



OFFICIAL REPORT
AITHISG OIFIGEIL

Finance and Constitution Committee

Thursday 27 September 2018

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FINANCE AND CONSTITUTION COMMITTEE

24th Meeting 2018, Session 5

CONVENER

*Bruce Crawford (Stirling) (SNP)

DEPUTY CONVENER

*Adam Tomkins (Glasgow) (Con)

COMMITTEE MEMBERS

*Tom Arthur (Renfrewshire South) (SNP)

*Neil Bibby (West Scotland) (Lab)

*Alexander Burnett (Aberdeenshire West) (Con)

*Willie Coffey (Kilmarnock and Irvine Valley) (SNP)

*Angela Constance (Almond Valley) (SNP)

*Murdo Fraser (Mid Scotland and Fife) (Con)

*Emma Harper (South Scotland) (SNP)

*Patrick Harvie (Glasgow) (Green)

*James Kelly (Glasgow) (Lab)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Rt Hon Elizabeth Truss MP (Chief Secretary to the Treasury)

Lindsey Whyte (Her Majesty's Treasury)

CLERK TO THE COMMITTEE

James Johnston

LOCATION

The Chamber

Scottish Parliament

Finance and Constitution Committee

Thursday 27 September 2018

[The Convener opened the meeting at 09:30]

Fiscal Framework

The Convener (Bruce Crawford): Good morning and welcome to the 24th meeting in 2018 of the Finance and Constitution Committee. As usual, I ask members and any other people who are here to turn their mobile phones to silent.

The only item on the agenda is evidence on the operation of Scotland's fiscal framework from Liz Truss MP, who is the Chief Secretary to the Treasury. Ms Truss is joined by Lindsey Whyte, the director of personal tax, welfare and pensions at Her Majesty's Treasury, and Chris Maxsted, who is the devolution spending principal at the Treasury. We are quite tight for time because the chief secretary is available only until 10.30. If we can keep our questions short and snappy, that will be helpful.

Before we go to questions from the committee, I invite the chief secretary to make an opening statement. We very much appreciate her appearance before the committee today.

Rt Hon Elizabeth Truss MP (Chief Secretary to the Treasury): Thank you very much, convener. It is great to be here in the main chamber of the Scottish Parliament, talking to the committee.

This is the ideal time to be talking about Scotland's fiscal framework. It is now two and a half years since the Scotland Act 2016 received royal assent, and that was when the fiscal framework was agreed. Around a third of the Scottish Government's budget is now determined by receipts raised in Scotland, and that proportion will rise to more than 50 per cent once the Scotland Act 2016 is implemented in full. That means that the Scottish Government has far more autonomy to vary the levels of tax and spending in Scotland.

Devolution of tax powers means more accountability and responsibility for how they are used. The arrangements that were agreed within the fiscal framework mean that the Scottish Government's budget position is much more closely linked to decisions that are made here on how to grow the Scottish economy. With the devolution of tax powers comes accountability for

how those powers are used and the responsibility for managing their effects.

Of course, the Scottish Government also has the advantages of being part of a wider macroeconomic system. In the fiscal framework, we agreed that United Kingdom-wide macroeconomic risks were best managed at a UK-wide level and, of course, Treasury ministers play a vital role in the stewardship of the Scottish economy in areas that are not devolved to the Scottish Parliament.

There has been some real success in the Scottish economy in recent years: 61,000 more businesses since 2010 and nearly 200,000 more people in employment. The Treasury will continue to share the benefits of the union across Scotland in all its work, from its tax policy on oil and gas to the on-going programme of city deals.

There are various complexities in the fiscal framework, and the process of implementing it continues. Two and a half years later, we are beginning to see some of the impacts of tax devolution, particularly as forecasts become outturns, but I very much recognise that this is new territory. The UK Government is keen to support understanding of the implications of fiscal devolution and its contingent risks, and we continue our dialogue with the Scottish Government on that. Yesterday, I met Derek Mackay to discuss the matter in some detail.

There are occasional complexities and issues to resolve, but I echo the comments that Derek Mackay made when he was here in May. The UK Government is committed to working in partnership with the Scottish Government to make sure that fiscal devolution operates as it was intended to operate in the recommendations of the Smith commission.

I am very pleased to be here today, to take any questions and further that discussion.

The Convener: Thank you, chief secretary. That is a very helpful opening.

