28 August 2015

Dear Kenneth,

I welcomed the publication on 29 June of the Finance Committee’s views and recommendations on an updated fiscal framework for Scotland. The written submissions, workshop and oral sessions all underline the importance of a sound fiscal framework for Scotland’s future, and I thank all those that contributed to the inquiry.

As you are aware, discussions are already underway between the Scottish Government and HM Treasury (HMT) on developing the new fiscal framework for Scotland.

When I appeared at the Finance Committee on 3 June, I expressed a commitment to keeping Parliament updated on decisions as appropriate; I have provided an update to the Committee following the first meeting of the Joint Exchequer Committee on 7 July. I welcome the invitation to respond to the recommendations of the Committee, and have done so in Annex A.

I hope you find this response to the Committee’s report helpful. I will be giving further oral evidence to the Committee on 2 September and would be able to expand on specific points then should that be useful.

Yours sincerely,

JOHN SWINNEY
ANNEX A

Existing Fiscal Frameworks:

22. One of the key issues for the Committee is the extent to which the Scottish Government will have the flexibility to pursue separate fiscal policies while recognising the need for consistency with the overall UK fiscal framework. An essential element of this flexibility will be the revised level of borrowing powers which the Scottish Government will have and the fiscal rules which govern how they operate. This is discussed in more detail below.

23. The Committee is concerned that the command paper suggests a much greater level of constraint on the Scottish Government’s fiscal flexibility than the Smith Commission. In particular, the Committee is concerned about the level of constraint implied by paragraph 2.2.7 of the command paper which states that “the fiscal framework must require Scotland to contribute proportionally to fiscal consolidation at the pace set out by the UK Government across devolved and reserved areas.”

24. The Committee recommends that while Scotland’s revised fiscal framework needs to be consistent with the UK’s overall fiscal framework this does not mean that they need to mirror each other. For fiscal devolution to work it is essential that the Scottish Government has some flexibility to pursue distinct fiscal policies consistent with the overall UK fiscal framework.

25. The Committee also recommends that there should be a legislative requirement for the Scottish Government to prepare a charter for budget responsibility, containing details of Scottish fiscal policies and how they will be implemented, for approval by the Scottish Parliament.

We welcome the Committee’s recommendations at paragraphs 22-25 and agree that a well designed fiscal framework should ensure that further devolution provides the right incentives and increases accountability – linking the Scottish Government’s budget to Scottish economic performance. It is essential that the Fiscal Framework provides the Scottish Government with genuine flexibility and choice to pursue its own distinct policy.

The Scottish Government believes that a principled approach should be taken to the design of the fiscal framework which reflects the recommendations of the Smith Commission report. In summary:

- The framework must be fair, transparent, and jointly agreed
- Once in operation, the framework should balance risks and opportunities to Scottish funding, and allocate risks to the government best equipped to manage them
- The framework must be sustainable – ensuring that it can accommodate future devolution, economic shocks, and changes to the UK fiscal framework
- The framework should provide incentives & increase accountability – creating a closer link between the Scottish economic performance and our spending power
- The framework should operate transparently and mechanically, with minimum scope for interpretation and discretion over which disagreements could arise
- The framework should give Scotland as much genuine fiscal choice as possible, within constraints consistent with effective management of the UK economy

For Scotland we are clear that this means:
• In respect of tax receipts devolved to Scotland, initial reductions to the block grant should reflect receipts at the point of transfer, based on an agreed methodology and set of data.
• Funding for welfare expenditure transferred into the block grant should reflect the full cost of the benefits devolved
• Transfers into the block grant should reflect the full cost of administering the new powers
• Through the act of devolution itself there should not be an increase or a decrease in Scottish Government spending power
• The Barnett formula should continue to be the driver of change (growth or shrinkage) in the block grant
• When the Scottish economy out-performs that of rUK, in addition to Barnett changes our spending power should increase, and should reduce if we under-perform
• We should be able to alter the time and quantum of our capital spending materially through capital borrowing powers
• We should have the tools to manage the increased risk from Scottish-level fiscal effects, such as tax receipts or demand-driven expenditure varying from forecasts

The ability to pursue distinct fiscal policies is dependent on the levers the Scottish Government has to influence the wider economy. The Scottish Government does not believe that, with partial and incomplete powers to grow the economy and tackle inequality, the Smith Commission recommendations meet the central and crucial test of coherence. The Scottish Government has identified full fiscal autonomy as its preferred package of powers short of independence (More Powers for the Scottish Parliament (October 2014)\(^1\)).

