Introduction

1. SCDI is an independent membership network that strengthens Scotland’s competitiveness by influencing Government policies to encourage sustainable economic prosperity. SCDI’s membership includes businesses, trades unions, local authorities, educational institutions, the voluntary sector and faith groups.

2. SCDI welcomes the opportunity to contribute to the new Scotland Bill Committee’s discussions on the Scotland Bill, which will have a considerable impact on the operations of the Scottish Parliament, the devolution settlement and future direction of Scotland.

3. In SCDI’s Blueprint for Scotland\(^1\), published in June 2010, we call for the strengthening of the Scottish Parliament’s responsibility for tax and spending decisions which promote sustainable economic growth. Following the announcement from the coalition Government that it would legislate on the Calman Commission’s proposals, SCDI has continued to be involved in the debate, holding discussion forums for our members and participating in the Scotland Office’s High Level Implementation Group for the Scotland Bill.

4. SCDI’s contribution to the debate reflects recommendations which were agreed by members after discussion of the report Scotland’s Economy: The Fiscal Debate\(^2\) which was commissioned by SCDI and published in 2007.

These included the following:

- The current financial arrangements do not provide sufficient incentive or discipline on the Scottish Parliament regarding spending decisions, due to its lack of responsibility for raising substantial revenue.
- The current arrangements, as represented by the ‘Barnett’ process, are unsustainable in the long term, and an evidence base must be built to ensure good quality information is ready and available to feed into consideration of any new system which may be established.
- Any new funding mechanism must provide benefit to Scotland.
- The Scottish Parliament should commission an independent, comprehensive review of Scotland’s fiscal arrangements, which should aim to identify a small number of key fiscal policy measures that would promote sustainable economic growth in Scotland and address some of the weaknesses in accountability and transparency present in the existing arrangements:

\(^{1}\) Blueprint for Scotland, [www.scdi.org.uk/blueprint](http://www.scdi.org.uk/blueprint)

o It should be conducted by a panel of independent academics, including members from outside the UK who have not previously engaged in the Scottish debate.

o It should consider Scotland as a discrete economy within the larger UK and EU economies, but should not assume either independence or continued membership of the UK. Instead, where Scotland’s political status is a key factor in assessing a particular fiscal measure, the options with and without independence should be set out.

o The review should also pay close attention to the implications of recent European Commission and ECJ decisions on the legality of different proposals for fiscal autonomy within Member States.

- A new comprehensive needs assessment for the regions of the UK, identifying appropriate English regions for comparison with the territories of Scotland, Wales and Northern Ireland is required.

- There is mixed evidence that devolving greater powers to sub-national governments to raise and spend their own public funds is in itself enough to promote economic growth.

- The majority of SCDI members that participated in consultation discussions regarding the fiscal debate were not convinced by the arguments either for the status quo or for different models of either fiscal autonomy or further devolution. The key problem is the lack of independent evidence which might help inform the decision. There is a strong case for more independent research into the pros and cons for small countries like Scotland of adopting different fiscal powers.

5. SCDI has a broad membership which has no single position on the Scotland Bill or wider fiscal proposals. However, members believe that the economy and Scotland’s global competitiveness should be central to the fiscal debate and the possible impact of the Scotland Bill on these issues should be uppermost in the Committee’s deliberations. However, feedback from SCDI members indicates that, in their view, the highest priority economic issues for the Scottish Parliament continue to be:

- Improving the skills of the workforce and increasing productivity
- Encouraging greater private sector research and development
- Ensuring an effective contribution from the public sector in support of growth
- Improving transport and IT infrastructure to help attract and stimulate growth
- Attracting inward investment and increasing Scotland’s exports

SCDI response to the Committee’s questions

1. Session 3 Committee recommendations
SCDI was pleased to provide evidence, both written and oral, to the Session 3 Scotland Bill Committee. We asked the Committee to consider a number of principles when reviewing the Scotland Bill:
• Do the proposals encourage and better enable the Scottish Government and Parliament to prioritise increasing sustainable economic growth?

• Will the proposals safeguard and/or create a more competitive economy, which supports higher business investment and net exports?

• Will the Scottish Parliament’s revenues and grant allow for resourcing of priority outcomes, and long-term planning in and reforms to public service delivery?

• Will they support a higher level of investment in enhancing Scotland’s infrastructural assets?

SCDI continues to seek reassurance, through economic modelling, including Scottish and UK Government facilitation for independent economic modelling, that the tax reforms proposed in the Scotland Bill and by the Scottish Government would support the Scottish economy through a period of economic volatility and/or fiscal contraction. SCDI members strongly believe there is a need for more evidence of how the Scotland Bill and the proposals by the Scottish Government to devolve corporation tax would impact on the economy and public spending, particularly in the event of a future economic downturn, where stability of public spending is essential.

