The Scottish Parliament
Pàrlamaid na h-Alba

Official Report

FINANCE COMMITTEE

Wednesday 24 February 2016

Session 4

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FINANCE COMMITTEE
7th Meeting 2016, Session 4

CONVENER

*Kenneth Gibson (Cunninghame North) (SNP)

DEPUTY CONVENER

*John Mason (Glasgow Shettleston) (SNP)

COMMITTEE MEMBERS

*Jackie Baillie (Dumbarton) (Lab)
*Lesley Brennan (North East Scotland) (Lab)
*Gavin Brown (Lothian) (Con)
*Mark McDonald (Aberdeen Donside) (SNP)
*Jean Urquhart (Highlands and Islands) (Ind)

*attended

THE FOLLOWING ALSO PARTICIPATED:

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

CLERK TO THE COMMITTEE

James Johnston

LOCATION

Committee Room 4

Scottish Parliament

Finance Committee

Wednesday 24 February 2016

[The Convener opened the meeting at 09:30]

Decision on Taking Business in Private

The Convener (Kenneth Gibson): Good morning and welcome to the seventh meeting in 2016 of the Finance Committee of the Scottish Parliament. I remind everyone to turn off mobile phones, tablets and other electronic devices.

Agenda item 1 is a decision on whether to take item 3 in private. Do members agree to do that?

Members *indicated agreement.*

Fiscal Framework

09:30

The Convener: Agenda item 2 is to take evidence on Scotland's fiscal framework. Regrettably, the Chief Secretary to the Treasury declined our invitation to appear before the committee today. However, he has previously indicated that he will be happy to attend once the framework has been agreed. Therefore, given the tight timescales involved for scrutiny, we will invite him to attend our next meeting, which will take place on 2 March.

We will now take evidence from the Deputy First Minister, who is joined by Alistair Brown, who is deputy director of the Scottish Government's fiscal responsibility division. I welcome our witnesses and invite Mr Swinney to make an opening statement.

The Deputy First Minister and Cabinet Secretary for Finance, Constitution and Economy (John Swinney): I am grateful to the members of the Finance Committee for their work to date on examining the proposals for a fiscal framework, and in light of yesterday's announcement to the Parliament I very much welcome this early opportunity to provide further detail to the committee.

Paragraph 94 of the Smith commission report recommended that the devolution of further tax and spending powers to the Scottish Government should be accompanied by an updated fiscal framework for Scotland. It is the framework that will determine how the powers proposed by the Smith commission can be used and so it is as important, if not more so, than the Scotland Bill itself.

My overarching aim has been to ensure that the new fiscal framework is fair and workable, and is in line with the principles that were set out in the Smith commission report. On 7 October, I set out to Parliament the areas where we needed to reach agreement as part of an acceptable fiscal framework. Those were the block grant adjustment for tax, the implementation and on-going costs associated with the devolution of welfare benefits, and securing additional capital and resource borrowing powers.

I have engaged constructively in the fiscal framework negotiations and I met the Chief Secretary to the Treasury on 10 occasions, through the joint exchequer committee. Over recent days, the First Minister and I have continued to work with the United Kingdom Government to secure a fair deal, and we have both discussed the detail of the fiscal framework with the Chancellor of the Exchequer.

As a result of those discussions, significant progress has been made across all the key areas of the fiscal framework, and the committee will know from the First Minister's supplementary statement to Parliament last night that there is on the table an agreement in principle that I believe we can recommend to Parliament. A draft heads of agreement will be published for scrutiny by Parliament by the end of this week.

We sought a fiscal framework that will give the Scottish Government the flexibility that it needs to create a fair and prosperous Scotland, and the ability to use the powers that we have in an effective way. To get to this point we have all had to compromise. There has been give and take as we worked our way through the deal, but I refused to compromise in one key area: the area of no detriment.

Smith said that the Barnett formula should determine the size of the block grant—that is the benchmark against which we must assess the operation of no detriment. The fiscal framework should not seek to undermine the operation of the Barnett formula as the basis for determining public expenditure in Scotland. Crucially, Smith identified that Scotland's budget should be no larger or smaller simply as a result of the initial transfer of powers.

We have reached an agreement on the block grant that involves using the UK Government comparability model, which will be configured to deliver the Scottish Government's preferred option of per capita indexed deduction. Under the proposal there will be not a single penny of detriment to the Scottish Government's budget as a result of the devolution of powers during the transition period, which will be the six years to March 2022. The UK Government will guarantee that the outcome of the Scottish Government's preferred funding model, per capita indexed deduction, is delivered in each of those years.

Alongside that there will be a review that will be informed by an independent report, which will present recommendations to both Governments by the end of 2021. The fiscal framework will not include or assume the method for adjusting the block grant beyond the transitional period. The two Governments will be required to jointly agree that method as part of the review, and that must deliver results consistent with the Smith commission's recommendations, including the principles of taxpayer fairness, economic responsibility and, crucially, the principle of no detriment. That secures no detriment now and for the next six years, and we have ensured that there can be no detriment imposed on Scotland at any point in the future.

We have agreed to increase the Scottish Government's capital borrowing limits to a cumulative £3 billion, with annual flexibility of 15 per cent of that. That increases our annual capital borrowing facility to £450 million to invest in infrastructure in Scotland and so improve economic performance.

We will receive the powers that are necessary to manage tax volatility and economic shocks by increasing the resource borrowing limits that are set out in the Scotland Act 2012, alongside introducing a new Scottish reserve. The borrowing limit for forecast error will be £300 million per annum, the aggregate annual limit for forecast error and economic shock will be set at £600 million, and the overall resource debt limit will be £1.75 billion.

On implementation and administration costs, we have agreed a one-off payment of £200 million to support implementation costs and on-going funding of £66 million per annum.