While the Scottish Government welcomes the extension of the fiscal responsibilities of the Scottish Parliament proposed by the Smith Commission, these clearly fall far short as over 70% of tax receipts remain in the control of Westminster, and the Parliament will be responsible for raising a little over a third of devolved expenditure. Moreover, the UK Government will retain responsibility for 86% of welfare spending in Scotland. The Scottish Government also regrets that the tax powers proposed are limited to partial powers over Income Tax, and with further devolution restricted to two taxes, Air Passenger Duty and Aggregates Levy. Assignment of VAT provides no devolved control of this tax but is effectively an alternative approach to calculating part of the Scottish block grant. These proposals do not provide the Scottish Parliament with control over key taxes – like corporation tax or Employers National Insurance Contributions – and key elements of the welfare system such as tax credits and out of work benefits.

Narrowing the gap between the Parliament’s spending and revenue raising powers would both increase its accountability and enable the Scottish Government to align better all elements of public policy with its objectives. A large gap between the Parliament’s potential revenue raising powers and spending responsibilities – as proposed by the UK Government’s Scotland Bill – reduces the scope to use those limited and narrow tax and welfare powers to address the Scottish Government’s key priorities, such as tackling austerity and inequality. This approach limits accountability and does not provide a coherent set of powers that the Scottish Parliament requires.

\(^1\) [http://www.gov.scot/Publications/2014/10/2806]
Borrowing

Fiscal Rules:
35. The Committee’s view is that it is essential that Scotland’s fiscal rules are agreed through a process of negotiation which recognises the flexibility of the Scottish Government to adopt its own fiscal policies within the overall UK fiscal framework.

36. The Committee recommends that Scotland’s updated fiscal framework should include two fiscal rules. The first should be a balanced budget rule to govern the level of borrowing in the short to medium term. The second should be a rule to govern the medium to long-term limit on net debt.

The Scottish Government agrees with the recommendations set out in paragraph 35 and will consider the recommendation at paragraph 36 in the context of the fiscal framework negotiations which are underway, which will assess fiscal rules.

From April 2015 Scottish Ministers have had the power to undertake borrowing to fund capital expenditure up to a statutory aggregate limit of £2.2 billion. HM Treasury limits our borrowing in any one year to 10 per cent of the capital budget. The 2015-16 Draft Budget set out our plans to borrow up to £304 million this year, the maximum permitted by HM Treasury, in order to maximise our infrastructure investment programme. This programme focuses on support for strategic infrastructure investment plans that underpin productivity growth and secondly, on promoting wellbeing to help address the challenge of poverty and inequality.

The Smith Commission recommended additional borrowing powers to enable the Scottish Government to balance risk and volatility in the Scottish budget and to support a long-term strategy for funding key infrastructure investment and further boost the Scottish economy. The Scottish Government considers that these borrowing powers must provide genuinely additional resources to the Scottish budget.

Capital borrowing powers must also offer the Scottish Government the flexibility to make additional investment in our infrastructure programme, over and above existing funding levels. The Scottish Government welcomes the Smith recommendation that both Governments should consider the merits of a prudential borrowing regime. Scotland has a track record of creating and operating sustainable fiscal rules. We already have a stated policy of limiting our future revenue commitments to a maximum of 5% of our expected future annual Departmental Expenditure Limits. The Scottish Government would not seek to borrow to fund any structural deficit and would seek to balance its budget over the cycle.

Current Spending:

58. The Committee’s view is that it is clear that the level of borrowing powers for current spending will need to be significantly increased and should be commensurate with the risks faced by the Scottish Government post-Smith.

59. The Committee notes that the precise types of risk Scotland may be exposed to will be determined by the block grant adjustment method which is intended to insulate Scotland from UK wide economic shocks. At the same time there will also be a Scotland-specific cyclical risk and the Scottish Government will require substantial new borrowing powers to manage this volatility.
60. Given the risks associated with volatility in the Scottish economy the Committee does not believe that it is appropriate to have a cash limit on current borrowing. Rather, the Scottish Government should agree a balanced budget fiscal rule with the UK Government which is consistent with the UK fiscal framework. The Committee’s view is that this does not necessarily mean that both Governments have the same balanced budget fiscal rule. For example, the Scottish Government could be required to balance the cyclically adjusted current budget over the economic cycle.

