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SCOTLAND BILL COMMITTEE

Tuesday 11 January 2011

Session 3

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SCOTLAND BILL COMMITTEE
1st Meeting 2011, Session 3

CONVENER

*Ms Wendy Alexander (Paisley North) (Lab)

DEPUTY CONVENER

*Brian Adam (Aberdeen North) (SNP)

COMMITTEE MEMBERS

*Robert Brown (Glasgow) (LD)
*Tricia Marwick (Central Fife) (SNP)
*David McLetchie (Edinburgh Pentlands) (Con)
*Peter Peacock (Highlands and Islands) (Lab)

COMMITTEE SUBSTITUTES

Michael Matheson (Falkirk West) (SNP)

*attended

THE FOLLOWING GAVE EVIDENCE:

Professor Andrew Hughes Hallett (University of St Andrews and George Mason University)
Professor Iain McLean (University of Oxford)
Professor Drew Scott (University of Edinburgh)

CLERK TO THE COMMITTEE

Stephen Imrie

LOCATION

Committee Room 6

Scottish Parliament

Scotland Bill Committee

Tuesday 11 January 2011

[The Convener *opened the meeting at 14:15*]

Decision on Taking Business in Private

The Convener (Ms Wendy Alexander): Good afternoon. I welcome everyone to the first meeting of the Scotland Bill Committee in 2011. I wish everybody a very happy and prosperous new year.

As usual, I encourage members to switch off BlackBerrys, pagers, phones and any other devices that are likely to interfere with the electronic gadgetry. We have a full turnout of committee members today and we are not joined by any additional members.

I ask the committee to agree to consider item 3 in private.

Members *indicated agreement.*

Scotland Bill

14:16

The Convener: The main item on our agenda is to take further evidence in our scrutiny of the Scotland Bill and the relevant legislative consent memoranda. I am pleased to welcome Professor Iain McLean, of the University of Oxford, to our meeting. As most members will know, he was a member of the independent expert group that the Calman commission established and he has published extensively—not least in *The Scotsman* today—on some of the key issues that are of relevance to us. I am also grateful to some of the others from whom we had hoped to hear today but who have instead provided very helpful written evidence.

I invite Professor McLean to make some opening remarks, after which we will ask questions.

Professor Iain McLean (University of Oxford): Thank you very much for inviting me here. I have circulated a written document, which I hope that all members of the committee have seen. I do not want to repeat myself, so I shall give you just the highlight as I see it. It seems to me that the financial arrangements that are proposed in the bill are less risky than either less devolution or more devolution. I am sure that that is a controversial point that will not appeal to all members of the committee. If questioned on that claim, I will try to justify it. If the Scottish Parliament rejects the bill, the way will be clear for the United Kingdom Government—the current one or a later one—to say that, if you do not like what you have been offered, it will follow the recommendation of the Welsh equivalent of the Calman commission, the Holtham commission, that the Barnett formula be superseded by a needs assessment. The consequences of that for Scotland would be quite painful.

I hope that my written evidence speaks for itself, so I will leave it there.

The Convener: Thank you. I ask Brian Adam to begin our questioning.

Brian Adam (Aberdeen North) (SNP): Welcome to the committee. We have heard about the risk, but the other side of risk is reward, is it not? You state in your written submission that the more that taxes are devolved, the greater the financial risk will be. Is not the opposite true? Is it not the case that the more fiscal powers that the Scottish Government has, the more that the risk will be spread and thus reduced, whereas relying on just one tax—an income tax—is inherently risky?

Professor McLean: With respect, I do not agree with that. Receipts from taxes are correlated one with another, so if the receipt from one tax is buoyant, receipts from other taxes will be buoyant.

Brian Adam: Surely not if they are set at different rates, which is precisely what is currently happening with VAT. The tax take from income tax is not currently buoyant but the tax take from VAT will rise significantly because the rate has been raised.

Professor McLean: Yes, the rate for VAT has been raised by the UK Government. However, if we are discussing the bill, which presupposes the continuation of the union, we are all told that devolution of VAT is ruled out by European Union rules. If we are discussing Scottish independence, that is another matter.

Even if VAT receipts were to move in the opposite direction to income tax receipts, I would not expect the other big taxes to do so. National insurance receipts automatically move in parallel with income tax receipts. I think that corporation tax receipts—excluding those from the North Sea, which we might come to later—vary with and not in the opposite direction to income tax.

Your initial question implied that more risk means more reward, if taxes are buoyant, which is of course true, but the downside risk is of tax receipts faltering and a future Scottish Parliament having to cut public expenditure in line with that.

Brian Adam: You point—rightly—to revenues from the North Sea, which are currently extremely buoyant and are going in the opposite direction to most of the economy. The bill would provide no opportunity to vary non-income tax rates. Surely having only one tax to vary is inherently more risky than the apparent stability that would come from income tax. A classic example is Ireland. One main reason why that independent country got into trouble is that it was overreliant on one tax—the property tax. Now, Ireland must make all kinds of adjustments, which would not be available to Scotland under the bill's proposals. Is that not the case?

Professor McLean: I will comment separately on North Sea oil and on property taxes. Members might be aware that the independent expert group, of which I was a member, published a report on North Sea oil that said that North Sea oil taxation was not a suitable candidate for devolution in the union, because receipts were extremely volatile and could move very quickly. That would be difficult for a Scottish Government that had continuing responsibilities in health, education and all the other services. That was the reasoning in the independent expert group's report. Members might know that the report's principal author was the UK's acknowledged leading expert on the subject, Alex Kemp. That is my answer on North Sea oil taxes.

As my written evidence says, the Scottish Parliament already controls in principle the two main property taxes—council tax and business rates. The proposal that stamp duty land tax should be devolved fits excellently in that framework. I would be happy if the Scottish Parliament made more tax effort on the taxes for whose rate and base it is already responsible—business rates and council tax.

Brian Adam: Alex Kemp has said that any volatility in the revenue from North Sea oil could be dealt with by having an oil fund, which would help to provide a buffer, and through appropriate borrowing powers. What is your view on the direction that oil prices are likely to take in the next five to 10 years?

Professor McLean: I have no expertise on the price; I defer to experts on that. Oil reserves in the North Sea are another question on which I am not expert. I am sure that the committee will take advice, but the long-term picture cannot be too bright—North Sea oil cannot be a revenue source on which the Scottish Parliament can rely for ever.

I am sorry, Mr Adam—I missed your second question.

Brian Adam: You have kind of covered it.

Why do you suggest in your written evidence that the no-detriment guarantees are generous? Surely they are no more than might be expected.

Professor McLean: The guarantees might be no more than might be expected, but members should notice that they are asymmetrical. If the bill is passed and if the arrangements that the UK Government has offered in the white paper are implemented, in the run-in period in which income tax revenue is assigned but not devolved to the Scottish Parliament, the UK Government will make up the difference if it changes the tax base or income tax allowances in a way that reduces the tax take in Scotland. I presume that that would be done through the block grant. If the base is reduced, Scotland will experience no detriment. If, however, the base is expanded, there will be a gain to Scotland. After all, any expansion in the base would also apply to the Scottish income tax rate. It is important that such a guarantee or offer be asymmetrical in the sense that the Scottish Parliament will gain if the base is widened and will not lose if the base is narrowed.

Brian Adam: But is it not a weakness that the principle is based on forecast revenues rather than on actual outcomes? In economic matters, forecasts can be notoriously wrong. Do you accept that it is perfectly possible for a forecast to be outwith the bill's borrowing powers?

Professor McLean: Yes. Later in my submission, I criticise the bill for the narrowness of the borrowing powers that it sets out. I am willing to address that question now or later, as members wish.

Brian Adam: Can you suggest an alternative to the published limits for borrowing powers that would deal with that situation?

Professor McLean: I suggest that, like the Canadian provinces, the Scottish Parliament should be able to raise money on the money markets. That approach has not brought civilisation as we know it to an end in Canada or in other federal states in which the markets make their own judgment of the riskiness of subnational bond issues.