Yesterday, we took some very interesting evidence from a range of people on the fiscal framework and its operation so far. I am sure that the chief secretary is aware that income tax powers operate in much more of a shared space between the UK Government and the Scottish Government than before. Therefore, the decisions that are taken by one Government can impact on the tax that is raised by another—particularly the income tax that is raised in Scotland. For example, decisions about corporation tax might drive the decisions of higher-income self-employed earners about how much or how little profit they take as income, and a reduction in corporation tax might encourage a greater level of incorporation, which could result in an unintended impact on the level

of income tax take in Scotland. Under the fiscal framework in these circumstances, the Scottish budget bears the risk. I could give some other examples, but I think that those are reasonable examples.

Given such potential outcomes, I would be interested to learn the extent to which Her Majesty's Treasury shares information about its budget proposals before they are announced, and vice versa, so that both sides can assess what the likely impact might be on each Government's tax take. I know that that can be a difficult space for Governments to be involved in, but it would enhance the partnership that you talked about in your opening statement. There is a potential tension that we need to understand when both Governments are talking to each other about their proposals. I do not know what reaction you will have to that suggestion.

Elizabeth Truss: The overall structure of the fiscal framework was decided as part of the deliberations of the Smith commission, which was, of course, an independent commission that looked into these issues. The issues were considered at the time and the package that was agreed recognised some of the complexities, including the interaction between the Scottish economy and the broader UK economy and the number of levers that the Scottish Government has to influence policy versus the number of levers that the UK Government has to influence policy—not just fiscal policy, but policy in areas such as housing and skills, which influence businesses and the economy.

Those issues were taken into account and we are, as I said, two and a half years into the fiscal framework. We are beginning to see the impact of income tax devolution, but I believe that this is a good period in which to look at how the framework is working and to make sure that the mechanics are correct. Of course, we will have the review of the fiscal framework come 2021.

On your point about budgets, quite a lot of the measures that we announce in budgets are for consultation precisely to give an opportunity for businesses across the UK to comment on those budget measures and to allow for dialogue with the devolved Administrations. One of the things that I discussed yesterday in my meeting with Derek Mackay was how we can work closely together on the whole area of economic growth, including what drives economic growth, and how we can ensure that our policies are aligned. One reason for not devolving corporation tax is the potential for cross-border tax competition. At the same time, Scotland needs the freedom to pursue its own policies in various areas, and that is the whole purpose of further fiscal devolution.

I think that we have got the right balance as a result of the Smith commission, but regular dialogue is very important. As the Treasury minister responsible for this area, I very much see my role having a strong interest in Scottish economic growth and in maintaining regular dialogue with Derek Mackay.

The Convener: That is helpful. Let me press you a bit further on that. Corporation tax remains a reserved matter. However, does the Treasury recognise that, if there is a change to corporation tax—it could be in personal allowances, or it could be in other areas—there is the potential for the income tax take in Scotland to be either increased or reduced? Does it take that into consideration in its pre-budget planning?

Elizabeth Truss: Policies could be pursued on either side of the border that would have an impact on income tax policy. They are two very interconnected economies, and I recognise that there would be an impact. I do not know whether Lindsey Whyte wants to say more about that.

Lindsey Whyte (Her Majesty's Treasury): In developing tax policies for the UK budget, we take into account a range of impacts and we engage with a range of stakeholders, including from Scotland. As the chief secretary says, the fiscal framework anticipates that some policy changes by either Government might have a direct impact on the tax receipts or welfare spending of the other. There is a process whereby either Government can raise those issues so that they are jointly analysed. They will be brought to the joint exchequer committee, and the chief secretary and Derek Mackay will work through any resolution that needs to be put in place.

The Convener: I hope that the framework can be as robust as it sounds. Rabbits out of a hat in budgets are common and are an experience we are all aware of. Sometimes, surprises come along because nobody has been consulted about an issue or, indeed, because the Government has ignored it. I know that that is a matter of political choice, but I want to make sure that people are aware of the potential impact on the Scottish budget.

Does anyone have a supplementary question on that subject?

Angela Constance (Almond Valley) (SNP): I am confident that it is a supplementary question, convener. The Chief Secretary to the Treasury spoke about beginning to see the impact of income tax devolution and the fact that there is an acknowledgement that different policy choices can have an impact on either side of the border. I am interested in whether you envisage arguments for more coherent packages of power. For example, the Scottish Parliament has the power to set rates

and bands for income tax, and there is a divergence in income tax policy between the two Governments. Have you heard any arguments in favour of the Scottish Parliament also being able to legislate for income tax reliefs and personal allowances, which the convener touched on? If not, why not? The committee bumps up against that issue a lot. How could things be more coherent and make more sense at a practical level?

Elizabeth Truss: Exactly where the line gets drawn was, I understand, part of the discussion that took place during the Smith commission's deliberations. The important point about the personal allowance is that it is linked to all kinds of benefits. The matter was discussed in the context of the Smith commission and we got to the position that we got to. We will see how that works over the next few years, and there will then be a review of the framework overall. I think that that is the right approach.