61. The Committee notes the concerns of some witnesses that the Holtham method of indexation may penalise Scotland due to both a relatively smaller number of higher rate tax payers and slower population growth. The Committee asks the Scottish Government whether it has carried out any analysis of the impact of both of these factors and, if so, that it makes this work public. The Committee also asks whether Ministers have considered basing the indexation of the block grant adjustment on the per capita tax base rather than the overall growth in the UK tax base and whether any analysis of this approach has been carried out.

62. The Committee reiterates its support for the Scottish Government’s proposal for more flexibility in how it spends any tax surpluses.

63. The Committee is, in principle, supportive of examining the proposal to allow current borrowing for preventative spending on the basis that it is about investing in the future. The Committee invites the Scottish Government to explore the practicality of this approach in its discussions with the UK Government on borrowing.

We agree with the Committee’s recommendations on current borrowing.

Greater powers over revenue and expenditure will increase volatility in the Scottish Government budget, and therefore, in line with what Smith recommended in paragraph 95(5), revenue borrowing powers should be expanded to support this. The details of the additional powers will be considered by Scottish and UK Ministers as part of the negotiations on the fiscal framework.

What the Scottish Government is seeking is sufficient revenue borrowing powers to be able to manage Scottish-specific risks arising from devolved powers, within the context of the overall UK fiscal framework. This should enable us to deal with tax and welfare forecast error, manage the budget over the economic cycle, and respond to any downturn in the economy.

We believe that current borrowing should be subject to specific rules set by Scottish Ministers that gives Scotland accountability and flexibility for the borrowing decisions it makes.

We understand that Scotland is part of the UK fiscal framework and so a balance has to be reached between impacting on this, whilst allowing the Scottish Government flexibility over borrowing. We believe that once a set of rules or limit for revenue borrowing has been agreed that management of these powers within the framework or up to this limit would be a devolved issue.
Borrowing for Capital Spending:

73. The Committee supports the introduction of a prudential capital borrowing regime on a statutory basis.

74. The Committee also recommends that the Scottish Government should agree a debt rule with the UK Government which is consistent with the UK fiscal framework. The Committee’s view is that this does not necessarily mean that both governments have the same debt fiscal rule.

75. The Committee agrees with the Devolution (Further Powers) Committee that consideration should be given to a debt rule as a percentage of cyclically adjusted GDP.

UK and Scottish Ministers will consider as part of the fiscal framework negotiations whether and what changes are required to Scotland’s existing capital borrowing powers, as introduced by the Scotland Act 2012. The Scottish and UK Governments have agreed to consider the merits of introducing a prudential borrowing regime for capital borrowing, as recommended by the Smith Commission, in the course of these negotiations. The Scottish Government welcomes the Committee’s support for the introduction of such a prudential regime. As I outlined to the Committee on 3 June, the Scottish Government believes that Ministers should be free to take strategic, affordable and sustainable capital borrowing decisions in support of our infrastructure investment programme, but recognising that Scotland’s capital borrowing framework must be consistent with the UK fiscal mandate.

We will also seek to reach agreement on the fiscal rules which should underpin Scotland’s fiscal framework. We note the recommendation made by the Devolution (Further Powers) Committee and endorsed by the Finance Committee in relation to a debt rule.

Moral Hazard:

81. The Committee recommends that the issue of moral hazard needs to be explicitly addressed in the fiscal framework.

The Scottish Government welcomes this recommendation and will consider it during the fiscal framework negotiations.

No Detriment:
99. The Committee is content with the first ‘no detriment’ principle that the Scottish Government and UK Government budgets should be adversely affected as a result of the decision to devolve further powers. This should include forestalling at the point of transfer.

100. The Committee recommends that the second ‘no detriment’ principle be treated as a high level principle to guide the governments in the application of the fiscal framework and in adjusting the block grant. Attempts to turn it into a rule to be applied mechanically to all potential spillover effects should be resisted as inefficient, counter-productive and likely to create unnecessary disagreement and dispute. Instead it should be used as a guide in intergovernmental discussions at official and ministerial level and wherever possible discussed before the implementation of policy changes.
101. Even as a high level principle, further work needs to be done on refining the boundaries within which the principle applies and to confirm that it applies only to major and calculable impacts on the budgets of either government and not to the behavioural consequences of moderate tax competition, for example. This interpretation appears to be implied by some of the wording in the command paper but, from the evidence we received, this is not clear.