Brian Adam: Do you agree that, if the UK Government chooses not to allow such an approach to widening borrowing powers, under these plans the only serious power that will be available to the Scottish Government to bridge any failure in revenue because the forecasts have all gone to pot will be to increase income tax?

Professor McLean: Or one of the other taxes under its control.

Brian Adam: What other taxes would be under its control?

Professor McLean: The small ones.

Brian Adam: So if the borrowing powers turned out to be insufficient, there would have to be either a massive hike in whatever land or environmental tax was available or an increase in income tax.

Professor McLean: But borrowing has to be repaid. If the borrowing powers were more generous and allowed the Scottish Parliament to go to the markets, and the markets noticed that there was a shortfall in current tax receipts compared with current expenditure, the markets would form their own judgment on the yield that they would expect from those rates. It seems to me that, in the scenario that you are painting, tax receipts would fall short; in such cases, any responsible Parliament—as I think everyone in this room hopes that the Scottish Parliament will become—would have no alternative but to cut expenditure or, as you say, increase tax rates. The arithmetic is ineluctable.

Brian Adam: What about corporation tax? In your submission, you argue that devolving corporation tax would lead to tax avoidance, citing the experience of Northern Ireland from a very long time ago. Why have you highlighted that fairly historical example?

Professor McLean: Because the evidence is quite strong. I cite the notorious case of the Vestey corporation, which had no intrinsic connections with Northern Ireland but incorporated there because Stormont politicians at the time said—as indeed Northern Ireland politicians are saying once again—that Northern Ireland's corporation tax rate must be competitive with that in the Republic of Ireland, by which I mean lower than that in Great Britain. If, for the sake of argument, that were to happen in Scotland, you would get massive what I would call pretend incorporations like the massive incorporations in the state of Delaware in the United States. If those were what are at present UK incorporations, the only result would be a tax loss to the UK as a whole, and there would be no gain to the Scottish economy or the Scottish Parliament.

Brian Adam: Presumably, then, you would advise the current UK Government against devolving corporation tax to Northern Ireland, which is something that it appears to be considering seriously.

Professor McLean: I certainly advised representatives of the previous UK Government in our independent expert group's sessions with civil servants and, if asked, would advise the present Government in the same way.

Brian Adam: What evidence is there in federal countries such as Canada that having different corporation taxes leads to tax avoidance? You cited Delaware in the United States in that regard, but its ability to do that has hardly brought the US to its knees.

14:30

Professor McLean: No, but it has reduced the yield of corporation taxes in the United States below what it would otherwise have been. I am not sufficiently expert on Canada to give an informed answer on the position there, but it is common knowledge that the particularly low tax rates in the province of Alberta are likely to have what I suppose politicians would call a chilling effect on corporation tax receipts in all the other provinces.

Peter Peacock (Highlands and Islands) (Lab): I want to move on to the question of income tax. In your paper, you refer to your belief that income tax allowances ought to continue to be reserved, even though in principle devolving them might seem like a good idea. Can you say a bit more about why you think that?

Professor McLean: Yes. It is a practical point about the burden that devolving allowances would throw on taxpayers, payroll providers and, indeed, HM Revenue and Customs, if it remains the body that levies tax, as the bill proposes. Identifying Scottish taxpayers may turn out to be non-trivial if you have to not only identify Scottish taxpayers but change the applicable allowances. Employers and pension providers would have to apply a different rate of allowances, and presumably therefore a different tax code, to their Scottish taxpayers than to taxpayers in the rest of the UK. I am diffident about saying any more on this matter as one of your advisers, David Ulph, is vastly better placed than I am to advise you.

Peter Peacock: You also refer in your written evidence to concern about compliance costs, and cite Quebec and states in the USA. Can you say more about that?

Professor McLean: My point was that in Quebec and in, I think, all 50 states of the USA the taxpayer has to make separate local and federal tax returns, and there is no co-ordination between the two, as is proposed for Scotland in the bill.

Peter Peacock: Okay. On access to the rates of income tax, the 10p rate would apply to basic rate tax but not to higher rates. There has been criticism of that proposal, because it would exclude Scotland from taking a view about the progressivity of the taxation system. Do you have a view on that?

Professor McLean: Yes. That view has been expressed, for instance, by Jim and Margaret Cuthbert. It is of course correct as far as it goes, in that if people move into higher tax bands, the Scottish Parliament will not, under the proposed arrangements, benefit proportionately. On the other hand, the balancing counter-effect—we will not know whether it will balance until we see some numbers or some modelling—is that if people move from zero tax to the standard rate of tax, the Scottish Parliament will get about half of that. I do not know how those two effects will measure out against each other, nor, I submit, will anybody else know, unless and until some modelling is done.

Peter Peacock: The upside of that equation is that Scotland arguably would benefit if it had access to those rates while the economy was growing and tax receipts were growing as more people moved into higher tax bands. Equally, when the economy took a turn for the worse, as it has done in recent years, we would tumble from that position pretty dramatically. The risk of loss is therefore as great as the risk of gain, is it not?

Professor McLean: That is correct. If the number of taxpayers in higher income tax bands declines, under the bill the UK Government will take the revenue hit, not the Scottish Parliament.

Peter Peacock: Okay. That is fine.

The Convener: Can I ask a number of questions on—

Peter Peacock: Sorry, convener, but I want to come back on something. Others have suggested that, instead of giving complete access to the upper bands, access to them could be capped in some way. In other words, there could be discretion to give limited access. I think that the Holtham commission referred to that. I hope that I am correct in saying that Professor Broadway also alluded to that possibility in his submission. Have you thought about that as an answer to the dilemma that may exist?

Professor McLean: I would have no problem with that. Just for the clerks, we had better say that it is Professor Boadway, not Broadway.

Peter Peacock: I beg your pardon.

Professor McLean: He is one of the world's greatest experts on the subject, and if he says that that is safe, I agree with him.

Peter Peacock: Okay. Thank you.

Tricia Marwick (Central Fife) (SNP): I return to the question of bonds, which you touched on briefly with Brian Adam. You argue in your written evidence that the Scottish Government should be able to issue bonds. For the committee's benefit, will you explain in detail what you believe the benefits of bonds are? Can you point to any other devolved Government that has the power to issue bonds?

Professor McLean: The easy answer to the second question is the provinces of Canada. If you said that they are federal rather than devolved, I would say sure, but I would be entirely content with the asymmetric devolution in the UK continuing and the Scottish Parliament having the same powers that the Canadian provinces have to raise capital from bond issues.

It seems to me that there would be benefits all round. There would be a benefit for the Scottish Parliament in that it would be easier to finance capital projects where a business case could be made. It would be easier for money markets because they would have an opportunity to invest in Scotland and to spread their portfolios. In addition, the rates or yield of the bonds would be a signal to everyone who was in the market or contemplating entering it as to how robust the Scottish Parliament's capital expenditure plans were. Those all seem to be good consequences of giving the Scottish Parliament the power to issue bonds.

Tricia Marwick: Thank you for that. In your written evidence, you touch on the fact that you are not convinced by the UK Government's arguments for not devolving air passenger duty and the aggregates levy. Will you expand on that and explain your concerns?

Professor McLean: With pleasure. Let me take the aggregates levy first. With all respect to the UK Government, it seems to me that its excuse is rather threadbare. It cites current litigation but, first, that litigation has been going on for a long time, and secondly, if the Scottish Parliament wishes to take any revenue risk arising from that litigation going badly from the point of view of the taxpayer—I mean the general taxpayer, rather than the particular interests that are bringing the litigation—it should be allowed to do that.

My second point on the aggregates levy is that it is part of a neat package. If there is a tax on digging holes in the ground, namely the aggregates levy, and another tax on filling them, namely landfill duty, it seems to me right that both of those should be under the control of the same Parliament. Furthermore, land does not move, and it seems to me to be a basic principle that stuff that does not move should be taxed by the lowest appropriate level of government, which in this case is the Scottish Parliament. There is also a connection between both of those, which are in a sense land taxes, and stamp duty land tax, which is proposed for devolution.