The committee will be keen to hear that I have agreed that the Scottish Fiscal Commission will produce the official forecasts of gross domestic product and tax revenues. I will lodge appropriate amendments at stage 3 of the Scottish Fiscal Commission Bill to give effect to those provisions.

That forms the basis of a fiscal framework that is true to the Smith principles. The deal will ensure that the funding for Scotland cannot be changed without the Scottish Government's agreement. It protects the Barnett formula and will allow the powers in the Scotland Bill to be delivered.

I am acutely aware that not all the detail is in front of the committee today. Once the material has been published this week, I will make every effort to be available to appear before the committee to look at the further detail, if that is the committee's wish.

The Convener: Thank you very much for that opening statement. We are all delighted that an agreement has been reached.

You talked about a number of areas and made it quite clear that the Scottish Government did not compromise on the issue of no detriment, but obviously there have been compromises on other issues, such as the Scottish Fiscal Commission and borrowing. Were any further compromises made that you wish to advise the committee of?

John Swinney: Obviously, the Scottish Government advanced particular propositions in the negotiation process when we were trying to secure the agreement. For example, I argued for a higher borrowing limit than £3 billion, but I accepted that the borrowing arrangement had to be consistent with the United Kingdom's chosen fiscal framework. The Smith commission report required that of me. If I am going to argue as strongly as I have argued for the implementation of the Smith commission report, I have to accept that, if there are constraining factors, I must live within them. I have therefore compromised on the total debt limit that I would like to have seen, the annual constraints on capital borrowing, and a variety of other issues.

Fundamentally, we have to take a step back from the conclusions and ask whether, in the round, the package is a reasonable one that can be recommended to Parliament. In my judgment, it is.

The Convener: Thank you. Prudential borrowing will not be one of the aspects of the framework, will it?

John Swinney: No, it will not be. An aggregate limit of £3 billion will be set on borrowing, which is an increase from the £2.2 billion that the Calman commission proposed, and, most significantly, there will be an expansion of the annual borrowing facility. The borrowing that we can undertake in 2016-17 is £316 million. The new facility will take that up to £450 million, so there is increased capacity to undertake capital borrowing.

One of the easier issues for us to resolve in the process was to do with resource borrowing. The Chief Secretary to the Treasury took an entirely understandable view about the risks of volatility to which the Scottish Government would be increasingly exposed. Again, the facilities that have been offered in that respect are appropriate in the circumstances.

The Convener: You have talked a lot about the fact that Scotland will not suffer detriment to the tune of one penny, but a number of issues that have come out over the past couple of weeks have raised alarm bells. For example, the Scottish Council for Voluntary Organisations has talked about £100 million-worth of employability budget being devolved, but only £7 million being devolved to go with that.

What is the position on such issues and on welfare, where there were considerable concerns about the full cost of the devolution? You mentioned figures of £200 million in set-up costs and £66 million a year, but what does that encompass and where do employability and welfare fit in?

John Swinney: I will separate those issues out after I make a preliminary remark. My comments in relation to the exercise of the no-detriment principle relate to the block grant. The employability expenditure is outwith the block grant. The point on no detriment—of there being not a pound lost from the Scottish block—is the relevant reference point of the argument on the block grant adjustment.

Employability is slightly different. The Smith commission report said that the employability programmes should be devolved to Scotland with the appropriate funding streams at the conclusion of the contract. As members will be aware, we expected those contracts to conclude in April 2016. However, they have been extended and therefore the moment of devolution will be later than that envisaged by the Smith commission. By the time that we reach the point of devolution, the UK Government will have taken decisions within its own competence to reduce the size of employability programmes in the United Kingdom, which will have a consequent effect on Scotland. In short, at the point of devolution, the employability programmes will be diminished compared to what they were when the Smith commission took its view.

The Treasury has advanced the argument that what should be devolved is the funding at the point of devolution, rather than the funding at the point of agreement to devolve. The Chief Secretary to the Treasury and I did not agree on that, but I had to accept it in the round of compromises. When it gets to the moment of devolution, the UK Government's spending on employability programmes will be significantly less than it was at the time of the Smith commission report, and that will be the consequential funding stream to Scotland. We expect that to be £7 million in 2017-18, £10 million in 2018-19, £11 million in 2019-20 and £13 million in 2020-21. The Scottish Government will have responsibility for employability programmes, but it will not have the funding streams that were envisaged by the Smith commission in 2014.

You asked about administration costs. There are costs associated with the set-up of new systems for welfare and other administration activities. We agreed a one-off capital figure for that of £200 million, which will be transferred to the Scottish Government, with an on-going annual figure of £66 million to support the operation of the programmes in years to come.

The Convener: How realistic is that settlement in terms of the ability to deliver the programmes?

John Swinney: The Department for Work and Pensions estimate for the set-up of equivalent systems in Scotland was £350 million. We have secured more than half of that capital cost. The lowest estimate that the Scottish Government had for the set-up cost was £400 million.

I was mindful again of the Smith commission report, which argued that the UK Government should pay a share of the set-up and implementation costs, not all of them. I was mindful that, if I were to hold to the details of the Smith commission report, it had to be on a fair and sustainable basis.

The Convener: How realistic is the £66 million in terms of the ability to deliver?

John Swinney: The DWP estimate of the cost of administering the systems in Scotland was £60 million, with a marginal saving of an additional £12 million. As is customary in relation to block grant adjustment issues, we decided to split the difference on the additional £12 million and add that to the £60 million. There would no block grant adjustment without a difference being split at some stage in the process.

The Convener: So the Scottish Government is reasonably content. Given that your borrowing is going up to £450 million, I think that you take the view that you will be able to fund the set-up costs of that new system.

09:45

John Swinney: I will come at that from the point of view that I do not believe that it is a given that it has to cost us more than £200 million.

