

Y Pwyllgor Cyllid

Lleoliad:
Ystafell Bwyllgora 3 – Senedd

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Cynulliad
Cenedlaethol
Cymru

National
Assembly for
Wales



I gael rhagor o wybodaeth, cysylltwch â:

Bethan Davies

Clerc y Pwyllgor

0300 200 6565

SeneddCyllid@Cynulliad.Cymru

Agenda – Dogfennau Ategol

Ariannu yn y Dyfodol: Ymatebion i'r Ymgynhoriad

Noder bod y dogfennau a ganlyn yn ychwanegol i'r dogfennau a gyhoeddwyd yn y prif becyn Agenda ac Adroddiadau ar gyfer y cyfarfod hwn

Ariannu yn y Dyfodol: Ymatebion i'r Ymgynhoriad (Tudalennau 1 – 276)

Y Pwyllgor Cyllid

Ariannu yn y Dyfodol

**Ymatebion i'r Ymgynghoriad
Mehfin 2015**

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Finance Committee

Future Funding

**Consultation Responses
June 2015**

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*Ar gael yn Gymraeg | *Available in Welsh

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FIN(4) FF01
Ymateb gan Ffederasiwn Busnesau Bach
Response From The Federation of Small Businesses

National Assembly for Wales Finance Committee Consultation into Future Funding FSB Wales

FSB Wales welcomes the opportunity to present its views to the National Assembly for Wales Finance Committee consultation into Future Funding. FSB Wales is the authoritative voice of businesses in Wales. With 10,000 members, a Welsh Policy Unit, two regional committees and twelve branch committees; FSB Wales is in constant contact with business at a grassroots level. It undertakes regular online surveys of its members as well as a biennial membership survey on a wide range of issues and concerns facing small business.

The overwhelming majority of businesses in Wales are micro or small businesses, which account for 98% of all businesses in Wales and provide a significant proportion of employment¹. Accounting for such an important element of the Welsh economy, small businesses have a major stake in the future funding of, and the devolution of fiscal powers to, Wales. FSB Wales believes these issues are important as they offer the key mechanisms and levers to support the development of stronger and more resilient economies across Wales.

Future Funding for Wales

FSB Wales broadly welcomes moves to strengthen the accountability and empowerment of the Welsh Government and the National Assembly for Wales through the provision of measures designed to increase fiscal autonomy. We welcomed the publication of the Holtham and Silk Reports as they provided positive and constructive proposals to increase the economic levers and financial resources available to Wales. We were pleased to provide our own detailed evidence to the Commission on Devolution². Our responses to the Commission, and those presented here, are based on extensive consultation with our members across Wales.

For our members the growth and development of the Welsh economy is critical to the future prosperity of Wales, and it is important to realise that the devolution of powers and the allocation of resources to Wales is important as a means to achieve this end. Therefore, the ultimate test for any decisions concerning future funding and devolution of powers is whether they are likely to assist in the development of Wales' economy, and in particular strengthening the resilience of local economies across Wales. A stronger and more distributed economy, based on supporting the development of small businesses across Wales, is of paramount importance as it is the means to achieve stronger and more sustainable communities across Wales.

Previous work undertaken by the FSB with CLES (the Centre for Local Economic Strategies) showed that small local firms re-spend 63p locally out of every £1, whereas larger firms tend to spend 40p out of every £1. The FSB-CLES research found that across the UK small local firms generate 58%

¹ Welsh Government (2011). *Size Analysis of Welsh Businesses*.

² FSB Wales (2012). Response to the Commission on Devolution in Wales

<http://www.fsb.org.uk/policy/rpu/wales/images/final%20fsb%20wales%20silk%20commission%20part%202.pdf>

FSB Wales(2013). Commission on Devolution in Wales: Part 2

<http://www.fsb.org.uk/policy/rpu/wales/images/submission%20to%20part%201%20of%20commission%20on%20devolution%20final.pdf>



more economic benefit for local economies over two rounds of re-spend than large firms did.³ Therefore, supporting the development of small businesses, and by extension the strength of Wales' local economies, presents an important opportunity to derive sustainable funding for Welsh Government via increased tax returns resulting from increased economic activity.

Reserved Powers

FSB Wales supports the introduction of a further Government of Wales Act to provide a lasting settlement for Wales' governance, and we believe that this should include a move to an expression of powers on the reserved model. This would provide an important opportunity to end the ambiguity over competency that has resulted in regular disagreements between the UK and Welsh Governments that have resulted from the Welsh model of executive devolution. The devolution of business rates has been one such area of ambiguity and this adds damaging uncertainty for Welsh businesses and the Welsh economy more generally. This lack of clarity and the existence of disagreement has led to potentially poorer outcomes for Welsh businesses, particularly where this has been subject to legal challenge, which is also costly and time consuming. For these reasons we welcomed the announcements in the recent Queen's Speech.

We also believe that powers over transport should be rationalised to provide greater clarity over what the Welsh Government is able to do, and this should include the transfer of transport powers to Wales to ensure a strategic approach can be taken towards transport planning in Wales. We note the recent Queen's Speech contained proposals to transfer bus regulation to Wales, but are concerned that further powers over rail are not proposed. We believe this is a missed opportunity as transport is a significant economic lever and it should be available to Wales.

Devolved Taxation

As the voice of small businesses in Wales, FSB Wales is mainly concerned with business taxation. We welcomed the recent decision to devolve Landfill Tax and Stamp Duty Land Tax to Wales, and the Welsh Government's proposals concerning the creation of a Welsh Revenue Authority. We have previously provided evidence on these taxes and the proposed Welsh Revenue Authority to the National Assembly for Wales Finance Committee's inquiry into the collection of devolved taxes⁴.

On the devolution of further taxation powers to Wales, FSB Wales has a measured view in relation to the devolution of corporation tax and would call for the inclusion of appropriate checks and balances to ensure that any measure could only be used to increase the competitiveness of small businesses in Wales. We are also concerned that any increase in corporation tax above that set in England could have a detrimental effect on the Welsh economy. Furthermore, lowering the rate to attract inward investment might seem to be an attractive option, but in itself it is a rather crude approach and broader approaches such as raising skills levels are far more likely to have a lasting impact on strengthening the Welsh economy. Reductions of corporation tax would have little impact on small businesses in Wales, as they are less likely to be incorporated.

³ FSB and CLES (2013). *Local Procurement: Making the Most of Small Businesses, One Year On*.

⁴ FSB Wales (2015). *The Collection and Management of Devolved Taxes in Wales*.



Borrowing Powers

Whereas we would welcome the devolution of the taxation powers identified above as a longer-term and more sustainable funding option for Wales, which also provides additional economic levers, the devolution of borrowing powers for capital projects is of less immediate concern to small businesses in Wales. FSB Wales believes that major infrastructural projects should be paid for as a specific capital investment by the UK Government. We also remain concerned that there is a danger that too much of the available funding could be swallowed up by projects such as the Welsh Government-preferred 'Black route' option for the proposed M4 relief road, leaving little for vital infrastructure investment in other parts of Wales to assist in the development of Wales' distributed local economies. The repayment of the borrowing would also reduce the available funding for more sustainable forms of business and infrastructural investment.

Fair Funding

The FSB supports the Holtham Commission findings that fair funding for Wales should be on the basis of relative need. As the move to a needs-based formula would likely take some time to achieve, however, we also support the Commission's suggestion of the more immediate implementation of a 'Barnett floor' as an interim measure to increase funding for Wales. The reform of the Barnett formula is important only insofar that it may increase the available funding to develop the Welsh economy.

In research we undertook with our members to inform our response to the Silk Commission, our members favoured the devolution of fiscal powers to Wales as a means of stimulating economic growth. This is not without qualification, and FSB Wales believes that the underlying incentive for the greater devolution of fiscal powers to Wales should be that Welsh Government must improve the conditions for economic growth as well as a renewed focus on ensuring value for money. We also found that our members believed that any increase in Welsh Government's powers should be matched in the National Assembly for Wales' powers in any areas that are not reserved, so as to ensure accountability and legislative competence.

In that respect, although reform of the Barnett formula may lead to a short-term funding boost for Wales, which should be utilised to support the development of the Welsh economy, the longer-term solution will be for Wales to have an increasing ability to control its own fiscal powers and economic destiny by the economic levers available.



Federation of Small Businesses Wales

1 Cleeve House
Lambourne Crescent
Llanishen
CARDIFF CF14 5GP

Telephone: 029 2074 7406

Email: policy.wales@fsb.org.uk

Web: www.fsb.org.uk/wales

The Federation of Small Businesses Wales

The FSB Wales is non-profit making and non-party political. The Federation of Small Businesses is the UK's largest campaigning pressure group promoting and protecting the interests of the self-employed and owners of small firms. Formed in 1974, it now has 200,000 members across 33 regions and 194 branches. FSB Wales currently has around 10,000 members, a Welsh Policy Unit, two regional committees and twelve branch committees meaning FSB Wales is in constant contact with small businesses at a grassroots level in Wales.

Lobbying

From the Press and Parliamentary Affairs Office in Cardiff, FSB Wales campaigns with AMs, MPs and MEPs in Cardiff Bay, Westminster and Brussels in order to promote our members' interests. FSB Wales also works closely with local, regional and national media outlets to highlight our members' concerns. Development Managers work alongside members in our regions to further FSB Wales influence at a regional level. More widely, the FSB has Press and Parliamentary Offices in Westminster, Glasgow, Belfast and Brussels to lobby the respective Governments.

Member Benefits

In addition, Member Services is committed to delivering a wide range of high quality, good value business services to members of the FSB. These services will be subject to continuing review and will represent a positive enhancement to the benefit of membership of the Leading Business organisation in the UK.

Vision

A community that recognises, values and adequately rewards the endeavours of those who are self employed and small business owners within the UK.

The Federation of Small Businesses is the trading name of the National Federation of Self Employed and Small Businesses Limited. Our registered office is Sir Frank Whittle Way, Blackpool Business Park, Blackpool, Lancashire, FY4 2FE. Our company number is 1263540 and our Data Protection Act registration number is Z7356876. We are a non-profit making organisation and we have registered with the Information Commissioner on a voluntary basis.

Cynulliad Cenedlaethol Cymru / National Assembly for Wales
Y Pwyllgor Cyllid / The Finance Committee
Future Funding For Wales Inquiry / Ymchwiliad i Ariannu Cymru yn y Dyfodol

FIN(4) FF02
Ymateb gan Prifysgolion Cymru
Response From Universities Wales

Finance Committee
National Assembly for Wales
Pierhead Street
Cardiff
CF99 1NA

SeneddFinance@Assembly.Wales

Dear Sir/Madam

Finance Committee Consultation on Future Funding

Universities Wales represents the interests of universities in Wales and is a National Council of Universities UK (UUK). Universities Wales' Governing Council consists of the Vice-Chancellors of all the universities in Wales and the Director of the Open University in Wales. There are a number of matters that we would like to highlight in relation to the future funding consultation that you are currently undertaking.

Universities Wales believes that the devolution settlement could well be improved by means of the transfer of more powers to Wales, but, that should not discourage voluntary policy coordination between the UK administrations where the nature of the policy area concerned has critical cross border elements. Since devolution, decisions in England, Northern Ireland, Scotland and Wales have had clear mutual impacts which merit discussion and careful consideration before major decisions are taken. In an area of public service delivery that has a crucial UK wide dimension, the need to develop policy with cross border ramifications in mind is essential.

For the HE sector in Wales to work to the best of its ability with partners in other UK nations, and across the world, maintaining productive and efficient intergovernmental relations is critical. The memorandum of understanding between the UK Government and the devolved administrations sets out these principles. The memorandum covers communication, consultation, the exchange of information and other matters. Although there is little evidence relating to this formal machinery and its effectiveness in coordinating HE policy, UUK's paper on devolution¹ and HE argues: "the UK government's policy making process often considers devolved concerns late, or not at all, and remains underdeveloped", and continues that this does not apply to links between the HE funding councils where there are long established arrangements for coordination and liaison. There is still work to be done to develop and enhance the communications,

¹ Universities UK – Devolution and higher education: impact and future trends
<http://www.universitiesuk.ac.uk/Publications/Documents/DevolutionAndHE.pdf>

exchange of information and consultation between governments, and we would urge further evidence collection on the effectiveness of existing arrangements to be utilised in improving relations. Proper, formal channels between UK HE policy making officials should be established and utilised as soon as practicable. Devolution rightly means that decisions on HE policy are made in Wales, taking into account Welsh needs. In reality, HE policy is influenced by factors outside the UK, although these factors affect all the UK administrations. The Bologna process for example is designed to introduce a system of academic degrees that are easily recognisable and comparable, promote the mobility of students, teachers and researchers, ensure high quality teaching and incorporate the European dimension into HE. The European Union is now a big influence on research and innovation, with major funding drivers to drive policy across the area. Thus, devolution for our universities is not just a question of how the UK nations work together, but how they work with partners beyond our shores. The focus and understanding of devolved policy amongst key UK agencies and departments working overseas is therefore crucial. Effective communications relating to the different policy contexts, for example how the different fees and funding regimes in the different UK nations operate, is critical. Whilst each nation has a different 'offer', we believe that governments should work together to increase understanding of the differences and what each of the policy contexts mean in practice to different groups. UK nations must be able to successfully compete in the global market.

Universities Wales sees the cross border nature of higher education both as a strength and as a future opportunity. The success of universities in Wales is dependent, not only on our ability to engender skills and prosperity in our local communities, but our ability to secure cross border students, research funding, and business partnerships, which will in turn directly benefit our communities. Any changes to the devolution settlement for Wales must benefit both the HE sector as well as the population of Wales. Universities need a policy framework at a Wales and UK level that facilitates the development of appropriate national policy, and not inhibit it. We trust that, as the Finance Committee considers future funding, that it will consider the need for collaboration by the Welsh Government and the UK Government, Ministers and officials at the different levels of government to ensure that universities are assisted in our efforts to create a learning society and enhance the knowledge economy in Wales.

Yours faithfully



Amanda Wilkinson
Director

Universities Wales (Unis Wales)

Director: Amanda Wilkinson

A National Council of Universities UK
Company limited by guarantee, registered in England and Wales No.
Charity No.

Tudalen y pecyn 8

Un o Gyngorau Cenedlaethol Prifysgolion y DU
Cwmni cyfyngedig trwy warant, a gofrestrwyd yng Nghymru a Lloegr Rhif
Rhif Elusen

Prifysgolion Cymru

Cyfarwyddwr: Amanda Wilkinson

FIN(4) FF03

Ymateb gan Y Sefydliad Siartredig Cyllid Cyhoeddus a Chyfrifyddiaeth
Response From The Chartered Institute of Public Finance & Accountancy

June 2015

CIPFA, the Chartered Institute of Public Finance and Accountancy, is the professional body for people in public finance. CIPFA shows the way in public finance globally, standing up for sound public financial management and good governance around the world as the leading commentator on managing and accounting for public money.

Further information about CIPFA can be obtained at www.cipfa.org

1. Executive Summary

1.1 Reflecting on the focus of the Committees inquiry into future funding considerations, this submission will concentrate on the following areas:

- The key weaknesses and limitations (*see appendix 1*) in the current Welsh funding settlement and how these should be addressed
- What type of financial information is needed by the Welsh Government to provide appropriate support for and scrutiny of future funding arrangements
- The relevance of the Barnett Formula funding arrangements and;
- The principles that should be adopted to underpin further devolution of fiscal powers to Wales

1.2 CIPFA would make the following conclusions and recommendations to the Committee for consideration in its inquiry.

- The current funding settlement for Wales sets out prescribed borrowing limits set by the UK Government.¹ These limits are already significantly lower than levels of affordable borrowing in Local Government in Wales. A prescribed level of borrowing sets limits on the fiscal levers available to the Welsh Government.

¹ Wales Act 2014, Section 20 'Borrowing'

- CIPFA would support the implementation of borrowing supported by a prudential management regime as recommended by the Smith Commission in Scotland.²
- CIPFA believes that the funding through the mechanism of the Barnett Formula is inconsistent with a position of further devolution of tax powers to devolved administrations.
- CIPFA advocates a position where further resource allocation across the UK should be principles based, transparent, accountable and should seek to address relative need as well as promotion of equity.³
- In order to support the devolved financial powers and enhanced accountability of the Welsh Government, there needs to be an appropriate robust system of financial reporting at a whole of Wales public sector level. This would include a balance sheet for Wales to assess the state of public finances in Wales and underpin enhanced scrutiny arrangements.⁴
- The Welsh Government should plan for a robust system of public financial management that includes an enhanced fiscal framework, independent scrutiny of Welsh Government tax and spending forecasts, all of which is support by legislative arrangements.

2. Borrowing and Prudential Management

- 2.1 The current financial settlement includes borrowing powers of up to £500m for current revenue spending shortfalls, which remains unchanged from the Government of Wales Act 2006.⁵ Capital borrowing powers providing a borrowing limit of £500m have been introduced in the Wales Act 2014.¹
- 2.2 The limits are set taking account of the ratio between devolved tax revenues and borrowing. Taking account of this, it is put forward by the UK Government that the current settlement for Wales is more generous than that proposed for Scotland.⁶

² The Smith Commission Report, paragraph 95 (5) (b) http://www.smith-commission.scot/wp-content/uploads/2014/11/The_Smith_Commission_Report-1.pdf

³ CIPFA Briefing – Funding Devolved Government - <http://www.cipfa.org/cipfa-thinks/briefings>

⁴ CIPFA Manifesto – things can only get worse, A call for sustainable public finance - <http://www.cipfa.org/cipfa-thinks/manifesto2015>

⁵ Government of Wales Act 2006, Section 122 (2)

⁶ HM Government, Wales Bill: Financial Empowerment and Accountability, para 88-90 - https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/294421/Wales_Bill_Command_Paper_-_English.pdf

- 2.3 CIPFA would support the approach taken by the Smith Commission in Scotland.² This would mean that the Welsh Government should also have sufficient borrowing powers to support capital investment, consistent with a sustainable overall UK fiscal framework. The Welsh and UK Governments would need to consider the merits of undertaking such capital borrowing via a prudential borrowing regime, similar to Local Government,⁷ and consistent with a sustainable overall UK framework.
- 2.4 We believe that this approach would facilitate a greater focus on medium to long term planning for Wales in its approach to Capital Investment. It would provide for greater accountability and transparency to the Welsh Assembly and Welsh Electorate, given that supporting prudential indicators are agreed, reviewed and published, and it would place the significant fiscal lever of borrowing for investment fully within the hands of the Welsh Government.
- 2.5 Within Local Government in Wales a similar prudential regime has been successfully in place for a number of years. A key element of the prudential regime is that Local Authorities set their authorised borrowing limit annually. Essentially this limit is the maximum that the elected members will allow executive officers to borrow and it is set in the context of its affordability on local taxation.
- 2.6 For an indication of the scale of borrowing in Local Government; in the 2010/11 financial year the total authorised limit across local government in Wales was over £5.0bn,⁸ significantly greater than the limit being imposed by the UK Government on Capital Borrowing for the Welsh Government. As at the 31st March 2013, outstanding loan debt on the balance sheets of Local Authorities in Wales stood at £2.4bn.⁹
- 2.7 In order to fully support this approach, CIPFA advocates putting in place the following:
- A formal updated fiscal framework for Wales, supported in legislation
 - An agreed set of Prudential Indicators, measuring affordability, sustainability and prudence of the medium term to longer term investment decisions of the Welsh Government
 - An agreed method for Independent Scrutiny of the revenue and spending forecasts of the Welsh Government

⁷ CIPFA, The Prudential Code for Capital Finance in Local Authorities (2011 Edition)

⁸ Prudential Borrowing and innovative approaches to capital funding Welsh Local Government Association – 2 March 2012 – paper to the Finance Committee of the National Assembly for Wales

⁹ Capital and Treasury Management Statistics 2013/14, CIPFA.

3. Barnett Formula Funding

- 3.1 CIPFA believes that continuation of the use of the Barnett Formula to deal with further devolution is not feasible. Further, we believe that the Barnett Formula in its current form should be withdrawn.
- 3.2 A way forward was outlined by the Steele Commission¹⁰ which drew attention to the arrangements put in place when Australia introduced a major package of reform to its fiscal system in 1999. The changes came with a guarantee that each state would not be worse off during the transitional period than it would have been had the changes not been implemented. The transition period was approximately 8 years and during this time states whose income fell below the guaranteed level were given non ring fenced grants to maintain overall revenue levels.
- 3.3 CIPFA believes that any future funding solution would have to consider relative public service needs. For example, a recent report on fiscal devolution concluded: 'for a system of fiscal devolution to balance equalisation and incentives it has to start with an assessment of need and resources; have a mechanism for reallocating disproportionate tax yield growth and include periodic reassessments'.¹¹ Any solution would also need to factor in the extent of local control over taxation including for example over non-domestic and domestic rates.
- 3.4 A clear case for a principles based approach to funding devolved government across the UK emerges from CIPFA's assessment of reviews of the Barnett Formula and consideration of International evidence. CIPFA has proposed four simple principles which would underpin the funding for all devolved government across the UK:³
- **Need** – the relative need and assessment of the socio-economic circumstances of each of the devolved government areas should be assessed;
 - **Equity** – this would be the cornerstone principle promoting equalisation across the nations of the UK.
 - **Accountability** – the devolved administrations should have some powers over taxation to provide a direct relationship between services provided and taxes paid, this making them more directly accountable, and

¹⁰ Moving to federalism – A New settlement for Scotland March 2006

¹¹ House of Commons, Communities and Local Government Committee Report, Devolution in England: the case for Local Government, June 2014

- **Transparency** – any funding mechanism should be transparent in its operation and should be the responsibility of a body independent of government.

3.5 We note that the UK Government has committed to establishing a process to review relative levels of funding within the block grant with the potential of introducing a floor in funding.¹² This will provide a Wales with a method to alleviate the process of future funding convergence under the Barnett Formula arrangements.

3.6 Placing a floor into the relative funding mechanism under Barnett for Wales does however raise the question of the funding position for the other devolved regions funded under Barnett Formula arrangements. This would put the regions on a different funding basis, if not implemented elsewhere, and further undermine the relevance of the current funding mechanism.

3.7 CIPFA supports the view taken by the UK Government which has stated that they will work with the Welsh Government to develop sustainable long-term funding arrangements within a robust fiscal framework that reflect the changes made.¹³

4. Financial Information to Support Future Funding Arrangements

4.1 An important component of supporting further devolution of powers to Wales is the quality of state level financial information and governance. Without good financial information and advice, policy makers and managers of public services fail to make sound decisions, leading to poor use of public money.

4.2 Robust financial reporting at a state level will be important for Wales for a number of reasons:

- To provide markets with an understanding of the state of public finances in Wales, supporting any move by the Welsh Government to raise finance through commercial markets.
- To provide transparency which helps inform voters and other stakeholders about the financial stewardship of the Welsh Government.

¹² UK Government: Powers for a Purpose: Towards a Lasting Settlement for Wales, (Chapter 4, para 4.9), February 2015,

¹³ UK Government: Powers for a Purpose: Towards a Lasting Settlement for Wales, (Chapter 4, para 4.11), February 2015,

- To underpin sound decision making and scrutiny arrangements under any revised fiscal framework and;
 - To enable medium to longer-term planning
- 4.3 CIPFA would advocate the development and use of projected combined Welsh public sector level balance sheets¹⁴ as an integral part of the Welsh Governments fiscal and budgetary frameworks.

5. Reserved Powers Model

- 5.1 CIPFA, having taken note of the available research,¹⁵ supports the view that the Reserved Powers Model offers a number of advantages over the Conferred Powers Model that is contained within the Government of Wales Act 2006.
- 5.2 The key advantage is to provide legal clarity over what powers the Welsh Assembly has and to remove any uncertainty in areas where it may be difficult under the Conferred Powers Model to specifically define all the areas of responsibility that the Welsh Government should have. The Reserve Powers Model has been previously proposed by the Richard Commission 2004,¹⁶ based on the Scottish Model of legislative powers.
- 5.3 Adoption of a Reserved Powers Model in Wales will also bring an element of consistency in approach to devolution across the regions of the UK. CIPFA does not expect full co-ordination of devolution settlements across the regions as it would be expected that regions will move at different paces and the appetite for devolved powers within the electorate in each regions may well differ. However, we do believe that it would be appropriate and fair if the model for devolution settlements had a degree of consistency.

¹⁴ CIPFA Manifesto 2015, section 6, page 18

¹⁵ Scottish Law Commission, Comments on White Paper 'Our Changing Democracy: Devolution to Scotland and Wales' Memorandum no. 32, June 1976

¹⁶ Report of the Commission on the Powers and Electoral Arrangements of the National Assembly for Wales <http://researchbriefings.files.parliament.uk/documents/SN03018/SN03018.pdf>

APPENDIX 1 – Summary of Limitations in the current funding system

<p>Block grant calculated by Barnett formula</p>	<p>The Welsh Government has no control over the level of funding available and must ensure public services are affordable within the funding envelope provided. Some control can be exercised over levels of local taxation and other funding sources; the block grant provides the majority of income for the Welsh Government.</p> <p>The Wales Act 2014 provides that a referendum can be held to give Welsh Ministers the power to vary income tax, and gives the Welsh Government control of stamp duty land tax and landfill tax. These measures may provide some additional funding depending on the choices made.</p>
<p>Limitations on how block grant can be spent</p>	<p>As the UK Government retains control over fiscal policy, HM Treasury imposes controls on the block grant. Under a reserve powers model the Welsh Government has discretion over how to spend the majority of the block grant in relation to devolved areas.¹⁷</p> <p>Some more volatile elements of expenditure are restricted.¹⁸ Spending in these areas is not within the discretion of the Welsh Ministers, and this funding must be used for the purpose for which it is provided, or returned to HM Treasury. Although this provides the Welsh Government's funding with an element of protection from the risks associated with such volatile, demand-led elements of spending, it also removes an element of control over the totality of their available funding.</p>
<p>Inability to hold reserves</p>	<p>Funding received in the block grant cannot be held in 'reserve' to be carried over into future financial years.¹⁹ Any unspent grant must be returned to the Treasury at the end of the financial year.</p> <p>There is a system by which the Welsh Government can ask to carry forward any unspent grant, the budget exchange mechanism.²⁰ However, this is subject to limits, and is designed to avoid the 'use it or lose it' effect where money is spent merely to avoid being lost,</p>

¹⁷ The departmental expenditure limits (DEL).

¹⁸ Included in the annually managed expenditure (AME).

¹⁹ It should be noted that local government in Wales can hold reserves.

²⁰ As detailed in HM Treasury's [Consolidated Budgeting Guidance](#).

	<p>rather than to manage financial pressures across years. This does not enable the funds to be held in a 'reserve' but rather allows access to the agreed amount in the next financial year.</p>
<p>Inability to borrow over the long term</p>	<p>Local government in Wales can borrow money, as long as this is affordable and prudent.²¹ This enables authorities to spread the cost of capital investment in schools, roads and other infrastructure, over a number of years.</p> <p>Under the current settlement, the Welsh Government has only limited ability to borrow money, with the power to borrow up to £500m to cover temporary shortfalls in revenue spending and £500m for Capital Investment¹</p>
<p>Limited information on future funding levels</p>	<p>In terms of financial planning for the future, the Welsh Government has only restricted information on its future level of funding. Although the block grant does provide a level of certainty, the amount of grant to be received is indicated as part of the UK Government's Spending Review process, which intends to provide figures for three financial years, to enable financial planning.²²</p> <p>The timing and lengths of Spending Review periods have varied, with the Spending Round 2013 providing figures for only two years (2014-15 and 2015-16), with no forecasts for financial years beyond the UK general election.</p> <p>Spending Reviews provide an indication of what the block grant is likely to be, these plans are often altered by decisions in UK Government Budgets and Autumn Statements, and therefore the block grant figures are subject to change, in either direction. These issues of timing and changes to the level of grant present difficulties in the ability of the Welsh Government to establish medium or long term financial plans.</p>

²¹ Local Government Act 2003, Chapter 1 Capital Finance, sections 1 - 6

²² Three year plans apply to the bulk of the grant, the departmental expenditure limit (DEL). However, the more volatile annually managed expenditure (AME) is planned for on an annual basis.

Cynulliad Cenedlaethol Cymru / National Assembly for Wales
Y Pwyllgor Cyllid / The Finance Committee
Future Funding For Wales Inquiry / Ymchwiliad i Ariannu Cymru yn y
Dyfodol

FIN(4) FF04

Ymateb gan NEA Cymru

Response From NEA Cymru

Finance Committee Inquiry into Future Funding: Written evidence from NEA Cymru

In response to the Finance Committee's inquiry into Future Funding for Wales I have pleasure in submitting evidence from National Energy Action Cymru.

NEA is the UK fuel poverty charity which for more than 30 years has campaigned for action and for greater investment in energy efficiency to help those who are poor and vulnerable. The charity works to eliminate the scourge of fuel poverty by enhancing knowledge and understanding of energy efficiency and fuel poverty, developing and progressing solutions to improve access to energy efficiency products and services, and campaigning for policies to address the issue. NEA Cymru is the dedicated Welsh arm of NEA.

NEA Cymru broadly welcomes further devolved powers for Wales, in particular on devolving decisions over energy policy to the Welsh Government as stipulated in the framework of the previous Government's St David's Day Agreement.

Barnett formula

1. Many campaigners have criticised the Barnett formulas failure to take into account needs based action, instead making contributions relative to population disparity.
2. Currently 30% of Welsh households (equivalent to 386,000 households) live in fuel poverty – this is greater than the proportion in both England (10.4%) and Scotland (27%)¹.
3. Wales also hold the highest proportion of individuals living in households with less than 60% of contemporary median household income in real terms after housing costs (24% – versus 23% in England, 22% in Northern Ireland, and 19% in Scotland²).
4. Regardless of Wales need for greater spending, Public Expenditure Statistical Analyses have continually shown that the Barnett Formula is failing Wales, as pound per-head spending has been lower than Northern Ireland and Scotland since 1985 (currently at £9,709 – £10,152 in Scotland and £10,876 in Northern Ireland³).
5. As such the need for greater funding for Wales is significant as the extent of cold temperatures, cost of cold homes, and lack of suitable household insulation is greater than in England.

Tax raising powers & convergence funding

¹ <http://gov.wales/docs/caecd/research/2015/150310-evaluation-nest-energy-efficiency-scheme-en.pdf>

² <https://www.gov.uk/government/statistics/households-below-average-income-hbai-199495-to-201213>

³ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/330717/PESA_2014_-_print.pdf

Cynulliad Cenedlaethol Cymru / National Assembly for Wales
Y Pwyllgor Cyllid / The Finance Committee
Future Funding For Wales Inquiry / Ymchwiliad i Ariannu Cymru yn y
Dyfodol

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Ymateb gan NEA Cymru

Response From NEA Cymru

6. Now the Smith Commission has developed into the Scotland Bill, it is clear that Scotland will receive a half share of revenue generated from VAT receipts. It is necessary that the same deal is made for Wales so it can adequately fund its poverty alleviation schemes that have been hit from Westminster austerity.
7. Over the current Westminster parliament Wales will contribute £690m⁴ (see annex) from VAT and generated carbon taxes from domestic energy bills to HM Treasury – none of these resources are invested towards insulating Welsh homes which would reduce energy costs for consumers, benefit receipts in other areas for government, demand times for the industry, and carbon emissions for the nation.
8. The Welsh Government's energy efficiency schemes – Arbed 2 & NEST – have shown a high return for government on the investment made insulating the homes of those in fuel poverty. NEST has overall received an investment of £58,023,822 and achieved a return of £1.29 back for each £1 spent; supported 46 SMEs, creating a total of 83 apprenticeships, trainees and jobs over the length of the scheme; while accruing annual energy savings of a total £7.48m for low income households over the course of the scheme⁵.
9. 'Whilst this investment is providing real returns and value for money for the Welsh Government, funding on energy efficiency is inadequate to meet the statutory target to eradicate fuel poverty in Welsh households by 2018. Currently total funding by the Welsh Government amounts to only 8.4% of the money that will leave Welsh domestic consumers' pockets through VAT and carbon taxes - as previously stated - £690m over the next 5 years.
10. Similarly, the Welsh Government's Arbed 2 programme is delivering an estimated return to the Welsh economy of £2 for every £1 invested⁶.
11. NEA Cymru welcomes further European Union European Regional Development Fund (EU-ERDF) to support energy efficiency programmes in Wales from 2015-2020. The £33million invested into Arbed 2 by the Welsh Government has enabled the Welsh Government to develop a far greater strategic and focused energy efficiency programme, helping more households living in fuel poverty.
12. The Welsh Government is to be commended to date for maintaining Arbed and NEST schemes despite a difficult economic climate. The new UK Government must recognise that austerity and welfare reform have had a real impact on the ability of the Welsh Government's work to eradicate fuel poverty and poverty in general. The UK Government must show its support and use revenues the UK Treasury receives from levies on energy bills

⁴ [http://www.nea.org.uk/Resources/NEA/Publications/2013/MANIFESTO%20FOR%20WARMTH%20\(LO%20RES\)%20CS6.pdf](http://www.nea.org.uk/Resources/NEA/Publications/2013/MANIFESTO%20FOR%20WARMTH%20(LO%20RES)%20CS6.pdf)

⁵ <http://gov.wales/docs/caecd/research/2015/150310-evaluation-nest-energy-efficiency-scheme-en.pdf>

⁶ <http://gov.wales/newsroom/environmentandcountryside/2015/welsh-government-energy-investment-is-cutting-fuel-bills-while-boosting-the-economy-says-carl-sargeant/?lang=en>

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to ensure funds are pledged to increase resources within the Welsh Government's energy efficiency programmes thereby bringing an end to fuel poverty for Wales.

Multiple benefits of energy efficiency

13. As mentioned above, both Arbed and NEST have shown the multiple benefits of investing in an energy efficiency scheme directed at the fuel poor.
14. The International Energy Agency (IEA) research – *Capturing the multiple benefits of energy efficiency* – recently highlighted and quantified the potential for energy efficiency to deliver jobs and economic growth, reduce pressure on health services, improve energy security and reduce carbon emissions – at the same time as providing a long-term, sustainable solution to unaffordable fuel bills for all consumers. In particular, their report demonstrated that large scale energy efficiency programmes can lead to increases in GDP of up to 1.1 per cent per year; can create significant employment (8-27 job years per €1million invested); and can have a benefit to cost ratio of 4:1⁷.
15. Furthermore the CCC's (Committee on Climate Change) response to DECC's consultation on the Fuel Poverty Strategy⁸, noted there was a greater potential for national policies to meet the fourth carbon budget as well as achieving the new fuel poverty targets. However the report also noted that while realigning existing national policies to explicitly target the fuel poor could help improve synergy between decarbonisation policy and social justice, new funding sources would be needed.

Key Recommendations

16. NEA Cymru calls on the Welsh Government to secure fairer funding from the UK government to enable it to develop effective policies to invest in fuel poverty in Wales.
17. NEA Cymru calls on the Welsh Government to utilise its future funding arrangements to invest in energy efficiency programmes to help improve the energy efficiency of homes and alleviate fuel poverty in Wales.

⁷ http://www.iea.org/bookshop/475-Capturing_the_Multiple_Benefits_of_Energy_Efficiency

⁸ <http://www.theccc.org.uk/publication/letter-fuel-poverty-strategy-consultation-response/>

TABLE 1: FUTURE TAXATION FROM DOMESTIC ENERGY BILLS

	PER DOMESTIC ELECTRICITY CUSTOMER (£)	NATION	COMBINED CONTRIBUTION (£BILL) PER YEAR	TOTAL 5YR COMBINED CONTRIBUTION (£BILL)	TOTAL 10YR COMBINED CONTRIBUTION (£BILL)
VAT	£31.50	UK	£2.83	£14.16	£28.33
CFP	£27.94	GB	£2.77	£13.87	£27.73
ETS	£11.05	ENGLAND	£2.36	£11.82	£23.63
TOTAL	£70.49	SCOTLAND	£0.27	£1.33	£2.65
PER DOMESTIC GAS CUSTOMER (£)		WALES	£0.14	£0.69	£1.38
VAT	£36.45	NI	£0.04	£0.19	£0.38
TOTAL	£106.94				

Annex – UK levies on energy bills from VAT, EU Emissions Trading Scheme, & UK Carbon Floor Price

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Ymateb y Gweinidog
Ministerial Response

Cyflwyniad

1. Diben y papur hwn yw amlinellu'r dystiolaeth ysgrifenedig i'r Pwyllgor Cyllid ar ariannu yn y dyfodol yng Nghymru.
2. Mae Llywodraeth Cymru yn croesawu'r cyfle i gyflwyno tystiolaeth i'r Pwyllgor er mwyn tynnu sylw at wendidau'r trefniadau ariannu presennol ar gyfer gwasanaethau cyhoeddus yng Nghymru, yn enwedig gwendidau fformiwla Barnett.
3. Bydd Llywodraeth Cymru yn parhau i bwyso am setliad cyllid i Gymru sy'n deg ac yn atal cydgyfeirio yn y dyfodol.
4. Mae Llywodraeth Cymru yn croesawu'r pwerau cyllidol newydd a gyflwynwyd yn Neddf Cymru 2014. Bydd pwerau i newid Treth Dir y Dreth Stamp a'r Dreth Dirlenwi yng Nghymru yn cynnig ysgogiadau ychwanegol i gyflawni nodau polisi yng Nghymru. Mae Llywodraeth Cymru yn croesawu pwerau benthyg newydd i helpu i ariannu buddsoddiad mewn seilwaith, ond mae o'r farn bod y terfyn benthyg yn Neddf Cymru 2014 yn cyfyngu ar y gallu i fuddsoddi yn y seilwaith y mae ei angen ar Gymru.

Gwendid setliad cyllid Cymru

5. Mae nifer o astudiaethau wedi edrych ar ddyrannu cyllid i Lywodraeth Cymru, gyda'r mwyafrif yn edrych ar y drefn ar gyfer cyfrifo'r grant bloc, sef y fformiwla Barnett¹. Mae'r astudiaethau hynny'n dadlau nad yw'r fformiwla Barnett yn fuddiol i Gymru ac y dylid gosod trefn o ddsbarthu adnoddau ar sail angen yn ei le.
6. Sefydlodd Llywodraeth Cymru y Comisiwn Annibynnol ar Ariannu a Chyllid i Gymru yn 2008 i ystyried manteision ac anfanteision y dull ar sail fformiwla o ddsbarthu anghenion gwariant cyhoeddus i Lywodraeth Cymru a nodi trefniadau ariannu amgen posibl².
7. Mae'r casgliad yn adroddiadau awdurdodol y Comisiwn yn glir – nid oes unrhyw gyfiawnhad gwrthrychol dros fformiwla Barnett. O ganlyniad uniongyrchol i fformiwla Barnett, mae'r cyllid cymharol y pen ar gyfer gwasanaethau datganoledig yng Nghymru wedi cydgyfeirio tuag at lefel y cyllid y pen ar gyfartaledd yn Lloegr. Os bydd fformiwla Barnett yn parhau, bydd cyllid y pen yng Nghymru yn cydgyfeirio tuag at y cyfartaledd ar gyfer Lloegr, waeth yr angen i wario mwy yn gymharol ar wasanaethau datganoledig yng Nghymru.

¹ Mae'r rhain yn cynnwys: Pwyllgor Dethol Tŷ'r Arglwyddi ar y Fformiwla Barnett; Pwyllgor Cyfiawnder Tŷ'r Cyffredin; a nifer o astudiaethau academaidd (Gweler Bristow, G (2008) The Barnett Formula and its Consequences for Wales: A Literature Review for a summary)

²Cylch gorchwyl llawn y Comisiwn oedd:

- Edrych ar fanteision ac anfanteision y dull a ddefnyddir ar hyn o bryd i ddsbarthu adnoddau gwariant cyhoeddus i Lywodraeth Cynulliad Cymru; a
- Chanfod ffyrdd gwahanol o gyllido gan gynnwys y posibilrwydd y gallai Llywodraeth Cynulliad Cymru gael pwerau amrywio trethi yn ogystal â mwy o bwerau benthyg arian.

8. Mae Llywodraeth Cymru yn cytuno ag argymhellion y Comisiwn Annibynnol ar Ariannu a Chyllid i Gymru y dylai trefniadau ariannu Cymru fod yn seiliedig ar anghenion. Nid oes sail i gyllid cymharol y pen yng Nghymru gydgyfeirio tuag at y cyfartaledd ar gyfer Lloegr.
9. Mae cefnogaeth unfrydol o hyd yng Nghynulliad Cenedlaethol Cymru i Lywodraeth Cymru gael ei hariannu'n deg. Ar 13 Mai 2015, cafwyd cefnogaeth unfrydol i'r cynnig canlynol:

bod Cynulliad Cenedlaethol Cymru yn cydnabod nad yw fformiwla gyllido Barnett er budd pennaf Cymru, yn nodi bod astudiaethau wedi dod i'r casgliad dro ar ôl tro nad yw Cymru'n cael ei chyllido'n unol â'r angen, ac yn galw ar Lywodraeth y DU i sicrhau bod Cymru yn cael ei chyllido'n deg drwy weithredu terfyn ariannu isaf sy'n cael cefnogaeth drawsbleidiol.
10. Bydd Llywodraeth Cymru yn parhau i alw ar Lywodraeth y DU i osod terfyn ariannu isaf sy'n deg ac yn atal cydgyfeirio yn y dyfodol.
11. Mae Llywodraeth Cymru o'r farn mai'r ffordd symlaf o osod terfyn ariannu isaf yw sicrhau, pan fydd gwariant yn dechrau cynyddu, bod Cymru'n cael yr un newid mewn canran mewn gwariant ar feysydd cyfrifoldeb datganoledig â Lloegr. Mae hyn ond yn gofyn am addasiad bach i fformiwla Barnett. Byddai hyn yn hawdd i'w ddeall ac yn hawdd i Drysorlys ei Mawrhydi ei weithredu. Pe bai cynnydd o 3 y cant mewn gwariant yn Lloegr ar swyddogaethau sydd wedi'u datganoli i Gymru, yna byddai cynnydd o 3 y cant yng Nghymru hefyd.
12. Yn y tymor hwy, mae Llywodraeth Cymru o'r farn y dylai corff sy'n annibynnol ar lywodraeth gynnal asesiad anghenion i bennu y lefel o gyllid ar gyfer y llywodraethau datganoledig. Ar hyn o bryd, mae Trysorlys y DU yn gweithredu heb unrhyw fath o gytundeb â'r gweinyddiaethau datganoledig. Mae hyn wedi arwain at anghydfod ynghylch a ddylai'r gweinyddiaethau datganoledig gael cyllid canlyniadol yn sgil gwariant yn Lloegr. Mae enghraifft ddiweddar yn cynnwys y gwariant adfywio sy'n gysylltiedig â'r Gemau Olympaidd, lle na chafodd Llywodraeth Cymru unrhyw gyllid Barnett yn sgil y gwariant hwn yn Lloegr. Fel y nododd Comisiwn Annibynnol y Bingham Centre for the Rule of Law yn ddiweddar: "the present arrangements fall short of our principles of consent and respect for the rule of law".
13. Daeth y Comisiwn Annibynnol ar Ariannu a Chyllid i Gymru a Chomisiwn Llywodraeth y DU ar Ddatganoli yng Nghymru (y Comisiwn Silk) ill dau i'r casgliad y gellid gwneud Llywodraeth Cymru yn fwy atebol yn ariannol drwy gynhyrchu cyfran o'r arian sydd ar gael i'w wario ar wasanaethau cyhoeddus o'r trethi datganoledig y mae'n eu rheoli.
14. Rhoddodd Deddf Cymru 2014 y rhan fwyaf o'r argymhellion yn adroddiad cyntaf y Comisiwn Silk ar waith. Mae Llywodraeth Cymru yn croesawu'r mesurau yn Neddf Cymru 2014, ac mae eisoes yn paratoi ar gyfer y trethi newydd i gymryd lle Treth Dir y Dreth Stamp a'r Dreth Dirlenwi yng Nghymru o 2018. Ni fydd Llywodraeth Cymru yn ystyried datganoli treth incwm nes bod y grant bloc yn cael ei osod ar sail deg a chynaliadwy drwy osod terfyn ariannu isaf.

15. Mae Llywodraeth Cymru hefyd yn croesawu datganoli pwerau benthyg i fuddsoddi mewn seilwaith cyfalaf. Mae Llywodraeth Cymru o'r farn y dylid cynyddu'r terfynau benthyg yn Neddff Cymru 2014 i alluogi Llywodraeth Cymru i fuddsoddi yn y seilwaith y mae ei angen ar Gymru i gefnogi twf a swyddi.
16. Mae angen i'r trefniadau ariannu fod yn fwy hyblyg er mwyn ymdopi ag amrywiadau cyllidebol a rheoli'r cyllid ar gyfer gwasanaethau cyhoeddus yn well o flwyddyn i flwyddyn. Mae Llywodraeth Cymru yn credu y dylai fod mwy o hyblygrwydd ynghylch defnyddio adnoddau sydd heb eu gwario, a mwy o hyblygrwydd rhwng ein cyllidebau cyfalaf ac adnodd.

Datblygiadau ynghylch cydgyfeirio, tangyllido a diwygio Barnett

17. Mewn datganiad ar y cyd gyda Llywodraeth Cymru yn 2012, cydnabu Llywodraeth y DU am y tro cyntaf fod cyllid Cymru wedi cydgyfeirio ers datganoli, a bod hyn yn bwnc llosg yng Nghymru.
18. Fel y cytunwyd yn y datganiad hwnnw ar y cyd, gwnaeth Llywodraeth Cymru a Llywodraeth y DU adolygiad ar y cyd o hynt cydgyfeirio cyllid cymharol Cymru cyn cylch gwariant 2015-16.
19. Yn y cyfnod cyn y cylch gwariant, rhoddodd swyddogion Llywodraeth Cymru a Thrysorlys y DU senarios gwariant amgen ar gyfer 2015-16 ar brawf, a aseswyd wedyn o ran eu heffaith ar lefelau cyllid cymharol Cymru. Ar sail y gwaith dadansoddi hwn, daeth y ddwy Lywodraeth i'r casgliad nad oedd unrhyw gydgyfeirio ar y gweill yn ystod cyfnod gwariant 2015-16. Mae manylion y gwaith dadansoddi hwn, gan gynnwys tueddiadau, i'w gweld ar wefan Llywodraeth Cymru (<http://llyw.cymru/about/cabinet/cabinetstatements/2013/relativefunding201516/?lang=cy>)
20. Yn y datganiad ar y cyd yn 2012, cydnabu Llywodraeth y DU ei bod yn debygol iawn y bydd cydgyfeirio pellach yn y dyfodol cyn gynted af y bydd cyllid yn cynyddu eto.
21. Roedd cyhoeddiad Dydd Gŵyl Dewi Llywodraeth y DU yn cynnwys cyflwyno terfyn isaf ar gyfer lefel y cyllid cymharol y mae'n ei roi i Lywodraeth Cymru, gyda Adolygiad o Wariant nesaf y DU i gytuno ar union lefel y terfyn a'r drefn ar gyfer cyflwyno hyn. Yn dilyn etholiad cyffredinol y DU, dywedodd Ysgrifennydd Gwladol Cymru: "we are absolutely committed to following through on this historic commitment to bring fair funding to Wales".
22. Mae cytuno ar y trefniadau manwl ar gyfer y terfyn ariannu isaf yn flaenoriaeth i Lywodraeth Cymru, ac mae trafodaethau'n mynd rhagddynt. Bydd Llywodraeth Cymru yn dadlau o blaid terfyn ariannu isaf sy'n deg i Gymru – ac i weddill y DU – ac yn atal unrhyw gydgyfeirio pellach.

Cynigion datganoli pellach

23. Cyhoeddodd Araith y Frenhines ar 27 Mai 2015 y bydd Bil Cymru yn cael ei gyflwyno yn ystod y tymor seneddol hwn. Bydd hyn yn cyflwyno deddfwriaeth i ddatganoli pwerau newydd i Lywodraeth Cymru mewn meysydd sy'n cynnwys

trafnidiaeth, ynni a threfniadau etholiadol. Bydd Bil Cymru hefyd yn deddfu ar gyfer model cadw pwerau i Gymru.

24. Bydd Llywodraeth Cymru yn parhau i bwysu am ddatganoli Toll Teithwyr Awyr (yn unol ag argymhelliad Comisiwn Holtham a Chomisiwn Silk) drwy Fil Cymru.
25. Bydd goblygiadau ariannol yn sgil datganoli pwerau newydd oherwydd bydd Llywodraeth Cymru yn gyfrifol am ystod ehangach o feysydd polisi. Bob tro y caiff cyfrifoldebau eu trosglwyddo o Lywodraeth y DU i Lywodraeth Cymru, dylid trosglwyddo'r gyllideb lawn, yn amodol ar graffu annibynnol, gyda'r posibilrwydd o gymrodeddu annibynnol i ymdrin ag unrhyw achosion o anghytuno sydd heb eu datrys ynghylch maint priodol trosglwyddiadau.

Trefniadau ariannu yn y dyfodol

26. Mae Llywodraeth Cymru o'r farn y dylid cytuno ar drefniadau ariannu a chyllidol yn y dyfodol ar y cyd gyda Llywodraeth y DU. Mae Llywodraeth Cymru a Llywodraeth y DU wedi sefydlu Cyd-bwyllgor y Trysorlysoedd i roi trosolwg Gweinidogol ar y gwaith cydweithredol hwn, gan gynnig fforwm chwemisol i drafod a chytuno ar fanylion datganoli cyllidol.
27. Mae'r cytundebau y daethpwyd iddynt ar y swm i'w neilltuo o'r grant bloc ar gyfer datganoli ardrethi annomestig yn llawn a'r gallu i Lywodraeth Cymru gyhoeddi bondiau yn dangos y cynnydd y mae Cyd-bwyllgor y Trysorlysoedd wedi'i wneud ers ei sefydlu. Mae Llywodraeth Cymru yn awyddus bod y gwaith hwn ar y cyd yn parhau i ystyried materion cyllidol yng Nghymru sydd heb eu datrys, gan gynnwys ariannu teg a datganoli Toll Teithwyr Awyr.
28. Er bod gwahaniaethau o ran datganoli pwerau cyllidol i Gymru, yr Alban a Gogledd Iwerddon, mae Llywodraeth Cymru o'r farn bod gwerth mawr mewn cytuno ar y trefniadau ariannol sydd ynghlwm â datganoli pwerau cyllidol mewn ffordd gydlynus lle bo'n bosibl. Fodd bynnag, bydd Llywodraeth Cymru ond yn cytuno ar drefniadau sydd er budd gorau Cymru.

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Ymateb gan Y Sefydliad Astudiaethau Cyllid
Response from The Institute for Fiscal Studies

Response to Consultation on Future Funding

David Phillips

1. Introduction

This is a response by David Phillips, a senior research economist at the Institute for Fiscal Studies (IFS). David has led the IFS's work on devolved finance issues. He is also a member of the Welsh Finance Minister's Tax Advisory Group. However, the views and opinions expressed here are those of the author only. The IFS has no corporate views.

This earlier work may also be useful to the committee's work. Please see the following publications:

<http://www.ifs.org.uk/publications/7711>

<http://www.ifs.org.uk/publications/7484>

<http://www.ifs.org.uk/publications/7442>

Please note this response focuses on the following areas:

- The trade-offs between different types of funding arrangements
- The practical issues involved in moving from

As a result, responses are not provided to all questions. And it does not make recommendations about which funding system should be used. Ultimately, that is a political question, involving bargaining between the nations and governments of the UK, and political views on the appropriate degree of redistribution across the UK and how to trade-off risk-sharing/insurance versus fiscal incentives.

2. What are the main weaknesses in the current financial settlement for Wales?

The Welsh Government currently receives the bulk of its money from the UK Government in the form of a block grant. This block grant is calculated each year as the prior year's grant plus (or minus) an increment calculated using the Barnett formula and based on changes in "comparable" budgets in England. In addition, the Welsh Government receives income from non-domestic rates (NDR), and Welsh local authorities receive money from council tax. Non-devolved spending (such as welfare) is the responsibility of the UK government.

From 2018-19, powers over and revenue from Stamp Duty Land Tax (SDLT) and Landfill Tax (LT) will be devolved to Wales, and the block grant will be reduced accordingly. There is also the potential for income tax to be partially devolved, subject to a referendum, which would necessitate similar adjustments to the block grant. As shall be discussed later, adjusting the

block grant is a complicated issue which has profound implications for the level of funding the Welsh Government will see in future, and the financial risks and incentives it will face. At the same time, the Welsh Government will acquire some borrowing powers (for both capital and current purposes) subject to strict rules.

A number of elements of this framework attract criticism:

- 1) That the Barnett formula is arbitrary and takes no account of relative needs (or revenue contributions for that matter).
- 2) That the result of the use of the Barnett formula is an underfunding of Wales, and in the long term, a “Barnett squeeze”.
- 3) That the specific way in which the Barnett formula treats devolved NDR revenues is flawed (<http://www.ifs.org.uk/publications/7442>) and has what appear to be unintended consequences. Whilst these flaws benefit Wales (from this year), Scotland and Northern Ireland during periods in which the Local Government budget in England is doing poorly relative to overall “comparable” departmental spending, the flaws would cost Wales (and Scotland and NI) if the Local Government budget were to do relatively well from budget settlements.
- 4) That information on the application of the Barnett formula is not readily available, and that application of the formula is controlled solely by the Treasury (which makes decisions about what spending is deemed ‘comparable’, for instance).
- 5) That a system largely based on block grant funding gives little financial incentive for the Welsh Government to boost economic performance, and hence boost revenues (or reduce welfare costs). Proposals for tax devolution will address this concern to some extent.
- 6) That the proposed borrowing powers are too limited and highly constrained, both on the capital side (see CIPFA’s submission) and on the current side (where borrowing will be available only for forecast errors).

There is disagreement about some of these issues.

For instance, the UK Government says that it thinks that Wales’ level of funding is within the appropriate range suggested by the Holtham Agreement, and has said it will consider a ‘funding floor’ to prevent any further convergence if agreement is reached on devolving income tax. It is also pointed out that the Barnett squeeze does not operate (at least to the same extent) when spending is being cut, and when there is lower population growth in Wales (as is currently the case).

But each is an issue worth considering by the Committee.

How can these be resolved?

Some issues can, in principle, be resolved relatively easily. For instance, further information about the application of the Barnett formula (or any replacement formula) could be published alongside each fiscal event (such as Budget or Autumn Statement). In addition, the Barnett formula (or any replacement formula) and associated Statement of Funding Policy could be managed by an independent body, rather than the Treasury.

Similarly, the flaws in the way the Barnett formula treats devolved NDRs can be corrected for by a simple change to the technical workings of the formula.¹

However, some of the issues reflect trade-offs between different objectives. For instance, a needs-based approach to funding would cushion Wales from any adverse budgetary effects from increases in its relative needs – such as weaker economic performance or a more rapidly ageing population –, but would also mean Wales would not gain from any reduction in its relative needs. The latter would blunt the incentives the Welsh Government has to take action to reduce relative needs and to boost economic performance. Depending on whether the needs based formula also took into account revenue-raising capacity, it could also blunt incentives to boost revenue growth from devolved taxes.

Addressing one issue (making the funding more responsive to changes in relative needs) may therefore make other problems worse (lessening the incentive of the Welsh government to take action to reduce spending needs). These trade-offs between risks and incentives are at the core of any funding arrangement for sub-national governments.

How will upcoming changes in relation to: a reserved-powers model for Wales, and the St David's Day devolution proposals and Smith Commission recommendations, impact on future funding arrangements of the Welsh Government?

The response to this question focuses on adjusting the block grant as a result of further devolution, and draws on work being undertaken as part of assessing the Smith Commission proposals.

Clearly when additional revenues or spending are devolved, adjustments have to be made to the block grant.

In principle at least, the *first year* adjustments to the block grant are relatively straightforward to implement, although the calculations involved may be complex. When devolving a tax, the block grant is reduced by the amount of revenue being transferred. When devolving responsibility for an additional area of spending, the block grant is increased by the amount the UK would have spent in Wales on that area.

Given the complex calculations that may be required in order to estimate these quantities, it would be preferable if the UK Government and Welsh Government agree on a methodology, and publish detailed information on the calculations. This will allow proper external scrutiny. If agreement on a single method cannot be reached, then both parties should publish detailed information on their methods, and resulting calculations. The OBR and an equivalent Welsh fiscal commission should assess and, if appropriate, sign off these calculations. Information should also be published on the mechanism by which ultimate agreement is reached (and what that agreement entailed). Consideration should be given for an independent institution to act as an arbiter.

Calculating the adjustment to the block grant in *subsequent years* is more conceptually complex. One cannot simply continue to deduct or add an amount equal to the revenues or spending devolved. Doing this would remove any incentive for the Welsh Government to boost tax revenues or limit expenditure growth (including through discretionary tax rises, or spending cuts): any change

¹ Again see <http://www.ifs.org.uk/publications/7442>.

in revenue or spending would simply be cancelled out by an offsetting change to the block grant adjustment.

There are a number of methods for adjusting the block grant, and each has different properties. The attached presentation sets out three possible mechanisms, and their advantages and disadvantages (including worked examples of how they perform under different scenarios).²

The following summarises the findings (with advantages in green, and disadvantages in red):

- Fixed % adjustment to block grant (i.e. block grant reduced by the same % in each year as in 1st year)
 - Easy to understand and can be implemented using Barnett formula
 - But Wales bears risk of UK-wide shocks it is ill-equipped to bear
- Index to % change in rUK revenues
 - Insulates Wales from UK-wide shocks but still growth incentive
 - In spirit of “no detriment simply from devolution” as Wales is left no better off or worse off in the long term if revenues grow at the same % rate as in rUK
 - Wales affected (a bit) by rUK decisions on taxes that in Wales are the responsibility of the Welsh Government
- Index to £s p.p change in rUK revenues
 - Also insulates Wales from UK-wide shocks while still proving growth incentive
 - Wales in principle unaffected by rUK decisions on taxes that in Wales are the responsibility of the Welsh Government
 - But Wales loses out unless its revenues grow more quickly in % terms than rUK

From a Welsh Government perspective, the last option would worsen the Barnett Squeeze. Indexing block grant adjustments to the percentage change in rUK revenues has attractions in general.

However, if yield from a particular tax were expected to grow less quickly (or more quickly) in Wales than in the rest of the UK due to underlying economic factors, indexing the block grant adjustments to revenue growth in the rest of the UK may not be appropriate. This may be the case for Stamp Duty, where the lower property prices in Wales mean that revenues might be expected to grow less quickly in Wales (as fewer properties will be subject to the highest tax rates even if property price growth kept up with growth in England). This issue has prevented agreement on the method to adjust the block grant after the 1st year of devolution of Stamp Duty (and Landfill Tax) in the case of Scotland. This suggests two options:

² The presentation is also available at: <http://www.ifs.org.uk/publications/7711>.

- 1) Assess each tax on a case-by-case basis to decide what method should be used to adjust the block grant. However, this risks a zero-sum bargaining approach by the devolved and UK governments where each side pushes for a system that is likely to benefit them for the particular tax in question.
- 2) Combine revenue from all taxes and make a single adjustment. Because the bigger taxes (like Income Tax) are not so prone to such problems of differential revenue growth, doing this may make it easier to use a single principles-based adjustment mechanism.

It is also worth discussing the 'no detriment' principles suggested by the Smith Commission for Scotland to see if they are relevant for Wales.

The ideas behind the two 'no detriment' principles seem sensible at first glance:

- Neither government should gain nor lose simply as a result of the decision to devolve revenues or spending responsibilities (1st no detriment principle);
- Each government should bear the risks and reap the benefits of their own policies, and not win or lose from knock on effects from the other government's policies. Related to this, it seems reasonable that changes in taxes in rUK for which the Welsh Government has responsibility in Wales, should *not* impact the amount spent for the benefit of Wales (together, the 2nd no detriment principle).

The difficulty arises in practice, when considering how to implement the principles.

It does not seem possible to design a block grant adjustment mechanism that satisfies the need for transparency and 'automaticity', and at the same time, satisfies both of these no detriment principles. For instance, indexing the block grant to the % change in equivalent revenues/spending in rUK seems to satisfy the spirit of the 1st no detriment principle, but does not fully satisfy the 2nd no detriment principle. Conversely, indexing the block grant to the £s p.p change in equivalent revenues/spending in rUK satisfies the 2nd no detriment principle, but does not seem in the spirit of the 1st (as it has an effect similar to the "Barnett squeeze").

There is a further issue with the 2nd no detriment principle: taken at face value, it implies that where there are knock-on effects from one government's decisions on the revenues or spending of the other, compensating transfers should take place. The calculation of such transfers would be difficult, however, involving complex calculations and modelling; seemingly minor and technical differences in assumptions may lead to very different answers. This aspect of the no detriment principles therefore leaves much scope for disagreement – which could cause difficulties for inter-governmental relations. Difficult negotiations would likely be required in such circumstances, which would mean the system was not "mechanical", and may lead to a lack of transparency.

This would suggest restricting the circumstances in which such transfers take place to the most significant and obvious examples of "knock on" effects; and requiring full information to be published by both the UK government and Welsh government on assumptions and modelling undertaken during negotiations about what compensating transfers should take place. Again, assessment and sign off of costings by the OBR and an equivalent Welsh fiscal commission seems worthwhile; as does investigation of whether an independent body can act as an arbiter.

It is also worth noting that while the “no detriment” principles may seem intuitively appealing, they are not a central feature of the fiscal frameworks of other countries, perhaps because of the difficulties of implementing such principles in practice.

What financial and economic information is needed by the UK and Welsh Governments to provide support for future funding arrangements?

The data requirements to implement future funding arrangements will depend upon precisely what those are.

Tax devolution will require forecasts and outturns data for revenues from devolved taxes in Wales and equivalent taxes in the rest of the UK (or England). The forecasts of those revenues will require improved data and forecasts on the Welsh economy – housing volumes and prices, landfill volumes, employment, earnings, profits and other incomes etc. It would also be useful to have more detailed statistics on the devolved taxes (e.g. income tax collected by income range or tax band; housing market transactions by stamp duty band, and revenue per band).

Any move to a needs-based formula for allocating the block grant will require data on the indicators that enter that formula. The Holtham Commission showed that it is possible to base a formula on a relatively small set of indicators which would reduce data requirements.

As discussed above, information on how the Barnett formula (or any replacement formula) has been applied at each fiscal event (and the resulting budgetary consequential) should be published to allow proper oversight and scrutiny.

Are there any issues the Committee should be aware of in relation to developments on the issues of convergence, underfunding and Barnett reform?

I would suggest the Committee examine two contributions to these issues.