It is quite difficult to disaggregate different parts of the package because, ultimately, the fiscal framework is about the Scottish Government taking on not only more responsibility for tax raising but more of the variability in tax revenues. If you change one part of it, you have to look again at the whole package.

I think that where the Smith commission got to was a reasonable place. Is it a complex system? Yes, it is inherently complex, because these are two very integrated economies. The UK Government retains responsibility for the macroeconomic environment and the line must be drawn at some point. However, I am not sure that the line could be drawn anywhere where it would be completely clean and you could say, "Here is the pure impact of what the Scottish Government is doing and here is the pure impact of what the UK Government is doing."

It is worth recognising that, when the UK Treasury produces its budgets, we see vastly fluctuating forecasts from the Office for Budget Responsibility. A lot of our budget setting is influenced by international factors—it could be something that is done in the European Union or it could be actions taken by the US on trade or the state of the Chinese economy—and it is difficult to separate out the different impacts. We have a workable framework that, so far, has proved effective. Of course, when we get to the review period, we should look at the details of precisely how that operates.

Angela Constance: The framework is not set in tablets of stone, given that we are now beginning, with the passage of time, to understand more about the impacts. Do you have any sense of where the flexibility is to improve the mechanics and workings of the fiscal framework?

09:45

Elizabeth Truss: My feeling is that we do not yet have the full mechanics in place—for example, for VAT assignment. No doubt, we will come to that later in the meeting. We are just getting the first outturns on income tax, so it is early days. We need to let it all bed down and get a proper view of the operation before the review takes place.

Adam Tomkins (Glasgow) (Con): Good morning, chief secretary. You may not be aware that two members of this committee were members of the Smith commission.

Elizabeth Truss: I am aware that you are one of them.

Adam Tomkins: Yes, indeed. The two of us might not agree on everything, but I think that we are probably agreed that we do not want to reopen that whole discussion. Certainly, I do not.

I want to pick up a theme that was introduced by the convener. It is a theme that the Prime Minister has referred to as a tendency in Whitehall to "devolve and forget". Those are her words. Taxation on income as a result of the Smith commission package and the Scotland Act 2016 is a shared responsibility between the United Kingdom Government and the Scottish Government. It is neither exclusively reserved nor exclusively devolved.

How does the Treasury ensure that in the exercise of these shared responsibilities, neither officials nor ministers in the Treasury forget about the bits of taxation on income that have been devolved? What steps have you taken inside the Treasury to ensure that the organisation understands that this is a very significant responsibility that it, as far as Scotland is concerned, now shares with the Scottish Government?

Elizabeth Truss: That is a fair point that the Prime Minister made in the past. I certainly do not think that it reflects how the Treasury operates now. We take our responsibilities for that taxation co-ordination seriously. My colleague Mel Stride has overall responsibility for the taxation framework and I know that he has discussions with Derek Mackay, as do I. Lindsey Whyte co-ordinates from an official point of view, so maybe Lindsey could say a bit more about that.

Lindsey Whyte: Yes. We take this very seriously as officials within the Treasury. We have a standing devolution team, of which Chris Maxsted is a member, which provides a central role and runs a capability-building approach to make sure that all the tax and welfare teams across the Treasury fully understand the changes in the devolution settlement and the underpinning financial arrangements so that we take into

account the new structures in the way that we develop tax policy. We do that through training programmes and we look to embed devolution very clearly through the structures and processes that we run for the budget.

Beyond that, it is part of a wider civil service approach to work in partnership with officials from all the Governments in the devolved Administrations to make sure that the whole of the civil service is focused on building devolution capability as well.

Adam Tomkins: How much of that structure is quadrilateral and involves the UK thinking about all three devolved nations, and how much of it is bilateral and specific to Scotland?

Lindsey Whyte: It is a combination of both. There is, from the Treasury perspective, a finance minister's quadrilateral process that involves all the devolved Administrations, and then we have bilateral processes. In the case of Scotland, that is the joint exchequer committee, which is the chief secretary and Derek Mackay, and that is supported by a process involving officials as well as a number of working groups underneath that, which deal with the different elements of the devolution framework and the fiscal framework.

The Convener: Angela Constance, I realise that you wanted to come in with another supplementary. I am conscious of time. If we have space later, we will come back to you.

Angela Constance: No problem.

The Convener: Alexander Burnett will cover issues of reconciliation.

