the Scotland-wide context it may be relatively minor, but in my constituency in the Borders it could be much more significant for the local economy.

Professor Smith: Yes, I understand that; I am not at all putting it down. It is obviously an issue for the businesses involved, but compared with the risks that businesses face if Governments get this very delicate balance of the relaxation of lockdown wrong—if we get that wrong—that is a much bigger risk to the economy than small differences between Scotland and England in their regional policies.

David Phillips: I concur with much of what Professor Smith said. I am not an epidemiologist and I am not a macroeconomist, so I would not want to say how these trade-offs exactly play out, but what you can see is that there have been different Governments making different trade-offs between the imperative to support and boost the economy and the imperative to get Covid-19 under control. Time will tell to what extent different strategies have worked more effectively there. It is clear, if you look at some of the timelines, that Scotland did relax more slowly and had more stringent rules in place for much of the lockdown but subsequently has been able to relax quite rapidly in succession, so the process of delay has come quickly in Scotland. While there are trade-offs there, I think it is hard to say at this stage what the overall impacts will be looking forward. I think it will depend on control of the virus going forward.

Q289 **John Lamont:** Lastly, I want to touch on some of the media coverage that there has been this week on the possibility of border closures within the UK and additional quarantine. I received an e-mail this morning from a bed and breakfast operator in my constituency. I am going to share a couple of paragraphs with you: "We own a bed and breakfast and we are ready to

go with reopening on 15 July with all the necessary protocols in place. We had hoped to see bookings start to come in for this date and beyond. Unfortunately, this is not the case. In fact, we are now seeing further cancellations from guests in England worried about border closures and quarantines. At the moment, it appears that there is more chance of UK residents travelling to Europe for a break than there is visiting Scotland. Are tourists welcome in Scotland? There needs to be clarity from the Scottish Government as well as unity with the UK Government." Do you agree there could be an economic impact if there was any serious suggestion of restricting the movement on either side of the Scotland-England border? Professor Smith?

Professor Smith: That question risks taking us far outside the remit of the Scottish Fiscal Commission. The issues that you have raised are issues for the Scottish Government, not for the Fiscal Commission. I will just confine myself to saying that, yes, restrictions on cross-border movement can have negative economic effects.

Q290 **John Lamont:** That is absolutely fine. Mr Phillips?

David Phillips: I would echo that you expect there to be negative effects. The direct effects on the economy of restricting movements across borders would be negative. That would need to be traded off against issues on the public health side. I hope that before these decisions are made there is an assessment of what the rate of transmission is in the different countries and communities and how movement might affect that, so that any decision is made on the balance of evidence from both the economic side and the public health side.

Q291 **Deidre Brock:** Good afternoon, gentlemen. Thank you for coming along. I wanted to ask about a couple of the recommendations within the report of the Scottish Government Advisory Group on Economic Recovery, which was published a few days ago. With regard to the green economic recovery suggestions in it, I have attended numerous environmental group meetings over the last few weeks on Zoom and many of the environmental groups that are taking part are very keen to see a green economic recovery progressed. The Scottish Government have made a commitment to that effect. Certainly there were those recommendations within the advisory group's report.

What possibilities do you see for green new deal proposals in the Scottish Government's plans? I am talking about things along the lines of the circular economy, which is mentioned in the report; things that can help to tackle global warming, biodiversity issues and nature-based solutions; and the sort of high-skilled green jobs that might come along with that approach. Could I get your views on that, please?

David Phillips: I will have a go first on that one. Again, I should say this is not a core area of my expertise, but I think many of the powers that relate to this area are devolved to the Scottish Government so they would have scope to act here. One of the things that will affect the extent to which the Scottish Government can lead this agenda via additional funding

for green investments depends on the fiscal arrangements, so the additional funding the UK Government provides. Under the Barnett formula, that is what the UK Government spends on investments and public spending in England and also the arrangements that are put in place for the borrowing powers for the Scottish Government over the next period. There are negotiations on the fiscal framework beginning fairly soon.