102. The Committee recommends that the outcome of discussions between the governments on the scope and application of the second ‘no detriment’ principle are made public so that the fairness of the fiscal framework is evident.

The Scottish Government welcome the recommendations from the Committee and recognise that there are a number of issues involved with interpreting the ‘no detriment’ principle. These will need to be carefully worked through to ensure it can be embedded within the fiscal framework in a way that is clear, fair and transparent. To this end consideration of the ‘no detriment’ principle should mean that there is no systematic bias against either government such that there should be no adverse financial impacts.

The Scottish Government agree that transparency is a necessary requirement for the effective operation of a fiscal framework and a detailed and shared understanding and development of the evidence will also be crucial. To assist with this at the meeting of the Joint Exchequer Committee on 7 July Ministers committed to information sharing between the two governments. Transparency will best be served by considering a process to apply the ‘no-detriment’ principle which is sustainable, repeatable and should minimise any reliance on subjective assessments where possible. Key to this will be a clear definition of what is in and out of scope when considering the ‘no-detriment’ principle as has been noted by the Committee. Alongside this we will give careful consideration to the role that external bodies such as SFC/OBR could have.

We will continue to work within the spirit of Smith to ensure a consensus is reached between Scottish and UK Governments to ensure the application of no detriment is symmetric and operates on the basis of a shared understanding of the evidence.

Block Grant and Funding Formula:

111. The Committee notes that the increasing complexity of the funding model for Scotland means that it is essential that the calculations of the block grant are open and transparent.

112. The Committee also notes that while the Scottish Government is consulted on the operation of the Barnett formula, the Treasury has the sole decision-making role.

113. The Committee recommends that there needs to be a greater willingness within the Treasury to seek agreement with the devolved institutions on the methodology and operation of the funding model.

114. The Committee recommends that the UK Government publishes details of the operation of the Barnett formula and adjustments to the block grant arising from fiscal devolution alongside each UK budget and Autumn Statement and that a UK Treasury Minister should be willing to appear before the Finance Committee shortly after the publication of the UK budget.
There will need to be a considered process for agreeing block grant adjustments and the future funding model for Scotland, which will take place as part of agreeing the fiscal framework for Scotland.

At the most recent meeting of the Joint Exchequer Committee on 7 July both governments agreed to look in detail at the range of options for future funding of the Scottish Government in relation to the new tax and spending powers.

As the Scottish Government have previously set out to the Committee these mechanisms should be robust, transparent and deliver a fair outcome for Scotland. These principles also hold for the other components of the fiscal framework.

When I appeared before the Committee on this matter in June I set out the Scottish Government’s view that the transparency of the Barnett process could be improved, as could the overall operation of the Statement of Funding Policy. This remains the Scottish Government’s view on this matter, and so we would endorse the Committee’s recommendations around this point, and it is something we will seek to pursue through the negotiations of the fiscal framework.

Scottish Fiscal Commission:

131. The Committee questions the extent to which the Swedish and Irish models are consistent with the Scottish Government’s proposals on forecasting. The Committee is unaware of any other example of a fiscal council relying solely on official government forecasts

132. The Committee notes that the draft SFC Bill describes the commission’s functions as assessing the reasonableness of the forecasts. It is not proposed in the draft Bill that the SFC should endorse the forecasts

133. The Committee notes the strong level of support among witnesses for the SFC carrying out its own forecasts and recommends that the draft Bill should be amended accordingly

The Scottish Fiscal Commission already plays a key role in supporting the responsible exercise of the modest tax powers devolved to the Scottish Parliament. The Commission was established on a non-statutory basis in 2014, with a remit proportionate to the fiscal powers devolved by the Scotland Act 2012 but which created a sound basis from which to expand the functions of the Commission as the fiscal powers of the Parliament develop and expand. In designing that remit, the Scottish Government was greatly assisted by the Committee’s inquiry into proposals to establish the Commission, which reported in February 2014.