SCDI members have expressed the view that greater financial responsibility for the Scottish Parliament should be considered within the context of policies for sustainable increases in Scotland’s comparatively sluggish long-term economic growth rate. Information gathered by SCDI does not show a clear and consistent link between taxation and expenditure decisions following devolution and this overarching economic priority. The interest of SCDI’s members is principally in whether new financial powers and accountability will further encourage and enable increasing sustainable economic growth via a competitive and stable environment for business growth and more closely aligning Scotland’s economic performance with the Scottish Parliament’s revenues.

Lack of evidence and conflicting evidence on the impact of any new fiscal powers is a key concern for SCDI members. SCDI and the Centre for Public Policy for Regions had proposed to undertake new and independent fiscal modelling for Scotland. This would have enabled more informed debate among policy-makers, businesses, civic Scotland and the public on the impact on the Scottish economy of changes in fiscal spending, and the impact of different ways of funding such spending. We were not granted access to the tax-benefits model developed by the Scottish Government which would have enabled this analysis to proceed and contribute to consideration of the Scotland Bill. SCDI believes that the Scottish Government and Treasury should offer access to their fiscal models for the purpose of independent analysis of economic and fiscal proposals.

The outlook for public spending in Scotland is the most challenging since devolution. SCDI has recently published six Budget principles3 and urged that these are applied to current and future decision-making by the Scottish Government and Parliament:

1. Increasing sustainable economic growth is now an even higher priority for the Scottish Government and public services
2. Scottish budgets should ring-fence priority outcomes, rather than departmental budgets.
3. The core functions of public sector bodies must be identified and resourced. This represents an opportunity to develop new models and partnerships for public service delivery.
4. Public spending should be subject to a ‘Scottish Exports Test’
5. The capital investment programme is a high priority, but business cases should be re-evaluated rapidly to ensure that projects are prioritised with current economic opportunities.
6. Scotland’s public spending should be reviewed to ensure inter-generational equity and funding to create new education, training and job opportunities for young people.

In an operating environment of greater fiscal powers, it will be of increasing importance for Scotland to have greater independent analysis of public spending. SCDI proposes the establishment of a Scottish Office for Budgetary Responsibility. A Scottish OBR could take a lead role in making an independent yet informed assessment of the public sector balance sheets, have control over forecasting and inform spending decisions.

2. Amendments made in the House of Commons
SCDI does not believe that the amendments made to the Scotland Bill in the House of Commons make a significant change to the Bill as first published. We note the bringing forward of borrowing powers as announced by the Westminster Government.

3. Borrowing Powers
SCDI broadly supports increased borrowing powers for the Scottish Parliament. As a result of the UK Comprehensive Spending Review, capital expenditure is due to fall in real terms by 35.9% from 2010-11 to 2014-15. SCDI is deeply concerned about the impact on plans to improve Scotland’s infrastructure, particularly its connectivity, and the vital construction sector, especially when the need for a new Forth Crossing and Southern General Hospital will account for the vast majority of its capital budget. SCDI believes that borrowing limits must be sufficient for the Scottish Government to manage its capital investment programme effectively and flexibly, and fluctuations in revenue arising from the substitution of a portion of the block grant with income tax revenues, within acceptable UK debt levels.

SCDI welcomes the bringing forward of borrowing powers as announced by the Westminster Government, however we note that this is still some way short of the original Scotland Bill Committee’s recommendations. SCDI believes that investment in strategic infrastructure that will provide a short-term boost to economic activity and increase long-term economic output, such as transport and digital connectivity, should be prioritised at this time, and we recommend further consideration of the proposed borrowing limit to support Scotland’s capital programme.
4. Scottish Income Tax
In SCDI’s response to the previous Committee, we recommended that the Committee should consider a number of practical issues regarding the implementation of the fiscal changes in the Scotland Bill. These include:

- The definition of a Scottish tax-payer
- Ease of adaptation for businesses and individuals on Self Assessment, including ensuring compatibility with accounting/payroll software
- Assurances that the Scottish Parliament will receive all the tax money it is entitled to
- Concerns about the ease of switching a designated main home
- Tax returns for mobile or foreign workers or those moving into or out of Scotland mid-year

Whilst some of these issues were mentioned in the Committee’s report, we do not yet feel that all our concerns in these areas have been fully addressed, and remain concerned that that the rules for designation as a Scottish tax-payer could underestimate the number of tax-payers in Scotland.