Professor Smith: I said right at the beginning that the Scottish Fiscal Commission does not get involved in policy analysis. I have been reasonably relaxed with most of the discussion in talking about issues that I think are relevant to the economy as a whole, even when they touch on specific policy areas, but I think getting involved in how much weight to give to green policies in the recovery would take me too far in the direction of policy analysis.

Q292 **Deidre Brock:** All right, thanks very much. On the fiscal arrangements that you just referenced, Mr Phillips, our Cabinet Secretary for Finance, Kate Forbes, said when she announced the Scottish Government proposals for addressing the effect of Covid on the economy recently with the £80 billion proposals that were made by them, "If the UK Government is not prepared to respond then Scotland must have the additional financial powers required to secure a sustainable economic recovery. Without those powers we will be at a severe disadvantage to other nations. It would be like trying to chart our way to recovery with one hand tied behind our back." What are the economic levers the Scottish Government currently lack that would help them to recover more quickly from this crisis more effectively?

David Phillips: I did a short report looking at the acute phase of the crisis. One of the issues we raised there is that during the short-term phase of the crisis, the Scottish Government had very limited powers to borrow for day-to-day spending and that meant that they were reliant on the funding coming via the Barnett formula in order to enact measures within Scotland to respond in the acute phase. There definitely has been a case to relax the rules around borrowing in the short term to give the Scottish Government more flexibility to respond more rapidly and potentially to deal with any greater impact that the Covid-19 crisis is having on Scotland. The Barnett formula is based on population shares and there is no guarantee that the impacts across the country will be based on population shares. I think in the short term there is a clear case to consider granting additional borrowing powers for the acute phase of the crisis.

What we also said in that note is that it is important not to rush decisions on long-term performance of funding systems in the midst of a crisis, but you can use the crisis as a prompt to consider whether the longer-term policies are fit for purpose. As it stands, the fiscal framework allows the Scottish Government to borrow a small amount. It effectively says that the overall fiscal stance—the gap between tax and spending—is a UK Government decision. The Scottish Government have a bit of power to

smooth things and can borrow a little, but it is the UK Government who set the fiscal stance.

In other kinds of context where you have subnational Governments that have substantial tax-raising and spending powers, there are some that have that same set-up, where effectively the devolved Governments have to run balanced budgets, whether that is due to national rules or self-imposed rules. In some other cases, the devolved Governments can borrow. I think you can see potential benefits and costs of allowing that flexibility to do more borrowing. On the one hand, given the Scottish Government have greater flexibility to borrow, it could allow them to borrow more money to invest in the short term and lead to a stronger economic recovery and it could allow them to invest more in priority areas, which could include green investments.

On the other hand, I think that one of the reasons that some countries have rules that prevent borrowing by subnational Governments is the risk that, potentially, the national Government would have to step in and bail out the subnational Government if they got into trouble. Whether that is an issue that is considered likely in the UK context is partly political. Ultimately, the decision whether to extend borrowing powers or not will come down to politics rather than economics. If I am being very frank, I think the thing that is preventing or discouraging the UK Government from granting significant additional borrowing powers to Scotland is more concerned with politically how they would be used in the context of constitutional debates, rather than necessarily looking at if we increased the borrowing powers from £3 billion to £10 billion or £15 billion, would that have a sizeable effect on fiscal stability of the UK or a need for bailing out the Scottish Government.

Q293 **Deidre Brock:** Are you suggesting that political considerations are outweighing whether or not the Scottish Government would use that flexibility effectively to help protect its economy?

David Phillips: I think that political considerations are very important in many aspects of negotiations on the fiscal framework, including the discussions about borrowing powers, yes.

Professor Smith: I broadly agree with what David Phillips just said about the importance of the distinction between the short-run strains that we see on the fiscal framework and possible long-run changes. From the perspective of the Fiscal Commission, there are a couple of things of which we are particularly conscious. One is that the arrangements that construct the Scottish Government budget each year depend crucially on our forecasts of, particularly, Scottish income tax revenue and the OBR forecasts of UK expenditure and revenue that go into what are called the block grant adjustments. The Scottish budget depends on forecasts.