Alexander Burnett (Aberdeenshire West) (Con): A critical element of this committee's pre-budget scrutiny is to examine the impact of the reconciliation process on the subsequent Scottish budget. Can you confirm that the reconciliation figure for the block grant adjustment following the publication of audited outturn figures for the 2017-18 Scottish income tax will be published by Her Majesty's Treasury by September 2019?

As a supplementary to that, it became clear in the committee yesterday that the three-year lag in this process presents its own issues; do you have any views as to how we could improve this process either through the frequency of the reconciliations or by introducing interim reconciliations?

Elizabeth Truss: Lindsey Whyte will cover the exact date and then I can answer the question about the lag.

Lindsey Whyte: I believe that figures for reconciliation in relation to stamp duty and landfill tax have been published for this autumn budget. Her Majesty's Revenue and Customs is

responsible for outturn figures and then the Treasury will continue the process of transparency around the block grant adjustments and reconciliation process for income tax and also for VAT assignment once that comes into place.

Elizabeth Truss: On the subject of the lag and the forecasting versus outturn issue, HMRC shares all the data it has with the Scottish Government, so the Scottish Government has the latest data. The issue with income tax is that although pay-as-you-earn data comes in relatively quickly, self-assessment data takes time to come through the system. That is exactly the same issue we face from an overall UK budget point of view. There is a lag in the system before the income tax returns catch up. This is why an additional buffer is being provided to the Scottish Government to manage those timing differences between the forecast and the outturn being received.

The Convener: Tom Arthur will cover areas of reserves and draw-down and the relationship to forecasting and some of the risks that we bear.

Tom Arthur (Renfrewshire South) (SNP): My question pertains more generally to flexibility. We have, as things stand, an option of a £250 million draw-down from the reserve. The Scottish Government is required to set a balanced budget, but the fiscal framework was conceived in the pre-Brexit era. We now live in an era where the respected Fraser of Allander institute forecasts a loss of between 30,000 and 80,000 jobs as a consequence of Brexit. The governor of the Bank of England suggests that house prices could fall by up to a third in the event of a no-deal Brexit. In this post-Brexit era, is the fiscal framework as flexible as it needs to be to give the Scottish Government the maximum scope for managing any volatility?

Elizabeth Truss: What I would say is, first of all, we are confident that we can secure a deal. There was a meeting of the Cabinet earlier this week where we discussed this very issue. We are very positive about the opportunity to secure that deal, which will achieve, among other things, frictionless trade.

What the Bank of England governor was talking about is making sure that the system is prepared for all eventualities. In no way is that the most likely eventuality, and it is important to recognise that those negotiations and a deal that would result in frictionless trade would not see the types of impacts that you are talking about—

Tom Arthur: Surely you would concede—

Elizabeth Truss: If I could just finish responding to your point about flexibility, there is the £300 million buffer to deal with timing issues. There is the access to the Scottish reserve, as you pointed out. When income tax devolution started, one of

the issues was making sure that the forecasting was in line with outturn. That was probably the biggest change because we did not have the data. No one had the data on exactly which people were Scottish taxpayers. That data is now much clearer, so the biggest change in relation to the difference between forecast and actual outturn has already occurred.

As you are aware, there are specific provisions for a Scotland-specific economic shock, which would give the Scottish Government recourse to additional buffers in the system. If there is a Scotland-specific economic shock, there is additional buffer room. If there was a UK-wide economic shock for whatever reason, the fiscal framework has been set up so that if there is a reduction in UK-wide tax revenues and a reduction in Scottish revenues, that will be accounted for within the block grant adjustment.

In the case of a Scotland-specific economic shock, that is covered by an additional buffer. In the case of a UK-wide economic shock, that works through the block grant adjustment system.

Tom Arthur: So you are entirely confident that, whatever eventualities come from the Brexit negotiations, the overall flexibility that exists within the fiscal framework will meet the requirements of the Scottish Government. You have no concerns at all regarding flexibility.

Elizabeth Truss: That is right.

The Convener: Can I just press you on that a bit? I know that it is hard to forget about Brexit, but can we just park that for a minute and look at the implications of forecast error alone in terms of the potential impact on the Scottish budget?

Some of the most recent figures for 2018-19, which was set as a sort of base year, would have shown a £389 million impact on the Scottish budget because of forecast error, yet if you use the draw-down from the Scottish reserve and utilise the borrowing powers, there is only £520 million in there. That is if there is no shock. In normal circumstances, even with forecast error, we are up against the buffers in terms of flexibility. I think that it is something that both the Scottish Government and the Treasury need to have a look at.