5a. Corporation Tax
Corporation tax is an important lever to promote growth and investment, and we therefore welcome discussion of whether its devolution to the Scottish Parliament and reform would benefit the Scottish economy overall. SCDI fully recognises the potential for competitive rates of corporation tax to attract foreign direct investment and encourage entrepreneurship and business growth. It is clear that a wide range of other factors also have a strong influence. SCDI believes that analysis of the relative benefits, disbenefits and importance of differential corporation tax rates is required, including whether real economic activity would be attracted or an incentive for businesses to “shift” profits around tax jurisdictions would be created; in other words, whether corporation tax competition within the UK would be efficient or lead to a “race to the bottom”.

This discussion must be evidence-based. SCDI has found that there is mixed evidence that devolving greater powers to sub-national governments to raise and spend their own public funds is in itself enough to promote economic growth. We have called for an independent, comprehensive review of Scotland’s fiscal arrangements, which should aim to identify a small number of key fiscal policy measures that would promote sustainable economic growth in Scotland and address some of the weaknesses in accountability and transparency present in the existing arrangements.

Given the volatility of Corporation Tax receipts, it is necessary to understand whether any proposed reforms would support the Scottish economy and public spending through a period of economic volatility and/ or fiscal contraction. Feedback from SCDI members continues to indicate that the highest priority issues for the Scottish Parliament are still skills, infrastructure, innovation and growing exports, and the potential benefits of devolving and reforming corporation tax needs to be considered along with the risks that there will be less public funding available to support these highly important economic priorities.
The UK Government has announced the phased reduction of the corporation tax to 23% by 2014, which would be the lowest headline rate of corporate tax in the G7. This suggests that the Scottish Government would have to make very substantive reductions to current corporation tax rates in Scotland to improve Scotland’s competitiveness with the rest of the UK, which would have commensurate implications for lower revenues and, therefore, public spending and services, at least in the short-term. It can also be anticipated that other UK regions would seek to maintain their corporation tax competitiveness if the Scottish Parliament cuts the Scottish rate.

Where different tax jurisdictions have always existed, businesses develop systems to comply and put appropriate processes into place when they expand into new markets. However, the creation of differing tax jurisdictions in an existing single market is quite different. Many Scottish businesses, and businesses based elsewhere in the UK, have grown organically over many years and their activities in Scotland and England are heavily intertwined. Some of these will have had no experience of operating in differing corporation tax jurisdictions. Those businesses which do operate internationally will have to calculate and attribute within the UK profits made overseas. The complexities and costs for businesses of separating out their existing activities and creating and maintaining distinct compliance processes could be considerable. There are numerous layers to the tax system, and many practical questions for businesses which remain unanswered. It needs to be considered whether there is the potential that these resources would be utilised more productively elsewhere.

There also exists the risk that some non-Scottish UK businesses which at present have small, marginally profitable operations in Scotland may decide to withdraw from the Scottish market rather than deal with new complexities and costs, or the risk that other non-Scottish UK businesses considering expansion into Scotland may regard them as a barrier, which could reduce investment and employment in Scotland as well as diversity and choice for Scottish consumers.

While HM Treasury has not yet provided an estimate of the administration costs associated with devolving corporation tax in Northern Ireland from which a comparison could be made and the Scottish Government’s stated commitment to a tax collection system which provides value for money is noted, it seems certain that the start-up, ongoing and anti-avoidance costs of a separate regime will be significant, particularly in a prolonged period of spending constraints. HM Treasury and the Scottish Government should work together to provide estimates for the extra costs in Scotland following HM Treasury’s work in Northern Ireland.

5b. Excise Duty on Alcohol

The latest figures from Scotland Food and Drink and the Scotch Whisky Association demonstrate the success and importance of the drinks industry to the sector, Scottish exports and Scotland’s economy. Most producers already successfully navigate global taxation systems when selling around the world, but, as with corporation tax, this is different from creating two systems from an existing single market. The rest of the UK remains a major market for the industry. It must be
recognised that the devolution of alcohol duty risks adding complexity, uncertainty and additional administration to Scottish alcohol producers and distilleries. In the case of selling to customers in the rest of the UK under a different rate of taxation, Scottish producers may have to set up a new, separate company in the rest of the UK, transport goods to the rest of the UK under bond and then pay the rest of the UK duty rates. Concerns exist on how assurances can be made that alcohol sold in the rest of the UK and Scotland had paid the correct duty. This could increase the administrative burden on Scottish-based companies that sell alcohol across the UK. If a lower rate of duty was in force on one side of the border, unregulated cross-border trading, such as happened between England and France, becomes a possibility and would need to be addressed.

SCDI would seek assurances that the transfer of excise duty complied with relevant European Directives. If it is devolved, we would strongly advocate that the same agency has responsibility for the collection of tax receipts across the UK. We would also recommend that the Scottish Government immediately introduce fundamental reforms to implement a fairer, simple and transparent system which taxes all drinks on the same basis which would be according to their alcohol content.