We were talking earlier in this session about how difficult forecasting is in the current environment. Even in the past couple of years we have seen some variations in income tax forecasts, which in forecasting terms are

relatively modest but give rise to required budget adjustments in the next financial year in the order of £500 million for past forecasting errors. In a situation where there is much higher uncertainty, you have to worry more about the fact that there may be more post-forecast adjustments needed.

In an environment where Governments are mounting major new policy initiatives—which in this case, for very good reasons, are funded by UK Government borrowing—there is the issue that David has been talking about of a funding system that for UK Government expenditure, for non-devolved expenditure, relies on either expenditure undertaken in Scotland by the UK Government or on Barnett consequentials coming through to the Scottish Government budget. In the current environment, where the Scottish Government is, as David explained, constrained to an essentially balanced budget but has hugely increased pressures on its budget, it is easy to see that there could be a very strong case for more flexibility in giving the Government more short-term borrowing leeway. While we understand the discussions between the Scottish Government and Treasury have led to a bit of flexibility, it is understandable why the Scottish Government might want more flexibility written into the rules.

Q294 **Deidre Brock:** There are suggestions—I think the Scottish Government suggested it—that one of the things we might propose would be a drop in VAT for the tourism and hospitality sectors. Is that something that you would see? It is clearly something that the Scottish Government think would be useful in addressing some of the problems of those sectors. As far as I am aware, the UK Government are not budging on that one. We do not have the ability to vary national insurance, for example, or the sorts of lever that independent countries have. I would be very keen to hear your views on VAT, certainly.

Professor Smith: I would simply say, yes, the current constitutional arrangement is that Scotland is not an independent country—it has some devolved powers and some devolved fiscal responsibilities, and that is different from being an independent country—but you are not going to get me to say anything about whether one system is better than another.

Chair: We had best leave it at that.

Q295 **Liz Twist:** A lot of what I was going to ask about the fiscal framework has been the subject of the discussion. I was going to ask about the limits on the amounts that Scotland can put into reserves and borrow, and the research by the IFS, which you have mentioned, David, about the limits not being designed to cope with situations like Covid-19, an unexpected surge of need. I was going to start by asking you, Professor Smith, what your view was of that and the IFS suggestion for greater access to borrowing via the National Loans Fund. Is there anything that you want to add to what you have already said?

Professor Smith: Just to emphasise what I have already said—that while the Fiscal Commission has a central role in administering the fiscal framework, we stand well back from discussions about the politics of the framework

and possible long-term changes because those are essentially for politicians. But for the reasons that I was talking about a few minutes ago, we recognise that in the current situation the fiscal framework is perhaps too inflexible in relation to the scale of problems faced by the Scottish Government, and indeed the UK Government, and there is a case for more borrowing flexibility to deal with the current situation.

Q296 **Liz Twist:** David Phillips, can I ask you to comment, if there is anything more you want to say? There is a range of views on this, from different commentators, as to whether it is a good idea, isn't there?

David Phillips: Yes. My view, and it remains my view, is that there are strengths and weaknesses with the current fiscal framework for Scotland in providing insurance and tools to the Scottish Government. On the one hand, the operation of the block grant adjustments—the fact that many of the most expensive schemes are operated at the UK level and funded by UK borrowing, such as the impacts, the costs of the furlough scheme and so on—provides significant insurance for Scotland. On the other, there are elements of the fiscal framework that look less well suited for purpose.

One is, potentially, the limits and the rules around borrowing, which we just talked about, which are quite stringent on defining when you can and when you cannot borrow, and you cannot borrow at all to fund new policy measures. That means, potentially, sometimes delays in the implementation and design of policies in Scotland. Secondly, the Barnett formula is not always the appropriate tool—is never the appropriate tool, I should say—with which to allocate funding. You would struggle to find an academic researcher who would stand up for the Barnett formula. In a time like this, when population may not be a good guide to the impact of the coronavirus crisis in different areas, I think it is worthwhile considering whether there are times when the Barnett formula could be amended.