The Convener: You just said that it would be £400 million—

John Swinney: That was the estimate that we had, but that does not necessarily mean that we have to spend that. The way in which I will take forward those priorities, if I am in a position so to do after the election, will be to try to control the costs, as the committee would expect us to.

The Convener: One of the issues in our report on the fiscal framework was moral hazard. We said that moral hazard needs to be explicitly addressed in the fiscal framework. How has that been addressed in the framework?

John Swinney: We are not at the conclusion of the drafting of the heads of agreement. I will certainly reflect on that point as we look at the finalisation of the heads of agreement document.

The Convener: That is fine. A lot of members want to come in with questions. We will start with Gavin Brown, who will be followed by Mark McDonald.

Gavin Brown: Cabinet secretary, I am pleased that you have been able to give a bit more detail than I had expected this morning. I want to probe some of it. You have outlined the changes in relation to capital borrowing, but when do they take effect? Might they take effect in the budget that we are about to vote on today, or are we talking about 2017-18?

John Swinney: They cannot take effect until the Scotland Bill receives royal assent, at the very least, which I do not imagine will happen before 1 April. If Mr Brown gives me a second, I can refer to some further handwritten notes that will help me here, but I imagine the commencement will be April 2017 for the borrowing powers.

Gavin Brown: You mentioned a number of limits but I was scribbling quite furiously at the time and I want to make sure that I have taken them down correctly. You said that the resource borrowing limits are £300 million per annum—

John Swinney: If it helps, convener, I am happy to provide a note to the committee. Indeed, I said earlier that a note will be provided.

The Convener: The information will also be in the *Official Report*.

Gavin Brown: So the limit is £300 million per annum for forecast errors.

John Swinney: That is correct.

Gavin Brown: You also mentioned £600 million. Is that for economic shocks?

John Swinney: It is the combined figure for forecast errors and economic shock.

Gavin Brown: So it includes the £300 million.

John Swinney: The £300 million is a subset of the £600 million.

Gavin Brown: What is the £1.75 billion figure?

John Swinney: That is the figure for cumulative debt stock, which can be built up as a consequence of resource borrowing. For completeness, I should say that the repayment period for that £1.75 billion debt stock is between three and five years, to be determined by the Scottish ministers.

Gavin Brown: Three to five years. So that is resource borrowing dealt with.

As you will know, I have had an interest in seeing the official forecast done by the Scottish Fiscal Commission, and I am pleased to hear that you are going to lodge amendments in that respect. To meet the parliamentary timetable, you will have to lodge the amendments by midday on the Friday before stage 3, which I think is two weeks tomorrow. Traditionally, the Government lodges amendments the day before to allow other members to see them. Are you willing to discuss this so that I do not have to wait until that Thursday to see the amendments and then think, “Oh right, there is actually something else that ought to go in”? Are you open to having that discussion so that I am not having to check things at the last minute and finding that I want to do something different?

John Swinney: Given that Mr Brown has put such industry into the proposition, I am very happy to have that conversation with him, and with any member. I recognise the committee’s interest—not least that of the convener—in that issue, and I am certainly happy to discuss the matter offline.

We are still working through the detailed provisions of what is expected, and it has been an area in which I have been keen to reach agreement with the Treasury on the issues that matter to it. What I have resisted is the Scottish Fiscal Commission being comprised on a basis identical to that of the Office for Budget Responsibility. For example, the Treasury advanced with me the need to have, like the OBR, non-executive directors. I do not think that it had quite understood that in the Fiscal Commission that function is exercised by three commissioners who are appointed by Parliament and over whom the Scottish Government has no control.

The key issue on which I have reach agreement with the Treasury is that the forecasts of revenues and GDP must be undertaken by an independent body, and that will be the focus of my attention in drafting the amendments at stage 3. I am not at all keen to reconstruct the Fiscal Commission, because it operates independently. Obviously, it will have to be resourced to exercise the functions that will now fall on it, but the precise agreements that we have arrived at relate to forecasting issues, which I know have been material to the committee and to Mr Brown.

Gavin Brown: I am grateful for that. The committee's fiscal framework report concluded that there ought to be discussion of fiscal rules. You might not be able to tell us about this until the end of the week, but have any fiscal rules been agreed between the Scottish and UK Governments as part of the fiscal framework?

John Swinney: I have gone through a few fiscal rules relating to capital borrowing limits, resource borrowing limits and repayment periods. That is the architecture of fiscal rules. If there were a requirement to have, for example, debt repayment on resource borrowing over a period of three to five years, that would be an obligatory fiscal rule and a limit within which we would have to operate. To that extent, then, those are fiscal rules.

I have not gone through the details of the Scotland reserve with the committee, but it will essentially draw together the current cash reserve provision that was created by the Scotland Act 2012 and the budget exchange mechanism facility to create a single Scotland reserve that will be capped in aggregate at £700 million with an annual draw-down maximum from the cash reserve of £250 million for resource and £100 million for capital. I consider those to be other fiscal rules that will define the arrangements within which we operate.

Gavin Brown: Finally, on how matters will progress, this committee and the Devolution (Further Powers) Committee—and perhaps other committees—will obviously conduct scrutiny of the framework. I understand that legislation is not formally required, so what happens at the end of the process? Do you simply lodge a motion that Parliament will vote on? How do you envisage the sign-off mechanism, if you like, by Parliament?

John Swinney: Essentially, if I understand the process correctly, this committee feeds its input into the Devolution (Further Powers) Committee, which is the lead committee for the consideration of the legislative consent motion. As I have indicated, I consider us to be in a position where we can recommend the Scotland Bill for legislative consent, subject, of course, to the scrutiny that is applied by the committees.