Should I comment on air passenger duty?

Tricia Marwick: Please do.

Professor McLean: The principle is not exactly the same, but it is an allied principle, and it concerns the famous EU jargon “the principle of subsidiarity”. It is obvious to us all that air transport to and from the Highlands and Islands is in a different category from air transport between, say, London and Edinburgh. I expect that any Government would want to consider a different rate for air passenger tax in cases where air transport is, if you will, a social service as much as a transport service. There therefore seems to be a powerful case for saying that it should be the Scottish Parliament, not the UK Parliament, that decides on those matters in relation to airports in Scotland.

Tricia Marwick: Okay. Your written evidence also mentions income tax on savings income, which will not be devolved despite the Calman recommendations. Again for the benefit of the committee and the record, will you explain what you believe the benefits of devolving income tax on savings income would be?

Professor McLean: What Calman proposed, to be pedantic, was not devolution but assignment of income tax on savings income. The commission accepted arguments from HMRC and others that sorting out who was a Scottish taxpayer or what savings income should be taxed as Scottish would be administratively expensive. However, if the revenue from income tax on savings held by people deemed to be Scottish taxpayers was simply assigned to the Scottish Parliament, that would align the interests of the Scottish Parliament, the interests—to a certain extent—of the taxpayer and certainly the interests of the financial institutions that generate tax receipts by providing homes for people’s savings. That would have to be a good thing.

Tricia Marwick: To wrap up what we have just spoken about—borrowing through issuing bonds, and smaller taxes such as air passenger duty, aggregates levy and income tax on savings—would you encourage the committee to make the point clearly in its final report that those things should be assigned or devolved to the Scottish Parliament?

Professor McLean: I would, yes.

Tricia Marwick: I will touch finally on council tax benefit and housing benefit. In your submission, you state:

> “the anomaly whereby Council Tax is devolved, but Council Tax Benefit is reserved, needs to be addressed in joint ministerial committees.”

As you are aware, the Calman commission recommended scope for Scotland to suggest changes to council tax benefit as it applies in Scotland. Should that recommendation be included in the bill? Given that Calman made a similar recommendation on housing benefit, would you suggest that there should be more powers for Scotland to change housing benefit as it applies in Scotland?

Professor McLean: The cases are not the same. The case for devolving council tax benefit is simply—to repeat myself—that it is anomalous that one level of Government should have the power to tax while another level of Government has the power to determine benefit. If nothing else, that sets up scope for party games between the two Governments, as we have already seen.

Since council tax is, in my view, a disguised land tax, and since I believe from first principles that land taxes should be implemented at the subnational level of government in a federal state, I guess it follows that I agree that control over the rates of council tax benefit in Scotland should lie primarily with the Scottish Parliament, although there may have to be some joint arrangements.

The case of housing benefit is different, because it is part of social protection, and the bill does not propose to devolve social protection and the accompanying tax receipts. There is an intellectually coherent case for doing that, but there is also an intellectually coherent case for saying that social protection is literally a form of national insurance, with the nation in question being the UK at present, and that there is therefore an argument for not devolving social protection expenditure, of which housing benefit is a part. The cases are different.

The Convener: I am aware that there are a couple of issues to discuss. We will finish the supplementaries on bonds, but we also want to cover the point about additional taxes before the end of the evidence session. I assume Peter Peacock's question is on bonds.

Peter Peacock: Yes—I want to take Professor McLean back to bonds. To be clear, are you arguing that there should be no limits at all on the potential for the Scottish Parliament to issue and raise bonds, and that you would simply leave that to a market consideration of the Parliament's ability to repay its debt? Is that a market judgment?

Professor McLean: Yes. I would be content to leave that to the market to judge.

Peter Peacock: In that context, would you see any need for an understanding between the UK Government and the Scottish Government—and, I presume, the Welsh and Northern Irish Governments, if they had similar arrangements—so that that could be tracked?

Professor McLean: You have touched on an important point: if the union continues and if control of UK levels of aggregate debt remains the responsibility of the UK Government, there must be some point at which the UK Government has a backstop power over the total debt on issue at any one time. However, Scotland, Wales and Northern Ireland are, if we put all three together, only 15 per cent of the UK, so I am fairly relaxed about how rigorous such a cap would have to be.

14:45

Peter Peacock: I am thinking about the particular merits of bonds as opposed to other forms of borrowing. The wider proposed borrowing powers are limited in a way that you disagree with, but they would, nonetheless, be controlled, partly because the UK Government would ultimately underwrite the borrowing. Arguably, the interest rates that we could achieve through the normal borrowing mechanisms would therefore be very competitive, whereas bonds might be less competitive. Given that local authorities in Scotland already have the powers to issue bonds, but do not do so in any significant way, would the same thing not tend to happen in practical terms at Scottish Parliament level? Is it a real or largely illusory power?

Professor McLean: If the Scottish Parliament is serious about devolution and about having a degree of fiscal autonomy, it should not want to hide under the UK umbrella and accept favourable rates on its borrowing just because it is underwritten by the UK. It seems to me that it should be for the Scottish Parliament and Scottish ministers—not the UK Parliament or UK ministers—to decide on the soundness of the capital projects to which they commit themselves, and to deal with revenue fluctuations. That should be squarely on the desks of the Scottish ministers or of whatever body is responsible for raising capital.

Peter Peacock: I understand that point of principle. For the sake of argument, however, how often would the Scottish ministers issue bonds, given the extra administrative costs and so on, if they could go to the Public Works Loan Board and borrow at a rate that is a quarter of a per cent better than they could with bonds—or would they be patriot bonds for which Scots accept a lower interest rate?

Professor McLean: They might be. I do not think that there is any argument in those comments against the idea of the Scottish Parliament having the power.

Peter Peacock: Indeed.

Brian Adam: Surely we have in practice already had that arrangement in Scotland. It was called the private finance initiative and public-private partnership, through which the Scottish Government borrowed at a rate that was higher than the Public Works Loan Board's lending rate, and through which we are stuck with losing £1 billion a year from our budget to service the debt. The principle of borrowing beyond the standard rate from the Public Works Loan Board has therefore already been established. Is not that the case?

Professor McLean: I think that we are all in the same place. I would rather have a more transparent mechanism than PFI/PPP for funding Scottish capital developments.

Brian Adam: The power to issue bonds works in Canada. Do the rates that are paid by the various provinces in Canada differ from each other because the market has set them up differently? How do the rates differ from the federal rates in Canada? Do any of the provinces do better than the federal Government, or do they all do worse?

Professor McLean: I have in my book entitled "The Fiscal Crisis of the United Kingdom", to which I referred in my written evidence, a five-years-out-of-date answer to the first question. The book includes a table of bond yields for the Canadian provinces as of when the book was published. I do not have the comparator between the Canadian provinces and the Canadian federal Government, but somebody—I hope that it would be your advisers rather than me—could provide supplementary evidence on that point. Indeed, the Canadian high commission might be asked.

The Convener: Thank you. I am anxious to move on.

I have a couple of further questions about the proposed tax powers for the Scottish Parliament and Scottish Government. The Calman commission recommended that the Scottish Parliament be assigned a share of income tax on savings and dividends. That proposal was rejected by both the previous and current Governments. Will you share with us whether you still believe that that assignment should take place, how the share might be calculated and whether that would have any impact on improving accountability?

Professor McLean: Again, I defer to at least one of your advisers, who could give a better-informed answer to that question than I can.

I do not see why assignment is so difficult that both the past and present UK Governments rejected it. The prior task is to establish who the Scottish taxpayer is. That has in any case to be done for income tax on earnings and pensions. Once that is done, the dividends and savings tax that someone pays can be identified and assigned. I do not see what the problem is, although there may be technical issues that I do not understand.

The Convener: I have two other related questions. In your paper, you mention rather intriguingly that we should significantly reform devolved taxes—business rates and council tax—and stamp duty land tax. Will you briefly augment that point?