We also had regard to international best practice, drawing on the work of the OECD and the International Monetary Fund (IMF) which recognises that the precise form and functions of an independent fiscal institution (IFI) should be determined by local needs and the local fiscal and institutional environment. In particular, the OECD provided written evidence to the Finance Committee’s earlier inquiry which showed that of the 17 IFIs in operation in OECD countries in 2013, only two had a role in producing macroeconomic forecasts (the UK Office for Budget Responsibility (OBR) and the Netherlands Bureau for Economic Policy Analysis). Seven IFIs assessed government forecasts, six prepared alternative forecasts and the

remaining two IFIs had no role in relation to forecasting. Of the eight fiscal bodies created since 2008, only the OBR has a role in preparing official forecasts.

More recently, we note that the IMF presented written evidence to the Committee’s fiscal framework inquiry which suggested that the “Scottish Fiscal Commission could contribute to the credibility of the government’s fiscal policy by assessing the realism of the Scottish government’s forecasts for devolved revenues and expenditures.”

The non-statutory Commission has a remit to independently scrutinise and report on the Scottish Government’s devolved tax revenue forecasts and on the economic determinants underpinning our forecasts of non-domestic rate income (NDRI). This reflects our view that the preparation of forecasts of tax revenues which underpin the Scottish Budget should be the responsibility of Scottish Ministers, who should in turn be directly accountable to the Scottish Parliament for those forecasts. The Scottish Fiscal Commission scrutinises and challenges our forecasts – including the methodologies and assumptions underpinning those forecasts – and reports the outcome of that scrutiny to parliament and to the public.

Some of the evidence presented to the Committee’s inquiry appears to suggest that the Commission performs a basic arithmetic “checking” function over the Scottish Government’s forecasts and determinants. We thought it may be helpful to clarify the position to the Committee. The Commission reached the conclusion that it was “able to endorse as reasonable the forecasts made by the Scottish Government” on the basis of a thorough assessment of the methodologies and assumptions which were applied to produce our forecasts, as evidenced in the Commission’s report. The Commission suggested alternative forecasting approaches. The Committee may recall that in scrutinising the economic determinants of the forecasts of NDRI underpinning the 2015-16 Draft Budget, the Commission expressed a view that the buoyancy assumptions “seem optimistic”. Based on that assessment, the Deputy First Minister revised down the NDRI forecast prior to publication of the Draft Budget.

The NDRI example clearly demonstrates that the Scottish Government will take action to respond to the Commission’s findings and that the Commission effectively has a “veto” over our tax forecasts, as the Deputy First Minister has previously outlined to the Committee.

By contrast, the UK forecasts for individual taxes published by the Office for Budget Responsibility at each UK fiscal event are prepared by HM Revenue and Customs and subject to in-house review by the OBR. Neither the nature of this scrutiny, nor its impact, is made public. This was evidenced by remarks which Edward Troup, Second Permanent Secretary at HM Revenue and Customs, made to the Committee on 21 January 2015.

“We measure and forecast, and the published forecasts are signed off by the Office for Budget Responsibility… 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 Treasury, and the Treasury would make those forecasts.”

In our view, the Scottish approach maximises the openness and transparency of the forecasting process – it means that a detailed account of the Scottish Government’s forecasting approach, the findings of an independent evaluation of that approach and the changes which the government has made to forecasts or assumptions in response to those

findings is publicly available. For example, we published a Devolved Taxes Forecasting Methodology paper alongside the 2015-16 Draft Budget⁴ and the Scottish Fiscal Commission published its own report⁵ evaluating that methodology.

In formulating our proposals to legislate for the Scottish Fiscal Commission, we have taken the opportunity to review the core functions of the Commission to ensure that they remain appropriate in anticipation of the devolution of further fiscal powers to the Parliament and the negotiation of a new fiscal framework for Scotland. Having carefully considered the Committee’s findings, together with the responses received to our consultation on a draft Scottish Fiscal Commission Bill (which closed on 26 June 2015), we are not persuaded that the Scottish Fiscal Commission should prepare the official forecasts for the devolved taxes.

The Parliament’s tax-raising powers will remain modest, even following full implementation of the additional powers recommended for devolution by the Smith Commission. The majority of the spending power of the Scottish Parliament will continue to be funded by a block grant from Westminster and so it is not necessary or possible for the Scottish Government, or indeed an IFI, to produce a full set of macro level fiscal projections for Scotland. As outlined above, we consider that the existing remit of the Commission maximises the transparency of the production of forecasts for individual taxes. It of course remains open to the Commission to prepare alternative forecasts or assumptions to support its scrutiny of the government’s forecasts.