Elizabeth Truss: I agree with you about the forecasting issue and there were clearly issues with the initial forecast, which have now been sorted out through the outturn process. However, one of the whole purposes of the fiscal framework is for the Scottish Government to take more revenue risk. If tax income is not what was anticipated, that means that spending adjustments or, alternatively, adjustments to tax rates have to take place.

There is the timing issue, which the buffer is designed to address, and we have seen that the buffer is absolutely capable of addressing any timing issues that have thus far been identified. However, on the broader issue, the whole purpose of the work of the Smith commission was that more revenue risk be held by the Scottish Government in exactly the same way as what happens if we have a forecast from the OBR at a UK budget that does not bring in the tax revenues that we expected and we have to adjust our budget accordingly.

The Convener: Yes, but this impact is not a result of any decisions taken either by the UK Government or the Scottish Government. It relates entirely to forecast errors from the Scottish Fiscal Commission and the OBR. Without any policy changes—without anything else, just forecast error—we would have been £389 million down in that base year. If that had been the reality of the first year of going live, we would have been up against the buffers of the reserve and the borrowing powers and that flexibility. I think that there is an issue in there that needs to be looked at by both Governments.

Lindsey Whyte: It is important to be clear that the number that I believe you are referring to is still a forecast number, so that will not be reconciled in the block grant adjustment until we have the outturn for income tax in 2019. It is because HMRC collects taxes for Scottish income that the Scottish Government does not itself have the flexibility to manage that in-year. We do not do in-year reconciliations ahead of the outturn. Of course, those forecast figures might move again before we do the reconciliation.

As the chief secretary alluded to earlier, the Scottish Government has powers that it can use between now and the reconciliation to help to manage things. In the event that there ends up being a forecast impact on the Scottish budget at the time we do reconciliation, there are also the borrowing powers that the chief secretary has alluded to.

The Convener: I think I have probably got as far as I can with that one. Sorry to labour it a bit. We will move on to VAT now, which James Kelly is interested in.

James Kelly (Glasgow) (Lab): In terms of the assignment of VAT, obviously this is a body of work that is on-going. A forecast of VAT assignment will be carried out. Can you give some detail on the work that has been undertaken with regard to the methodology for that forecast and how robust it is?

10:00

Elizabeth Truss: The VAT assignment was agreed as part of the Smith commission and the fiscal framework. It was agreed that there would be a methodology and since then we have been working with the Scottish Government on that methodology. We will shortly be publishing the proposed methodology. It is essentially based on the work that we already do when we report the VAT gap to the European Union, for example, so it is a robust methodology. It is also used internationally. The way that value-added tax is divided up between the Canadian provinces is another example of this methodology being used, so we think that it is a very robust methodology that is used extensively internationally.

We have been working with the Scottish Government on the methodology and I believe that we are in agreement. I had that discussion with Derek Mackay yesterday, so we will be ready to publish it very soon. Lindsey Whyte might want to give more details on the precise methodology.

Lindsey Whyte: The assignment model looks at expenditure in Scotland compared with the UK and it then works out an attributed VAT share for Scotland. We have to do that because businesses do not currently have to disaggregate their VAT returns by geographic area. We are using independent expenditure data from the Office for National Statistics and both Governments have agreed to commission an enhanced survey from the ONS to improve the data, which will be available through the implementation period. That model is being developed by experts in HMRC working very closely with the Treasury and with Scottish Government officials. As the chief secretary says, the model has been developed in very close co-operation and it will be jointly published by both Governments shortly.

James Kelly: I have a couple of follow-up questions. I understand that the first forecasts will be produced later this year. Is that still the case?

Elizabeth Truss: The methodology will be produced shortly rather than the forecast, I think. Is that right?

Lindsey Whyte: We will have initial forecasts this year. In the autumn budget, the OBR will do a forecast for rest of UK VAT, and shortly afterwards, for the Scottish budget, the Scottish Fiscal Commission will forecast Scottish VAT receipts to inform the implementation year.

James Kelly: Will that forecast use the new methodology that has been developed?

Lindsey Whyte: Yes.

James Kelly: Disaggregating the Scottish level of VAT is not done currently, so how will that be worked out? Obviously, that is crucial not just to

establishing the forecast but to making sure that the actual VAT figures are correct.

Lindsey Whyte: That is why we have developed the expenditure model and the attributed share for Scotland. That is the methodology that is internationally recognised, as the chief secretary has said. We are using that rather than putting a significant cost on businesses to disaggregate their VAT returns themselves.

James Kelly: Sorry—I am not absolutely clear on that. Is that for the forecast?