Professor McLean: With pleasure. Let us first take stamp duty land tax. On a purely technical basis, it is a completely terrible tax. As members know, it is applied on a slab basis to transactions: up to a certain point, you pay zero per cent; up to the next threshold, it is 1 per cent; for the next, it is 2 per cent; and so on. The perfectly obvious consequence, of course, is that a lot of very expensive carpets and curtains are sold in transactions that come in just below the tax band. That creates an obvious tax loss to the taxing authority. Even if present stamp duty land tax were to be taken on its own, there would be scope for significant reform once it was in the hands of the Scottish Parliament.

My broader point is that both taxes that the Scottish Parliament controls—namely, council tax and business rates—are disguised land taxes. The substantial proportion of the price of houses or business premises is the price of the land on which they stand. If I were the dictator of a future Scottish Parliament, I would take those three bad and disguised land taxes and roll them up into a single transparent land tax. That would give appropriate incentives to people who want to develop land and it would help to ensure that land is in best use and that the authority that is responsible for granting or refusing enormous changes in the value of land per hectare by virtue of planning permissions is aware of the true opportunity costs of granting and refusing permission. The present system does not allow for that.

The Convener: You touch on one of the most significant and under-discussed aspects of the proposals: the opportunity for the Scottish Parliament to create new taxes following discussion and agreement with the UK Government. Obviously, one cannot predict what proposals might come forward, but it has been suggested that a land tax that more effectively taxes unproductive economic activity—not productive economic activity that is taxed in rates—might be one area for a future Scottish Parliament to look at.

The suggestion has also been made that a future Scottish Administration might want to consider the difficult issue of higher education funding, including whether a graduate contribution—even a graduate tax—might play a role.

In addressing our issues with alcohol, there was anxiety that the profits from any minimum pricing regime would accrue to retailers. The suggestion has been made that such profits could, if the regime were differently designed, accrue to a public health purpose.

It has also been suggested that there could be a bed tax to fund international air routes. Will you expand on whether the bill will open up those areas? Is there scope for new or better-designed taxes to replace existing ones? There has been very little discussion on that. An understanding of the potential of the bill in that respect is of interest to the committee.

Professor McLean: Any or all of those examples would be appropriate. There are obvious difficulties with some of them—higher education, for example—although they are perhaps no greater than existing difficulties, such as the question of who counts as a Scottish student.

I turn to the sin taxes. I was a little disappointed that the Scottish Parliament's earlier efforts to impose minimum pricing for alcohol got nowhere. With one slight reservation, I think that that is an appropriate use of devolution. The slight reservation, as I have mentioned in evidence in another context, relates to the hyperstore that would immediately go up just outside Carlisle, were the Scottish Parliament to impose minimum pricing. An obvious tax avoidance issue is involved. Nevertheless, if that is what the Scottish Parliament wants to do, it should have the power to do it. My comment would be the same on the other examples that you gave.

The Convener: So, the bill represents a significant extension of opportunities for the

Scottish Parliament both to raise revenue and to redistribute it where it is raised.

Professor McLean: Yes. The bill will grant the Scottish Parliament the powers; it is for the Parliament to decide how or whether to use them.

The Convener: We are tight for time, so I will take questions from Robert Brown and David McLetchie and some final follow-up questions.

Robert Brown (Glasgow) (LD): I seek your guidance on technical income tax issues. Some critics of the proposals in the bill and in the Calman commission's report have referred to the potential for fiscal drag once the income tax reforms are introduced. If I understand it rightly, the argument appears to be that over time, as salary levels rise and so on, there is a move from the lower levels of tax into the higher bands. Do you accept that, generally, that happens as gross domestic product advances and so on?

Professor McLean: Yes. Partly, I have been here before when answering an earlier question. The argument is associated particularly with Jim and Margaret Cuthbert, who argue that fiscal drag will naturally lead, over time, to more income tax payers being in the higher tax bands and that the Scottish Parliament will suffer because it will get proportionally less of the tax yield from those taxpayers.

There are two answers to the argument. The first, which I have already given, is that it is countered by the fact that fiscal drag will also bring people into the tax net for the first time, thereby raising the Scottish tax revenue from those people from zero to approximately 10p in the pound. Without some modelling, I cannot tell how the two effects will balance out.

The second point is that fiscal drag is not an issue in the long run, because in the long run a Government of any party will want to keep tax allowances and thresholds at a realistic level and will re-index them from time to time. That is not a partisan point.

Robert Brown: You are suggesting that although there may be fiscal drag—subject to modelling—in practice it will have to be dealt with by adjustments that are based on Westminster changes in allowance rates, which will catch up over time.

Professor McLean: Yes. In the short term, there is almost always fiscal drag if nominal incomes are growing. Fiscal drag is real, but modelling is required to establish which effect—a relative loss or failure to gain from relatively richer people, or a gain from relatively poorer people—is greater from the point of view of the Scottish Parliament only.

Robert Brown: The second leg of the argument is—if I understand it correctly—that because the system will be based on HMRC estimates, the Treasury will be able to get those wrong, as it always does. Because it tends to get them wrong in the wrong direction, we will land ourselves with under-receipt of revenues under the heading at a time when we are looking for rather greater receipt and vice versa, because of the way in which changes in the economic cycle work through.

Professor McLean: For the most part, the issue is acute only in the transitional period, during which income tax is assigned, rather than the Scottish Parliament being out on its own. We have already discussed the no-detriment principle that the UK Government has included in the white paper. According to my reading, that works quite favourably for Scotland in such circumstances.

The other point is that the white paper gives a role not only to the Treasury but to the Office for Budget Responsibility. From talking to a member of that office, I happen to know that it has just realised it will have some new responsibilities, if the bill is passed, and is shaping up to those now. That gives partial protection against forecasts of future tax take with an optimistic bias.

Robert Brown: Another criticism relates to the question of what might happen were the Scottish Parliament to vary the 10p rate up or down. For the sake of argument, it might reduce income tax by 1p or 2p as part of a package to try to stimulate the economy in various ways. Other things being equal, that would produce reduced take. However, if it led to there being more employment, jobs and firms, it would produce higher take.

The argument is that because of the balance and the difference between the standard and higher rates of tax, we could find ourselves in a position in which the UK Government had an increase in tax revenues as a result of such investment and policy change by the Scottish Government but the Scottish Government's receipts went in the opposite direction. That seems to be theoretically possible, at least. Do you have any views on the likelihood of that happening and the seriousness of the issue?

15:00

Professor McLean: It is theoretically possible, but I think that the likelihood of its occurring is infinitesimally small and that the seriousness of the issue is therefore infinitesimally small. I am sorry to be a tax bore: the proposition depends on Scotland's being on the right-hand side of what tax experts call the Laffer curve, whereby existing rates are so high that they defeat the point of doing the taxed activity to the extent that people do not do it, so if you reduce the rates, you increase the yield. There is no empirical evidence in any of Jim and Margaret Cuthbert's papers to suggest that Scotland is on the right of the Laffer curve, and I have many reasons for suspecting that it is not.

Robert Brown: I have a more general question. The Calman commission and the Scotland Bill were, among other things, designed to strengthen the union by providing more robust long-term arrangements. From your professional expertise, you know something about federal systems in other countries. Could you identify for us the key elements that hold federal systems together? There can be all sorts of situations in which arguments arise and issues spin out that break things up. What are the key factors that encourage organisations to stay together in that context? I am thinking of examples such as Canada, the United States or other countries where there is some sort of federal arrangement in place.

Professor McLean: That is a challenging question. The answer must be different for each federal country. Generally, in each federal country, there is a will to be part of the larger country as well as a feeling of local loyalty that makes people want the lower tiers of government. That will may be very weak, as—notoriously—in the case of Quebec, but even in Quebec, it looks as if the Quebecers can rub along with being part of Canada. Although some Quebec nationalists might not admit it publicly, even they might see some advantages to being in a large federation.