First, a recent paper by myself, which looks at the Barnett Formula’s treatment of devolved NDRs:

<http://www.ifs.org.uk/publications/7442>

Secondly, a paper by Jim Cuthbert (actually from 2001) which provides some analytical results on the extent to which the Barnett formula leads to convergence at given levels of nominal spending growth, and different levels of relative population growth:

<http://strathprints.strath.ac.uk/52628/>

The proposal to put operate a funding floor for Wales by adjusting the Barnett formula so that Wales gets 115% of any increase in per-person comparable spending in England (if needs were assessed to be 115% of those in England) should be seen in the light of the paper by Mr Cuthbert. In effect, if population growth were slower in Wales, such a mechanism would lead to funding in Wales moving quite away above that floor.

Cynulliad Cenedlaethol Cymru / National Assembly for Wales
Y Pwyllgor Cyllid / The Finance Committee
Future Funding For Wales Inquiry / Ymchwiliad i Ariannu Cymru yn y Dyfodol

FIN(4) FF06a
Ymateb gan Y Sefydliad Astudiaethau Cyllid – Atodiad A
Response from The Institute for Fiscal Studies – Annex A

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The Smith Commission proposals: the unresolved issue of the “fiscal framework”

David Phillips

CIPFA Scotland Conference 2015, March 26th 2015

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The Smith Commission proposals

- Significant devolution of tax powers and revenues
 - ~ £10 – 11bn of income tax, ~£4 bn of VAT, and others
 - Devolved or assigned revenues will make up >50% of Scottish Government spending
- Partial devolution of welfare
 - ~ £2.5bn of mainly disability benefits
 - Powers to top up benefits and vary housing elements of UC
- Need to adjust the block grant given to Scottish government to account for additional revenues and spending responsibilities
- And changes to the wider ‘fiscal framework’ are needed given additional budgetary risk

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Coming up

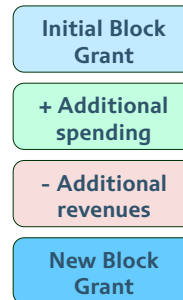
- The Smith Commission and the fiscal framework
 - The big unresolved issue
 - The Commission’s principles for the framework
- Assessing the options for adjusting the block grant
 - Do any of them satisfy all the Commission’s principles?
- Borrowing powers
 - What about a prudential borrowing regime?
- Beyond the Smith Commission proposals
 - The financial implications of ‘full fiscal autonomy’
- Concluding thoughts

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Adjusting the Block grant in year 1

- Adjusting the block grant in year 1 is conceptually simple:



- But what about in subsequent years?

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Adjusting block grant in subsequent years

- Cannot just keep making the same cash-terms adjustment
 - Need to account for inflation and economic growth
- But cannot adjust based on how much is raised from devolved taxes and spent on devolved welfare each year
 - Remove incentive for Scottish govt. to grow tax revenues and limit expenditure growth
 - Changes in block grant would neutralise such efforts

Revenues up
£500m

Block grant
cut £500m

= no net
change

- Smith Commission recognises importance of issue
 - Adjustment should be “indexed appropriately”
 - But what would be an appropriate method?

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The Smith Commission’s fiscal principles (I)

- Smith Commission also sets out a number of principles the new fiscal framework (including block grant adjustments) should meet:

95.1 “Barnett Formula”

The block grant from the UK Government to Scotland will continue to be determined by the Barnett formula

95.2 “Economic Responsibility”

The Scottish budget should benefit in full from Scottish Government policy decisions increasing revenues or reducing expenditures, and bear the full cost of policy decisions that reduce revenues or increase expenditures.

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The Smith Commission’s fiscal principles (II)

95.3 “No detriment as a result of the decision to devolve further powers”

The Scottish and UK Governments’ budgets should be no larger or smaller simply as a result of the initial transfer of tax and/or spending powers, before considering how these are used.

95.4 “No detriment as a result of UK or Scottish Government policy decisions post-devolution”

Where policies of either government affect spending or revenues of others, compensating transfers should take place. Changes in rUK to taxes devolved to Scotland should not affect government spending in Scotland

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The Smith Commission’s fiscal principles (II)

95.5 “Borrowing powers”

Need to be consistent with the mechanism by which block grant is adjusted to account for tax and spending devolution

95.8 “UK economic shocks”

The UK Government should continue to manage risks and economic shocks that affect the whole of the UK.

95.6 “Implementable and stable”

Once a revised funding framework has been agreed, its effective operation should not require frequent ongoing negotiation.

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Assessing block grant adjustment options

- There are a number of ways block grant adjustment can be calculated in subsequent years
- Adjust the block grant by a constant %
- Index the adjustment to what happens to revenues from equivalent taxes (or spending on equivalent welfare) in rUK
 - In % terms
 - In £s per person (p.p) terms
- We need to assess the various methods
 - How do they perform under different scenarios?
 - Do they satisfy Smith Commission's principles?

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Adjusting by a constant percentage (I)

- Suppose year 1 block grant is £30bn and income tax revenues of £10bn is being devolved*
 - Block grant is therefore reduced by £10bn to £20bn
 - Reduction is equivalent to 33% of initial block grant
- In future years reduce block grant by 33% compared to what it otherwise would be
 - e.g. if grant otherwise £33bn: $£33bn - 33\% = £22bn$
- The good...
 - Can adjust for rUK policy changes using Barnett formula
 - Simple & a similar system already operates for business rates

* We abstract from devolution of other taxes and welfare only to keep examples simple.

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Adjusting by a constant percentage (II)

- The bad...
 - Scottish budget would end up bearing risk of shocks that affect the whole of the UK, contrary to Smith Commission

Following devolution, Scotland's budget is £20bn (grant) + £10bn (revenues)

e.g. Income tax revenues fall by 20% in Scotland and rUK (UK-wide shock)

UK gov't leaves spending unchanged so underlying block grant still £30bn and adjusted still £20bn

Scotland's budget is now £20bn (grant) + £8bn (revenues): a shortfall of £2bn due to 20% revenue fall

- And the ugly...
 - Scotland isn't well placed to bear such risks
 - Fewer mechanisms to compensate
 - Borrowing is likely to be more expensive for Scotland

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Indexing to % change in rUK revenues (I)

- Keeping with example of 20% revenue fall in Scotland and rUK
 - Block grant adjustment is reduced by 20% from £10 to £8bn
 - Scottish Gov't budget is now £22bn (grant) + £8bn (revenue) = £30bn
 - Scottish Gov't budget is insulated from UK-wide shocks
 - Need less additional borrowing powers to smooth shocks
- If Scottish and UK revenues change at same % rate, Scotland's overall budget is same as without devolution
 - In the spirit of the first "no detriment" principle (95.3)
- But does gain/lose if its revenues do better/worse than rUK
 - Ensures incentives to grow economy and manage fiscal risks

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Indexing to % change in rUK revenues (II)

- rUK revenues also affected by UK government policy changes
- Suppose UK government cuts income tax in rUK by £10bn.
 - This is equivalent to about 8%, so block grant adjustment reduced by 8% (£0.8bn) to £9.2bn
- Further, imagine this is funded by cutting spending in rUK
 - Barnett formula means £10bn cut in spending in rUK reduces underlying block grant to Scotland by about £0.92bn
- Net effect is to reduce Scottish Govt. budget by £0.12bn
 - £0.8bn - £0.92bn
- So Scottish Govt sees its budget cut to fund a tax cut in rUK
 - Violates second “no detriment” principle (95.4)

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Indexing to £s p.p change in rUK revenues (I)

- Problem arises because revenues per person differ between Scotland and rUK
 - Barnett formula works on £s p.p. changes not % changes
- Indexing block grant adjustment to £s p.p change in rUK revenues solves this problem
- But introduces another problem
 - Scottish revenues would have to grow quicker in % terms to keep up £s per person growth in rUK revenues

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Indexing to £s p.p change in rUK revenues (II)

- Scottish income tax revenues in 2013-14 were £11.4 billion
 - £2,140 per person, compared to £2,460 in rUK
- Suppose devolved at that time, and thereafter revenues grow 5% in Scotland and rUK
- 10 years after devolution, the amount taken off block grant would increase to £19.7 billion, but Scottish revenues would only grow to £18.9 billion.
 - Shortfall of £1.1 billion
 - Shortfall would continue growing over time
- Scottish revenues would have to grow quicker than those in rUK to avoid such a fate
 - Does not feel in the spirit of 1st “No Detriment” principle (95.3)



Summarising the options

- Fixed % adjustment to block grant
 - Easy to understand and implement using Barnett formula
 - But Scotland bears risk of UK-wide shocks it is ill-equipped to bear
- Index to % change in rUK revenues
 - Insulates Scotland from UK-wide shocks but still growth incentive
 - In spirit of “no detriment simply from devolution”
 - Scotland affected (a bit) by rUK decisions on devolved taxes
- Index to £s p.p change in rUK revenues
 - Scotland unaffected by rUK decisions on devolved taxes
 - But Scotland loses out unless its revenues grow more quickly in % terms than rUK – not in spirit of 1st “no detriment” principle

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Can any mechanism satisfy all Smith principles?

- Clear trade-offs between different Smith Commission principles
- Our ongoing analysis suggests that there is **no method that will satisfy all the principles**
 - Fiddly fixes would increase risk of political deadlock
- Need to prioritise principles and choose method accordingly
- **Indexing to % change in rUK revenues looks best to me**
 - Insulates Scotland from UK-wide shocks
 - Taxes in rUK go up and down and the (relatively small) increases and reductions in Scotland's budget this method causes would balance out
- Problems under other methods larger & likely to grow over time
 - e.g. after 20 years, loss to Scotland at 5% revenue growth under £s p.p. indexation would increase to £2.8bn.

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Should the “no detriment” principles be ditched?

- More generally, not clear “no detriment” principles are sensible
 - Devolution necessarily increases budget risk (& possible “detriment”)
- Consider “compensation” for knock-on effects
- Suppose Scotland increases top rate of tax to 50%
 - Scots work less, so pay less NICs – Scottish govt compensate UK govt?
 - Scots shift income from earnings to dividends; or Scots move from Scotland to rUK – UK govt compensate Scottish govt?
 - How do you measure these effects?
- Such an approach necessarily require lots of negotiation
 - £millions at stake, so lots to argue about – political chaos?
- Better to accept there may be some detriment to either govt?
 - Other countries (e.g. US, Canada, Australia) do

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Borrowing powers

- Scotland would need borrowing powers commensurate with the fiscal risks it faces under devolution
- By insulating Scotland from UK-wide shocks, indexing block grant adjustment to % change in rUK revenues reduces necessary scale of extra borrowing powers
 - Reduces Scotland's debt interest bill
 - Less risk of UK govt. having to bail out Scotland?
- CIPFA has argued for a system of prudential borrowing
 - Argue it has worked well for local authorities
 - Central government can intervene if local authorities over-borrow
 - But politics with Scotland is difficult – intervention by UK govt could cause a political and constitutional crisis
 - Could be in some groups' interests to cause such a crisis

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Beyond Smith: full autonomy (I)

- Smith proposals not necessarily the end of the devolution journey
 - SNP has argued for “full fiscal autonomy”
- Full fiscal autonomy normally interpreted as Scotland raising all its own revenues and controlling all its spending
 - Includes contribution to UK govt for defence, foreign affairs, and servicing Scotland's share of UK's existing debt
 - No more Barnett formula
- Latest GERS figures for 2013-14 show:
 - Scottish deficit of 8.1% of GDP, compared to 5.6% for UK as a whole
- Oil price falls mean Scotland's relative position likely worsened
 - In 2015-16 deficit of 8.6% of GDP (4.0% UK)

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Beyond Smith: full autonomy (II)

- At the moment full fiscal autonomy would therefore entail
 - Very high borrowing (not feasible?) or
 - Substantial tax rises or spending cuts
- Oil revenues need to be about £8bn a year to make up for loss of funding under Barnett formula
 - Currently forecast at £0.6 billion a year
 - May rebound, but volatile, and longer term decline
- Faster growth in onshore economy would help close the gap
 - Easier said than done
 - Main policies suggested involve taxing less or spending more – make the gap bigger, not smaller
- Full fiscal autonomy would entail significant fiscal challenges

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Conclusions

- Updating the fiscal framework to account for further devolution is important – for responsibility, fairness, and incentives
- But it looks like cannot satisfy all Smith Commission principles
 - And “no detriment” principles not so sensible in practise as on paper
- Devolution necessarily involves budget risks
 - Policymakers should focus on ensuring the system is workable and risks shared sensibly between UK and Scottish govt
 - Politics is key: Will two governments design and operate a system in good faith? Or will it be used a battleground for point scoring?
- Borrowing is another key issue – not sure prudential borrowing is the right approach
- Smith Commission may only be start of the journey
 - Full fiscal autonomy presents a big fiscal challenge

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FIN(4) FF07
Ymateb gan Llywodraeth yr Alban
Response from Scottish Government

Information provided by the Scottish Government in relation to the Future Funding inquiry

1. The Scottish Parliament Finance Committee's Report "Further Fiscal Devolution" - available at [Appendix A](#)
2. Scottish Government written evidence to the report - available at [Appendix B](#)
3. The Scottish Parliament's Devolution (Further Powers) Committee Interim Report - available at [Appendix C](#)
4. Ongoing finance committee inquiry into the Scotland's fiscal framework:
[http://www.scottish.parliament.uk/S4_FinanceCommittee/Meeting%20Papers/Public_papers\(5\).pdf](http://www.scottish.parliament.uk/S4_FinanceCommittee/Meeting%20Papers/Public_papers(5).pdf)
5. House of Lords: Select Committee on the Barnett Formula
<http://www.publications.parliament.uk/pa/ld200809/ldselect/ldbarnett/139/139.pdf>

Our constraint as officials in the Scottish Government is that we do not have deep knowledge and understanding of the current financial settlement for Wales, its potential weaknesses, and how it might develop in future. In addition, because our Ministers do not have a position on these and other related issues listed by the Committee, we cannot offer to explain the Scottish Government's policy on them.

What we can do is to explain the Scottish Government's policy on funding for Scotland, bearing in mind that this is an issue of current interest in the context of the report of the Smith Commission and the Scotland Bill which was given its Second Reading in the House of Commons on 8 June. It is also an issue that - as the papers sent on by Dave Ferguson demonstrate - has

generated a lot of Scottish Parliamentary scrutiny and also commentary from others. If the Committee would find it helpful in advance of the hearing, we can provide links to further papers prepared by academics based in Scotland on relevant issues such as Barnett and convergence. In any comments on these papers, Sean and I can seek = to state and explain the Scottish Government's position on the issues.

Also relevant to the Committee's considerations is the statement in the Smith Commission's report (see paragraph 95(1)) that "the block grant from the UK Government to Scotland will continue to be determined via the operation of the Barnett Formula." Our Ministers have welcomed this.

In addition to the papers provided by Dave, Committee members might also find it helpful to be aware of the Scottish Government's submission to the Smith Commission from October last year:

<http://www.gov.scot/Publications/2014/10/2806/6>

I would draw your attention in particular to chapter 4 – SCOTLAND'S ECONOMY AND PUBLIC FINANCES – which includes commentary on how the Scottish Government envisages the Barnett formula would operate during the transition to full domestic economic and fiscal autonomy.



The Scottish Parliament
Pàrlamaid na h-Alba

Finance Committee
6th Report, 2015 (Session 4)
Further Fiscal Devolution

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The Scottish Parliament
Pàrlamaid na h-Alba

Finance Committee

Remit and membership

Remit:

1. The remit of the Finance Committee is to consider and report on-

(a) any report or other document laid before the Parliament by members of the Scottish Government containing proposals for, or budgets of, public expenditure or proposals for the making of a tax-varying resolution, taking into account any report or recommendations concerning such documents made to them by any other committee with power to consider such documents or any part of them;

(b) any report made by a committee setting out proposals concerning public expenditure;

(c) Budget Bills; and

(d) any other matter relating to or affecting the expenditure of the Scottish Administration or other expenditure payable out of the Scottish Consolidated Fund.

2. The Committee may also consider and, where it sees fit, report to the Parliament on the timetable for the Stages of Budget Bills and on the handling of financial business.

3. In these Rules, "public expenditure" means expenditure of the Scottish Administration, other expenditure payable out of the Scottish Consolidated Fund and any other expenditure met out of taxes, charges and other public revenue.

(Standing Orders of the Scottish Parliament, Rule 6.6)

Membership:

Richard Baker (from 14 January 2015)
Gavin Brown
Malcolm Chisholm
Kenneth Gibson (Convener)
Jamie Hepburn (until 25 November 2014)
John Mason (Deputy Convener)
Mark McDonald (from 26 November 2014)
Michael McMahon (until 13 January 2015)
Jean Urquhart

Committee Clerking Team:**Clerk to the Committee**

Jim Johnston

Senior Assistant Clerk

Catherine Fergusson

Assistant Clerk

Alan Hunter

Committee Assistant

Tom Williams



The Scottish Parliament
Pàrlamaid na h-Alba

Finance Committee

6th Report, 2015 (Session 4)

Further Fiscal Devolution

The Committee reports to the Parliament as follows—

INTRODUCTION

1. The Committee agreed at its meeting on 8 October 2014 to undertake an inquiry into further fiscal devolution. The Committee considered both the options for the devolution of further financial powers and a number of implementation issues. The Committee's Adviser drafted a summary of the evidence received in relation to the taxes considered by the Smith Commission and this is attached as Annexe A. The main body of the report focuses on implementation issues and builds on the previous work of the Committee in scrutinising the implementation of the financial powers within the Scotland Act 2012.
2. The Committee published a call for evidence on 8 October and received 23 submissions.¹ The Committee also held a number of oral evidence sessions including with the Chief Secretary to the Treasury (CST) and the Cabinet Secretary for Finance, Constitution and Economy ("the Cabinet Secretary"). The Committee would like to thank everyone who gave evidence to the inquiry.
3. The Committee has also published a call for evidence² on the proposals for a fiscal framework for Scotland recommended by the Smith Commission³ and set out in more detail in the UK Government Command paper, *Scotland in the United Kingdom: An enduring settlement*.⁴
4. It is intended that the findings in this report will help to inform the Committee's consideration of the proposed fiscal framework.

Scotland's Fiscal Framework

5. The Smith Commission recommends that the "devolution of further responsibility for taxation and public spending, including elements of the welfare

¹<http://www.scottish.parliament.uk/parliamentarybusiness/CurrentCommittees/83965.aspx>

²<http://www.scottish.parliament.uk/parliamentarybusiness/CurrentCommittees/86486.aspx>

³http://www.smith-commission.scot/wp-content/uploads/2014/11/The_Smith_Commission_Report-1.pdf

⁴<https://www.gov.uk/government/publications/scotland-in-the-united-kingdom-an-enduring-settlement>

system, should be accompanied by an updated fiscal framework for Scotland, consistent with the overall UK fiscal framework.” The UK and Scottish Governments should jointly work via the Joint Exchequer Committee (JEC) to agree the framework which should include:

- Funding of the Scottish budget;
- Adjustments to the block grant arising from further devolution;
- Operation of borrowing powers and cash reserve;
- Fiscal rules;
- Independent fiscal institutions.

6. Chapter 2 of the UK Government’s command paper sets out its view on the proposed fiscal framework for Scotland. It defines a fiscal framework as the “set of rules and institutions that are used to set and coordinate sustainable fiscal policy.”⁵ Two key elements are identified: fiscal rules and fiscal institutions.

7. The Command paper states that the new fiscal framework “will be agreed and implemented jointly by the UK Government and Scottish Government through the Joint Exchequer Committee, with suitable engagement with both the UK and Scottish Parliaments.”⁶

8. The CST anticipates that “the framework will be established early in the next UK Parliament, alongside the introduction of a debate on the proposed legislation in the House of Commons.”⁷ The Cabinet Secretary’s view is that the “negotiations on the fiscal framework will be more complex than those on the block grant adjustment for the Scotland Act 2012, although we can build on that experience.” In response from questioning from the Committee he agreed that a defined timescale for the negotiations on the fiscal framework would “probably help” and that it should be tied to the “enactment of the legislation.”⁸

9. The Committee recommends that a clear timetable is agreed and published by the UK and Scottish Governments for the implementation of Scotland’s fiscal framework. This should include allowing sufficient time for consultation with both parliaments on a draft framework.

No Detriment

10. The Smith Commission recommended that there should be “no detriment” as a result of the decision to devolve further powers which means both Governments’ “budgets should be no larger or smaller simply as a result of the initial transfer of tax

⁵https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/397079/Scotland_EnduringSettlement_acc.pdf paragraph 2.2.3

⁶https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/397079/Scotland_EnduringSettlement_acc.pdf paragraph 2.4.37

⁷ [Scottish Parliament Finance Committee, Official Report, 28 January 2015, Col 24](#)

⁸ [Scottish Parliament Finance Committee, Official Report, 28 January 2015, Col 53](#)

and/or spending powers, before considering how these are used.”⁹ It also recommended that there should be no detriment to the budget of the other government “as a result of UK Government or Scottish Government policy decisions post-devolution.”¹⁰

11. The CST told the Committee:

“it is important that we have in the command paper some clear principles about how the fiscal framework within which the new system will operate will be governed. In particular, there is the no detriment principle, which in a sense ensures that there is no gain or loss as a consequence of the fact of devolution to either Scotland or the rest of the United Kingdom, but which confers proper responsibility to each to bear the consequences of actions determined here and actions determined in the UK Parliament.”¹¹

12. In response to questioning from the Committee in relation to the clarity of the no detriment principle the CST responded that “there is a lot of detail behind that, and that detail has still to be worked on, but the principles that are set down are clear.”¹² The Cabinet Secretary takes a different view. He argues that the principle is “not well defined at the moment” and “when we attempt to turn the principle into reality, we will have a few years like those we had with the block grant adjustment.”¹³

13. The Committee notes that there are clear differences between the two Governments regarding the clarity of the no detriment principle. The Committee intends to take further evidence on this issue as part of its forthcoming inquiry on the fiscal framework.

Gaming

14. Professor Heald has highlighted to the Committee on a number of occasions that the new tax powers may be vulnerable to gaming by the UK Government. He warns, for example, that the UK Government “will not allow Scotland (or Wales or Northern Ireland) to erode its own tax base and the Treasury will have retaliatory instruments.”¹⁴ He also suggests that if:

“the UK Treasury does not have a financial stake in the Scottish income tax base, I would expect both malicious actions (eroding that base through other tax measures) and malign neglect (inadequate attention being paid to interactions with other tax measures and inadequate enforcement from HMRC

⁹ http://www.smith-commission.scot/wp-content/uploads/2014/11/The_Smith_Commission_Report-1.pdf paragraph 95(3)

¹⁰ http://www.smith-commission.scot/wp-content/uploads/2014/11/The_Smith_Commission_Report-1.pdf paragraph 95(4)

¹¹ [Scottish Parliament Finance Committee, Official Report, 28 January 2015, Col 2](#)

¹² [Scottish Parliament Finance Committee, Official Report, 28 January 2015, Col 27](#)

¹³ [Scottish Parliament Finance Committee, Official Report, 28 January 2015, Col 46](#)

¹⁴ [http://www.scottish.parliament.uk/S4_FinanceCommittee/Meeting%20Papers/2014_11_05_Public_papers\(2\).pdf](http://www.scottish.parliament.uk/S4_FinanceCommittee/Meeting%20Papers/2014_11_05_Public_papers(2).pdf)

in the entirely new situation where determination of Scottish residence matters).¹⁵

15. In oral evidence to the Committee in June 2014 he suggested that “there must be some basis on which the Scottish Government, the Welsh Government and the Northern Ireland Executive can plan their use of the tax powers without concern that subsequent changes to the tax system at the UK level will compromise the operation of those powers”.¹⁶ The implementation of further tax powers in Scotland must be accompanied by “some mechanism for co-ordination between the UK level and the Scottish level.”¹⁷ One option suggested by the Law Society of Scotland is a financial fair play clause.

16. In response to questioning from the Committee on the idea of a fair play clause the CST stated that the “idea of fair play is one reason why the fiscal framework and the no detriment clause are so important.”¹⁸ However, he disagreed with Professor Heald’s argument that the operation of the devolved taxes are vulnerable to gaming by the UK Government suggesting there “is no evidence to support it.”¹⁹

17. The Cabinet Secretary takes a different view and suggests we have already seen an example of gaming. He cites the decision of the UK Government to change the rates and thresholds for Stamp Duty Land Tax (SDLT) in December 2014 following the publication in October 2014 of the Scottish Government’s proposed rates for Land and Buildings Transaction Tax (LBTT).²⁰

18. The Committee notes that there are clear differences between the two Governments regarding the question of gaming. The Committee recommends that the issue of gaming needs further consideration within the context of the no detriment principle.

Block Grant and Barnett Formula

19. The devolved administrations are primarily funded by a block grant and formula system. The Barnett Formula is used to calculate changes to the block grant and not the underlying baseline. Professor Trench notes that all “key decisions regarding the working of the formula and the block grant and formula system are taken by HM Treasury.”²¹ The formula is not enshrined in statute, or given any legal or constitutional form.

Barnett Formula

20. The Smith Commission recommended that “the block grant from the UK Government will continue to be determined via the operation of the Barnett Formula.” The UK Government Command paper states that consistent “with the

¹⁵[http://www.scottish.parliament.uk/S4_FinanceCommittee/Meeting%20Papers/2014_11_05_Public_papers\(2\).pdf](http://www.scottish.parliament.uk/S4_FinanceCommittee/Meeting%20Papers/2014_11_05_Public_papers(2).pdf)

¹⁶ [Scottish Parliament Finance Committee, Official Report, 25 June 2014, Col 4517-4518](#)

¹⁷ [Scottish Parliament Finance Committee, Official Report, 5 November 2014, Col 19](#)

¹⁸ [Scottish Parliament Finance Committee, Official Report, 28 January 2015, Col 12](#)

¹⁹ [Scottish Parliament Finance Committee, Official Report, 28 January 2015, Col 13](#)

²⁰ [Scottish Parliament Finance Committee, Official Report, 28 January 2015, Col 54](#)

²¹ <https://devolutionmatters.wordpress.com/the-barnett-formula-and-the-financing-of-devolution/>

commitment made by all three main UK-wide party leaders, the Barnett formula will continue.”²²

21. Professor Heald has previously questioned in written evidence to the Committee what is meant by retaining the formula. He asks whether this means one or more of the following:

- That the Barnett name will be kept;
- That the population-based adjustment mechanism will continue, whether or not in combination with needs assessment; and/or
- That Scotland’s per capita public expenditure will be maintained.

22. Professor Kay argues that the Barnett Formula is “now inevitably under pressure” and will “generate resistance and resentment in a way that it has not done in the past.”²³ Professor Bell and David Eiser point out that the formula has “been extensively criticised on several grounds” including that it:

- takes no account of the relative spending needs across the UK;
- is based on policy changes in England;
- lacks transparency in how it is operated by the UK Treasury.

23. Professor Bell suggests that the formula “might come under more pressure if there is a substantially greater income tax take in Scotland, and I suspect that there will be pressure from outside Scotland because it is unpopular outside Scotland.”²⁴ Professor Holtham provided a written submission to the Committee in June 2014 in which he states that since the formula “is entirely arbitrary and without any reasoned justification some sort of reform would be appropriate.”²⁵

24. Professor Heald suggests that “we need a debate about how the block grant works” including a “serious discussion about the population adjustment mechanism versus a regular needs assessment.”²⁶ He also questions the assumption that the block grant will become less important as more fiscal powers are devolved. He suggests in written evidence that “the size of the block grant indicates the level of Scottish spending that the UK Government is willing to underwrite.”

25. The CST pointed out that there is a political consensus regarding the Barnett formula which suggests “widespread support for continuing it long into the future.”²⁷ He also advised that there “are no proposals from the UK Government – and I am

²² https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/397079/Scotland_EnduringSettlement_acc.pdf paragraph 2.4.2

²³ [Scottish Parliament Finance Committee, Official Report, 5 November 2014, Col 15](#)

²⁴ [Scottish Parliament Finance Committee, Official Report, 8 October 2014, Col 9](#)

²⁵ http://www.scottish.parliament.uk/S4_FinanceCommittee/Meeting%20Papers/FC_Public_papers_25_June%283%29.pdf

<http://www.scottish.parliament.uk/parliamentarybusiness/28862.aspx?r=9611&mode=pdf>

²⁶ [Scottish Parliament Finance Committee, Official Report, 5 November 2014, Col 16](#)

²⁷ [Scottish Parliament Finance Committee, Official Report, 28 January 2015, Col 6](#)

not aware of any from any political party – to change any aspect of how the Barnett formula operates.”²⁸

26. The CST also suggested that following the devolution of the Smith Commission recommendations, the block grant determined by the Barnett formula will be responsible for around 35% of the expenditure undertaken by the Scottish Government.²⁹ However, when this figure was put to the Cabinet Secretary he responded that the “highest number I could get devolved and assigned taxes to as a percentage of expenditure in Scotland, taking into account all the changes under Smith, would be 48 per cent. That would leave the block grant at 52 per cent.”³⁰

27. The Committee has written to both the CST and the Cabinet Secretary seeking clarification of how their respective figures were calculated.

Transparency

28. A number of witnesses raised concerns regarding the lack of transparency in relation to how the block grant is calculated. Professor Heald suggested to the Committee in written evidence in June 2014 that there “is a transparency deficit that is undesirable now and – unless removed – would make major devolved taxes unworkable.”³¹

29. Professor Trench also informed the Committee in June that there are “very strong reasons to change the way the grant is administered and organised, so that fewer decisions are taken unilaterally by HM Treasury, there is greater transparency about the working of the formula and the funds allocated using it, and there is greater scope for impartial intervention and review of decisions about the formula.”³²

30. Professor McLean points out that “how the Barnett formula works is entirely in the hands of HM Treasury; it is not a statutory matter. If the Scottish Parliament or the Scottish Government does not like what HM Treasury is doing, there are...no mechanisms to pursue that, except perhaps the joint ministerial committee.”³³ He suggests that the block grant should be determined by a public body “under the joint control of, say, the Scottish, Northern Irish, Welsh and UK Parliaments.”³⁴ One possible model would be the Commonwealth Grants Commission in Australia.

31. While the CST recognised that the operation of the Barnett formula can be quite complicated he disagreed that there is a lack of transparency in the way in which it works. He also pointed out that apart from a mathematical error he couldn't recall any disagreement with the devolved administrations about the operation of the formula. He advised the Committee that the “operation of the Barnett formula is a technocratic process and the outcome of the mathematical calculations can be and

²⁸ [Scottish Parliament Finance Committee, Official Report, 28 January 2015, Col 7](#)

²⁹ [Scottish Parliament Finance Committee, Official Report, 28 January 2015, Col 3](#)

³⁰ [Scottish Parliament Finance Committee, Official Report, 28 January 2015, Col 38](#)

³¹ http://www.scottish.parliament.uk/S4_FinanceCommittee/Meeting%20Papers/FC_Public_papers_25_June%283%29.pdf

³² http://www.scottish.parliament.uk/S4_FinanceCommittee/Meeting%20Papers/FC_Public_papers_25_June%283%29.pdf

³³ [Scottish Parliament Finance Committee, Official Report, 29 October 2014, Col 36](#)

³⁴ [Scottish Parliament Finance Committee, Official Report, 29 October 2014, Col 36](#)

is scrutinised by officials in the Scottish Government, the Welsh Government and the Northern Ireland Executive.”³⁵

32. The Committee notes that while there may be some discussion between the UK and Scottish Governments on the operation of the Barnett formula this is done in private and cannot be viewed as transparent.

33. The Committee’s view is that there is a need for much greater transparency and accountability in relation to how the block grant is calculated. The Committee intends to consider what mechanisms are required to ensure the transparency and accountability of how the block grant is calculated as part of its forthcoming inquiry on the fiscal framework.

Block Grant Adjustment

34. The Smith Commission recommended that “the initial devolution and assignment of tax receipts should be accompanied by a reduction in the block grant equivalent to the revenue foregone by the UK Government, and that future growth in the reduction to the block grant should be indexed appropriately.”³⁶

35. The Chartered Institute of Taxation (CIT) stated in written evidence that “in respect of the block grant, it is important that the formula for reduction is transparent. Additionally, there must be co-ordination between the UK and Scottish Governments in relation to taxes.” The Law Society of Scotland’s view is that “there ought to be more of an agreed timetable for reaching agreement on the adjustment to the block grant.”³⁷

36. The Committee has repeatedly raised concerns in relation to the transparency and timings of changes to the block grant arising from further fiscal devolution. In its report on Draft Budget 2015-16 the Committee emphasised that there needs to be much greater transparency from both the UK Government and the Scottish Government and that sufficient time is made available to allow effective parliamentary scrutiny of adjustments to the block grant prior to implementation.

37. The Cabinet Secretary recognises in his response to the Committee that “a key requirement of any block grant adjustment is that it is transparent and that the Parliament can agree to it.” He also states that he “will take forward the issues raised by the Committee when seeking a permanent block grant adjustment mechanism.”³⁸ The clerks are also working with Scottish Government officials to bring forward any necessary changes to the Written Agreement.

38. The CST stated that “it is important to have an adjustment mechanism that is transparent and able to operate automatically as far as possible.”³⁹

³⁵ [Scottish Parliament Finance Committee, Official Report, 28 January 2015, Col 7](#)

³⁶ http://www.smith-commission.scot/wp-content/uploads/2014/11/The_Smith_Commission_Report-1.pdf

³⁷ [Scottish Parliament Finance Committee, Official Report, 10 December 2014, Col 13](#)

³⁸ [http://www.scottish.parliament.uk/S4_FinanceCommittee/General%20Documents/Cabinet_Secretary_for_Finance_Constitution_and_Economy_to_Convener_dated_3_February_2015\(1\).pdf](http://www.scottish.parliament.uk/S4_FinanceCommittee/General%20Documents/Cabinet_Secretary_for_Finance_Constitution_and_Economy_to_Convener_dated_3_February_2015(1).pdf)

³⁹ [Scottish Parliament Finance Committee, Official Report, 28 January 2015, Col 10](#)

39. The two Governments also agreed through the JEC a set of principles for making adjustments to the block grant and these are attached as Annexe B.

40. **The Committee asks the Scottish Government how useful these principles were in informing the negotiations on the adjustment to the block grant arising from the Scotland Act 2012 and whether there is any plan to review them.**

41. **The Committee also recommends the need to develop a more robust framework for considering future adjustments to the block grant which should be made public.**

Constraining Factor

42. The Committee also heard from the Cabinet Secretary during the draft budget process that the UK Government has sought to include a “constraining factor” within the block grant adjustment. This means attempting to calculate up to about 2029 or 2030 what the devolved taxes would generate and adjust the block grant on this basis so that neither the UK or the Scotland would be better or worse off. The Committee agreed with the Cabinet Secretary that this totally defeats the point of devolving the taxes.

43. In response to questioning from the Committee on the proposal for a constraining factor the CST pointed out that “that work was done as an aid to understanding which of the sets of numbers was likely to be more accurate, to inform how the adjustment works.”⁴⁰

44. However, the Cabinet Secretary told the Committee, the “Treasury proposed what was an essentially a constrained model. We would try to predict stamp duty until 2029-30, which would specify how much tax we envisage would be raised, and then we could calculate an index mechanism that would enable Scotland to be no better or no worse off after all that calculation out to 2029-30.”⁴¹ He rejects this as an “absurd proposition” but warns that the constraining factor may be raised again by the UK Government in discussions on the fiscal framework and the no detriment principle.⁴²

45. The Committee agreed with the Cabinet Secretary in its report on the Draft Budget 2015-16 that the inclusion of a constraining factor “totally defeats the point of devolving the taxes.”⁴³ The Cabinet Secretary responded that “it should be the case for all future block grant adjustment mechanisms that the Scottish budget should benefit if devolved taxes perform better than if the taxes had not been devolved.”⁴⁴

46. The CST was also asked by the Committee whether he agreed that a constraining factor “defeats the point of devolving the taxes”. He responded that “I agree with you on that. The framework is designed to ensure, exactly as you say, that if the Scottish Parliament makes decisions that are beneficial and lead to higher

⁴⁰ [Scottish Parliament Finance Committee, Official Report, 28 January 2015, Col 18](#)

⁴¹ [Scottish Parliament Finance Committee, Official Report, 28 January 2015, Col 45](#)

⁴² [Scottish Parliament Finance Committee, Official Report, 28 January 2015, Col 46](#)

⁴³ http://www.scottish.parliament.uk/S4_FinanceCommittee/Reports/fiR-15-01w.pdf paragraph 65

⁴⁴ [http://www.scottish.parliament.uk/S4_FinanceCommittee/General%20Documents/Cabinet_Secretary_for_Finance_Constitution_and_Economy_to_Convener_dated_3_February_2015\(1\).pdf](http://www.scottish.parliament.uk/S4_FinanceCommittee/General%20Documents/Cabinet_Secretary_for_Finance_Constitution_and_Economy_to_Convener_dated_3_February_2015(1).pdf)

tax revenues over time, that should benefit the resources that are available to the Scottish Government.”⁴⁵

47. The Committee will write to the CST asking him to confirm that there is no intention to include a constraining factor within any adjustment to the block grant and that any attempt to do so would be inconsistent with the no detriment principle.

Statement of Funding Policy

48. The purpose of HM Treasury’s Statement of Funding Policy (SFP) is “to set out the policies and procedures, which underpin the exercise of setting the budgets of the devolved administrations.”⁴⁶ The Statement is agreed between the Chief Secretary to the Treasury and the Secretaries of State for Scotland, Wales and Northern Ireland following consultation with the devolved administrations.⁴⁷ It is, therefore, a UK Government document and does not have to be agreed by the devolved administrations. The Statement has not been revised since 2010 and, therefore, does not include any reference to the arrangements for implementing the financial powers within the Scotland Act 2012.

49. Professor Trench questions why “our financing system essentially depends on an informal Treasury document that the Treasury drafts on its own.”⁴⁸ He argues that “the Treasury was not merely judge in its own cause, with a jury from its side of the fence, but it wrote the rules as well!”⁴⁹ He suggests that at “the very least, there needs to be an impartial mediator” and that the devolved administrations should have a role in drafting and agreeing a revised Statement.

50. The SFP states that the UK Government recognises “it may need to be revised” in response to the implementation of the proposals of the Calman Commission.

51. The CST was asked why the SFP has not been updated since 2010 and his officials responded that there was mutual agreement with the Scottish Government that the “sensible time to update the funding policy would probably be in advance of the next spending round.”⁵⁰ He also confirmed that the devolved administrations would be consulted on any changes.

52. The Committee asks why the SFP has not been updated since 2010 to include, for example, the principles for agreeing adjustments to the block grant.

⁴⁵ [Scottish Parliament Finance Committee, Official Report, 28 January 2015, Col 9](#)

⁴⁶ [Scottish Parliament Finance Committee, Official Report, 28 January 2015, Col 9](#) paragraph 2.2

⁴⁷ http://webarchive.nationalarchives.gov.uk/+http://www.hm-treasury.gov.uk/d/sr2010_fundingpolicy.pdf

⁴⁸ [Scottish Parliament Finance Committee, Official Report, 19 November 2014, Col 38](#)

⁴⁹ <https://devolutionmatters.wordpress.com/>

⁵⁰ [Scottish Parliament Finance Committee, Official Report, 28 January 2015, Col 35](#)

Inter-Governmental Machinery

53. The Smith Commission states that “the current inter-governmental machinery between the Scottish and UK Governments, including the Joint Ministerial Committee (JMC) structures, must be reformed as a matter of urgency and scaled up significantly to reflect the scope of the agreement arrived at by the parties.” It also states that “parallel, formal processes should be developed for the Scottish Parliament and UK Parliament to collaborate more regularly in areas of joint interest in holding respective governments to account.” There should be much stronger and more transparent parliamentary scrutiny, for example, through the “pro-active reporting to respective Parliaments” of the conclusions of the JMC and the JEC.

54. The Scottish and UK Governments have previously agreed to provide the minutes of the JEC meetings to the Scottish Parliament (through the Finance Committee) and to the UK Parliament (through the Scottish Affairs Committee). However, the JEC has not met since February 2013.

55. The Cabinet Secretary stated that the experience of the JEC, “which was added to the arrangements post Calman to try to resolve some of the financial issues, has failed. It has proved no useful function in relation to the agreement for the block grant adjustment.”⁵¹

Finance Ministers’ Quadrilateral (FMQ) Meeting

56. ICAS recommended in their submission to the Smith Commission that as “proposed by the Calman Commission, consideration should also be given to enhancing the present FMQ meeting or similar to incorporate representatives of the devolved jurisdictions and that the scope of its discussions should be widened to cover not just expenditure but also taxation and macro-economic issues.”⁵² This last met in November 2013.

57. The Cabinet Secretary pointed out that most “business is transacted bilaterally” and that the JMC and JEC and “even to an extent” the FMQ “are a bit formal and mechanical” and not “particularly meaningful.”⁵³

58. The Cabinet Secretary was asked by the Committee about the transparency and accountability of informal arrangements between the two governments. He responded that “I try to ensure that the Committee is advised of as much information as I can provide as timeously as I can provide it about the sequence of measures that we are taking.”⁵⁴ He also stated that there is a “general point about accountability and transparency, which given the sensitivity of the issues that we are now dealing with, has to be reflected strongly by both Governments.”⁵⁵

59. The Committee agrees with the Smith Commission that there needs to be much stronger and more transparent parliamentary scrutiny of inter-governmental relations as more powers are devolved to Holyrood. However,

⁵¹ [Scottish Parliament Finance Committee, Official Report, 28 January 2015, Col 41](#)

⁵² [http://www.scottish.parliament.uk/S4_FinanceCommittee/Meeting%20Papers/Papers_for_the_public\(2\).pdf](http://www.scottish.parliament.uk/S4_FinanceCommittee/Meeting%20Papers/Papers_for_the_public(2).pdf)

⁵³ [Scottish Parliament Finance Committee, Official Report, 28 January 2015, Col 41](#)

⁵⁴ [Scottish Parliament Finance Committee, Official Report, 28 January 2015, Col 41](#)

⁵⁵ [Scottish Parliament Finance Committee, Official Report, 28 January 2015, Col 41](#)

given the apparent emphasis on informal bilateral relations rather than formal mechanisms there are issues around transparency and accountability which need to be addressed.

60. The Committee notes that the JEC has not met since February 2013 and that in the Cabinet Secretary's view it has failed. The Committee also notes the observation of the Cabinet Secretary that most business is transacted bilaterally and outwith the formal machinery of the JMC and JEC. This emphasis on informality provides challenges in delivering the Smith Commission recommendation that there should be much stronger and more transparent parliamentary scrutiny.

61. The Committee will take further evidence on how the inter-governmental machinery including the JEC be strengthened and made more transparent. In particular, the Committee will examine good practice in other fiscal federations and will invite SPICe to provide a comparative analysis. The Committee will also consider how we can ensure effective parliamentary scrutiny if most inter-governmental business is transacted outwith these formal mechanisms.

Scottish Fiscal Commission (SFC)

62. The Smith Commission recommended that the Scottish Parliament should seek to expand and strengthen the independent scrutiny of Scotland's public finances.

63. ICAS support the establishment of a Scottish Office of Budget Responsibility (or significant enhancement of the role and resources of the SFC) to improve the scrutiny and accountability of the Scottish Parliament in relation to fiscal powers.

64. The Scottish Government states in its programme for government that:

"The Scottish Fiscal Commission currently operates on a non-statutory basis. We will develop legislation to put the Commission on a statutory footing, and it is intended that such a Bill would allow for the functions and duties of the Commission to be reviewed and expanded in future. The Scottish Government proposes that the remit of the Scottish Fiscal Commission should expand to reflect any new fiscal powers devolved to the Scottish Parliament."⁵⁶

65. The Finance Committee has recommended that the SFC adheres to the OECD principles for independent fiscal institutions and "in particular, the principles of independence, non-partisanship and transparency."⁵⁷ The Committee also recommended that "it is essential that the SFC should be independent and seen to be so."⁵⁸ The Scottish Government agreed with these recommendations in its response to the Committee's report. It believes that the "independence of the SFC is

⁵⁶ <http://www.scotland.gov.uk/Resource/0046/00464455.pdf> page 44

⁵⁷ <http://www.scottish.parliament.uk/parliamentarybusiness/CurrentCommittees/72938.aspx> paragraph 9

⁵⁸ <http://www.scottish.parliament.uk/parliamentarybusiness/CurrentCommittees/72938.aspx> paragraph 8

essential” and intends that the SFC will adhere to the OECD principles both initially on a non-statutory basis and once established on a statutory basis.⁵⁹

66. The UK Government Command paper states that “it will be crucial that the remit and capacity of the” SFC fully reflects the devolution of further powers. The UK Government’s view is that the Scottish Government “should bring forward proposals fully consistent with the OECD principles, and reflecting the UK experience with the OBR, to enhance” the SFC “as part of agreement to a new fiscal framework for Scotland.”⁶⁰

Forecasting

67. The Committee heard conflicting views from the CST and the Cabinet Secretary in relation to who should have responsibility for economic forecasting including tax receipts. The CST suggested that the SFC should be given similar responsibilities to the OBR in relation to economic forecasting. This would mean that the SFC would have responsibility for originating the forecasts rather than commenting on Scottish Government forecasts. He stated that “having forecasts generated independently offers you the opportunity to give greater scrutiny to what the Scottish Government then decides to do.”⁶¹ He also believes that the SFC should forecast the receipts for the Scottish rate of income tax.

68. The Cabinet Secretary stated that the “current arrangements are entirely satisfactory” and the SFC “has a veto over my forecasts.”⁶² He also suggested in relation to the OBR forecasts that “HMRC does most of the work behind the scenes and gives the data to the OBR, which does not do anything with them that is much different from what” the SFC “does with the numbers.”⁶³

69. HMRC stated that “although the OBR has been praised for its independence, from our perspective, the process feels very much the same as it was when the Treasury was doing the forecasting – we had the same conversations with colleagues in the Treasury, and the Treasury would make those forecasts. Both then and now, it is HMRC that provides the underlying data and the first cut of the forecasts for discussion.”⁶⁴

70. The Committee stated in its report on proposals for a fiscal commission that “the Scottish Government should consider the option of inviting the SFC to produce the official macro-economic and fiscal forecasts for Scotland.”⁶⁵

71. The Government responded that it:

“believes that responsibility for carrying out economic and fiscal forecasts, including tax receipt forecasts, should lie with the Scottish Government and that primary accountability should be of Ministers to the Parliament. This is

⁵⁹ http://www.scottish.parliament.uk/S4_FinanceCommittee/General%20Documents/20140424_Scottish_Government_response.pdf

⁶⁰ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/397079/Scotland_EnduringSettlement_acc.pdf paragraph 2.4.34

⁶¹ [Scottish Parliament Finance Committee, Official Report, 28 January 2015, Col 31](#)

⁶² [Scottish Parliament Finance Committee, Official Report, 28 January 2015, Col 49](#)

⁶³ [Scottish Parliament Finance Committee, Official Report, 28 January 2015, Col 49](#)

⁶⁴ [Scottish Parliament Finance Committee, Official Report, 21 January 2015, Col 45](#)

⁶⁵ http://www.scottish.parliament.uk/S4_FinanceCommittee/Reports/fir-14-01w.pdf

consistent with the accountability of Ministers for economic and fiscal policy, to the limited extent that these are presently devolved. However the Government strongly believes that to provide maximum assurance to the Parliament, all forecasts should be subject to independent scrutiny by the SFC, with public reporting on that scrutiny. It believes that this approach will ensure robust and transparent forecasting and will assist the Parliament in holding the Scottish Government to account in as effective a way as possible.”⁶⁶

72. The Committee will take further evidence on whether the SFC or the Scottish Government should generate the economic forecasts as part of its inquiry on Scotland’s Fiscal Framework.

Borrowing

73. The Scotland Act 2012 provides Scottish Ministers with borrowing powers for three purposes from April 2015—

- up to 10% of the Capital DEL budget for capital spending for each year with a statutory limit of £2.2 billion;
- up to £200m annually and £500m in total to deal with deviations between forecast and actual revenues;
- an appropriate cash working balance to deal with temporary shortfalls between receipts and expenditure.

74. The Scottish Government is able to borrow up to £304m in 2015-16 and can do so from the National Loans Fund (NLF), from the banks on commercial terms or through issuing bonds. The Government has indicated that it plans to use these new powers in 2015-16. The modelling in the draft budget assumes that the money is borrowed from the NLF with repayments made over 25 years and charged at an interest rate of 5% from 2016-17 onwards.

75. Professor Heald argues in his written submission that “tax devolution (or the assignment of tax revenues) means that extensive borrowing powers are required in order to manage year-on-year fluctuations in revenues.”

76. Professor MacDonald argues that if the Scottish Government is being asked to take on more fiscal risk then it has to be given borrowing powers. His view is that borrowing should be done on the open market as this is “the only clean and effective way to bring market discipline.”⁶⁷ This is a view shared by Professor McLean who argues that “market discipline is the control that really works.”⁶⁸ However, Professor Kay cautioned that “realistically, the UK Treasury is not going to allow the Scottish Government what would be substantive borrowing powers.”⁶⁹

⁶⁶http://www.scottish.parliament.uk/S4_FinanceCommittee/General%20Documents/20140424_Scottish_Government_response.pdf

⁶⁷ [Scottish Parliament Finance Committee, Official Report, 5 November 2014, Col 8](#)

⁶⁸ [Scottish Parliament Finance Committee, Official Report, 29 October 2014, Col 30](#)

⁶⁹ [Scottish Parliament Finance Committee, Official Report, 5 November 2014, Col 9](#)

77. Professor Muscatelli suggests that borrowing powers should be extended to “allow each devolved part of the UK to smooth out” asymmetric macroeconomic shocks which temporarily affect tax revenues. The extent of the borrowing powers may be limited by “a deficit ceiling, or there might be some sort of deficit rule that it would need to maintain over the cycle in a way that was consistent with the UK’s macroeconomic framework.”⁷⁰

78. Professor Trench stated in his written submission to the Committee in June that the devolved administrations should have the power to issue bonds. However, the UK Government could limit its liability from such borrowing by setting and publicising a ceiling of the maximum amount of devolved borrowing which it will indemnify.⁷¹

79. The Smith Commission recommends that the Scottish Government should have “sufficient, additional borrowing powers to ensure budgetary stability and provide safeguards to smooth Scottish public spending in the event of economic shocks, consistent with a sustainable overall UK fiscal framework.” It should also have “sufficient borrowing powers to support capital investment, consistent with a sustainable overall UK fiscal framework.” Borrowing should also be subject to fiscal rules agreed by both Governments.

80. The UK Government Command paper states that meeting the Commission’s recommendations on borrowing will be dependent on a number of factors and will be subject to discussion between the two governments but “it is clear from international best practice that a set of fiscal rules and robust institutional arrangements will need to be in place to ensure that the overall UK public finances remain sustainable.”⁷²

Borrowing for capital expenditure

81. The Smith Commission recommended consideration of a prudential borrowing regime to support capital investment which should be consistent with a sustainable overall UK framework. The UK Government Command paper explains that the “Prudential Code was introduced to replace a system of credit approvals being sought by local authorities from central government, which in turn replaced an allocation of funds from central government for capital expenditure.” It goes on to state that the “application of a similar regime for the Scottish Parliament will be considered as set out in the Smith Commission Agreement.”⁷³

82. The Committee asked the CST to clarify whether the UK Government’s view is that the prudential borrowing regime which the Smith Commission recommends considering should replace rather than augment the capital grant. The CST responded that there “are positives and downsides to a prudential regime. Replacing the capital grant which we have at the moment could be difficult and I would have misgivings about that.”⁷⁴

⁷⁰ [Scottish Parliament Finance Committee, Official Report, 19 November 2014, Col 6](#)

⁷¹ http://www.scottish.parliament.uk/S4_PublicAuditCommittee/Meeting%20Papers/Papers_for_the_public.pdf

⁷² https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/397079/Scotland_EnduringSettlement_acc.pdf paragraph 2.4.28

⁷³ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/397079/Scotland_EnduringSettlement_acc.pdf paragraph 2.4.27

⁷⁴ [Scottish Parliament Finance Committee, Official Report, 28 January 2015, Col 16](#)

Borrowing for preventative spending

83. ICAS recommended in their submission to the Smith Commission that consideration is given to extending the borrowing powers of the Scottish Government and Scottish local authorities to “fund preventative spend initiatives within prescribed limits.”⁷⁵ This is justified on the basis that “preventative spending has a quality which is normally associated with capital expenditure in that its objective would be to deliver long-term benefits through reducing demand for public services and creating future savings.”⁷⁶

84. The Committee will take further evidence on what additional borrowing powers should be devolved and what fiscal rules should be applied to these powers.

85. The Committee would welcome the view of the Scottish Government on the proposal to allow borrowing to fund preventative spending within prescribed limits.

Scottish Cash Reserve

86. The UK Government has indicated that if receipts from the devolved taxes exceed forecasts then the priority should be to pay off any debt from previous years when receipts were lower than forecasts. If there is no outstanding debt then the additional revenues should be credited to a Scottish cash reserve “with the intention that they are used for any potential future deficits” and “will provide the flexibility to offset good and bad years.”⁷⁷

87. The Committee considered this issue as part of its scrutiny of Draft Budget 2015-16 and agreed with the Cabinet Secretary that the Scottish Government should have the flexibility to either spend the surplus tax receipts or put them in the cash reserve.

88. When questioned by the Committee on whether there should be flexibility, the CST responded that he would “be reluctant to go down that route” and it is important to build up the cash reserve to manage volatility in receipts. However, “it can of course be debated as part of the discussions on the financial framework.”⁷⁸

89. The Committee reiterates its view that the Scottish Government should have the flexibility to either spend any surplus tax receipts or put them in the cash reserve and will write to the CST.

Annual Tax on Enveloped Dwellings (ATED)

90. The Law Society of Scotland raised the issue of the appropriateness of retaining ATED in Scotland following the devolution of Stamp Duty. ATED was introduced in the UK in 2013 as a means of tackling SDLT avoidance. The Law

⁷⁵ http://www.scottish.parliament.uk/S4_FinanceCommittee/General%20Documents/ICAS.pdf

⁷⁶ http://www.scottish.parliament.uk/S4_PublicAuditCommittee/General%20Documents/Additional_writ ten_evidence_to_the_Finance_Committee.pdf

⁷⁷ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/69803/Scotland_Bill_Command_Paper.pdf page 39

⁷⁸ [Scottish Parliament Finance Committee, Official Report, 28 January 2015, Col 25](#)

Society of Scotland suggested that, given the Scottish Government has adopted a different approach to tax avoidance and that there is a provision within the LBBT legislation to address the issue, then ATED should not apply to properties in Scotland. While ATED currently only applies to properties with a value of £2m, this will reduce to £500,000 by April 2016.

91. The Committee has written to the Cabinet Secretary asking whether the Scottish Government has discussed with the UK Government whether ATED should continue to apply in Scotland. The Cabinet Secretary responded that we have “not considered it necessary to date to seek devolution of ATED or to seek disapplication of the tax in Scotland.” He points out that while the Scottish Government supports the intended purpose of ATED it “has thus far had very limited application in Scotland.”

92. The Committee asks whether the Scottish Government intends to continue monitoring the level of ATED being collected in Scotland and to inform the Committee if there is any significant change in the amount paid.

Conclusion

93. The Committee recognises that there is a need for confidentiality in inter-governmental relations and that much of this work takes place informally and between government officials. However, as recommended by the Smith Commission there is also a need for much stronger and more transparent parliamentary scrutiny. This should include as a minimum regular updates to the Parliament.

94. The Committee has published a call for evidence on the proposals for a fiscal framework for Scotland and intends to publish its report by the end of June. The Committee will then invite the Cabinet Secretary and HM Treasury to provide oral evidence in September. The Committee views this work as an initial contribution to the debate on the content of the fiscal framework and expects that both Parliaments are formally consulted on a draft framework.

ANNEXE A

Inquiry into the options for the further devolution of further financial powers to the Scottish Parliament - adviser briefing.

1. Following the Referendum in September 2014, the Smith Commission for further devolution of powers to the Scottish Parliament was formed. The Finance Committee agreed to contribute to the debate by examining the options for devolution of further financial powers to the Scottish Parliament and on 8 October 2014 called for written evidence to be submitted by 14 November 2014.¹ The Committee took further oral evidence from individuals or bodies², most of whom submitted written evidence prior to the relevant meeting.³ The Smith Commission gave its recommendations, which have cross-party support, on 27 November 2014⁴ and these formed the basis of a Command Paper, *Scotland in the UK: An enduring settlement*, published by the UK Government on 22 January 2015.⁵ This briefing summarises the evidence offered to the Finance Committee on the issues arising from the devolution of specific taxes whether or not recommended for devolution by the Smith Commission.

2. The Smith Report is structured as Heads of Agreement endorsed by the five political parties represented in Parliament and participating in the Commission. The recommendations on further devolution of taxes appear in Pillar 3 of the Heads of Agreement.⁶ The Commission proposes further devolution of power over the rates and bands of income tax on non-savings income, assignment of the first 10 percentage points of the standard rate of VAT, power to charge tax on air passengers leaving Scotland (replacing Air Passenger Duty) and the power to charge tax on commercial exploitation of aggregates (replacing Aggregates Levy). Taxes which it is proposed will remain fully reserved are National Insurance Contributions, Inheritance Tax, Capital Gains Tax, Corporation Tax and Oil & Gas Taxation, Fuel Duty and Excise Duties. The Heads of Agreement do not give reasons for these decisions. The Command Paper refers only to the taxes recommended for devolution and does so in Chapter 3 of the paper.⁷

Taxes proposed by the Smith Commission for devolution

Income Tax

3. The Scotland Act 1998 devolved a limited power to the Scottish Parliament over the basic rate of income tax, providing at Section 73 for a power to increase or decrease the basic rate percentage of income tax for Scottish Taxpayers by a number not exceeding 3 in respect of Scottish Taxpayers. This power did not extend to the savings or dividend rates applicable to Scottish Taxpayers and I will refer

¹ The call for evidence and written submissions can be found at

<http://www.scottish.parliament.uk/parliamentarybusiness/CurrentCommittees/82234.aspx>

² Details of those who provided oral evidence are set out in Annexe C of the report.

³ The written evidence submitted in advance can be found in the papers for the relevant meeting and the oral evidence in the Official Report of each meeting. Both may be accessed at

<http://www.scottish.parliament.uk/parliamentarybusiness/CurrentCommittees/85021.aspx>

⁴ [Report of the Smith Commission](https://www.smith-commission.scot/), <https://www.smith-commission.scot/>

⁵ <https://www.gov.uk/government/publications/scotland-in-the-united-kingdom-an-enduring-settlement>

⁶ [ibid.](#) pages 23 to 27.

⁷ [Scotland in the UK: An enduring settlement](#), pages 39 to 43.

hereafter to the income to which the dividend and savings rates do not apply as *non-savings income*. This power has never been exercised.

4. The Scotland Act 2012 devolved significantly greater powers over rates of income tax to the Scottish Parliament. Sections 25 & 26 provide that Parliament may set a Scottish Rate. The basic, higher and additional rates of tax for Scottish taxpayers are calculated by deducting 10 percentage points from the UK rates and adding the Scottish Rate set for the year. The legislation for this is already in place and the expected commencement date is 6 April 2016. This Scottish Rate of Income Tax (SRIT) is a significant extension of the existing power to vary the basic rate. It is not restricted to plus or minus 3 per cent and it applies to all three rates, not just the basic rate. More importantly, this is not something that the Scottish Parliament may opt into if it wishes. If the Scottish Parliament does not set the SRIT for any year, Scottish taxpayers will benefit from the full 10% deduction in their rates and the Scottish Government will receive no income tax.

5. This power to set the SRIT is constrained by the rates and bands set by the UK Parliament. The Scottish Parliament cannot change the number or breadth of the bands and the SRIT adjustment will apply uniformly to the rate set for such a band. The SRIT applies only to non-savings income.

6. The Smith proposal is to remove the constraints on rates and bands and to remove the slice of each band reserved for the UK Exchequer under the SRIT. However, the limitation to non-savings income remains. As a result the full amount of income tax paid by Scottish Taxpayers on non-savings income will accrue to the Scottish Government and the Scottish Parliament will set the bands and rates on such income. The rules defining income and its calculation, the introduction or amendment of reliefs, the personal allowance, the savings and dividend rates and the annual imposition of income tax will remain reserved to the UK Parliament. As a UK wide tax, although with Scottish variation in rates and bands, it will continue to be administered and collected by HMRC.⁸

7. The reservation of the personal allowance to the UK government while rates and thresholds are fully devolved seems a little odd. There is a good practical reason why reliefs in general are not devolved. The thresholds for the savings and dividend rates apply to total taxable income and devolving reliefs would have meant two different calculations of taxable income for Scottish taxpayers, one for savings and dividend income and another for non-savings income. This would give rise to a significant increase in the complexity of tax administration. As the personal allowance is in effect a zero-rate band, its devolution could be handled arithmetically with the other rates and bands. However, Danny Alexander MP, Chief Secretary to the Treasury (CST), explained that the personal allowance played a particular role in wider economic incentives in the labour market and that was the reason that it was reserved.⁹

8. Peter Kelly of the Poverty Alliance suggested that control over the personal allowance was fundamental to tackling poverty and should be devolved.¹⁰ The CST

⁸ [Scotland in the UK: An enduring settlement](#), page 23, paragraphs 75 to 79.

⁹ [Scottish Parliament Finance Committee, Official Report, 28 January 2015, Col 28](#)

¹⁰ [Scottish Parliament Finance Committee, Official Report, 17 December 2014, Col 4](#)

pointed out that, while the personal allowance could not be reduced by the Scottish Parliament, Parliament could set a zero rate band which would effectively increase the personal allowance.¹¹ The suggestion that reservation of the personal allowance is required to ensure that Scottish MPs can vote on the UK Budget and Finance Bill appears to miss the point that UK rates and thresholds for savings and dividend income, an integral part of the annual rate setting, continue to apply in Scotland.