As I made clear yesterday to the Devolution (Further Powers) Committee, I have been conscious of the forbearance of parliamentary committees in their not being able to scrutinise the hard detail of the fiscal framework. That detail will become available with the heads of agreement in the course of the next couple of days, which will enable scrutiny to be undertaken. As I have also indicated, I recognise the timing constraints that have been created, so I will make myself available to come to the committee at any time if members wish to see me again on these questions. We will then recommend the bill for legislative consent.

As for legislative change, I am led to believe that the United Kingdom believes that it requires to make technical amendments to the Scotland Bill in the House of Lords to ensure that the capital borrowing provisions can take effect. Obviously, there will be the usual intergovernmental dialogue around the contents of those amendments before they are tabled.

Mark McDonald (Aberdeen Donside) (SNP): Good morning, Deputy First Minister. It is good to see that we have a deal, if for no other reason than I questioned you 24 hours ago in this very room and it would have started to feel like "Groundhog Day" otherwise.

I wish to consider a couple of bits of the detail of what has been agreed. Yesterday, Willie Rennie expressed some concern, which he has reiterated today, about the way in which the model for the transitional period has been arrived at. You have said today that it is effectively per capita indexed deduction by another name. Can you go into the detail of how that has been arrived at?

John Swinney: Essentially, we have agreed to use what the Treasury has described as its comparable model, which considers the share of taxation—income tax, stamp duty land tax, landfill tax, VAT, air passenger duty and aggregates tax—that emanates from Scotland and creates a block grant adjustment accordingly. If that had been applied in the fashion proposed by the Treasury, it would have delivered detriment to the Scottish budget, and we could not agree to that. We therefore agreed to a variation of that model to deliver the outcome that would have been created by per capita indexed deduction.

The key question here is: what is being delivered and what is the impact on the money? The impact on the money is driven by per capita indexed deduction. That is what we wanted to secure, and that is what we have secured. That is where the basis of no detriment comes from. Essentially, we have got either an elegant or an inelegant route to get to per capita indexed deduction.

Mark McDonald: Willie Rennie was concerned that the Treasury model's underlying the arrangements could pose problems after the transitional period. I presume, though, that the independent review, which requires both Governments to agree, will act as a check against that.

With regard to the independent review, the committee has in the past suggested the need for some arbitration mechanism to deal with disagreements between the Scottish Government and the Treasury. Do you envisage the independent review process providing a model for something similar to emerge in future years?

John Swinney: I do not think that that is the case, because the agreement cements an important principle on which I secured agreement in the Smith commission. The crucial difference with this agreement is that the Smith commission, at my request, agreed that, whatever fiscal rules were put in place, they had to be agreed jointly between the Scottish Government and the United Kingdom Government as equals. For the first time, we could not have something imposed upon us. That is the origin of the Scottish Government's negotiating strength in reaching this agreement.

In agreeing to the block grant adjustment mechanism, I was anxious to ensure that that facility—that opportunity and equality of status—was protected for the future, and it has been cemented into the agreement and protected. When the review takes place in 2022, both Governments have to agree the mechanism that creates the independent report, both Governments have to receive it and both Governments have to agree the reaction to it. The cementing of that equality of status between the Scottish Government and the United Kingdom Government into the agreement is the reason why I feel able to recommend the proposed framework for legislative consent and why I do not believe that there is any foundation whatever to Mr Rennie's remarks.

Mark McDonald: I appreciate that.

When the Devolution (Further Powers) Committee took evidence from the Secretary of State for Scotland last night, he could not, for obvious reasons, go into the composition of the review or who would undertake it. After all, we are talking about five years into the future. Will its composition—by which I mean, the individuals or organisations that will undertake the review—be jointly agreed by both Governments?

John Swinney: That is correct.

10:00

Mark McDonald: Again, at last night's meeting of the Devolution (Further Powers) Committee, the secretary of state outlined what he envisaged as the timeline for when the various powers would come into effect. You have helpfully highlighted when you believe the borrowing powers will come into effect; however, the secretary of state envisaged some powers being available to the Parliament in April 2017, while it might take a bit longer for other powers to become available. On the radio this morning, you disagreed with Mr Mundell's analysis of the Parliament's readiness to exercise some of those powers by April 2017. Can you expand on that for the committee's benefit?

John Swinney: Certainly. What I have agreed with the Chief Secretary to the Treasury is that it will be possible for the income tax powers to be exercised in April 2017, APD in April 2018 and the borrowing powers in April 2017. We will have to do further work on when it will be practical for the welfare powers to be exercised, but the approach will be informed by the output of the joint ministerial committee on welfare.

Mark McDonald: One of the questions that was asked last night was whether the welfare powers would be transferred as a basket of powers or whether the powers that it would be easy to devolve at an early stage would be devolved early. Given the administrative elements, would you want all those powers to pass over at the same time?

John Swinney: We will have to look carefully at all the operational arrangements, because we are dealing with benefits to individuals. The provisions on benefits are very different from the stamp duty provisions, but—if it is not a contradiction to say so—there is a similarity in that stamp duty had to be switched off to enable land and buildings transaction tax to be switched on. One Government must be ready to start up, and the other Government must be ready to shut down.

The same applies to welfare benefits, although the switchover is more significant, because it affects people's livelihoods and relates to income on which they are dependent. Therefore, with any benefit, we have to be absolutely certain that we have the necessary arrangements in place. The arrangements that we have on the welfare powers will require negotiation and dialogue, but I see no practical impediment to that being undertaken.

I should add that we expect VAT assignment to take place in the financial year 2019-20.

Mark McDonald: Why is VAT being devolved then rather than at the beginning of the process?

John Swinney: Essentially because we must ensure that we have a strong methodology and a strong database to deal with it. That work is not being undertaken at the moment.

Jackie Baillie (Dumbarton) (Lab): First of all, on welfare, my experience is that it is easier to switch things off than to switch them on. I assume, therefore, that it is a case of our testing our readiness to accept those benefits. Would that be fair?

