HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

Jocelyn Davies AC
Chair of National Assembly for Wales' Finance Committee
Cardiff Bay
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8 June 2012

Dear Jocelyn,

INQUIRY INTO BORROWING

Thank you for your letter dated 25 May containing two further questions relating to tax and borrowing powers. Please see a response to each question below.

1. **Whether there an inherent link between borrowing powers and the devolution of tax varying powers, or is it possible for there to be borrowing powers without tax varying powers.**

   In principle, I believe there is an inherent link between borrowing powers and the ability to raise revenue independently to support borrowing for two reasons. First, borrowing powers can be appropriate and necessary to reflect and manage the increased responsibility from raising revenue. Secondly, an independent source of income can be adjusted as appropriate to support the costs of borrowing.

   While it is the case that the Northern Ireland Executive (NIE) has borrowing powers without tax varying powers, these powers exist in lieu of prudential borrowing for Local Authority-type functions, many of which fall to the central government sector in Northern Ireland. This is reflected in the purpose of the bulk of NIE borrowing, for schools and roads, both of which are LA functions in the rest of the UK.

CHIEF SECRETARY TO THE TREASURY

2. The Scotland Act transfers over time the volatility associated with tax raising powers to the Scottish Parliament. Could you clarify the impact tax varying powers might have on future borrowing powers.

   From 2016 the Scottish Parliament will be responsible for setting and raising a Scottish rate of income tax. OBR forecasts suggest this could raise between £4.4bn to £4.8bn in Scotland.

   In order to ensure a smooth transfer of tax powers, the UK Government will manage any errors in forecasts on behalf of the Scottish Parliament for a transitional period lasting between two to three fiscal years.

   Although errors in forecasts are expected to even out over time, Scottish Ministers will have a number of tools available to manage the volatility from forecasts from extended borrowing powers to cutting back spending in other areas. The borrowing limits in the Scotland Act, which are appropriate for managing forecasting errors in normal times, will be reviewed at Spending Reviews.

DANNY ALEXANDER