9. Although the Smith proposal might seem to be simply a development of the SRIT, David Eiser, speaking before the publication of the Smith Report, saw such a development as significant:

*That would bring a very large revenue source fully into the control of the Scottish Parliament and it would give the Scottish Government the ability to address issues to do with inequality and redistribution. It would not represent the full panoply of tax powers, but relative to other countries around the world it would be a substantial level of tax devolution to a devolved government.*¹²

As one of the UK's larger revenue generators, the devolution of Income Tax on non-savings income will reduce the so-called fiscal imbalance as well as giving power to the Scottish Parliament to take an independent stance on inequality and redistribution. The fiscal imbalance is the difference between the proportion of national expenditure under the control of a sub-central government and the proportion of national revenue it controls. In international comparisons of sub-central governments, Scotland is currently an outlier in terms of the high proportion of expenditure and the low proportion of revenue under its control. The proposed devolution of non-savings income tax will shift the Scottish government towards the median at the decentralised end of the continuum.¹³ Indeed, together with the other tax and spending measures, the command Paper considers that, in controlling 60% of spending and retaining 40% of Scottish tax, Scotland will be one of the most powerful sub-central governments in the OECD, just behind the Canadian Provinces and Swiss Cantons.¹⁴

10. While the Scottish Government will have devolved power to set rates and bands, there will be constraints on the extent to which they are able to introduce differential rates from rUK. Professor Bell pointed out that factors of production, labour and capital, would ultimately move in response to differential taxes.¹⁵ The average person may be relatively unlikely to move elsewhere in the UK if his or her effective rate of tax is higher as a consequence of being a Scottish Taxpayer. But Professor David Heald pointed out that 22.55% of income tax in Scotland is paid by 42,000 individuals having incomes of £100,000 or above, who form 1.59% of taxpayers. These are a subset of the 217,000 taxpayers with income over £50,000

¹¹ [Scottish Parliament Finance Committee, Official Report, 28 January 2015, Col 28](#)

¹² [Scottish Parliament Finance Committee, Official Report, 8 October 2013, Col 10](#)

¹³ [Scotland's fiscal future in the UK, D. Bell and D. Eiser, Figure 2, Page 10,
http://esrcscotecon.files.wordpress.com/2014/09/scotlands-fiscal-future2.pdf](#) and [Scottish Parliament Finance Committee, Official Report, 5 November 2014, Col 23](#), comments by Prof. MacDonald.

¹⁴ [Scotland in the UK: An enduring Settlement](#), paragraph 2.2.10.

¹⁵ [Scottish Parliament Finance Committee, Official Report, 8 October 2014, Col 10](#)

who together pay 44% of the income tax but represent only 8% of taxpayers.¹⁶ High earners are more likely to be able to find well-remunerated opportunities elsewhere in the UK and be willing to move. If higher rates of tax and bands on non-savings income of Scottish taxpayers are disproportionate to the higher rates of tax and bands on savings and dividend income set by the UK Government, there will also be increased pressure to convert non-savings income into dividend income. For owner managers, the self-employed and "contractors", this is already well-used planning to reduce NIC liabilities and the incentive will increase. There will also be pressure to arrange one's patterns of residence to avoid falling within the definition of a Scottish Taxpayer or simply to misinform HMRC about one's circumstances.¹⁷

11. Prof. Bell and D. Neiser caution that the potential movement of tax bases between different jurisdictions creates interdependence of tax rates and forms a real restraint on increasing rates of tax. This is particularly so with more mobile tax bases such as income tax. They cite a number of empirical studies of mobility, for example in Canada and Switzerland, but also caution that other factors may counteract mobility, such as better public services from higher taxation.¹⁸

12. The impact on Scottish finances of the devolution of Income Tax lies not only in the control of rates and bands but also how the block grant is adjusted in consequence of devolution. Professor Gallagher made the point that Income Tax's redistributive effects between income groups inevitably result in geographical redistribution, as income groups are not evenly distributed around the UK. By decoupling the setting of rates and bands for Scotland and the rest of the UK, with the governments potentially having different redistributive intentions, questions arise as to the consequential adjustments to the block grant. If, for example, the UK government were to decide to increase NHS spending and fund it by income tax increases, Scots might benefit through block grant consequentials but would not contribute to the funding.¹⁹ Conversely, if the UK government introduced charges for NHS services and reduced income tax as a result, the block grant would reduce but Scots would not see a corresponding reduction in income tax.²⁰ As Professor Gallagher commented, it is possible to design suitable block grant adjustments to avoid the risk of unintended advantages and disadvantages from tax and spend decisions made by one Government or the other and such issues will need to be addressed.²¹

13. The Command Paper identifies the issue, offering two worked examples of a decrease in 'rest of UK' income tax or alternatively an increase. Whether directly through an impact on reserved expenditure, or indirectly, through Barnett consequentials, the Scottish taxpayer could suffer public service cuts without a reduction in income tax or benefit from increased spending without a higher income

¹⁶ [Scottish Parliament Finance Committee, Official Report, 5 November 2014, Col 4](#) and [Scottish Parliament Finance Committee, Public Papers, 5 November 2014](#), Heald, paragraph 11.

¹⁷ [Scottish Parliament Finance Committee, Official Report, 5 November 2014, Col 4 & 19](#), comments by Prof. Heald.

¹⁸ [Scotland's fiscal future in the UK, D. Bell and D. Eiser](#), pages 12 and 13.

¹⁹ [Scottish Parliament Finance Committee, Official Report, 12 November 2014, Col 31 & 32](#)

²⁰ [ibid. columns 43 & 44](#),

²¹ [ibid. column 41 and Scottish Parliament Finance Committee, Public Papers, 12 November 2014, Gallagher, page 3](#).

tax cost.²² Under the Smith Commission's second 'no detriment' principle, *no detriment as a result of UK Government or Scottish Government policy decisions post-devolution*, a mechanism for adjustment between the governments must be developed.²³ The Chief Secretary to the Treasury suggested that the "two systems" would operate separately with revenues from Scottish income tax being spent in Scotland and revenues from income tax in England being spent in England. As income tax raised in England is less than expenditure in England on devolved matters, he considered that there was no substance to the concern that changes in the UK rates of income tax could unfairly disadvantage or benefit Scottish taxpayers.²⁴ The Cabinet Secretary for Finance, Constitution and Economy, considered that the concept of 'no detriment' was not well defined at the moment and that turning the principle into reality will take a number of years of negotiation and discussion.²⁵

14. In addition to the agreement of appropriate block grant adjustments, there will need to be consultation and cooperation between governments on income tax legislation. The Scottish Government publishes its draft Budget in the autumn including tax rates for the following year. If the Chancellor changes the tax base to which those rates apply in his Spring Budget, the Scottish Government's Budget will be impacted. Peter Kelly gave the example of a change in the personal allowance by the Chancellor impacting on the Scottish Government's rates and bands and called for the two Governments to work together in setting tax policy.²⁶ The CST suggested that changes to personal allowances, for example, will not be last minute announcements because HMRC needs significant lead time to prepare PAYE notices of coding. Rates and bands can be changed at short notice but these will not impact the Scottish Budget.²⁷ Similar issues will also arise, if less acutely, in budgeting for assigned VAT, as VAT rates have been changed at relatively short notice in the past.

15. There were differing views on the timing of the introduction of the Smith Commission's proposals for income tax. HMRC is working towards the introduction of SRIT on 6 April 2016. This involves the identification of Scottish taxpayers and the development of PAYE and other systems necessary to calculate and account for the tax due by them. Essentially, the additional requirements of the Smith proposals are further complexities in the calculation of the tax due. Isobel d'Inverno of the Law Society of Scotland suggested cutting out the "inflexible and strange proposal" of SRIT and implementing the Smith Commission proposal from 2016. On the contrary, Alexander Garden of the CIOT and Elspeth Orcharton of ICAS favoured implementing SRIT as planned and then moving to fuller devolution once it was clear that the identification of Scottish taxpayers and the new systems were satisfactory and that appropriate block grant adjustments were understood and agreed.²⁸

Value Added Tax

²² [Scotland in the UK: An enduring settlement](#), paragraph 2.4.14.

²³ [Report of the Smith Commission](#), paragraph 95(4)

²⁴ [Scottish Parliament Finance Committee, Official Report, 28 January 2015, Col 21](#)

²⁵ [Scottish Parliament Finance Committee, Official Report, 28 January 2015, Col 46](#)

²⁶ [Scottish Parliament Finance Committee, Official Report, 17 December 2014, Col 7 and 8](#)

²⁷ [Scottish Parliament Finance Committee, Official Report, 28 January 2015, Col 13, 15 and 29](#)

²⁸ [Scottish Parliament Finance Committee, Official Report, 10 December 2014, Col 32](#)

16. The Smith Commission proposal is that *the receipts raised in Scotland by the first 10 percentage points of the standard rate of Value Added Tax (VAT) will be assigned to the Scottish Government's Budget.*²⁹ To this, the Command Paper has added the first 2.5 percentage points of the reduced rate of VAT.³⁰ The standard rate is currently 20% and applies to supplies of goods and services that are not exempt, zero rated or taxed at the reduced rate of 5%. The difference between exemption and zero-rating is that no deduction is given for VAT incurred in the provision of exempt goods or services while a deduction is given in the case of zero-rated goods and services. Thus businesses providing zero-rated goods and services may find that their deductible input VAT exceeds their chargeable output VAT, giving rise to a refund from HMRC. Examples of exempt supplies are land, finance, health, education, postal services and others. Examples of zero-rated services are most foods, sanitation, books and newspapers, international services and others. The reduced rate of VAT applies to domestic fuel and power, energy saving materials, women's sanitary products, children's car seats and others. Certain small businesses and farmers may elect to account for VAT as a flat percentage of turnover at rates varying from 14.5% to 4% depending on the type of business. Professor Heald quoted a figure of 55% as the proportion of consumer expenditure subject to VAT.³¹ The VAT assigned under the Smith Commission proposal will not be a proportion of all VAT raised in Scotland but only that VAT raised through the application of the standard and reduced rates.

17. Instituting a value added tax and the removal of all other sales taxes is a condition of membership of the European Union. The EU sets down the structure of VAT and the range within which lower, standard and higher rates may be set. The zero-rate is essentially an "infra-low" rate below the normally permitted range. The maintenance of the zero-rate on a wide range of goods and services is a specific derogation agreed when the UK joined the EU. Those giving evidence to the Committee were in agreement that the EU constraints on VAT would not permit a sub-central government such as the Scottish Government to set rates of VAT different from those set by the central government. This constraint means that assignation rather than devolution is the only option for VAT and Professor Macdonald commenting on this (before publication of the Smith Report) proposed assigning 50% of VAT to the Scottish Parliament.³²

18. With assignation of a proportion of VAT, rather than devolution, the Scottish Government will have no control over the tax base or the rates. These will be decided by the UK Government. The other factor determining the amount of revenue received will be the level of economic activity. In the longer term, the Scottish Government may hope to exercise some positive influence on that. Professor Gallagher was concerned at the risk to the Scottish Government of revenue fluctuations that could not be managed through rate changes.³³ Pressed on the issue, he agreed that as part of a package the acceptance of a measure of risk was reasonable but that 10% was the maximum he would be comfortable with.³⁴

²⁹ [Report of the Smith Commission](#), paragraph 84.

³⁰ [Scotland in the UK: An enduring settlement](#), paragraph 3.3.1.

³¹ [Scottish Parliament Finance Committee, Official Report, 5 November 2014, Col 17](#)

³² [Scottish Parliament Finance Committee, Official Report, 5 November 2014, Col 18](#)

³³ [Scottish Parliament Finance Committee, Official Report, 12 November 2014, Col 41](#)

³⁴ [Scottish Parliament Finance Committee, Official Report, 12 November 2014, Col 54](#)

Professor Muscatelli on the other hand considered that the only reason not to assign the whole of VAT would be to treat the unassigned portion as a form of equalisation fund and he gave Germany as an example.³⁵ The idea of equalisation is that if Scotland's economy does better than the rest of the UK, the rest of the UK would benefit through its proportion of the Scottish VAT yield. If on the other hand Scotland's economy does worse, the absolute amount of Scottish tax yield paid to the rest of the UK automatically reduces while centrally funded expenditure in Scotland benefits from the more buoyant VAT yield in the rest of the UK.

19. As mentioned by Professor McLean and others, with VAT as one of the major taxes, assignment of a proportion of it is significant in reducing the fiscal imbalance referred to in paragraph 8 above even although it does not give control.³⁶ In referring to this lack of control, Professor Muscatelli suggested that some form of consultation between the UK Government and the Scottish Government on VAT changes would be appropriate and he referred to other countries which assign VAT revenues and where sub-central authorities debate the tax take.³⁷ Professor Heald also raised the question of the block grant adjustment necessary when VAT revenues increase and whether this differs depending on whether the increase is a result of a UK change to the tax or not.³⁸

20. The representatives of the professional bodies raised an issue with the wording *receipts raised in Scotland* in the Report of Smith Commission.³⁹ The essence of a value added tax is that it is collected at each stage of the supply chain with a deduction given for the VAT charged earlier in the chain. As each business charges VAT to their customer and, in most circumstances, recovers the VAT they have been charged by their suppliers, paying over the difference to HMRC, the only people who bear the tax are the final consumers. The final consumers are the non-business purchasers of the goods and services or business purchasers who cannot recover input VAT as they make exempt supplies or are otherwise not registered for VAT. UK VAT registered businesses make one VAT return encompassing all UK business carried out by the person or entity. Against this background, Alexander Garden of the CIOT questioned whether it was currently possible to determine Scottish VAT receipts with an acceptable degree of accuracy.⁴⁰ Elspeth Orcharton of ICAS and Isobel d'Inverno of the Law Society of Scotland shared his concern and set out the alternative bases of a) determining VAT on consumption by final consumers in Scotland or b) on the basis of the VAT accounted for by businesses producing goods or services in Scotland. While a methodology note by HMRC points to the former basis, Orcharton and d'Inverno suggested that the latter basis captured Scotland's productive capacity. Either basis will require businesses to provide additional information on the location of customers or on the location of their business activities and an appropriate methodology needs to be worked out.⁴¹

³⁵ [Scottish Parliament Finance Committee, Official Report, 19 November 2014, Col 27](#)

³⁶ [Scottish Parliament Finance Committee, Official Report, 29 October 2014, Col 27](#)

³⁷ [Scottish Parliament Finance Committee, Official Report, 19 November 2014, Col 11, 12, 18 and 19](#)

³⁸ [Scottish Parliament Finance Committee, Official Report, 5 November 2014, Col 29](#)

³⁹ [Report of the Smith Commission](#), paragraph 84

⁴⁰ [Scottish Parliament Finance Committee, Official Report, 10 December 2014, Col 3 and](#)

⁴¹ <http://www.scottish.parliament.uk/parliamentarybusiness/28862.aspx?r=9690&mode=pdf>

⁴¹ [Scottish Parliament Finance Committee, Official Report, 10 December 2014, Col 4, 15, 16, 17, 25 and 26](#)

21. Questioned on the issue, the CST confirmed that the basis of determining the Scottish share of VAT had still to be determined and he was open to considering whether the assignment should be based on value added in Scotland rather than consumption in Scotland.⁴² The Cabinet Secretary for Finance, Constitution and Economy indicated that he was equally open to considering the matter and emphasised the importance that allocation must be on a verified basis.⁴³ Lindsey Fussell, HM Treasury, indicated that other countries, which assign VAT between tiers of government, offer a number of examples to build on.⁴⁴

Air Passenger Duty

22. Air Passenger Duty (APD) was one of the taxes identified as suitable for devolution by the Calman Commission but it was omitted from the Scotland Act 2012. Professor Muscatelli who advised the Calman Commission expressed surprise that it had not been included in the Scotland Act 2012 and was unaware of the reasons for its exclusion.⁴⁵ APD is an excise duty levied on aircraft operators on their carriage of passengers on flights from airports in the UK. The rate depends on the distance of the destination from London (determined as Bands A to D) and the class of travel. For luxury business jets, there are premium rates. From 1 November 2011, the rates for long haul flights from Northern Ireland were reduced to the Band A rate. From 1 April 2015, the Bands B to D will be merged into one long-haul band and the rates for luxury business jets are increased.

23. The Smith Commission proposes that the power to charge tax on air passengers leaving Scottish airports will be devolved to the Scottish Parliament which will be free to make its own arrangements for the design and collection of any replacement tax. This is full devolution including the power to define the tax base, the rules for taxing it and the rates and, indeed, whether to charge a tax at all.⁴⁶

24. There was little concern amongst those who gave evidence about practical difficulties. The representatives of the professional bodies, for example, considered that there were little technical or administrative difficulties in devolving the tax. Elspeth Orcharton of ICAS suggested that, if speed of implementation was desired, HMRC be asked to collect the new Scottish rate of APD while Revenue Scotland put the arrangements in place for a longer term transfer of administrative responsibility.⁴⁷

25. The only significant concern raised was the potential impact of tax competition and, in particular, the impact of lower Scottish APD rates on Newcastle Airport. Professor Heald, while noting that the reduced rate of APD for Northern Ireland had not created problems, was concerned that a significantly reduced Scottish Rate could have an effect on North of England airports, creating "internal political trouble in the UK". He also queried whether there might be EU issues of state aid.⁴⁸ Professor Gallagher, while broadly in favour of the devolution of APD, also

⁴² [Scottish Parliament Finance Committee, Official Report, 28 January 2015, Col 30](#)

⁴³ [Scottish Parliament Finance Committee, Official Report, 28 January 2015, Col 48](#)

⁴⁴ [Scottish Parliament Finance Committee, Official Report, 28 January 2015, Col 30](#)

⁴⁵ [Scottish Parliament Finance Committee, Official Report, 19 November 2014, Col 12](#)

⁴⁶ [Report of the Smith Commission](#), paragraph 86.

⁴⁷ [Scottish Parliament Finance Committee, Official Report, 10 December 2014, Col 15 and 16](#)

⁴⁸ [Scottish Parliament Finance Committee, Official Report, 5 November 2014, Col 27 and 28](#)

expressed concerns about reduced Scottish rates harming the development of Newcastle Airport and speculated about the potential for varying UK rates on a regional basis to protect Newcastle's position.⁴⁹ Professor Muscatelli on the other hand considered that tax competition on APD could, on balance, have a beneficial effect by creating alternative hubs to the overstretched ones in the south-east of England.⁵⁰ The CST quoted a study which suggested that zero APD in Scotland would produce a 10% reduction in traffic in Newcastle and a 3% reduction in Manchester. He did not expect the Scottish Government would reduce tax on air passengers to zero so the economic impact in the north of England would be modest and simply a feature of the minor degree of tax competition that would be introduced by a lower Scottish rate.⁵¹

26. Garry Clark of the Scottish Chambers of Commerce considered that APD had a negative drag on the connectivity of Scottish Airports and this related to the devolved responsibility over tourism and enterprise. He advocated devolving and reducing or even eliminating APD.⁵² While Nicola Walker of the Scottish CBI agreed that APD was distortive and uncompetitive, she would rather these issues were dealt with at the UK level rather than create competition within the UK. While many Scottish members favoured devolution of APD, non-Scottish airports were most concerned at the prospect of devolution.⁵³

Aggregates Levy

27. Like APD, Aggregates Levy was identified by the Calman Commission as suitable for devolution. Legal issues prevented its devolution in the Scotland Act 2012. The Smith Commission propose that the power to charge tax on the commercial exploitation of aggregate be devolved to the Scottish Parliament once the legal issues have been resolved. The Scottish Government will have the power to design and collect any tax replacing Aggregates Levy.⁵⁴ Little mention was made of Aggregates Levy by those giving evidence but Professor Alan Trench counted it amongst taxes on land which he recommended for devolution.⁵⁵ Similarly, in their written evidence, the Law Society of Scotland refer to the immobile nature of the tax base resulting in little technical difficulty and its usefulness as an additional but limited fiscal lever.⁵⁶

Taxes proposed by the Smith Commission for reservation

National Insurance Contributions

⁴⁹ [Scottish Parliament Finance Committee, Official Report, 12 November 2014, Col 53](#)

⁵⁰ [Scottish Parliament Finance Committee, Official Report, 19 November 2014, Col 12](#)

⁵¹ [Scottish Parliament Finance Committee, Official Report, 28 January 2015, Col 27](#)

⁵² [Scottish Parliament Finance Committee, Official Report, 21 January 2015, Col 5](#)

⁵³ [Scottish Parliament Finance Committee, Official Report, 21 January 2015, Col 6](#)

⁵⁴ [Report of the Smith Commission](#), paragraph 89.

⁵⁵ [Public Papers, 19 November 2014, written evidence by Prof Trench, paragraph 9.](#)

⁵⁶ [Public Papers, 10 December 2014, submission from the Law Society, paragraph 18.](#)

28. The Smith Commission proposes that *all aspects of National Insurance Contributions (NIC) will remain reserved*. National Insurance comes in three distinct forms. It is levied on the earnings, benefits and profits of employees and self-employed persons (Class 1 primary, Class 2 and Class 4) and it is levied on employers on the wages, salaries and benefits provided to their employees (Class 1 secondary). Persons not liable may pay voluntary contributions in order to qualify for some benefits (Class 3). If by *tax* we mean a compulsory levy which brings no benefit to the payer other than enjoyment of general public goods, the NIC scheme is a hybrid, being voluntary for some (Class 3), qualifying individuals for benefits unavailable to non-payers (Class 1 primary and Classes 2 to 4) but effectively a payroll tax for employers (Class 1 secondary).

29. No NIC is levied on the earnings or profits of individuals once they reach the state pension age but employers must continue to pay for employees over the state pension age. There are lower earnings limits for employees and employers and a small-earnings exception limit for the self-employed below which no contributions are payable. Above the upper earnings limit, currently £41,865, employees cease to pay the main rate, currently 12%, on their earnings and pay only 2% on the excess. The self-employed pay a flat rate Class 2 contribution, currently £2.75 weekly, and a profit related contribution, currently 9%, up to the upper earnings limit and 2% on the excess. If viewed as a tax, this is regressive with the effective rate of NIC as a percentage of total earnings or profits falling as these increase above the upper earnings limit. The rate for employers applies to earnings without upper limit and is currently 13.8%. There are various exemptions and reliefs which may reduce NIC for some individuals or employers.

30. The evidence to the committee reflected the hybrid nature of NIC with the link between individuals' contributions and benefits, its relationship to income tax and the nature of employers NIC as a payroll tax all being offered as reasons to reserve or devolve NIC. As one of the experts giving evidence after the Smith Commission reported, Elspeth Ocharton of ICAS linked the reservation of NIC, along with employment law and the minimum wage, to the desire for a level playing field for employment purposes across the UK.⁵⁷

31. The link between NIC and entitlements to benefit and pension was cited by a number of experts as a reason, or a potential reason, for reserving NIC to the UK Government. Professor Gallagher considered that NIC on individuals was a gateway to the pension system and he wished to retain and strengthen the contributory principle. As such, he would not want NIC to be devolved. He noted, however, that the 2% above the upper earnings limit was a "substitute for income tax" on the employee and that the employer's contribution is a payroll tax which could be devolved.⁵⁸ While Professor Heald considered that economists were correct to regard NIC as a tax, public perception linked it to pension and benefits and politicians found that perception useful. For that reason and to avoid complicating future reform of the NIC system he was against devolving NIC.⁵⁹ Professor Muscatelli believes that there is now little linkage between NIC and the amount spent

⁵⁷ [Scottish Parliament Finance Committee, Official Report, 10 December 2014, Col 24](#)

⁵⁸ [Scottish Parliament Finance Committee, Official Report, 12 November 2014, Col 52 and 59](#)

⁵⁹ [Public Papers, 5 November 2014, Heald, para 14\(c\)](#); and [Scottish Parliament Finance Committee, Official Report, 5 November 2014, Col 22 and 23](#)

on benefits and he suggested that NIC on individuals should be merged over time with Income Tax. As essentially integral to Income Tax, NIC is a candidate for devolution.⁶⁰ This view was also shared by Professor MacDonald, who considered that NIC was no longer geared to the welfare state but was an income tax. If the Income Tax base was to be devolved, so should NIC.⁶¹

32. In considering the linkage between NIC and Income Tax, it is important to note that there are two aspects to this linkage, the rates and base. Devolution of Income Tax under the Smith Commission proposal is devolution of the power to set rates and bands while legislating the tax base is reserved. If the key aspect of the linkage is that NIC rates are a supplementary tax on income, then devolution of the power to set NIC rates might logically follow devolution of the power to set income tax rates. On the other hand, the harmonisation of the NIC and Income Tax base, advocated by the Office of Tax Simplification⁶², would require the power over the NIC *earnings* base to remain reserved while the Income Tax base remains reserved. Both the CIOT and the Law Society referred to the opportunity that full devolution (rates and base) would give to rationalise or amalgamate Income Tax and NIC.⁶³

33. Employers NIC is not part of the contributory aspect of NIC and reliefs from it are already used as an economic lever to encourage employment of certain groups or assist and encourage certain businesses. Professor Muscatelli considered that devolution of employers NIC along with devolution of Corporation Tax would provide the Scottish Government with effective tools for economic development.⁶⁴ Peter Kelly of Poverty Action also recognised that devolution of NIC could be an important economic power.⁶⁵ Professor Trench considered that the case for devolution of employers NIC was weakened if there was no devolution of substantial welfare functions and cautioned that devolution would entail a significant overhaul of how the NI Fund works.⁶⁶ The STUC were concerned at competition dangers if employers NIC were devolved.⁶⁷

Capital taxes

34. The Smith Commission proposes that *all aspects of Inheritance Tax (IHT) and Capital Gains Tax (CGT) will remain reserved.*⁶⁸ Although bundled together as capital taxes, these two taxes are quite different. IHT is a tax on the transfer of wealth, taxing the estate of an individual when they die and also taxing certain lifetime gifts, principally those made within seven years of death. Capital Gains Tax on the other hand taxes the profit made on disposal of an asset. IHT taxes persons domiciled in the UK on all their assets and non-domiciled persons on their UK assets. CGT taxes UK residents on gains on disposal of assets wherever located

⁶⁰ [Scottish Parliament Finance Committee, Official Report, 12 November 2014, Col 17, 18 and 26.](#)

⁶¹ [Scottish Parliament Finance Committee, Official Report, 5 November 2014, Col 22](#)

⁶² *Review of Tax Reliefs*, Office of Tax Simplification, March 2011, http://webarchive.nationalarchives.gov.uk/20130129110402/http://www.hm-treasury.gov.uk/d/ots_review_tax_reliefs_final_report.pdf

⁶³ [Public Papers, 10 December 2014, CIOT, paragraph 1.3, Law Society, paragraph 13.](#)

⁶⁴ [Scottish Parliament Finance Committee, Official Report, 10 December 2014, Col 24 and 26](#)

⁶⁵ [Scottish Parliament Finance Committee, Official Report, 17 December 2014, Col 8](#)

⁶⁶ [Public Papers, 12 November 2014, Prof Alan Trench, paragraphs 9 and 20](#)

⁶⁷ [Public Papers, 17 December 2014, STUC, section 2, Specific Tax Powers](#)

⁶⁸ [Report of the Smith Commission](#), paragraph 81.

while non-residents, with certain exceptions, are not charged on the disposal of assets even if located in the UK.

35. As a tax based on residence, devolution of CGT could be based on the existing Income Tax definition of Scottish Taxpayer. Scottish domicile has the potential to be a much more difficult way to determine the tax base for devolved IHT. Domicile is typically acquired from one's father at the time of birth and only changes if a clear and settled intention to associate oneself with a different jurisdiction is demonstrated. Given mobility of population within the UK, there would be significant scope to argue that an individual had retained their domicile of origin or had changed it for a domicile of choice depending on which gave the most favourable tax position. There is a rule deeming long-term, non-domiciled residents of the UK to be domiciled in the UK for IHT purposes. This rule deems someone to be domiciled in the UK if resident in not less of 17 of the 20 years ending with the year in question. No doubt some such rule, linking domicile to settled residence, could be used to simplify the concept for devolved IHT.⁶⁹

36. Views on devolving these two taxes varied. The STUC and the Poverty Alliance saw devolution as essential to tackling inequities of land ownership and the redistribution of wealth⁷⁰ while Professor McLean, Professor Gallagher and ICAS saw these as small-yielding, complex taxes unlikely to be worth devolving.⁷¹

Inheritance Tax

37. For IHT the major concern expressed was erosion of the tax base as a result of choice of jurisdiction. As mentioned in paragraph 31 above, IHT could be modified so as to remove the ambivalence between domicile of origin and domicile of choice, replacing it with a settled residence test. This still leaves physical relocation as a tax planning opportunity. Professor Gallagher referred to Australian experience where people would choose to die in the lowest tax jurisdiction.⁷² On the other hand Professor MacDonald referred to experience in Switzerland where devolution of inheritance tax had not created a problem.⁷³ The Swiss experience is also mentioned by Bell and Eiser who quote research that found little evidence of mobility of wealthy retirees and cast doubt on allegations of tax competition between the cantons.⁷⁴ Professor Heald illustrated the risks of tax competition where an increase in IHT rates in Scotland might be matched by a reduction in IHT rates in Wales to attract wealthy taxpayers. Professor Kay agreed that devolution could create pressure for lower rates rather than resulting in raised rates to make the tax more progressive.⁷⁵

Capital Gains Tax

⁶⁹ [Public Papers, 10 December 2014, CIOT, Annex, section 9; ICAS, paragraph 5.34; and Law Society of Scotland, paragraphs 29 & 30](#)

⁷⁰ [Public Papers, 17 December 2014, STUC paragraph 1.6 and Poverty Alliance, paragraph 4.7.](#)

⁷¹ [Public Papers, 29 October 2014, Prof. Iain McLean; Scottish Parliament Finance Committee, Official Report, 12 November 2014, Col 61 and 62; and Public Papers, 10 December 2014, ICAS, paragraph 5.32](#)

⁷² [Scottish Parliament Finance Committee, Official Report, 12 November 2014, Col 34.](#)

⁷³ [Scottish Parliament Finance Committee, Official Report, 5 November 2014, Col 2](#)

⁷⁴ [Scotland's fiscal future in the UK, D. Bell and D. Eiser, page 13.](#)

⁷⁵ [Scottish Parliament Finance Committee, Official Report, 5 November 2014, Col 28](#)

38. With CGT, Professor McLean also suggested mobility was an issue, but mobility of the assets taxed rather than mobility of the taxpayer.⁷⁶ However, as currently legislated, CGT is based on the residence of the taxpayer and the CIOT suggested that this be maintained for a Scottish CGT to avoid overlap with UK CGT.⁷⁷ Professor Kay suggested that CGT was even more vulnerable to taking advantage of residence rules than IHT.⁷⁸ However, current UK CGT legislation contains anti-avoidance measures to prevent avoidance by means of short-term change of residence and similar measures could be continued in a devolved tax. The Law Society considered devolution of CGT possible but that avoidance opportunities would need to be countered.⁷⁹

39. The close connection between Income Tax and CGT was noted. Professor Heald warned of a risk to the Scottish tax base if Income Tax was devolved but CGT was not. Conversion of income into capital gains is a common tax planning device and such planning could move the tax base from higher rate Scottish income tax to lower UK CGT rates.⁸⁰ The link is stronger with savings and dividend income than with non-savings income and this led Professor Kay and ICAS to suggest that CGT should remain reserved while income tax on savings and dividend income is reserved.⁸¹ Professor Muscatelli noted that devolution of Income Tax would open the way to devolving CGT.⁸² The CIOT noted an opportunity for partial devolution with the Scottish Parliament setting a Scottish CGT rate analogous to the Scottish Rate of Income Tax and this could, indeed, be extended to mirror the Smith Commission proposal of full power over rates and bands.⁸³

40. The higher rate of CGT, 28%, applies to gains which, when added to the person's taxable income for the year, take them above the higher rate for the year. With power over rates and bands of Income Tax being devolved to the Scottish Parliament while CGT remains reserved, the Command Paper confirms that CGT rate of 28% will apply to a Scottish taxpayer where, when added to their taxable income, the gain lies above the UK income tax higher rate band.⁸⁴

Corporate taxes

41. The Smith Commission proposes that *all aspects of Corporation Tax (CT) and all aspects of the taxation of oil and gas receipts will remain reserved.*⁸⁵ While some

⁷⁶ [Scottish Parliament Finance Committee, Official Report, 29 October 2014, Col 28](#)

⁷⁷ [Public Papers, 10 December 2014, CIOT, section 2.](#)

⁷⁸ [Scottish Parliament Finance Committee, Official Report, 5 November 2014, Col 2](#)

⁷⁹ [Public Papers, 10 December 2014, Law Society of Scotland, paragraph 31.](#)

⁸⁰ [Public Papers, 5 November 2014, Prof. Heald, paragraph 12](#) and [Scottish Parliament Finance Committee, Official Report, 5 November 2014, Col 2](#)

⁸¹ [Scottish Parliament Finance Committee, Official Report, 5 November 2014, Col 2](#); and [Public Papers, 10 December 2014, ICAS, paragraph 5.22.](#)

⁸² [Scottish Parliament Finance Committee, Official Report, 19 November 2014, Col 7](#)

⁸³ [Public Papers, 10 December 2014, CIOT, section 2.](#)

⁸⁴ [Scotland in the UK: An enduring settlement](#), paragraph 3.2.4.

⁸⁵ [Report of the Smith Commission](#), paragraphs 82 and 83.

Oil and Gas receipts are in the form of Petroleum Revenue Tax, the bulk falls within CT as tax on the profits of "ring fenced" trades or as supplementary charge on such profits. However, the ring fence rules essentially carve out a separate tax regime and the debate, as well as the figures provided in GERS statistics, lump the various receipts relating to Oil and Gas together and treat them separately from CT. I will summarise the evidence on CT and the evidence on Oil and Gas taxation separately.

Corporation Tax

42. The majority of those giving evidence were against, or had major reservations, about the devolution of Corporation Tax. Maintaining a level playing field or avoiding tax competition within the UK was one motive. The STUC supported, not just one UK rate, but harmonisation of CT throughout the EU.⁸⁶ Nicola Walker of the CBI said that their members valued the single rate of CT in the UK and that it was good also for inward investment.⁸⁷ Not everyone saw tax competition as negative. Tax competition is a fact internationally and within some federal states such as the US. Professor Bell pointed out that differences between US states in their rates of corporate taxes did not give rise to serious competition issues. Other barriers to relocation predominated.⁸⁸ David Eiser's view was that the similarity of the UK nations made relocation of business simpler than in the US and consequently differing CT rates would have greater effect.⁸⁹ Professor MacDonald commented that competition between Canadian Provinces works well but the asymmetry between Scotland and the rest of the UK, together with an already low CT rate of 20%, would militate against it doing so here.⁹⁰

43. There was considerable concern at the scope for tax avoidance and mention made of media stories regarding multi-national groups paying little tax in the UK compared to their economic activity here. Devolution would open the way to similar avoidance within the UK.⁹¹ Professor Heald referred to the current OECD drive to tighten the rules under the Base Erosion and Profit Shifting (BEPS) project but believed differing tax rates within the UK would remain vulnerable to profit shifting.⁹² There is scope for mitigating this by using alternative methods of allocating profits to jurisdictions as mentioned below in paragraphs 39 and 40.

44. Another common concern was the difficulty of determining the Scottish profits of a company operating both in Scotland and also elsewhere in the UK. Corporation tax is charged on the profits of a company resident in the UK or on the permanent establishment in the UK of a non-resident company with double tax rules enshrined in legislation and treaties to mitigate double taxation where two countries tax the same profit. If the same methodology were to be applied in determining Scottish profits, it would require companies operating in Scotland and elsewhere in the UK to

⁸⁶ [Public Papers, 17 December 2014, STUC](#)

⁸⁷ Meeting 21 January 2015, personal notes (OR not published at time of writing.)

⁸⁸ [Scottish Parliament Finance Committee, Official Report, 8 October 2014, Col 5](#)

⁸⁹ [Scottish Parliament Finance Committee, Official Report, 8 October 2014, Col 5](#)

⁹⁰ [Scottish Parliament Finance Committee, Official Report, 5 November 2014, Col 21](#)

⁹¹ [Scottish Parliament Finance Committee, Official Report, 29 October 2014, Col 26 and 27](#), Prof McLean; and [Scottish Parliament Finance Committee, Official Report, 12 November 2014, Col 52 and 53, Prof. Gallagher.](#)

⁹² [Scottish Parliament Finance Committee, Official Report, 5 November 2014](#), Prof. Heald, paragraph 14(a).

keep separate accounts and apply transfer-pricing principles between the parts of the enterprise.⁹³ Alexander Garden of the CIOT and others expressed concern that large numbers of business, not previously exposed to the international allocation of profits, would have a significant increased burden thrust on them.⁹⁴ There was recognition by ICAS and others that an alternative method of allocating profit to Scotland could be devised.⁹⁵

45. Professor Muscatelli, who saw potential in devolving CT for economic development, suggested one alternative basis for allocating CT profit. He referred to the Holtham Commission (2010) and their proposal that profit allocation be linked to factors such as level of employment. He saw this, or alternatively capping the level of rate variation, as a way to avoid harmful competition and discourage "brass plate" relocation.⁹⁶ Interestingly, the Corporation Tax (Northern Ireland) Bill⁹⁷ introduced in the House of Commons on 8 January 2015 partially adopts this approach. The whole profit of small and medium enterprises (SMEs - EU definition) will be taxed at the Northern Ireland Rate if 75% of staff time and 75% of staff costs relate to work in Northern Ireland. Large enterprises will have their profits apportioned using a slightly modified version of the international rules.⁹⁸

46. The potential that differential rates of CT might be challenged under the EU state aid rules was mentioned by Professor Trench and others,⁹⁹ while the Law Society of Scotland referred to the complications that could arise with full devolution in adapting the UK's tax treaty network and obligations.¹⁰⁰

47. As well as full devolution of CT, including the power to determine the tax base, there could be devolution of power to set rates and bands only, similar to the Smith Commission's proposal for Income Tax.¹⁰¹ This would still require a method of determining Scottish corporate profits as is done for Northern Ireland in the new Bill mentioned in paragraph 40 above. Even without that, the CIOT pointed out that there is precedent for capital allowance rates and some other reliefs to vary by region or location, so such a power could be delegated to the Scottish Parliament or exercised by mutual agreement.¹⁰² Assignment of revenues rather than devolution was mentioned both positively and negatively as an alternative to devolution of CT. Professor Muscatelli considered that assignment provided no economic levers,¹⁰³ while Professor MacDonald considered that assignment, but not devolution, of CT would be acceptable.¹⁰⁴ On assignment of CT, the CIOT commented on the difficulty

⁹³ [Public Papers, 10 December 2014, CIOT, paragraphs 3.3 and 5.1; and ICAS paragraph 5.24](#)

⁹⁴ [Scottish Parliament Finance Committee, Official Report, 10 December 2014, Col 13](#)

⁹⁵ [Public Papers, 10 December 2014, ICAS, paragraph 5.26.](#)

⁹⁶ [Public Papers, 19 November 2014, Prof. Muscatelli; Scottish Parliament Finance Committee, Official Report, 19 November 2014, Col 4 and 5](#)

⁹⁷ Bill 149, www.publications.parliament.uk/pa/bills/cbill/2014-2015/.../15149.pdf

⁹⁸ HMRC, *Corporation Tax: devolution of rate-setting power to Northern Ireland*, page 1 <https://www.gov.uk/government/publications/corporation-tax-devolution-of-rate-setting-power-to-northern-ireland>

⁹⁹ [Scottish Parliament Finance Committee, Official Report, 19 November 2014, Col 48](#)

¹⁰⁰ [Public Papers, 10 December 2014, Law Society of Scotland, paragraph 26.](#)

¹⁰¹ [Ibid. ICAS paragraph 5.23.](#)

¹⁰² [Ibid. CIOT, paragraph 5.5.](#)

¹⁰³ [Scottish Parliament Finance Committee, Official Report, 19 November 2014, Col 23 and 24](#)

¹⁰⁴ [Scottish Parliament Finance Committee, Official Report, 5 November 2014, Col 21](#)

of ascertaining to an acceptable standard the revenue attributable to Scotland,¹⁰⁵ while ICAS suggested that assignment of CT based on a measure of Scottish economic activity is a possibility.¹⁰⁶

Oil and Gas Taxation

48. The views expressed to the Committee on devolution of Oil and Gas Taxation largely turned on the relative importance given to the immobility of the source and the volatility of revenues. Professor McLean gave greater weight to Adam's Smith's preference for taxing "ground rents" and suggested that Oil and Gas taxation is a prime candidate for devolution.¹⁰⁷ If the people of Scotland want devolution of taxes, which they do, they simply must learn to live with the volatility.¹⁰⁸ Professor Heald on the other hand viewed natural resource rents as part of the pool of UK resources and gave that and the volatility of revenues as a reason not to devolve.¹⁰⁹ Professor MacDonald considered that non-devolution and distribution through the block grant was an effective cushion for Scotland from the volatility of oil revenues. While it would be in principle possible to replace this cushion with an oil fund, it would be very difficult to achieve in the near term.¹¹⁰ Professor Gallagher suggested that the key choice was not determined by conflicting economic theories but by the fact that tying Scottish public spending to an inevitably declining source meant a real cut in public expenditure.¹¹¹ Declining oil revenues are better managed at UK level.¹¹² Professor Trench considered the larger size of the UK and its ability to collect larger amounts from a range of smaller taxes made for better management of volatile oil and gas revenues.¹¹³

49. Professor Muscatelli considered that the sector could still be hugely important for Scotland and issues around future development require the use of clear economic levers.¹¹⁴ However, he considered it critical that, if there is devolution, then it is complete devolution. The industry needs stability and certainty and that would not be provided if there were divided responsibilities.¹¹⁵ The long-term decline of the source is not so much a macroeconomic shock as an economic development trend and requires management by growing other aspects of the economy.¹¹⁶ Shorter-term fluctuations can be managed by evaluating the borrowing powers necessary to offset sudden changes in revenue.¹¹⁷

50. The CIOT make a practical point regarding tax relief for future abandonment cost. Companies with installations on the Continental Shelf are currently entitled to relief for the costs of removing them when production ceases. If Oil and Gas taxation is devolved, the Governments would need to agree on the future funding of

¹⁰⁵ [Public Papers 10 December 2014, CIOT, paragraph 3.6.](#)

¹⁰⁶ [Ibid. ICAS, paragraph 5.29.](#)

¹⁰⁷ [Scottish Parliament Finance Committee, Official Report, 29 October 2014, Col 26 and 27](#)

¹⁰⁸ [Scottish Parliament Finance Committee, Official Report, 29 October 2014, Col 30.](#)

¹⁰⁹ [Public Papers, 5 November 2014, Heald, paragraph 14\(d\).](#)

¹¹⁰ [Scottish Parliament Finance Committee, Official Report, 5 November 2014, Col 25](#)

¹¹¹ [Scottish Parliament Finance Committee, Official Report, 12 November 2014, Col 47](#)

¹¹² [Scottish Parliament Finance Committee, Official Report, 12 November 2014, Col 48](#)

¹¹³ [Scottish Parliament Finance Committee, Official Report, 19 November 2014, Col 52 and 53.](#)

¹¹⁴ [Scottish Parliament Finance Committee, Official Report, 19 November 2014, Col 20](#)

¹¹⁵ [Scottish Parliament Finance Committee, Official Report, 19 November 2014, Col 11](#)

¹¹⁶ [Scottish Parliament Finance Committee, Official Report, 19 November 2014, Col 23](#)

¹¹⁷ [Scottish Parliament Finance Committee, Official Report, 19 November 2014, Col 26](#)

the relief and the companies will need assurance that they will get the relief when the time comes.¹¹⁸

Fuel Duty and Excise Duties

51. The Smith Commission proposes that *all aspects of Fuel Duty and Excise Duties will remain reserved*.¹¹⁹ Excise Duties, which include Fuel Duty, are subject to EU directives which prescribe upper and lower limits for rates. Some states have received derogations from these and it is also possible to add to the range of goods, with some states imposing duty on coffee and chocolate. The EU allows the imposition of "parafiscal taxes" on health or other legitimate grounds which could be applied while retaining a unified excise duty rate.¹²⁰

52. Subject to EU legal restrictions and to the provisions of the Treaty of Union,¹²¹ most experts agreed that devolution of excise duties, as a tax on consumption, was possible. The principle concerns were around cross-border shopping and illegal smuggling with problems at the Channel and the land border with the Irish Republic being cited.¹²² Professor Macdonald was concerned that devolution of Excise Duties in a single market might create distortions which could outweigh the benefits to health policy, for example, of an increase in alcohol duty. Although excise duties are, in a sense, a consumption tax they are levied at the production stage which, he considered, would make the problem greater.¹²³ He did however suggest that excise duties could be assigned,¹²⁴ a view shared with the STUC and Poverty Alliance who wished to assign 50%.¹²⁵

Gavin McEwen
11 February 2015

¹¹⁸ [Public Papers, 10 December 2014, CIOT, paragraphs 3.3 and 6.3](#)

¹¹⁹ [Report of the Smith Commission](#), paragraph 92.

¹²⁰ [Public Papers, 10 December 2014, CIOT, section 7](#).

¹²¹ [Public Papers, 19 November, Trench, paragraph 9](#); and [Official Report, 19 November 2014, column 48, Prof Trench](#).

¹²² [Scottish Parliament Finance Committee, Official Report, 29 October 2014, Col 34](#), Prof. McLean; and [Public Papers, 10 December 2014, CIOT, section 7](#), and Law Society, paragraph 36.

¹²³ [Public Papers, 5 November 2014, MacDonald, section 3](#).

¹²⁴ [Ibid.](#)

¹²⁵ [Public Papers, 17 December 2014, STUC, paragraph 2.5](#); and [Scottish Parliament, Finance Committee, Official Report, 17 December 2014, column 13](#), Peter Kelly.

ANNEXE B: PRINCIPLES AGREED THROUGH THE JOINT EXCHEQUER COMMITTEE IN SEPTEMBER 2011 FOR THE ADJUSTMENT OF THE BLOCK GRANT

Design

1. Apply the overarching objective of fairness to both the UK and Scottish Governments by:
 - a) minimising the risk of gains/losses from funding transfers on both the UK and Scottish Governments;
 - b) ensuring that the mechanism is not, when implemented, designed to gain advantage in one set of fiscal circumstances or another;
 - c) considering the effects of a shared tax base (including issues related to policy spillover and tax avoidance).
2. Ensure the mechanism delivers on the Scotland Bill's aims to increase financial accountability, giving the Scottish Parliament a direct financial stake in Scotland's economic success;
3. Ensure the mechanism is consistent with Azores criteria and State Aid principles;
4. Ensure the sustainability of the system to adapt to future decisions on tax devolution;

Implementation

5. Ensure that, when the system is introduced it does not cause an unmanageable change in the Scottish Budget (up or down) in the first year;

Operation

6. Ensure that the necessary information and data is shared on a timely and accurate basis to allow both the UK and Scottish Government to plan ahead;
7. Ensure the mechanism delivers value for money by designing a model that is relatively simple to implement and operate and incurs minimal administrative cost;

Review

8. Apply principles of transparency; and
9. Review to ensure that the system remains fair and 'fit for purpose'.

ANNEXE C: ORAL AND WRITTEN EVIDENCE

26th Meeting, 2014 (Session 4) Wednesday 29 October 2014

ORAL EVIDENCE

Professor Iain McLean, Professor of Politics, University of Oxford.

27th Meeting, 2014 (Session 4) Wednesday 5 November 2014

ORAL EVIDENCE

Professor David Heald, Professor of Accountancy, University of Aberdeen; Professor John Kay, Professor of Economics, London School of Economics; Professor Ronald MacDonald, Professor of Political Economy, University of Glasgow.

28th Meeting, 2014 (Session 4) Wednesday 12 November 2014

ORAL EVIDENCE

Professor Jim Gallagher, Member of Nuffield College Oxford, and Visiting Professor Glasgow University.

29th Meeting, 2014 (Session 4) Wednesday 19 November 2014

ORAL EVIDENCE

Professor Anton Muscatelli, Principal and Vice-Chancellor, University of Glasgow; Professor Alan Trench; Ben Thomson, Campaign for Scottish Home Rule.

32nd Meeting, 2014 (Session 4) Wednesday 10 December 2014

ORAL EVIDENCE

Elsbeth Orcharton, Director, Corporate and International Taxation, The Institute of Chartered Accountants of Scotland; Isobel d'Inverno, Convener of the Tax Law Committee, Law Society of Scotland; Alexander Garden, Chair, Chartered Institute of Taxation Scotland Hub.

33rd Meeting, 2014 (Session 4) Wednesday 17 December 2014

ORAL EVIDENCE

Peter Kelly, Director, Poverty Alliance; Dave Moxham, Deputy General Secretary, Scottish Trades Union Congress.

3rd Meeting, 2015 (Session 4) Wednesday 21 January 2015

ORAL EVIDENCE

Colin Borland, Head of External Affairs, FSB Scotland; Garry Clark, Head of Policy and Research, Scottish Chambers of Commerce; Nicola Walker, Director of Devolution, Confederation of British Industry; Edward Troup, Second Permanent Secretary, and Sarah Walker, Deputy Director and Head of Devolution Team, HM Revenue and Customs.

4th Meeting, 2015 (Session 4) Wednesday 28 January 2015

ORAL EVIDENCE

Rt Hon Danny Alexander MP, Chief Secretary to the Treasury, and Lindsey Fussell, Director Public Services, HM Treasury, UK Government.

John Swinney, Cabinet Secretary for Finance, Constitution and Economy, and Sean Neil, Acting Deputy Director of Finance, Scottish Government.

WRITTEN EVIDENCE

- [Professor Alan Trench](#)
- [Professor Anton Muscatelli](#)
- [Ben Thompson](#)
- [CIOT \(63KB pdf\)](#)
- [CIPFA \(277KB pdf\)](#)
- [Confederation of British Industry \(51KB pdf\)](#)
- [COSLA \(24KB pdf\)](#)
- [Damian Forster D&N Forster Property \(13KB pdf\)](#)
- [Professor David Heald](#)
- [Dr JR Cuthbert and Mrs M Cuthbert \(148Kb pdf\)](#)
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- [PwC \(123KB pdf\)](#)
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- [Scottish Retail Consortium \(69KB pdf\)](#)
- [SCVO \(39KB pdf\)](#)
- [The Law Society of Scotland \(70KB pdf\)](#)
- [Transform Scotland \(19KB pdf\)](#)

SUPPLEMENTARY WRITTEN EVIDENCE

- [ICAS \(88KB pdf\)](#)

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Deputy First Minister
and Cabinet Secretary for Finance, Constitution and Economy
John Swinney MSP



T: 0300 244 4000
E: dfm@scotland.gsi.gov.uk

Kenneth Gibson MSP
Convenor
Finance Committee
Scottish Parliament
Edinburgh
EH99 1SP

17 May 2015

Dear Kenneth,

**SCOTTISH GOVERNMENT RESPONSE TO FINANCE COMMITTEE 6TH REPORT, 2015
(SESSION 4) ON FURTHER FISCAL DEVOLUTION**

Thank you for the opportunity to reply to the Finance Committee's 6th Report (Further Fiscal Devolution) on behalf of Scottish Government.

There has clearly been a significant effort to gather the widest possible range of oral and written evidence from witnesses during the enquiry, culminating in the publication of your Report on 4 March 2015. The report provides a very welcome, contribution to the debate.

I enclose the Scottish Government's response which I hope you will find helpful I look forward to discussing some of these aspects further when I attend the Committee's hearing on 3 June 2015.

Yours



JOHN SWINNEY

ANNEX

SCOTTISH GOVERNMENT RESPONSE TO FINANCE COMMITTEE 6TH REPORT, 2015 (SESSION 4) ON FURTHER FISCAL DEVOLUTION

Scotland's Fiscal Framework

9. The Committee recommends that a clear timetable is agreed and published by the UK and Scottish Governments for the implementation of Scotland's fiscal framework. This should include allowing sufficient time for consultation with both parliaments on a draft framework.

The Deputy First Minister met with the Chancellor of the Exchequer on 2nd March to discuss implementation of the financial elements of the Smith Commission Agreement, including the fiscal framework. Both governments agreed that Scottish Government officials should work jointly with HM Treasury officials in the period up to the UK election to prepare a draft workplan and timetable for approval by UK and Scottish Government Ministers as soon as possible after the UK election.

No detriment and gaming

13. The Committee notes that there are clear differences between the two Governments regarding the clarity of the no detriment principle. The Committee intends to take further evidence on this issue as part of its forthcoming inquiry on the fiscal framework.

18. The Committee also notes that there are clear differences between the two Governments regarding the question of gaming. The Committee recommends that the issue of gaming needs further consideration within the context of the no detriment principle.

The Scottish Government welcomes the Committee's intent to take further evidence on the no detriment principle and related question of gaming. As the Deputy First Minister noted in his appearance before the Finance Committee on 28 January this is a new element to be agreed as part of a revised fiscal framework, and as such it is important to gain a detailed and shared understanding of how it should work and what the implications may be.

Also as the Deputy First Minister noted in the same evidence session, this is not the case at the moment, and the no detriment principle is not currently well defined. The UK and Scottish Governments must work jointly together to address this. As part of this work it must be remembered that the Smith Commission stated that "*there should be a shared understanding of the evidence to support any adjustments*" and careful consideration will need to be given to how UK and Scottish Governments can practically embed this into an agreement on a fiscal framework.

The evidence that the Committee will take on the no detriment principle will be valuable in contributing to this shared understanding. The question of gaming is one which the Deputy First Minister set out as believing should be examined as part of an effective no detriment principle.

Block grant and Barnett Formula

27. The Committee has written to both the CST and the Cabinet Secretary seeking clarification of how their respective figures were calculated.

The Deputy First Minister wrote to the Convener on 3 March 2015 providing details of the Scottish Government analysis of devolved and assigned tax revenues as a percentage of devolved expenditure. This analysis was based on 2012-13 figures, which were the most recent figures available at the time of writing. As the Committee will be aware, *Government Expenditure and Revenue Scotland 2013-14* was published on 11 March 2015. Table 2.9 in this publication provides an analysis of fiscal powers under the Scotland Act 2012 and the Smith Commission for 2013-14 using these updated figures. The Committee may wish to note that the estimate of devolved and assigned tax revenues as a percentage of devolved public expenditure remains at 48% in 2013-14.

Transparency

32. The Committee notes that while there may be some discussion between the UK and Scottish Governments on the operation of the Barnett formula this is done in private and cannot be viewed as transparent.

33. The Committee's view is that there is a need for much greater transparency and accountability in relation to how the block grant is calculated. The Committee intends to consider what mechanisms are required to ensure the transparency and accountability of how the block grant is calculated as part of its forthcoming inquiry on the fiscal framework.

Transparency is a necessary requirement for the effective operation of a fiscal framework for Scotland, and is something the Scottish Government will pursue as I seek agreement with the UK Government. As the Deputy First Minister noted in his appearance on 28 January 2015 there has been a need to balance what can be discussed in public with the Committee whilst undertaking negotiations with HM Treasury. However, the Deputy First Minister made clear that he will try to ensure that the committee is advised of as much information as can be provided in as timeously a manner as possible regarding the sequence of measures that are being taken. The Scottish Government looks forward to engaging with the Committee on any suggestions they may have for building further transparency in the fiscal framework.

Block grant adjustment

40. The Committee asks the Scottish Government how useful these principles were in informing the negotiations on the adjustment to the block grant arising from the Scotland Act 2012 and whether there is any plan to review them.

41. The Committee also recommends the need to develop a more robust framework for considering future adjustments to the block grant which should be made public.

The Deputy First Minister has previously made clear to the Committee his frustration with the progress made in agreeing a block grant adjustment for the fully devolved taxes. There will need to be better progress for agreeing future block grant adjustments, which will take place as part of agreeing a fiscal framework for Scotland. The principles that the Smith Commission set out remain pertinent to the task of agreeing future block grant adjustments, and as such would likely form part of the discussions as progress is sought in this area.

The Scottish Government would be happy to provide an update on progress with these negotiations at a suitable point in the process.

Constraining factor

47. The Committee will write to the CST asking him to confirm that there is no intention to include a constraining factor within any adjustment to the block grant and that any attempt to do so would be inconsistent with the no detriment principle.

The Deputy First Minister has previously set out that he would not agree to any block grant adjustment mechanism which may deny Scotland the benefit which may arise from its use of newly devolved powers. The Scottish Government welcomes the Committee's intention to seek clarity over this matter from the Chief Secretary to the Treasury.

Statement of Funding Policy (SFP)

52. The Committee asks why the SFP has not been updated since 2010 to include, for example, the principles for agreeing adjustments to the block grant.

The Statement of Funding Policy is a UK Government publication, and they have the responsibility to update it. The fiscal framework will be required to be agreed by both the Scottish and UK governments.

Inter-governmental machinery

59. The Committee agrees with the Smith Commission that there needs to be much stronger and more transparent parliamentary scrutiny of inter-governmental relations as more powers are devolved to Holyrood. However, given the apparent emphasis on informal bilateral relations rather than formal mechanisms there are issues around transparency and accountability which need to be addressed.

60. The Committee notes that the JEC has not met since February 2013 and that in the Cabinet Secretary's view it has failed. The Committee also notes the observation of the Cabinet Secretary that most business is transacted bilaterally and outwith the formal machinery of the JMC and JEC. This emphasis on informality provides challenges in delivering the Smith Commission recommendation that there should be much stronger and more transparent parliamentary scrutiny.

61. The Committee will take further evidence on how the inter-governmental machinery including the JEC be strengthened and made more transparent. In particular, the Committee will examine good practice in other fiscal federations and will invite SPICe to provide a comparative analysis. The Committee will also consider how we can ensure effective parliamentary scrutiny if most inter-governmental business is transacted outwith these formal mechanisms.

The Scottish Government welcomes the work the Committee is undertaking in this area and will be closely review any findings. The Scottish Government agrees with the Smith Commission recommendation that we need to review current inter-governmental machinery. Smith recommended that the Memorandum of Understanding between the UK Government and the devolved administrations be reviewed. This work is underway, led by the Joint Ministerial Committee (JMC) Joint Secretariat, which comprises officials from the UK Government and the three Devolved Administrations.

The Scottish Government will look to agree with the UK Government the most appropriate governance arrangements for the bilateral work on the fiscal framework, including the role of the Joint Exchequer Committee. The Scottish Government agrees that effective Parliamentary scrutiny of these arrangements is important and will want to be as transparent as possible about progress.

Forecasting

72. The Committee will take further evidence on whether the SFC or the Scottish Government should generate the economic forecasts as part of its inquiry on Scotland's Fiscal Framework.

The Scottish Government notes this finding. We published *A Consultation on the Scottish Fiscal Commission* on 26 March 2015 which sets out our detailed proposals for legislation to establish the Scottish Fiscal Commission as an independent statutory body in Scotland, including a draft Bill.

The consultation paper proposes that the core function of the Commission should be to provide independent scrutiny of tax forecasts and other fiscal projections prepared by Scottish Ministers, on the basis that this approach maximises the openness and transparency of the forecasting process. We will carefully consider the consultation responses, together with any evidence on this point provided to the Finance Committee's inquiry on Scotland's Fiscal Framework, before reaching a final view.

Borrowing for capital expenditure

84. The Committee will take further evidence on what additional borrowing powers should be devolved and what fiscal rules should be applied to these powers.

85. The Committee would welcome the view of the Scottish Government on the proposal to allow borrowing to fund preventative spending within prescribed limits.

The Scottish Government notes the Committee's findings and will follow with interest the further evidence taken by the Committee on devolution of additional borrowing powers.

We welcome the Smith Commission proposal that both the Scottish and UK Governments should consider the merits of introducing a prudential borrowing regime, which would enable us to exercise greater discretion over borrowing to support responsible investment decisions in Scotland's economic interests, including those which support our prevention aims.

Scottish Cash Reserve

89. The Committee reiterates its view that the Scottish Government should have the flexibility to either spend any surplus tax receipts or put them in the cash reserve and will write to the CST.

The Deputy First Minister has been consistently clear that the Scottish Government should have the power to spend any surplus tax receipts as it so chooses to do so. It would be inconsistent with the principles of devolution if this were not the case. The Scottish Government welcomes the Committee's agreement with this position, and its intention to write to the Chief Secretary to Treasury on this matter.

Annual Tax on Enveloped Dwellings (ATED)

92. The Committee asks whether the Scottish Government intends to continue monitoring the level of ATED being collected in Scotland and to inform the Committee if there is any significant change in the amount paid.

The Deputy First Minister set out in a letter to the Convener on 12 January 2015, that the Scottish Government has not considered it necessary to date to seek devolution of ATED or to seek disapplication of the tax in Scotland. The Scottish Government will continue to keep this situation under review now that Land and Buildings Transaction Tax has come into force and in light of actual and planned reductions in the ATED thresholds in 2015 and 2016.

Conclusion

93. The Committee recognises that there is a need for confidentiality in inter-governmental relations and that much of this work takes place informally and between government officials. However, as recommended by the Smith Commission there is also a need for much stronger and more transparent parliamentary scrutiny. This should include as a minimum regular updates to the Parliament.

94. The Committee has published a call for evidence on the proposals for a fiscal framework for Scotland and intends to publish its report by the end of June. The Committee will then invite the Cabinet Secretary and HM Treasury to provide oral evidence in September. The Committee views this work as an initial contribution to the debate on the content of the fiscal framework and expects that both Parliaments are formally consulted on a draft framework.

Agreeing a fiscal framework is essential in enabling the Scottish Government to use the powers the Smith Commission recommends for devolution effectively and for the gains of their use to accrue to Scotland. The Scottish Government welcomes the interest that the Committee is taking in this important matter and the Deputy First Minister would be happy to appear before the Committee and provide an update on 3 June as progress is made towards reaching agreement of a fiscal framework.

Scottish Government

May 2014



The Scottish Parliament
Pàrlamaid na h-Alba

Published 14th May 2015
SP Paper 720
3rd Report, Session 4 (2015)

Devolution (Further Powers) Committee

New Powers for Scotland: An Interim Report on the Smith Commission and the UK Government's Proposals





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www.scottish.parliament.uk/devolution-of-further-powers



devolutioncommittee@scottish.parliament.uk



0131 348 5206



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Committee Membership



Convener
Bruce Crawford
Scottish National Party



Deputy Convener
Duncan McNeil
Scottish Labour



Linda Fabiani
Scottish National Party



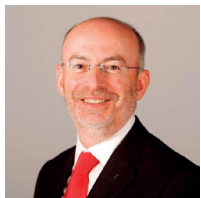
Rob Gibson
Scottish National Party



Alex Johnstone
Scottish Conservative
and Unionist Party



Alison Johnstone
Scottish Green Party



Stewart Maxwell
Scottish National Party



Lewis Macdonald
Scottish Labour



Mark McDonald
Scottish National Party



Stuart McMillan
Scottish National Party



Tavish Scott
Scottish Liberal
Democrats

Executive Summary

1. Following the result of the Scottish Independence Referendum on 18 September 2014, the previous UK Government launched a process culminating in the publication of a cross-party agreed report of the Smith Commission and the publication of draft legislative proposals by the then UK Government to take forward the recommendations of the Smith Commission.
2. The Devolution (Further Powers) Committee has been tasked to scrutinise the recommendations of the Smith Commission and any subsequent proposals for further legislation.
3. Over the course of 7 months, involving nearly 20 committee meetings, around 50 submissions of written evidence and fact-finding visits and public meetings in Hamilton, Aberdeen and Lerwick, we have carefully considered views on the Smith Commission's recommendations and how these have been translated into proposed law by the previous UK Government.
4. The culmination of this process is the publication of this Interim Report on the Smith Commission and the then UK Government's Proposals. The report is an initial step as its findings do not necessarily represent the Committee's final view on these matters or on the question of whether the Scottish Parliament should give its legislative consent to these proposals. Such considerations await our scrutiny of any bill that is introduced by the new UK Government following the May 2015 UK General Election.
5. **The purpose of our report has been to provide a considered and constructive commentary for the new UK Government on the current package of measures being proposed for further devolution and where these can be improved. In short, all of the Committee want to see both the letter and the spirit of the Smith Commission's report fully translated into a legislative package in the next UK Parliament.**
6. In the time available between the publication of the then UK Government's proposals and the dissolution of the UK Parliament for the last General Election, the Committee has not been able to consider detailed evidence on all aspects proposed for further devolution. Instead, we have focused on the following:
 - The permanency of the Scottish Parliament and the Sewel Convention (legislative consent procedures);
 - Taxation and borrowing;
 - Welfare and benefits;
 - The Crown Estate; and

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- Inter-governmental relations and parliamentary oversight.
7. **In some of these areas, the Committee believes that the current draft legislative proposals meet the challenge of fully translating the political agreement reached in the Smith Commission. In other areas, improvements in drafting and further clarification are required. In some critical areas, the then UK Government's draft legislative clauses fall short.**
 8. **Our key conclusions and recommendations are set out in the final section of this report. In addition, Annex A provides a summary position of the Committee's detailed conclusions and recommendations against the question – do the draft clauses fully meet both the letter and the spirit of the agreement reached by the five political parties represented in the Scottish Parliament during the Smith Commission's work?**

Next steps

9. Following the UK General Election, the Committee will re-commence with its detailed scrutiny of all of the provisions in any 'Scotland Bill' that may be introduced by the new UK Government in its first Queen's Speech. The Committee expects to issue a further call for evidence in mid-2015 and to take further evidence during the remainder of 2015 and early 2016, with a view to issuing a Final Report on any bill and the issue of legislative consent before the Scottish Parliament is dissolved in advance of the Scottish Parliamentary elections of May 2016.
10. Throughout this process, the Committee intends to continue with its practice of as wide as possible public engagement, with further meetings and visits across Scotland.