John Swinney: Yes. As we will be the paying authority, we must be able to pay out, so we must make sure that the necessary arrangements are in place.

Jackie Baillie: Do you have a timetable in mind?

John Swinney: Not at this stage. Obviously, the Government will want to exercise the powers as soon as possible, but as Jackie Baillie will understand we must be able to do that in a fashion that means that we can deliver on our commitments.

Jackie Baillie: Of course.

I welcome the agreement that has been reached and the cabinet secretary's change of heart or compromise—whichever it was—on the Scottish Fiscal Commission. I think that it is absolutely right for the commission to do the independent official forecasting, and I am glad that he has been persuaded of that case.

It will be extraordinarily helpful if the detail of precisely what that will mean can be published before stage 3 of the Scottish Fiscal Commission Bill. I think that I heard a commitment to do that by the end of this week. Was I mistaken?

John Swinney: The heads of agreement will be published by the end of this week, and it will include what we have agreed with the UK Government on that particular question. As I said earlier in response to Gavin Brown, we have talked quite extensively in the joint exchequer committee about the arrangements that it would be appropriate to put in place. Some of what the UK Government was arguing for was unnecessary, and I think that I have successfully persuaded it of that. As far as the agreement is concerned, the key thing has been the formulation of official forecasts on GDP and revenues, and that point is beyond dispute.

Jackie Baillie: I wonder whether I might push at what appears to be a slightly open door and ask you about the sustainability of public finances and how the Government is meeting the fiscal rules. After all, both are areas in which we felt the Fiscal Commission might benefit from having a role.

John Swinney: I will consider those points, but I am keen to know what Jackie Baillie means by "fiscal rules". I am clear about what I mean by "fiscal rules". If I have a fiscal rule that limits our revenue borrowing to £300 million, I know what the rule is. They are clearly matters of public report. If Jackie Baillie will write to me with her suggestions, I will happily consider them.

Jackie Baillie: I am even happy to meet you, along with colleagues. That might be quicker and more persuasive.

The Convener: Steady on.

John Swinney: It looks like I am going to have a regular queue at my office door to talk about this question.

The Convener: Just send him an email.

Jackie Baillie: That is fantastic, cabinet secretary. Thank you.

Let us move on to the review that is set for March 2022. I have listened to what you have outlined, and I think that it is a reasonable framework. However, I am curious to know what will happen when one party disagrees. Some commentators suggest that the discussion or debate—indeed, argument—has only been put off for five years. As I do not want that to be the case, I am curious to know what will happen when one party disagrees.

John Swinney: My desire would be to avoid that happening. The crucial point is the guarantee for the public in Scotland that nothing can be imposed on us because of the requirement for the framework to be jointly agreed.

I am not sure whether Jackie Baillie is being sceptical about the possibility of the Government reaching an agreement.

Jackie Baillie: Not at all.

John Swinney: I have an agreement about which I am not complaining, even though I have not got everything that I wanted. We have been able to secure agreements; for example, I pressed for movement on the Scotland Bill, because I felt that that was necessary to deliver what the Smith commission envisaged, and the UK Government has made that movement. I hope that members will recognise—indeed, Jackie Baillie herself might recognise this—that the Scottish Government is making reasonable points in these arguments to ensure that we deliver the agreements that we are required to deliver.

Jackie Baillie: The cabinet secretary will be more than aware that my position was very supportive of the Government.

John Swinney: It was.

Jackie Baillie: Indeed, I suggested that the cabinet secretary remain at the table until the agreement was reached. However, let us put that to one side and look at what is an issue that we need to understand. If either Government—it might be the UK Government rather than the Scottish Government—disagrees, what will happen? I recognise that nothing can be imposed for the future, but would we go back to something else and if so, what would we go back to?

John Swinney: We are getting into hypothetical territory here, and I am unwilling to speculate on what might happen. We have in place a mechanism that gives us confidence that nothing can be imposed on Scotland. The process will be informed by an independent report that we will have supported and participated in establishing, and we will be able to have a discussion on those matters with the United Kingdom Government that will be informed by the experience of an entire parliamentary session.

Jackie Baillie: I accept all of that. I accept that you have a mechanism that you feel comfortable with and which finds favour with me, and I accept that nothing will be imposed. However, I want to understand exactly what all the potential scenarios are. What will happen if there is a fundamental disagreement and the parties remain in their positions, not necessarily because of the intransigence of the Scottish Government but possibly because of the UK Government? What will happen to the Scottish Government's financial stability? That is what I am interested in.

John Swinney: As I said in my earlier answer, that is a hypothetical question. We have put in place arrangements that will enable us to deliver no detriment over the period up to 2022, and we have secured the preservation of our negotiating status on an equal basis with the Treasury in 2022 with a process that will be informed by an independent report. I think that that is a very reliable set of arrangements that will protect the Scottish interest.

Jackie Baillie: I absolutely agree. My problem is with understanding what the consequences will be if there is no agreement. I think that it is of value to this Parliament, and to this committee, to understand precisely what is at stake. You might have secured no detriment for a period of five years—and we absolutely support that—but I am worried that, if an agreement is not reached, the no-detriment period will not be preserved beyond that time. There is a shared interest—

John Swinney: That cannot happen in the scenario that Jackie Baillie has put to me because nothing can be imposed on us.

Jackie Baillie: So we keep what we currently have, and there is no change.

John Swinney: I am simply saying to Jackie Baillie that the scenario that she has put to me cannot happen because nothing can be imposed on us.

Jackie Baillie: Just so that I am clear, I will ask this question: does that mean that we will keep what we have and that there will be no reduction—in other words, no change?

John Swinney: I have tried to give as definitive an answer as I can within the context of the agreement. That is the firmest response that I can give to Jackie Baillie.

Jackie Baillie: Thank you very much.