Looking to the longer term and the questions that were raised there, I would not rush into making major changes immediately off the back of the impacts of Covid-19, but it does allow us to think—give us a chance to think—about these issues in the longer term. There are three. One is the scale of borrowing powers and how those borrowing powers can be used. The second is the Barnett formula. The third—this is quite unusual internationally—is the way the fiscal framework works. It effectively says that at the point at which it was set up, in 2016, Scotland was fully protected from any risks of its tax revenues being higher or lower at that point. But from then on, if that varies either more quickly or less quickly, for the devolved taxes, Scotland bears all the risk or gains it all. You have full insurance at the start, but no insurance and no risk sharing going forward. That is quite a strange situation. You tend not to find that if you look at other countries.

Then there is the question of while Scotland is in the UK, does that slightly strange set-up make sense, especially if you thought it was the case that coronavirus was having differential long-term impacts on the economy of Scotland versus the rest of the UK? Is there a greater role for risk sharing

between the different parts of the UK via the fiscal framework? I think that is something that is worth considering.

Q297 **Liz Twist:** What about access to borrowing via the National Loans Fund specifically? Is that the appropriate vehicle?

David Phillips: Yes. The Scottish Government have the power to borrow via the National Loans Fund, but they also have the power to borrow via other means. The National Loans Fund would be generally the most cost-effective and easiest way.

Q298 **Douglas Ross:** Good afternoon to our witnesses. There has been a lot of discussion about the Higgins report. Mr Higgins has refused to appear in front of this Committee. Do you agree with some of the criticism of his report, which is that it looks more at the powers that Scotland does not have rather than looking to make changes with powers Scotland does have?

David Phillips: I must make an admission that I have not read this report in full.

Q299 **Douglas Ross:** You have quoted from it already today in response to Ms Black.

David Phillips: Yes, I have read small parts of the report, I can admit that, but I have not read the report in full, so I would not want to give an overall assessment of the report.

In response to your question, some areas have been mentioned that Scotland does have powers over. For example, it discusses in the tax section about potential changes to business rates that the Scottish Government have those powers. It also discusses changes to VAT, which the Scottish Government do not have powers over.

There are two points on those particular suggestions. One is I think that the report emphasises there needs to be good intergovernmental communications between the two Governments so that support is co-ordinated between different measures and measures under the control of the UK Government and those under the control of the Scottish Government align well. I think that is very important whether it is VAT and business rates or whether it is the furlough scheme and aspects of the opening up of lockdown.

The second thing I would raise specifically on those areas, and those are the only areas that I have had a chance to look at in detail—

Q300 **Douglas Ross:** I do not want to draw you any further, then. It is difficult to ask you to comment on a report you have not fully read. I think that is why there will be some concern that we do not have Mr Higgins in front of us today.

You both mentioned the furlough scheme and others. How would you describe the UK Government's support going into Scotland during this

crisis? I do not mean an explanation of what they have done. Other witnesses have called it significant, one of the best in the world, most comprehensive in the world. How would you describe how the UK Government have financially supported Scotland during this crisis?

Professor Smith: Again, straying gently into making judgments about policy, the Fiscal Commission would join with the OBR in making the judgment that the broad shape of the UK response to the Covid crisis was an appropriate shape and the furlough scheme was a bold and apparently well-designed intervention. No doubt when we look back at this, we will be able to find things that could have been done better, but, broadly speaking, the UK Government's response to the crisis was big, therefore good, and pretty well designed.

On the issue of does it respond enough to the needs of particular parts of the economy and does it respond to Scottish needs as well as it does to English needs, I would say we are not in a position where you would make a judgment about that. The problem was a UK-wide problem; the furlough scheme has operated, apparently, as effectively in Scotland as it has in the rest of the UK. We have been asked at this session quite a bit to identify areas where Scottish need might be different and we have, between the two of us, identified possibly relevant differences between Scotland and the rest of the UK, but probably the big difference would come if the Scottish Government wanted to do something very different from what was being funded through the UK schemes, and the consequential effects on the UK. I did not find any conclusive evidence in the Higgins report to point to things where there was a desperate need for Scotland to do something different from what the UK is doing.