Elizabeth Truss: No, it is for the outturn as well. For the outturn, we essentially attribute a certain amount of VAT to Scotland using, for example, sales data. We do not ask every single business to report whether their goods were sold in England or Scotland. We are using a model to calculate that, and it is internationally recognised. As I mentioned, it is already used in Canada to separate out VAT between the provinces. It is used in terms of what we report to the EU on our VAT gap.

James Kelly: Essentially, it is an estimate.

Elizabeth Truss: It is a model. It does not track every single good and attribute it to a particular country.

Willie Coffey (Kilmarnock and Irvine Valley) (SNP): Just to follow that point up, is it correct to say that it is not based on the reconciliation of actual receipts but is based on the survey data that I think your colleague mentioned? The other taxes that are devolved are based on the adjustments that were made in reconciliation of real receipts, but this is not.

Elizabeth Truss: That is right. It is a model to attribute the VAT to Scotland. It is not the actual receipts from the goods sold. It is a different process of outturn and reconciliation from income tax; in income tax, we are tracking individual taxpayers.

Willie Coffey: Do you think that we may move towards proper reconciliation based on receipts when we get the time and the opportunity to do that?

Elizabeth Truss: It would be an incredible burden on business to ask for every single item that is sold to be attributed to Scotland or to other parts of the UK. It is important to recognise that it was agreed as part of the Smith commission and the fiscal framework that a model and a methodology would be developed. What we are doing shortly is publishing that methodology. The principle that we would have a methodology to attribute that VAT was established as part of the fiscal framework. The precise details of the methodology are the model that we will shortly

release, which the committee, of course, will be able to comment on, along with everybody else.

Willie Coffey: During the Smith commission, there was some discussion about the full transfer of VAT powers and rights to Scotland. However, that was ruled out, as I understand it, by one of your predecessors, Mr Gauke, because of EU directives about different VAT rates within member states. Now that we are potentially in a different situation post-Brexit, is that something that the Government might be willing to revisit at some future date?

Elizabeth Truss: My view is that we already have a lot on our plate with implementing the existing Smith commission proposals and the fiscal framework and making sure that they work. I think that we should focus on doing that now.

It is also important to recognise that the Scottish Government has significant levers over the amount of VAT generated in Scotland. It is very intimately connected with economic growth. I mentioned areas of policy such as housing policy, skills policy, and planning policy. Those will all affect VAT take. I think that we have the right balance. The important thing is to get it done and implement it properly first. We have agreed with the Scottish Government the timelines for implementing VAT devolution. It is also important to be able to explain the principles as clearly as possible to the public.

Willie Coffey: But would you rule out doing that at any future stage after it is bedded in?

Elizabeth Truss: No Parliament can bind its successor.

Willie Coffey: Excellent. Thank you for that.

The Convener: I think that Emma Harper wants to raise VAT issues, too.

Emma Harper (South Scotland) (SNP): Willie Coffey has already covered what I wanted to ask about, convener.

The Convener: In that case, Neil Bibby will ask about air passenger duty.

Neil Bibby (West Scotland) (Lab): Good morning. Last year, the Scottish Government and the UK Government agreed to delay the devolution of air passenger duty. One of the key issues for the delay was the lack of exemption for Highlands and Islands passengers. What progress has been made on addressing the concerns around those exemptions? When do you think air passenger duty is likely to be devolved?

Elizabeth Truss: You are absolutely right to say that the critical issue with regard to air passenger duty is the Highlands and Islands exemption. The issue with regard to the Scottish Government exiting existing APD arrangements and

establishing a new tax is the potential for a Highlands and Islands exemption not to meet state-aid requirements. Part of the EU deal that we have put on the table is that we want to continue to be part of a state-aid regime, because we think it very important for competition policy that the UK has a robust regime in that respect. We are working with the Scottish Government on the matter. We have offered to help by approaching the European Union, but I do not believe that we have been asked to do so on the Scottish Government's behalf.

Perhaps Lindsey Whyte will say a bit more about that.

Lindsey Whyte: As I understand it, the Scottish Government is running a series of workshops with a range of stakeholders to explore options for the new tax to ensure that it complies with the new EU guidance for establishing a new tax. We will continue to work and engage with it as we develop the forward framework for the UK.

Neil Bibby: Just to clarify, did you say that the Scottish Government has not asked the UK Government to approach the European Commission?

Lindsey Whyte: That is right.

Elizabeth Truss: The Scottish Government is developing this new tax. I know that Derek Mackay very recently appeared before the committee to discuss the overall fiscal framework; we have offered to assist and are working with the Scottish Government on the matter, but ultimately the solution has to come as part of the development of the new tax.

Murdo Fraser (Mid Scotland and Fife) (Con): As a follow-up to Neil Bibby's question on APD, has the Treasury suggested to the Scottish Government any possible workarounds that might allow APD to be devolved while protecting the Highlands and Islands discount?