Obviously, the value of the Barnett formula to Scotland's public finances has really come to the fore during the discussions. Have you undertaken any analysis of the value of Barnett? If so, can that analysis be shared with the committee?

John Swinney: The Barnett formula is applied at every fiscal event, and we see the implications in our budget, which will be discussed this afternoon.

Jackie Baillie: That is okay. I will pursue that separately.

Finally, I have a technical question about resource borrowing. You have said that you are able to borrow £300 million per annum for forecast errors. Is there a threshold to that? Does some of the responsibility lie with the Scottish Government if you get that wrong? My understanding of the current powers is that that is the case.

John Swinney: That amount is for the forecast errors for the taxes for which we are responsible.

Jackie Baillie: I understand that, but my question is about the threshold at which that is triggered. For example, my understanding is that just now it is triggered at, I think, £150 million. Is it the case that, if you get the forecast wrong, you have to cover a certain percentage before you can borrow?

John Swinney: No.

Jackie Baillie: So there is no threshold.

John Swinney: There is no threshold.

Jackie Baillie: Thank you.

Jean Urquhart (Highlands and Islands) (Ind): I was also really quite interested in the Barnett formula because, although the committee has taken evidence from lots of people, there was always a mystery surrounding Barnett and how it works, including among people who are involved with the Treasury. Throughout everything, we have been talking about having clarity on the calculations that are done on the Barnett formula. If we have that clarity now, I imagine that it is for the first time. Do you agree?

John Swinney: In my view, the calculations that are applied by the Barnett formula are pretty open. In essence, they are driven by two documents. One is the statement of funding policy, which includes a set of comparability indicators on, for example, health. Therefore, if there is a change to health expenditure in England, there is 100 per cent comparability for Scotland on health, because it is an entirely devolved function. On some other functions, such as defence, there is zero comparability. If there is an increase on defence expenditure, there is no consequential benefit to the Scottish block of expenditure, but if there is an increase in health expenditure in England, there is a population share of the entirety of the increase.

The comparability indicators are included in the statement of funding policy and the OBR will now publish a set of numbers that will examine the change within policy decisions that the United Kingdom Government makes. For example, if the UK Government was to increase health expenditure by £500 million, the OBR would record that and scrutinise it, then the comparability factor for health would be applied to it.

10:15

For every fiscal event, I receive from the UK Government a spreadsheet that shows me the change in the budget lines. A £500 million increase for health would give us a consequential. A £500 million increase for defence would give us a zero consequential. I can see all that and I scrutinise it all. My officials go through it with a fine-toothed comb to ensure that what was intended in Barnett changes is delivered.

Periodically, the statement of funding policy will be reviewed to consider the comparability indicators but, generally, it is a pretty transparent process. Whether it is widely understood is a completely different question, but it is reasonably transparent.

Jean Urquhart: If taxes in the rest of the UK were increased for a reserved matter—you mentioned defence—how would that affect taxes in Scotland?

John Swinney: Well, it would depend on which tax was increased. Let us say that it was national insurance contributions. That would affect Scotland because it is not a devolved tax. If it was income tax, only income tax in the rest of the United Kingdom would be increased, because we have the power over non-savings, non-dividend income tax in Scotland.

Jean Urquhart: However, if the tax was specifically raised for a reserved matter, Scotland would have a share of it. For example, if the UK Government raised tax to pay for Trident, would there not be Barnett consequences in Scotland because we would be paying equally? As you say, if there was an increase in health service spending, we would be given our share. If there was an increase in spending on reserved matters in which we have a share, would the Barnett formula be adjusted accordingly?

John Swinney: That issue is resolved in the UK Government's strategic choices across public expenditure in the UK. The UK Government undertakes its spending review processes and decides how much money it will spend on health, education, rural affairs and defence. It makes those decisions at UK Government level and makes its tax decisions about how it will fund them. The Barnett formula is then applied to those decisions. If there was a very significant increase in defence expenditure to pay for the renewal of Trident, for example, that would mean that less money would be available in the fiscal envelope to spend on services from which we might get a consequential.

Within its powers, the UK Government is able to spend money on defence. Let us say for argument's sake that that reduced the amount of money that it could spend on health. In that case, when the Barnett consequentials were applied, we would get no benefit in the block grant from the money that was spent on defence and, whatever happened to the health budget—let us say that it was cut to facilitate the defence expenditure—a negative consequential would arise for us out of it.

Jean Urquhart: The no-detriment principle was open to interpretation. Given Scotland's much smaller tax base and tax revenues, and given that our population growth has been and is expected to be slower than population growth in the rest of the UK, are we sure that the principle will kick in and ensure that we always have higher spending per head?

John Swinney: The Scottish block—and I think that this point is not widely recognised or understood—already carries population risk, because the Barnett formula is a product of population. If Scotland's population is a larger proportion of the UK population in year 5 than it was in year 1, that will have an effect on the calculation of the Barnett formula. Population is already a risk that is carried by the Scottish

Government, through the operation of the Barnett formula, because Barnett, fundamentally, is a population-based formula, which looks at Scotland's population relative to that of the rest of the United Kingdom.

On the question of no detriment, paragraph 95(1) of the Smith commission report said that the Scottish block of public expenditure

"will continue to be determined via the operation of the Barnett Formula."

That is the test of no detriment, and that is why I used the words that I used in my opening remarks. What should we have got out of the Barnett formula? That is the test. Therefore, the block grant adjustment mechanism must not in any way undermine that Barnett line.

In essence, that is what I have secured—and believe you me, it was not on the table 11 months ago. A very different proposition was on the table then: an approach known as levels deduction, which over 10 years would have reduced our budget by £7 billion.

Jean Urquhart: I am pleased that you are content that we have an agreement, but although the Barnett formula will be adjusted and you are content that there will be no detriment, and all of that, it seems to me that we will still have no power to grow our population. In many ways, we will be working with the system as it is, without the levers—as you might call them—and the power to react to having a smaller population by enabling the population to grow. Is that true?