I know your question was about the furlough scheme, but if I can pick a different example, the Higgins report put a lot of emphasis on the desire to have a high level of long-term public investment in response to low interest rates. Most economists would think that is a good thing. If the UK were not doing it and the Scottish Government wanted to do it, for the sorts of reason that David was talking about, that would raise questions about whether the fiscal framework was an appropriate framework. That is still quite a big "if" because we are waiting to see the extent to which the UK Government's ambitious words about public investment are translated into action. If they are, the Scottish Government might feel that the UK Government are going down the right line and we are happy to be part of that process. If not, more fundamental questions about the fiscal framework would be on the agenda.

Q301 **Douglas Ross:** Time is marching on. I have a couple of final questions, Mr Phillips, both to you. You mentioned in your opening remarks about how changes—slight differences—could have an impact on how Scotland responds compared to other parts of the United Kingdom. You mentioned construction, for example, as in more industries in Scotland shut down than elsewhere in the UK. Have you seen any evidence on a public health basis for that decision by the Scottish Government or did they just decide to take

that decision? Is it backed up by evidence?

David Phillips: That is not my area of expertise, so I do not know what evidence underlined the decision. I was just commenting that that was one of the differences.

Q302 **Douglas Ross:** Finally, you wrote, a couple of years ago, that the weak public finance position in Scotland implies that if we were ever to have Scotland separated from the rest of the United Kingdom in an independence referendum, there would be greater austerity in Scotland. How does that analysis you did pre-Covid now look during Covid?

David Phillips: The analysis pre-Covid was based on the fact that revenues per person in Scotland, even including oil revenues, are about the same as for the UK as a whole, but spending per person is substantially higher in Scotland because of the high levels of funding that Scotland gets through the block grant funding by the Barnett formula. That means a higher budget deficit in Scotland that an independent Scotland would have to bear itself, rather than it being subsumed within the UK Government deficit. Unless we see a substantial change in the relative economic performance of Scotland versus the rest of the UK—that Scotland comes out of the crisis relatively quite a bit stronger than the rest of the UK—I would not expect that to have changed.

The point we were making in that report is that, as an independent country, Scotland would have to bear the costs of higher public spending itself, rather than that being shared out across the whole of the United Kingdom. It would still have to do that post Covid. Things would only change if post Covid either spending or revenue patterns were substantially different from what they were before. That could be the case, but I see no evidence at the moment that that is likely to be the case.

Q303 **Douglas Ross:** It could be even worse than what you were envisaging in 2018?

David Phillips: Certainly, the overall fiscal environment of the UK is worse now than it was back then. In the report that colleagues did with Citi, they thought UK Government would have to borrow around twice as much as they were expecting back in the March Budget as a result of the Covid impact. If deficits in the UK pushed up, that would also push up the Scottish deficit, the implicit one within the UK and as an independent country. It is less clear whether that gap has grown or not. With the uncertainty about whether Scotland would be hit a bit harder or a bit less hard in the long term compared with the rest of the UK, it could be a bit higher or a bit lower than it was, but my expectation is that that gap would still be there.

Q304 **Wendy Chamberlain:** I am going to continue along the fiscal framework line and hopefully you will be able to speak to my questions. The fiscal framework agreement came into place in 2016 when the devolving of tax and welfare powers took place. Benny Higgins's report has stated that the current fiscal framework is not designed for times of emergency and arguably that is where we are. It is due for review in 2021.

My first question is, do you agree that that potentially should be accelerated, which is what the advisory group has said? You both indicated that potentially there may be scope for temporary changes to the framework's borrowing limits. Would you like to expand on what those could and might look like? My final question is even if the Scottish Government could borrow more, should they, given that it is very likely that the UK Government would be able to have more favourable rates and terms of borrowing? Can I take that to Professor Smith first, please?

Professor Smith: On the latter point, I would not expect that the Scottish Government borrowing in their own name with the UK Government sitting behind it, because Scotland is still part of the UK, would pay significantly higher interest rates than the UK Government, but I might just be wrong about that.