The Scottish Fiscal Commission is one of a small number of sub-sovereign IFIs which exist across the world and the Scottish Government’s commitment to the creation of a statutory Commission is evidence of our wider commitment to fiscal competence and discipline in the management of Scotland’s devolved public finances.

While there is wide variation in the specific roles of international IFIs, there is widespread acceptance that these bodies should be independent of government and seen to be so. The Scottish Government consulted on draft legislation to create such an independent Commission and we are currently considering suggestions as to how we can further strengthen those arrangements prior to introduction of the Bill to Parliament. This will ensure that Scotland has a credible and effective Scottish Fiscal Commission which is equipped to challenge the Scottish Government on our fiscal projections and provide parliament and the public with a full account of its findings. The Scottish Government believes that enactment of our legislative proposals will play a vital role in delivering the Smith Commission’s recommendation that “the Scottish Parliament should seek to expand and strengthen the independent scrutiny of Scotland’s public finances”.

We look forward to continuing our discussions with the Committee on the role of the Scottish Fiscal Commission following introduction of the Bill to Parliament later this year.

139. The Committee recommends that the remit of the SFC should include judging the performance of the Scottish Government against its fiscal targets and an assessment of the long-term sustainability of the public finances

140. The Committee recommends that the draft Bill should be amended accordingly.

141. The Committee intends to submit this section of the report on the SFC as its submission to the Scottish Government’s consultation on the draft Bill. The

⁵ http://www.scottishfiscalcommission.org/media/media_364407_en.pdf
Committee will also have a further opportunity to consider these issues once the legislation is introduced in the Autumn.

142. The Committee welcomes the commitment of the Ministers to provide the Commission with sufficient and appropriate resources to discharge its remit and will look at this further when it considers the Financial Memorandum for the Bill

The Scottish Government recognises that it may be desirable for the Scottish Fiscal Commission to have a future role in assessing the Scottish Government’s performance against fiscal rules agreed with the UK Government as part of the ongoing negotiations on a new fiscal framework for Scotland. This was included as a potential future function of the Commission in our recent consultation. The Scottish Parliament does not yet have competence to legislate for additional functions for the Commission to reflect the further fiscal powers recommended for devolution by Smith and so our legislative proposals reflect the powers devolved to the Scottish Parliament under the Scotland Act 2012 only.

The consultation draft of the Bill includes a regulation-making power which enables Scottish Ministers, with the approval of the Scottish Parliament, to expand the remit of the Commission to take account of these new fiscal powers once the new Scotland Act is in place, and indeed following any future further expansion of the Parliament’s fiscal powers. The Scottish Government will bring forward its proposals for modifications to the Commission’s functions to reflect Scotland’s new fiscal framework at the appropriate time, following consultation with the Commission. There will be opportunity for Parliament and the public to scrutinise these proposals.

The Scottish Ministers have undertaken to provide the Commission with sufficient and appropriate resources to discharge its remit. We are currently in discussions with the Commission regarding future resource requirements and these will be laid out for parliamentary scrutiny in the financial memorandum accompanying the forthcoming Bill.

Intergovernmental relations (IGR) on Fiscal Rules:

173. The Committee notes that it is abundantly clear that the existing institutional IGR framework is not fit for purpose. The increasingly complex nature of devolution and the degree of interdependency at both a bilateral and multilateral level requires substantial change to both the structure and culture of inter-governmental relations. In particular, the Committee agrees that it is clear that the “machinery for devolved finance can no longer be left to the discretion of HM Treasury.”

174. The Committee recommends:

- for inter-governmental relations to be meaningful in relation to fiscal matters then there is a fundamental need to change HM Treasury’s role as the sole decision maker at both a bilateral and multilateral level;
- at a bilateral level, Scotland’s fiscal framework should be agreed through the JEC and by both Westminster and the Scottish Parliament;
- at a quadrilateral level, the SFP should be agreed through the FMQ and by the respective parliaments and assemblies.
- both documents should be subject to periodic review;
- there needs to be a much more structured approach to IGR on fiscal meetings including at least bi-annual meetings of both the JEC and FMQ;
- there needs to be a much more systematic approach to the reporting of the meetings of the JEC and FMQ with a clear expectation of the level of information to be provided;
• this should include, as a minimum, advance notification of agendas to allow the Parliament to contribute its views and a detailed and timeous minute of discussions to allow for effective parliamentary scrutiny;
• the Cabinet Secretary should write to the Finance Committee following informal meetings with UK Finance Ministers providing details of the fiscal matters discussed;
• consideration should be given to providing a statutory basis for both the JEC and the FMQ;
• consideration should be given to establishing an independent body to advise on the calculation of the block grant;
• consideration should be given to establishing an independent arbiter to resolve disputes on issues such as the block grant adjustment.