John Swinney: That is a fair assessment, and it is really a product of the conclusions of the Smith commission. In the Smith commission, I argued for more economic responsibility and more economic levers to be devolved to the Scottish Parliament, and by reading the Smith commission report you can see how far I got. There are legitimate issues in that regard. We are constrained in our ability to grow the economy, given the availability of economic levers. That is why the application of the no-detriment principle in the fashion that I have set out is so important to the agreement.

John Mason (Glasgow Shettleston) (SNP): Cabinet secretary, I congratulate you on getting the agreement. I was not sure where the negotiations were taking us, and I thought that some Opposition parties were not quite as committed to holding the line as you have been. The fact that there is no detriment is excellent.

I heard you talk on the radio about the main concession, which is that the Scottish Fiscal Commission will do the forecasting. I am disappointed about that, but I accept that it is one of the compromises that had to be made. Do you anticipate that the Scottish Fiscal Commission will require more resources as a result?

John Swinney: Yes, without a doubt. I had probably better prepare the committee for a supplementary financial memorandum. I know how sticky the committee is about the requirement for financial memoranda, so I had better keep myself on the right side of that requirement. Since the convener is such an enthusiast for those arrangements I am sure that that will be accommodated.

John Mason: It will probably fall to me to question whether the amount of money is too generous. I felt that what it was getting was already pretty generous. We shall see.

Has there been any reaction from the Fiscal Commission members? Are they definitely willing to carry on in their roles, given the new plans?

John Swinney: At the weekend I was able to forewarn Lady Rice that those plans might be a possibility. I have not had the opportunity to speak to her since the agreement was made yesterday afternoon. I am keen to discuss the issues with her and the other members of the commission to establish whether they will carry on, and I will report on that to the committee accordingly.

John Mason: I take it that we are not being given any resources from Westminster, despite the fact that they want us to give the commission that enhanced role.

John Swinney: I am going to accommodate that within the wider capital and set-up costs.

John Mason: Fair enough.

You have said that VAT assignment will be brought in in 2019-20. Does that require any legislation on our part?

John Swinney: No.

John Mason: Can you clarify what has been agreed with regard to how we get our share of VAT? One question that has been asked is whether it will relate purely to final spend—when the consumer buys a biscuit, for example—or whether we will get any share of the value added by a factory that happens to be built in Scotland.

John Swinney: We have agreed a consumption-based approach in principle. As I indicated earlier to a committee member—I think that it was Mr Brown—such assignation is new territory, and we will have to work through many of those details with the United Kingdom Government as part of the process.

John Mason: So it has been agreed that the share will be consumer based.

John Swinney: It is consumption based.

John Mason: Will building or expanding a factory in Scotland not automatically give us an uplift in VAT?

John Swinney: I would prefer not to venture into the detail of that without being able to do some more work on the matter. We will have plenty of opportunity—and I am certainly very keen—to understand the committee's perspective on some of those questions to inform our work as we move forward. However, there is no methodology that we can take off the shelf and apply here, and I am keen not to get into territory that we have not yet defined.

John Mason: That is fair. VAT has perhaps not had the scrutiny that other sectors have had, and I am sure that we will be keen to look at that.

What aspects will require legislation in the Scottish Parliament? I assume that APD and the welfare side will need legislation. Will legislation be required for income tax?

John Swinney: I do not think so, but I would need to look at the mechanism for the Scottish rate of income tax. The resolution-making powers that we use for the Scottish rate of income tax, which of course we exercised a couple of weeks ago, are sufficient to enable us to exercise the new powers under the Smith commission. I do not think that anything more will be required. As for the set-up arrangements, the architecture of income tax devolution is now in place and ready to operate in the new financial year.

On welfare, if the Government wishes to create new welfare provisions, they will have to be legislated for. The current welfare provisions will be able to be taken forward as they stand.

No legislation is required for capital or revenue borrowing. I might, if I judge it necessary, decide to bring forward legislation, say, to amend the Revenue Scotland and Tax Powers Act 2014 to create certain fiscal arrangements. However, I do not think that there is a requirement for legislation.

That is probably about it. Obviously there will have to be some stage 3 amendments to the Scottish Fiscal Commission Bill.

10:30

John Mason: There have been references to admin costs, particularly with regard to welfare—the £200 million and the on-going £66 million or whatever each year. With the Scottish rate of income tax, we have been somewhat at the mercy of Her Majesty's Revenue and Customs's charges. I take it that that will continue to be the case with increased income tax powers. It will very much depend on what HMRC wants to charge us, and we will have to pay it all.

John Swinney: We will have to, but I reassure the committee and Mr Mason that the Government looks very closely at the estimates that are put forward. We exercise significant control over those estimates and, actually, HMRC has required less funding than we envisaged it would in the implementation of the Scottish rate of income tax.

John Mason: Finally, how detailed will the heads of agreement that we are expecting this week be? Will they be more detailed in some areas than others?

John Swinney: They will be pretty detailed; indeed, they will have to be to provide the clarity that is required on these questions. The draft heads of agreement that I have in front of me extends to about 19 pages, but it predates the issues that were resolved yesterday and will have to be revised to take that into account. The answer to your question, therefore, is yes, they will be quite detailed.

John Mason: That is great. Thanks very much.

Lesley Brennan (North East Scotland) (Lab): First, I welcome the agreement but, obviously, we are still trying to take in the details. On the agreed model for the block grant adjustment, it is not explicitly per capita indexed deduction, but you are comfortable with the results that have come out of the model. It is therefore a wee bit of a fudge—the results are similar to the outcomes for per capita indexed deduction.