Going back to the issue of the framework, I think David Phillips and I have both been agreeing that there needs to be more short-run flexibility in the current unusual circumstances. As you said, there is due to be a review of the fiscal framework in 2021. I am not convinced by the Benny Higgins suggestion that that be brought forward. The two Governments have enough on their plates at the moment, dealing with immediate problems. In ways that I hope emerged in this discussion, there is a lot of uncertainty about how things are going to turn out. Things are going to crop up over the next year that none of us has thought about and predicted, and the time to think about a change in the long-term relationship is not when people are firefighting short-term problems. I think that it is more sensible—perhaps I am speaking for myself here, because it is not an issue that the commission has discussed—in the current environment to deal with the short-run issues, understand as best we can what issues they raise, and leave the design of long-run changes on their current timetable.

Q305 **Wendy Chamberlain:** Mr Phillips?

David Phillips: I think there are two changes that could be made to the fiscal rules without having to change the limits at all. The first is changing the rules around when borrowing can take place. There is a rule in there that says that the Scottish Government can borrow up to £600 million, but only £300 million unless there is a Scotland-specific shock, and it then defines that in a quite specific way. Scrapping the rules around Scotland-specific shock, allowing access to the full £600 million more generally, would be a quite straightforward change to make and would not require a change to the actual numerical limit. Also, allowing access to borrowing for policy measures—basically, to change the fiscal stance modestly—to borrow to spend a bit more or to offer some additional business rates relief, for example, could be done while keeping those limits in place.

What we have said previously is that having fixed limits—limits that are fixed in cash terms—does not make sense and, at the very least, the limits should be indexed to the amount of revenues and spending that is at stake. Just inflation, let alone the economic growth that we have seen between 2016 and 2020—at the start of 2020 at least—means that those limits

which were agreed in 2016 have already been eroded in real terms. Increasing those limits in line with the amounts of revenue that were at risk would also make sense.

On the timetable for the fiscal framework review, I very much agree with what Professor Smith just said. I think the negotiations around the framework will be pretty political. With where we are in the Covid-19 crisis, we need to be encouraging co-operation and collaboration between the two Governments to ensure that policies are well aligned across UK Government policy and Scottish Government policy. Accelerating debate and decision-making on this politically contentious issue might make that more difficult.

Q306 **Wendy Chamberlain:** Douglas Ross was referring to the investment or the stimulus package that UK Government have had in Scotland. I suppose potentially one of the advantages of the current arrangements, beyond the fiscal framework, is that furlough payments, business support, universal credit and self-employed support have come to people in Scotland without going across the Scottish Finance Minister's desk. That means, for example, that payments have not been subject to Barnett consequentials, but have been based on the needs and applications for the schemes. The latest figures, last month, suggested that over 775,000 people had benefited from either the furlough or the self-employed schemes, but do we think we have any real clarity on the actual money that that equates to? I am not convinced that we do. Is there an opportunity better to bring figures of that kind to politicians like ourselves, but also to the public?

Professor Smith: Yes, I suppose necessarily when we have a UK-funded and UK Government-organised scheme like the furlough scheme, we are relying on the Government who manage it to make sure that they respond flexibly to the needs of different parts of the country, and that has advantages as well as disadvantages. The speed of action by the UK Government in running their own programme might be faster than if it were devolved. On the other hand, a devolved Government can perhaps respond more sensitively to what they see as their own understanding of the needs in their own area.

As far as numbers are concerned, here, as with many other things, there are lots of things that we do not currently have adequate numbers on. It will be useful when the dust has settled a bit on what has happened this year to go back and look at important issues like that, such as, what did we learn from how well the furlough scheme worked and what kinds of programme can we run effectively from London and what kinds of programme are much better run by a devolved Government?

Q307 **Wendy Chamberlain:** Briefly to Mr Phillips?

David Phillips: All I would add is that I think there are some weaknesses of the current fiscal framework—the issues around borrowing—but there also are some strengths. It is a strength that some of the most costly schemes, where impacts could differ around the country, are funded on a

needs basis because the UK Government pay on a needs basis, but also are paid for by the UK Government and, therefore, the borrowing is the UK Government's responsibility and they have greater access to loans and borrowing than the devolved Government would have. The way the fiscal framework works, protecting Scotland from the aftershock effects on the whole of the UK, is a strength. Those are strengths of the current fiscal system. Those strengths could be extended. That is why I said that given that things like the coronavirus furlough scheme are funded on a needs basis, the Barnett formula, which is funded not on a needs basis, is sitting increasingly incongruously at the heart of our fiscal system.