Federations come in many forms. Some federations, such as Australia, are quite strongly redistributive, while others, such as the United States and Switzerland—I think that Canada is in an intermediate position—are examples of federations that are barely, if at all, redistributive, although the United States has become more redistributive recently. As I said earlier, where there is an element of redistribution, there is an element of national insurance and social insurance for areas of the country that might experience sudden shocks, such as the floods that Queensland is experiencing, to take today's example.

Robert Brown: So, in essence, the welfare/benefits/pensions system in the UK that we touched on earlier, which is an area in which redistribution takes place fairly automatically, is an element that holds together and helps to strengthen the unity of the country. Is that a reasonable observation?

Professor McLean: There certainly is such an element. I am cautious about saying whether the system strengthens the unity of the country because I am very keen not to take sides, as between independence, devolution and no devolution. That element has been a feature, and has been understood to be a feature, of the UK national insurance system ever since 1911, when it was initiated by Lloyd George on the understanding that it would provide for regional absorption of shocks as well as across-life-cycle absorption of shocks for individuals.

Robert Brown: That is a good Liberal point on which to end my questioning. Thank you very much.

The Convener: I am mindful of the time. David McLetchie will move us on to the next section of questioning, but Tricia Marwick might have a final question in the same area.

Tricia Marwick: I just have one point to make.

You said in response to Ms Alexander that it would be up to the Scottish Parliament or the Scottish Government to decide whether to use the extra taxes that she talked about, such as minimum pricing for alcohol or a bed tax, but is not it the case that additional taxes that the Scottish Parliament or the Scottish Government might decide it wanted would have to be approved by Westminster?

Professor McLean: That is not the case, from my reading of the bill. That is partly a lawyer's question. From my reading of the bill, the powers will exist: if the powers are there, such decisions will become devolved matters. It sounds as though other views might have been expressed to you.

Tricia Marwick: It is my understanding that if we sought additional taxes in the way that you suggest, Westminster would need to approve them.

The Convener: It is within the discretion of the Scottish Parliament to propose anything that it wishes, but thereafter there is a negotiation to be had, as is common to other unitary and federal countries with decentralised tax regimes.

I am keen on keeping to time, but Brian Adam wants to say something before David McLetchie finishes this line of questioning.

Brian Adam: If you support the idea that Scotland ought to be able to raise new taxes, why do you take the view that income tax is enough? It depends on the reason why one wants Scotland to have more tax-raising powers. Do we want more taxes to balance out the risk of revenue coming from income tax alone or do we want more tax-raising powers as a policy driver?

Professor McLean: None of the examples that were mentioned by the convener when she introduced the subject would bring a big tax yield. At the beginning of my evidence I made a point about correlated risks being a reason for saying that devolving more taxes is riskier than devolving fewer, but that point does not kick in to any serious extent. I do not think that there is any inconsistency in being content for Scotland to introduce what would be small new taxes plus the powers in the bill, plus the powers that Calman recommended that the bill did not adopt, but without going to the big and difficult ones, which are national insurance, corporation tax, North Sea oil and VAT. I spoke about all those in my evidence.

David McLetchie (Edinburgh Pentlands) (Con): Good afternoon, Professor McLean. I want to explore with you one of the key assertions that has been made by the Scottish Government and others, that a greater degree of fiscal devolution would enhance economic growth in Scotland. What is your view of that proposition?

Professor McLean: I defer to the point that was made by Mr Adam at the start—the risks and potential rewards are higher, but sitting here we cannot say which will be prominent. If, as a consequence of devolution of taxes the Scottish economy grew faster than it otherwise would, I believe that what you tell me Scottish ministers are saying is right. If, on the other hand, tax receipts were to falter, the Scottish Parliament would be faced with hard decisions on spending.

David McLetchie: Yes, but the proposition in the Scottish Government's paper seems to be that the change in the constitutional position would in itself be a generator of greater economic growth. What is the foundation for saying that?

Professor McLean: I would be a wee bit sceptical of that unless the Scottish ministers could produce evidence from other times and places where that has happened. Earlier, there was talk about patriot bonds being issued and it was suggested that people might for patriotic reasons be willing to do things that they would otherwise not do. I have not seen any hard evidence on that, so I am afraid that I cannot help.

David McLetchie: From your knowledge and research and from the work that was done by the expert group that used to be the Calman commission, is there any substantial academic evidence to support that proposition?

Professor McLean: I am not aware of any substantial academic evidence in support of the proposition. To the best of my recollection, the subject never came up in discussions among the independent expert group, nor was it mentioned in the reports.

David McLetchie: Following on from Mr Adam's point about risk and rewards, is it fair to say that whether greater economic growth was generated would depend more on what was done with the powers than it would on whether they simply exist?

Professor McLean: Yes. In my answer to the convener about land taxes, I gave an example; it would be possible to design land taxes in a way that aligned the incentives of the taxpayer, Scottish local authorities and the Scottish Parliament better than the present regime does. That might yield gains all round—for taxpayers and the Scottish Parliament. However, that would be in the design of one set of taxes—namely taxes on real property.

David McLetchie: There is no magic formula or model that says that because you have a basket of taxes, you raise this or that tax, this rate or that allowance, that generates more economic growth than you would otherwise make.

Professor McLean: I am not aware of such a model.

David McLetchie: I presume that everybody would follow it if it existed because then we would all be richer, would we not?

Professor McLean: I cannot comment on that, partly because I am conscious that the next witnesses from whom you are about to hear might take a different view on that from me.

David McLetchie: They might, but I just thought it fair to try and get a balanced, or contra, view on the matter.

Robert Brown: The next witnesses have submitted a paper that expressly alleges that

"every 1% of the budget transferred to Edinburgh could potentially increase incomes per head between 1.3% and 0.6%".

Will you make any observation on that allegation in Professor Hughes Hallett and Drew Scott's submission that the witnesses say is based on an examination of certain Organisation for Economic Co-operation and Development countries?

Professor McLean: I cannot, without having seen the submission. I have seen their paper from last June, but the one that you quoted sounds like a new one that I have not yet seen. If it helps, once I have had time to look at it, I would be happy to give the committee my views on it.

The Convener: That is an appropriate point at which to conclude this evidence-taking session. I thank Professor McLean very much for his evidence. I suspend the meeting for a moment until the next witnesses can join us.

15:11

Meeting suspended.

15:15

On resuming—

The Convener: Before we start, I point out that, for various reasons, some members struggle with artificial light. As this room is on a higher floor, we have more natural light and I ask that everyone simply live with the descending gloom. I think that the only people who might be irritated are those in broadcasting.

I welcome to the meeting our second panel of witnesses: Professor Andrew Hughes Hallett, who is visiting professor at the school of economics and finance at the University of St Andrews, professor of economics and public policy at George Mason University in the United States and member of the independent expert group that was established by the Calman commission; and Professor Drew Scott, who is familiar to many of us and is professor of European Union studies at the University of Edinburgh and co-director of the Europa institute.

I invite Professors Scott and Hughes Hallett to make some opening remarks.

Professor Drew Scott (University of Edinburgh): Thank you, convener. I will make some remarks on behalf of us both.

We thank the committee for its invitation. We are very pleased to have the opportunity to comment on the Scotland Bill and hope that our views will assist the committee in its work. Given that we submitted our written evidence only yesterday—we had transnational travel co-ordination problems—we understand that you might not have had the opportunity to read it ahead of the meeting and, as a result, it might be useful if I briefly summarise our principal concerns.

However, before I do so, I want to make two contextual points for the sake of clarity. First, as economists, we have focused exclusively on the economic implications of the bill's financial provisions as set out in the accompanying command paper. In our evidence, we do not comment on any other aspects of the bill or on the political or constitutional implications of the proposed funding regime.