Introduction

A brief timeline

11. On 15 October, 2012, the *Edinburgh Agreement*¹, signed by then First Minister Alex Salmond MSP and Prime Minister David Cameron MP, paved the way for a national referendum held on 18 September, 2014, on the issue of independence for Scotland.
12. Following a record turnout of nearly 85% of those registered to vote in the referendum, just over 2 million voted to remain in the UK (55.3%), with a little over 1.6 million (44.7%) voting for independence.²
13. On the morning after the referendum, the Prime Minister held a press conference leading to the establishment of a commission to look at proposals for the devolution of further powers to the Scottish Parliament.
14. The commission would be chaired by Lord Smith of Kelvin, who would be assisted by 2 representatives of each of the five political parties represented in the Scottish Parliament. This became known as the Smith Commission.
15. The Smith Commission published its report on 30 November 2014³, with the previous UK Government publishing its response in January 2015 – in the form of a Command Paper and a set of draft legislative clauses⁴ – which, in its view, would give effect to the agreement reached by all five political parties within the Smith Commission.
16. Since January 2015, the Prime Minister and the then Deputy Prime Minister in the then UK Government, and the then Leader of the Opposition in the House of Commons, all publicly signalled their intention to introduce a bill in the UK Parliament, as part of a first Queen's Speech, to take forward proposals for further devolution.
17. Any bill of this nature – affecting as it does the legislative competences of the Scottish Parliament and the executive powers of the Scottish Government – will require the consent of the Scottish Parliament before it can be passed into law by the UK Parliament.⁵

This report

18. At its meeting of 29 October 2014, the Scottish Parliament agreed that the work of the previous Referendum (Scotland) Bill Committee should be refocused and augmented, now that the independence referendum had been held; thereby creating the Devolution (Further Powers) Committee.
19. The remit of the Committee is—

To consider matters relating to The Scotland Act 1998 (Modification of Schedule 5) Order 2013, the Scottish Independence Referendum Act 2013, its implementation and any associated legislation. Furthermore, (i) until the end of November 2014 or when the final report of the Scotland Devolution Commission has been published, to facilitate engagement of stakeholders with the Scotland Devolution Commission and to engage in an agreed programme of work with the commission as it develops its proposals; and (ii) thereafter, to consider the work of the Scotland Devolution Commission, the proposals it makes for further devolution to the Scottish Parliament, other such proposals for further devolution and any legislation to implement such proposals that may be introduced in the UK Parliament or Scottish Parliament after the commission has published its final report.

20. **This interim report sets out the summary of the evidence that we have taken so far on the major components within the package of measures being proposed by the previous UK Government, and our conclusions and recommendations at this stage of the process.**
21. **This report is not our final view on the matter or an indication of any recommendation for legislative consent at this stage.** Upon introduction of any bill in the UK Parliament following the UK General Election on 7 May, we would begin the process of considering the bill and any proposals for amendments. Any final decision by the Scottish Parliament on legislative consent is likely to take place in the early part of 2016.
22. **All five political parties on the Committee have entered into the process of producing this report with the aim of finding as much consensus as possible to provide a constructive commentary for the new UK Government on the current package of measures being proposed for further devolution and where these can be improved. In short, all of the Committee want to see both the letter and the spirit of the Smith Commission's report fully translated into a legislative package in the next UK Parliament.**

Our advisers

23. To assist us in the preparation of this report, the Committee appointed three advisers:
 - Professor Nicola McEwen, University of Edinburgh;
 - Christine O'Neill, Chairman, Brodies LLP; and
 - Dr. Heidi Poon, Judge of the First tier Tribunal (Tax Chamber), External Lecturer, University of Edinburgh.
24. **The Committee is grateful to all of our advisers for their work.**

Our approach to date and engagement with the people of Scotland

25. The Scottish Independence Referendum campaign was marked by the degree of public engagement culminating in the highest turnout in Scotland for an electoral event since the extension of the franchise. The Smith Commission worked to an extremely tight timescale but nevertheless sought to maximise public engagement within its work whilst recognising the time constraints it was operating within.
26. Nevertheless, the Committee has received a range of views from across civic society in Scotland that, despite the Smith Commission's best efforts, the timetable set for it did not allow sufficient time to foster wider public engagement and participation in the process given the importance of the issues being considered. Lucy McTernan, from the Scottish Council for Voluntary Organisations (SCVO), commented on the voluntary sector's experience of engaging with the Smith Commission process as follows—

” The voluntary sector engaged with the Smith Commission with great enthusiasm. It was a very intense period of work and the voluntary sector had a lot to say on all the subjects that eventually emerged in the commission's report. [...] We found doing this kind of work in that very intense and quick way quite frustrating. It did not allow us to engage with the people whom we represent and involve them in the thorough way that we would have liked.

” Everybody who engaged did so thoroughly and with a lot of enthusiasm, because this is such an important set of issues, but we need to create the space for discussion about what is appropriate governance for Scotland and for Scottish society and people, wherever they are, in whichever communities.⁶

27. There has also been recognition, in evidence submitted to the Committee, that the widespread public engagement during the Referendum is a democratic phenomenon that should not be allowed to dissipate. Within this context, witnesses have also stressed the need for the Scottish Parliament to speak directly to the public and go further than engaging with what may be termed mainstream, representative organisations. For example, Dave Moxham, from the Scottish Trades Union Congress (STUC) commented—

” ...people need to be really aware that although we are civil society organisations that engage with Parliament, the referendum process has shown some of us that that is not enough. I am enjoying the meeting very much and I am glad to be here, but it is not enough for Parliament to have a relationship with existing civil society organisations and then think that it has done its job. That links in with the idea that we and others have raised

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about citizen juries and other ways of creating a representative democracy that is also able to do detail; doing the detail is often what is difficult. We have the time to do that, but unless there is, for example, a two-year referendum process it is hard for the person in the street to do that. We need to think about the mechanisms that we can use to supplement the consultative role that Parliament undertakes.⁷

28. The Devolution (Further Powers) Committee has, since its establishment, recognised the need to engage with local organisations and the wider public in communities across Scotland. The initial work of the Committee was focussed on the issues associated with extending the voting franchise to 16 and 17 year olds for future Scottish Parliament and local government elections. As part of this process, the Committee undertook informal engagement events with 16 and 17 year old school pupils, in Fort William and Levenmouth, who were eligible to vote in the Referendum. In addition, the Committee also undertook an [online survey](#) which obtained the views of over 1,200 16 and 17 year old voters on the issue of extension of the franchise.



Committee members speaking to 16-17 year old voters in Levenmouth as part of our engagement efforts and Parliament Day

29. This approach has continued through into the Committee's scrutiny of the Smith Commission recommendations and the translation of these recommendations into draft legislative clauses. The Committee has held public meetings, and informal discussions with local stakeholder groups, in Hamilton, Aberdeen and the

Shetland Islands. The content of these discussions has informed the work of the Committee and subsequently of this report.



Committee members at a public meeting in Aberdeen to discuss proposals for devolution

30. The Committee recognises that it can only attempt to make a contribution to the process of public engagement in relation to the proposals for further devolution. Nevertheless, the Committee intends to ensure that public engagement remains a key motif of its scrutiny over the remainder of the lifetime of the Committee's work.
31. **The Committee believes that further public engagement, directly with the people of Scotland as well as representative bodies, charities, industry groups, voluntary bodies etc. is still a vital activity that needs to be carried out and is fully committed to the spirit of the recommendation made by the Smith Commission in this respect.**
32. The Committee calls on the UK and Scottish Governments to consider how to commit to the spirit of the Smith Commission's recommendation in this respect.

Constitutional matters

Background

33. The Smith Commission's report made a range of recommendations within the area of constitutional matters.
34. Table 1 below produced by SPICe sets out a comparison of the Smith Commission's proposals and the previous UK Government's Command Paper in the area of **constitutional matters**.

Table 1

Smith Commission Report	Para	Draft Clauses	Clause
<ul style="list-style-type: none"> Permanence of the Scottish Parliament UK legislation to state that the Scottish Parliament and Scottish Government are permanent institutions. 	21	<p>Clause 1 seeks to give effect to the Smith Commission recommendation to state in statute that the Scottish Parliament and Government are permanent institutions. Clause 1 would amend the Scotland Act 1998 to state that:</p> <p style="text-align: center;">“A Scottish Parliament is recognised as a permanent part of the United Kingdom’s constitutional arrangements” and,</p> <p>Section 44 of the 1998 Act would be similarly amended to state that:</p> <p style="text-align: center;">“A Scottish Government is recognised as a permanent part of the United Kingdom’s constitutional arrangements” (new s1A)</p>	1
<ul style="list-style-type: none"> The Sewel Convention The Sewel Convention to be put on a statutory footing 	22	<p>Clause 2 seeks to give effect to the Smith Commission recommendation to make the Sewel Convention statutory. It would do this by adding a new sub-section to section 28 of the 1998 Act stating:</p> <p style="text-align: center;">“But it is recognised that the Parliament of the United Kingdom will not normally legislate with regard to devolved matters without the consent of the Scottish Parliament”</p> <p>However, section 28(7) of the 1998 Act, which provides that this section does not affect the power of Westminster to legislate for Scotland, is not amended or repealed by the draft clauses.</p>	2

<p>• Operation of the Scottish Parliament and Scottish Administration</p> <p>Scottish Parliament to have powers to make decisions about all matters relating to the arrangements and operations of the Scottish Parliament and Scottish Government, including:</p> <ul style="list-style-type: none"> ○ the overall number of MSPs or the number of constituency and list MSPs. ○ the disqualification of MSPs from membership and the circumstances in which a sitting MSP can be removed. 	<p>26</p> <p>26(1)</p> <p>26(2)</p>	<p>Clause 3 would provide the Scottish Parliament with the powers over the operation of the Scottish Parliament and Government recommended by Smith by making amendments to paragraph 4 of Schedule 4 of the 1998 Act. These amendments would add further exceptions to the prohibition which prevents the Scottish Parliament from modifying the 1998 Act.</p> <p>The powers set out in this draft clause will require a super majority, as provided for in draft clause 4.</p>	<p>3</p>
<p>• Elections</p> <p>The Scottish Parliament to have all powers in relation to elections to the Scottish Parliament and local government elections in Scotland (but not in relation to Westminster or European elections), including powers in relation to campaign spending limits and periods and party political broadcasts. The Scottish Parliament already has many of these powers in relation to local government elections in Scotland.</p> <p>The Scottish Parliament to have competence over the functions of the Electoral Commission in relation to Scottish Parliament elections and local government elections in Scotland. The Electoral Commission to report to the UK Parliament in relation to UK and European elections and to the Scottish Parliament in relation to Scottish Parliament and local government elections in Scotland.</p> <p>The Boundary Commission to report to the Scottish Parliament in relation to boundary reviews for the Scottish Parliament. UK Government powers in relation to Scottish Parliament boundaries will transfer to the Scottish Government.</p> <p>Devolve the relevant powers in time to enable the franchise in Scotland to be extended to 16 and 17 year olds for the 2016 SP elections.</p>	<p>23</p> <p>24(2)</p> <p>24(3)</p> <p>25</p>	<p>Clause 5(2) sets out restrictions on the day on which a general election to the Scottish Parliament can be held, in order to prevent the date coinciding with other elections being held in Scotland.</p> <p>Clause 5(3) would substitute a new Section 12 in the Scotland Act 1998 including the amendment to Section 12 contained in Section 1 of the Scotland Act 2012 (which is not yet in force). The draft clause gives powers over Scottish Parliament elections to Scottish Ministers, instead of the Secretary of State.</p> <p>This clause maintains the Secretary of State's power to combine Scottish Parliament elections, with the permission of Scottish Ministers, again negating the need to bring Section 2 of the Scotland Act 2012 into force.</p> <p>The proposed new Section 12 includes giving Scottish Ministers responsibility over the limits of election expenses of candidates, but not of registered political parties.</p> <p>Clause 6 devolves the franchise for Scottish Parliament and local elections to the Scottish Parliament. A reservation will be maintained on the digital service, i.e. the Individual Electoral Registration Digital Service (IERDS) and the verification of applications to the system.</p> <p>The Scottish Parliament will gain the power to extend the franchise to 16 and 17 year olds for the Scottish Parliament elections and local government elections. A Section 30 / 63 Order devolving this power has been passed by the Scottish and UK Parliaments and the Privy Council to enable the franchise to be extended to 16 and 17 year olds in</p>	<p>5 - 9</p>

Devolution (Further Powers) Committee

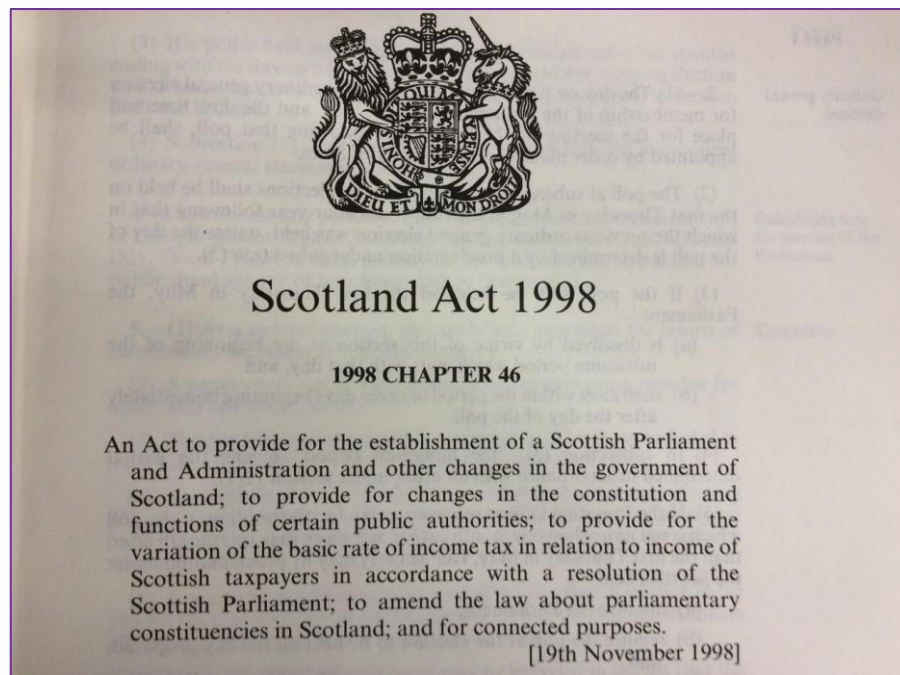
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		<p>time for the 2016 Scottish Parliament election should the Scottish Parliament choose to do so.</p> <p>Clause 7 devolves responsibility for the control of campaign expenditure and expenditure by third parties in relationship to Scottish Parliament and local government elections, except for elections combined with other elections.</p> <p>Clause 8 will devolve powers over Sections of the Political Parties, Elections and Referendums Act 2000 relating to the Electoral Commission, with regard to Scottish Parliament elections, to the Scottish Parliament.</p> <p>Clause 9 would amend Schedule 1 of the Scotland Act 1998 to require reports on reviews of Scottish Parliament constituency boundaries, carried out by the Boundary Commission for Scotland, to be submitted to Scottish Ministers, instead of the Secretary of State. Orders to put in place recommendations from those review reports will no longer need to be approved in the UK Parliament.</p>	
<ul style="list-style-type: none"> • Supermajority for legislation on the Scottish Parliament franchise etc. <p>Legislation changing the franchise, the electoral system or the number of constituency and regional members for the Scottish Parliament to be passed by a two-thirds majority of the Scottish Parliament.</p>	27	<p>This is similar to the requirement in the Scotland Act 1998 and the Fixed Term Parliaments Act 2011, which provide that the Scottish and UK Parliaments can only be dissolved by a two-thirds majority in the Scottish Parliament and the Commons respectively.</p>	4

35. In relation to these recommendations, the Committee has focussed this section of the interim report on the permanence of the Scottish Parliament, Legislative Consent Memoranda (frequently termed the 'Sewel' Convention), and the devolution of certain equalities matters. In addition, the Smith Commission made a number of recommendations in relation to inter-governmental relations and this subject is considered in detail later in this report.

Permanency of the Scottish Parliament and Scottish Government

36. The Smith Commission recommended that “UK legislation will state that the Scottish Parliament and Scottish Government are permanent institutions”.⁸ Section 1(1) of the Scotland Act 1998 provides that “there shall be a Scottish Parliament”. The previous UK Government’s proposed draft clause adds an additional subsection which provides that “a Scottish Parliament is recognised as a permanent part of the United Kingdom’s constitutional arrangements”.⁹ The draft clauses contain similar provisions in relation to the Scottish Government.



The Scotland Act 1998

37. The main tenet of UK Parliamentary sovereignty, that no Parliament can bind its own successor Parliaments, is a well-established doctrine. This doctrine poses a significant obstacle to establishing the permanency of the Scottish Parliament in UK legislation. This difficulty was recognised by Lord Smith when he commented in evidence to the Committee that—

” The UK law will say that this institution is permanent; that is our intention. However, nothing—since the Magna Carta, I think—can be permanent; I am told by constitutional experts down in London, in what used to be called Dover house but is probably now called Scotland house, that that cannot be done because it would bind future Parliaments. However, we intend the law to be written in such a way that a plague of boils or something will break out if anyone ever decides to prorogue—or whatever you want to call it—this Parliament. The language will be as strong as it is possible to be.¹⁰

38. He further stated that—

” You are absolutely right that nothing is permanent, because future democratically elected Governments could change that permanence. However, this Parliament will be permanent and it will be described as permanent in UK law. Of course, as I say, UK law can be changed.¹¹

” If you know a way of making the institution permanent, tell me, because that is the Scottish people’s will.¹²

39. The Committee is aware that the UK Parliament has passed legislation, such as the Canada Act 1982 and the Hong Kong Act 1985, which provided for the UK Parliament permanently relinquishing Parliamentary sovereignty over these jurisdictions. **However, the Committee is of the view that such legislation does not provide a helpful precedent given that Scotland currently remains part of the United Kingdom. In any event, it is at least arguable that these earlier examples do not represent legal limits on the sovereignty of the United Kingdom Parliament: each could in theory be repealed by an Act of the Westminster Parliament, however unlikely that might be.**

40. In his evidence to the Committee, the previous UK Government’s Secretary of State for Scotland, Alistair Carmichael MP, recognised that the legal position makes entrenching the Scottish Parliament in legislation “a challenging prospect” but considered that, in practice, “the permanence of the Scottish Parliament is guaranteed by the will of the Scottish people”.¹³

41. The Committee has received a range of evidence that the draft clauses do not fully implement the recommendation of the Smith Commission as a result of using the phraseology that the ‘Scottish Parliament *is recognised* as a permanent part of the United Kingdom’s constitutional arrangements’. For example, the Law Society of Scotland commented—

” The phrasing in the draft clause does not literally implement the terms of Paragraph 21 of the Smith Report. The use of the phrase “recognised as permanent” has a different nuance from a statement that “the Scottish Parliament and Scottish Government are permanent institutions”. The difference in wording between the Smith Report and the draft clause is significant. The draft clause could be said to acknowledge or declare a matter of fact rather than provide a statement in law.¹⁴

42. The Committee also received a joint written submission from Dr Eve Hepburn, from the University of Edinburgh, and Professor Sionaidh Douglas-Scott, from University of Oxford, who considered that draft clause 1 did not fulfil the Smith Commission recommendation and that, as currently drafted, the draft clause had no legal content. Dr Hepburn and Professor Douglas-Scott stated that a more substantial concern is that—

” ...in none of the depictions of ‘permanence’ worded in the vow, the Smith Report or the Command Paper, were there any attempts to detail the

practicalities of entrenching permanence in law. The draft clauses do not contain any provisions to render the Scottish parliament permanent, for instance by ensuring that the provisions contained within the Scotland Act cannot be abolished or amended unless certain conditions are met.¹⁵

43. Dr Hepburn and Professor Douglas-Scott suggested a range of amendments to the draft clause in order to seek to entrench the Scottish Parliament based around a model of 'federacy'. 'Federacy' refers to a situation where a sub-state unit within a state with an asymmetric distribution of territorial powers provide specific protections to the powers of a sub-state unit. Examples cited included the Aland Islands in Finland and the position of Greenland within the Danish state. Dr Hepburn and Professor Douglas-Scott summarised the rationale for their proposed amendments to the permanency clause as being to include—

” ...a new provision that any changes to the Scotland Act must require mutual consent from both the UK and Scottish Parliaments, giving the Scottish Parliament greater control over its destiny and ensuring a form of equal partnership between Scotland and the UK that is characteristic of federal-type arrangements. There are legal precedents for the UK Parliament renouncing a degree of its sovereignty, including the renunciation of a certain amount of its sovereignty to the EU and to the UK's former colonies. It would not be unthinkable to apply the same self-limitations with regard to Scotland.¹⁶

44. The view of the Scottish Government on this issue was given by the Deputy First Minister in his evidence. He said—

” On the issue of permanency, particular words are used in the clause that I am not sure need to be there. I do not know quite what the purpose is of adding the words “recognised as”, and I think that it would be clearer if they were not in clause 1. The proposed new subsection (1A) in section 1 of the 1998 act states:

” A Scottish Parliament is recognised as a permanent part of the United Kingdom's constitutional arrangements.

” It would be blunter if it read, “A Scottish Parliament is a permanent part of the United Kingdom's constitutional arrangements.” We all know the limitations of that type of arrangement. Given that knowledge, I think that it would be better if we stated it as boldly as possible.¹⁷

45. On the issue of 'super majorities' and whether this provision could be applied to any legislation that would abolish the Scottish Parliament, the Deputy First Minister wrote to the Committee as follows—

” The Scottish Government would be content with any move to attach super-majority requirements to future Westminster legislation that sought to

remove powers from the Scottish Parliament or to dissolve the Scottish Parliament. However we note that the prevailing Westminster doctrine of parliamentary sovereignty might make this hard to achieve in practice if a super-majority requirement at Westminster could itself be amended or repealed by a simple majority.¹⁸

46. Whereas, the view of the former Secretary of State for Scotland was as follows—

” The draft clause delivers the Smith Commission Agreement by stating in law that a Scottish Parliament is a permanent part of the UK’s constitutional arrangements. There has never been any question in the past 16 years that the Scottish Parliament and Scottish Government are anything other than permanent. Placing conditions or procedures on these draft clauses and on the face of the statute book would invite a scenario that was never envisaged in 1998 and is not envisaged today.¹⁹

47. **The Committee is of the view that the inclusion of the words ‘is recognised’ in draft clause 1 has the potential to weaken the effect of this clause, which would be unfortunate given the all-party agreement to this recommendation as part of the Smith Commission, and the views expressed to us by the former Secretary of State for Scotland that he perceives that the permanence of the Scottish Parliament and Scottish Government is guaranteed.**

48. Accordingly the Committee recommends that the UK Government removes the words ‘is recognised’ from this clause.

49. **In evidence to the Committee, the former Secretary of State for Scotland commented that he was “open to thinking about different ways in which ... permanence could be achieved”²⁰. The Committee welcomes the open-minded approach of the former Secretary of State with regard to this issue. The Committee therefore considers that there is scope to further strengthen the permanency provisions.**

50. The Committee considers that the effect of the clause on permanency, as currently drafted, is primarily declaratory and political rather than legal in effect. The UK doctrine of Parliamentary sovereignty makes achieving permanence problematic. The Committee recommends that the Scottish electorate should be asked to vote in a referendum if the issue of permanency was in question, with majorities also being required in the Scottish Parliament and the UK Parliament.

The Sewel Convention/Legislative Consent Memoranda

51. The process for agreeing to Legislative Consent Memoranda, frequently termed the Sewel Convention, refers to a statement made by Lord Sewel, then Parliamentary Under-Secretary of State at the Scottish Office, during the passage of the Scotland Act 1998 through the House of Lords. He said “we would expect a convention to be established that Westminster would not normally legislate with regard to devolved matters in Scotland without the consent of the Scottish Parliament.”²¹
52. The Convention was subsequently set out in a Devolution guidance note (DGN 10)²² between the Scottish and UK Governments albeit this guidance does not have the force of law. The guidance sets out the process to be followed with regard to UK Government legislation, draft legislation and Private Members’ Bills.
53. The Smith Commission recommended that “the Sewel Convention will be put on a statutory footing”.²³ The previous UK Government’s draft clauses seek to amend section 28 of the Scotland Act 1998 to include the wording, “But it is recognised that the Parliament of the United Kingdom will not normally legislate with regard to devolved matters without the consent of the Scottish Parliament”.
54. The Law Society of Scotland, in written evidence, considered that the Sewel Convention had worked “relatively well” and that “there appear to have been no significant problems with the operation of the Convention”.²⁴ The Law Society went on to consider whether the draft clause would be justiciable in the event that Westminster legislated in a devolved area without the consent of the Scottish Parliament and concluded—

” ... in theory, it might be litigated upon but would a court strike down UK legislation affecting a devolved area where the consent of the Scottish Parliament had not been given? Under the terms of Section 28(7) the answer to that question is probably not. However, purposive interpretation and declarations of incompatibility under the Human Rights Act 1998 as well as an enhanced sense of constitutionalism under devolution legislation indicate that when the courts consider UK legislation to be seriously flawed Parliament has considered itself bound to alter that legislation. It may therefore be the case that the courts will be called upon to adjudicate in a declaratory way in the event of a statutory formulation of the Sewel Convention being breached.²⁵

55. The Law Society of Scotland also raised concerns that the draft clause does not fully place the Sewel Convention on a statutory footing in terms of the formulation of the Convention set out in the Devolution guidance note (DGN10). The Law Society commented—

” It is significant that DGN10 also requires the consent of the Scottish Parliament in respect of provisions of a Bill before the UK Parliament which

would alter the legislative competence of the Scottish Parliament or the executive competence of the Scottish Ministers (see DGN 10 at paragraphs 4(iii) and 9). It would seem, however, that Clause 2 would not apply to this latter category of provision.²⁶

56. Commenting on the legal effect of the draft clause, Professor Alan Page, from the University of Dundee, observed—

” The convention extends to Westminster legislation altering the Scottish Parliament’s legislative competence and the executive competence of Scottish Ministers as well as with regard to devolved matters. It would be preferable therefore for that to be made clear on the face of the legislation. The implication that Westminster might unilaterally alter the Scottish Parliament’s legislative competence might however be politically more difficult to pass into law than the implication that it might legislate with regard to devolved matters.²⁷

57. The Royal Society of Edinburgh, in a written submission to the Committee in partnership with the British Academy, commented on the wording of the draft clause as follows, “if the legislation is to put the Sewel Convention on a statutory footing, it is insufficient to state that the UK Parliament would not ‘normally’ legislate in areas devolved to Scotland since that can only give rise to legal uncertainty”.²⁸

58. Appearing before the Committee, the Deputy First Minister gave his view of the current provisions relating to the Sewel Convention. He said—

” Draft clause 2 would put the Sewel convention into statute as a convention, rather than put the convention on a statutory footing. That is an issue that we need to explore with the UK Government.

59. He subsequently went on to add—

” The issue is about whether the substance—the process—is put into statute to give us confidence around the substance of Sewel, as opposed to stating in statute, “There shall be a Sewel convention”. That gets to the point of the convener’s questions about whether, if we put more of the substance into statute, that would restrict the flexibility to negotiate. All that I am saying is that, if we put the substance into statute, we have to do it in a fashion that respects the point that the convener has made about the necessity for flexibility.²⁹

60. The former Secretary of State for Scotland’s view was as follows—

” The Sewel Convention refers to the statement made by Lord Sewel during the passage of the Scotland Bill 1997/8 that he would “expect a convention to be established that Westminster would not normally legislate with regard

to devolved matters in Scotland without the consent of the Scottish Parliament.

- ” As successive UK Governments have adhered to the Sewel Convention, the language that forms the basis of the Sewel Convention was adopted in the draft clause. For the same reason i.e. because of that adherence to the general principle, there has been no need to unpack the words “not normally”. It was not intended by Lord Sewel to carry a technical meaning and, similarly, the expectation is that the phrase in the clause will take its ordinary English language meaning. The draft clause published on 22 January places the Sewel convention on a statutory footing and therefore delivers the recommendation in the Smith Commission Agreement.³⁰

61. The Committee considers that the current draft clause, whilst placing the purpose of the Sewel Convention in statute, does not incorporate in legislation the process for consultation and consent where Westminster plans to legislate in a devolved area. The Committee considers that it should do so. Moreover, the Committee considers that the use of the words ‘but it is recognised’ and ‘normally’ has the potential to weaken the intention of the Smith Commission’s recommendation in this area and recommends that these words be removed from the draft clause.

Equal Opportunities

62. The report of the Smith Commission made the following recommendation with regard to equal opportunities—
- ” The Equality Act will remain reserved. The powers of the Scottish Parliament will include, but not be limited to, the introduction of gender quotas in respect of public bodies in Scotland. The Scottish Parliament can legislate in relation to socio-economic rights in devolved areas.³¹
63. The previous UK Government’s Command Paper comments on the purpose of the draft clauses in this area as follows—
- ” This power will enable the Scottish Parliament, by imposing new requirements on public bodies in Scotland, to introduce new protections for employees and customers of those bodies with regard to their devolved functions. However, the Scottish Parliament will not be able to lower the protections found in the Equality Act 2010.³²
64. Draft clause 24 of the previous UK Government’s Command Paper seeks to give effect to the recommendation of the Smith Commission in this area by narrowing the scope of the general reservation of equal opportunities, within the Scotland Act 1998, by introducing new ‘exceptions’ to the general reservation.
65. The draft clauses also contain an ‘exception to the exception’ which states that the power is not devolved “to the extent that provision is made by the Equality Act 2006 or the Equality Act 2010”. The Coalition for Racial Equality and Rights (CRER) commented on this aspect of the clause in the following terms—
- ” The expression “to the extent that provision is made” is ambiguous. On one view, that could mean that if the Equality Act deals with a subject in any way – “provision is made”, and that’s the final word and not amenable to legislation by the Scottish Parliament. Another view would be that unless a proposal by the Scottish Parliament in relation to Scottish functions of a Scottish public authority is actually prohibited by the Equality Act, then it would be safely acting within its powers. Depending on how that clause is interpreted, it could lead to a situation where there is very limited scope at all for the Scottish Parliament to take action on equalities.³³
66. **This particular provision is an area that the Committee intends to return to at a later date upon introduction of any new ‘Scotland Bill’ following the UK General Election. At this stage, the Committee seeks clarification, from the UK Government, on the scope of the provision in clause 24 with regard to the extent to which the Equality Act 2006 and 2010 would limit the ability of Scottish Ministers to legislate with regard to equalities issues.**
67. **The Committee also notes that the Equality Act 2006 is not mentioned in the Smith Commission recommendation, yet the reservation in the draft clause**

also includes the 2006 Act and seeks clarification, from the UK Government, on what effect the inclusion of this Act has upon the proposed power for Scottish Ministers in this area.

Socio-economic inequalities

68. Clause 24 would provide the Scottish Parliament with the power to legislate in relation to those aspects of socio-economic inequalities which fall within the subject matter of Part 1 of the Equality Act 2010. Part 1 of the Equality Act 2010, which is entitled 'socio-economic inequalities', creates a 'socio-economic equality duty' which requires public authorities to consider socio-economic inequalities in their decision-making processes. Specifically, the 2010 Act provides that each authority to which the duty applies must, "when making decisions of a strategic nature about how to exercise its functions, have due regard to the desirability of exercising them in a way that is designed to reduce the inequalities of outcome which result from socio-economic disadvantage".³⁴
69. Part 1 of the Equality Act 2010 has never been brought into force by the UK Government and so public authorities in the United Kingdom are not yet bound to observe the socio-economic equality duty.
70. Part 1 of the Equality Act 2010 confers on Scottish Ministers a power to add new public authorities to the list of those to whom the socio-economic equality duty applies.
71. BEMIS Scotland commented, in written evidence, that they are uncertain what powers the clause relating to the socio-economic inequalities provides to Scottish Ministers, stating—
- ” With devolution of these powers in relation to a socio-economic duty we would like to clarify the position that this will afford the Scottish Government/Parliament on the enactment of a future Scotland (2015) Bill.³⁵
72. In a letter to the Committee, the Deputy First Minister set out his views on the provisions in clause 24 relating to socio-economic duties. He said—
- ” ...we are considering the drafting and interpretation of clause 24 very carefully. It remains unclear to us what more the clause will enable us to do and we are having discussion with the UK Government on this.³⁶

73. The Committee remains unclear about the scope of the proposed extension of legislative competence to socio-economic rights and, in particular, whether any extension would be limited to the socio-economic equality duty contained in Part 1 of the Equality Act 2010. It recommends that further thought be given to the drafting of this clause to ensure that the aims of the Smith Commission are fulfilled.

Gender quotas

74. The Smith Commission recommended that the devolution in relation to gender quotas include, but not be limited to, the introduction of gender quotas in respect of public bodies in Scotland. The draft clause relates to the Scottish functions of any Scottish public authority or cross-border public authority.

75. This is not an area in which we have taken a significant amount of evidence on which to make observations or conclude. However, in evidence and advice to the Committee, a view was expressed that the way that the draft clauses are currently drafted could imply that the Equality Act 2010 may still reserve the creation of gender quotas. This is because of the inclusion of the phrase “except to the extent that provision is made by the Equality Act 2006 or the Equality Act 2010”.

76. Speaking to the Committee on this matter, the Deputy First Minister said—

” ...the command paper says that that should be the case, but our reading of the clause is that it is far from clear that that is actually the provision. It may be a question of drafting and interpretation. We would certainly want the ability to act in that fashion, but we are not confident that what is in front of us enables us to do so.”³⁷

77. In correspondence to the Committee, the former Secretary of State for Scotland said—

” This draft clause [clause 24] delivers the Smith Agreement recommendation that the Scottish Parliament will have powers to introduce gender quotas in respect of public bodies in Scotland. On this, and all the clauses we have produced, we are considering any feedback we have received as we refine the draft clauses.”³⁸

78. The Committee considers that the words “except to the extent that provision is made by the Equality Act 2006 or the Equality Act 2010” creates doubt about the power of the Scottish Parliament to legislate for gender quotas in relation to Scottish public authorities and cross-border public authorities. It recommends that further thought be given to the drafting of this clause to ensure that the aims of the Smith Commission are fulfilled.

Taxation

Background

79. Alongside plans for the devolution of further powers on welfare and benefits, the Smith Commission and previous UK Government's proposals for greater fiscal powers for the Scottish Parliament form the two most significant components of the overall package of provisions.
80. Increased levels of fiscal autonomy have been a feature of devolution since the re-establishment of the Scottish Parliament in 1999 through the passage of the Scotland Act 1998.
81. The first Scotland Act's main financial provision was to give the Scottish Parliament the power to set the Scottish Variable Rate and alter the basic rate of income tax up to 3p in the pound. This power was not used.
82. The Scotland Act 2012 amended the income tax varying powers of the Scottish Parliament by replacing the Scottish Variable Rate with 'the Scottish Rate of Income Tax' (SRIT), scheduled for implementation in April 2016. The provision is to reduce the rate of income tax in Scotland by ten percent for each band set by the UK Parliament, adding the SRIT set by the Scottish Parliament. The SRIT provision allows the Scottish Parliament to reduce the basic, higher and additional rates by up to 10p in the pound, or to increase the rates by any amount without limit. In addition, the borrowing powers of the Scottish Government were extended (see subsequent section of this report).
83. Apart from the powers to vary income tax rates, the Scotland Act 2012 also implemented the proposals in Calman Commission Report with regard to the two taxes that were named as candidates for devolution. From 1 April 2015, the Stamp Duty Land Tax is replaced by Land and Buildings Transaction Tax (LBTT) in Scotland, and the UK-wide Landfill Tax, by the Scottish Landfill Tax (SLfT).
84. Aggregates Levy and Air Passenger Duty (APD) were two further taxes recommended for devolution in the Calman Commission Report. The Aggregates Levy had been considered by the previous UK Government for devolution but has not taken place due to the levy being subject to legal proceedings. These two taxes are again recommended for devolution by the Smith Commission.

The recommendations of the Smith Commission and the previous UK Government's proposals

85. Table 2 below produced by Scottish Parliament Information Centre (SPICe) sets out a comparison of the Smith Commission proposals and the previous UK Government's Command Paper in the area of **taxation**.

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Table 2

Smith Commission Report	Para	UK Government Command Paper	Draft clause
<p>• Income Tax</p> <p>The Scottish Parliament to have power to set the rates of Income Tax and the thresholds at which these are paid for the non-savings and non-dividend income of Scottish taxpayers (as defined in the 2012 Act).</p> <p>There will be a corresponding adjustment in the block grant received from the UK Government, in line with the funding principles set out in paragraph 95.</p> <p>The Scottish Government to reimburse the UK Government for additional costs arising as a result of the implementation and administration of the Income Tax powers described above.</p>	<p>76</p> <p>78</p> <p>79</p>	<p>Draft clauses 10-12 broadly seek to give effect to the extension of income tax powers recommended by the Smith Commission. These would give the Scottish Parliament the power to set rates and bands in relation to non-savings and non-dividend income of Scottish taxpayers, above the UK personal allowance.</p> <p>Draft clause 12 also seeks to deal with the interaction between Income Tax and Capital Gains Tax (CGT). Currently individuals who pay Income Tax at the higher rate also pay CGT at the higher rate. This clause sets out that the rate of CGT that applies to Scottish income taxpayers will continue to be calculated using the UK Income Tax rate limits.</p> <p>There are no draft clauses in relation to the corresponding adjustment in the block grant or the Scottish Government reimbursing the UK Government for costs arising from implementing/administering these powers. These recommendations do not require legislation and it is anticipated that details for these would be outlined in the Command Paper accompanying the Scotland Bill.</p>	<p>10</p> <p>11</p> <p>12</p>
<p>• Value Added Tax</p> <p>The receipts raised in Scotland by the first 10 percentage points of the standard rate of Value Added Tax (VAT) to be assigned to the Scottish Government's budget. Receipts to be calculated on a verified basis, to be agreed between the UK and Scottish Governments, with a corresponding adjustment to the block grant, in line with the principles set out in paragraph 95.</p>	<p>84</p>	<p>Draft clause 13 would give effect to the Smith Commission recommendation that the Scottish Government be assigned receipts from the first ten percentage points of VAT. With the agreement of both governments it also proposes to go slightly further by notionally assigning 2.5 percentage points of the reduced rate of VAT as well (which stands at 5 per cent).</p> <p>The amount of VAT receipts attributable to Scotland is to be the subject of an agreement between the UK Government and the Scottish Government.</p> <p>There are no draft clauses in relation to the corresponding adjustment to the block grant. This does not require legislation and it is anticipated that further details would be outlined in the Command Paper accompanying the Scotland Bill.</p>	<p>13</p>
<p>• Air Passenger Duty</p> <p>The Scottish Parliament to have the power to charge tax on air passengers leaving Scottish airports</p> <p>The Scottish Government to reimburse the UK Government for any costs</p>	<p>86</p> <p>87</p> <p>88</p>	<p>Draft clause 14 would make this a devolved tax, as recommended by the Smith Commission. It would give HMRC the ability to 'switch off' these UK taxes in Scotland from a date to be set by secondary legislation.</p> <p>There are no draft clauses in relation to the Smith Commission recommendation that a fair share of</p>	<p>14</p>

incurred in 'switching off' APD in Scotland and a fair and equitable share of associated administrative costs to be transferred to the Scottish Government. The Scottish Government's block grant to be adjusted in line with the principles set out in paragraph 95.		the administrative costs for this tax should be transferred to the Scottish Government or in relation to the corresponding adjustment to the block grant. These recommendations do not require legislation and it is anticipated that details for these would be outlined in the Command Paper accompanying the Scotland Bill	
<ul style="list-style-type: none"> Aggregates Levy The Scottish Parliament to have the power to charge tax on the commercial exploitation of aggregate in Scotland. The Scottish Government to reimburse the UK Government for any costs incurred in 'switching off' Aggregates Levy in Scotland and a fair and equitable share of associated administrative costs to be transferred to the Scottish Government. The Scottish Government's block grant to be adjusted in line with the principles set out in paragraph 95. The UK and Scottish Governments to work together to avoid double taxation and make administration as simple as possible for taxpayers 	89 90 91 93	Draft clause 15 would make this a devolved tax, as recommended by the Smith Commission. It would give HMRC the ability to 'switch off' these UK taxes in Scotland from a date to be set by secondary legislation. There are no draft clauses in relation to the Smith Commission recommendations that a fair share of the administrative costs for this tax should be transferred to the Scottish Government or in relation to the corresponding adjustment to the block grant and the avoidance of double taxation. These recommendations do not require legislation and it is anticipated that details for these would be outlined in the Command Paper accompanying the Scotland Bill.	15

86. Table 3 below produced by SPICe sets out a comparison of the Smith Commission proposals and the previous UK Government's Command Paper in the area of the **fiscal framework, including borrowing**.

Table 3

Smith Commission Report	Para	UK Government Command Paper	Draft clause
<ul style="list-style-type: none"> Scotland's Fiscal Framework The devolution of further responsibility for taxation and public spending, including elements of the welfare system, should be accompanied by an updated 	95	Although the UK Government has not published any draft clauses in relation to the fiscal framework, the Command Paper indicates intent to fulfil these Smith Commission recommendations through non-legislative means.	None

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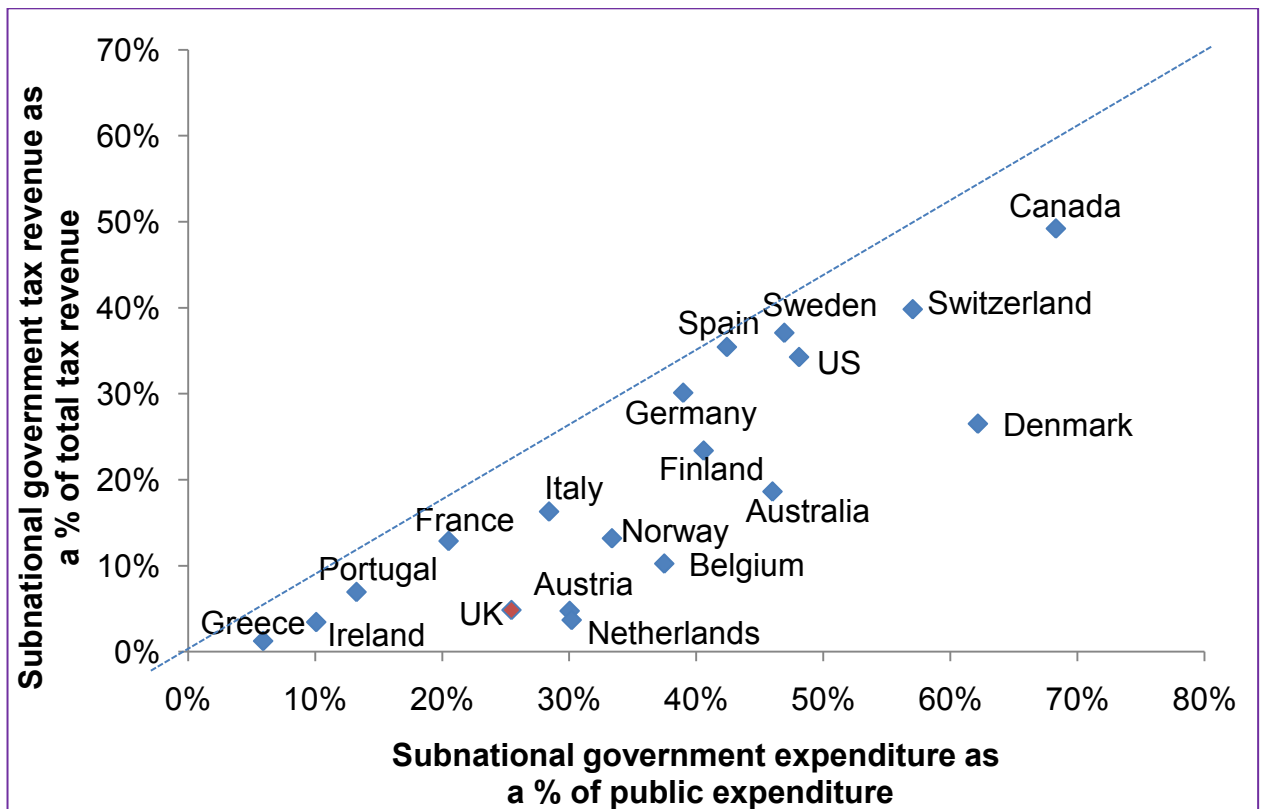
<p>fiscal framework for Scotland, consistent with the overall UK fiscal framework.</p> <p>The following aspects should be incorporated into Scotland's fiscal and funding framework.</p> <p>(1) <u>Barnett Formula</u>: the block grant to continue to be determined by the Barnett Formula.</p> <p>(2) <u>Economic Responsibility</u>: Scottish budget should benefit in full from policy decisions by the Scottish Government that increase revenues or reduce expenditure, and bear the full costs of policy decisions that reduce revenues or increase expenditure.</p> <p>(3) <u>No detriment as a result of the decision to devolve further power</u></p> <p>(4) <u>No detriment as a result of UK or Scottish Government policy decisions post-devolution</u></p> <p>(5) <u>Borrowing Powers</u>: Scotland's fiscal framework should provide sufficient, additional borrowing powers to ensure budgetary stability and provide safeguards to smooth Scottish public spending in the event of economic shocks, consistent with a sustainable overall UK fiscal framework. The Scottish Government should also have sufficient borrowing powers to support capital investment, consistent with a sustainable overall UK fiscal framework.</p> <p>(6) <u>Implementable and Sustainable</u>: the arrangements should be reviewed periodically to ensure that they continue to be seen as fair, transparent and effective.</p> <p>(7) <u>Independent Fiscal Scrutiny</u>: the Scottish Parliament should seek to expand and strengthen the independent scrutiny of Scotland's public</p>		<p>Specifically, the UK Government has committed to agreeing a fiscal framework with the Scottish Government through the Joint Exchequer Committee. The intention is to provide this alongside the introduction of the Scotland Bill so that both Parliaments will be able to consider the settlement as a whole from the outset. It may be that there is some legislation required in due course, but this depends on the nature of the new fiscal framework.</p> <p>Note that the UK Government did not publish any draft clauses in relation to borrowing. Whether any changes to Scotland's borrowing powers are needed will depend on a number of other factors likely to be determined by the overall fiscal framework (such as the risks the Scottish Government is exposed to by the method of block grant adjustment). While there is a power in the Scotland Act 2012 to increase borrowing limits by order, there may need to be further primary legislation in due course (e.g. if the circumstances under which the Scottish Government can borrow are changed).</p>	
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<p>(8) <u>UK Economic Shocks</u>: the UK Government should continue to manage risks and economic shocks that affect the whole of the UK.</p> <p>(9) <u>Implementation</u>: the two Governments should jointly work via the Joint Exchequer Committee to agree a revised fiscal and funding framework for Scotland based on the above principles.</p>			
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Comparative information

87. The extent of fiscal devolution or financial decentralisation can be a disputed calculation. The Scottish Parliament’s research team – SPICe – produced briefing material for this Committee at the outset of our work. The purpose of the research was to highlight the different scale of decentralisation across a number of countries selected by SPICe, compared to the United Kingdom; see Figure 1 below. It is important to note that in certain states with asymmetric distributions of fiscal powers between sub-national jurisdictions, such as Spain, the level of fiscal decentralisation can vary substantially between sub-national jurisdictions.

Figure 1: Fiscal decentralisation in the UK compared to OECD countries (2013)



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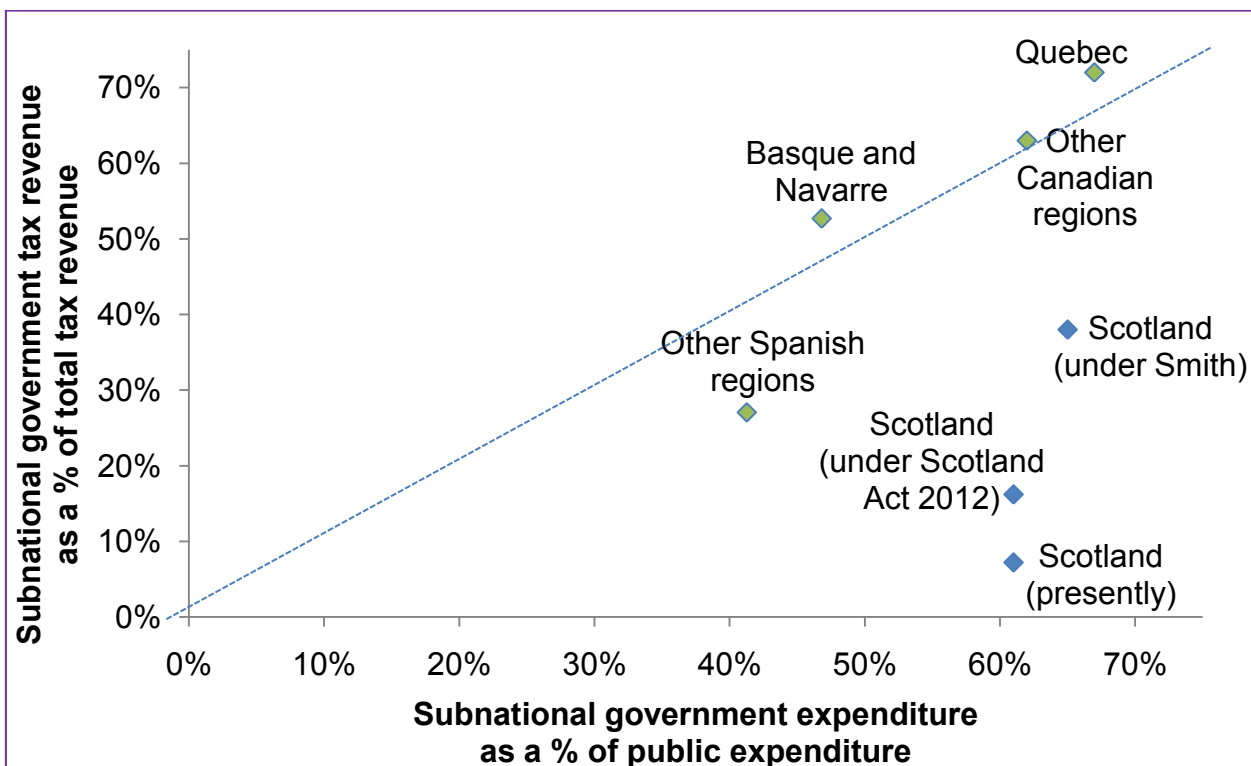
New Powers for Scotland: An Interim Report on the Smith Commission and the UK Government's Proposals, 3rd Report, Session 4 (2015)

Source: OECD (2015), OECD (2013) for Australian expenditure

Note – the UK figures represent devolution across the UK before the implementation of the Scotland Act 2012 financial provisions.

88. The degree of decentralisation tends to be highest in countries either with a federal system, such as Canada and Switzerland, or with a highly decentralised system of public services, such as Spain. By comparison, Belgium and Australia are examples where sub-national governments have relatively low levels of fiscal autonomy.
89. It is important, however, to recognise that even when a tax is devolved, there are varying levels of control that a sub-national government may have over the tax. Broadly speaking, this ranges from the full power to introduce taxes and the power to set tax rates and bases, to tax sharing arrangements where multiple levels of government can set tax rates or the central government assigns a proportion of tax revenues to the sub-national government.
90. Figure 2, below, shows the varying levels of control that sub-national state governments have over devolved taxes across the countries selected.

Figure 2: Fiscal decentralisation to Scotland compared with other sub-central areas



Source: SPICe calculations using GERS (2015), Statistics Canada (2015) and personal communication with Antoni Zabalza and Julio Lopez-Laborda (2015).

Note – Canadian figures are for 2009 and Spanish figures are for 2011.

91. It is observed that Basque and Navarre do not control all public expenditure, despite having full fiscal autonomy. This is because these sub-central governments are not responsible for spending on defence, foreign affairs, the royal household, airports, high speed rail, etc. Social security contributions and pensions are also not a responsibility these sub-national governments.
92. While these figures aid understanding of fiscal decentralisation in Scotland, the UK and other OECD countries, SPICe have a number of concerns about the accuracy and comparability of the information in Figure 2. In particular, a key test of accuracy is the extent to which figures for sub-central areas in Figure 2 (calculated by SPICe) aggregate up to the national totals in Figure 1 (provided by the OECD). This is shown in the Table 4 below:

Table 4

Country	Revenue decentralisation		Expenditure decentralisation	
	Figure 1	Figure 2 (aggregated)	Figure 1	Figure 2 (aggregated)
Canada	49%	65%	68%	63%
Spain	35%	29%	42%	42%

93. Looking more closely at the situation in Scotland as a consequence of any final agreement to the set of fiscal provisions set out by the previous UK Government in its Command Paper and draft clauses, it is also the case that a calculation of the level of spending that is now covered by devolved taxes varies between sources.
94. As with the international comparisons above, SPICe produced comparator information to assist us with our inquiry. It is important to recognise at the outset that this assessment of the level of fiscal autonomy can vary depending on how this is defined. Typically, one of three calculations is made:
 - *Expenditure decentralisation* - The percentage of public expenditure in Scotland that is devolved (thus, devolved expenditure as a percentage of expenditure in Scotland).
 - *Revenue decentralisation* - The percentage of revenues raised in Scotland that are devolved or assigned (thus, devolved and assigned revenues as a percentage of revenues raised in Scotland).
 - *Self-funding percentage* - The extent to which own revenues fund devolved expenditure (thus, devolved and assigned revenues as a percentage of devolved expenditure).

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95. Using these three different types of comparison, SPICe produced calculations for the Committee of the level of fiscal autonomy as a consequence of any agreement to the previous UK Government's proposals. Table 5 shows the percentage of tax revenues that are devolved or assigned; at present, under the Scotland Act 2012 and under the Smith Commission proposals.

Table 5: A comparison of figures provided on fiscal devolution

Scenario	Percentage of tax revenues devolved	Percentage of tax revenues assigned	Total percentage devolved and assigned
At present (March 2015)	7.2%	-	7.2%
Once Scotland Act 2012 fully implemented	16.0%	-	16.0%
Under Smith Commission proposals	28.9%	9.3%	38.2%

Notes: Based on 2013-14 revenue figures from [Government Expenditure and Revenue Scotland](#) (Scottish Government 2015). Total revenues include a geographical share of North Sea Revenue.

96. The different percentages for expenditure decentralisation and self-funding arise from different figures being used for devolved expenditure. Different figures being used for Scottish income tax revenues accounts for the difference in the revenue decentralisation percentages.

Evidence received

Views in general on the content and coherence of the tax proposals

97. The transfer of increased tax revenue raising powers has been a feature of devolution since the Scotland Act 1998. There have been mixed views on the extent the process of tax devolution has gone so far and should go in the future, and the spectrum of views are again reflected in the evidence the Committee received on the specific provisions in the draft clauses of the Command Paper in respect of further tax devolution.
98. Business organisations such as the Institute of Directors (IoD) in Scotland were broadly positive about a degree of further fiscal devolution. Its Director, David Watt, told the Committee that “it is a very good principle that this Parliament should be accountable for its income—at least, a significant amount of it—as well as for its expenditure”.³⁹ For the IoD, the process for further devolution needed to take the views of business in Scotland into account during implementation of any new power.
99. Other business and business-related groups such as the Glasgow Chamber of Commerce and the Scottish Council for Development and Industry (SCDI) also

expressed general support for the package of tax powers. For example, Stewart Patrick of the Glasgow Chamber said—

” We are constantly struck by the fact that the proportion of revenue that is raised in Scotland or in the UK city regions is under 20 per cent, whereas the Organisation for Economic Co-operation and Development average is more than 50 per cent. That has implications for the productivity and performance of the country. We therefore welcome the Smith commission’s nod towards further devolution of powers beyond the UK Parliament.⁴⁰

100. Whilst welcoming the focus on the income tax powers, both the Glasgow Chamber of Commerce and the SCDI expressed views that other taxes, specifically corporation tax, should not be part of the devolution package. Ross Martin of SCDI said—

” ...our position on corporation tax is to leave it as is. However, if a deal were done with Northern Ireland that changed the system in that part of the UK, we would want to go back to our members over time to look at the evidence of any impact that that had.⁴¹

101. Other evidence received by the Committee, whilst supportive of aspects of the current devolution plans, considered that more could have been achieved. For example, Dave Moxham, Deputy General Secretary of the Scottish Trades Union Congress (STUC) said, “We welcomed the increase in tax powers, although we would have gone further”.⁴²

102. Professor Anton Muscatelli, giving evidence in a personal capacity, told the Committee that—

” In my view, given that there now seems to be a strong appetite in Scotland for greater fiscal autonomy, the cleanest solution would have been to have a package that would have involved not only complete income tax devolution, including the personal allowance, but national insurance contributions and which would have perhaps allowed some flexibility around employers’ national insurance contributions to try to affect employment, since that issue seems to be of concern to Scotland.

” I also suggested that, in the light of European rules, areas such as VAT could be subject to assignation and that some flexibility could be introduced around corporate taxation to avoid administrative complexity and to link in more with employment decisions, when companies decide where to locate in the UK. The Holtham commission in Wales suggested that there could be such flexibility. Some of those options to go further than the current set of powers that is proposed by Smith could have been explored.⁴³

103. Professor Andrew Hughes Hallett of the University of St. Andrews was also critical of the overall content and cohesiveness of the taxation proposals. He wrote—

” If devolution is to be partial or incomplete, it would pay to create a portfolio of smaller devolved taxes, or of larger taxes partly devolved rather than devolve one large tax. There are reasons for this. First, it will always be more effective to have a coherent set of taxes belonging to a consistent economic strategy, with coherent movements between them when you make changes. This cannot be done with a single devolved tax. Second, and probably more important, Scotland needs a diverse tax base.⁴⁴

104. For Professor Heald of the University of Aberdeen, one potential problem of the current package of measures proposed for devolution related to how the interaction of tax policies north and south of the border will operate and how to avoid what he referred to as ‘gaming’. Referring to the recent development of the Land and Buildings Transaction Tax in Scotland which was to replace Stamp Duty Land Tax, he said—

” One saw in the autumn statement the disruptive potential of what the UK Government does. This Parliament spent a long time trying to reform stamp duty land tax and to produce a property tax that would be implementable by the beginning of April, but the UK Government has basically disrupted that implementation by suddenly changing the tax in the rest of the UK. The question of the interaction between the two Parliaments is therefore crucial. The Smith package can be made to work, but one must think very carefully about the institutional arrangements.⁴⁵

Powers over income tax

105. The Smith Commission recommended the Scottish Parliament to have the power to set the rates of income tax and the thresholds. The Scottish rates of income tax and thresholds will apply to all income (other than savings and dividends) of a Scottish taxpayer as defined by Scotland Act 2012. The determination of the income tax base, the setting of annual personal allowances, together with certain aspects concerning tax-band thresholds, are reserved to the UK Parliament.

106. The business organisations we took evidence from were broadly supportive of this further augmentation of the powers, under the 2012 Act, for a Scottish Rate of Income Tax (SRIT). However, some, such as the IoD Scotland, expressed concerns over the potential impact on businesses if the implementation of the new regime proved complex. David Watt recalled his previous experience in rolling out the development of SRIT under the Scotland Act 2012. He said—

” As one who recently sat through discussions on the coming Scottish rate of income tax and the defining of a Scottish taxpayer with 10 Treasury officials at the other end of a video camera and about five people, most of whom were actuaries, sitting in an office in the bowels of Melville Crescent, I can tell members that things are pretty painful as they are. If that is an example of how long it will take to do things, we will have challenges in the administration and definition of income tax.⁴⁶

107. SCDI's Chief Executive, Ross Martin, set out what principles he wanted to see underpin the further devolution of powers over income tax. He said—

” To come back to the guiding principles of transparency, predictability and the desire for stability, the strong message from our members is that as long as the system contains those characteristics, and as long as there are no shocks or any structural changes that might impact unduly on one part and have a knock-on effect on another part, changes to certain aspects of it can be dealt with. That kind of predictability and the drive for stability are the overriding concerns; changes to individual taxes, allowances or credits are just the meat and drink of systems, and companies and organisations are used to dealing with them both nationally and, for our members who operate in different fiscal regimes across the world, in federal schemes or whatever.⁴⁷

108. Professor Hughes Hallett was critical of a reliance on income tax as one of the main measures being devolved as he felt that experience has shown that this does not result in economic growth or job creation. He was also concerned at the retention of elements of income tax powers by the previous UK Government, such as the power to set levels of personal allowances and thresholds. He said—

” There should be no shared taxes, including no sharing of tax bands, of tax thresholds, or of exemptions or decisions about the definition of the tax base. This is to prevent conflicts, exploitable differences, or inconsistencies or ambiguity emerging between the two authorities responsible for each part of the tax. To allow that would create problems in implementation. It would also create problems of accountability. In order to remove the possibility that inconsistencies and/or exploitable differences may emerge, you would have to ensure that either a single tax authority implemented the tax or that all definitions (tax base, bands etc.) are unified – in which case little accountability is imposed on the regional tax authority while little incentive remains for using the devolved tax.⁴⁸

109. The Institute of Chartered Accountants in Scotland (ICAS) expressed the view that the previous UK Government had adequately transposed the recommendations on income tax into draft legislative clauses. In its written evidence, ICAS said, “The draft clauses in the paper ‘Scotland in the UK: an enduring settlement’ will, in general terms, achieve their objectives of devolving certain powers and taxes”.⁴⁹

110. ICAS did recommend, however, that very careful consideration be given to when the new powers being proposed now were to be implemented, given that the devolution of increased powers over income tax as part of the Scotland Act 2012 were only now coming on-stream. It said—

” The income tax proposals combine a pragmatic way of devolving further elements of income tax whilst retaining the UK infrastructure of tax collection with HMRC and employers, thereby avoiding the costs and

efforts of whole-scale change. At the same time the income tax proposals build upon existing devolved authority because a Scottish rate of income tax (SRIT) is already in place for April 2016, and extend this by offering the Scottish Parliament further decision making and finance raising responsibilities. ICAS recommends that implementation should be phased in over a number of years. The SRIT planned for 2016 should be permitted to settle in, say over two years, before there is further devolution of income tax.⁵⁰

111. On the issue of the timing for the introduction of new income tax powers, the Deputy First Minister said—

” I am working on the assumption that we will be able to reach agreement on all questions for the Scotland bill to be passed by spring 2016. In April 2016, the Scottish rate of income tax, which is being introduced as a result of the Calman proposals, will begin to take effect. Given that the proposals envisage a two to three-year transition period or assurance about the sums that would be raised by a Scottish rate of income tax, we will be in a transition period in that respect for at least two or three years.

