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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