Secondly, our evidence presents an economic analysis of the Scotland Bill's provisions. We do not offer any commentary on the relative or absolute merits of alternative financial arrangements, including fiscal autonomy, which we have written about quite extensively. I say this for two reasons: first, as we understand it, the committee's purpose is to examine the Scotland Bill, not alternatives to it; and, secondly, we want to alert the committee to the fact that, when we invoke comparisons either implicitly or explicitly in our evidence, our comparator is the status quo ante—in other words, what we have just now or what one might call the full Barnett model.

With regard to our evidence, I want to emphasise the four substantive concerns that have arisen at the conclusion of our work. First, although the Scotland Bill's fiscal provisions will result in a minor increase in the Scottish Parliament's financial accountability, any modest economic gains arising from that source are likely to be swamped by the economic costs that the new financing regime will impose on the Scottish economy.

Secondly, the economic costs of the new funding model derive from two sources: the deflationary bias via reductions in public spending in Scotland associated with the replacement of a full Barnett funding model with one that relies in part on revenues raised from a new Scottish income tax; and the pro-cyclical dynamic instability arising from the limited non-capital borrowing powers for which the bill provides in the context of the financial reconciliation procedures that are being introduced. I realise that that is quite a mouthful, and I hope that we get a chance to explain where we see that dynamic instability coming from.

Thirdly, we are concerned that the range of taxes that are being devolved to the Scottish Administration is inadequate to insure Scottish public spending against an economic shock that weakens the Scottish employment base on which the new Scottish income tax yield depends. We disagree with the idea that not having more taxes increases risk. As portfolio managers will tell you, diversifying the income base minimises risk. That is especially significant at a time when many economists in the UK agree that the public spending cuts that are being imposed by the current UK Government are likely to cause significant job losses in Scotland over the course of the current UK Parliament. For example, a recent Ernst & Young Scottish ITEM—independent Treasury economic model—club forecast suggests that there could be 30,000 public sector job losses over the next four to five years; on the other hand, PricewaterhouseCoopers has forecast possible total job losses in all branches in Scotland of 95,000 over the same period.

If those forecasts are accurate, they imply a significant lowering in the Scottish income tax base and, therefore, a lowering in the tax revenues accruing from that base, on which Scotland's budget will by that time partly depend. The obvious implication is that additional Scotland-only public spending cuts will be required when the new system goes live or Scottish income tax will have to rise in order to protect public spending in Scotland. It is the perfect storm scenario: lost jobs, low tax base and public spending problems. We add to the problems by cutting Scottish spending.

Finally, our analysis demonstrates that the borrowing provisions in the bill are inadequate. On the basis of the evidence to hand, we expect both the annual and aggregate ceilings for the non-capital borrowing facility to be too low to insure public spending against the financial consequences of errors in forecasting income tax revenues. We also suggest that the ceiling on capital borrowing bears no obvious relation to rate of return or risk considerations, which should in part determine public sector investments, and that that ceiling should be replaced by a provision that permits the Scottish Government to issue its own debt instruments and to borrow on the international capital markets.

We are happy to explain how we reached those conclusions in the course of the discussion, but I hope that those few opening remarks provide some flavour of the economic problems that we detect in the financial provisions of the bill.

The Convener: Thank you. In your helpful evidence, which you provided yesterday, you cite your own working paper from March, “Scotland: A New Fiscal Settlement”. Are you aware that John Swinney told us at the end of December that that paper formed the basis of the Scottish Government’s submission to the UK Government on the Calman proposals?

Professor Scott: I am not aware of that.

The Convener: You were not aware that that paper was the basis of the Scottish Government’s submission to the UK Government.

Professor Scott: I have not read the Scottish Government’s submission.

The Convener: I simply note that the Scottish Government tells us that your paper was its key document.

Professor Scott: That is very flattering, but we cannot help who uses our evidence.

The Convener: I understand that. Clarity here is important. The First Minister told us in October:

> “We know thanks to the work of Andrew Hughes Hallett and Drew Scott that with economic powers we could grow the Scottish economy ... 1% a year.”

Is that correct? Is it an accurate reflection of your research?

Professor Andrew Hughes Hallett (University of St Andrews and George Mason University): We certainly could. I do not know where the First Minister gets the 1 per cent from. A question at the end of the previous session this morning referred to the fact that, on the basis of the academic evidence available, for each percentage point increase in devolved powers—meaning revenues—the level of GDP could be expected to increase by 0.6 to 1.3 per cent. That is the result of various other people’s academic work, which we have not done ourselves, and on data from nine OECD countries, so it is fairly representative of the kind of country that you would want as a comparator. That is a range. You could take whatever figure you want within that. You might ask—

The Convener: Forgive me, but the numbers are complex, so I think that it is important that everyone is on the same page. I take it from what you said that you have now set aside the assessment that your work proves that we could grow the Scottish economy by 1 per cent a year in favour of what the Scottish Government said yesterday, which was:

> “Analysis by Professors Andrew Hughes Hallett and Drew Scott suggests that *‘a 1% point increase in fiscal devolution ... might be expected to raise GDP by 1.3 percent after five years above what would otherwise have been the case*’.”

Is that accurate?

Professor Hughes Hallett: That is what I have just said, yes.

The Convener: So it is not 1 per cent a year; it is 1.3 per cent after five years.

Professor Hughes Hallett: It is between 0.6 and 1.3 per cent.

The Convener: I was very interested in that, because it was the sole piece of evidence that the Scottish Government produced yesterday—your research. I went back and had a look at “Scotland: A New Fiscal Settlement”. Can you simply tell us the source for that analysis?

Professor Hughes Hallett: A range of studies, all of which are summarised in a paper by somebody called Lars Feld. The reference is given in that paper.

The Convener: Perhaps we should pursue that a little bit further. The reference that you provide in the paper is “Feld et al (2007)” and footnote 35 mentions “empirical studies”. Does any of them provide evidence for the 1.3 per cent GDP growth and, if so, which one?

Professor Hughes Hallett: I said that the range of estimates that came from the different studies that are summarised in that paper is between 0.6 and 1.3 per cent.

The Convener: So they came up with the figure of 1.3 per cent, not you. That is important.

Professor Hughes Hallett: Yes. It is not work that I have done. I am just reporting what the academic literature says.

The Convener: Perhaps I can pursue the issue a little further because it is the single most important piece of evidence that the Scottish Government cites. In the 2007 paper, Feld says:

"The empirical evidence reported in this paper does not provide for unambiguous results on the impact of a higher decentralization of governmental activity on economic growth."

I note that Feld subsequently published two further papers. The 2010 paper says:

"There is, however, no robust evidence for a positive effect on growth rates, neither positive nor negative."

I wonder why you have used a Feld paper from six or seven years ago when his most recent publication says that there is no robust evidence.

Professor Hughes Hallett: Two thousand and seven is not six or seven years ago.

Typically, when we separate the countries that are in the developing world from those that are in the OECD world, we find positive effects in the OECD world. That has been the level of the debate.

You might want to check whether there is any evidence outside of those papers. The International Monetary Fund 2010 data on the GDP per head in various countries and the level of decentralisation in those countries show that the UK had a GDP per head of £36,298. The OECD tax assessment paper from 2008 says that it is 10 per cent decentralised or devolved. We can compare it against some other countries, such as Switzerland—

The Convener: Can I stop you there? You do not cite an IMF study anywhere in your paper that proves the relationship.

Professor Hughes Hallett: No. I am providing additional evidence.

The Convener: I invite you to comment on the references that you have provided. You have provided three empirical studies to reinforce the result that devolution increases growth.

Professor Hughes Hallett: No—

The Convener: Your paper says:

"Subsequent empirical studies have continued to reinforce this result, that devolution increases growth: Thiessen (2003), Thornton (2007), Imi (2005)."

I have had the opportunity to look at all three of those papers, and I will give you one line from each of them. Thiessen says:

"No relationship between economic performance and the reliance of sub-national governments on own revenue sources ... could be found."

Thornton says:

"its impact on economic growth is not statistically significant."

Iimi says:

"it is still arguable whether decentralisation stimulates economic growth."