Elizabeth Truss: I believe that it has suggested some ideas. However, this is ultimately the responsibility of the Scottish Government, so there is a limited amount that we can do.

Lindsey Whyte: The Treasury and HMRC are continuing to offer support to and work with Scottish Government colleagues on developing the options.

Patrick Harvie (Glasgow) (Green): Good morning. On that last point, perhaps the real explanation is that the Scottish Government is just not that keen to implement a policy that will make its own budget process that much more difficult.

However, I will move on. Let me ask you to think a few years ahead to the review of the framework. You have mentioned that a couple of times

already, and I am obviously aware that at the moment you do not want to be drawn on what the outcomes of the review would be. It is just too soon to speculate on that. However, the UK Government—indeed, both Governments—must have given some thought to the review process. They must have thought about how it should happen and the ways in which it needs to open up debate and dialogue not just between the Governments but in respect of parliamentary scrutiny—after all, we need to remember that 2021 is an election year here—and, I hope, public scrutiny. Do you have any thoughts on the process for taking forward the review?

Elizabeth Truss: We have not yet considered the design of the process. My focus has been on implementing the existing arrangements and making sure that we have a good working relationship with the Scottish Government in terms of overall economic co-ordination. At this stage, it is probably too early to set out the details of that, but I think that it is more important to make sure that the policy works. My point is that there will be a review in due course, but I do not think that it is the right time to talk about this, given that we are in the early stages of implementation.

Patrick Harvie: But there would be some advantage in starting to think about, say, the public understanding of how the framework works. Given that we are in a period of some fairly major disagreements between the two Governments and quite a polarised political climate in which such disagreements can quite easily snowball, a process that tries to build greater public understanding of how this quite complex system works and an assurance that any review will be carried out in an open, participative way will surely help to address some of the confusion and some of the lack of understanding about the framework's operation.

Elizabeth Truss: First of all, I do not entirely agree with your characterisation of the relationship between the two Governments. I think that we have a positive working relationship. The Treasury and the Scottish Government have a very good official relationship for implementing what is a complex settlement on various issues. I therefore do not agree with the contention that that dialogue is not taking place.

As far as the public is concerned, it is more important at this stage to explain the current arrangements than talking about any future review. That will give the public confidence and help with wider public understanding of the additional responsibilities that the Scottish Government has taken on. Indeed, one of the reasons for my appearance before the committee is that I am very keen to help promote that wider understanding and get that message across.

10:15

Patrick Harvie: What more will be done to try to improve that understanding? After all, the public statements from the joint exchequer committee are pretty minimal.

Elizabeth Truss: I think that, with the Scottish Government setting different rates of income tax and our having that income tax outturn, things are becoming clearer to people. I am very happy to work with the committee if you feel that we can put more information out there or, indeed, if you can suggest a clearer format. The issue is inherently quite complicated, but I am all for making it clearer. I do not know whether Lindsey Whyte has any thoughts on the work that we are doing to communicate things better.

The Convener: In your response, Lindsey, will you also explain to us how the Barnett formula works? [*Laughter.*]

Lindsey Whyte: We are publishing a lot of information. For example, both Governments publish annual reports on the implementation of the Scotland Acts 2012 and 2016; we supplement that with a UK Government publication on the block grant adjustments, and there is a Scottish Government publication that brings that together with Scottish Government receipts. Of course, the Scottish Government is best placed to explain the whole picture, because it has both sides of the ledger, as it were. We at the Treasury and HMRC work very closely with Scottish Government officials to provide the right information, and we continually review what information is helpful and should be included in those reports.

Elizabeth Truss: I am happy to take up with the Scottish Government the question of how we jointly communicate these changes better to the wider public. I think that that could be extremely helpful.

Patrick Harvie: Finally, I would make the case for putting on the agenda earlier rather than later a discussion between the Governments—and with the parliamentary committees, too—about the way in which the future review should happen. You have mentioned the Smith commission a number of times now. I would say that that guddle of a process, with the work going on behind closed doors and on a breakneck timescale, is an absolutely brilliant model of everything not to do when reviewing the framework's operation in future, especially as the closer we get to the election in Scotland, the more difficult it will be to take a calm, cool look at the issues. I suggest that agreement on an open, collaborative and publicly participative process should be reached sooner rather than later.

Elizabeth Truss: Thank you. I hear what you are saying.

The Convener: I think that Angela Constance still wants to ask a supplementary to an earlier question.