6a. Aggregates Levy
The aggregates levy is a highly complex regulation and there is a risk that devolution will make the system even more complex for aggregates producers.

There is little evidence that the aggregates levy has reduced consumption of aggregates or increased recycling. It is doubtful that the devolution of the levy would change this and, with the industry challenging its legality in the European Court, SCDI has not seen a strong case for the transfer of this power to the Scottish Parliament.

6b. Air Passenger Duty
Given its relatively greater distance from major markets, the issue of air passenger duty is of particular importance to the Scottish economy and Scotland’s targets to increase the value of its exports and tourism revenues. The withdrawal of the Scottish Government’s Route Development Fund due to EU state aid rules has set back efforts to develop direct international air routes. Ireland, a major competitor country to Scotland in sectors such as tourism, recently reduced the burden on aviation in order to attract more visitors.

The Scottish Government has said that, if APD is devolved, it would exercise its new powers to support Scotland’s connectivity and attract new routes. With a firm commitment from the Scottish Government to maintain and enhance the competitiveness of the aviation sector, SCDI would support devolution of APD.

7a. Crown Estate
SCDI members have differing views on whether there is a need to reform the legal framework within which the Crown Estate Commissioners operate. This is an issue which is of interest to a range of important industries for Scotland. Feedback from business in a range of sectors suggests that they are, broadly, content with the improvements which have been made in their relationships with The Crown Estate
and – so far as increasing sustainable economic growth is concerned – they do not believe that a strong case for change has been made. SCDI appreciates that there can be real community concern about accountability.

The question of reform of the legal framework for the Crown Estate may be considered separately from the question of retention of its Scottish revenues. SCDI would support retention of this revenue stream in Scotland, whether or not the legal framework in which the Crown Estate Commissioners operate changes.

As economic opportunities grow, the pace of delivery speeds up and the need for close relationships increases. The Crown Estate must continue to strengthen its presence in Scotland and its partnerships, nationally, regionally, locally and with leading industries. SCDI has suggested that The Crown Estate might consider reinstating a “principal officer for Scotland” to head up the organisation and act as the main point of contact for the Scottish Government and key stakeholders.

7b. Power Companies and Carbon Emissions Reductions Target
This is a very complex area. In order to comment on this, SCDI needs more time to consider these issues and engage in detailed discussion with our members.

8. Broadcasting
SCDI has no comment to make in this area

9. European Union
SCDI has no comment to make in this area

10. UK Supreme Court
SCDI has no comment to make in this area

11. Further Changes to the Scottish Parliament’s Powers
Scotland has a different labour market from the rest of the UK and a demographic outlook which means our working age population needs to expand to enable growth in key sectors of the Scottish economy. However, as analysis by the Migration Advisory Committee has shown, it has attracted a lower than average share of highly skilled and skilled migrants to the UK. SCDI believes that should support the UK Government’s policy of enabling more balanced regional economic growth. Most of the migrant workers coming to Scotland under Tier 2 do so after meeting the resident labour market test and Scotland has not experienced the same impacts of migration which have been felt in parts of south-east England. Overall, highly-skilled and skilled migrant workers in Scotland have made a positive contribution to the Scottish economy and its local economies, local taxation, and the delivery of public services in communities. SCDI recommends that the UK Government should take a flexible approach in Scotland and introduce a regional variation which attracts skilled migrants to work in the Scottish economy. We strongly support the call for the introduction of a Scotland Skilled Workers Flexibility so it is provided with a distinct annual allowance in relation to Tier 2, at a level which is responsive to Scotland’s economic needs. We also consider that a lower qualifying salary level for Intra-Company Transfers would be appropriate for Scotland.
SCDI also calls for flexibility for Scotland’s universities and colleges. These institutions are a cornerstone of Scotland’s international reputation and major export earners. Scottish institutions should have the opportunity to succeed in the highly competitive global market for higher education. International students contribute nearly £188m in fees and £231m in spending to the Scottish economy each year, providing diversity within the education system and promoting Scotland’s global reputation for high-quality education. Each year, a number of international graduates choose to stay in Scotland, supporting our population and delivering new skills essential to the success of the Scottish economy. Scotland’s different economic and demographic circumstances require a different approach to immigration regulations.

In SCDI’s *Blueprint for Scotland*, we called for a more localised approach to support people claiming out-of-work benefits into work and employment. This included a call for local devolution of responsibility for delivery of New Deal for the disabled, and greater cross-parliament work to develop benefit and student support mechanisms that work together to take full account of the differing student support systems in use across the UK.

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