I am struggling to find the piece of evidence that supports your assertion that there will be a 1.3 per cent increase in GDP as a result of fiscal decentralisation. Where is the study?

Professor Scott: With great respect, I am struggling to find the relevance of this to the Scotland Bill. If you would like us to conduct a seminar on our work, we could do it in a more convivial atmosphere. If you want to interrogate our work—

The Convener: Is it your work or is it somebody else's work?

Professor Scott: With respect, Ms Alexander, we are here today to provide evidence on the impact of the Scotland Bill, not to discuss the academic and intellectual arguments surrounding an alternative that is not being legislated for. We gave up our time today on the assumption that we were going to discuss the Scotland Bill, not have an academic seminar about secondary evidence.

The Convener: I am trying to establish whether it is primary or secondary evidence. Yesterday, the Scottish Government—

Professor Scott: I still fail to see the relevance of this to the Scotland Bill.

The Convener: Let me share it with you. Yesterday, the Scottish Government published a paper saying—

Professor Scott: What the Scottish Government publishes is not our responsibility.

The Convener: It says that you believe that a 1 per cent increase in fiscal devolution might be expected to raise GDP by 1.3 per cent after five years. You cite four papers in your working paper, none of which appears to me to support that assertion. Where are the workings?

Professor Scott: Ms Alexander, I see no relevance to the Scotland Bill in this line of questioning, so I request that we move on to the subject at hand, which is the Scotland Bill.

The Convener: Is there a study?

Do other members wish to comment?

15:30

David McLetchie: The relevance is that the nature of the powers and responsibilities that the Parliament should have is intrinsic to the bill and is at the heart of political debate in Scotland. Is it not reasonable that members should explore not only the options in the bill but the Scottish Government's counter-proposals? The Scottish Government might have taken your name in vain, but it has most certainly taken your name. Not only is your work referred to in the paper that the convener just cited, we are told that it formed the basis of no fewer than 17 discussions in the past six months or so between the Scottish Government and HM Treasury, so it must be relevant.

Professor Scott: With the greatest respect, I cannot be responsible for the use to which our work is put. I am happy for any work to which my name has been assigned to be critically assessed within the normal standard of academic discourse, but that is not why I am here today. I am not responsible for the use that the Scottish Government makes of our work, nor for the use that you make of it. We are here today on the understanding that we are to discuss the Scotland Bill, and we spent considerable time preparing our evidence on that basis. I tried to impress that upon members before the session started. I see little gain in our being present today to discuss the Scotland Bill if in fact we are discussing our academic work, which is in a different place. With the greatest respect, we are not here to advocate fiscal autonomy; we are here to discuss what we see as the serious economic difficulties with the Scotland Bill. Frankly, I think that that should be given some consideration.

David McLetchie: Indeed it should but, in the course of that consideration, people have come to us with propositions as to how the deficiencies that you detect might be remedied. Actually, many of those who have come forward with such propositions support the propositions that are in your research papers. It is therefore surely perfectly reasonable for us to ask the authors of those papers about the sources of the propositions that many others, not just the Scottish Government, cite in support of their conclusions and in support of their criticisms of the Scotland Bill.

Professor Scott: Sir, with respect, the request for evidence that the committee placed on the internet and to which we responded—with some care and attention, I add—makes no reference to fiscal autonomy and has no invitation to us to comment on fiscal autonomy or to rebut the arguments that others have made against our propositions. I am entirely comfortable with people being against our propositions. As an academic, I have no difficulty believing that other people have different views that are seriously held and deeply convicted. However, with respect, when we were invited to provide evidence, we were not instructed to address, either in detail or in general, the inner workings of fiscal autonomy. We were requested expressly by the committee to concentrate on particular questions relating to the Scotland Bill, and that is why we are here.

The longer we delay the discussion of the Scotland Bill, the less useful our presence here will be. It strikes me that we should simply leave if all we are going to do is discuss fiscal autonomy, because that is not what we spent the last two weeks working on. We spent the last two weeks working on the Scotland Bill.

The Convener: Do you believe that there is a relationship between increasing fiscal devolution and GDP growth rates?

Professor Scott: Our position on that is clear. I do not see why I need to reinforce it.

The Convener: What is it?

Professor Scott: Again, I do not see the relevance of that question to this inquiry.

The Convener: With respect, the bill deals with fiscal devolution, so it is not unreasonable to ask whether there is a relationship.

Professor Scott: I am happy to address the specific question about whether the devolution of income tax powers as set out in the bill can be expected to lead to economic growth. My answer is that I doubt it very much, because I doubt that income tax is a useful instrument to achieve economic growth outcomes. You have already rehearsed the reasons for that, which are that we do not know what happens to the net effect if taxes are raised or lowered. That depends on what economists call the income and substitution effects. All that we say in our evidence is that the dispute over whether the income or the substitution effect will dominate will lead to disagreements between forecasters as to what the GDP consequence of reducing income tax rates will be. We do not pretend to argue that reducing income tax will have X effect on GDP.

Tricia Marwick: The UK Government has told the committee that the Scotland Bill will substantially increase the Scottish Government's accountability. Do you agree with that claim?

Professor Scott: The numbers are of course disputed but, from the numbers that are presented, we find it difficult to see that the devolution of tax powers that is proposed in the bill will increase to 35 per cent the share of spending that is under the Parliament's control. That is simply a matter of arithmetic—we cannot achieve that figure. We can get close to 20 per cent, if not 25 per cent, but we cannot get 35 per cent. However, we are happy to accept that that might relate to the data set on which we are working, which is disputed.

The question that follows is whether more financial accountability per se will improve economic performance in Scotland. In that regard, the expectation is weak.

Tricia Marwick: Let me get this straight: the UK Government says that the Parliament will be responsible for raising 35 per cent of its revenue, but you understand the revenue that will be raised to be between 15 and 25 per cent. That suggests a gap of about 10 percentage points between the UK Government's claim for the bill and what you think that the bill can achieve.

Professor Scott: That is our arithmetic, but I do not suggest that we have the perfect data set. If tax revenue of £4.6 billion is about 15 per cent of the Scottish Parliament's budget, that implies that we already have 20 per cent of taxes devolved, which is self-evidently not the case. The arithmetic is problematic for us, but that is not a major part of our disagreement or difficulty with the economics of the provisions; it is an observation that we do not quite understand how the 35 per cent was calculated. However, as we have just demonstrated, one can find disagreement over numbers quite easily.

Tricia Marwick: We heard from Professor Iain McLean that the proposals in the bill represent a low-risk approach for Scotland. Do you agree with that assertion?

Professor Scott: No—we say the opposite. If all the eggs are placed in the income tax basket, that is a higher risk. We do not agree—it is a matter of empirical fact—that the other taxes are highly correlated. The taxes would have to be highly correlated to allow people to say that a basket of taxes would not diversify the risk. As any portfolio manager would say, among different income sources, some are high risk and some are low risk. The correlation between different taxes that are earned in Scotland or on the basis of resources in Scotland implies that, the broader the tax base that is used as the income stream, the less the risk is.

I am sorry—I do not want to dominate the discussion.

Professor Hughes Hallett: If you go down the track of saying that adding more taxes increases risks, you should take income tax out of the bill.

Professor Scott's correlation point is correct. To say that adding more taxes increases the risk is to assume that the correlation between taxes is 1—perfect. If we think about that, it cannot be true, because different taxes have different drivers. Income tax is driven by the activity level in the Scottish economy, whereas—should I mention it?—North Sea oil revenues are driven by world demand for oil. The correlation between those taxes is very low. Corporation tax is likely to lead income tax in movement, so the fluctuations in the tax revenues might look similar, but they would be out of phase. Of course, people would love them to be out of phase if possible, because that would mean that one was high while the other was low. That would provide the diversification that Professor Scott talks about.