Angela Constance: I apologise, convener—I might have missed this in our papers or in the Chief Secretary to the Treasury's presentation this morning, but do we have any timings for reviewing the operation of the fiscal framework? I think that I heard you say that it will be reviewed in due course.

Elizabeth Truss: Yes, we do have timings. It will be done by 2021.

Lindsey Whyte: The Smith commission set out the timing and said that the review will be informed by an independent report with recommendations presented to both Governments by the end of 2021.

Angela Constance: How do you envisage the Scottish Government and the UK Government working together to agree the process for compiling that independent report?

Elizabeth Truss: As I have said, we are still in 2018, and we are focusing on the implementation of the fiscal framework. Once that is completed, we will work on the review process.

Angela Constance: Yes, but winter is coming. It might be 2018, but 2020 is not that far away. It would be good, convener, if these kinds of process issues were agreed early to ensure confidence in and transparency of the process and that the review focuses on the substantive issues of the day, whatever they may be, instead of our having arguments about process or guddling about with process late in the day.

Elizabeth Truss: I take those comments on board.

The Convener: I want to ask about stuff that we learned yesterday with regard to certain areas that might need to be looked at in the review. At yesterday's meeting, the committee heard about the potential impact of demographic change on the size of the Scottish income tax base, particularly the relative size of the working-age population in both the UK and Scotland. Obviously, Scotland's demographics are different to the rest of the UK, with our population share ageing quicker. Might the review need to look at that kind of demographic impact, perhaps in light of the type of Brexit that we get? Some of the information that we received yesterday quite clearly showed the Scottish economy's dependence on the EU migrant workforce to feed our tax base. Do you agree that we need to look at that as we move into the review period?

Elizabeth Truss: I will make two comments in response to that. First, the agreement in the fiscal framework is for an indexed per capita adjustment

for Scotland, which protects against the risk of population decrease, although clearly the Scottish Government would not get the benefits of population increase. That is significantly different from the comparable methodology in place for Wales.

The Convener: Yes, but that relates to an overall population process.

Elizabeth Truss: I am just pointing out that, compared with other fiscal frameworks that we have in place, the Scottish Government is protected against risk with regard to population size relative to the tax take in both countries.

As for your question about demographics, the Scottish Government has levers to influence demographics in Scotland, so I do not think that the issue of the shape of the population is entirely exogenous to Scotland. I have already talked about broader policies for attracting business to Scotland such as planning and development policies, housing policies and skills policies, and to say that all of those are simply exogenous to the Scottish Government is not a fair reflection.

Of course, those issues were all debated during the Smith commission process, and what you are suggesting, convener, is that they be debated further. However, I would suggest that we need to see the outturns more clearly and the impact of tax devolution before considering what might be discussed in the review. I think that we have a few more years to go before we see that—it is still very early days.

The Convener: I am the first to recognise that the Scottish Government's powers over the overall economy are there for us to use, but that might not necessarily help in dealing with the age-related problem. That is the specific issue that I was trying to address.

Elizabeth Truss: You mentioned migration. Of course, the Migration Advisory Committee's report was very clear in not recommending a separate migration policy for Scotland. Indeed, that was confirmed by the director of the Confederation of British Industry, who suggested that such a move would not be helpful from the perspective of Scottish business.

The Convener: I would argue for that, but that was not the point that I was trying to make. The fact is that the current system looks at the overall population base—it does not disaggregate things down to the level of age. That is what I am asking the Treasury to look at, but I see that I am not getting anywhere with that issue, either.

Murdo Fraser: I want to raise a separate issue. In its budget for the current year, the Scottish Government changed a number of tax bands and tax rates. One of the impacts of the move is that

the basic rate of tax now applies to a narrower range of incomes compared with the UK basic rate, and that has had some consequences for access to, for example, the married couples allowance and certain tax reliefs, including pensions. I know that the Treasury has worked to make adjustments at UK level to ensure that there is no detriment or additional benefit to Scottish taxpayers as a result of Scottish Government budget decisions, but as far as you are aware, have all the issues arising from the current year's budget been resolved?

Elizabeth Truss: I believe so.

Lindsey Whyte: Yes. I believe that they have been resolved and legislated for.

Murdo Fraser: Okay. If in a future budget the Scottish Government were to make similar changes that might affect allowances, would the Treasury be similarly minded to be helpful in terms of making further adjustments?

Elizabeth Truss: The Treasury always likes to be helpful, Mr Fraser, but I cannot make any promises. We would have to look at the overall budgetary implications of any such move.

The Convener: I am conscious of the time, chief secretary. I am very grateful to you for coming along this morning to answer some of our questions on the fiscal framework.

I now close the meeting.

Meeting closed at 10:26.

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