” [...] My preference is to move as quickly as we can towards the full provisions envisaged by Smith instead of having a long period for the implementation of the Calman proposals, but we would have to test out the detail to determine how readily that could be translated into practical reality. Obviously, it is dependent on interaction with HMRC, as it will collect the Scottish rate of income tax under both the Calman and Smith scenarios.⁵¹

112. Professor Heald raised the issue of the costs, complexity and timing of the implementation of new powers over income tax, and particularly the administrative and IT challenges ahead. He said—

” There is obviously a lot of reputational risk for the Scottish Parliament if the devolved tax powers are not implemented effectively. These things are difficult because the tax and benefits systems are complex and IT systems have to cope with millions of people and transactions. One has only to look at the difficulties with universal credit to see that this is a high-risk area that one has to think about carefully. That clearly means that sufficient resources have to be put into these things and they have to be given enough time.⁵²

113. For ICAS, one of the on-going challenges with implementation of SRIT and of any further devolution of income relates to the residency test and the definition of a ‘Scottish taxpayer’. ICAS told the Committee that it will be important to think about the practical consequences of the proposals and—

” ...the need to identify a Scottish taxpayer – who are they and who is responsible for their identification? In broad terms, a Scottish taxpayer is

someone with their main residence in Scotland. Classification issues are more likely to occur with the top and bottom ends of the income scale; i.e. the very wealthy and more mobile, those who work across different parts of the UK, and migrant low-paid workers.⁵³

114. One of the key features of the previous UK Government's proposals for devolution of income tax, as recommended by the Smith Commission, is that it proposes devolution of the setting of income tax rates and thresholds on non-savings and non-dividend income. Specifically, the Smith Commission recommended that "other aspects of Income Tax will remain reserved to the UK Parliament, including the imposition of the annual charge to Income Tax, the personal allowance, the taxation of savings and dividend income, the ability to introduce and amend tax reliefs and the definition of income".⁵⁴

115. In his evidence to the Committee, Lord Smith explained the rationale for these exclusions—

” We were concerned about starting to interfere with savings, dividend income and interest income. There is a huge industry in Scotland and a lot of people's pensions are dependent on these issues. If we start to create differences across borders in areas such as pensions, we are taking a very big step that could lead to a lot of confusion.⁵⁵

116. Some of the evidence we heard was critical of this aspect of the proposals, which is reflected in the draft legislative clauses and Command Paper. For example, NUS Scotland said in its written evidence—

” We believe that by only devolving non-savings taxes, the Scottish Parliament is put in a precarious position for any future tax rises, and particularly the introduction of a higher rate of tax. As was seen in the year before the introduction of the 50p rate in 2010, and then in the year following the reduction to 45p, those who it affected were able to shift extremely large sums of money between years and between income and dividends, in order to either escape or benefit from the changes in rates. Without the ability to tax dividends, there is a great risk that Scotland will never be able to fully utilise or benefit from any future reform of income tax.⁵⁶

117. Research published by the Institute for Fiscal Studies (IFS), in December 2014, set out the opportunities and challenges that devolution of this particular aspect of income tax would bring. Author of the research, David Phillips, wrote—

” Full devolution of income tax on non-savings and non-dividend income removes anomalies under the system of partial devolution due to take effect in April 2016 which skews the Scottish Government's incentives towards tax rises and away from tax cuts. However, the system is not perfect. In particular, because the Scottish income tax would not apply to

dividends (or savings) income, if Scottish tax rates were higher than UK tax rates, some could respond by shifting their income into dividends, on which the UK rate will apply. This tax avoidance would reduce the amount Scotland could raise from higher tax rates. This problem could be fixed by also devolving the taxation of dividend and savings income to Scotland, but practical issues make doing so difficult.⁵⁷

118. On the continued reservation of the personal allowances element of income tax, the IFS said—

” Although, with full powers over rates and bands, the Scottish Government could presumably introduce a zero-rate band, giving it the power to, in effect, increase but not decrease, the personal allowance in Scotland. With this in mind, it is hard to see any economic rationale for not devolving the personal allowance.⁵⁸

119. Finally, in an issued related to the devolution of income tax, some charities and voluntary organisations, and their representative bodies, raised the issue of gift aid. The Scottish Council for Voluntary Organisations (SCVO) told the Committee that “Gift aid needs to be considered alongside the devolution of income tax; there are implications for charities relating to the collection and level of Gift Aid which need addressing immediately”.⁵⁹ SCVO explained—

” If income tax rates were to differ between Scotland and the rest of the UK, and Gift Aid continued to be a direct relief on income tax, then there would be complications for charities and Community Amateur Sports Clubs, and for donors. For example, a donor would likely need to declare at the time they make a donation whether they are a Scottish or rest-of-UK tax payer. Since this is calculated on where a tax-payer lives for the majority of the financial year, this may not always be clear to donors at the time of donation – what would happen, say, if they moved from one jurisdiction to another later in the year? Moreover, it is unclear whether tax-payers are currently aware that this is how their tax status for income tax purposes is defined – tax-payers would need to be educated that this is the case.⁶⁰

120. SCVO also suggested that there may be unnecessary complications for pan-UK charities when receiving donations from different parts of the UK, with a lack of clarity on which government should pay the gift aid.

Assignment of a share of VAT revenues

121. The recommendation of the Smith Commission, taken forward by the previous UK Government in its Command Paper, is that the Scottish Government should be assigned receipts from the first ten percentage points of the standard rate of VAT. Receipts are to be calculated on a verified basis.

122. The bulk of the evidence received by the Committee, whilst welcoming the principle, called for greater clarity in terms of how the assignment of revenues would work. As ICAS told the Committee—

” Clause 13 in the ‘Draft Scotland Clauses 2015’ regarding VAT delivers the mechanics of the assignment of VAT, but with the large caveat that it applies ‘where there is an agreement between the Treasury and Scottish Ministers...’. The rules for agreeing this have not been provided and it may not be easy to identify ‘Scottish VAT’.⁶¹

123. In oral evidence, Charlotte Barbour of ICAS elaborated further. She said—

” The assignment of VAT offers more opportunity for discussions on how that might be calculated. It slots in with the difficulties with the fiscal framework and some of the no-detriment issues. I am not quite sure how you would calculate it. If you take a rather general estimation process, that will not marry up with and give you a true reflection of the Scottish economy. However, the better it marries up with the economy, the more difficult it is to calculate. Such elements might run through how you calculate no detriment.⁶²

124. Professor Anton Muscatelli agreed. He told the Committee—

” I, too, think that that will be difficult to measure. That is one of the reasons why, when we see assignation being used around the world, it is not as a way of handing over tax powers that can then influence the tax base but more as a way of saying, “Here’s your share of the tax take and you can use it on spending decisions. To impose administrative requirements that call for value added to be tracked at every stage would be hugely burdensome.”⁶³

125. For PricewaterhouseCoopers (PwC), “The key to implementation [of the new proposals on VAT assignation] is obviously the agreement between Treasury and Scottish Ministers as to how to calculate ‘the amount attributable to Scotland for each period’ and how the adjustment to block grant will be calculated”.⁶⁴

126. Other bodies, such as the STUC, were more broadly supportive of the assignment of a share of VAT. Its Deputy General Secretary, Dave Moxham, said—

” ... I am quite a fan of assigned revenue. I fully take your point that it is not a power in the sense of being usable to promote particular behaviours, but I return to my point about how good Scottish policy is reflected in the block grant. A degree of assigned revenue clearly rewards the Scottish Government for economic growth and, in our view, the closer we get to an amount of revenue that is derived from positive actions undertaken by the Scottish Government, the better. I take your point about it not being a lever, but I still think that it is useful that we move towards a situation in which a

larger proportion of Scottish revenue is derived from positive Scottish Government economic activity.⁶⁵

127. Commenting on the issue of how to calculate the assignment of a share of VAT revenues, the Deputy First Minister said—

” A lot of technical and analytical work will need to be done to determine on what basis VAT should be assigned. As with all such matters, there is no one straightforward way of doing that, so we will have to work our way through a multiplicity of options. The opportunity to define much of that presents itself in the work that the Chancellor and I have commissioned from civil servants, which will be undertaken in the course of the next eight weeks or so.⁶⁶

128. He also added that—

” There are two separate issues. One is establishing the analytical base for how VAT should be apportioned and the other is the policy question of guaranteeing that if those estimates are exceeded, Scotland retains the benefit of that improved economic performance and consequential improved VAT take. Those two separate issues have to be resolved as part of the exercise, and the policy question is an inherent part of the fiscal framework that must be put in place.⁶⁷

129. The former Secretary of State for Scotland also commented on the issue of VAT in a letter to the Committee. He said—

” ...I can confirm that VAT assignment will link the Scottish Government's budget with economic activity in Scotland, providing incentives for growth. The amount of VAT to be assigned to the Scottish Government's budget will be based on an estimated share of the total VAT generated in the UK. The Scottish Government will be assigned the first 10 percentage points of the estimated VAT revenue generated by standard rated economic activity in Scotland and the first 2.5 percentage points of the estimated VAT revenue generated by reduced rated economic activity in Scotland, with corresponding adjustments to the Scottish block grant. The inclusion of the 2.5 percentage points reduced rate element enables assignment of precisely 50% of Scottish VAT receipts on the basis of current VAT rates. The UK and Scottish Governments will need to agree a methodology for estimating how much of that VAT is generated by Scotland and how much by the rest of the UK. The UK and Scottish Governments will also need to agree the operating principles, including mechanisms for verifying that the methodology has been applied correctly and how any adjustments might be carried out and arrangements for audit and transparency, including publication of results.⁶⁸

Air Passenger Duty

130. The report of the Smith Commission recommended that Air Passenger Duty (APD) should be devolved and the Scottish Parliament should have the power to charge a tax on air passengers leaving Scottish airports, with full control over the design and collection of any replacement tax. It further recommended that a fair share of the administrative costs would be transferred to the Scottish Government. This recommendation has been taken forward by the previous UK Government in its Command Paper.
131. A range of business organisations who appeared before the Committee during our evidence-taking, or whom submitted written views, including IoD Scotland, Glasgow Chamber of Commerce, the Scottish Chambers of Commerce and the Scottish Council for Development and Industry, all expressed support for the devolution of APD. This was coupled with support for either a reduction or scrapping of this duty after devolution had taken place.
132. Similarly, bodies such as ICAS expressed their support for devolution in the written evidence provided to the Committee, as did the National Farmers Union of Scotland who wrote—
- ” ...we do welcome the UK Government’s intention set out in the Command Paper to devolve Air Passenger Duty to the Scottish Parliament. During the Smith consultation phase, this was an issue raised time and again by NFUS members who considered it vital to increasing internal connectivity within Scotland and acting as a stepping-stone to furthering movement, investment and enterprise in Scotland’s more remote areas.⁶⁹
133. Ross Martin of SCDI, in his appearance before the Committee, cited the potential for cross-border effects if APD is devolved and reduced/eliminated in Scotland. He highlighted research produced by HM Treasury in recent months which—
- ” ...predicted that [abolition of APD in Scotland] would have a 3 per cent impact on Manchester, which is—in the chancellor’s language—manageable, and a 10 per cent impact on Newcastle. Obviously, there would have to be a mechanism by which Newcastle was given a measure of support. From our discussions with the UK Government, we believe that it is alive to the issue. If APD can be reduced and abolished even quicker under the current arrangements, without going through the transfer of powers, that will be all the better, but if it will take devolution, we will be willing to look at that.⁷⁰
134. In written evidence provided to the Committee, the leaders of Glasgow, Edinburgh and Aberdeen International Airports stated that, whilst they recognised the concern that had been expressed about possible cross-border effects, they did not feel it applied as the amount of tax competition would be minimal and that Scottish airports do not, in their view, compete substantially for flights with airports in the north of England.⁷¹

135. In its written evidence, the Scottish Tourism Alliance was also supportive of the devolution of APD with a view to reduction/abolition, and called for “A working group made up of the Parliament and industry [to] be established to oversee a workable, effective and timeous transparent, implementation plan around a ‘new deal’ for APD in Scotland.”⁷²

Aggregates levy

136. Devolution of the Aggregates Levy has been a perennial candidate for devolution by the UK Government for a number of years, pending conclusion of the on-going legal proceedings.

137. The Smith Commission recommended that, once the current legal issues in relation to aggregates levy have been resolved, the Scottish Parliament should have the power to charge a tax on the commercial exploitation of aggregates in Scotland, with full control over the design and collection of any replacement tax. A fair share of the administrative costs would be transferred to the Scottish Government.

138. Clause 15 of the previous UK Government’s draft legislative clauses takes forward the Smith Commission’s agreement on the Aggregates Levy. Through this clause the power to charge tax on the commercial exploitation of aggregate in Scotland will be devolved to the Scottish Parliament. This devolution will take place once the current legal issues in relation to the Aggregates Levy have been resolved, using the commencement order making power in clause 15. These issues arise out of unresolved challenges to the lawfulness of the levy dating back to 2002.

139. Following the resolution of these challenges, the UK Government states that the clause will enable the Aggregates Levy to be turned off for aggregate commercially exploited in Scotland (including aggregate from Scottish territorial waters), giving the Scottish Parliament the power to make its own arrangements with regard to the design and collection of any replacement tax on the commercial exploitation of aggregate in Scotland. This will be subject only to the requirement that any tax so introduced fully complies with EU law.

140. The previous UK Government has stated that it will work with the Scottish Government to ensure that double taxation is avoided. This may require changes to the way that the Aggregates Levy operates in the rest of the UK. If required, these consequential changes will be made following the resolution of the legal challenges, further discussion with the Scottish Government and consultation with the quarrying sector. The previous UK Government has, therefore, not included this in draft clause 15.

141. The Committee has heard a limited amount of evidence relating to this provision. For the industry body, the British Aggregates Association (BAA), the concerns about the levy were more fundamental than simply its devolution. Richard Bird of the BAA wrote—

” The aggregates levy has been and is a very bad tax both here and in Northern Ireland where an even more bizarre situation arose. The sad thing is that Westminster has offered it as a devolved tax to Scotland, particularly as the current coalition government stated that it would drop the levy if it came to power.⁷³

142. In his view, the Aggregates Levy has done very little to enhance the environment and in fact in many cases had a negative effect on the environment.
143. In its submission, the Scottish Chambers of Commerce stated that, “On balance, Scottish Chambers of Commerce believes that there would be little risk attached to devolving the Aggregates Levy.”⁷⁴

Fiscal framework, institutional arrangements and the operation of ‘no detriment’

144. Leaving aside the specific tax proposals and translation of the Smith Commission’s recommendation into draft legislation, the most significant issue that we took evidence on were the proposals for a new fiscal framework between the Scottish and UK Governments that would underpin this package of devolved powers. This includes the provisions on ‘no detriment’ arrangements. Additionally, the overall issue of what kind of institutional structure for oversight, regulatory functions etc. also featured in the evidence we have heard so far.

Background

145. At present, the majority of the Scottish Government’s budget is funded by a block grant authorised by the UK Government. The Barnett Formula ensures that, when there are changes to spend in England in comparable devolved expenditure, the Scottish budget is also adjusted. This adjustment is based on spending comparability and Scotland’s population share, with the relevant percentages presented in the Statement of Funding Policy. The Scottish Government is not obliged to make changes in the same spending areas.
146. The provisions agreed to under the Scotland Act 2012 mean that there will be a deduction from the Scottish block grant as a result of the revenue-raising powers being transferred to the Scottish Parliament. There are two elements to the block grant adjustment; the initial reduction and the way in which the reduction is calculated, or indexed, in future years.
147. The Scottish and UK Governments have agreed a one-off adjustment to the block grant for 2015-16 for the two new devolved taxes. With regard to SRIT, the UK and Scottish governments have agreed to develop and agree the block grant adjustment mechanism based on the proposals of the Holtham Commission. This approach recalculates the block grant adjustment mechanism year by year by indexing it to movements in the Non Savings Non Dividend income tax base in the rest of the UK

148. The Smith Commission, and subsequently the previous UK Government, proposed that any devolution of further responsibility for taxation and public spending, should be accompanied by an updated fiscal framework for Scotland. Specifically, that—

- Additional devolution should bring about **no detriment** to the Scottish or UK Governments' budgets, simply as a result of the initial transfer of tax powers. This means that devolution should be accompanied by a reduction in the block grant equivalent to the revenue forgone by the UK Government, and that future growth in the reduction of the block grant should be indexed appropriately. Changes to the taxes in the rest of the UK (for which responsibility has been devolved to Scotland) should only affect spending in the rest of the UK. Changes to the devolved taxes in Scotland should only affect public spending in Scotland.
- The Barnett Formula will continue to operate to ensure that Scotland receives its population-based share of any changes in comparable spending by UK Government departments.
- The devolved Scottish budget should fully benefit/bear the costs of policy decisions by the Scottish Government and their impact on revenues.

Evidence received

149. In preceding paragraphs, the Committee has noted the views of Professor Heald that, unless efforts are made to prevent it, any new fiscal framework and arrangements for no detriment run the risk of 'gaming' by one side or another. His view was supported by SCDI in its evidence. Responding to a question from a Committee member, Ross Martin of SCDI said—

” There is a recognition that such things have to be made clear at the outset to reduce considerably the latitude for mischief making—or gaming, as Mark McDonald has called it. There are mature systems around the world from which we can learn lessons about relative power and the relationship between the federal and state levels.⁷⁵

150. In an additional written submission of evidence provided to the Committee following his appearance, Professor Anton Muscatelli highlighted the importance of paragraphs 95(3) and 95(4) of the Smith Commission's report. He said—

” Both of these will require very close scrutiny when legislation is brought forward. In the case of paragraph 95(3) evaluating the administrative costs of devolving additional spending powers needs to be done on an appropriate and fair basis to take account of the full cost of delivery of the additional programmes. In addition, future block grant indexation has to be implemented fairly, and none of this is set out in full in the Command Paper.⁷⁶

151. Professor Muscatelli concluded that there was insufficient detail at the moment to be clear on how the no detriment arrangements might work because the details had not been published in the draft legislation.⁷⁷
152. For Professor Andrew Hughes Hallett, the functioning of the no detriment arrangements within the new fiscal framework and the specific restrictions placed on either government cannot be taken to mean literally no effect on any other party or it would never be possible to make any changes at all. He recommended that—
- ” The Committee should be careful to distinguish first and second round effects of a devolved power. That will allow it to consider devolution when it is not a zero-sum game; and where it is designed to correct imbalances of the past or to create gains to parties outside government.⁷⁸
153. A number of organisations and individuals that provided evidence to the Committee called for greater detail on the fiscal framework to be produced as a matter of urgency and for there to be clarification of the institutional landscape that will define how it operates, particularly regarding how there will be independent scrutiny.
154. For example, both the IoD Scotland and SCDI made comments on the need to review the current institutional set up governing both the new fiscal powers and the borrowing provisions (see subsequent section). Ross Martin of SCDI put it succinctly—
- ” Over the piece—not just on borrowing, but on the whole array of powers—Scotland, not having previously had responsibility for revenue raising and that side of the balance sheet, as the Deputy First Minister would put it, does not have the mechanisms by which to make an independent assessment. In particular, the role of the Office for Budget Responsibility comes into question. Whether or not the OBR, as it currently exists, would be the appropriate body and mechanism for that, or whether its role should be devolved in some way, as some members would suggest, there needs to be a maturation of the accountability and responsibility aspect. That was a major aspect of our members’ views. With rights come responsibilities, and with responsibilities comes a need for regulation—clever, agile, flexible, accessible and transparent regulation.
- ” There must be a proper discussion about how we do that, who is going to be responsible for it, what the metrics will be and who will be responsible for policing it and for any fiscal transfers that are required, for example. There are a range of issues that the Scottish Parliament has not necessarily had to tackle in the past, and it will have to get up to speed on them pretty quickly.⁷⁹

155. The Royal Society of Edinburgh (RSE) agreed with the suggestion of an equivalent body to the Office of Budget Responsibility (OBR) in Scotland. It told the Committee, “We believe that there is a need for an equivalent body to the Office for Budget Responsibility to be established for Scotland; in addition we recommend the establishment of a new body to provide independent analysis of the fiscal arrangements and balancing mechanisms that will exist between the United Kingdom and the four nations within the UK.”⁸⁰
156. The RSE also called for much greater clarity as to the mechanism by which reductions in the block grant calculated under the Barnett formula (or any substitute formula) can be negotiated and agreed between the UK and Scottish governments in an open and transparent manner, and for the meaning of ‘no detriment’ to be defined.⁸¹
157. In his evidence to the Committee, the Scottish Government’s Deputy First Minister agreed that the details of the fiscal framework and the workings of the no detriment principle were important and that the Scottish Parliament should be provided with the necessary information before it considers any legislative consent of any new bill introduced after the UK General Election. He said—

” There has to be a fiscal framework in place that is acceptable to Parliament before any LCM [legislative consent motion] can be agreed to. It is in no way possible or plausible for an LCM to be agreed to without an agreed fiscal framework that is to the satisfaction of Parliament being in place.⁸²

The role of the Scottish Parliament and parliamentary oversight

158. The particular importance of parliamentary oversight of both the development and functioning of the fiscal framework, and arrangements for no detriment and block grant adjustments, were highlighted by some of those who gave evidence to the Committee.
159. For example, Audit Scotland, in its written submission, stated that—

” Fiscal transparency becomes increasingly important, as the level of financial devolution increases, so that Parliament can properly scrutinise and take informed decisions such that public trust in government is maintained.

And that—

” Early consideration of the accountability processes and risk sharing arrangements between the parties will help successful design of the detailed rules and regulations.⁸³

160. In its recent report on *Further Fiscal Devolution*, the Scottish Parliament’s Finance Committee pressed this particular point. It recommended that—

” ...a clear timetable is agreed and published by the UK and Scottish Governments for the implementation of Scotland’s fiscal framework. This should include allowing sufficient time for consultation with both parliaments on a draft framework.⁸⁴

161. It further recommended that, “there needs to be much stronger and more transparent parliamentary scrutiny of inter-governmental relations as more powers are devolved to Holyrood.”⁸⁵

162. The Deputy First Minister commented on the balance to be struck in his opinion between private intergovernmental dialogue and parliamentary oversight during his evidence. He explained—

” The civil servants have to try to work their way through all the possible evidence that could be considered to do with resolving just one question in the fiscal framework, and there will be many such questions to be resolved. The civil servants have to marshal the evidence, test it and get it to a point at which they can extract the issues that ministers need to resolve so that, after the election is out of the way, ministers can consider the evidence and see what those issues are. We should be open to considering how much of that evidence can be shared with parliamentary committees to ensure that they have confidence in the process. Although there was a 15-minute discussion on the block grant adjustment, a lot of detailed work went into evidencing both propositions. Ultimately, we had to resolve the issue, and we did that by deciding on a figure that was in the middle. There was plenty of evidence that supported a block grant adjustment of £526 million and plenty of evidence that supported a figure of £461 million. We came to a political agreement about what was reasonable within that.

” Subject to reaching an agreed position with the United Kingdom Government about how comfortable it is with information sharing with committees, I am keen to be as open as possible about the process, because I acknowledge the importance of the Parliament being satisfied that a robust fiscal framework is in place.⁸⁶

Conclusions and recommendations on taxation provisions

163. **The focus of this interim report and of the Committee’s scrutiny to date has primarily been concerned with how the recommendations in the Smith Agreement have been translated into draft legislation by the previous UK Government and what improvements can be made.**

164. **On income tax, the Committee concludes that the essence of the Smith Commission’s recommendations has been translated appropriately by the previous UK Government into the draft legislative clauses. We have no particular concerns at this stage with the drafting. However, there are significant issues still to be resolved regarding the implementation of the**

new powers, such as an appropriate definition of residency for a Scottish taxpayer, the details of the administration of the new regime (who collects the tax and how it will function), the costs on business and individuals, the need to avoid double taxation and the timing and phasing of the new powers on income tax relative to those already devolved under the Scotland Act 2012.

165. **One area that requires further clarification from the UK Government, however, is whether the current provisions would permit the Scottish Parliament to set a zero rate of income tax.**

166. The Committee recommends that details on the implementation of the new powers over income tax be produced before the Scottish Parliament is expected to give its legislative consent.

167. **The Committee concludes that the wording of the previous UK Government's draft clauses for the assignment of a share of VAT revenues is adequate as currently drafted. However, there is still significant uncertainty on how the assignment of a share of revenues will be calculated and whether the Scottish Government will be able to reap the rewards of any economic stimulus that yields higher VAT revenues.**

168. The Committee recommends that details of the assignment of VAT revenues and the share of any benefits be produced before the Scottish Parliament is expected to give its legislative consent. The Committee further recommends that a bilateral process by discussion is entered into between the two governments to reach agreement for the 'verified basis' for VAT attribution to Scotland for assigning the receipts.

169. **The Committee is content with the proposals and the current drafting of the clauses relating to the devolution of Air Passenger Duty and the Aggregates Levy. In due course, the Scottish Government should set out its policy plans for both of these newly devolved powers.**

170. The single most critical observation we make at this stage relates to the proposed new fiscal framework, 'no detriment' principle, block grant adjustments and the institutional landscape. The details of these matters will be critical to the smooth and transparent functioning of the taxation provisions as recommended by the Smith Commission.

171. The Committee welcomes the recent report of the Finance Committee which considered further fiscal devolution and in particular the elements of the report which considered the implications of the Smith Commission recommendation that an updated fiscal framework for Scotland be developed.⁸⁷ In particular, the Committee notes that the Finance Committee found there to be clear differences

between the Scottish and UK Governments regarding the clarity of the no detriment principle. The Committee notes the Finance Committee's recent announcement that it will undertake an inquiry examining the proposals for a fiscal framework as set out in the previous UK Government Command paper. The Committee looks forward to the Finance Committee's report on this issue.

172. The Committee notes the evidence that the Public Audit Committee has taken from the Auditor-General for Scotland regarding accountability and audit arrangements arising from the Smith Commission recommendations. In evidence to the Public Audit Committee, the Auditor-General commented on the importance of the Scottish Fiscal Commission in relation to the taxation powers proposed for devolution by observing that-

” It is very clear that the OBR and the Scottish Fiscal Commission will need to work closely together on the issues in exactly the same way as Audit Scotland and the National Audit Office do. We do not want huge amounts of duplication in our respective roles, but we need to respect the fact that the UK Parliament and the Scottish Parliament have separate sets of interests that in many cases will overlap but which will not be the same. Both Parliaments need to be assured about the forecasts that the OBR and the Fiscal Commission will produce, the adjustments that are made to Government funding streams and, in our case, the annual results that come out of that in the financial statements.⁸⁸

173. The Smith Commission recommended that a key component of an updated fiscal framework should be that 'no detriment' should occur to either Government as a result of the decision to devolve further power. No detriment was considered by the Smith Commission to consist of two components. Firstly, that the Scottish and UK Governments' budgets should be no larger or smaller simply as a result of the initial transfer of tax and / or spending powers. Secondly, that post-devolution of powers that where either the UK or Scottish Government makes policy decisions that affect the tax receipts or expenditure of the other, that the decision-making government will either reimburse the other if there is an additional cost, or receive a transfer from the other if there is a saving. The Smith Commission also recommended that there should be a shared understanding of the evidence between both Governments in order for any adjustments to be made.
174. The Committee has taken evidence which has questioned the timescales over which no detriment will apply and also stressed the need for an independent source of financial data to be established in order that there can be an independent source of data via which a shared understanding of the evidence can be obtained.

175. The Committee recommends that greater clarity is required with regard to how 'no detriment' will operate in practice with particular regard to the timescale and range of policy effects which will be considered as

constituting no detriment. Accordingly, the Committee calls on both the Scottish and UK Government to detail their understanding of the principle of no detriment. The Committee also calls on both Governments to detail how they consider a shared understanding of the evidence, with regard to the calculation of no detriment, will be obtained.

176. It will also be important for the two Governments to have a shared understanding of the figures and calculations for tax matters, and we recommend that both Governments enter into an agreement to establish a common database of tax information. This will assist with the process of dispute resolution. In addition, the Committee recommends that independent scrutiny of these matters, by the Scottish Fiscal Commission, will be an essential component of the scrutiny landscape if these proposals are to be implemented effectively.

177. As yet, we are not able to conclude that we are content with the fiscal framework and no detriment arrangements as these details are currently being discussed between the two governments. For the Committee, both the process of these negotiations and the outcome requires proper parliamentary scrutiny. We recommend both Governments reach an urgent agreement on just how this will be achieved and for the Scottish Government to report to the Committee on what arrangements it proposes to put in place for parliamentary oversight.

178. **In any case, the Committee concludes that any final detail of the fiscal framework and the other matters we have considered is provided to the Scottish Parliament before the question of legislative consent to any new bill is considered in the early months of 2016.**

179. **Given the importance of the fiscal framework and intergovernmental working more generally, the Committee gives notice that it intends to continue to develop ideas and recommendations in this area in advance of, and then alongside, scrutiny of any bill introduced by a new UK Government after the UK General Election. We will liaise closely with other parliamentary committees on this matter.**

Borrowing

Background – current situation

180. The ability to borrow to fund longer-term capital investment or to cover short-term revenue requirements is a common feature of governments across the world.
181. Currently, through the Scotland Act 2012, provisions are in place to enable the Scottish Government to borrow up to £2.2 billion in total for capital investment from 2015-16. Within this, the Scottish Government is able to borrow up to 10 per cent of its capital Departmental Expenditure Limits (CDEL) budget annually, which means that the Scottish Government will face a limit of £304 million in 2015/16.⁸⁹
182. The Scottish Government is currently able to borrow this aggregate amount of £2.2 billion from the National Loans Fund (NLF), by commercial loan, or by issuing bonds. There is provision to raise (but never lower) this cap.
183. Additionally, the Scotland Act 2012 provides that, from April 2015, the Scottish Government is able to borrow up to £200 million in any one year with a cumulative limit of £500 million to deal with the situation when outturn tax receipts for devolved taxes such as Land and Buildings Transaction Tax or from the Scottish Rate of Income Tax are less than forecast. The first 0.5% (circa. £125 million) of tax shortfall must be absorbed by the Scottish budget. Furthermore, Scottish Ministers are required to repay their loans within a maximum of four years.
184. Finally, in December 2014, the previous UK Government announced that it was taking the next step in the formal process to give the Scottish Government the power to issue bonds from 1 April 2015.⁹⁰

Comparative information

185. In Scotland, local authorities have the power to borrow for capital purposes. There are no formal limits on the level of borrowing, although the Scottish Government and HM Treasury monitor borrowing levels to ensure they remain within acceptable limits.
186. The Northern Ireland Executive has certain borrowing powers proscribed in statute, with the existing general borrowing limit set at £3 billion through the Northern Ireland (Miscellaneous Provisions) Act 2006.⁹¹ Under the Northern Ireland Act 1998, the Executive may also borrow up to £250 million from the National Loans Fund to manage temporary shortfalls in budgets. The Reinvestment and Reform Initiative (RRI) was introduced in 2002 to fund capital investment (although the Executive has also borrowed under the RRI for resource costs with HM Treasury permission). It addresses the fact that the Northern Ireland Executive retains control over a range of functions which are normally the responsibility of local government in Scotland and Wales. RRI borrowing is formally limited by HM Treasury, with the limit currently set at £200 million per

year. However, HM Treasury has frequently allowed additional borrowing, for example to bail out the Presbyterian Mutual Society, and for shared educational facilities under the 'Together Building United Communities' strategy.

187. The Welsh Assembly Government is able to borrow up to £500 million in total from the National Loans Fund to cover temporary shortfalls under the Government of Wales Act 2006⁹². The Wales Bill does not change the revenue borrowing limit but provides Welsh Ministers with the power to borrow for current spending (with a maximum of £200 million in a single year). The UK Government intends this power to come into force alongside the implementation of devolved taxes in 2018/19. The UK Government may increase or decrease the overall limit by secondary legislation but not below the initial £500 million. The Bill also provides for increased capital borrowing powers with an overall cap of £500 million on capital borrowing and an annual limit of £125 million from 2018/19.⁹³
188. There are a number of international examples of successful sub-national devolution of borrowing powers, including in the US, Canada, Australia and Switzerland.

The recommendations of the Smith Commission and the previous UK Government's proposals

189. Paragraph 95 (5) of the Smith Commission's Report made the following recommendations in relation to borrowing:⁹⁴
- There should be sufficient additional revenue borrowing powers to ensure budget stability and provide sufficient safeguards to smooth public spending in the event of economic shocks.
 - There should also be sufficient capital borrowing powers to support capital investment, consistent with a sustainable overall UK fiscal framework and that the merits of a prudential borrowing regime should be considered.
190. It is proposed that borrowing powers should be agreed by the Scottish and UK Governments and their operation kept under review.
191. There are no published draft legislative clauses relating to borrowing within the previous UK Government's Command Paper. However, the previous UK Government does provide some commentary on how it envisages new borrowing powers will be provided to the Scottish Government and how these need to function within the proposed fiscal framework.

Evidence received

Critique of the current borrowing powers within the Scotland Act 1998 and Scotland Act 2012

192. In his Foreword to the report of the Smith Commission, Chairman, Lord Smith of Kelvin expressed his own personal view that increasing borrowing powers for the Scottish Government was an integral element of the new powers set out in the Commission's report. He said—

” Significantly more devolved spending in Scotland will now come from tax raised in Scotland with the remainder coming from the block grant provided by the UK Government. To balance this increased financial responsibility, the Parliament will be given increased borrowing powers, to be agreed with the UK Government, to support capital investment and ensure budgetary stability.⁹⁵

193. His view was echoed in the evidence we received from other experts in this field. For example, Professor David Bell of the University of Stirling highlighted the current borrowing provisions as set out in the Scotland Act 2012, and posed the question of whether these would be sufficient. In his view, they would not be.⁹⁶

194. In his written evidence, Professor Bell commented that, in particular, the current borrowing provisions designed to cover short-term revenue requirements had been designed for a different devolved tax structure than will be in place if further powers are devolved. He said—

” Once the Scotland Act 2012 comes into force, there will be an additional source of volatility, namely unexpected variation in tax revenues. This volatility will grow as Scotland becomes more dependent on its own revenues. So the implementation of the Smith proposals would increase substantially the potential volatility in Scotland's revenues. Hence the provisions to deal with that volatility will also have to increase. This might suggest that the £200 million limit is relatively modest, since it was designed for a different revenue structure.⁹⁷

195. Don Peebles of CIPFA Scotland (The Chartered Institute of Public Finance and Accountancy) highlighted the comparison between the proposed capital borrowing limit for the Scottish Government (£2.2 billion) and the position of local authorities. He stated that the level of outstanding debt for local government is £15 billion. His conclusion was that, “even now, local authorities have considerably greater powers than the national [Scottish] Government”.⁹⁸

196. CIPFA were supportive, however, of borrowing as a legitimate activity of governments, stating—

” It is also important to remember that, although risk is associated with debt and borrowing, borrowing is not a bad thing. It can be quite important for

Government to implement borrowing policies on a short to medium-term basis, although there is a long-term consequence associated with that.⁹⁹

197. The Institute of Directors in Scotland in their evidence to the Committee were supportive of the principle of the Scottish Government being able to borrow, provided it was for a purpose, namely capital borrowing to finance infrastructure projects. Its Director in Scotland, David Watt, told the Committee that—

” We do not want borrowing for the sake of borrowing. As with all other powers, we want it for a purpose, such as infrastructure development.¹⁰⁰

198. The Scottish Federation of Housing Associations (SFHA) in its written evidence was critical of the recently extended borrowing powers under the 2012 Act. It said—

” SFHA believes that the Fiscal Framework should give maximum powers in this area [borrowing], to provide further levers with which to balance priorities with resources. The Scotland Act has recently increased the cap on borrowing by the Scottish Government to £500 million. For purposes of comparison this is only slightly more than the current annual value of public investment in housing in Scotland and significantly less than the combined borrowing capacity of the SFHA’s members of approx. £4 billion. This is insufficient for the country to be able to effectively manage new powers. The ability for the Scottish Parliament to make genuine long-term strategic decisions in line with current devolved powers is compromised by the lack of flexibility with respect to borrowing for capital investment.¹⁰¹

199. The Deputy First Minister set out his views to the Committee on the need to reform the current borrowing powers. He said—

” What was set out in the Smith report and what we will have to put into practice must acknowledge the importance of the revenue borrowing issue that I was discussing a moment ago to deal with volatility in revenues. We need greater flexibility and a greater facility to undertake borrowing for capital investment purposes, and the fiscal framework will have to determine how those things should be put in place and deployed.¹⁰²

Principles of any new borrowing regime

200. In his evidence to the Committee, Philip Milburn of The Investment Association, set out his overarching thoughts on what the markets and fund/asset managers would be looking for in any new borrowing regime established by further devolution. He said—

” The markets will always want as much certainty as possible. The stronger the framework and the stronger the legislation, the more the markets will understand and the less they will charge as a risk premium. Basically,

strong legislation is what the markets generically—not me specifically—would look for.¹⁰³

201. His views on the perceptions that the markets and fund/asset managers might take of the new borrowing powers were supported by Professor Bell who warned that it was important that there was a clear institutional framework in place for any new regime. He said, “it is reasonable to ask whether there should be an external body that looks at borrowing and which has the confidence of the markets and can give some of the certainty that Philip Milburn was talking about”.¹⁰⁴ Professor Bell’s view was without such clarity being in place, the markets would penalise a Scottish Government through the levels of interest they would charge to lend money under this new regime.
202. For Don Peebles of CIPFA, three elements needed to be put in place within the context of any new regime for enhanced borrowing, namely a combination of primary legislation, regulation and professional practice.¹⁰⁵
203. Some of those who gave evidence to the Committee were particularly supportive of the move towards what the Smith Commission and the previous UK Government describe as a ‘prudential borrowing regime’. Currently, the Scottish Government is held to limits in terms of the amount of short-term revenue or long-term capital borrowing it can undertake (see above).
204. Specifically, the Smith Commission agreed that consideration should be given to the introduction of a prudential regime for Scottish Government capital borrowing, similar to that which has regulated local authority borrowing in England, Scotland and Wales since 2004.
205. Questioned on whether the previous UK Government’s Command Paper and draft clauses had delivered on this particular recommendation, Don Peebles said—

” ... the discussion and the recommendation from the Smith commission was for the introduction of a prudential borrowing framework. The expectation was that that would translate through to the clauses, but it is not there. The command paper discusses the issue as though there will be a prudential framework, but the trigger point, which would be a proposal for primary legislation, is not there. Therefore, we can talk about a framework, but we do not have one and we do not have the basis to enable one to be introduced.¹⁰⁶

206. In his view, a prudential borrowing regime, which had regard to affordability, sustainability and prudence rather than being restricted by limits, has not been bought forward by the previous UK Government. In his comments to the Committee, he drew the distinction between comments that had been made about a prudential framework in the Command Paper with the absence of any detailed information in the draft clause that would deliver this type of regime.¹⁰⁷

207. CIFPA's preference was to adopt a borrowing regime that did not set a fixed, numerical limit on borrowing, but which was governed by issues of affordability and sustainability. The Investment Association made similar comments, with Mr Milburn telling the Committee that—

” I would try to avoid a hard limit, be it £2.2 billion or £5 billion. I would veer towards a form of percentage of Scottish GDP—obviously, it would need to be negotiated—so that a countercyclical measure can be put in place. If you assume there is a downturn in recession and GDP shrinks by 2 to 3 per cent, that starts to be a sensible area.¹⁰⁸

208. Professor Bell also agreed with this type of approaching, stating that in his view—

” People might want the limit to be a share not of current GDP but of cyclically adjusted GDP. In that way, the cyclical effects are taken out.¹⁰⁹

209. In addition to his views on the merits or otherwise of a specific index-linked limit in any new borrowing regime, Professor Bell stressed the fundamental importance of establishing a regime for accurately forecasting tax revenues and tracking spending in the context of borrowing powers. In his view, this was an important principle to get right in any new borrowing framework. A failure to correctly forecast tax receipts or spend what a government had predicted it would when it entered into borrowing ran the risk of building up uncertainties which would, in his view, only emphasise the need for the correct institutional and intergovernmental framework to be put in place in the UK.¹¹⁰

210. In written evidence to the Committee, Professor Hughes Hallett suggested that borrowing powers that adhered to 'the golden rule' were preferable and that the currently suggested borrowing regime was inadequate. He said—

” Since we are moving to a world with more uncertain and potentially volatile revenues, but fixed contractual costs, adequate borrowing measures need to be included in the devolution package. What adequate means in this context needs to be determined as part of the detailed negotiations, but it should certainly be sufficient for the “golden rule of public finance” (that borrowing be allowed to cover spending on public capital, but not for current spending) to operate freely and to cover normal expected fluctuations in public revenues. The golden rule is important here because it ensures adequate spending on public investment, especially on research and development, infrastructure investment, and training which are now considered by many to be the critical components for stimulating growth in a slow-growth environment. The current limits on borrowing (½% of GDP across the cycle to offset normal revenue fluctuations; and a running total of 2% of GDP for capital projects) fall well short of adequate for any measure of further devolution.¹¹¹

Bailouts

211. In his written evidence to the Committee, Professor David Bell highlighted that it is relatively common for sub-nation state governments across the world to experience fiscal distress. He stated that even though fiscal frameworks are intended to minimise this risk and to ensure that nation state governments macroeconomic policies are not affected by fiscal difficulties at the sub-nation state level, such problems do occur.¹¹²
212. Although there were no guarantees, Professor Bell informed the Committee that academic research into precedents in Austria, Germany, Italy and Sweden pointed towards bailouts being the norm especially where the political risk of failing to provide a bailout was deemed too high or where the nation state government and sub-nation state governed shared the same political persuasion.¹¹³
213. Philip Milburn's view was that—
- ” ...in the context of the international market, £2.2 billion is such a small amount of money that it would be implicitly assumed that, if the Scottish Government got into borrowing difficulties, there would be some form of bailout from the UK Government. That would be implicitly but not explicitly assumed by the markets.¹¹⁴
214. Professor Bell suggested to the Committee that it was not likely that the Scottish Government would need any bailout as a result of an inability to service the costs of capital borrowing even if up to the limit of £2.2 billion. He said if the Scottish Rate of Income Tax generated about £11 billion a year and half of VAT receipts added another £5 billion or so, then the servicing costs on borrowing of £2.2 billion “would go nowhere near the revenue that would be raised from income tax and VAT together, so I do not think that, in the first instance, would be much of an issue”.¹¹⁵
215. One potential criticism of a move towards a prudential borrowing regime (as opposed to one governed by set borrowing limits) is the suggestion that a sub-nation state government will be able to borrow regardless of ability to pay and irrespective of the views of the nation state or central government. In his evidence to the Committee, Don Peebles stressed that this was not currently the case in relation to the prudential regime in place for Scottish local authorities. He told the Committee, “on the point about local authorities and the possibilities that could transpire, under the 2003 act there is a reserved power for the Scottish Government that means that it can revert to central control, in effect”. He thought that any future ‘Scotland Bill’ introduced by a new UK Government after the UK General Election in May 2015 could have similar provisions.¹¹⁶

Commentary on the current proposals of the previous UK Government

216. The main criticism of those who gave evidence on borrowing to the Committee was the current absence of any detail, particularly in terms of legislative clauses,

of what the proposed new prudential regime cited in the Smith Commission and in the Command Paper itself would look like and how it would function. CIPFA told the Committee that the lack of substance in the clauses was perhaps an “omission” at this stage.¹¹⁷

217. Don Peebles elaborated on this point—

” A useful comparator is the introduction of the prudential code for local authorities by the Local Government in Scotland Act 2003. Primary legislation was required to enable the significant change—which it was at the time—that introduced a more flexible framework. Our expectation was that there would almost certainly be some indication or some forward notification of change, but you are right to observe that the clauses are silent on borrowing powers—a point that we made in our written submission.¹¹⁸

218. Both Professor David Bell and Philip Milburn of The Investment Association made calls for further clarity on certain aspects, such as where interest rate payments on borrowing would rank in terms of seniority of debt. Mr Milburn said—

” All that the markets want is to have interest paid on money that is loaned and to get that money back. There are almost institutional questions around that.¹¹⁹

219. He also wanted greater clarity on what revenues will service the debt, whether it would be the Scottish tax revenue or the Scottish tax revenue plus the remaining transfers from Westminster, or a mixture of both.¹²⁰

220. Professor Bell also called for further information on what the current proposals and draft legislative clauses imply for the interplay between the new borrowing powers and the capital grant element of DEL (CDEL).¹²¹

221. This was also an issue for the Deputy First Minister who told the Committee that—

” I sense that borrowing for capital purposes might lead to a removal of the Scottish Government’s CDEL provisions, and I want to make it absolutely crystal clear to the committee that that is not my interpretation of Smith. I think that Smith envisages that we will have on-going CDEL capability and the ability to use capital borrowing to enhance our CDEL provision. Revenue borrowing is quite a different proposition altogether.¹²²

222. For Philip Milburn, one important change in any future regime compared to the current proposals would be for the Scottish Government to be able to retain any underspends on a year-by-year basis. He said “In any future regime, it would be prudent not to have that clawback as such, because you will want to be able to hang on to that money for future years.”¹²³ His view on reserves was supported by CIPFA who stressed that the ability to hold reserves would mean that a future Scottish Government could more easily manage volatility.

223. Finally, both CIFPA and Professor Bell called for a revision to the nation's accounting standards, with the former telling the Committee—

” ...we heavily favour having a balance sheet for Scotland that would form part of whole-of-Scotland accounts that would allow us to assess the overall performance of the country and its public services. At the moment, we cannot do that without aggregating the audited financial statements of the nearly 200 public bodies that exist. We therefore favour whole-of-Scotland accounts.¹²⁴

224. Finally, in a letter to the Committee, the former Secretary of State for Scotland provided some additional comments relating to borrowing. He said—

” Additional borrowing power will need to be agreed between the UK and Scottish Governments and will depend on the funding and fiscal framework which will be agreed between the UK Government and the Scottish Government. We will review further what primary and secondary legislative changes may be needed in light of an agreement on the overall Scottish fiscal framework, including additional independent scrutiny of the Scottish Government's public finances.¹²⁵

Conclusions and recommendation on borrowing

225. **The Committee is content with the agreement entered into by all parties to the Smith Commission that the current borrowing powers of the Scottish Parliament are too restrictive and too limited. Furthermore, we are supportive of a move towards a prudential regime which gives the Scottish Government more flexibility, within an overall framework that is governed by sound principles of affordability and sustainability, to borrow both for short-term revenue requirements as well as longer-term capital investment purposes.**

226. **We note the comments made to us that setting cash limits on the amount of borrowing that can be undertaken, especially for capital investment, is not necessarily consistent with the prudential regime specified by the Smith Commission or the most sensible way to proceed. One of the measures for assessing affordability, under a prudential regime, the Committee suggests would be the performance of the economy based on indicators such as cyclically-adjusted GDP.**

227. **We recommend that a future Scottish Government should be able to retain underspends so as to better manage volatility.**

228. **The current draft legislative clauses are silent on how a new borrowing regime will operate. This means that, at this stage, we are not able to conclude either way as to whether the agreements entered into as part of the Smith Commission have been delivered or could be improved.**

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229. We recommend that this area in particular is a high priority for both governments to develop and for both to report to the Scottish Parliament and its committees in the coming months so that we can adequately scrutinise plans for more borrowing powers before any future bill is passed.

Welfare and benefits

Background

230. Alongside the provisions on taxation, the proposals in relation to the devolution of some aspects of welfare and benefits are one of the most significant components of the Smith Commission's proposals.

231. Table 6 below shows the value of the benefits that are proposed, by the previous UK Government in its draft clauses, for devolution, based on the DWP spend on these benefits. The value is just over £2.5bn, or around 14% of current total welfare spend in Scotland.

Table 6: Value of Benefits Proposed for Devolution 2013-14

	£m
Disability Living Allowance	1,473
Attendance Allowance	481
Winter Fuel Payments	186
Carer's Allowance	182
Industrial Injuries Disablement Benefit	91
Severe Disablement Allowance	91
Discretionary Housing Payments *	18
Personal Independence Payments	17
Funeral Payments	4
Sure Start Maternity Grants	3.9
Cold Weather Payments **	0.0275
Total	£2,547

Sources: DWP *Benefit Expenditure by Region 1996/97 to 2013/2014*:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/361362/Expenditure_by_region_201314.xlsx

Department for Work and Pensions. *Outturn and Forecast: Budget 2014*. Available at:

<https://www.gov.uk/government/statistics/benefit-expenditure-and-caseload-tables-2014>. Funeral payments based on 10% of estimated GB spend in 2013-14 Sure Start based on 10% of GB spend in 2013-14. PIP spend: Scottish Government estimate in *Social Security for Scotland: Benefits being Devolved to the Scottish Parliament*: <http://www.gov.scot/Publications/2015/03/1692>

*this is the DWP spend, the Scottish Government has also provided DHP funding. In 2013-14 the Scottish Government made £20m available for DHPs and in 2014-15 it made £35m available.

** There were only 1,100 payments for 2013/14 due to a mild winter

The recommendations of the Smith Commission and the previous UK Government's proposals

232. Table 7 below produced by SPICe sets out a comparison of the Smith Commission proposals and the previous UK Government's Command Paper in the area of **welfare and benefits**.

Table 7

Smith Commission Report	Para	Draft Clauses
<p>• Universal Credit The Scottish Government to have the administrative power to change the frequency of UC payments, vary the existing plans for single household payments, and pay landlords direct for housing costs in Scotland.</p> <p>The Scottish Parliament to have the power to vary the housing cost elements of UC, including varying the under-occupancy charge and local housing allowance rates, eligible rent, and deductions for non-dependants.</p>	<p>44</p> <p>45</p>	<p>Clauses 20 and 21 seek to give effect to paragraph 44. The clauses would give Scottish Ministers concurrent regulation making powers under the Social Security Administration Act 1992. Clause 20(4) and Clause 21(2) seeks to give Scottish Ministers powers to make regulations under certain sections of the Social Security Administration Act 1992. These powers would allow Scottish Ministers to vary plans for single household payments change the frequency of universal credit payments and make direct payments of UC.</p> <p>Clause 20 seeks to give effect to this recommendation. The clause aims to give Scottish Ministers regulation making powers under section 11(4) of the Welfare Reform Act 2012 (determination and calculation of housing costs element) where the claimant rents accommodation. The Command Paper at point 4.2.4 states that this power will include the power to vary or remove the under-occupancy charge.</p> <p>Both Clauses (at 20(4) and 21(3)) require that Scottish Ministers cannot make regulations unless they have consulted with the Secretary of State about the practicability of implementing regulations and the Secretary of State has given agreement as to when any such change made by the regulations is to have effect, such agreement not to be unreasonably withheld.</p>
<p>• Benefits devolved outside Universal Credit The following benefits to be devolved to the Scottish Parliament: (1) Benefits for carers, disabled people and those who are ill: Attendance Allowance, Carer's Allowance, Disability Living Allowance (DLA), Personal Independence Payment (PIP), Industrial Injuries Disablement Allowance and Severe Disablement Allowance.</p>	<p>49</p>	<p>Clause 16 seeks to give effect to the devolution of benefits for carers and disabled people, as listed in paragraph 49(1) of the Smith Commission report. It seeks to do this by amending the current exception to the reservation on social security.</p> <p>Clause 16 defines 'disability benefit' for people who:</p> <ul style="list-style-type: none"> • have a physical or mental condition that has a significant, long term, adverse effect on their ability to carry out day-to-day activities; • or a significant need arising from impairment to a person's physical or

<p>(2) Benefits which currently comprise the Regulated Social Fund: Cold Weather Payment, Funeral Payment, Sure Start Maternity Grant and Winter Fuel Payment.</p> <p>(3) Discretionary Housing Payments.</p>		<p>mental condition (e.g. for attention or for supervision to avoid substantial danger to anyone).</p> <p>Clause 16 appears to encompass the legislative definitions for DLA/PIP/AA.</p> <p>The definition for carer's benefit includes being aged 16 or over, not in full-time education, not gainfully employed, and looking after a disabled person in receipt of a disability benefit. This appears to be similar to the existing criteria for Carer's Allowance.</p> <p>Severe Disablement Allowance (SDA) is payable to those incapable of work. The Scottish Parliament will have legislative competence over the provision of SDA, or a like benefit, for those claimants who remain eligible for the benefit at the point of devolution. This is because SDA was closed to new claimants in 2001, and existing claimants below state pension age have been, or are in the process of being, reassessed for eligibility to Employment and Support Allowance, which remains reserved.</p> <p>Industrial Injuries Benefit – for those who have suffered an injury or developed a disease at work. The Command Paper (para 4.3.1) clarifies that the correct term for Industrial Injuries Disablement Allowance is Industrial Injuries Benefit (IIB), which is the term used to describe benefits “paid as a consequence of workplace prescribed disease or injury”.</p> <p>Clause 17 seeks to give effect to the devolution of the Regulated Social Fund to the Scottish Parliament. It aims to do this by amending the current exception to the reservation on social security.</p> <p>Clause 19 seeks to give effect to the recommendation to devolve responsibility for discretionary housing payments (Smith paragraph 49(3)). The clause roughly follows the framework of regs 2, 3 and 4 of the Discretionary Financial Assistance Regulations 2001 which provide the current framework for discretionary housing payments. The Command Paper says, “The clause will devolve legislative competence in relation to Discretionary Housing Payments (DHP), subject to certain restrictions similar to those that already exist in respect of DHPs”.</p>
<ul style="list-style-type: none"> Powers to create new benefits and top-up reserved benefits <p>The Scottish Parliament to have powers to create new benefits in areas of devolved responsibility, in line with the funding principles set out in paragraph 95.</p>	<p>54</p>	<p>Paragraph 4.3.10 of the Command Paper says that the powers to create new benefits in areas of devolved responsibility are conferred by draft clauses 16, 17 and 19. These clauses relate to benefits for carers and disabled people, the</p>

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<p>The Scottish Parliament to have powers to make discretionary payments in any area of welfare without the need to obtain prior permission from DWP.</p> <p>The UK Government's Benefit Cap to also be adjusted to accommodate any additional benefit payments that the Scottish Parliament provides.</p>	<p>54</p> <p>56</p>	<p>Regulated Social Fund and DHPs. The draft clauses define the power to create new benefits to apply to areas of welfare responsibility that are devolved.</p> <p>Clause 18 seeks to give effect to paragraph 54 of the Smith Commission Agreement regarding discretionary payments. The Command Paper says (at 4.3.11) that the clause “broadens the provisions in the Scotland Act that allow for the Scottish Welfare Fund”. The clause substitutes text in section F1 of Part 2 of Schedule 5 of the 1998 Act. The existing section F1 gives Scottish Ministers powers over:</p> <p>“providing occasional financial or other assistance to or in respect of individuals for the purposes of</p> <p>a) meeting, or helping to meet, an immediate short term need</p> <p>i) arising out of an exceptional event or circumstances, and;</p> <p>ii) that requires to be met to avoid a risk to the well-being of an individual”.</p> <p>The Command Paper (paragraph 4.3.12) says that the “UK Government will ensure that if Scottish Ministers were to increase the amount of a payment in relation to any benefit included within the cap, then the additional amount provided by the Scottish Government would be disregarded for the purposes of the cap, and only the amount of the payment equivalent to that provided by the UK Government would be subject to the cap.”</p> <p>There is a cap on total household benefits at £500 per week for a family and £350 per week for a single person.</p>
<p>• Employment provision</p> <p>The Scottish Parliament to have all powers over support for unemployed people through the employment programmes currently contracted by DWP on expiry of the current commercial arrangements. The Scottish Parliament to have the power to decide how it operates these core employment support services. Funding for these services to be transferred from the UK Parliament in line with the principles set out in paragraph 95.</p>	<p>57</p>	<p>Clause 22 would insert an exception to paragraph H3 of Schedule 5 to the Scotland Act which seeks to give the Scottish Parliament legislative competence for employment schemes in relation to disabled people and those at risk of long-term unemployment who are claiming reserved benefits. The main scheme is the Work Programme. The conditionality and sanctions regime which governs referrals to the Work Programme will remain reserved.</p> <p>Schemes in relation to unemployment must last at least a year.</p> <p>Clause 22 also seeks to extend the existing shared ministerial competence for employment and training under the Employment and Training</p>

		Act 1973 to include provision made under s.17B of the Jobseekers Act 1995. This means that power would be shared between Ministers of the Crown and Scottish Ministers.
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Evidence received

Commentary in general on the welfare provisions in the Smith Commission Report and the previous UK Government's draft legislative clauses

233. The report of the Smith Commission made a range of recommendations in relation to welfare policy as the table above indicates. The Committee has received a range of evidence which, by way of general commentary, welcomed the opportunities that will be available to the Scottish Government should these powers be devolved. For example, John Dickie of the Child Poverty Action Group commented—

” ...there are real opportunities in the powers that are proposed for devolution and in the draft clauses, even as they stand. For example, there are opportunities to improve the delivery of universal credit and, potentially, levels of housing support, given the devolution of the housing element of universal credit. There is the potential to provide support with maternity costs and to improve the adequacy of and access to disability and carers benefits.¹²⁶

234. Similarly, the ‘*Statement to the Joint Ministerial Working Group on Welfare*’ by organisations representing women, which was sent to the Committee by way of written evidence, also welcomed the opportunities that were being devolved. The statement noted that—

” ...there are real opportunities for the Scottish Government to improve the welfare system for women, to involve those directly affected in shaping how new powers are used, and to ensure that the gender discrimination at the heart of the UK system is not replicated in Scotland¹²⁷

235. Nevertheless, despite a recognition that there are opportunities arising from the proposals contained in the draft clauses, some of the evidence we received set out significant concerns that the draft clauses do not implement the recommendations of the Smith Commission in terms of welfare. For example, Inclusion Scotland concluded, in written evidence, that—

” ...the clauses as currently drafted seem unlikely to deliver in full what the Smith Commission proposed, and the way they have been drafted may restrict the ability of the Scottish Parliament to use the new powers to their best potential. Inclusion Scotland believes that many of these concerns can be addressed if the draft clauses are redrafted in line with the original

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intention of the Scotland Act, that is defining the matters that are reserved to Westminster rather than the powers devolved to Scotland.¹²⁸

236. Similarly, Professor Paul Spicker of Robert Gordon University stated—

” There is a shortfall in the powers that have been suggested in the draft clauses relative to what was in the Smith agreement. There is a great deal of complexity. We begin from a position in which all social security powers remain reserved, unless there are specific exceptions. The way in which Smith has been translated into the clauses has seen, in general terms, erosion at most points of the conditions under which transfers are possible and a limitation on certain powers, including some powers that the Scottish Parliament already has.¹²⁹

237. The Committee has received a considerable range of evidence expressing disappointment at: the scope of the Smith Commission recommendations; that the previous UK Government will continue to make policy and financial changes to the welfare system, such as the roll-out of Universal Credit, and; at the level of engagement which has taken place to date with stakeholders in this area.

238. The Poverty Alliance’s written evidence is an example of the type of evidence we received. It states—

” Unfortunately, when the draft clauses were published it became apparent that the powers promised in the Smith report were to be much more restricted than we could have ever imagined. We believe the speed of these negotiations has been too fast and not allowed for the much needed conversation and civil participation to enable the building of a system which works for those in poverty.¹³⁰

239. The views of the former Secretary of State for Scotland on the issue of the draft clauses and whether they delivered on the recommendations of the Smith Commission were set out in a letter to the Committee—

” ...it is this Government’s view that the draft clauses do meet both the substance and the spirit of the Smith Commission, however we recognise there are some areas where the Scottish Government have a different interpretation of the Smith Commission recommendations and we encouraged the Scottish Government to provide comments at official level on both technical and policy views on the draft clauses. In addition we initiated the establishment of a Joint Ministerial Working Group on Welfare to allow the detail of these issues to be discussed.¹³¹

Power to create new benefits and top-up reserved benefits

240. The Smith Commission recommended that the Scottish Parliament “have new powers to create new benefits in areas of devolved responsibility” and “also have

new powers to make discretionary payments in any area of welfare without the need to obtain prior permission from DWP".¹³²

241. The Committee has received a range of evidence from stakeholder groups that consider that the draft clauses, which have the effect of restricting the creation of new benefits to areas of welfare to be devolved under the proposed Bill, do not yet fulfil the agreement reached by the Smith Commission. The power envisaged in the Smith Commission's report to top up benefit payments in any area of welfare seems to have been defined within the draft clauses as the power to introduce short-term discretionary payments under certain conditions to meet immediate or exceptional need.

242. For example, in his evidence to the Committee, Professor Paul Spicker commented—

” There is no power to create new benefits in these areas, because the criteria on which the benefits can be distributed are being specified in the legislation. There is no power to top up reserved benefits, which, again, was in the proposals. All that there is—it is being passed off as if it were that—is a discretionary power to deliver short-term benefits in cases of immediate need, which is a power that the Scottish Parliament already has as a result of an order relating to the discretionary social fund.¹³³

243. Evidence received from a number of charities and voluntary organisations set out similar views. Citizens Advice Scotland summed up the views of a number of these types of organisations when stating—

” The interpretation of the Smith Commission report was that the Scottish Government could craft its own welfare system, outside of Universal Credit, taking into account the needs of Scotland. Whether this is indeed the case needs to be clarified and made clear in legislation. Equally the draft legislation does not make clear how powers to top-up benefits would be created, and this provision needs to be enshrined in legislation.