The Scottish Government agrees with the Committee that we need to improve current intergovernmental relations.

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.

I have agreed that the Chief Secretary of the Treasury and myself will meet regularly over the next few months under the auspices of the Joint Exchequer Committee to discuss and agree the fiscal framework. The framework will be agreed jointly by both governments and we are aiming to conclude negotiations by the autumn, in line with the timetable for the Scotland Bill. It will be important that both governments come to a shared understanding and agreement on the fiscal framework and the evidence underpinning it. I am keen to avoid the difficulties both governments faced in reaching agreement on the block grant adjustment for the Scotland Act 2012 in the future. I have made clear that a robust and credible fiscal framework will need to be agreed before recommending to the Scottish Parliament that legislative consent is given to the Scotland Bill.

As part of the discussions about the fiscal framework we will need to think through on going governance of fiscal arrangements beyond the framework negotiations which will recognise and respect the responsibilities of the Scottish and UK Governments. The Committee’s recommendations are helpful to note in this regard.

Together with the other devolved administrations, the Scottish Government has called upon HM Treasury to improve the level and timing of its engagement on financial issues with an impact on all administrations, including the forthcoming UK Spending Review and revision of the Statement of the Funding Policy. The Finance Ministers of Scotland, Wales and Northern Ireland have written to the Chief Secretary to the Treasury to seek a Finance Ministers’ Quadrilateral meeting in early course.

Economic and Fiscal Data:

183. The Committee welcomes the work which the Scottish Government is carrying out in developing national accounts and a macro-economic forecasting model for Scotland

184. The Committee recommends that the SFC should identify specific areas where economic and fiscal data need updating and that these are addressed by the Scottish Government as a matter of priority.
185. The Committee asks that the Scottish Government provides regular updates on the progress of its discussions with HMRC on access to data including the level of access for the SFC and the data on VAT assignment.

Ministers are in agreement that negotiations on the fiscal framework should be supported by information sharing principles which ensure that both governments have access to the same information, subject to legal requirements, in good time to support the decision-making process. These principles should ensure that Scottish and UK Ministers have access to robust and consistent financial, economic and other information so that Ministers receive advice with a common analytical underpinning and in which both governments have confidence. Officials need to work together to identify a list of relevant data sets which will be required to underpin analysis in support of the negotiations on the fiscal framework.

While the information sharing principles agreed to support the negotiation of the fiscal framework will provide a basis for information sharing principles to support the ongoing operation of the fiscal framework, it is recognised that these principles will need to be reviewed to ensure that they remain fit for purpose.

Conclusion:

186. The Committee is strongly of the view that the workability and effectiveness of further fiscal devolution is largely dependent on Scotland’s revised fiscal framework. The Committee believes that the manner in which the fiscal framework is agreed will be a significant indicator as to how further devolution is likely to work in practice.

187. As many of our witnesses emphasised, the Treasury’s current role as sole decision maker on fiscal matters is not sustainable. There has to be a willingness to work with the devolved institutions in seeking agreement on fiscal matters post-Smith. This will require cultural change both within the Treasury and at all levels of inter-governmental relations. There needs to be a culture of genuine respect between the various governments within the UK.

188. From a parliamentary perspective there needs to be a culture of openness and transparency in communicating inter-governmental discussions and decision-making in relation to the development, implementation and operation of the fiscal framework. It is essential, therefore, that the framework is developed openly and transparently and is subject to meaningful consultation with both the UK and Scottish parliaments. The significance of this document to the new devolution arrangements means that it is simply not appropriate for it to be agreed solely between the two governments.

The Scottish Government agrees with the points and recommendations made in paragraphs 186 to 188. Openness and transparency are key factors and ones which we recognise as being important. We have previously given a commitment to keep the Scottish Parliament updated on the negotiations with HM Treasury and we are happy to continue to do so.

It is also important that the Scottish Parliament is satisfied that a robust and credible fiscal framework has been agreed before it gives legislative consent to the Scotland Bill.