One thing we have seen during the coronavirus crisis is that statistics are not always available in as timely a way as you would ideally like and certainly not made available in an easy-to-access sort of way. That is particularly the case with the issues around the fiscal framework and Government funding. We have not had updates—a full update, the sort of spreadsheet that Treasury puts together on funding—for Barnett consequentials for quite a while now. That sort of transparency around the funding arrangements for the devolved nations is really important, given the sort of politically contentious nature of some of the debates around funding and the fiscal framework, and harks back to the wider constitutional debates. You need to have the figures there in an easily accessible way for parliamentarians, but also for people like myself and civil society to assess and appraise

Q308 **Chair:** I have a couple of quick questions. I am not looking for long answers because we are right at the very end of the session. Just observing the Prime Minister's £5 billion spending, this Rooseveltian plan around the build-build-build agenda, when we observe that in relation to the Barnett formula, what are your views about the efficacy of Barnett formula with spending plans? The Scottish and Welsh Governments are saying that not a single penny is going to be coming to the devolved Administrations. Is that your view? Is this the best way to do it?

Professor Smith: The main question that people have raised about the Prime Minister's announcements earlier this week was to what extent they were about new money rather than being reannouncements of bits and pieces of things that had already been announced. Obviously, if there is no real money behind the announcements, there is no real money to go into consequentials. The big question will come when we see the true shape of the UK Government's full infrastructure investment plans. Then we will be in a much better position to comment.

Q309 **Chair:** Mr Phillips, is population funding still the best way to allocate funding packages across the United Kingdom?

David Phillips: No. The Barnett formula is an ill-designed and ill-suited way to fund devolved Governments. The funding that Scotland, Wales and Northern Ireland get is increasingly arbitrary and bears little relation to their needs. One of the things that has halted the reform of the Barnett formula is the perception that if Scotland were to have its needs assessed,

it would potentially get less funding than it does under the current set-up. That has been a big blockage.

Very quickly on your point about the £5 billion and what does it mean for devolved Governments, echoing what Professor Smith said, the way the Barnett formula works is it only applies the consequentials to new money. If this is just simply the rebranding of existing money, it makes sense that it would not lead to additional funding for Scotland.

Q310 **Chair:** You were very helpful to us, Mr Phillips, when this Committee looked at the fiscal framework, which I think had a great deal of influence on the final outcome and we were grateful for your input.

Do you both think—I am looking for a quick response again—that we need to revisit the fiscal framework as a priority? Have you observed deficiencies around the framework throughout the Covid crisis and emergency that would need to be addressed with some urgency in the next few months to maybe the next year?

Professor Smith: The quick answer is yes. We have both talked about deficiencies that the current crisis has exposed and the framework being over-constrained in the extent to which the Scottish Government get borrowing powers in the fiscal framework. Are there other issues that should be addressed? Well, yes, and the fiscal framework will be reassessed in 2021. Do they urgently need to be assessed? Should we bring forward that 2021 assessment? I have already said I do not see a case for bringing the fundamental review of the fiscal framework forward.

David Phillips: I agree that it should not necessarily be brought forward. I think the review of the fiscal framework is an important issue for Scotland. Considering the flexibilities around the current borrowing powers, and at least ensuring that the borrowing powers are indexed in line with the growth of the tax basis, is a minimum.

In the first framework negotiations, the Scottish Government expended all their political capital on issues of the block grant adjustment and the decision to use a certain method—the index per capita method—was seen as a great victory for the Scottish Government in that. There is a trade-off between how well the Scottish Government do in the block grant versus the borrowing powers. Looking at a wider assessment of the fiscal framework, rather than just rehashing the issues that were discussed last time round, could be important in a future inquiry or in future work in this area.

Chair: We are very grateful to both of you for coming to the Committee this afternoon and helping us. I think there are couple of little things that we would like from you, following this, and I am sure the Clerks will get in touch with you. If there is anything else, of course, that you observe about this inquiry, please get in touch. We are quite happy to take any further representations. For today, thank you ever so much for your attendance.