” In addition, as currently drafted, the definition of discretionary payments within clause 18 is too restrictive. It refers to discretionary payments as being made to individuals to meet a short-term need to avoid a risk to their well-being. Our understanding of the Smith Commission agreement is that the Scottish Parliament would have a much broader power to make discretionary payments, where such payments would be 'discretionary' because there is an administrative or governmental decision to make a payment outwith existing entitlements.¹³⁴

244. The Scottish Government also regards clause 18 as more restrictive than was intended by the Smith Commission. In its view, the Smith Commission agreement to create 'new powers to create new benefits in areas of devolved responsibility' covered all areas of devolved responsibility and was not limited to replacing the

benefits to be devolved under the draft clauses. The Scottish Government has also expressed concerns at the restrictions imposed by draft clause 18 on its ability to top up reserved benefits.

245. In his evidence to the Committee, the Deputy First Minister elaborated—

” I do not think that draft clause 18 meets what was set out by the Smith commission. Within the commission, there was quite an explicit discussion on this point of distinction: whether the issue was the creation of the ability to establish new benefits in the areas that were being devolved, or “in areas of devolved responsibility”.

” My clear recollection is that there was agreement around the creation of new benefits in areas of devolved responsibility. To me, that should shape the clause, but that is not what happened.¹³⁵

246. He further elaborated—

” Members should be fully aware of the difficulties and the limitations that are associated with the reservation on social security provisions. I can think of one particular issue that has stretched us significantly in trying to resolve policy questions. With regard to the council tax reduction scheme, the social security reservation was a significant impediment to the Scottish Government’s being able to work with our local authority partners in ameliorating the reduction that was applied in council tax benefit by the UK Government. We were able to do so, but it was a major impediment, and we should not underestimate the significance of that reservation in relation to handling legitimate aspirations of the Scottish Government and the Scottish Parliament. That is why, in my previous answer to Mr Maxwell, I made the point that it is vital that sufficient scope is carved out of that reservation to enable us to create “new benefits in areas of devolved responsibility”, as the Smith commission envisaged.¹³⁶

247. In a letter the Rt. Hon Iain Duncan Smith MP, Secretary of State for Work and Pensions, told the Committee that discretionary payments were not the same as benefits and that because social security remained reserved, it was important to ensure that any power for discretionary payments didn’t inadvertently allow for new benefits to be created in areas that were not to be devolved. The clause had therefore been drafted to give the ability to make payments in the area of welfare but not the ability to create benefits, hence the reference to short-term need.¹³⁷

248. The UK Secretary of State for Work and Pensions further explained in his letter that draft clause 18 does broaden the current exception in that there will no longer be a requirement for a person’s need to have arisen out of an exceptional event or circumstances. As such, a payment can be made to meet any need related to an individual’s well-being as long as it does not create an on-going entitlement. The only exception is if the need has arisen as the result of a sanction to a reserved

benefit. The clause does provide for a payment to be made in these circumstances if it is to cover an immediate short-term need that arises from an exceptional event or circumstance. This replicates the power in the Scottish Welfare Fund. The DWP therefore “does not consider that the draft clause restricts the existing powers.”¹³⁸

Definition of a carer

249. The Smith Commission recommended the devolution of benefits for carers. Clause 16 of the previous UK Government’s draft legislative clauses seeks to implement this recommendation and in doing so defines ‘carers benefit’ as being ‘a benefit which is normally payable in respect of the regular and substantial provision of care by a relevant carer to a disabled person’. The clause also defines a carer as being ‘a person who is 16 or over, is not in full time education, and is not gainfully employed’.

250. The Committee has received a number of submissions during our work that expressed concern at the definition of ‘carer’ being proposed in the draft clauses. For example, Carers Scotland commented—

” The power to create a new benefit to replace Carers Allowance or make changes to Carers Allowance for carers in Scotland appears to be more restrictive than what we believe the Smith Commission outlined. Clause 16 appears to suggest that the power extends only to benefit to carers who are aged 16 or over, not in full time education, and not gainfully employed. We believed that this is unnecessarily restrictive and limits any future developments to, for example, support carers who wish to study whilst managing a caring role.¹³⁹

251. NUS Scotland made a similar point in its written evidence to the Committee stating—

” ...benefits which are proposed for devolution, and could benefit students, such as carer’s allowance still retain a number of restrictive UK regulations, including the fact that you may not be in full-time education, therefore ruling out any opportunity for the Scottish Parliament to redesign a more beneficial payment.¹⁴⁰

252. Carer’s allowance is a benefit which interacts with other benefits which will remain reserved. The Committee has received a range of evidence questioning how the ‘no detriment’ provision in the Smith Commission’s report will operate in relation to the interaction of devolved and reserved benefits. In relation to Carers Benefit, Richard Gass of Rights Advice Scotland commented in evidence to the Committee that—

” The definition of a carer is such that they must provide regular and substantial care but not be in full-time employment or in education. At present, the Government says that at least 35 hours of care a week must

be provided. There would be nothing to prevent Scotland from setting the level at 17 hours a week or from allowing carers allowance to be paid to more than one person. However, the consequence is that entitlement to carers allowance is a passport to an increased element of a reserved benefit, and that brings us back to the issue of no detriment.¹⁴¹

253. Carers Scotland also raised concerns with regard to the drafting of the clauses on Carers Benefit in relation to no detriment. It said

” Equally these clauses appear to apply to any changes the Scottish Government may wish to make to Carers Allowance in line with its own policy direction. For example, we have been given to understand that the description “not gainfully employed” refers to the earnings limits currently in place for Carers Allowance – where a carer cannot earn more than a prescribed amount (after certain deductions) before all Carers Allowance is lost. This earnings limit will be £110 per week in April 2015.

” This limit is very low and every year many carers lose complete entitlement to Carers Allowance when the minimum wage rises, even when their earnings are merely a few pence above the earnings limit.¹⁴²

254. Carers Scotland questioned whether the restrictive nature of the clauses will prevent the Scottish Government from removing this “cliff edge” or increasing the earnings limit in line with, for example, the Living Wage rather than the minimum wage and was seeking clarification on these matters.

255. The Scottish Government takes the view that this particular clause is broadly acceptable but does not allow it to take a wider view of certain aspects, for example, definitions of who might be eligible. In his evidence, the Deputy First Minister said—

” Some clauses either come very close to fulfilling, or do fulfil, what was expected by the Smith commission, but there are a number of instances where we do not believe that to be the case, and we have made representations to the UK Government. I will highlight the cases where we think the commitments have been fulfilled. We think that that is the case in relation to elements of paragraph 49 of the Smith commission report, on “Benefits for carers, disabled people and those who are ill”.¹⁴³

256. In a follow-up letter, the Deputy First Minister elaborated—

” ...aspects of Clause 16 as currently drafted will significantly restrict the ability of the Scottish Parliament to exercise complete autonomy over the benefits it inherits, as paragraph 51 of the Smith Commission report called for.

” [...] Additionally, and equally restrictive, the Clause defines a 'relevant carer' as someone who is over 16, is not in full-time education, and is not

gainfully employed. The result is that the Scottish Parliament will not have the power to determine the structure and value of these benefits as envisaged by the paragraph 51 of the Smith Commission report.¹⁴⁴

257. In a letter from the Rt. Hon Iain Duncan Smith MP, Secretary of State for Work and Pensions, disagreed with the Scottish Government on the issue of the definition of carer. He wrote—

” ...taken together with existing devolved powers in areas like social care, the clauses do ensure that the Scottish Parliament will have the powers to set out the way in which support is provided for carers, including the rate at which it is paid, and there is also a very broad definition of “the disabled person” in respect of whom a carer’s benefit can be paid.

” I believe that we fully meet the intent and spirit of the Smith Commission report as far as the “structure and value” is concerned. There are many areas in which we have framed the clauses in a way which allows flexibility to the Scottish Parliament to depart from other eligibility rules in the existing benefits.¹⁴⁵

Definition of disability

258. Draft clause 16 includes the provision which seeks to devolve benefits to disabled persons. Elsewhere in the previous UK Government’s proposals, in relation to the devolution of employment support programmes, draft clause 22 defines disability as having the same meaning as that contained in the Equality Act 2010. The Committee has received a range of evidence which has questioned why two differing definitions of disability are being applied in the draft clauses and, in particular, concern has been expressed at what some witnesses have considered to be the narrow definition of disability being applied in draft clause 16.

259. For example, in written evidence, the Scottish Federation of Housing Associations (SFHA) expressed the following view on this issue—

” Housing associations provide homes for many disabled tenants and SFHA – along with other organisations - is concerned about the varying definition of ‘Disability’ in different sections of the Draft Clauses. In Clause 16, a disabled person is defined as someone “to whom a disability benefit is normally payable” (p 106). In Clause 22 it says that a “ ‘disabled person’ has the same meaning as it has in the Equality Act 2010.” The definition needs to be consistent and match the definition of the Equality Act.¹⁴⁶

260. Professor Paul Spicker commented on the definition of disability in clause 16 as follows—

” I am rather concerned that the extremely strange definition of disability does not include certain groups that would have been fairly automatically included in other definitions, such as people with terminal cancer, multiple

sclerosis or fluctuating conditions. That would be easy to deal with in legislative terms if the same phrase that is used in clause 22 was used in clause 16.

” There is not a major problem about the drafting, but what is it that the UK Government has done with this particular clause? Why has it been done that way? It seems that it has wished to carry forward the current criteria for DLA and attendance allowance rather than to create the opportunity for the Scottish Parliament to define benefits within that area of responsibility, which was the declared intention.¹⁴⁷

261. Responding to Professor Spicker’s comments, John Dickie, from Child Poverty Action Group Scotland, observed—

” I agree with what Paul Spicker said about the definitions of disability constraining the possibilities. Even more than that, the clause as it is currently framed does not allow for the payment of a PIP/DLA replacement in Scotland to those who are terminally ill if there is no current impairment to their capability. It took a separate section of the Welfare Reform Act 2012 to allow for payment of PIP/DLA to terminally ill claimants. As the clauses are currently framed, the capability is not there to enable that in Scotland. There is a gap—there is a clear problem that needs to be resolved.¹⁴⁸

262. In response to this issue, the Deputy First Minister commented—

” ...it is clear to me that Clause 16, by setting out the criteria to whom disability benefits may be paid, restricts the ability of the Scottish Parliament to be able to determine eligibility for any replacement benefit.¹⁴⁹

263. In correspondence from the Rt. Hon Iain Duncan Smith MP, Secretary of State for Work and Pensions, explained the rationale for the two different definitions. He wrote—

” There are indeed differences in the proposed definitions, but the legislative and factual context of clause 16 is different from the context of clause 22. The two clauses are drawn up differently for the purposes of meeting differing issues of devolution.

” [...] Putting this another way, clause 22 is not a provision concerning the kind of social security benefits covered by clause 16, so the definitions of “disabled person” need not necessarily be tied to those which apply for benefits.¹⁵⁰

264. The Department of Work and Pensions’ letter to the Committee did provide an assurance that both definitions would apply to people with terminal cancer, MS or other fluctuating conditions, or who are terminally ill.

Universal Credit

265. The Smith Commission recommended that Universal Credit (UC) should remain a reserved benefit. However, it was proposed that the power to vary the housing cost elements of UC and administrative powers relating to the frequency of UC payments, to vary existing plans for single payments to households and to allow landlords to be paid directly should be devolved. Lord Smith explained, in evidence to the Committee, the rationale for this recommendation in the following terms—

” As you know, the universal credit system is a major new reform in the welfare system. The parties agreed that it would be quite difficult to break that asunder but that Scotland could have flexibilities around it, particularly in things such as the housing element.

” You know that a lot of housing is already devolved, so the Scottish Government having the housing element of the universal credit made a lot of sense as there would be complementarity. There are quite different housing issues in Scotland compared with elsewhere in the UK. Housing payments could be increased or reduced, there could be flexibility around timing and so on. However, it was felt that to attack universal credit was not somewhere we could go in arriving at a consensus in the room.¹⁵¹

266. The powers which have been proposed for devolution have been welcomed by a range of stakeholders, albeit many of them would have wished a greater degree of devolution in this policy sphere. For example, the Wise Group commented in written evidence that—

” The power to split Universal Credit payments within households, to increase the frequency of payments and to make housing element payments direct to landlords will allow the flexibility in benefit payments to fit with the needs of some of the most vulnerable groups in society.¹⁵²

267. Citizens Advice Scotland described the proposals for devolution with regard to Universal Credit as follows—

” The devolution of limited powers over Universal Credit (UC) is welcome though CAS would have preferred if all the elements of UC had been devolved in their entirety to allow for it to be responsive to the needs of Scottish people. However, it does appear that within these limited powers, there is some scope for some policy innovation and to enable policy changes which would benefit Scotland's citizens.¹⁵³

Shared and concurrent powers

268. As highlighted earlier in this report, the Smith Commission recommendations will result in a significant degree of shared or concurrent powers. This situation is particularly acute with regard to recommendations in relation to Universal Credit. The Smith Commission report recognised this in specifically recommending that—

” Joint arrangements for the oversight of DWP development and delivery of UC, similar to those established by HM Revenue and Customs (HMRC) in relation to the Scottish rate of Income Tax, should be established by the UK and Scottish Governments.¹⁵⁴

269. The importance of inter-governmental relations to the effective implementation of UC has been a recurring theme during the Committee’s evidence-taking on this issue. Prior to the publication of the draft legislative clauses, Mary Taylor from the Scottish Federation of Housing Associations (SFHA) said—

” Given the terrain that we are in, the Smith commission was helpful in shining a light on the whole area of intergovernmental working. When there is a mixture of devolved and reserved powers, whatever they are, we need to have effective mechanisms for managing them at both political and official levels. Smith rightly identified those as issues—they are coming to light as issues through the stakeholder group. It is a matter of trying to manage the follow-on from Smith.¹⁵⁵

270. SFHA further elaborated their view on this issue, in written evidence following the publication of the previous UK Government Command Paper, as follows—

” Overall, the draft clauses reveal the complexity of the new devolution settlement, setting out an array of exceptions to the powers which will still be reserved to Westminster. They make critical the need for intergovernmental cooperation between the Scottish and UK Governments, not just to implement the new powers, but to manage the interdependencies of the new settlement on an on-going basis.

” This is especially important for welfare powers, where the interconnections will be complex and the people who rely on benefits are often vulnerable. For example, some benefits that will be devolved can act as a passport to benefits and other exemptions which will remain reserved. Universal Credit is reserved, but aspects of the housing elements of Universal Credit will be devolved to the Scottish Parliament. So careful on-going management of these powers between the two governments will be essential for delivery of an effective and safe welfare system.¹⁵⁶

271. For Citizens Advice Scotland (CAS), the newly-established Joint Ministerial Committee on Welfare has an important role to play in ensuring that the social security systems run by both the Scottish and UK Governments will engage with and work with each other. CAS recommended that this be made clear and was written into legislation, ensuring both governments are sharing information,

processes and, where necessary, systems and infrastructure. In its view, it is imperative if people are to navigate the systems that there is clear legislation, guidance, and regulations in place governing the interaction between both systems especially in areas of Universal Credit.¹⁵⁷

272. The importance of establishing a structure which will enable issues such as 'no detriment' to be addressed, both at an individual and governmental level, will be essential and will require a shared understanding between governments of the evidence base and the mechanisms which will be put in place to resolve disputes or tensions. Jim McCormick, from the Social Security Advisory Committee (SSAC), commented on this issue that—

” Inevitably, there will need to be last-resort ways of resolving tension and conflict and, ultimately, there will need to be appeals. However, in the interim, the best solution will be to work through what the proposals could mean in practice in half a dozen key areas in which either powers are being wholly devolved or an administrative power is coming, so there is a concurrent power shared. We need both Governments and Parliaments to work through those examples early so that we have a clear sense of where we might be going if different choices are made. Ultimately, it comes down to where the costs and benefits of different choices lie. Even if the evidence is contested in future, we will need to have robust procedures in place, and we need to do some of that design in advance.¹⁵⁸

273. The role of the Scottish and UK Parliament in scrutinising this process of inter-governmental relations has also been a recurring theme in evidence taking. Currently, SSAC performs a scrutiny role in relation to DWP and the Northern Ireland Executive's functions in relation to welfare. Jim McCormick highlighted the role of SSAC, and the issue of Parliamentary scrutiny more generally, as follows—

” The Social Security Advisory Committee currently has a remit for the DWP and the Department for Social Development in Northern Ireland in relation to secondary legislation on welfare and pensions, and it can give advice to ministers, whether that advice is asked for or proactively given. It also has the power to undertake independent work on areas of concern. Our hope is that, emerging from the joint ministerial group on welfare, both Governments will actively consider how such an arrangement can be put in place through SSAC or others to ensure that Scottish parliamentary scrutiny and the capacity for scrutiny outside the Parliament are improved.¹⁵⁹

274. The Scottish Government agrees that there will be a need for on-going discussion between the two governments on all aspects of delivery and administration as part of planning for implementation. On this matter, the Deputy First Minister said—

” On welfare administration, you will appreciate that this is very early in the process for discussing options. We recognise the skills and expertise that

different sectors and organisations can bring to the table in delivering the new social security benefits. We will wish to consider a range of delivery options carefully and in consultation with all interested parties. I am happy to keep the Committee apprised of our work in this area.¹⁶⁰

275. Referring to the importance of the new joint ministerial group on welfare as an important vehicle for intergovernmental dialogue and the on-going discussions between officials, the view of the former Secretary of State for Scotland was as follows—

” the UK Government stands ready to provide the information and support necessary to enable the Scottish Government to take on these areas of responsibility [welfare] in a successful way.¹⁶¹

Universal Credit: Policy flexibility

276. The aspects of Universal Credit which have been proposed for devolution have been broadly welcomed by stakeholders and in certain instances considered that it should be relatively straight forward for a future Scottish Government to make policy choices regarding the frequency / timing of Universal Credit payments and to whom the payments are made. For example, John Dickie from the Child Poverty Action Group Scotland stated—

” In theory, the system has been designed to allow for that anyway, so there should not be huge issues in applying a different policy approach to direct payments, payments to the main carer and more frequent payments. It is also important to note that there is no legislative barrier even now to the UK Government and the Scottish Government agreeing to provide a more wide-ranging flexibility on those matters.¹⁶²

277. Indeed, in some areas it has been considered that the draft legislative clauses may be broader than what the Smith Commission proposed. For example, Professor Spicker noted, in oral evidence to the Committee, that the draft clause provision in relation to frequency of payments is broader than the Smith Commission recommendation commenting—

” In the case of universal credit, Smith proposed that there should be the power to alter frequency of payments. What the draft clauses suggest is a power to alter the timing of payments. Those two things are not equivalent. Timing is rather broader than frequency, and it could, for example, affect when the first payment is made, at least in principle.¹⁶³

278. However, the Committee also received evidence which suggests that if the Scottish Government wished to undertake more substantial policy variation then there could be significant barriers which would undermine the ability of a future Scottish Government to make significant alterations to the operation of Universal Credit.

279. Citizens Advice Scotland (CAS) expressed concerns along these lines in the written evidence we received. It said that, in practice, devolving the abilities for the Scottish Government to vary elements of Universal Credit within a wider system administered by the Department of Work and Pensions will be highly challenging, but possible.

280. To achieve this, CAS called for further clarity on a number of elements: how the devolved elements of UC will operate in the UK-wide system; and how the Scottish Government can make their requirements work on a UK Government system.

281. Citizens Advice Scotland concluded that—

” Regardless of what approach is enshrined in legislation, operating this system in practice will require joint working at an administrative level between the Scottish and UK Governments. CAS recommends that work begins as soon as possible to ensure that the full range of options available for variation in Universal Credit devolved to the Scottish Government will be practically possible to implement with minimal delay should the Scottish Government choose to exercise them.¹⁶⁴

282. In its view—

” It would not be acceptable to the public or in the best interests of vulnerable claimants if devolved powers could not be used because of inflexible process, IT systems or disputes over responsibilities. Setting up joint working arrangements on an administrative basis between the two governments at this stage would help to overcome that.¹⁶⁵

Universal Credit: ‘Veto’ Power?

283. Draft Clauses 20(4) and 21(3) require Scottish Ministers, when using a power to vary the person to whom, or the timing of, Universal Credit payments, including the housing cost component of Universal Credit, to “have consulted the Secretary of State about the practicability of implementing the regulations”. The Secretary of State would then have to give “agreement as to when any change made to the regulations is to start to have effect, such agreement not to be unreasonably withheld”.¹⁶⁶ In addition, the Secretary of State will not be able to create regulations in this area unless the Secretary of State consults Scottish Ministers.

284. The Scottish Government believes that the requirement to obtain legal consent is unnecessary. The Deputy First Minister, in a statement in the Scottish Parliament on the draft legislative clauses, commented—

” I highlight the provisions that require the Scottish ministers to consult UK ministers and those that say that the Scottish ministers must obtain consent. No one in this chamber would want decisions of this Parliament on issues such as the bedroom tax to be frustrated by the need for consent

from the UK Government. Even the Secretary of State for Scotland agreed over the weekend that there should be no right of veto. It is therefore important that the UK Government revisits the clauses that require consent.¹⁶⁷

285. The Committee has received a range of evidence regarding whether or not these clauses represent a veto. For example, the Poverty Alliance in a written submission considered that the clauses did constitute a veto. They said—

” We were also particularly disappointed to see what is ultimately a veto given to the Secretary of State over any future changes to the devolved elements of Universal Credit by the Scottish Government.¹⁶⁸

286. Inclusion Scotland considered that the clauses probably did not amount to a veto but could be inconsistent with the spirit of the Smith Commission report. Inclusion Scotland observed—

” There has been some comment on whether draft clauses 20(4) and 21(3) amounts to a UK Government veto on the devolved powers on Universal Credit. Given that agreement cannot be “unreasonably withheld” by UK Ministers, it probably does not constitute a veto, although it could result in a delay to the implementation of mitigation policies agreed by the Scottish Parliament. This may not be consistent with the spirit of the Smith Commission which implies that the devolved welfare powers can be exercised without the need to obtain prior permission from the DWP.¹⁶⁹

287. CAS considered this issue at length and expressed concern that should this process result in dispute between the Scottish and UK Governments then this could cause confusion for recipients of Universal Credit. CAS’s view was that the clauses do require the Scottish Government to consult the UK Government and to gain their agreement to the timing of any variance. They observed that, should the UK Government wish to make regulations in this area that affected Scotland; they need only consult the Scottish Ministers, but are not required to seek their agreement.

288. For Citizens Advice Scotland—

” This raises a number of issues. Firstly, enabling the UK Secretary of State to make regulations in an area which is devolved to the Scottish Parliament without its consent does not appear to be consistent with the Smith Commission agreement that the Sewel Convention should be put on a statutory footing. Secondly, whilst the intention appears that the timing of any changes needs to be subject to negotiation on what it is practically possible to do, there is scope for wide interpretation of the circumstances it might be considered ‘reasonable’ for the Secretary of State to withhold their agreement to the Scottish Government utilising their devolved power to make regulations in this area.

” This may have the effect of causing the same stand-off and claimant confusion as if no process were outlined in the clauses. Citizens Advice Scotland believes that this section should be re-drafted to ensure that the Scottish Government can exercise its devolved function, whilst at the same time ensuring that practical considerations are reflected in the legislation.¹⁷⁰

289. The Deputy First Minister commented at some length on whether the requirements on the Scottish Government to consult with, and seek the agreement of, the UK Government on some aspects of welfare and benefits constituted a veto. He said—

” It is not terribly difficult to foresee how what appear to be pretty innocuous requirements to consult the secretary of state and secure his or her agreement could be translated into what is essentially a blocking power, because all sorts of excuses could be used to prevent something from happening. Our concern is that how clauses 20 and 21 are drafted conveys the ability of a UK minister to prevent the Scottish Government from doing something. If that minister has a reasonable explanation for why they are doing that, that passes the test in the clause, which to me therefore gives the UK Government the ability to veto a decision that the Scottish Government and Scottish Parliament have taken.

” The UK Government contends that the arrangements in clauses 20 and 21 are about administrative operation and efficiency and all the rest of it but, having just spent a couple of years of my life trying to make progress on the block grant adjustment and being stalled and delayed with more analysis—before I knew it, two years of my life had passed—it seems to me that the clauses present a serious impediment to the ability of the Scottish Parliament to exercise the powers that were envisaged by the Smith commission.¹⁷¹

290. He concluded as follows—

” Another important point of principle is involved about the proper definition of devolution. To me, devolution involves passing over the power to the Scottish Parliament to do with as it sees fit. It is not about the UK Government saying, “We’ll pass over the power, subject to our agreeing that it is all fine for it to proceed.” That is not devolution, as it retains control in the UK Government in the form of a veto and the ability to say, “Actually, we don’t approve of what is happening here and we’ll find some way of preventing it from happening.”¹⁷²

291. The view of the former Secretary of State for Scotland was as follows—

” As we set out in the draft clauses, the Command Paper and on the day of publication, there is no veto. The clauses are quite clear that the Secretary of State will not unreasonably withhold his consent; the provision simply

recognises the fact that Universal Credit will remain a reserved benefit administered by the UK Government – something that was agreed and signed up to by all parties to the Smith Commission – and as a result there is a need to ensure that Scottish Government proposals can be delivered effectively as part of an integrated delivery plan. This drafting mechanism simply reflects the reality of the close inter-governmental working that will be required, and I have every confidence that officials in both Governments will be able to work together constructively in practice.¹⁷³

Under Occupancy Charge/'Bedroom Tax'

292. Draft clause 20 seeks to provide for the Smith Commission recommendation that “the Scottish Parliament will have the power to vary the housing cost elements of UC, including the under-occupancy charge and local housing allowance rates, eligible rent, and deduction for non-dependents”.¹⁷⁴ The previous UK Government’s Command Paper summarises the purpose of draft clause 20, in relation to the under-occupancy charge which is frequently termed the ‘bedroom tax’, in the following terms—

” Scottish Ministers will have the power to decide in what circumstances an under-occupancy charge will be made, and at what percentage reduction rate from the housing costs covered by Universal Credit for social sector tenants. This means that Scottish Ministers will be able to decide whether to apply any under-occupancy reductions, or to choose to set them at different levels and provide for an extra room for certain groups of claimants. They will also be able to decide on the level of any deductions for non-dependents and whether to introduce further categories of exemption from the non-dependent deductions. In calculating the amount of rent to be included in the housing costs calculation the Clause will enable Scottish Ministers to decide in what circumstances the level of rents charged by social sector landlords would be considered excessive. For private sector tenants they would be able to vary the local housing allowance rates by varying the manner in which the maximum level of housing support is set.¹⁷⁵

293. Draft clause 19 seeks to give effect to the recommendation to devolve responsibility for discretionary housing payments. The Committee received evidence from some that draft clause 19 would not fully mitigate the impact of the under-occupancy charge (if the Scottish Government did not use its powers under draft clause 20 to remove the under-occupancy charge). For example, John Dickie of the Child Poverty Action Group Scotland, said—

” The new clause does not give power to enable local authorities to make discretionary housing payments to individuals who are not in receipt of housing benefit. Because of the way in which the under-occupancy charge—the bedroom tax—is applied at the moment, some claimants, particularly those who are in work and receiving a relatively small amount

of housing benefit, lose all that benefit, which essentially means that they are not entitled to a discretionary housing payment. In effect, as the clauses are currently drafted, we could not fully mitigate the impact of the bedroom tax through discretionary housing payments, given that some people will not be entitled to such payments because they have lost all their housing benefit as a result of the bedroom tax. That is an effect of the clauses and something for the committee to be aware of.¹⁷⁶

294. In its evidence, CAS raised a wider issue with regard to whether discretionary housing payments would remain available to Scottish local authorities should a future Scottish Government decide to remove the under-occupancy charge. They commented—

“...we would like to have full understanding and clarity of what will happen to current DHP payments made available to local authorities from UK Government funding, if Scottish Ministers chose to make exemptions such as those CAS advocate, or indeed choose to remove the Under Occupancy charge altogether.

“In particular, we would like clarity over whether the funding from the UK Government currently allocated to Scottish local authorities' DHP pots would remain, to avoid the full £50m burden of mitigating this policy falling entirely on the Scottish Government.¹⁷⁷

295. The view of the former Secretary of State for Scotland was as follows—

“With regards to Discretionary Housing Payments (DHP), clause 19 provides for the devolution of powers to provide DHPs as they currently apply in England, Wales and Scotland. As a result, the restrictions set out in the draft clause already exist with respect of DHPs and are not new. The Scottish Parliament will have great freedom to design and deliver a system of support for people who need help with their housing costs.¹⁷⁸

Winter Fuel Payments

296. The Smith Commission recommended the devolution of a range of benefits which are collectively termed the 'Regulated Social Fund'. The fund includes cold weather payments and winter fuel payments. Draft clause 17(3) proposes to devolve to Scottish Ministers 'expenses for heating in cold weather'. However, the Committee has received evidence that this clause may not include winter fuel payments. For example Professor Spicker commented—

“I think—although I do not know—that winter fuel payments will not be possible under the draft clauses. The white paper says that those payments will be possible, but the form of words that legitimated winter fuel payments has been removed. Is that deliberate? I cannot tell you. Will that actually be the effect? Again, I cannot say with any confidence whether it will.¹⁷⁹

297. The Scottish Federation of Housing Associations (SFHA) took a more definitive position commenting that draft clause would not include winter fuel payments as follows—

” One area of concern is the change in wording between the Smith Agreement and Draft Clauses on the recommendation to devolve the Winter Fuel Payment (WFP) (Smith para 49). In the Draft Clause 17, this is changed to “expenses for heating in cold weather.” However, the WFP and Cold Weather Payments are two different things, so if the current wording of the Draft Clause is not changed, WFP would continue to be reserved, which appears to be contrary to the intention of the Smith Agreement.¹⁸⁰

Scottish Welfare Fund

298. The Committee received some evidence that the effect of draft Clause 18, which deals with discretionary payments, could restrict eligibility to the Scottish Welfare Fund which the Scottish Government currently provides.

299. For the Child Poverty Action Group Scotland, the key issue is that, with the current powers that the Scottish Welfare Fund operates under, it is possible for people to access crisis grants, for example, even if they have lost reserved UK benefits as a result of being sanctioned, as long as there is a risk to their wellbeing. Child Poverty Action Group Scotland pointed out that being sanctioned is not an automatic bar to their accessing the support. In its view, that is important because, in some cases, people have been sanctioned and left with no money and the Scottish Welfare Fund has been crucial in supporting them.

300. Child Poverty Action Group Scotland said—

” It looks as though clause 18 restricts that further by saying that there needs to be an additional exceptional event or circumstance. Clearly, that could act as a bar to the scope in which Scottish welfare fund payments could be made if someone has been sanctioned in relation to a UK benefit. Even further than that, and not just in relation to someone having their benefits sanctioned, the draft refers to benefit being lost as a result of the claimant’s conduct. That could mean someone losing benefit because they have failed to return a form or filled in the form wrongly. That sometimes happens to people with mental health problems, learning difficulties and literacy issues. That could be described as a conduct issue. It would be a serious blow for people in such situations not to have access to the Scottish welfare fund under the new discretionary payment powers.¹⁸¹

301. The Scottish Government believes that Clause 18 does not appear to give Scottish Ministers new powers in relation to discretionary payments.

Employment Programmes

302. In relation to employment, the Smith Commission recommended that—

” The Scottish Parliament will have all powers over support for unemployed people through the employment programmes currently contracted by DWP (which are presently delivered mainly, but not exclusively, through the Work Programme and Work Choice) on expiry of the current commercial arrangements. The Scottish Parliament will have the power to decide how it operates these core employment support services.¹⁸²

303. Generally, the evidence the Committee received in this area welcomed the devolution of powers relating to employment. For example, the British Association for Supported Employment (BASE) commented—

” BASE believes that the potential devolution of powers over employment programmes provides a welcome opportunity for Scotland to radically improve the way jobseekers with a complex or substantial economic disadvantage are supported into or back into the labour market.¹⁸³

304. Some of the evidence we received, whilst welcoming the powers to be devolved, expressed a view that a greater degree of devolution was required within this sphere. The Employment Related Services Association (ERSA) adopted this view in its evidence which states—

” While ERSA broadly welcomes the recommendations of the Smith Commission Report, it still has concerns that sufficient provision has not been made in the draft clauses to create appropriate incentives. ERSA continues to believe that this would be best achieved through the devolution of responsibility for all in work and out of work welfare policies and benefits to the Scottish Government, including responsibility for Jobcentre Plus in Scotland.¹⁸⁴

305. The Scotland Act 1998 reserved employment policy including job search and support (with the exception of careers service and training for employment). Draft clause 22 sets out further exceptions to the reservation in the 1998 Act with regard to “assisting disabled persons to select, obtain and retain employment” and to assist “persons claiming reserved benefits who are at risk of long-term unemployment to select, obtain and retain employment, where the assistance is for at least a year”.¹⁸⁵

306. The Committee has received evidence questioning whether this particular draft clause fully meets the intention of the Smith Commission. For example, Inclusion Scotland commented in written evidence that—

” The Smith Commission proposes that “The Scottish Parliament will have all powers over support for unemployed people through the employment programmes currently contracted by DWP.” However, both the narrative and draft clauses appear to restrict this power to employment support schemes that last over a year. It is not clear why this restriction has been

included and it appears to be a direct contradiction of the Smith Commission proposal.

” Indeed, it can be argued that the most effective employment support schemes are short term schemes designed to identify the barriers preventing someone gaining employment and providing support, training and assistance to overcome these. If a scheme lasts for more than a year without supporting someone into employment, surely it has failed?

” The UK Government also appears to have arbitrarily applied the reference to conditionality and sanctioning for Universal Credit (paragraph 46) to devolved employment support schemes, including the use of mandatory placements. It is not clear how this is compatible with the Scottish Parliament having all powers over support for unemployed people through the employment programme, for example if the Scottish Parliament determines that participation in such schemes should be voluntary.¹⁸⁶

307. The Committee has also received a number of submissions questioning whether the Access to Work programme will be devolved. For example the Wise Group commented, in written evidence, that—

” Within the proposed legislation, there is a lack of any proposed method or programme involving Access to Work, which is a key lever for getting people into work. We would currently seek to clarify whether this will be devolved as part of the package of DWP contracts as it is an important programme which can be vital in the process of increasing employability for ESA customers.¹⁸⁷

308. The Scottish Government's view of draft clause 22 is the current scope falls short of implementing the Smith Commission's recommendation that the Scottish Parliament will have “all powers over support for unemployed people through the employment programmes currently contracted by DWP through the Work Programme and Work Choice.” In a follow-up letter after his evidence to the Committee, the Deputy First Minister said—

” We strongly agree with the concerns about employment raised in evidence to the Committee. The main effect of Clause 22 of the draft Scotland Bill suggested by UK Government is that it would devolve Work Programme and Work Choice only. We believe that devolution of employment support on this basis is inconsistent with both the letter and spirit of paragraph 57 of the Smith Commission report, which states that the Scottish Parliament will have all powers over support for unemployed people through the employment programmes currently contracted by the UK Department for Work and Pensions.

” Our concerns are concentrated in two key areas. Firstly, the clauses restrict the transfer of powers to the Scottish Parliament to 'those at risk of long

term unemployment'. Secondly, the UK Government's stipulation that our future devolved services must operate for at least one year restricts scope for innovation and flexibility in designing new programmes. Neither of these restrictions that appear in Clause 22 reflect paragraph 57 of the Smith Commission report, the intention of which is clearly to devolve all employment support programmes.

- ” These are fundamental points which would restrict our ability to develop existing and future support programmes for the unemployed and to fully integrate future services in Scotland. We have expressed our dissatisfaction to UKG, and continue to press them on this. At the last Joint Ministerial Group on Welfare on 11th March, Scottish Ministers offered to revise the draft clause to be more in line with the Smith Commission report.
- ” In respect of Access to Work, we have asked the UK Government to clarify whether Access to Work will be devolved under clause 22 and they have made clear their expectation that as this programme is a JobCentre Plus service to customers and not a contracted employment programme it will remain reserved.¹⁸⁸

309. In correspondence, the Rt. Hon Iain Duncan Smith MP, Secretary of State for Work and Pensions, explained the rationale for the two different definitions. He explained that claimants need different types of support to enter the job market and that, in the early stages, some of this comes from Jobcentre Plus, which remains a reserved issue. In the longer-term, claimants are referred onto Work Programme or Work Choice and the aspects of the provisions to be devolved.¹⁸⁹

310. The close connection between employment support and benefit entitlement will necessitate close inter-governmental cooperation if the structure of support is to operate effectively. This aspect of the proposals to devolve employment support has elicited a wide range of comment in evidence to the Committee. For example, Jim McCormick, of SSAC, commented—

- ” It strikes me that a revised work programme could help people at risk of long-term unemployment and disabled people into work and could support them in staying in work. Under the proposals, we might end up in a situation in which future public service providers in Scotland—which might be third sector providers—would be accountable to the Scottish Parliament for their financial performance and their programme performance but would still have to apply a conditionality system and a sanctions regime to those programmes.
- ” As well as creating problems for claimants, that would create strange incentives for providers—it would create incentives for gaming and false reporting. That is a particularly jagged edge, because one thing that we know about the current social security system and the welfare reforms is that a tougher sanctions system has caused a great deal of difficulty for

some of the most vulnerable people in our society. That jagged edge around conditionality is a particular cause for concern.¹⁹⁰

311. The interaction between reserved and devolved programmes particularly with regard to the DWP conditionality and sanctions regime remaining reserved has been of particular concern to some of our witnesses. On this matter, John Dickie told the Committee that—

” ...as far as working-age benefits are concerned, the current reserved conditionality and sanctions regime, which is undermining people’s attempts to move into work and towards the labour market, will still apply. That comes back to Jim McCormick’s point about the jagged edge between what we in Scotland might want to do differently in devolved employment programmes and the requirement for those programmes to work within a reserved benefits regime that too often imposes arbitrary conditions or conditions that are not helpful in supporting people to move into work and which imposes damaging sanctions on them when they fail to meet those conditions.

” Even under the current proposals, there will be real opportunities to do things differently, to ensure that employment support in Scotland is more suited to the local labour market and more appropriate to the childcare and other support that are available to enable parents, for example, to move back into work and—I hope—to reduce the number of inappropriate or arbitrary tasks that people have to undertake to meet the benefit requirements. However, there will be a limit to that, because the benefits regime will be as it is now—unless, of course, we manage to get it changed in the way that we want.¹⁹¹

312. The issue of how the ‘no detriment’ principle outlined in the Smith Commission report will operate in the context of the devolution of employment support programmes has also been a recurring theme in evidence. Jim McCormick summed up this issue as follows. He said—

” The important underlying issue is incentives. If a future Scottish work programme or a variation in the work choice programme that we have at the moment were to invest in a different way—for example, by investing more in training, childcare and a kind of social investment cycle—it might take longer to get the payback but the payback might be bigger. Therefore, it is important that we understand the relationship between the policy choices that are made in Scotland and the actual outcomes rather than the apparent, short-term outcomes.

” Paragraphs 2.4.16 and 2.4.17 in the command paper talk about the need for ‘a shared understanding of the evidence’. That sounds like a technical point, but I suspect that it will be extremely important in working through what we mean by no detriment. Where is the incentive for Scotland to

invest more or differently in order to get a better payback? We are only in the foothills of understanding what “a shared understanding” means in the context of the relationship between policy choices and outcomes, and I suspect that, quite quickly, we will need some worked-through examples of what that might mean. Employment programmes and universal credit are two areas that jump out immediately from the draft clauses.¹⁹²

313. The Employment Related Services Association (ESRA) highlighted the importance of the relationship and interaction between devolved employment support programmes and Job Centre Plus. ESRA commented—

” ERSA and its members also believe that while not explicitly referred to in the draft clauses it is important for the Westminster and Scottish Governments to establish a good referral mechanism from Jobcentre Plus to subsequent employment support in Scotland. Specifically ERSA recommends that the Joint Ministerial Working Group should consider how to manage the referral from Jobcentre Plus at 52 weeks to the next phase of employment support in Scotland. This will be a crucial period in engaging jobseekers and ERSA is keen to ensure that a robust mechanism, which includes a warm handover process and information sharing, is developed to adequately meet jobseeker need.¹⁹³

Inter-governmental relations in welfare provision

314. The preceding discussion of the welfare provisions, particularly those with regard to Universal Credit and employment support, have highlighted the central importance of having an effective structure of inter-governmental relations if the Smith proposals are to be implemented. The Smith Commission recommendations, and the drafting approach taken in the clauses, significantly alter the structure of the devolution settlement from a system based on largely separate powers between tiers of government to a system of shared or concurrent powers in many spheres of policy.

315. Welfare is an area of policy where effective inter-governmental relations will be paramount in order to deliver the spirit and substance of the Smith Commission recommendations. This issue will be considered later in this report but is raised here given the range and strength of concerns which have been raised on this issue.

316. Jim McCormick, representing SSAC, succinctly summed up the issue in the following terms—

” Smith observed that we have weak intergovernmental working, which is a problem and is not an ideal context for welfare devolution. The draft clauses go some way to responding to that, but they also contain an explicit reference to concurrent powers in relation to universal credit, which puts us formally into a very different place in terms of how Governments, and

therefore Parliaments, will need to work together. We are used to thinking in terms of reserved/devolved splits, but now there are shared areas.

” We need to start thinking about appropriate oversight, scrutiny and transparency arrangements so that, whatever emerges from the revised clauses, we have much better machinery for independent and parliamentary oversight.¹⁹⁴

317. The Scottish Federation of Housing Associations (SFHA), in written evidence, summed up the complexity and potential risks of this new structure of shared powers between tiers of government within this policy sphere as follows—

” Overall, the draft clauses reveal the complexity of the new devolution settlement, setting out an array of exceptions to the powers which will still be reserved to Westminster. They make critical the need for intergovernmental cooperation between the Scottish and UK Governments, not just to implement the new powers, but to manage the interdependencies of the new settlement on an on-going basis.

” This is especially important for welfare powers, where the interconnections will be complex and the people who rely on benefits are often vulnerable. For example, some benefits that will be devolved can act as a passport to benefits and other exemptions which will remain reserved. Universal Credit is reserved, but aspects of the housing elements of Universal Credit will be devolved to the Scottish Parliament. So careful on-going management of these powers between the two governments will be essential for delivery of an effective and safe welfare system.¹⁹⁵

Conclusions and recommendations on welfare and benefits

General

318. **The purpose of our report has been to provide a constructive commentary to a new UK Government on the draft clauses as they relate to the Smith Commission recommendations. However, the Committee has concerns with a number of the welfare provisions and considers that the relevant clauses do not yet meet the spirit and substance of the Smith Commission’s recommendations and potentially pose challenges in any attempt to implement them. Central to the effective delivery of the welfare clauses will be ensuring that key stakeholders in the delivery of welfare are fully involved in shaping the welfare provisions and their delivery.**

319. **The Committee believes that the welfare provisions will impact upon some of the most vulnerable and disadvantaged individuals in Scottish society. It is imperative therefore that the welfare clauses meet the expectations of Scottish society, provide genuine policy discretion to the Scottish Government as envisaged by the cross-party agreement within the Smith Commission, and are capable of being implemented efficiently and in a way**

that ensures any new benefits or discretionary payments introduced in Scotland by either government provide additional income for a recipient and do not result in an automatic offsetting reduction in their entitlement to other benefits, discretionary payments, tax credits or allowances.

320. Accordingly, the Committee recommends that a new UK Government further engages in the development of legislation in this area in co-operation with stakeholders in Scotland on the welfare clauses in any Scotland bill. This should include securing the agreement of the Scottish Government and stakeholders that the welfare clauses do meet the spirit and substance of the Smith Commission recommendations. In addition, the process via which it will be ensured that the introduction of any new benefits or discretionary payments by a future Scottish Government should provide additional income to a recipient without any offsetting reduction in reserved entitlements should be made clear and have been agreed to by stakeholders and the Scottish Government.
321. The Committee also calls on the UK Government to consider the issues raised in this report both with regard to the scope of the clauses as currently drafted and issues with regard to implementation before drafting legislation in this area.

New and top-up benefits

322. The Committee reaffirms the agreement in the Smith Commission report that the Scottish Parliament should have the power to create new benefits in areas of devolved responsibility and also new powers to make discretionary payments in any area of welfare without the need to obtain prior permission from the DWP, whilst recognising that there will be a need for the Scottish Government to provide the DWP with early notification of its intentions because of the potential for overlap with the administrative responsibilities of the UK Government in welfare matters. The Committee notes the view that the approach taken of creating exceptions to existing benefits limits the scope of policy discretion which would be available to a future Scottish Government to create new benefits or to top-up benefits. The Committee recommends that the UK Government re-consider the draft clauses designed to devolve the creation of new benefits and enable the top-up of reserved benefits in order to ensure that the relevant sections of any future Bill meet the spirit and substance of the Smith Commission thereby ensuring that the Scottish Government would have genuine policy discretion in this area.

Carers

323. The Committee is concerned that the current definition of carer in the draft clauses appears overly restrictive and could limit the policy discretion of future Scottish administrations in this area. The Committee recommends that the clause should be re-drafted to ensure that the future Scottish administrations are able to define what constitutes a carer.

324. The Committee also recognises that the fiscal framework is currently the subject of discussion between the Scottish and UK Government. The Committee considers that the issue of 'no detriment' as it applies to individuals, particularly those in receipt of benefits, should be a crucial component of these discussions. The Committee seeks clarity on the procedures through which the commitment in paragraph 55 of the Smith report will be honoured to ensure that any new benefits or discretionary payments introduced by the Scottish Parliament will provide additional income for recipients and not be offset by reductions in entitlements to benefits, tax credits or tax relief provided by the UK Government.

Definitions of disability

325. The Committee is concerned that the definition of disability contained in draft clause 16 is overly restrictive and would not provide a future Scottish Government with the power to develop its own approach to disability benefits in the future. Accordingly, the Committee recommends that the definition of disability used in the Equality Act 2010 is also used in draft clause 16.

326. **The Committee welcomes the assurances from the DWP that both definitions of disability used in the draft clauses would apply to people with terminal cancer, MS or other fluctuating conditions, or who are terminally ill.**

Universal Credit – a shared power

327. The Committee recognises that the effective operation of inter-governmental relations will be critical to the successful operation of the devolved aspects of Universal Credit. The Committee welcomes the recent establishment of the Joint Ministerial Working Group on Welfare and expects this forum to become an effective means of dealing with relations between the UK and Scottish governments in this sphere. The Committee expects to be kept fully informed on discussions between governments on the arrangements being developed for inter-governmental relations with regard to Universal Credit and welfare issues in general. The Committee noted the commitment of both the Scottish and UK governments to provide detailed minutes of the Joint Exchequer Committee to the Scottish Parliament Finance Committee and the Scottish Affairs Committee. We would encourage the Joint Ministerial Working Group on Welfare to follow this example, by providing detailed minutes of its meetings to appropriate committees in the Scottish and Westminster Parliaments.

328. The Committee recommends that the principles which will govern the operation of inter-governmental relations with regard to welfare should be placed in any future Bill devolving power in this area. Moreover, the Committee expects that this will include the principles via which Parliaments can maintain scrutiny and oversight of the inter-governmental machinery with regard to welfare.

Universal credit – policy flexibility

329. The Committee considers that the policy autonomy of a future Scottish Government with regard to its devolved welfare responsibilities should not be constrained as a consequence of process issues relating to the boundary between devolved and reserved systems and processes.

330. The Committee therefore recommends that Joint Ministerial Working Group on Welfare considers as a matter of urgency the extent to which the policy autonomy of a future Scottish Government may be undermined as a consequence of being reliant on systems which have been designed by DWP and how any such barriers of this kind can be overcome. Such an understanding should form a key understanding or principle governing inter-governmental relations in this sphere.

Universal Credit – ‘veto’ power?

331. The Committee concludes that there is a case to be made that draft clauses 20(4) and 21(3) could be considered or perceived as a veto. The Committee considers that this is an issue which requires resolution through the Joint

Ministerial Working Group on Welfare. In effect, this issue provides an early test of the effectiveness of inter-governmental relations. The Committee expects this issue to have been resolved to the satisfaction of both the Scottish and UK Governments before any future legislation is introduced. During this process, the Committee would expect the Scottish Government to report to Parliament and its committees on the progress of discussion and specifically before any final agreement is reached.

Under Occupancy Charge/'Bedroom Tax' and Discretionary Housing Payments

332. The Committee seeks clarity on the issues which have been raised with regard to the inter-play between the power to remove the under-occupancy charge and discretionary housing payments. The Committee considers that it is essential that the application of these clauses should not have the effect of causing detriment to individuals in receipt of discretionary housing payments.

Winter Fuel Payments

333. The Committee considers that it is imperative that any future Bill is drafted to ensure that both winter fuel payments and cold weather payments are devolved, and agreement is reached on adopting a system of payments which better reflects the climate conditions in different parts of Scotland. The Committee seeks an assurance from the UK Government that if the current draft clause excludes the devolution of winter fuel payments then any future Bill is drafted to ensure that such payments are devolved.

Scottish Welfare Fund

334. The Committee seeks clarification from the UK Government that access to the Scottish Welfare Fund will not be restricted as a consequence of the draft clause provisions in relation to discretionary payments.

Employment Programmes

335. The Committee considers that the clauses as currently drafted do not fully implement the Smith Commission recommendations. The Committee considers that the Smith Commission intended that all employment programmes currently contracted by DWP should be devolved. Therefore, the Committee recommends that any future Bill should not place any restriction on the type of person receiving support or in regard to the length of unemployment any person has experienced. The Committee considers that this should include the devolution of the Access to Work Programme.

336. The Committee recognises that the effective operation of inter-governmental relations will be critical to the successful operation of the devolved aspects of employment support. The Committee welcomes that this is recognised in

the previous UK Government Command Paper and also welcomes the recent establishment of the Joint Ministerial Working Group on Welfare and expects this forum to become an effective means of dealing with relations between governments in this sphere. The Committee expects to be kept fully informed on discussions between governments on the arrangements being developed for inter-governmental relations with regard to employment support and welfare issues in general.

337. The Committee recommends that the principles which will govern the operation of inter-governmental relations with regard to welfare, including employment support, should be placed in any future Bill devolving power in this area. Moreover, the Committee expects that this will include the principles via which Parliaments can maintain scrutiny and oversight of the inter-governmental machinery with regard to welfare and employment support.

Inter-governmental Relations in Welfare

338. The Committee considers that the operation of inter-governmental relations will be central to the effective implementation of many of the Smith Commission recommendations. However, the operation of inter-governmental relations will be critical within the area of welfare policy. The Committee therefore welcomes the recent establishment and meetings of the Joint Ministerial Working Group on Welfare.

339. The Committee recognises that for inter-governmental relations to operate effectively that there must be space for the discussions between governments to take place in confidence and the Committee recommends that any future Bill should place the general principles underpinning the operation of inter-governmental relations on welfare in statute. The Committee also considers that the general principles underpinning the structures which will be put in place for dispute resolution should also be placed in statute. Such a Bill should also include the general principles which will enable Parliamentary scrutiny of this process to take place. The Committee considers that the detail of the process for conducting inter-governmental relations should then be placed in a Memorandum of Understanding agreed between the governments. During this process, the Committee expects the Scottish Government to report to the Parliament and its committees on the progress of discussion and specifically before any final agreement is reached.

The Crown Estate

Background

340. The Crown Estate is the Crown property, rights and interests that are managed by the Crown Estate Commissioners in England, Wales, Northern Ireland and Scotland. The Crown Estate is not the personal property of HM the Queen – it is owned by the Sovereign in right of the Crown. The Sovereign is the legal owner but has no powers over management or control.
341. The Crown Estate Commissioners is a statutory corporation constituted by the Crown Estate Act 1956. Under the Crown Estate Act 1961, Commissioners must follow directions from the Chancellor of the Exchequer and the Secretary of State for Scotland. Crown Estate profits flow direct to HM Treasury. In 2013/14, Crown Estate profits from activities in Scotland were £13.6 million, 3.9% of the UK total. The total property value of the Crown Estate in Scotland was £267 million.¹⁹⁶
342. Scotland is represented by a Scottish Commissioner. Whilst one Commissioner has always been from Scotland, this was not required under statute. The Scotland Act 2012 required that a, “Crown Estate Commissioner with special responsibility for Scotland shall be appointed on the recommendation of the Chancellor of the Exchequer, who shall consult the Scottish Ministers before making that recommendation.” This Commissioner “must be a person who knows about conditions in Scotland as they relate to the functions of the Commissioners.”¹⁹⁷
343. Chaired by the Scottish Commissioner, the Crown Estate’s Scottish Management Board comprises the Chief Executive, the Scottish Leadership Team (which comprises staff in Edinburgh) and additional senior staff. The Crown Estate has been subject to considerable parliamentary scrutiny over the past 8 years including consideration by committees in the UK and Scottish Parliaments.
344. In Scotland, the Crown Estate Commissioners manage four rural estates, including the Glenlivet Estate, mineral and salmon fishing rights, about half of the coastal foreshore and almost all seabed to 12 nautical miles. It is important to note that the Crown Estate does not claim any foreshore in Shetland. In Orkney there are numerous stretches of foreshore where Crown ownership has been displaced by Udal titles.
345. Through, for example, leasing of moorings, the Crown Estate plays a role in supporting aquaculture, marine leisure, ports and harbours, and offshore renewable energy, the latter is important for Scottish waters, such leases are commercial agreements, which enable the construction and operation of renewable energy projects for a specified period (for example, 50 years). In return for the grant of rights, the developer pays the Crown Estate a commercially negotiated rent.

346. The urban estate comprises 39-41 George Street, Edinburgh, and a 50% interest in an English Limited Partnership which owns Fort Kinnaird Retail Park in Edinburgh. On 29 November 2014, rights to naturally occurring oysters and mussels transferred to Scotland from the Crown Estate (Scottish Government 2014). A full list of Crown Estate Assets in Scotland is set out in Table 8 below.

Table 8: Crown Estate Assets in Scotland.

Asset	Definition
George Street	the land owned by Her Majesty known as 39 to 41 George Street, Edinburgh
Seabed	the land owned by Her Majesty forming the seabed of Scottish Territorial Waters
Storage Rights (Seabed)	the rights of: (1) Unloading gas to installations and pipelines; (2) Storing gas for any purpose and recovering stored gas; and (3) Exploration with a view to use for (1) and (2)
Energy rights (Seabed)	the rights of exploitation, exploration and connected purposes for the production of energy from wind or water
Mineral Rights (Seabed)	the right to exploit the Seabed and its subsoil other than for hydrocarbons
Cables (including interconnectors)	the right to install all or part of a distribution or transmission system on or under the Seabed
Pipelines	the right to install pipelines
Whitehill	the Whitehill estate in the County of Midlothian owned by Her Majesty;
Glenlivet	the Glenlivet estate in the County of Moray owned by Her Majesty
Applegirth	the Applegirth estate in the County of Dumfries and Galloway owned by Her Majesty
Fochabers	the Fochabers estate in the County of Moray owned by Her Majesty
Aquaculture Rights (Seabed)	the right to farm aquatic organisms;
Mooring Rights (Seabed)	the right to lay and use permanent moorings
Foreshore	the land that is owned by Her Majesty: (1) In Orkney and Shetland, lying between mean high water springs and lowest ebb tide; and (2) In the rest of Scotland, lying between mean high and low water springs
Internal Waters	the land owned by Her Majesty forming the internal waters of Scotland
Salmon Fishing	the right to fish for salmon in rivers and coastal waters where the right belongs to Her Majesty
Gold and Silver (onshore minerals)	the right to all naturally occurring gold and silver except where the right is vested in some person other than Her Majesty
Reserved Minerals	all the reserved mineral rights owned by Her Majesty in Scotland other than on the Seabed

Source: Prepared January 2015 by the Crown Estate, following a request from SPICe

The recommendations of the Smith Commission and the previous UK Government's proposals

347. The Smith Commission report recommended that responsibility for the management of the Crown Estate's economic assets in Scotland, and the revenue generated from these assets, be transferred to the Scottish Parliament. This was to include the Crown Estate's seabed, urban assets, rural estates, mineral and fishing rights and the Scottish foreshore for which it is responsible.¹⁹⁸

348. Table 9 below produced by SPICe sets out a comparison of the Smith Commission proposals and the previous UK Government's Command Paper in the area of **The Crown Estate**.

Table 9

The Smith Commission	Scotland in the UK
<p>Responsibility for the management of the Crown Estate's economic assets in Scotland, and the revenue generated from these assets, will be transferred to the Scottish Parliament. This will include the Crown Estate's seabed, urban assets, rural estates, mineral and fishing rights, and the Scottish foreshore for which it is responsible.</p>	<p>Clause 23 would allow, but not require, the UK Treasury to make a scheme, through a statutory instrument, transferring all Scottish functions of the Crown Estate Commissioners to Scottish Ministers. This scheme can only be made with agreement of Scottish Ministers and may be modified "by agreement" (with modifications to be retrospective). The scheme will also transfer responsibility for liabilities e.g. to ensure renewables are decommissioned. "Rights and liabilities" are expected to be identified in detail in the scheme.</p> <p>The scheme will not include "property, rights or interests held by a limited partnership registered under the Limited Partnerships Act 1907". Fort Kinnaird Retail Park in Edinburgh falls into this category, and management and revenues associated with this site would remain reserved.</p> <p>Clause 23 includes provision as the "Treasury considers necessary or expedient" relating to interests of defence, national security, telecommunications, oil & gas, and electricity. There is reference to an intention to transfer to the Scottish Parliament competence to legislate on the management of Scottish assets before the transfer scheme.</p>

	<p>Revenues would transfer to the Scottish Consolidated Fund, however the Command Paper refers to safeguards that taxation of oil and gas receipts will remain reserved.</p> <p>After the transfer, the Crown Estate will still be able to invest in Scotland with the management of any such investment, and revenues flowing from it, remaining reserved matters.</p>
<p>Following this transfer, responsibility for the management of those assets will be further devolved to local authority areas such as Orkney, Shetland, Na h-Eilean Siar or other areas who seek such responsibilities. It is recommended that the definition of economic assets in coastal waters recognises the foreshore and economic activity such as aquaculture.</p>	<p>Clause 23 makes no explicit reference to further devolution to local authority level, though does state that functions could be transferred to “a person nominated by the Scottish Ministers” at the point of transfer. It is expected any further devolution from Scottish Ministers would take place through Scottish Parliament legislation.</p>
<p>The Scottish and UK Governments will draw up and agree a Memorandum of Understanding to ensure that such devolution is not detrimental to UK-wide critical national infrastructure in relation to matters such as defence & security, oil & gas and energy, thereby safeguarding the defence and security importance of the Crown Estate’s foreshore and seabed assets to the UK as a whole.</p>	<p>The Command Paper, but not clause 23, states that a Memorandum of Understanding will be drawn up between the Scottish and UK Governments.</p>
<p>Responsibility for financing the Sovereign Grant will need to reflect this revised settlement for the Crown Estate.</p>	<p>The Sovereign Grant is not mentioned in the Command Paper – the link between Crown Estate profit and the Sovereign Grant is a proxy, rather than relating to direct funding.</p>

Evidence received

The legislative route adopted for devolution

349. As set out above, the Smith Commission proposed that responsibility for the management of the Crown Estate’s economic assets in Scotland, and the revenue generated from these assets, would be transferred to the Scottish Parliament.

Following this transfer, responsibility for the management of those assets would be further devolved to local authority areas such as Orkney, Shetland, Na h-Eilean Siar or other areas who seek such responsibilities.¹⁹⁹

350. In its Command Paper, the previous UK Government sets out its approach for the devolution of these economic assets. Specifically, the new powers will be given to the Scottish Government by a transfer scheme, transferring in a single transfer the Crown Estate Commissioners' functions of managing wholly-owned Scottish property assets currently forming part of the Crown Estate.

351. The previous UK Government explains its reasoning as follows—

” The scheme has been chosen for a number of reasons. Firstly, it will enable the rights and liabilities that are transferring to be identified in detail so that the ‘starting point’ for the management of the Scottish assets in Scotland is made clear in a public manner. Secondly, it will enable provision to be made for the protection of strategic UK assets. Thirdly, the scheme will include provision for the protection of the employment rights of those Crown Estate staff who are connected with the management of the Scottish assets. This is essential to ensure that the Commissioners are able to transfer a viable on-going enterprise.

” With the approval of the Scottish Ministers, the Treasury may make a transfer scheme in relation to the management of the Scottish assets.²⁰⁰

352. During its consideration on this matter, the Committee heard evidence questioning why this particular legislative approach (a statutory transfer scheme which HM Treasury may make) was adopted.

353. Andy Wightman, and independent writer and researcher on land rights, set out his views on why the previous UK Government had proposed what he viewed as a complex scheme to transfer the rights. He said—

” Given its complexity, it at least has the potential to frustrate what is in my view a fairly simple task of devolving administration and management of the rights in question. That should be a fairly straightforward legislative matter, but because of the way in which the command paper has been drafted, the complex scheme that has been proposed could end up a quagmire.²⁰¹

354. This requirement for a scheme was also questioned by Aileen McHarg, Professor of Public Law at the University of Strathclyde in her written submission to the Committee. She wrote, “As others have noted, this is a more complex way of transferring responsibility for the Crown Estate in Scotland than is strictly necessary.”²⁰² Professor McHarg suggested that—

” All that would have been required would have been to delete paragraph 2(3) from Schedule 5, Part 1. This would have automatically given the

Scottish Ministers and Scottish Parliament control over the Crown Estate assets in Scotland along with other “functions exercisable by any person acting on behalf of the Crown.”²⁰³

355. Professor McHarg sought to explain the reasoning that the previous UK Government may have had for the adopted of the transfer scheme in her submission to us. She wrote that—

” ..in making the scheme, the Treasury is required to make such provision as it considers necessary or expedient in the interests of defence or national security [...] These are reasonable objectives. However, it is not clear why the device of a transfer scheme is necessary in order to secure them.”²⁰⁴

356. In his evidence to the Committee, the Deputy First Minister was critical of the translation of the agreement in the Smith Commission into the draft legislative clauses as set out in the Command Paper. He said—

” ... we need to interact closely on the scheme, because it looks very complicated when, in fact, it was envisaged that the Crown Estate function and the management of the assets would be devolved to the Scottish Parliament. From looking at the scheme, it seems overly complicated for the realisation of the policy objectives that we all share.”²⁰⁵

357. In evidence to the Committee, Vivienne King of The Crown Estate set out its position on the use of a transfer scheme. She said—

” We are looking for absolute clarity on the transfer of the management functions of the Crown Estate so that, from day 1 after transfer, the business, which we have been running successfully, can continue running to that standard and customers understand exactly where they stand with us. [...] My firm belief is that a statutory transfer scheme is the ideal vehicle. Of course, the matter is being led by the Treasury, but I am supportive of its approach.”²⁰⁶

358. Some members of the Committee also questioned the specific use of the word “may” in the current draft clause relating to the role of HM Treasury in making a transfer scheme. Ms King of The Crown Estate explained—

” You will appreciate that parliamentary counsel draft the statutes, not me. My understanding is that that wording is necessary to empower the Treasury to deliver on the requirements of Smith.”²⁰⁷

359. In his evidence to the Committee, the Deputy First Minister recommended that, “the clause should say that the Treasury “shall” do that, or even “will” do it, which is a bit firmer.”²⁰⁸

360. The former Secretary of State for Scotland provided his view on this matter in writing. He said—

” The UK Treasury’s discretion to make the scheme is there in order to facilitate agreement between Scottish and UK Ministers. Draft clause 23 provides that the Treasury may not make a scheme without the agreement of the Scottish Ministers. The majority of the scheme should be non-contentious (it will simply transfer the management of the Scottish assets) but for those aspects which need to be negotiated we think it right that agreement is reached. The use of ‘may’ and the requirement for the consent of Scottish Ministers achieves that. No timescale has been included as it will first be necessary to have the legislation enacted and commenced, and the date of transfer will depend on many factors including the readiness of the transferee. Nonetheless, we are looking to implement the transfer as soon as possible after the Royal Assent subject to the preparedness of the Scottish Government.²⁰⁹

The role of successor to The Crown Estate in the rest of the UK to continue to invest in Scotland – two Crown Estates?