John Swinney: The agreement that we reached yesterday—and it might help the committee if I read this into the record—says:

> "For a transitional period covering the next Scottish Parliament, the Governments have agreed that the block grant adjustment for tax should be effected by using the Comparable Model (Scotland's share), whilst achieving the outcome delivered by the Indexed Per Capita ... method for tax and welfare. This will ensure that the Scottish Government's overall level of funding will be unaffected if Scotland's population grows differently from the rest of the UK."

That is the wording that has been agreed. In short, the UK Government's comparability model is being reconfigured to deliver the outcome that would have been created by per capita indexed deduction. That is either an elegant or an inelegant solution—I shall leave it to the committee to decide.

Lesley Brennan: Models are generally inelegant, because there is always discussion and agreement—or compromise—is there not?

I want to ask about the £600 million, which you said was for economic shocks and forecasting errors. You talked about £300 million, but is it £600 million in total if there was an economic shock, or is it—[*Interruption*.] I am sorry—I am trying to think out loud here. If there are no forecast errors, will you be able to spend all the £600 million on an economic shock?

John Swinney: I can borrow up to £600 million for forecast errors and economic shocks. To me, that means that if I had no forecast errors I could, if I wished, borrow £600 million for economic shocks.

However, I should clarify for the committee that that is for what would be described a Scotland-only economic shock. If there is a UK economic shock, that is a UK macroeconomic issue, and the UK takes its decisions on those questions. A Scotland-specific shock is triggered when onshore Scottish GDP growth is below 1 per cent in absolute terms on a rolling four-quarter basis and 1 per cent below UK GDP growth over the same period. There is a rule specifying a Scotland-only economic shock, and that will be part of the agreement. That is what has to be triggered to enable the Scottish Government to undertake any resource borrowing to deal with an economic shock.

Lesley Brennan: Okay, and that is onshore—

John Swinney: I am sorry—I should add that the use of GDP measures is one of the reasons why the United Kingdom Government was keen to have a forecast of GDP undertaken by the Scottish Fiscal Commission.

Lesley Brennan: You have said that the issue is onshore GDP growth. Would oil and gas revenue still be considered as UK revenue?

John Swinney: The fiscal regime of the oil and gas sector is entirely within the United Kingdom Government's competence.

Lesley Brennan: I just wanted to be sure that we understood that.

Following on from that, have I understood it correctly that the limit for cumulative debt stock, with regard to borrowing for resource and revenue income, is £1.75 billion?

John Swinney: That is correct.

Lesley Brennan: So if there were a downturn you would have three years of spending that £600 million, would you not? Then we would need to repay that money. If there were three years of extra spend of £600 million, we would need to start paying that back in year 4 because it needs to be repaid within three to five years. Is that correct?

John Swinney: That is correct, and I consider that to be one of the elements of the fiscal rules and the exercise of fiscal responsibility. Without nailing my colours to the mast, I think that, if there were two years in which you were having to borrow for economic shocks at £600 million per annum, you would need to take some action to remedy that pretty soon.

Lesley Brennan: My last question is about population. What is the Scottish Government doing about that? The population has inflows, but there are outflows as well, with people leaving Scotland and going elsewhere for jobs. When I used to teach at university, quite a lot of the students would leave Scotland for Australia, New Zealand and even England. What other factors could the Scottish Government bring to bear to keep our own population here?

John Swinney: We as a Government have a keen interest in encouraging the growth of the Scottish population, whether by encouraging people who live elsewhere to come here to live or encouraging people who have been educated here to stay here. We do a variety of things, a lot of which are driven by the economic climate and economic opportunities. I spend a lot of my time with the universities sector, trying to ensure that we have exciting research and development opportunities that enable people to see their future here.

However, despite the whole variety of different interventions to try to encourage people to come and live in Scotland, there are other mechanisms and incentives that we would like to have at our disposal. A good example is the post-study work visa. The Smith commission said that we should make progress on that and almost every university principal in the country believes that we should make progress on it, but the UK Government has said, "No, we're not having it." It is an example of where we might have laudable aspirations here in Scotland, but we cannot fulfil them because the UK Government says, "We're not doing that." I hope that we can get movement on some of those questions in due course.

Lesley Brennan: Thank you, cabinet secretary.

The Convener: That concludes questions from committee members, but I have a couple more just to round up.

First, what role do you envisage for the joint exchequer committee in implementing the framework?

John Swinney: The joint exchequer committee will have an on-going role in taking forward the fiscal framework. It will be an essential part of the framework's governance arrangements, and I expect it to remain closely connected to its development.

The Convener: Finally, will the framework provide a breakdown of the block grant adjustment for each of the individual devolved taxes?

John Swinney: I do not know how much detail we will go into, except to say that the comparability factors for tax will be included in the agreement. The agreement is there to set the rules, and the application of those rules will be evidenced by the material that emerges through the formulation of the Scottish block of expenditure. Things will become clear to us from the numbers that emerge at each fiscal event.

The Convener: Thank you for that. Are there any further points that you wish to make before we wind up?

John Swinney: No, convener. That is fine.

The Convener: Thank you, as always, for answering our questions so comprehensively.

John Swinney: I suppose that the one thing that I would say is that if, when it receives the heads of agreement, the committee wishes to see me again, I am happy to come back at a time suitable to you to ensure that members have the opportunity to fully scrutinise the heads of agreement before feeding the committee's contribution into the work of the Devolution (Further Powers) Committee. I understand that, since I left my office this morning, the Devolution (Further Powers) Committee, having seen me yesterday before the fiscal agreement had been reached, has asked to see me again. If the Finance Committee also wishes to see me again, I will do everything that I can to accommodate that request.

The Convener: It is more or less a certainty that we will want to see you again. We are looking to have Mr Hands next week, too.

Thank you very much for that. I close the public part of the meeting, but we will have a couple of minutes' break to allow the official report, members of the public and our witnesses to leave.

10:42

Meeting continued in private until 10:51.

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