361. In the Command Paper, the previous UK Government set out its view that it will remain possible for The Crown Estate to make investments in Scotland and the management of any such investment by the Crown Estate in property in Scotland after the transfer and that this will remain a reserved matter.²¹⁰ Reference to continued investment activity by the corporate entity that remains in the rest of the UK after devolution was not mentioned in the agreement of the Smith Commission.

362. Gareth Baird, Crown Estate Commissioner for Scotland explained the rationale behind a continued investment role for the remainder of the Crown Estate that would now operate from the rest of the UK. He said—

” At the moment, pre further devolution, the Crown Estate is a £10 billion-asset organisation. As Vivienne King said, our benchmarks in industry are recognised as being either at the top or very near the top. I am not speaking as a Crown Estate commissioner now; I am speaking as a Scot. Why would we in Scotland not want a very big, successfully managed business investing in our country?²¹¹

363. Alan Laidlaw of The Crown Estate elaborated further on the types of investment that might be envisaged by the non-devolved part of The Crown Estate. He said—

” None of the assets of the sea bed or the coastal areas would be involved. I suspect that it would probably concern areas of business investment into sectors that we are involved in elsewhere—ports and harbours, energy and others. We are discussing schemes with our tenants where they are looking for capital investment. That is alongside our ownership of the foreshore and sea bed. We would be a partner, potentially to help unlock economic activity in key sectors in Scotland.

” I was not involved in the drafting of the clauses, but I suspect that they are there so that if, for instance, a large harbour was undergoing an expansion and wanted £30 million of investment, that might be open to the Crown Estate body corporate from the south in the future.²¹²

364. Asked whether there was scope for a joint investment in projects, such as a harbour development in Scotland, between the two corporate entities after devolution, Alan Laidlaw said. “That is highly unlikely. Having been involved in such decisions, I could not envisage that ever happening.”²¹³

365. In a follow-up letter to the Committee, Gareth Baird, explained—

” We would not envisage making any future investment in coastal assets, rural assets, or the seabed, in or around Scotland. As with other parts of the UK the focus for our investment activity would be prime retail schemes, for example shopping centres or retail parks, where we can deploy in excess of £80-100m per asset. We often do this in partnership with major international investors, including some of the world’s largest sovereign wealth funds; investment which is generally welcomed locally. We do not see this as building up a “new Crown Estate” in Scotland, which is clearly of concern to the Committee.²¹⁴

366. In its submission to the Committee, NFU Scotland was split on the implications of a continued role for the corporate entity from the rest of the UK to continue to invest in Scotland. It said—

” Whilst this is a move away from previous understanding about the operation of the Crown Estate in Scotland post-devolution, NFUS considers that once the existing Crown Estate assets in Scotland are handed over to Scotland, investment in Scotland by the ‘Scottish Crown Estate’ will be of primary concern and, so long as good management and continued investment in current assets continue, UK Crown Estate purchasing further assets in Scotland is negligible.²¹⁵

367. Others who gave evidence to the Committee were not as supportive of a continued role. Explaining his concerns about the current proposals, Andy Wightman said—

” There is a further complication in that there is a proposal that the Crown Estate Commissioners should continue to have an involvement in Scotland after the rights over which they currently have responsibility are devolved. That seems to me to be both improper and politically very complex.²¹⁶

368. He elaborated further—

” I do not understand why, in the same breath, one would devolve the administration and management, yet a new Crown estate would arise,

phoenix-like, from the ashes of the scheme to continue to be administered and managed exactly as it is now.²¹⁷

369. The Deputy First Minister was also critical during his evidence to the Committee. He said—

” The Crown Estate continuing is a very interesting concept. This is where we get into the space in which I think that the spirit of the Smith commission is not being respected. We all know what we are talking about here. This issue has been around for a long time and lots of people have got long-standing commitments in this area that they thought would be fulfilled by the Smith commission. Hey presto! One Thursday morning a committee is advised that, although it has been devolved, the Crown Estate will still be here and continuing its activities. It is disrespectful to the spirit of the Smith commission and what it concluded.²¹⁸

370. He explained his views later in his evidence to the Committee—

” I return to what the Smith commission said on this, which was about the devolution of the Crown Estate to Scotland and, within Scotland, to our island communities. If the Smith commission had said that the Crown Estate assets would be devolved but the Crown Estate would be allowed to continue in Scotland, people’s jaws would have hit the table. There is a real danger of having an undesirable and confusing competitive environment, but more importantly, the Crown Estate has taken a fundamentally disrespectful view.²¹⁹

371. The former Secretary of State for Scotland wrote to the Committee on this issue. He said—

” It is correct that, in theory, the Crown Estate will still be able to make commercial investments in Scotland as and when suitable investment opportunities arise just like any other business. Taking a different approach would be to turn away potential inward investment in Scotland. This has not, however, been a particular feature of the way that the Crown Estate has operated over the year.

” Any future investments in Scotland by the Crown Estate would continue to be made in accordance with its commercially independent investment strategy which reflects the requirements of the Crown Estate Act 1961. The Act requires a commercial return to be secured from investments, but does not preclude joint investment with any fully compatible party.

‘Jointly held’ economic assets that are excluded from transfer – Fort Kinnaird

372. The draft legislative clauses produced by the previous UK Government allow for the functions relating to the Crown Estate that exist of property, rights or interests in land in Scotland, excluding property, rights or interests mentioned in subsection

(3) to be devolved. Subsection 3 excludes property, rights or interests held by a limited partnership registered under the Limited Partnership Act 1907.²²⁰

373. One particular asset that falls into this category is that of the Fort Kinnaird. Fort Kinnaird is a large outdoor retail park located in the South-East of Edinburgh and opened in 1989. Work began in 2013 on a £24 million extension to the park. This is not listed amongst the Crown Estate's urban assets and as such would not be devolved. In correspondence with SPICe the Crown Estate advised—

” Fort Kinnaird isn't classified as an asset in the same way. It is held in an English Limited Partnership as a joint venture unit trust managed and majority owned by British Land plc., known as the Gibraltar Limited Partnership. The investment includes retail assets in both Scotland and in England. We are working on the basis that a partnership share in an ELP (which includes English and Scottish properties) does not fall within the description of “an economic asset in Scotland” and we are working with officials to inform legislation that will provide confirmation on that point.²²¹

374. This position was explained by Vivienne King of The Crown Estate during her appearance. She said—

” Fort Kinnaird is held in a separate structure. It is not actually a Scottish asset in the Crown Estate's Scottish portfolio; our interest in it is a partnership interest that is held in a mixed property English limited partnership along with another property in Cheltenham. We do not have a direct interest in the property and do not manage it. We have never included it in the financial statement for Scotland that is contained in our Scotland report. As a result, it is not an economic asset in Scotland as envisaged by Smith.²²²

375. In subsequent correspondence requested by the Committee, The Crown Estate set out further details in relation to the Fort Kinnaird investment. This confirmed that the net revenue (covering all revenue generated in the English limited partnership (net of borrowing) from all its interest) in the Gibraltar Partnership totalled £38.8 million between 2007/08 and 2013/14. The Crown Estate explained—

” The Crown Estate is a 50:50 joint venture partner with the Hercules Unit Trust – which owns the other limited partnership interest. Hercules Unit Trust is a property unit trust, managed by Schroders, which holds investments worth around £1.7 billion in retail property across the United Kingdom. Hercules Unit Trust is circa 67 per cent owned by FTSE100 listed property company British Land, the balance being owned by a range of pension funds and other institutional investors. The Crown Estate's revenues from the Gibraltar Partnership (which holds assets in England and Scotland) are split 50:50 with the Hercules Unit Trust.²²³

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376. Asked for his view on whether Fort Kinnaird should have been included in the economic assets to be devolved, the Deputy First Minister said—

” This is a very good example of what I have been talking about. If Fort Kinnaird were not to be devolved, that would strike me as not being in the spirit of what the Smith commission agreed.²²⁴

377. Asked by the Committee whether The Crown Estate would have any intention of making future investments in Scotland through this type of limited partnership investment structure prior to devolution taking place and whether there would be anything that would legally prevent The Crown Estate from doing so, the organisation responded—

” We have no intention of making such investments prior to devolution, but would not want to be barred from making such investments. Legally, we do not believe that we are prevented from doing so.²²⁵

378. The former Secretary of State for Scotland set out his views on this matter in a letter to the Committee. He said—

” ...the management of all the Crown Estate’s wholly-owned Scottish assets will be transferred under the transfer scheme. This does not include Fort Kinnaird. The Crown Estate holds an interest in an English limited partnership which owns property in different parts of the UK including Fort Kinnaird in Scotland.²²⁶

Definition of zones

379. At point of devolution, responsibility for the foreshore and the territorial seabed will transfer to Scottish Ministers and the Scottish Parliament. During an early part of our scrutiny, the question arisen of how far this extended out from the shore. The Scotland Office clarified the situation as follows—

” Currently, the Crown Estate has responsibility for management of the foreshore and territorial seabed out to 12 nautical miles. The Crown Estate also has responsibility for certain economic activities in the Exclusive Economic Zone (which extends to a maximum of 200 nautical miles from shore). Post devolution, the Crown Estate’s role will pass to the new Scottish Manager.²²⁷

380. What was less clear from the evidence heard by the Committee is whether there is any distinction between the differing zones referred to in the Smith Agreement and Command Paper and how these are defined, particularly the concept of a “Scottish zone”. Three different zones are mentioned in the proposals as far as the sea bed is concerned: the exclusive economic zone, the Scottish zone and the Scottish maritime zone.

381. In follow-up information, The Crown Estate explained—

- ” The “Scottish zone”: The “Scottish zone”, which is referenced in new section 90B(2)(b) of the draft bill is already defined in section 126(1) of the Scotland Act 1998 as being “*the sea within British fishery limits (that is, the limits set by or under section 1 of the Fishery Limits Act 1976) which is adjacent to Scotland*”
- ” The referenced fishery area includes the whole of those areas on the continental shelf where The Crown Estate manages sovereign rights to minerals, offshore renewables and gas storage (under the Continental Shelf Act 1964, the Energy Act 2004 and the Energy Act 2008 respectively) to a maximum of 200nm from shore.
- ” Those boundaries were later formalised under the Scottish Adjacent Waters Boundaries Order 1999 (setting the limits as against the rest of the UK) and we are therefore clear that Crown assets managed by The Crown Estate on the continental shelf adjacent to Scotland (to a maximum of 200nm) will devolve to Scottish Ministers.²²⁸

Devolution / decentralisation beyond the Scottish Parliament

382. As an integral part of the plans for the Smith Commission to devolve the management and revenues of the economic assets held in Scotland to the Scottish Parliament was the agreement that this should be followed by a further process. Specifically, the Smith Commission recommended that, following transfer to the Scottish Parliament, responsibility for the management of those assets would be further devolved to local authority areas such as Orkney, Shetland, Na h-Eilean Siar or other areas who seek such responsibilities. It was recommended that the definition of economic assets in coastal waters recognises the foreshore and economic activity such as aquaculture.

383. As part of the evidence received on this matter, the Committee took representations via a written submission from Comhairle nan Eilean Siar, Shetland Islands Council and Orkney Islands Council on behalf of *Our Islands: Our Future Campaign*. They wrote—

- ” The position of the Campaign is that the management of local asset revenues by Local Authorities makes sense because only these Local Authorities truly represent the communities hosting Marine Estate developments and only these Local Authorities have a detailed knowledge of their own economic situation with the insight to provide targeted economic interventions when they are needed.²²⁹

384. Similarly, the view of local authority umbrella group CoSLA was that—

- ” This proposal builds on COSLA’s long standing case for greater devolution of Crown Estate and also Marine planning responsibilities to coastal authorities and communities...We need to ensure that the Smith Commission’s recommendations are acted on in full by ensuring that

Crown Estate operations and associated revenues are fully devolved to Local Government.²³⁰

385. Representatives of The Highland Council told the Committee that it was keen to ensure that devolution down to local authority level happens, and that they are included in the other areas who seek such responsibilities referred to in the Smith Agreement. Steve Barron, Chief Executive of Highland Council stated—

” The Highland Council’s position is well aligned with that of the island authorities. The council wishes to see Crown Estate revenues directed to local coastal communities and the management of Crown Estate transferred from the commissioners to the Scottish Parliament and local communities, as appropriate [...] The Smith Commission report mentions the islands specifically but does not mention Highland Council. That is of concern to us, given the lead role that we have played in establishing and leading the working group and the high relative value of the Highlands in terms of the Crown Estate income.²³¹

386. In his evidence session, the Deputy First Minister reaffirmed his support for this process. He said—

” We are open to pursuing that discussion with island authorities. We recognise their specific and special interest in the area. That is why Mr Mackay is working with the island authorities on those points. We have to see it within the wider context of the framework that is put in place.²³²

387. Not all of those who gave evidence to the Committee were fully supportive of the proposal to devolve certain economic assets to local authorities. In their written submission to the Committee, Scottish Renewables, RYA Scotland and Walter Speirs, Director, Muckairn Mussels Ltd made comments along these lines as follows—

” **Scottish Renewables** – “While Scottish Renewables understands the case for greater local ownership and sharing of revenues, we would again emphasise that strategic oversight of our offshore assets would best be achieved by a Scotland-wide body which could ensure continued investment in the growth of offshore renewables, and a consistent leasing process for developments.”²³³

” **RYA Scotland** - “The decentralisation of powers from a single expert body to multiple local bodies is likely to result in a loss of institutional knowledge and expertise. Further we are concerned that the bodies receiving these new powers may not have the financial or staff resources to properly discharge their duties in respect to marine seabed and foreshore management [...] we have concerns regarding the suggestion of devolving powers beyond the level of a single national body. With a few specific exceptions of island authorities, we believe the case for decentralising the

powers and functions of the Crown Estate to local authorities has yet to be soundly made.”²³⁴

” **Walter Speirs** - “I agree that what the Smith Commission has proposed is correct in one sense, but it is also hugely complex. There is a simple solution: there is the management job to be done with the estates, and at present that is done very well, in my opinion, by the Crown Estate. The revenues seem to be what is in question, but I see no reason why, through the existing management structure, the revenues cannot be channelled to wherever the Scottish Government decides to put them. That would mean that existing tenants would not have a period of uncertainty in which, in all probability, different regimes would operate in different areas of Scotland.”²³⁵

388. However, Steve Barron, Chief Executive, The Highland Council, and Councillor Angus Campbell, Leader, Comhairle nan Eilean Siar, were both very confident that their local authorities could deal with the new responsibilities. Steve Barron told the Committee that—

” Highland Council is well able to take on the responsibilities and has in-house expertise. We are already working with harbours and we are dealing with marine planning and aquaculture issues perfectly professionally. Taking on the new powers and responsibilities would enhance rather than add to what we do.”²³⁶

And that—

” It is very clear to us that the work that the Crown Estate does on the ground could easily be taken into local authorities. We have the ability to do such things already, so it would be an expansion of that.”²³⁷

389. To better understand the importance of this matter to island communities, the Committee undertook a visit to the Shetland Islands in March 2015. The ability of the local authority, in its opinion, to take on these responsibilities was made clear to us in the meetings we held with Shetland Island Council. Others we met on the island broadly shared this view although some expressed the need for any revenues generated to be carefully ring-fenced and invested back into local industries such as aquaculture and not to be considered as general revenue.

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Committee members on a visit to The Shetland Islands at Scottish Sea Farms Taing Shore Base, Burra Isle, Shetland

390. It was further made clear to us that there is scope for a wider devolution to, or at least partnership working with, others in these areas such as harbour and port authorities, local marine interests and experts etc.

Conclusions and recommendations on The Crown Estate

391. The Committee agrees that the particular legislative approach adopted to devolve the management and revenues of The Crown Estate could be construed as overly complicated unless there is full transparency and full consultation with the Scottish Parliament and Government during the process. The Committee believes that there is merit in considering an approach based on that set out by Professor McHarg and others. The Committee recommends that the UK Government considers revising its drafting approach

392. Furthermore, if a transfer scheme of this type is to be adopted, then the Committee recommends that the UK Government replaces the word “may” in draft clause 23 with “shall”.

393. **The Committee believes that it is right and proper that the corporate entity that exists to manage the non-devolved assets of The Crown Estate in the rest of the UK should be free to decide its own activities. However, the Smith Agreement was very clear that the management and revenue of The Crown Estates economic assets held in Scotland should be devolved. The UK**

Government's current proposals may result in the creation of 'two Crown Estates'. We believe this is not consistent with the Smith Agreement. The Committee therefore has serious concerns regarding the situation in Scotland post-devolution and the competition and confusion that may arise from this.

394. The Committee would wish to see absolute clarity on this matter from the UK Government and HM Treasury in particular (as The Crown Estates' sponsoring department) and we recommend that, at the very least, there should be an obligation placed on the non-devolved Crown Estate to consider the option of shared investments with the devolved Crown Estate in Scotland, with a fair allocation of revenues.

395. The Committee notes the previous UK Government's intention to exclude Fort Kinnaird from devolution. The Committee sees no need for this proposal and calls on The Crown Estate and HM Treasury to find a means of ensuring that a full share of the Crown Estate's revenues from Fort Kinnaird accrue to Scotland. Furthermore, the Committee is concerned that the investment vehicle used in the example of Fort Kinnaird could be repeated as a means of avoiding the devolution of future investments in the intervening period between the passing of any bill and the transfer of assets.

396. We seek clarity on the longer-term operation of the policy and financial position of the Crown Estate on this issue. The Committee believes that Scotland should receive its fair share from any such investment vehicles operating within Scotland in the future.

397. The Committee is reassured by the clarification provided by the Scotland Office on the issue of economic rights and assets out to 12 and 200 nautical miles. However, when any bill is introduced, we believe that it will be important to be clear about the definition of any zone referred to in the legislation to avoid the potential for confusion.

398. Once the powers over the Crown Estate have been transferred, the Committee recommends the early implementation of the Smith Commission recommendation that "responsibility of the management of the Crown Estate assets in Scotland should be devolved further to local authorities such as Orkney, Shetland, Na h-Eilean Siar or other areas who seek such responsibilities".²³⁸ These are matters where discussions should, in our view, continue to progress as a matter of urgency and we endorse the work of the Scottish Government and the *Our Islands, Our Future* initiative to reach an amicable agreement that suits local circumstances.

399. **The Committee believes that there is scope in some communities for further devolution of the management of certain economic assets to, or at least partnership working with, others in these areas such as harbour and port authorities, local marine interests and experts etc.**

400. We recommend that the Scottish Government keeps this and other committees in the Parliament up-to-date with the discussions with local authorities and others as they continue, and report to the Scottish Parliament for endorsement before agreement on any proposals for further devolution is reached.

401. The Committee recognises that The Crown Estate has made itself available to report to Parliamentary committees on an annual basis (and has done three or four times) and that this Committee recommends that the Scottish Parliament would expect such regular scrutiny to continue.

402. The Committee notes the previous UK Government's intention that the Scottish and UK Governments will draw up an Memorandum of Understanding, including further detail on the legal protections for defence or national security as well as providing that the transfer of management responsibility for the Crown Estate is not detrimental to UK-wide critical national infrastructure in relation to matters such as oil and gas, telecommunications and energy, thereby safeguarding the importance of the Crown Estate's foreshore and seabed assets to the UK as a whole. **The Committee expects the Scottish Parliament to be consulted during the process of drawing up the MoU.**

403. Finally, the Committee welcomes the comments from the Crown Estate Commissioner for Scotland that discussions are already underway with staff on the implications to them. The Committee expects the recommendations in the Smith Commission report to be fully implemented, such as the commitment to the protection of the employment rights of those Crown Estate staff who are connected with the management of the Scottish assets.

Other provisions and issues

Background

404. The report of the Smith Commission and the previous UK Government's Command Paper contain a number of provisions that have not been covered by the Committee in preceding sections of its report, as they were not the immediate focus of the oral evidence sessions we were able to organise in the time available before the UK General Election. However, some of these provisions were areas where we did receive some written evidence and this is reflected below.
405. It would be the intention of the Committee that should such provisions be contained in any bill introduced by a new UK Government after the UK General Election, then these would be scrutinised as part of the legislative consent process.

Recommendations of the Smith Commission

Payday Loan Shops

406. The Smith Commission report states that the Scottish Parliament will have the power to prevent the proliferation of Payday Loan shops.²³⁹ In its Command Paper, the previous UK Government stated that—
- ” Planning powers are already devolved in Scotland, meaning that the Scottish Parliament already has legislative competence to pass laws in relation to planning, including the use of shops for payday loan businesses across Scotland.
 - ” Officials in the UK Government and Scottish Government will continue to discuss this part of the Smith Commission Agreement to consider whether any other action is required to deliver it.²⁴⁰
407. As such, the previous UK Government has not included the proposals of the Smith Commission in their draft clauses.
408. In its written submission of evidence to the Committee, Citizens Advice Scotland wrote—
- ” We are aware that planning laws can only tackle Payday Loan shops and do not tackle online presence of many payday companies. In response to a recent consultation, CAS supported the intention to allow planning authorities the ability to control the provision of both payday lending shops and betting offices if they feel the need due to overprovision in the local area. The impacts of inappropriate high-cost lending are numerous and CAS has extensively set out our evidence on the impacts of such borrowing in recent years. Using planning laws should not be seen as providing a

blanket ban on such facilities but the government's proposal did allow for individual decisions to be made on a local basis thus allowing for controls to be implemented if there is local reasoning for doing so. CAS believes that the level of control that was consulted on is appropriate and allows the planning authority to take into account if further provision would be damaging to an area and its citizens. CAS is therefore disappointed that the Scottish Government decided after consultation that they will not progress the ability for planning authorities to control over-provision.²⁴¹

409. Citizens Advice Scotland concluded—

” We would reiterate this stance if both Governments are to address fully and positively, the issues people currently face with debt and access to credit and banking. CAS would recommend, as we did in our Smith Commission submission, that this is done through closer co-operation and communication, not just between Governments, but between other institutions and organisations directly with the Scottish Government, Scottish Parliament and other stakeholders in Scotland such as Citizens Advice Scotland.²⁴²

410. Money Advice Scotland commented as follows that—

” more should be done to raise awareness of the negative impacts and alternatives to payday loans. Such as:

- Regulation on advertising: mainstream events and appealing to children (e.g. football matches, puppet advertising, attractive bright colours on adverts making it appear fun and non-serious to borrow money with high interest rates).
- Further regulation on interest rates and charges.
- Regulation on delivery of sale of loan: identify that the customer understands what they are signing up to and the impacts it may have upon their finances. There needs to be better affordability tests in the first instance²⁴³

411. The initial view of the Committee is that the current provisions could go further and consideration could be given to including powers over licensing and regulation not just planning.

Fixed-Odds Betting Terminals

412. The Smith Commission report states that the Scottish Parliament will have the power to prevent the proliferation of Fixed-Odds Betting Terminals.²⁴⁴ While the previous UK Government's draft clauses look to devolve this power to the Scottish Parliament, and places the relevant clause under the heading '*Power to change the number of fixed odds betting terminals*', the Command Paper states "The

amendments made by this section do not apply in relation to a betting premises licence issued before this section comes into force.”²⁴⁵

413. The Committee received a small number of written submissions of evidence in this area. The submission by the Law Society of Scotland, for example, questions whether the previous UK Government’s draft clauses give proper effect to paragraph 74 of the Smith Commission Agreement. The Law Society wrote—

- ” We note that the exception will only permit the variation of the number of FOBTs authorised by a new betting premises licence, but does not in terms of Clause 33(6), apply to existing betting premises licences.
- ” Consideration should be given to devolve competence to permit the variation of the number of gaming machines authorised by existing gaming licences.
- ” Furthermore the Gambling Act 2005, Section 172 provides the authority for allowing various categories of gaming machines, defined in the relative regulations according to stake and prize money. Clause 33(1) excepts from the reservation the setting of the number of gaming machines where the stake is more than £10. The Scottish Parliament should be able to limit the number of machines irrespective of the value of the stake.²⁴⁶

414. The submission from the Association of British Bookmakers Ltd (ABB) looked at the issue of problem gambling. ABB stated that it did not believe that reducing the number of fixed-odd betting terminals was the best way to deal with the issue. ABB concluded as follows—

- ” All current research indicates that problem gambling is about the person not the product. Therefore we firmly believe that the proposed policy undermines a co-ordinated and effective harm reduction strategy for Scotland.²⁴⁷

415. **At this stage the Committee has not taken any detailed oral evidence on this issue. We look to do so once we receive any bill introduced by a new UK Government. However, at this stage, the Committee questions whether the draft clause, as currently written, gives any meaningful effect to the Smith Commission proposals in this area. The draft clause would only provide the power to restrict the number of Fixed-Odds Betting Terminals where a new betting premise licence is being sought. The Committee has some sympathy with the Law Society of Scotland submission that the clauses should be amended to include the ability to limit the number of gaming machines in both existing and new betting premises.**

Tribunals

416. The report of the Smith Commission recommended that—

” 63. All powers over the management and operation of all reserved tribunals (which includes administrative, judicial and legislative powers) will be devolved to the Scottish Parliament other than the Special Immigration Appeals Commission and the Proscribed Organisation Appeals Commission.

” 64. Despite paragraph 63, the laws providing for the underlying reserved substantive rights and duties will continue to remain reserved (although they may be applied by the newly devolved tribunals).²⁴⁸

417. Inclusion Scotland stated that they welcomed the draft clauses transferring responsibility for administration of tribunals to the Scottish Government and hoped that the Scottish Parliament will use this new power to address the financial barriers caused by increased fees for taking cases to tribunals.²⁴⁹

418. The Committee also received evidence from the Law Society of Scotland that highlights some concerns regarding the draft clause relating to Tribunals (Clause 25). It said—

” In general terms we welcome the inclusion of Clause 25 which is directed at tribunals dealing with reserved matters in Scotland. We however have reservations about the drafting of Clause 25, believing it does not give effect to Paragraphs 63 and 64 of the Smith Commission Report. We believe that Clause 25 sets limitations on the transfer of responsibility for management of transferred tribunals.²⁵⁰

419. However, the Law Society of Scotland stated that in implementing Paragraph 63 of the Smith Commission Report there must be some scope for the continued reservation of the substantive law and that that may take forms which require some limitation on the functions transferred. Its view was that limitations on the transfer should be only such as are objectively necessary and that they must not be unduly restrictive of the principle in Paragraph 63.

420. The Society called for the complete transfer of responsibility in this area to avoid questions as to the status of tribunals which deal with Scottish matters but which were not within the devolved responsibility of the Scottish Parliament. In its view, without clarification in statute, questions might arise as to whether such tribunals dealing with Scottish issues (while not part of the Scottish Tribunals system) were in fact part of the English legal structure.

421. The Law Society of Scotland also set out a series of further issues which are set out in its written evidence to the Committee.

422. **The Committee welcomes the transfer of powers for tribunals to the Scottish Parliament but notes the views of the Law Society of Scotland about the drafting of the relevant clause and potential limitations. The Committee seeks assurances from the UK Government on these matters before a new bill is introduced after the UK General Election.**

Broadcasting

423. The report of the Smith Commission recommended that—

- ” There will be a formal consultative role for the Scottish Government and the Scottish Parliament in the process of reviewing the BBC’s Charter. The BBC will lay its annual report and accounts before the Scottish Parliament and submit reports to, and appear before, committees of the Scottish Parliament in relation to matters relating to Scotland in the same way as it does in the UK Parliament.
- ” The power to approve OFCOM appointments to the board of the MG Alba will rest solely with Scottish Ministers.²⁵¹

424. In its Command Paper, the previous UK Government stated that this will be enacted by Memorandum of Understanding (MoU). This MoU, entered into by the UK Government, Scottish Government, Scottish Parliament and the BBC, will fulfil the Agreement’s proposal by setting out commitments that guarantee a full consultative role for the Scottish Government and Scottish Parliament in the review of the Royal Charter and the on-going scrutiny of the BBC.²⁵²

425. **It could be expected that the discussions on the MoU would need to be completed before work on reviewing the BBC’s Royal Charter begins in the summer of 2015. The Committee, therefore, gives notice that it intends to take a role in considering the draft MoU and report to Parliament in due course.**

Food labelling and seafood/red meat levies

426. These are areas where the Committee took some informal evidence from local industry groups during our visit to the Shetland Islands. Some concerns were raised by these bodies and we intend to return to these issues following introduction of any bill after the UK General Election. **In any reforms to these schemes, the Committee believes it will be important that Scotland has the ability to introduce an EU recognised ‘Made in Scotland’ label and also that Scotland is able to decide at any stage whether to opt into UK arrangements on seafood/red meat levies and, if so, receives an equitable share of any UK monies levied.**

Elections, the workings of the Scottish Parliament etc.

427. The Smith Commission made a series of recommendations relating to elections to the Scottish Parliament and to the functioning of the Parliament. The Committee has not taken detailed evidence on these matters at this stage. The Committee is aware that work is on-going at official level to comment on the draft clauses. The Committee intends to return to these issues following introduction of any bill after the UK General Election. The Committee expects the commitments in the Smith Agreement to be translated into legislation by a new UK Government. The

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Committee will work with other committees, such as the Standards, Procedures and Public Appointments Committee on these matters.

Telecommunications, postal services, energy, transport, health and social affairs, and consumer protection

428. The Smith Commission made a series of recommendations relating to elections to the Scottish Parliament and to the functioning of the Parliament and the Committee expects these to be translated into legislation. The Committee has not taken detailed evidence on these matters at this stage. The Committee intends to return to these issues following introduction of any bill after the UK General Election.

Additional issues raised by the Smith Commission

429. The Smith Commission report also made a number of recommendations on other additional issues for consideration. These were areas where the political parties raised a number of additional policy matters which do not involve the devolution of a power to the Scottish Parliament. Whilst the Committee did not take any formal oral evidence on these issues, we did receive various written submissions that looked at some of the issues, and we reflect this evidence below.

Post-Study Work Visas

430. The Smith Commission recommended that both governments work together to explore the possibility of introducing formal schemes to allow international higher education students graduating from Scottish further and higher education institutions to remain in Scotland and contribute to economic activity for a defined period of time.²⁵³

431. In previous years, the Scottish Government introduced a scheme similar to the Smith Commission's recommendations known as the *Fresh Talent – Working in Scotland Scheme*. *Fresh Talent* was an immigration scheme launched to deal with problems of population decline and skill shortages in Scotland. It ended on 29 June 2008, when it was replaced by the Tier 1 (Post Study Work) Programme at UK level. *Fresh Talent* allowed non-EEA nationals who successfully complete a relevant Scottish degree or postgraduate qualification to work or set up a business in the UK for 24 months without needing a Work Permit. The principle of the scheme, and of its successor, was to retain skilled and educated graduates as part of the UK labour force, who could then switch to longer term schemes. The Tier 1 (Post Study Work) Programme closed on 5 April 2012.

432. In its submission to the Committee, the National Union of Students Scotland stated it was—

” ...disappointed that the publication of the draft clauses did not also include an update on this, and the other areas for consideration, and concerned that it will simply be deferred until following the UK general election, leaving

it to the whim of the government of the day as opposed to being part of this, defined process.²⁵⁴

433. As a minimum, the NUS Scotland called for the introduction of more flexibility in Scotland and a scheme similar to *Fresh Talent*.
434. Universities Scotland in its submission asked for, the “Early introduction of a devolved capacity to re-introduce a two-year post-study work entitlement for international students graduating from Scottish higher education institutions”.²⁵⁵ It noted that the Scottish Government has put work in hand with Universities Scotland and other stakeholders to design a new scheme to allow international graduates to contribute to the Scottish economy, but its implementation is dependent on UK Government agreement.
435. **The Committee reinforces the recommendation of the Smith Commission on this issue and believes that this important issue should be addressed through discussion between the two governments in advance of the introduction of any new bill after the UK General Election.**

Victims of Trafficking

436. The Smith Commission raised the issue of victims of human trafficking. It said both governments should explore the possibility of extending the temporary right to remain in Scotland for someone who is identified as a victim of human trafficking, including in particular to enable the individual to participate in relevant legal proceedings.
437. In a written submission received from Scottish Women’s Convention (SWC), it said—
- ” The SWC would wholeheartedly support this proposal. The women whose lives have been blighted by exploitation, rape and other forms of abuse are valued, and they deserve to be afforded the opportunity to access the support and assistance necessary to move on from their ordeal.²⁵⁶

438. **The Committee reinforces the recommendation of the Smith Commission on this issue and believes that this important issue should be addressed through discussion between the two governments in advance of the introduction of any new bill after the UK General Election.**

Additional issues for consideration

439. The Committee notes the other issues contained within the Smith Commission report in the section of the report entitled ‘Additional issues for consideration’, relating to: asylum seekers; fines, forfeitures, fixed penalties imposed by courts and tribunals and sums recovered from crimes; and, the functions and operations of the Health and Safety Executive. **The Committee reaffirms the view of the**

Smith Commission that these issues need to be the subject of discussion between the two governments.

440. The Committee also notes the recommendations of the Smith Commission in relation to health and social affairs which were that:

” The parties are strongly of the view to recommend the devolution of abortion and regard it as an anomalous health reservation. They agree that further serious consideration should be given to its devolution and a process should be established immediately to consider the matter further.

” The devolution of xenotransplantation; embryology, surrogacy and genetics; medicines, medical supplies and poisons; and welfare foods (i.e. matters reserved under Sections J2 to J5 of Head J – Health and Medicines, Schedule 5 to the Scotland Act 1998) should be the subject of further discussions between the UK and Scottish Governments. Those discussions are without prejudice to whether or not devolution takes place and in what form.

441. **The Committee considers that these issues require serious further consideration and discussion between the Scottish and UK Governments.**

Inter-governmental relations and parliamentary oversight

Background and recommendations of the Smith Commission

442. By design, intergovernmental relations (IGR) in the UK are mainly informal and underpinned by the need for good communication, goodwill and mutual trust. The Memorandum of Understanding (MoU), the concordats between the Scottish government and Whitehall departments, and the Devolution Guidance Notes were intended at the time of the initial devolution to Scotland, Wales and Northern Ireland to embody and nurture a co-operative working culture among civil servants in different administrations on a day-to-day basis.
443. The MoU provided for the establishment of a Joint Ministerial Committee (JMC) to bring together all three of the devolved administrations with the UK Government. It met only a few times in plenary and functional formats before becoming largely redundant in 2002. The exception was the JMC (Europe) where there was a clear and continuing need to bring the devolved administrations together with the UK Government before European Council meetings.
444. The JMC was only resurrected after the emergence of party political incongruence in the composition of governments north and south of the border in 2007. It now meets annually in plenary format and when required (usually annually) in its domestic format. Meetings of the JMC (Europe) continue to conform to the timetable of European Council meetings.
445. Table 10 below sets out further information on the recent frequency of JMC meetings.

Table 10: The number of Joint Ministerial Committee meetings since June 2007

Year	Plenary	Europe	Domestic
2007	0	4	0
2008	1	4	0
2009	1	4	2
2010	1	4	2
2011	1	4	1
2012	1	4	2
2013	1	4	1
2014	1	4	1

Source: Information provided to SPICe by the Scottish Government

446. It is important to note that the JMC is a consultative not an executive body – it facilitates communication, not co-decision. In 2011, it developed a Dispute Avoidance and Resolution Protocol for those issues ‘where a dispute cannot be resolved bilaterally or through the good offices of the relevant territorial Secretary of State’. Several disputes have been considered under this protocol, including a dispute raised by the three devolved administrations with the UK Government over Barnett consequentials arising from spending on the 2012 London Olympics.
447. The JMC remains the tip of the iceberg of intergovernmental relations. A number of other forums bring the UK and devolved governments together, e.g. the ‘Finance Quadrilaterals’ between devolved Finance secretaries and Treasury ministers. Some bilateral forums have emerged, including the Joint Exchequer Committee and, recently, the new Joint Ministerial Working Group on welfare, though these are mainly focused on facilitating the implementation of new devolved powers.
448. Most intergovernmental exchange continues to take place below the radar, between officials of varying levels of seniority working in similar or overlapping policy issues on a (vertical and horizontal) bilateral basis and ultimately in ad hoc meetings between ministers.

The Smith Commission’s views

449. The report of the Smith Commission emphasised the need for change to the current system of inter-governmental relations in operation within the United Kingdom. Lord Smith, in his foreword to the Commission report, highlighted this issue as follows—

” Throughout the course of the Commission, the issue of weak inter-governmental working was repeatedly raised as a problem. That current situation coupled with what will be a stronger Scottish Parliament and a more complex devolution settlement means the problem needs to be fixed. Both Governments need to work together to create a more productive, robust, visible and transparent relationship. There also needs to be greater respect between them.²⁵⁷

450. In his evidence to the Committee in this subject, Lord Smith commented on the current system of inter-governmental relations in the following terms—

” The system is kind of broke and is not working perfectly, and that is getting in the way. I am talking about civil servants, too. If we fix things quite formally at ministerial level, there will be an opportunity for such an approach to cascade down.²⁵⁸

451. The current system of inter-governmental relations is primarily governed by a range of non-statutory arrangements. Professor Aileen McHarg of the University of Strathclyde summarised these arrangements as follows—

” The current machinery for inter-government relations is largely non-statutory – contained in a Memorandum of Understanding (MoU) and Supplementary Agreements, as well as various Bilateral Concordats between the UK Government and the devolved administrations, which are expressly declared not to be legally-binding.²⁵⁹

452. As part of a process of reform, the Smith Commission recommended a number of changes in relation to inter-governmental working. These included that:

- the current Joint Ministerial Committee structures required to be reformed and scaled up to reflect the content of the Smith Commission report;
- formal processes should be developed via which the Scottish and UK Parliaments can collaborate in order to hold their respective Governments to account;
- the Memorandum of Understanding between the UK Government and devolved administrations be revised;
- a stronger and more transparent process of parliamentary scrutiny of inter-governmental relations be established; and
- mechanisms be established to resolve inter-administration disputes.

Evidence received

Views of the two governments

453. The former Secretary of State for Scotland commented, in evidence to the Committee, on the approach of the UK Government post-devolution in 1999 that—

” In many ways, after the Scottish Parliament was set up in 1999, the UK Government kind of left the field in Scotland. We did not do enough to remind people here of the continuing, substantial responsibilities that we have as a Government, and more requires to be done in that regard. One thing that the referendum campaign brought about was a beefing up of the Scotland Office operation in terms of stakeholder engagement—I use that term loosely. That involved better engagement not just from the Scotland Office but from UK Government departments across the field.

” At the Scottish business board a few weeks ago, one of the members said to me that it had been great for the past couple of years, with people such as the permanent secretary to the Department for Transport coming up to talk to and engage with people directly, and he asked me to promise that that sort of engagement will continue. I could give him that promise, because I am determined that it will.

” There is no denying the fact that we—I mean the UK Government in a previous guise—somewhat took our eye off the ball. There is no point getting excited about that now, but we will do it differently in the future.²⁶⁰

454. The Deputy First Minister commented on the current operation of inter-governmental relations and the scope for improvement in the following terms—

” A lot of the joint work that goes on between the Scottish and United Kingdom Governments is good and orderly, but there is room for significant improvement in other areas. Generally, those are areas such as welfare policy, where we disagree about how we should proceed. I get very frustrated by having decisions taken in London of which I completely disapprove; that is at the heart of my frustration about many of the choices that we have to make.

” In trying to resolve such issues, we must have better intergovernmental machinery. However, we should not try to persuade ourselves that all the disagreements that we have will disappear with lovely intergovernmental machinery; we will still disagree about certain matters because of our different views. That is a difficulty of politics.²⁶¹

455. Speaking specifically about IGR mechanisms in the area of finance, the Deputy First Minister set out his views to the Committee on reforms that he believed were necessary. He said—

” One of my frustrations with the finance ministers' quadrilateral and the Joint Exchequer Committee is that, ultimately, if we do not like what happens, the Treasury view tends to prevail. I do not think that that enables the obtaining of an outcome that is satisfactory to the Scottish interest in all circumstances.

” One issue that needs to be explored is how we can make the intergovernmental machinery a more meaningful part of the process—how we can enable discussions to take place in such a fashion that they lead to devolved Administrations feeling that they have made some progress, as opposed to being thwarted by a final view being taken by the Treasury or the UK Government.²⁶²

Effectiveness of the current system for IGR and on the recommendations for reform

456. Professor Charlie Jeffery, in evidence to the Committee, commented on the current inter-governmental machinery and whether the structures were currently in place to implement the Smith recommendations. He said—

” The answer to that is: not yet, no. Page 15 of the Smith report says that there is a need to lay out details of the new bilateral governance arrangements which will be required to oversee the implementation and

operation of the tax and welfare powers to be devolved by way of this agreement.

” Those details are not there. They need to be there and we have heard from the panellists some features of the machinery that will be needed, including regularity, transparency and a clear set of principles that will underlie the operation of such arrangements. However, those arrangements are clearly not yet in place.²⁶³

457. Some of the evidence received by the Committee was critical of the ability of the Scottish Government and other devolved administrations to influence and shape the agenda of intergovernmental dialogue. Professor Aileen McHarg said to the Committee that—

” ...the current system for inter-governmental relations has been much less effective in allowing the Scottish government (and other devolved administrations) to exercise an effective influence in areas of mutual concern. It has been argued that the preference for informality – and for ad hoc and bilateral relations – enables the UK government to determine the extent to which and the terms on which discussions take place. The devolved administrations have no consistent means of ensuring that they are consulted, or that their views are taken into account, and there is a risk that their interests may simply be overlooked by UK policy-makers. There is limited evidence of a partnership approach in areas of mutual interest, and there have also been complaints of a lack of mutual respect, although relations are better in some areas than others.²⁶⁴

New institutional structures, bilateral versus multilateral and formal versus informal

458. The importance in any process of reform of ensuring that future arrangements have an institutional structure was touched upon by Professor Michael Keating. He stressed the need for inter-governmental relations to be viewed through a multi-lateral lens. In his view, “the Smith report contains a lot of good intentions and words about co-operation and so on, but if that is not underpinned by institutions, it will not necessarily amount to very much”.²⁶⁵ Professor Keating elaborated on this during his appearance at the Committee. He said—

” What has been lacking in the debate is any appreciation of what happens in federal systems. There has been a lot of loose talk about federalism and how it is the answer, but the point about federal systems is that both levels have guaranteed powers and institutional capabilities that allow them to co-operate. Otherwise it is just one-way traffic: it is just the Treasury laying down the law and the Scottish Parliament having to accept those rules. We do not have that federal spirit at all in the United Kingdom; it has to develop.

Devolution (Further Powers) Committee

New Powers for Scotland: An Interim Report on the Smith Commission and the UK Government's Proposals, 3rd Report, Session 4 (2015)

” It is difficult to talk about a bilateral UK-Scottish arrangement when other parts of the UK are putting forward their own demands and will have to be part of the process. They may not have exactly the same arrangements, but it would be very difficult to imagine a system in which there was one set of arrangements for Scotland and a completely different set of arrangements for Wales or Northern Ireland, responding to different principles and different ideas.²⁶⁶

459. Professor Charlie Jeffery of the University of Edinburgh explored this area with the Committee in more detail. In his view, it would be utterly characteristic of this state for different arrangements to be produced for different parts of it, each with their own impenetrable complexities. That, in his opinion, would be the natural *modus operandi*. For Professor Jeffery-

” There is a challenge on this Parliament, and on this committee in preparing the Parliament's thinking on the Smith commission powers, to situate Scotland's debate within the wider UK and not to see it as something that is self-contained in Scotland. There are very clear links across debates. The Welsh debate about fair funding is essentially a debate about what many see as unfair funding for Scotland. The drive, which is becoming significant in English public opinion, for some kind of institutional recognition for England has an awful lot to do with perceptions about Scotland.

” If we are to come to an arrangement involving a set of UK-wide transparent, regular arrangements, those debates need to be connected and reconciled as one single set of issues, and not considered as issues to be dealt with bilaterally through bespoke arrangements for each bilateral relationship.²⁶⁷

460. Giving evidence before her appointment as an adviser to the Committee, Professor Nicola McEwen, highlighted the balance between the need for bi-lateral and multi-lateral structures to manage inter-governmental relations in the United Kingdom. She said—

” I agree that there is a need not only for stronger multilateral agreements but for bilateral arrangements, because there are specific issues for the Scotland-UK relationship as a result of the settlement.²⁶⁸

IGR and discussions on development of policy on EU matters

461. This report has already considered a range of issues relating to the operation of inter-governmental relations regarding the taxation, welfare and employment support recommendations of the Smith Commission. However, the Smith Commission also highlighted the importance of inter-governmental relations with regard to representing the views of the Scottish Government in European Union policy-making structures. The Smith Commission stated--

” The parties recognise that foreign affairs will remain a reserved matter. They also recognise the need to reflect fully the views of the other devolved administrations when drawing up any revised governance arrangements in relation to Scottish Government representation of the UK to the EU. In that context, the parties agree that the implementation of the current Concordat on the Co-ordination of European Union Policy Issues should be improved.²⁶⁹

462. In his written evidence to the Committee, Professor Alan Page of the University of Dundee discussed this issue further. In his opinion, one of the amendments that the SNP Government sought but failed to secure to the Bill that became the Scotland Act 2012, in order to make it a Bill ‘worthy of the name’, was a statutory right to be included in the UK delegation at formal and informal meetings of EU Ministers at which non-reserved matters affecting Scotland were to be considered. He told the Committee that—

” The question of intergovernmental relations has an important European Union dimension. In its submission to the Smith Commission, the SNP renewed its call for ‘guaranteed rights to engage directly with EU institutions and EU decision-making processes in areas of devolved competence.’ The Commission agreed that the implementation of the current *Concordat on Coordination of European Policy Issues*, which govern relations between the UK Government and the devolved administrations in relation to EU matters, should be ‘improved’, but precisely what, if anything, that means in terms of ‘guaranteed rights’ remains to be seen.²⁷⁰

Role of Parliament in scrutinising inter-governmental relations

463. The Committee received a range of evidence that particularly highlighted the lack of the transparency of the current system of inter-governmental relations in the UK and the need for parliamentary oversight. Professor Aileen McHarg, for example, summarised the main characteristics of the current system in terms of transparency and accountability as being—

- A lack of transparency and democratic oversight in the design and review of the arrangements;
- An excessive insistence on confidentiality, and inadequate publicity for the work of the JMC;
- No consistent arrangements at either UK or Scottish level for parliamentary oversight of inter-governmental relations;
- Weak to non-existent inter-parliamentary links;
- Weak judicial oversight – this is side-stepped by lack of use of formal legal provisions, but is likely to be quite limited anyway²⁷¹.

464. In Professor McHarg's view, the shortcomings of the current system are symptomatic of weak constitutional recognition of the principle of "shared rule" – i.e. that the devolution of power needs to be balanced by mechanisms for territorial co-operation²⁷².

465. For her, a new set of principles for IGR in the future should be adopted, namely:

- An extension of existing arrangements to reflect new areas of inter-governmental working such as taxation and welfare;
- Stronger guarantees that the interests of devolved administrations be taken into account in areas of overlapping responsibilities;
- Statutory recognition of the fundamental principles of inter-governmental working;
- A greater commitment to transparency in the conduct of inter-governmental relations; and
- Stronger arrangements for Parliamentary oversight.

466. For Professor Michael Keating, the nature of inter-governmental relations is such that it tends to be done behind closed doors and as such tends to downgrade the role of Parliament. In this sense, the experience of inter-governmental relations in the United Kingdom is far from unique although Professor Keating did highlight some positive practices in Nordic countries when speaking on this issue before the Committee. He said—

” With regard to the capacity of Parliaments to hold Governments to account in relation to European negotiations, the Nordic countries and particularly Denmark give an example of what can be done. Ministers have to come and explain their position to extremely specialised committees that know the dossiers, and those committees report back to the Parliaments. Something like that could be done here for intergovernmental relations. All the arguments about not showing your hand or about confidentiality are just special pleading by Governments that do not want to be held accountable.²⁷³

467. He concluded that—

” In the case of Scotland, I would add that, if the Scottish Government and the Scottish Parliament are going to be given greater responsibilities for European matters and will be participating more fully in the Council of Ministers, the accountability arrangements here will have to be improved, as they were in Westminster.²⁷⁴

Conclusions and recommendations

468. The Committee concludes that ensuring that the Scottish and UK Parliaments, and other devolved assemblies, can effectively scrutinise inter-governmental relations represents a significant challenge posed by the Smith Commission for these legislatures.
469. The Committee recognises that, in part, it is a challenge to which the Scottish Parliament must respond. To this end the Committee signals its intention to undertake further work in this area in the period before the summer recess of 2015, and on the issue of inter-governmental relations more generally, during the passage of any bill that may be introduced after the UK General Election. This will include not just the machinery of inter-governmental relations but also how the Scottish Parliament can assess the Scottish Government's performance in delivering new powers.
470. As previously noted in relation to welfare (paragraph 339), the Committee recognises that for inter-governmental relations to operate effectively that there must be space for discussions between governments to take place in confidence. However, the Committee recommends that any future bill should place the general principles underpinning the operation of inter-governmental relations in statute. The Committee also considers that the general principles underpinning the structures which will be put in place for dispute resolution should also be placed in statute. Such a bill should also include the general principles which will enable Parliamentary scrutiny of this process to take place. The Committee considers that the detail of the process for conducting inter-governmental relations should then be placed in a Memorandum of Understanding agreed between the governments. During this process, the Committee expects the Scottish Government to report to the Parliament and its committees on the progress of discussion and specifically before any final agreement is reached.
471. The Committee agrees with the Smith Commission that the largely non-statutory machinery governing inter-governmental relations needs reform. In our view, it is not fit for purpose and will be unable to cope with requirements arising from the Smith Commission's recommendations.
472. The Committee considers that establishing a statutory and institutional structure for a scaled up approach to inter-governmental relations represents the most significant challenge to be addressed in implementing the Smith Commission recommendations.
473. The Committee considers that these issues will be most acute in relation to the policy areas of European Union representation, taxation, welfare and employment support.
474. The shift from a devolution settlement based on a system of largely separate powers to one of shared powers, which is recommended by the Smith

Commission, represents a fundamental shift in the structure of devolution settlement. The Committee agrees with the view that this will require both bi-lateral structures to be established between the UK and Scottish Governments as well as multi-lateral structures between the UK Governments and the devolved administrations.

475. The Committee has considered the issue of inter-governmental relations with regard to the taxation and welfare proposals earlier in this report. As a consequence of the importance of the new arrangements for the inter-governmental structures, we recommend that these are subject to parliamentary scrutiny before any legislation in this area can be passed. This will include the detail of a new fiscal framework and the principles which will govern the operation of welfare, including the operation of 'no detriment', and for dealing with Scottish Government representation with regard to EU issues. The Committee recommends that the general principles which will govern the operation of inter-governmental relations should be placed in any future Bill devolving power in this area.

Coherence and cohesiveness of the proposals for further devolution

Background

476. Prior to the publication of the Smith Commission's report and again prior to the previous UK Government setting out its views in its Command Paper, the Committee took a range of evidence from representatives of civic society organisations, the business community and academics. During these sessions, the Committee received evidence where some organisations expressed a view that the package of proposals recommended by the Smith Commission lacked a degree of coherence and would benefit from additional powers being devolved. These views continued to be expressed by some in the evidence that the Committee has received since the publication of the draft legislative clauses.
477. **As noted at the beginning of this report, all members of the Committee entered into the process of producing this report with the aim of finding as much consensus as possible in order to provide a constructive commentary for a new UK Government on the current package of measures being proposed for further devolution. Accordingly, the Committee does not, at this stage, intend to take a collective position on this strand of the evidence it has gathered. Some members consider that the powers proposed for devolution do not go far enough. For example, in relation to taxation, some members consider that a wider range of taxes such as National Insurance Contributions, Corporation Tax and aspects of Income Tax such as personal allowances and thresholds should be devolved. For other members on the Committee, this is not the case and they are content with the current proposals. This section of the report is intend to give a 'voice' to the evidence that the Committee has received which has questioned the coherence of the package of proposals for further devolution.**

Evidence received

Economic coherence

478. The Deputy First Minister, in evidence to the Committee prior to the publication of the draft clauses, questioned the coherence of the Smith Commission recommendations with regard, in particular, to the extent to which the proposals would provide the flexibility to improve Scotland's economic performance. In particular, the Deputy First Minister highlighted three areas where he considered additional powers would have aided economic performance and job creation. The Deputy First Minister stated—

” There could have been movement on issues such as the power to vary and control employers' national insurance contributions, which employers see

as being a crucial factor in determining the cost of employment and, therefore, the ability to recruit additional staff.

” Secondly, discretion over research and development tax credits in order to encourage investment by the private sector would have been good. One of the recurring analyses in the past 25 to 30 years of Scottish economic history has been the relatively poor performance in private sector research and development in our economy. We have to do something distinctive to improve that. Obviously, another way in which that could be dealt with would be to give us powers over corporation tax; that has been a long-standing position of the Scottish Government. We believe that those measures could have delivered for the Scottish Government greater flexibility to enhance and improve economic performance.²⁷⁵

479. The coherence of the taxation proposals was questioned by Professor Michael Keating who suggested that the devolution of a broader range of taxes would have provided greater flexibility to the Scottish Government. Professor Keating observed—

” On the taxation side, it would have been better to think about the range of taxes that might be appropriate for the Scottish Parliament. There was an unfortunate fixation on income tax, so practically all the extra tax powers are loaded on to a single tax, which itself has various problems—I am sure that my colleagues on the panel can explain them—rather than there being a broad range of taxes, as would be more normal in devolved and federal systems.²⁷⁶

480. Dave Moxham, of the STUC, also sought a greater range of taxation powers to be devolved and highlighted that the STUC would have preferred greater devolution of powers than the Smith Commission proposed in relation to labour market policy. Mr Moxham stated—

” ...the trade union movement in Scotland is looking extremely closely and with a not uncritical eye at the potential to devolve a range of powers relating to what we categorise as workplace protections, including employment law, the minimum wage and health and safety, that in our view fit the committee’s prescription for improving the quality of work and wages and reducing the benefits bill.

” Although we were aware of many of the historical arguments about the clear advantages of maintaining a single market across the UK, in the end we looked at the fact that the Scottish Government already exercises a large number of economic and economic development powers. In addition, it has the justice system, which clearly interacts with the workplace. When we looked at the issue in the round, we came to the clear view that control over such workplace protections, including the minimum wage, fitted better

with devolution. Therefore, we feel that that is a clear omission from the Smith proposals.²⁷⁷

481. Support for devolution of the minimum wage was made by a number of witnesses, including Peter Kelly, from the Poverty Alliance, who said—

” We, too, called for control of the national minimum wage to be devolved. That brings me back to the point that I made at the start about coherence, which we mentioned in our submission to Smith. Given the range of employability and social security powers that we had hoped would come, it would have been natural to have included the national minimum wage in that overall package to support people in making the transition from being out of work to being in work.

” We are disappointed that the national minimum wage has not been devolved. Although there is still much that we can do—and much that the Scottish Government and a range of organisations around the table and outside Parliament are doing—to promote a living wage, the fundamental point is that having the legal mechanism to set a floor for wages would have been very helpful in linking the economic development ambitions of the Scottish Government and the Scottish Parliament.²⁷⁸

482. Business organisations, who gave evidence to the Committee, were generally content with the powers that were proposed for devolution. However, some witnesses did express concern that, should corporation tax be devolved to Northern Ireland, consideration should be given to also devolving this tax to Scotland. For example, David Watt, from the IoD, commented—

” ...the IoD has been strongly against devolving corporation tax, but I suspect that I will have to hold back my members in Scotland from demanding that if it is devolved to Northern Ireland. There will be challenges if that happens. There is an issue there, as well.²⁷⁹

483. A range of organisations that deal with welfare issues highlighted the linkages between employability and equalities and suggested that the devolution of equalities legislation and employment law would have resulted in a more coherent package of proposals for devolution. For example, Bill Scott, of Inclusion Scotland, reflected on the degree of support this proposal had amongst people with disabilities as follows—

” We were very careful to warn all the disabled people who came to our engagement events that the simple transfer of powers would not change anything for the better or for the worse, because those powers would then have to be used one way or another, and they could well be used to affect our lives negatively rather than for the better. Nevertheless, the overwhelming message that we got back from 80 or 90 per cent of people was that they wanted equalities law and employment law to be devolved.

” If employability is going to be addressed, we have to bear in mind the key policy areas that affect the employability of disabled people. Less than half of disabled people are in work. Of those who are in work, the majority are in entry-level jobs and depend on the minimum wage being set at a level that removes them from poverty; otherwise, they would just be exchanging out-of-work poverty for in-work poverty. They got the point. They saw that bringing everything up here would provide a coherent approach that would allow us to affect employability over the longer term and to address the particular issues that single parents, disabled people and so on face in the current market.²⁸⁰

Coherence - Welfare

484. The Committee has received a range of evidence which whilst welcoming the powers proposed for devolution, in terms of welfare, questioned whether the Scottish Government will have sufficient financial flexibility to be able to exercise these powers effectively. Frequently, witnesses drew parallels to the situation in Northern Ireland with regard to the devolution of welfare powers. For example, the Chartered Institute of Housing stated—

” Our main concern was that if certain elements of welfare were devolved to the Scottish Government without the means to fund these changes, this could result in a situation, similar to that in Northern Ireland, whereby the Scottish Government would technically have the power to make changes to welfare provision but the complexity of the system and lack of fiscal leverage would mean that, in reality, the opportunity for implementing and changes would be severely restricted.²⁸¹

485. That Universal Credit should have been devolved in its entirety, in part as a means of avoiding potential ‘cliff edges’ between two governments having responsibility for different aspects of the same system, was another theme to emerge in evidence the Committee received. Mary Taylor, from SFHA, emphasised that SFHA supported the entire devolution of Universal Credit by stating that—

” The Scottish Federation of Housing Associations has consistently thought that the powers to support tenants to live in any kind of housing, in the form of housing benefit, should have been devolved at the time that the Parliament was set up. More recently, on taking advice about the way that social security was going and the formation of universal credit, we arrived at the position that the whole of social security needed to be devolved in its entirety.²⁸²

486. From a different perspective, the Committee received evidence which considers that the Smith Commission recommendations will not provide future Scottish administrations with the powers to be able to address poverty effectively and do not include a range of policy areas which would be required in any coherent

attempt to do so. Satwat Rehman, representing One Parent Families Scotland, took this perspective when reflecting, in oral evidence to the Committee, that—

- ” We, too, engaged effectively and widely with single parents in the lead-up to and during the referendum. They have shown energy for continuing to be involved, particularly on the issues that affect them. Welfare benefits, the work programme and Jobcentre Plus are the areas that they expressed the most disappointment about when we went back to them with what came out of the Smith commission. Although the work programme will be devolved, the policy framework will remain reserved and the regime of conditionality and sanctions, which is having such a negative impact on the families with whom we work, will remain in place.
- ” On whether we are content with what came out of the commission, when we look back at the tests that we were going to apply to it—would what was proposed alleviate or reduce poverty and support children and families, particularly single-parent families; would it avoid or address the cliff edges that exist currently between the two regimes; and would it address inconsistencies in the system?—it is clear that the proposals fall short in a number of areas that colleagues have spoken about.
- ” One area in particular that is not mentioned in the Smith report even though we had a specific session on it with Lord Smith is childcare. For us, that is one of the starkest examples of what happens when supply and demand—funding, in a way—is split across two Parliaments. We are disappointed that there is no mention of childcare and nothing to consider how it could be addressed through the greater powers that will be given to Scotland.²⁸³

An Enduring Settlement?

487. Finally, a constant theme throughout the Smith Commission report, and indeed this report, has been the importance of fostering effective inter-governmental relations if the Smith Commission recommendations are to be implemented effectively. The extent of shared powers which are contained within the Smith Commission report represents a significant shift in the structure of the devolution settlement and will present significant challenges to deliver. The degree of interdependence has led a variety of witnesses to question the sustainability of the package of powers proposed for further devolution. In this regard, Professor Nicola McEwen, giving evidence before her appointment as a Committee adviser, observed—

- ” I think that we are moving away from the reserved powers model that was one of the strengths of the original devolution settlement. That increases the powers of the Parliament, but at the same time it makes Parliament more dependent in a way, because of the direct interdependencies in relation to tax and welfare policy. Managing that interdependence would

create some anomalies and some constraints on policy options. There are lots of challenges.

” The report is implementable and, in the implementation process, we will start to get some more substance on what the proposals actually mean, which could change things along the way. However, I do not think that it is sustainable. Politics might dictate the process of change anyway, but I think that new anomalies will emerge that increase pressure to revisit the issue and come up with something a bit more coherent.²⁸⁴

488. The approach taken to drafting the legislative clauses which shifts from the approach of the Scotland Act 1998 of defining reserved powers to creating exceptions to reserved powers has also been considered by many witnesses to not only be a source of future instability but also acts to limit devolved powers. Inclusion Scotland summarised this view, in written evidence, by stating that whilst it—

” ...is disappointed that the Smith Commission proposals do not match the aspirations of disabled people, particularly in relation to powers on welfare and taxation, we believe that there are substantial opportunities to design a fairer Scotland that promotes the right to Independent Living for disabled people. However, the clauses as currently drafted seem unlikely to deliver in full what the Smith Commission proposed, and the way they have been drafted may restrict the ability of the Scottish Parliament to use the new powers to their best potential.

” Inclusion Scotland believes that many of these concerns can be addressed if the draft clauses are redrafted in line with the original intention of the Scotland Act, that is defining the matters that are reserved to Westminster rather than the powers devolved to Scotland.²⁸⁵

Conclusion

489. **The Committee notes the evidence it has received on the coherence of the Smith Commission recommendations. The focus of this report is on whether the draft legislative clauses meet the spirit and substance of the Smith Commission report, and to produce findings around which all members can agree. Accordingly, the Committee does not take a view on these issues at this juncture.**

Key conclusions and recommendations

490. The following text contains an extract of the key conclusions and recommendations that can be found throughout the body of this report. **The conclusions and recommendations were agreed unanimously.**

491. **Annexe A** to this report provides a summary position of the Committee's detailed conclusions and recommendations against the benchmark of whether the draft clauses fully meet both the letter and the spirit of the agreement reached by the five political parties represented in the Scottish Parliament during the Smith Commission's work.

General

492. This report is not the Committee's final view on the Smith Commission or the then UK Government proposals, or an indication of any recommendation for legislative consent at this stage. Upon introduction of any bill in the UK Parliament following the UK General Election on 7 May, we would begin the process of considering the bill and any proposals for amendments. Any final decision by the Scottish Parliament on legislative consent is likely to take place in the early part of 2016.

493. **In some of the areas set out in the previous UK Government's Command Paper, the Committee believes that the current draft legislative proposals meet the challenge of fully translating the political agreement reached in the Smith Commission. In other areas, improvements in drafting and further clarification are required. In some critical areas, the then UK Government's draft legislative clauses fall short.**

The need for greater public engagement

494. The Committee believes that further public engagement, directly with the people of Scotland as well as representative bodies, charities, industry groups, voluntary bodies etc. is still a vital activity that needs to be carried out and is fully committed to the spirit of the recommendation made by the Smith Commission in this respect. **The Committee calls on the UK and Scottish Governments to consider how to commit to the spirit of the Smith Commission's recommendation in this respect.**

Constitutional matters

Permanency of the Scottish Parliament and Scottish Government

495. The Committee is of the view that the inclusion of the words "is recognised" in draft clause 1 on the permanency of the Scottish Parliament and Scottish Government has the potential to weaken the effect of this clause, which would be unfortunate given the all-party agreement to this recommendation as part of the Smith Commission, and the views expressed to us by the then Secretary of State

for Scotland that he perceives that the permanence of the Scottish Parliament and Scottish Government is guaranteed. **Accordingly the Committee recommends that the UK Government removes the words ‘is recognised’ from this clause.**

496. In evidence to the Committee, the then Secretary of State for Scotland commented that he was “open to thinking about different ways in which ... permanence could be achieved”. The Committee welcomes the open-minded approach of the previous Secretary of State with regard to this issue. The Committee therefore considers that there is scope to further strengthen the permanency provisions.
497. **The Committee considers that the effect of the clause on permanency, as currently drafted, is primarily declaratory and political rather than legal in effect. The UK doctrine of Parliamentary sovereignty makes achieving permanence problematic. The Committee recommends that the Scottish electorate should be asked to vote in a referendum if the issue of permanency was in question, with majorities also being required in the Scottish Parliament and the UK Parliament.**

Sewel Convention and Legislative Consent Memoranda

498. **The Committee considers that the current draft clause 2, whilst placing the purpose of the Sewel Convention in statute, does not incorporate in legislation the process for consultation and consent where Westminster plans to legislate in a devolved area. The Committee considers that it should do so. Moreover, the Committee considers that the use of the words “but it is recognised” and “normally” has the potential to weaken the intention of the Smith Commission’s recommendation in this area and recommends that these words be removed from the draft clause.**

Equal opportunities: socio-economic inequalities and gender quotas

499. This particular provision is an area that the Committee intends to return to at a later date upon introduction of any new ‘Scotland Bill’ following the UK General Election. **At this stage, the Committee seeks clarification, from the UK Government, on the scope of the provision in clause 24 with regard to the extent to which the Equality Act 2006 and 2010 would limit the ability of Scottish Ministers to legislate with regard to equalities issues.**
500. The Committee also notes that the Equality Act 2006 is not mentioned in the Smith Commission recommendation, yet the reservation in the draft clause also includes the 2006 Act and **seeks clarification, from the UK Government, on what effect the inclusion of this Act has upon the proposed power for Scottish Ministers in this area.**
501. The Committee remains unclear about the scope of the proposed extension of legislative competence to socio-economic rights and, in particular, whether any extension would be limited to the socio-economic equality duty contained in Part 1

of the Equality Act 2010. **It recommends that further thought be given to the drafting of this clause to ensure that the aims of the Smith Commission are fulfilled.**

502. The Committee considers that the words “except to the extent that provision is made by the Equality Act 2006 or the Equality Act 2010” creates doubt about the power of the Scottish Parliament to legislate for gender quotas in relation to Scottish public authorities and cross-border public authorities. **It recommends that further thought be given to the drafting of this clause to ensure that the aims of the Smith Commission are fulfilled.**

Taxation

Income tax

503. **On income tax, the Committee concludes that the essence of the Smith Commission’s recommendations has been translated appropriately by the then UK Government into the draft legislative clauses. We have no particular concerns at this stage with the drafting. However, there are significant issues still to be resolved regarding the implementation of the new powers, such as an appropriate definition of residency for a Scottish taxpayer, the details of the administration of the new regime (who collects the tax and how it will function), the costs on business and individuals, the need to avoid double taxation and the timing and phasing of the new powers on income tax relative to those already devolved under the Scotland Act 2012.**
504. **One area that requires further clarification from the UK Government, however, is whether the current provisions would permit the Scottish Parliament to set a zero rate of income tax.**
505. **The Committee recommends that details on the implementation of the new powers over income tax be produced before the Scottish Parliament is expected to give its legislative consent.**

Assignment of VAT

506. **The Committee concludes that the wording of the former UK Government’s draft clauses for the assignment of a share of VAT revenues are adequate as currently drafted. However, there is still significant uncertainty on how the assignment of a share of revenues will be calculated and whether the Scottish Government will be able to reap the rewards of any economic stimulus that yields higher VAT revenues.**
507. **The Committee recommends that details of the assignment of VAT revenues and the share of any benefits be produced before the Scottish Parliament is expected to give its legislative consent. The Committee further recommends that a bilateral process by discussion is entered into between the two**

governments to reach agreement for the 'verified basis' for VAT attribution to Scotland for assigning the receipts.

Aggregates Levy and Air Passenger Duty

508. The Committee is content with the proposals and the current drafting of the clauses relating to the devolution of Air Passenger Duty and the Aggregates Levy. In due course, the Scottish Government should set out its policy plans for both of these newly devolved powers.

Fiscal framework, institutional arrangements and 'no detriment'

509. **The Committee recommends that greater clarity is required with regard to how 'no detriment' will operate in practice with particular regard to the timescale and range of policy effects which will be considered as constituting no detriment.** Accordingly, the Committee calls on both the Scottish and UK Government to detail their understanding of the principle of no detriment. The Committee also calls on both Governments to detail how they consider a shared understanding of the evidence, with regard to the calculation of no detriment, will be obtained.

510. It will also be important for the two governments to have a shared understanding of the figures and calculations for tax matters, and **we recommend that both governments enter into an agreement to establish a common database of tax information.** This will assist with the process of dispute resolution. **In addition, the Committee recommends that independent scrutiny of these matters, by the Scottish Fiscal Commission, will be an essential component of the scrutiny landscape if these proposals are to be implemented effectively.**

511. As yet, we are not able to conclude that we are content with the fiscal framework and no detriment arrangements as these details are currently being discussed between the two governments. For the Committee, both the process of these negotiations and the outcome requires proper parliamentary scrutiny. **We recommend both governments reach an urgent agreement on just how this will be achieved and for the Scottish Government to report to the Committee on what arrangements it proposes to put in place for parliamentary oversight.**

512. **In any case, the Committee concludes that any final detail of the fiscal framework and the other matters we have considered is provided to the Scottish Parliament before the question of legislative consent to any new bill is considered in the early months of 2016.**

513. Given the importance of the fiscal framework and intergovernmental working more generally, the Committee gives notice that it intends to continue to develop ideas and recommendations in this area in advance of, and then alongside, scrutiny of

any bill introduced by the new UK Government after the UK General Election. We will liaise closely with other parliamentary committees on this matter

Borrowing

514. **The Committee is content with the agreement entered into by all parties to the Smith Commission that the current borrowing powers of the Scottish Parliament are too restrictive and too limited. Furthermore, we are supportive of a move towards a prudential regime which gives the Scottish Government more flexibility - within an overall framework that is governed by sound principles of affordability and sustainability - to borrow both for short-term revenue requirements as well as longer-term capital investment purposes.**
515. We note the comments made to us that cash setting limits on the amount of borrowing that can be undertaken, especially for capital investment, is not necessarily consistent with the prudential regime specified by the Smith Commission or the most sensible way to proceed. One of the measures for assessing affordability, under a prudential regime, the Committee suggests would be the performance of the economy based on indicators such as cyclically-adjusted GDP.
516. **We recommend that a future Scottish Government should be able to retain underspends so as to better manage volatility.**
517. The current draft legislative clauses are silent on how a new borrowing regime will operate. This means that, at this stage, we are not able to conclude either way as to whether the agreements entered into as part of the Smith Commission have been delivered or could be improved. **We recommend that this area in particular is a high priority for both governments to develop and for both to report to the Scottish Parliament and its committees in the coming months so that we can adequately scrutinise plans for more borrowing powers before any future bill is passed.**

Welfare

General

518. The purpose of our report has been to provide a constructive commentary to the new UK Government on the draft clauses as they relate to the Smith Commission recommendations. However, **the Committee has concerns with a number of the welfare provisions and considers that the relevant clauses do not yet meet the spirit and substance of the Smith Commission's recommendations and potentially pose challenges in any attempt to implement them.** Central to the effective delivery of the welfare clauses will be ensuring that key stakeholders in the delivery of welfare are fully involved in shaping the welfare provisions and their delivery.

519. The Committee believes that the welfare provisions will impact upon some of the most vulnerable and disadvantaged individuals in Scottish society. It is imperative therefore that the welfare clauses meet the expectations of Scottish society, provide genuine policy discretion to the Scottish Government as envisaged by the cross-party agreement within the Smith Commission, and are capable of being implemented efficiently and in a way that ensures any new benefits or discretionary payments introduced in Scotland by either government provide additional income for a recipient and do not result in an automatic offsetting reduction in their entitlement to other benefits, discretionary payments, tax credits or allowances.
520. Accordingly, **the Committee recommends that the new UK Government further engages in the development of legislation in this area in co-operation with stakeholders in Scotland on the welfare clauses in any Scotland Bill.** This should include securing the agreement of the Scottish Government and stakeholders that the welfare clauses do meet the spirit and substance of the Smith Commission recommendations. In addition, the process via which it will be ensured that the introduction of any new benefits or discretionary payments by a future Scottish Government should provide additional income to a recipient without any offsetting reduction in reserved entitlements should be made clear and have been agreed to by stakeholders and the Scottish Government.
521. **The Committee also calls on the UK Government to consider the issues raised in this report both with regard to the scope of the clauses as currently drafted and issues with regard to implementation before drafting legislation in this area.**

New and top-up benefits

522. **The Committee reaffirms the agreement in the Smith Commission report that the Scottish Parliament should have the power to create new benefits in areas of devolved responsibility and also new powers to make discretionary payments in any area of welfare without the need to obtain prior permission from the DWP, whilst recognising that there will be a need for the Scottish Government to provide the DWP with early notification of its intentions because of the potential for overlap with the administrative responsibilities of the UK Government in welfare matters.** The Committee notes the view that the approach taken of creating exceptions to existing benefits limits the scope of policy discretion which would be available to a future Scottish Government to create new benefits or to top-up benefits. **The Committee recommends that the UK Government re-consider the draft clauses designed to devolve the creation of new benefits and enable the top-up of reserved benefits in order to ensure that the relevant sections of any future Bill meet the spirit and substance of the Smith Commission thereby ensuring that the Scottish Government would have genuine policy discretion in this area.**

Carers

523. **The Committee is concerned that the current definition of carer in the draft clauses appears overly restrictive and could limit the policy discretion of future Scottish administrations in this area. The Committee recommends that the clause should be re-drafted to ensure that the future Scottish administrations are able to define what constitutes a carer.**
524. The Committee also recognises that the fiscal framework is currently the subject of discussion between the Scottish and UK Government. The Committee considers that the issue of 'no detriment' as it applies to individuals, particularly those in receipt of benefits, should be a crucial component of these discussions. **The Committee seeks clarity on the procedures through which the commitment in paragraph 55 of the Smith report will be honoured to ensure that any new benefits or discretionary payments introduced by the Scottish Parliament will provide additional income for recipients and not be offset by reductions in entitlements to benefits, tax credits or tax relief provided by the UK Government.**

Definitions of disability

525. **The Committee is concerned that the definition of disability contained in draft clause 16 is overly restrictive and would not provide a future Scottish Government with the power to develop its own approach to disability benefits in the future. Accordingly, the Committee recommends that the definition of disability used in the Equality Act 2010 is also used in draft clause 16.**
526. The Committee welcomes the assurances from the DWP that both definitions of disability used in the draft clauses would apply to people with terminal cancer, MS or other fluctuating conditions, or who are terminally ill.

Universal Credit – a shared power

527. The Committee recognises that the effective operation of inter-governmental relations will be critical to the successful operation of the devolved aspects of Universal Credit. The Committee welcomes the recent establishment of the Joint Ministerial Working Group on Welfare and expects this forum to become an effective means of dealing with relations between the UK and Scottish governments in this sphere. The Committee expects to be kept fully informed on discussions between governments on the arrangements being developed for inter-governmental relations with regard to Universal Credit and welfare issues in general. The Committee noted the commitment of both the Scottish and UK governments to provide detailed minutes of the Joint Exchequer Committee to the Scottish Parliament Finance Committee and the Scottish Affairs Committee. We would encourage the Joint Ministerial Working Group on Welfare to follow this example, by providing detailed minutes of its meetings to appropriate committees in the Scottish and Westminster Parliaments.

528. **The Committee recommends that the principles which will govern the operation of inter-governmental relations with regard to welfare should be placed in any future Bill devolving power in this area. Moreover, the Committee expects that this will include the principles via which Parliaments can maintain scrutiny and oversight of the inter-governmental machinery with regard to welfare.**

Universal credit – policy flexibility

529. The Committee considers that the policy autonomy of a future Scottish Government with regard to its devolved welfare responsibilities should not be constrained as a consequence of process issues relating to the boundary between devolved and reserved systems and processes.
530. **The Committee therefore recommends that Joint Ministerial Working Group on Welfare considers as a matter of urgency the extent to which the policy autonomy of a future Scottish Government may be undermined as a consequence of being reliant on systems which have been designed by DWP and how any such barriers of this kind can be overcome.** Such an understanding should form a key understanding or principle governing inter-governmental relations in this sphere.

Universal Credit – ‘veto’ power?

531. **The Committee concludes that there is a case to be made that draft clauses 20 (4) and 21 (3) could be considered or perceived as a veto. The Committee considers that this is an issue which requires resolution through the Joint Ministerial Working Group on Welfare.** In effect, this issue provides an early test of the effectiveness of inter-governmental relations. The Committee expects this issue to have been resolved to the satisfaction of both the Scottish and UK Governments before any future legislation is introduced. During this process, the Committee would expect the Scottish Government to report to Parliament and its committees on the progress of discussion and specifically before any final agreement is reached.

Under Occupancy Charge/‘Bedroom Tax’ and Discretionary Housing Payments

532. The Committee seeks clarity on the issues which have been raised with regard to the inter-play between the power to remove the under-occupancy charge and discretionary housing payments. The Committee considers that it is essential that the application of these clauses should not have the effect of causing detriment to individuals in receipt of discretionary housing payments.

Winter Fuel Payments

533. The Committee considers that it is imperative that any future Bill is drafted to ensure that both winter fuel payments and cold weather payments are devolved, and agreement is reached on adopting a system of payments which better reflects the climate conditions in different parts of Scotland. **The Committee seeks an**

assurance from the UK Government that if the current draft clause excludes the devolution of winter fuel payments then any future Bill is drafted to ensure that such payments are devolved.

Scottish Welfare Fund

534. **The Committee seeks clarification from the UK Government that access to the Scottish Welfare Fund will not be restricted as a consequence of the draft clause provisions in relation to discretionary payments.**

Employment Programmes

535. **The Committee considers that the clauses as currently drafted do not fully implement the Smith Commission recommendations. The Committee considers that the Smith Commission intended that all employment programmes currently contracted by DWP should be devolved. Therefore, the Committee recommends that any future Bill should not place any restriction on the type of person receiving support or in regard to the length of unemployment any person has experienced. The Committee considers that this should include the devolution of the Access to Work Programme.**

536. The Committee recognises that the effective operation of inter-governmental relations will be critical to the successful operation of the devolved aspects of employment support. The Committee welcomes that this is recognised in the then UK Government Command Paper and also welcomes the recent establishment of the Joint Ministerial Working Group on welfare and expects this forum to become an effective means of dealing with relations between governments in this sphere. The Committee expects to be kept fully informed on discussions between governments on the arrangements being developed for inter-governmental relations with regard to employment support and welfare issues in general.

537. **The Committee recommends that the principles which will govern the operation of inter-governmental relations with regard to welfare, including employment support, should be placed in any future Bill devolving power in this area.** Moreover, the Committee expects that this will include the principles via which Parliaments can maintain scrutiny and oversight of the inter-governmental machinery with regard to welfare and employment support.

Intergovernmental Relations in Welfare

538. The Committee considers that the operation of inter-governmental relations will be central to the effective implementation of many of the Smith Commission recommendations. However, the operation of inter-governmental relations will be critical within the area of welfare policy. The Committee therefore welcomes the recent establishment and meetings of the Joint Ministerial Working Group on Welfare.

539. The Committee recognises that for inter-governmental relations to operate effectively that there must be space for the discussions between governments to

take place in confidence and **the Committee recommends that any future Bill should place the general principles underpinning the operation of inter-governmental relations on welfare in statute. The Committee also considers that the general principles underpinning the structures which will be put in place for dispute resolution should also be placed in statute.** Such a Bill should also include the general principles which will enable Parliamentary scrutiny of this process to take place. **The Committee considers that the detail of the process for conducting inter-governmental relations should then be placed in a Memorandum of Understanding agreed between the governments.**

During this process, the Committee expects the Scottish Government to report to the Parliament and its committees on the progress of discussion and specifically before any final agreement is reached.

The Crown Estate

540. The Committee agrees that the particular legislative approach adopted to devolve the management and revenues of The Crown Estate could be construed as overly complicated unless there is full transparency and full consultation with the Scottish Parliament and Government during the process. The Committee believes that there is merit in considering an approach based on that set out by Professor McHarg and others. **The Committee recommends that the UK Government considers revising its drafting approach regarding the provisions relating to The Crown Estate.**
541. **Furthermore, if a transfer scheme of this type is to be adopted, then the Committee recommends that the UK Government replaces the word “may” in draft clause 23 with “shall”.**
542. The Committee believes that it is right and proper that the corporate entity that exists to manage the non-devolved assets of The Crown Estate in the rest of the UK should be free to decide its own activities. However, the Smith Agreement was very clear that the management and revenue of The Crown Estates economic assets held in Scotland should be devolved. The then UK Government’s proposals may result in the creation of ‘two Crown Estates’. We believe this is not consistent with the Smith Agreement. **The Committee therefore has serious concerns regarding the situation in Scotland post-devolution and the competition and confusion that may arise from the creation of ‘two Crown Estates’.**
543. The Committee would wish to see absolute clarity on this matter from the UK Government and HM Treasury in particular (as The Crown Estates’ sponsoring department) and **we recommend that, at the very least, there should be an obligation placed on the non-devolved Crown Estate to consider the option of shared investments with the devolved Crown Estate in Scotland with a fair allocation of revenues.**
544. The Committee notes the former UK Government’s intention to exclude Fort Kinnaird from devolution. **The Committee sees no need for this proposal and**

- calls on The Crown Estate and HM Treasury to find a means of ensuring that a full share of the Crown Estate's revenues from Fort Kinnaird accrue to Scotland.** Furthermore, the Committee is concerned that the investment vehicle used in the example of Fort Kinnaird could be repeated as a means of avoiding the devolution of future investments in the intervening period between the passing of any bill and the transfer of assets.
545. **We seek clarity on the longer-term operation of the policy and financial position of the Crown Estate on this issue. The Committee believes that Scotland should receive its fair share from any such investment vehicles operating within Scotland in the future.**
546. The Committee is reassured by the clarification provided by the Scotland Office on the issue of economic rights and assets out to 12 and 200 nautical miles. However, when any bill is introduced, we believe that it will be important to be clear about the definition of any zone referred to in the legislation to avoid the potential for confusion.
547. **Once the powers over the Crown Estate have been transferred, the Committee recommends the early implementation of the Smith Commission recommendation that “responsibility of the management of the Crown Estate assets in Scotland should be devolved further to local authorities such as Orkney, Shetland, Na h-Eilean Siar or other areas who seek such responsibilities”.** These are matters where discussions should, in our view, continue to progress as a matter of urgency and we endorse the work of the Scottish Government and the *Our Islands, Our Future* initiative to reach an amicable agreement that suits local circumstances.
548. The Committee believes that there is scope in some communities for further devolution of the management of certain economic assets to, or at least partnership working with, others in these areas such as harbour and port authorities, local marine interests and experts etc.
549. We recommend that the Scottish Government keeps this and other committees in the Parliament up-to-date with the discussions with local authorities and others as they continue, and report to the Scottish Parliament for endorsement before agreement on any proposals for further devolution is reached.
550. The Committee recognises that The Crown Estate has made itself available to report to Parliamentary committees on an annual basis (and has done three or four times) and that **this Committee recommends that the Scottish Parliament would expect such regular scrutiny to continue.**
551. The Committee notes the then UK Government's intention that the Scottish and UK Governments will draw up an Memorandum of Understanding, including further detail on the legal protections for defence or national security as well as providing that the transfer of management responsibility for the Crown Estate is not detrimental to UK-wide critical national infrastructure in relation to matters

such as oil and gas, telecommunications and energy, thereby safeguarding the importance of the Crown Estate's foreshore and seabed assets to the UK as a whole. This Committee expects the Scottish Parliament to be consulted during the process of drawing up the MoU.

552. Finally, the Committee welcomes the comments from the Crown Estate Commissioner for Scotland that discussions are already underway with staff on the implications to them. This Committee expects the recommendations in the Smith Commission report to be fully implemented, such as the commitment to the protection of the employment rights of those Crown Estate staff who are connected with the management of the Scottish assets.

Other provisions in the draft legislative clauses or additional issues cited in the Smith Commission's report

Payday loan shops

553. **The initial view of the Committee is that the current provisions for payday loan shops could go further and consideration could be given to including powers over licensing and regulation not just planning.**

Fixed-Odds Betting Terminals

554. At this stage, the Committee questions whether the draft clause, as currently written, gives any meaningful effect to the Smith Commission proposals in this area. The draft clause would only provide the power to restrict the number of Fixed-Odds Betting Terminals where a new betting premise licence is being sought. **The Committee has some sympathy with the Law Society of Scotland submission that the clauses should be amended to include the ability to limit the number of gaming machines in both existing and new betting premises.**

Tribunals

555. The Committee welcomes the transfer of powers for tribunals to the Scottish Parliament but notes the views of the Law Society of Scotland about the drafting of the relevant clause and potential limitations. **The Committee seeks assurances from the UK Government on these matters before a new bill is introduced after the UK General Election.**

The BBC and the agreement to a Memorandum of Understanding

556. In its Command Paper, the former UK Government stated that there will be an Memorandum of Understanding (MoU) entered into by the UK Government, Scottish Government, Scottish Parliament and the BBC, to set out commitments that guarantee a full consultative role for the Scottish Government and Scottish Parliament in the review of the Royal Charter and the on-going scrutiny of the BBC.

557. It could be expected that the discussions on the MoU would need to be completed before work on reviewing the BBC's Royal Charter begins in the summer of 2015. The Committee, therefore, gives notice that it intends to take a role in considering the draft MoU and report to Parliament in due course.

Food labelling and seafood/red meat levies

558. In any reforms to these schemes, the Committee believes it will be important that Scotland has the ability to introduce an EU recognised 'Made in Scotland' label and also that Scotland is able to decide at any stage whether to opt into UK arrangements on seafood/red meat levies and, if so, receives an equitable share of any UK monies levied.

Elections, the workings of the Scottish Parliament etc.

559. The Committee has not taken detailed evidence on these matters at this stage. The Committee intends to return to these issues following introduction of any bill after the UK General Election. The Committee expects the commitments in the Smith Agreement to be translated into legislation by the new UK Government.

Telecommunications, postal services, energy, transport, health and social affairs and consumer protection

560. The Committee has not taken detailed evidence on these matters at this stage. The Committee intends to return to these issues following introduction of any bill after the UK General Election

Post-Study Work Visas & Victims of trafficking

561. The Committee reinforces the recommendation of the Smith Commission on these issues and believes that this important issue should be addressed through discussion between the two governments in advance of the introduction of any new bill after the UK General Election.

Asylum seekers; fines, forfeitures and fixed penalties imposed by courts and tribunals; and the functions of the Health and Safety Executive

562. The Committee reaffirms the view of the Smith Commission that these issues need to be the subject of discussion between the two governments.

Inter-governmental Relations

563. The Committee concludes that ensuring that the Scottish and UK Parliaments, and other devolved assemblies, can effectively scrutinise inter-governmental relations represents a significant challenge posed by the Smith Commission for these legislatures.

564. The Committee recognises that, in part, it is a challenge to which the Scottish Parliament must respond. To this end the Committee signals its intention to undertake further work in this area in the period before the summer recess of

2015, and on the issue of inter-governmental relations more generally, during the passage of any bill that may be introduced after the UK General Election. This will include not just the machinery of inter-governmental relations but also how the Scottish Parliament can assess the Scottish Government's performance in delivering new powers.

565. As previously noted in relation to welfare (paragraph 339), the Committee recognises that for inter-governmental relations to operate effectively that there must be space for discussions between governments to take place in confidence. However, **the Committee recommends that any future Bill should place the general principles underpinning the operation of inter-governmental relations in statute. The Committee also considers that the general principles underpinning the structures which will be put in place for dispute resolution should also be placed in statute.** Such a Bill should also include the general principles which will enable Parliamentary scrutiny of this process to take place. **The Committee considers that the detail of the process for conducting inter-governmental relations should then be placed in a Memorandum of Understanding agreed between the governments.** During this process, the Committee expects the Scottish Government to report to the Parliament and its committees on the progress of discussion and specifically before any final agreement is reached.
566. **The Committee agrees with the Smith Commission that the largely non-statutory machinery governing inter-governmental relations needs reform. In our view, it is not fit for purpose and will be unable to cope with requirements arising from the Smith Commission's recommendations.**
567. The Committee considers that establishing a statutory and institutional structure for a scaled up approach to inter-governmental relations represents the most significant challenge to be addressed in implementing the Smith Commission recommendations.
568. The Committee considers that these issues will be most acute in relation to the policy areas of European Union representation, taxation, welfare and employment support.
569. The shift from a devolution settlement based on a system of largely separate powers to one of shared powers, which is recommended by the Smith Commission, represents a fundamental shift in the structure of devolution settlement. The Committee agrees with the view that this will require both bi-lateral structures to be established between the UK and Scottish Governments as well as multi-lateral structures between the UK Governments and the devolved administrations.
570. The Committee has considered the issue of inter-governmental relations with regard to the taxation and welfare proposals earlier in this report. As a consequence of the importance of the new arrangements for the inter-governmental structures, **we recommend that these are subject to**

parliamentary scrutiny before any legislation in this area can be passed. This will include the detail of a new fiscal framework and the principles which will govern the operation of welfare, including the operation of 'no detriment', and for dealing with Scottish Government representation with regard to EU issues. **The Committee recommends that the general principles which will govern the operation of inter-governmental relations should be placed in any future Bill devolving power in this area.**

¹ The Edinburgh Agreement. Available at:

<http://www.gov.scot/About/Government/concordats/Referendum-on-independence>

² Scottish Independence Referendum results. Available at: <http://scotlandreferendum.info/>

³ The Smith Commission Report. Available at: <https://www.smith-commission.scot/smith-commission-report/>

⁴ UK Government, Command Paper, *Scotland in the United Kingdom: An enduring settlement*. Available at: <https://www.gov.uk/government/publications/scotland-in-the-united-kingdom-an-enduring-settlement>

⁵ Sewel Convention. Available at: <http://www.parliament.uk/site-information/glossary/sewel-convention/>

⁶ Scottish Parliament Devolution (Further Powers) Committee. *Official Report*, 15 January 2015, Col. 4.

⁷ Scottish Parliament Devolution (Further Powers) Committee. *Official Report*, 15 January 2015, Col. 37.

⁸ Smith Commission. *Report of the Smith Commission for further devolution of powers to the Scottish Parliament*, para. 21.

⁹ UK Government. *Scotland in the United Kingdom: An enduring settlement*, p.92.

¹⁰ Scottish Parliament Devolution (Further Powers) Committee. *Official Report*, 2 December 2014, Col. 23.

¹¹ Scottish Parliament Devolution (Further Powers) Committee. *Official Report*, 2 December 2014, Col. 23.

¹² Scottish Parliament Devolution (Further Powers) Committee. *Official Report*, 2 December 2014, Col. 23,

¹³ Scottish Parliament Devolution (Further Powers) Committee. *Official Report*, 4 December 2014, Col. 3.

¹⁴ Law Society of Scotland. Written evidence submitted to the Committee.

¹⁵ Dr Hepburn and Professor Douglas-Scott. Written evidence submitted to the Committee.

¹⁶ Dr Hepburn and Professor Douglas-Scott. Written evidence submitted to the Committee.

¹⁷ Scottish Parliament, Devolution (Further Powers) Committee, *Official Report*, 12 March 2015, Col 34.

¹⁸ Letter from the Scottish Government to the Committee, 25 March 2015. Available at:

http://www.scottish.parliament.uk/S4_ScotlandBillCommittee/General%20Documents/2015.03.24_Letter_from_the_DFM_to_the_Convener.pdf

¹⁹ Letter from the Scotland Office to the Committee, 23 March 2015. Available at:

http://www.scottish.parliament.uk/S4_ScotlandBillCommittee/General%20Documents/2015.03.23_Letter_from_SOS_to_Convener.pdf

²⁰ Ibid, Col. 3.

²¹ House of Lords, *Hansard*, 21 July 1998, Col. 791.

<http://hansard.millbanksystems.com/lords/1998/jul/21/scotland-bill>

²² See Devolution Guidance Note 10: Post Devolution Primary Legislation affecting Scotland:

<http://www.gov.scot/Resource/Doc/37349/0066833.pdf>

²³ Smith Commission. *Report of the Smith Commission for further devolution of powers to the Scottish Parliament*, para. 22.

²⁴ Law Society of Scotland. Written evidence submitted to the Committee, p.5.

²⁵ Law Society of Scotland. Written evidence submitted to the Committee p.6.

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- ²⁶ Law Society of Scotland. Written evidence submitted to the Committee, p.5.
- ²⁷ Professor Alan Page. Written evidence submitted to the Committee, footnote 22.
- ²⁸ Royal Society of Edinburgh / British Academy. Written evidence submitted to the Committee, p.5
http://www.scottish.parliament.uk/S4_ScotlandBillCommittee/General%20Documents/The_Royal_Society_of_Edinburgh.pdf
- ²⁹ Scottish Parliament, Devolution (Further Powers) Committee, *Official Report*, 12 March 2015, Col 35.
- ³⁰ Letter to the Committee from the Secretary of State for Scotland, 29 March 2015. Available at
[http://www.scottish.parliament.uk/S4_ScotlandBillCommittee/General%20Documents/2015.03.29_Letter_from_SOS_to_Convener\(1\).pdf](http://www.scottish.parliament.uk/S4_ScotlandBillCommittee/General%20Documents/2015.03.29_Letter_from_SOS_to_Convener(1).pdf)
- ³¹ Smith Commission. *Report of the Smith Commission for further devolution of powers to the Scottish Parliament*, para. 60.
- ³² UK Government. *Scotland in the United Kingdom: An enduring settlement*, p.65-66.
- ³³ Coalition for Racial Equality and Rights. Written evidence submitted to the Committee.
- ³⁴ Equality Act 2010, Part One, Section 1(1).
<http://www.legislation.gov.uk/ukpga/2010/15/part/1>
- ³⁵ BEMIS. Written evidence submitted to the Committee, p.3.
- ³⁶ Letter from the Scottish Government to the Committee, 25 March 2015. Available at:
http://www.scottish.parliament.uk/S4_ScotlandBillCommittee/General%20Documents/2015.03.24_Letter_from_the_DFM_to_the_Convener.pdf
- ³⁷ Scottish Parliament, Devolution (Further Powers) Committee, *Official Report*, 12 March 2015, Col 38.
- ³⁸ Letter from the Scottish Government to the Committee, 25 March 2015. Available at:
http://www.scottish.parliament.uk/S4_ScotlandBillCommittee/General%20Documents/2015.03.24_Letter_from_the_DFM_to_the_Convener.pdf
- ³⁹ Scottish Parliament, Devolution (Further Powers) Committee, *Official Report*, 22 January 2015, Col 4.
- ⁴⁰ Scottish Parliament, Devolution (Further Powers) Committee, *Official Report*, 22 January 2015, Col 3.
- ⁴¹ Scottish Parliament, Devolution (Further Powers) Committee, *Official Report*, 22 January 2015, Col 11.
- ⁴² Scottish Parliament, Devolution (Further Powers) Committee, *Official Report*, 15 January 2015, Col 5.
- ⁴³ Scottish Parliament, Devolution (Further Powers) Committee, *Official Report*, 5 February 2015, Col 28.
- ⁴⁴ Professor Andrew Hughes Hallett. Written submission to the Committee.
- ⁴⁵ Scottish Parliament, Devolution (Further Powers) Committee, *Official Report*, 11 December 2015, Col 3.
- ⁴⁶ Scottish Parliament, Devolution (Further Powers) Committee, *Official Report*, 22 January 2015, Col 20.
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Annexe A – a summary guide to the Committee’s views on the draft legislative clauses compared to the Smith Agreement

Permanency of the Scottish Parliament	Red
The Sewel Convention and the legislative consent of the Scottish Parliament	Red
Equal opportunities	Yellow
Income Tax	Yellow
Assignment of a share of VAT	Yellow
Air Passenger Duty	Green
Aggregates levy	Green
Fiscal framework, no detriment etc.	Yellow
Borrowing	Yellow
Welfare and Benefits	Red
The Crown Estate	Red
Intergovernmental Relations and Parliamentary Oversight	Yellow
Other provisions and issues	Yellow

Key

Red	Amendments required to the draft legislative clause(s)
Yellow	Clarification required on the draft legislative clause(s) or some amendment needed, or further information required on how these provisions will operate
Green	No significant issues raised in the evidence received to date on the Smith Commission’s recommendations or the draft clauses

Annexe B

Extract from the minutes of the meetings of the Committee and links to the Official Reports

4th Meeting, 2014 (Session 4), Tuesday 2 December 2014

Present:

Bruce Crawford (Convener)

Rob Gibson

Annabel Goldie

Alison Johnstone

Bill Kidd (Committee Substitute)

Lewis Macdonald (Deputy Convener)

Mark McDonald

Stuart McMillan

Drew Smith

Also present: Patrick Harvie

Apologies were received from Linda Fabiani, Stewart Maxwell, Tavish Scott.

The meeting opened at 9.00 am.

1. Declaration of interests: Alison Johnstone and Mark McDonald had no relevant interests to declare.

2. The Smith Commission: The Committee took evidence from—

Lord Smith of Kelvin, Chair, and Jenny Bates, Head of Secretariat, The Smith Commission.

The meeting closed at 10.09 am

Official Report:

<http://www.scottish.parliament.uk/parliamentarybusiness/28862.aspx?r=9663#.VH3ORdJSiz4>

5th Meeting, 2014 (Session 4), Thursday 4 December 2014

Present:

Bruce Crawford (Convener)
Linda Fabiani
Rob Gibson
Alex Johnstone
Alison Johnstone
Bill Kidd (Committee Substitute)
Lewis Macdonald (Deputy Convener)
Mark McDonald
Stuart McMillan
Tavish Scott
Drew Smith

The meeting opened at 9.01 am.

1. Declaration of interests: Alex Johnstone declared that he had no relevant interests.

2. The Smith Commission: The Committee took evidence from—

Rt. Hon Alistair Carmichael, Secretary of State for Scotland, and Chris Platt, Principal Private Secretary, Scotland Office;

and then from—

John Swinney, Deputy First Minister & Cabinet Secretary for Finance, Constitution and Economy, Gerald Byrne, Elections and Constitution Division, and Sean Neill, Fiscal Responsibility Division, Scottish Government.

The meeting closed at 11.29 am.

Official Report:

<http://www.scottish.parliament.uk/parliamentarybusiness/28862.aspx?r=9674>

Supplementary Written Evidence

 [The Scotland Office](#)

 [The Scottish Government](#)

6th Meeting, 2014 (Session 4), Thursday 11 December 2014

Present:

Bruce Crawford (Convener)
Linda Fabiani
Rob Gibson
Alex Johnstone
Alison Johnstone
Bill Kidd (Committee Substitute)
Lewis Macdonald (Deputy Convener)
Mark McDonald
Stuart McMillan
Tavish Scott
Drew Smith

The meeting opened at 10.00 am.

1. The Smith Commission: The Committee took evidence from—






Professor David Bell, Professor of Economics, University of Stirling;
Professor David Heald, Professor of Accountancy, University of Aberdeen
Business School;
Professor Nicola McEwen, Associate Director, ESRC Centre on Constitutional
Change;
Professor Charlie Jeffery, Professor of Politics, University of Edinburgh;
Professor Michael Keating, Professor of Politics, University of Aberdeen.

The meeting closed at 11.35 am.

Official Report:

<http://www.scottish.parliament.uk/parliamentarybusiness/28862.aspx?r=9688>

Written evidence

-  [Professor David Heald](#)
-  [Professor Charlie Jeffrey](#)
-  [Professor Michael Keating](#)
-  [Professor Nicola McEwen](#)
-  [Professor David Bell](#)

2nd Meeting, 2015 (Session 4), Thursday 15 January 2015

Present

Bruce Crawford (Convener)

Linda Fabiani

Rob Gibson

Alex Johnstone

Alison Johnstone

Lewis Macdonald (Deputy Convener)

Stewart Maxwell

Mark McDonald

Stuart McMillan

Duncan McNeil

Tavish Scott

The meeting opened at 9.31 am.

1. Declaration of interests: Duncan McNeil declared that he had no relevant interests beyond those declared in the Register of Interests.

2. Choice of Deputy Convener: The Committee chose Duncan McNeil as its new Deputy Convener.

3. Evidence from civic Scotland organisations on the Smith Agreement. The Committee took evidence from—

Peter Kelly, Director, Poverty Alliance;

Dave Moxham, Deputy General Secretary, Scottish Trades Union Congress;

Lucy McTernan, Deputy Chief Executive, Scottish Council for Voluntary Organisations;

Satwat Rehman, Director, One Parent Families Scotland;

Bill Scott, Director of Policy, Inclusion Scotland;

Mary Taylor, Chief Executive, Scottish Federation of Housing Associations

All the witnesses were invited to send any additional written evidence they wished. It was further agreed that the Convener and the Deputy Convener would meet with the witnesses listed above (if available) to discuss how civil society and the general public can engage with the Committee as it continues its work looking at draft clauses and any subsequent bill to devolve further powers to the Scottish Parliament

The meeting closed at 11.29 am







Devolution (Further Powers) Committee

New Powers for Scotland: An Interim Report on the Smith Commission and the UK Government's Proposals, 3rd Report, Session 4 (2015)

Official Report:

<http://www.scottish.parliament.uk/parliamentarybusiness/28862.aspx?r=9729>

Written Evidence

-  [Poverty Alliance](#)
-  [STUC](#)
-  [SCVO](#)
-  [One Parent Families Scotland](#)
-  [Inclusion Scotland](#)
-  [SFHA](#)

3rd Meeting, 2015 (Session 4), Thursday 22 January 2015

Present

Bruce Crawford (Convener)

Linda Fabiani

Rob Gibson

Alex Johnstone

Lewis Macdonald

Stewart Maxwell

Mark McDonald

Stuart McMillan

Duncan McNeil (Deputy Convener)

Tavish Scott

Apologies were received from Alison Johnstone.

The meeting opened at 9.31 am.

1. Evidence from Scottish business organisations on the Smith Agreement. The Committee took evidence from—

David Watt, Executive Director, Institute of Directors;

Ross Martin, Chief Executive, Scottish Council for Development and Industry;

Alan Watt, Chief Executive, Civil Engineering Contractors Association;


Stuart Patrick, Chief Executive, Glasgow Chamber of Commerce.

The meeting closed at 11.30 am.

Official Report:

<http://www.scottish.parliament.uk/parliamentarybusiness/28862.aspx?r=9746>

Written Evidence

 [Institute of Directors](#)

 [SCDI](#)

 [CECA Scotland](#)

 [Glasgow Chamber of Commerce](#)

4th Meeting, 2015 (Session 4), Thursday 5 February 2015

Present:

Bruce Crawford (Convener)
Linda Fabiani
Alex Johnstone
Alison Johnstone
Bill Kidd (Committee Substitute)
Stewart Maxwell
Mark McDonald
Stuart McMillan
Duncan McNeil (Deputy Convener)

Apologies were received from Rob Gibson, Lewis Macdonald and Tavish Scott.

The meeting opened at 9.01 am.

1. Decision on taking business in private: The Committee agreed to take item 3 in private.

2. Evidence on Taxation clauses: The Committee took evidence from—

Charlotte Barbour, Head of Taxation (Private Clients & Small Businesses), ICAS;
Professor Anton Muscatelli, Principal, University of Glasgow;
Gwyneth Scholefield, Director, and Steve Couch, Partner,
PricewaterhouseCoopers.

3. Choice of Adviser (in private): The Committee considered a list of candidates for the posts of adviser and selected its preferred nominees.

The meeting closed at 10.56 am.

Official Report:

<http://www.scottish.parliament.uk/parliamentarybusiness/28862.aspx?r=9775>

Written Evidence

 [PricewaterhouseCoopers](#)

5th Meeting, 2015 (Session 4), Thursday 19 February 2015

Present:

Bruce Crawford (Convener)

Linda Fabiani

Rob Gibson

Alex Johnstone

Alison Johnstone

Lewis Macdonald

Stewart Maxwell

Mark McDonald

Stuart McMillan

Duncan McNeil (Deputy Convener)

Tavish Scott

In attendance: Professor Nicola McEwen, Committee Adviser

The meeting opened at 9.02 am.

1. Decision on taking business in private: The Committee agreed to take item 3 in private and that all future agenda items on reviews of evidence would be heard in private.

2. Evidence on Welfare Clauses: The Committee took evidence from—

John Dickie, Director, Child Poverty Action Group;

Richard Gass, Member of the Policy and Standards Committee, Rights Advice Scotland;

Paul Spicker, Professor of Public Policy, Robert Gordon University;

David Ogilvie, Head of Policy and Public Affairs, Chartered Institute of Housing;

Jim McCormick, Expert Adviser (Scotland), Social Security Advisory Committee.

3. Evidence on Welfare Clauses (in private): The Committee considered evidence heard during the meeting.


The meeting closed at 11.25 am.

Official Report:


<http://www.scottish.parliament.uk/parliamentarybusiness/28862.aspx?r=9786>

Written Evidence

 [CPAG](#)

 [Paul Spicker](#)

 [Chartered Institute of Housing](#)

 [Rights Advice Scotland](#)

6th Meeting, 2015 (Session 4), Thursday 26 February 2015

Present:

Bruce Crawford (Convener)
Linda Fabiani
Rob Gibson
Alex Johnstone
Alison Johnstone
Bill Kidd (Committee Substitute)
Lewis Macdonald
Mark McDonald
Stuart McMillan
Duncan McNeil (Deputy Convener)

Apologies were received from Stewart Maxwell, Tavish Scott.

In attendance: Heidi Poon, Committee Adviser

The meeting opened at 9.01 am.

4. Evidence on Borrowing Powers: The Committee took evidence from—

Professor David Bell, Professor of Economics, University of Stirling;
Don Peebles, Head of CIPFA Scotland;
Philip Milburn, Investment Manager, Kames Capital and the Investment
Association.

5. Review of evidence (in private): The Committee reviewed the evidence
taken on borrowing powers at today's meeting.

The meeting closed at 11.21 am.

Official Report:

<http://www.scottish.parliament.uk/parliamentarybusiness/28862.aspx?r=9803>

Written Evidence

-  [David Bell](#)
-  [CIPFA](#)
-  [Investment Association](#)

7th Meeting, 2015 (Session 4), Thursday 5 March 2015

Present:

Bruce Crawford (Convener)

Linda Fabiani

Rob Gibson

Alex Johnstone

Alison Johnstone

Lewis Macdonald

Stewart Maxwell

Mark McDonald

Stuart McMillan

Duncan McNeil (Deputy Convener)

Tavish Scott

The meeting opened at 9.01 am.

2. Evidence on the Crown Estate provisions The Committee took evidence from—

Andy Wightman, Independent Writer and Researcher on Land Rights;

Dan Finch, Chief Executive, Moray Offshore Renewables;

Walter Speirs, Director, Muckairn Mussels Ltd and former Director at Scottish Aquaculture Innovation Centre;

Angus Campbell, Leader, Comhairle nan Eilean Siar;

Steve Barron, Chief Executive, Highland Council;

and then from—

Gareth Baird, Scottish Commissioner, Vivienne King, Director of Business Operations and General Counsel, Ronnie Quinn, Head of Ocean Energy and Energy & Infrastructure Lead (Scotland), and Alan Laidlaw, Rural and Coastal Portfolio Manager (Scotland), The Crown Estate.

3. Review of evidence heard (in private): The Committee reviewed the evidence heard on the Crown Estate during today's meeting.

The meeting closed at 11.38 am.

Official Report:



<http://www.scottish.parliament.uk/parliamentarybusiness/28862.aspx?r=9818>

Written Evidence

 [Andy Wightman](#)

Devolution (Further Powers) Committee

New Powers for Scotland: An Interim Report on the Smith Commission and the UK Government's Proposals, 3rd Report, Session 4 (2015)

-  [Muckairn Mussels](#)
-  [Moray Offshore Renewables](#)
-  [Comhairle nan Eilean Siar, Shetlands Islands Council and Orkney Islands Council on behalf of Our Islands: Our Future Campaign](#)
-  [The Highland Council](#)
-  [The Crown Estate](#)

Supplementary written evidence

-  [The Crown Estate](#)

8th Meeting, 2015 (Session 4), Thursday 12 March 2015

Present:

Bruce Crawford (Convener)

Linda Fabiani

Rob Gibson

Alex Johnstone

Alison Johnstone

Bill Kidd (Committee Substitute)

Lewis Macdonald

Stewart Maxwell

Stuart McMillan

Duncan McNeil (Deputy Convener)

Tavish Scott

Apologies were received from Mark McDonald.

In attendance: Christine O'Neill, Nicola McEwen and Heidi Poon, Committee Advisers

The meeting opened at 9.31 am.

1. Proposals to devolve further powers to Scotland and scrutiny of the UK Government's draft legislative clauses: The Committee took evidence from—

John Swinney, Deputy First Minister & Cabinet Secretary for Finance, Constitution and Economy, Donald McGillivray, Deputy Director, Elections and Constitution Division, Stephen Kerr, Head of Social Security Policy and Delivery Division, and Sean Neill, Acting Deputy Director, Finance and Fiscal Responsibility Division, Scottish Government.

2. Decision on taking business in private: The Committee will consider whether its consideration of a draft report on proposals for further devolution should be taken in private at future meetings at its next meeting.

3. Review of evidence (in private): The Committee reviewed the evidence heard at today's meeting.

The meeting closed at 11.36 am

Official Report:

<http://www.scottish.parliament.uk/parliamentarybusiness/28862.aspx?r=9851>

Devolution (Further Powers) Committee

New Powers for Scotland: An Interim Report on the Smith Commission and the UK Government's Proposals,
3rd Report, Session 4 (2015)

Supplementary written evidence



[The Scottish Government](#)

10th Meeting, 2015 (Session 4), Thursday 26 March 2015

Present:

Linda Fabiani
Rob Gibson
Alex Johnstone
Alison Johnstone
Bill Kidd (Committee Substitute)
Lewis Macdonald
Stewart Maxwell
Mark McDonald
Stuart McMillan
Duncan McNeil (Deputy Convener)
Tavish Scott

Apologies were received from Bruce Crawford (Convener).

In attendance: Heidi Poon, Nicola McEwen and Christine O'Neill, Committee Advisers

The meeting opened at 10.05 am.

1. Draft report on proposals to devolve further powers to Scotland and scrutiny of the UK Government's draft legislative clauses (in private): The Committee discussed a draft report.

The meeting closed at 11.29 am.

Devolution (Further Powers) Committee

New Powers for Scotland: An Interim Report on the Smith Commission and the UK Government's Proposals, 3rd Report, Session 4 (2015)

11th Meeting, 2015 (Session 4), Thursday 2 April 2015

Present:

Bruce Crawford (Convener)

Linda Fabiani

Rob Gibson

Alex Johnstone

Alison Johnstone

Lewis Macdonald

Stewart Maxwell

Mark McDonald

Stuart McMillan

Duncan McNeil (Deputy Convener)

Tavish Scott

The meeting opened at 10.50 am.

3. Draft report on proposals to devolve further powers to Scotland and scrutiny of the UK Government draft clauses (in private): The Committee considered a draft report.

The meeting closed at 11.33 am.

12th Meeting, 2015 (Session 4), Thursday 23 April 2015

Present:

Bruce Crawford (Convener)

Linda Fabiani

Rob Gibson

Alison Johnstone

Lewis Macdonald

Stewart Maxwell

Mark McDonald

Stuart McMillan

Tavish Scott

Apologies were received from Alex Johnstone and Duncan McNeil (Deputy Convener).

The meeting opened at 9.00 am.

2. Draft report on proposals to devolve further powers to Scotland and scrutiny of the UK Government's draft legislative clauses (in private): The Committee discussed a draft report.

The meeting closed at 11.32 am.

13th Meeting, 2015 (Session 4), Thursday 30 April 2015

Present:

Bruce Crawford (Convener)
Linda Fabiani
Rob Gibson
Alison Johnstone
Lewis Macdonald
Stewart Maxwell
Mark McDonald
Stuart McMillan
Tavish Scott

Apologies were received from Alex Johnstone, Duncan McNeil (Deputy Convener).

The meeting opened at 8.03 am.

1. Draft report on proposals to devolve further powers to Scotland and scrutiny of the UK Government's draft legislative clauses (in private): The Committee considered a draft, interim report.

4. Draft report on proposals to devolve further powers to Scotland and scrutiny of the UK Government's draft legislative clauses: The Committee considered and agreed its interim report.

The meeting closed at 10.08 am.





Annexe C

List of other written evidence

-  [Aileen McHarg](#)
-  [Alan Page](#)
-  [Andrew Hughes Hallett](#)
-  [Association of British Bookmakers](#)
-  [BASE](#)
-  [BEMIS](#)
-  [British Aggregates Association](#)
-  [Campaign for Scottish Home Rule](#)
-  [Carers Scotland](#)
-  [Citizens Advice Scotland](#)
-  [Citizens Advice Scotland - additional submission](#)
-  [COSLA](#)
-  [CRER](#)
-  [Dr. Eve Hepburn and Prof. Sionaidh Douglas-Scott](#)
-  [ENABLE Scotland](#)
-  [Engender](#)
-  [ERSA](#)
-  [Federation of Small Businesses](#)
-  [Gavin Roberts](#)
-  [Glasgow Airport](#)
-  [Ian Martlew](#)
-  [ICAS](#)
-  [Inclusion Scotland](#)
-  [John SH Drummond Moray](#)
-  [Law Society of Scotland](#)
-  [Money Advice Scotland](#)
-  [NFU Scotland](#)
-  [NUS Scotland](#)
-  [Poverty Alliance](#)
-  [Royal Society of Edinburgh](#)
-  [RYA Scotland](#)
-  [ScotlandIS](#)
-  [Scottish Chambers of Commerce](#)
-  [Scottish Federation of Housing Associations](#)
-  [Scottish Renewables](#)
-  [Scottish Retail Consortium](#)
-  [Scottish Tourism Alliance](#)
-  [Scottish Women's Convention](#)
-  [SCVO](#)
-  [SELECT](#)

Devolution (Further Powers) Committee

New Powers for Scotland: An Interim Report on the Smith Commission and the UK Government's Proposals,
3rd Report, Session 4 (2015)

-  [SELECT background paper 1](#)
-  [SELECT background paper 2](#)
-  [Universities Scotland](#)
-  [Wise Group](#)



FIN(4) FF08

Ymateb gan Alan Trench

Response from Alan Trench

MEMORANDUM BY ALAN TRENCH

1. This memorandum is intended to assist the Committee in relation to my oral evidence on 17 June 2015. In it I shall briefly address issues that I understand are of particular concern to the committee. More detail on these matters can be found in my January 2013 paper *Funding Devo More*, and in the report *A Constitutional Crossroads: Ways forward for the United Kingdom* published in May 2015 by the Bingham Centre for the Rule of Law, for which I acted as adviser.¹
2. Both these reports discuss in some detail the need for a changed approach to administrative arrangements to make fiscal devolution work. These concerns apply even to the very limited degree of fiscal devolution to Wales that is presently underway. What is needed includes an independent expert body to carry out the technical work necessary to understand devolution finance, including calculations of grant and changes to it, and the impact of fiscal devolution where that takes place. It also includes an independent body to resolve any disagreements or disputes that arise between governments (not necessarily only financial ones, but the need is particularly acute when it comes to financial matters).² There also need to be clearer arrangements for accountability of any UK Government agency that collects devolved taxes on behalf of a devolved government. As part of a wider reconstruction of financial arrangements, the present system by which the block grant is paid to the Secretary of State, who remits funds to the Welsh Consolidated Fund after deducting the costs of running his or her office, should also cease. Grant should be paid directly to the Welsh Government, and the costs of running the Wales Office borne by the UK Government rather than the funding of devolved public services.

The main weaknesses in the Welsh funding settlement and how these could be resolved

3. It is hard to see how issues of Welsh ‘under-funding’ relative to need are pressing at present. The evidence suggests that ‘under-funding’ was never very great, and has largely ceased to apply.³ The reasons for this are not altogether clear, but the protection

¹ *Funding Devo More* can be found at www.ippr.org/publications/funding-devo-more-fiscal-options-for-strengthening-the-union. *A Constitutional Crossroads* can be found at <http://www.biicl.org/ingham-centre/devolution>

² As regards intergovernmental co-ordination, see also my paper for the ‘UK’s Changing Union’ project: A. Trench *Intergovernmental Relations and Better Devolution*, December 2014, available at <http://sites.cardiff.ac.uk/wgc/files/2014/12/INTERGOVERNMENTAL-RELATIONS-AND-BETTER-DEVOLUTION-FINAL-Dec-2014.pdf>. See also my blog post ‘Better intergovernmental relations for better devolution’, *ClickonWales* 15 December 2014, <http://www.clickonwales.org/2014/12/better-intergovernmental-relations-for-better-devolution/>

³ In evidence to the Commons Welsh Affairs Committee in March 2015, the Parliamentary Under-secretary of

of health and schools spending in England under the Conservative-Lib Dem Coalition government until May 2015, and similar commitments made by the Conservatives, has played a significant part in this.

4. The issues that will affect Wales are therefore two-fold. First is the possible impact of convergence, if public spending should increase. This is, in reality, only a limited prospect given the new Government's commitments to fiscal austerity, although maintaining real-terms funding for the NHS and schools in England will produce nominal increases that, other things being equal, will lead to convergence. Second, there is the question of what room for manoeuvre the Welsh Government and National Assembly might have in the light of austerity; if the UK Government prefers to limit spending on public services generally, the working of the Barnett formula will mean the National Assembly has largely to follow likewise, or make cuts in some areas to protect funding in others. Securing funding at the level of 'relative need' ensures Wales gets an appropriate share of the 'cake' of public spending, but is of little use if decisions made for England mean that the cake shrinks. Wales may still get its 'fair share', but have less money to spend overall.
5. What Wales faces is the problem that arises from the way the Barnett formula works. By allocating changes in spending to devolved governments following changes in spending on 'comparable functions' in England, it implicitly assumes that devolved governments will have a similar model of public services to those in England. While devolved governments are free to move (vire) money between functions within the block grant, the overall amount of the block grant assumes an 'English' model of services and, if the English model of services changes, devolved governments will either have to follow suit or make cuts in one area to continue to maintain funding for another. Wales receives the worst of this because it is funded at about the level of relative need; Scotland and Northern Ireland, which are both funded above that level, are under less immediate pressure to follow an English policy choice.
6. It is hard to think of ways to resolve this problem. The only option that offers greater leeway, though to a limited extent, is greater fiscal devolution provided that this is accompanied by an effective equalisation mechanism. Increased reliance on own-source tax revenues increases the scope to have a different approach to public policy compared to reliance on a grant that is driven by English policy choices.
7. It is worth noting that the new UK Government's plans for 'English votes for English laws' may make this problem all the more acute. Much depends on exactly how this applied, but if Welsh MPs are unable to vote on matters that affect devolved funding Wales will find itself dragged along by English policy choices without any of its elected

State claimed that Wales currently receives 116 per cent of UK average funding for devolved functions. This is in line with earlier forecasts made by the UK Government. See House of Commons Welsh Affairs Committee *Oral evidence: Responsibilities of the Secretary of State for Wales*, HC 400, Tuesday 17 March 2015, Q. 93. The Welsh Government has not, to my knowledge, challenged this figure.

representatives – whether in Parliament or the National Assembly – being able to take part in decisions about that.⁴

How the agreement for a reserved-powers model for Wales, and the other St David's Day devolution proposals, could impact future funding

8. It is hard to see how a 'reserved powers' model, as such, would affect the funding of the National Assembly and Welsh Government. This would be a legal change that would affect the constitutional structure of Welsh devolution but not the functions devolved. What would affect future funding would be the adequacy (or not) of changes made to the block grant in respect of further substantively-devolved functions. The Welsh Government's position – that 'it will be crucial for the two Governments to negotiate a fair budget transfer of both running costs and programme budgets to go with these new responsibilities' – is entirely understandable, and to be endorsed.⁵ Questions about the costs of providing an existing package of services are not straightforward and the difficulties they have presented in the past (over such issues as student support) emphasise the problems they present. This accentuates the need for the sort of independent mechanisms to advise on technical matters and to resolve disputes discussed in paragraph 2 above.

Reviewing developments on the issues of convergence, underfunding and Barnett reform highlighted in the Holtham and Silk reports

9. The St David's Day Agreement contains an assurance in relation to convergence and 'fair funding' by means of a 'Barnett floor'.⁶ This commitment is rather vague – indeed, rather vaguer than those previously given by the Coalition in October 2012 and by the Labour UK Government in November 2009.⁷
10. In reality, the point of a 'Barnett floor' is highly questionable, since the current level of funding is probably about right. What is needed is a mechanism to address the issue of convergence. That is rather more straightforward, and indeed would be simple to introduce administratively by a modest change to the formula used to apply the Barnett formula to Wales.

⁴ This issue is discussed further in chapter 5 of the Bingham Centre report, *A Constitutional Crossroads*. See particularly section 5.2.

⁵ Welsh Government, *Devolution, Democracy and Delivery. Powers to achieve our aspirations for Wales* WG 22188, July 2014, paragraph 29.

⁶ HM Government, *Powers For A Purpose: Towards a lasting devolution settlement for Wales* Cm 9020, February 2015, paragraph

⁷ For discussion, see my blog posts on *Devolution Matters*: 'The UK-Welsh Government agreement on borrowing powers and Barnett convergence', 25 October 2012, <https://devolutionmatters.wordpress.com/2012/10/25/the-uk-welsh-government-agreement-on-borrowing-powers-and-barnett-convergence/> and 'Financing devolution by grants: Calman, Holtham and Barnett', 29 November 2009, <https://devolutionmatters.wordpress.com/2009/11/29/financing-devolution-calman-holtham-and-barnett/>

11. However, it is worth noting that even a commitment to a Barnett floor (or a convergence-avoiding mechanism) involves an agreement about the level of relative needs in Wales between the UK and Welsh Governments. That means even a rather nebulous commitment may raise the technical and political issues of a needs assessment, and all the difficulties and delay that may cause.

The financial and economic information which the UK and Welsh Governments need to provide to support future funding arrangements

12. Any future funding arrangements will require much better data about public finances than we have at present. The UK Government's annual *Public Expenditure Statistical Analyses* publication includes information about spending on key functions, and now also tells us about whether (for Scotland, Wales and Northern Ireland) spending is by the UK or devolved government. (In *PESA 2014*, this was table 9.21, 'Identifiable expenditure on services for Scotland, Wales and Northern Ireland in 2012-13'.) This is however a comparatively recent development. We still have only limited information about changes to the block grant triggered by changes in spending on 'comparable functions' in England. (This is presented in the Wales Office Annual Report, and remains sufficiently broad it is hard to verify.) All this information is in the hands of the Welsh Government, but they choose not to publish it themselves.
13. When it comes to tax revenues, information is much more scarce. The Welsh Government – unlike its Scottish and Northern Ireland counterparts – makes no effort to publish estimated tax receipts from Wales. (The Scottish Government has an annual publication, *Government Expenditures and Revenues Scotland*, also known as *GERS*. The Department for Finance and Personnel Northern Ireland publishes an annual 'Net Fiscal Balance Report' from time to time, most recently for 2011-12.) HM Revenue & Customs has embarked on an 'experimental' series of territorially-disaggregated statistics, most recently published for 2013-14, calculated on a different basis to *GERS* and the Northern Ireland Net Fiscal Balance reports.⁸
14. It is nothing short of deplorable that the Welsh Government has not sought to help clarify the debate by producing its own figures similar to *GERS*, but has left it to other, UK Government, agencies to do so – and to let this be done in an inconsistent way that is also hard for those interested to find. Publishing accurate, verifiable figures would be one role a 'UK Finance Commission' might undertake. The Welsh Government's failure to take any action regarding this means it has little ground to complain about unfairnesses in the system, however, as it has left these to be matters of assertion rather than verifiable data.

Alan Trench
14 June 2015

⁸ The most recent data are at <https://www.gov.uk/government/statistics/disaggregation-of-hmrc-tax-receipts>