The situation is similar for VAT. I can say that from experience. I am not a visiting professor at the University of St Andrews—I am an actual professor there—but my other half is in Virginia, which is in surplus right now even though the US federal budget is in deficit. The reason for Virginia's position is that corporation taxes, which are paid to Virginia, are way up, because such taxes depend on costs. Costs are being pushed down in the recession, so the first thing that happens is that profit margins rise. The taxes go out of phase, which is exactly what is wanted.

On the question of North Sea oil revenues, Professor Kemp said in his report for the expert group that he recommended—and the expert group originally recommended—that a geographical share of oil revenues should be attributed to the Scottish budget and that borrowing should be allowed. That recommendation did not survive in the rewrite, but the reason why Professor Kemp said that was exactly the same: the correlations are not as good as 1, and the result is a diversified portfolio. As Professor Scott said earlier, any investment manager would tell you that that is a good way of doing things.

Tricia Marwick: Alex Kemp wrote to *The Scotsman* today to say that he favoured the sharing of oil revenue on a geographical basis; I now understand where that came from.

I return to the no-detriment aspect of the bill, which many have asserted will either reduce or remove any of the economic risks. Do you have a view on that?

Professor Scott: It will reduce one risk, which is the risk that the UK Government decides to alter the tax base, tax rates or any other detail that would impact on Scotland and the Scottish budget directly. That is as far as no detriment goes; it is not a clause that says, "If your revenues do not rise as quickly as they otherwise would have done under the full Barnett model, we will compensate you." The no-detriment provision relates explicitly to any changes to the tax regime that are introduced by the UK Government—for example, the change from a direct to an indirect tax preference, as is happening just now. The Scottish budget would not suffer for that reason alone, so the provision is an improvement.

As a footnote to the other point, we looked at a range of countries with devolved tax systems—Germany, Canada, the USA, Spain and Belgium—and could find no other system that places all its revenue eggs in one significant income tax basket. Tax sharing extends to corporation tax, general sales tax, VAT and so on. As far as we can find from the literature and from examples, no other jurisdiction is as significantly dependent on one tax base as Scotland would be if the bill in its current form were implemented.

Tricia Marwick: I want to touch briefly on the capital borrowing powers that the bill contains. Do you think that they are adequate to allow the Scottish Government to boost economic growth and create jobs?

Professor Scott: Borrowing is a good thing, and I will say two things about it. I agree very much with the comment that was made in the previous session that the market is—or at least should be—better placed to identify risks, and that it would give a Scottish Government the ability to invest rationally to the point at which the marginal returns are equal to the marginal costs of borrowing, which is how the Government should be doing it.

My concern about borrowing is that, if you are going to borrow unlimited on capital markets, which are not perfectly efficient as we know to our cost, you must ensure that you have the revenue flows—the tax bases—to finance the borrowing and pay off the capital. I am slightly concerned about the combination of unlimited borrowing, inefficient capital markets and a lack of tax revenue to service and finance the borrowing.

I am also concerned that the unlimited borrowing powers in this package would not be totally advisable. Unlimited borrowing powers within a subnational jurisdiction would probably have to be couched in a broader macroeconomic architecture. You would not want Governments going off and borrowing willy-nilly; you would have to have some co-ordination mechanism on the capital borrowing side.

I do not know where the figure of £2.3 billion came from; it is not for me to decide, and I have no idea—

Tricia Marwick: It is the cost of the new Forth bridge.

Professor Scott: That is true; I do not know whether it is a coincidence or a line of argument. I am concerned that the capital borrowing side needs much clearer articulation, both from those who want more borrowing powers and from those who support this borrowing power. We need clearer articulation about what we are trying to achieve with borrowing powers and how those could be made economically sustainable.

15:45

Robert Brown: Can I go back briefly to Professor Scott's point about the percentage? Is the difference whether or not we include council tax and the uniform business rate in the calculation of the resources that are available to Scotland?

Professor Scott: My understanding is that those are not directly under the Scottish Parliament's control, so I did not include them in our calculations—although I would not say that they were calculations; I am talking about literally working out a percentage with a calculator, because I am not hugely interested in that. There is, I think, a minor increase in accountability: we get to somewhere like 20 or 25 per cent. We cannot get to 35 per cent. The difference might be in treating council tax and—

Robert Brown: Of course, the argument on that is that it is within the legislative and administrative control of the Scottish Parliament to provide for local tax arrangements, so they are part of the basket. Just to be clear on the definitions, we are not really talking about different figures. We are talking about different assumptions but about the same figures, I think.

Professor Scott: If you go back and look at Peter Burt's work for the local government finance review committee, you will see that he expressed some dubiety about any direct relationship between accountability per se and outcomes. He says, and I think I would agree, that there is no robust evidence that more accountability per se causes anything. In the same way, I would agree that there is no evidence that constitutional change per se causes anything. It is what you do with it that matters.

Robert Brown: I think that there is an issue of terms here, as well. At the risk of going back to an earlier argument, the term "fiscal autonomy", which is used extensively in your work, seems to cover both full fiscal autonomy, which is at one end of the scale, and a series of other situations on that scale, which I might characterise from my perspective as fiscal federalism. I think that the term was used as such in the Steel commission report. Just so that we understand the terms, is that a fair summary?

Professor Scott: Yes. I would just impress on you that when we say "fiscal autonomy", we do not mean fiscal independence. There is some confusion. I do not think that we have argued separately or together that any subnational jurisdiction—that is, a jurisdiction within the context of a broader nation state—should have fiscal independence. As an economic proposition, that would lead to co-ordination errors, which would require compensations, which would be costly. We are not arguing that within the context of a unified UK Scotland should have fiscal independence.

You are right to say that the literature abounds with terms of various degrees along a spectrum. We are using the language that would be expected in an academic paper.

Robert Brown: I suppose that what we are trying to get at in considering the Scotland Bill is where on that spectrum the Scotland-UK relationship should end up.

I would like to explore one particular point. You indicate in your paper that income tax growth has tended to be outstripped by GDP growth by about 0.21 per cent a year. I am intrigued by that, because one would have thought that there would be some sort of relationship between income tax, as a reflection of the population's income from its labour or the work that takes place, and the general state of the economy. Will you give a bit of background on why that should be? For example, is it because of more movement towards indirect taxation? Is it something to do with the increase in national insurance that has taken place? Is it because more borrowing has taken place in recent years? Do those factors influence the relevant percentages for growth in income tax receipts on the one hand and GDP growth on the other?

Professor Hughes Hallett: I will take that on. They could, but if we leave out the current recession period and stop at 2007, because other things happen at that point, typically what has happened is that the thresholds and bands have been raised. The upshot is that the growth in income tax receipts has been slower than the growth in other taxes. The numbers show it. If we look at just the past 10 years, we can see that there is a difference of a percentage point or two between those things. Because of those movements, income tax has ended up operating more or less as a flat tax.

Robert Brown: In the context of the Scotland Bill and the proposals that are before us, I seek your advice on how that technical aspect should be dealt with. There is some potential for problems if it is not dealt with correctly.

Professor Hughes Hallett: If you are restricted under the Scotland Bill to just income tax—I would prefer that not to be the case—the way to deal with it is to give the Scottish Parliament control over those bands and thresholds, and obviously the exemptions that go into the thresholds. It could then change them in the ways that it wanted. The other thing that you could do to improve the performance of income tax is to give the Scottish Parliament control over half of each of the bands instead of just 10p in each of the bands. If the growth in the upper bands of Scottish income is slower than elsewhere, that will be a downward drag on the budget in a different sense.

Robert Brown: I presume that the other way of tackling the problem would be through the operation of the no-detriment clause. If the UK Government changed the levels at which particular bands started, there would have to be a compensatory mechanism for the Scottish Government.

Professor Hughes Hallett: Indeed. As Professor Scott said, that is the reason why the no-detriment clause was introduced. Of course, it is about no detriment à propos forecasting errors. Your income may be guaranteed for whatever forecast has been made for a year or two, but then the payback comes in and, in that sense, the no-detriment guarantee disappears.

Robert Brown: I want to ask about the slightly different issue of risk that you talked about before. The issue goes back to reliance on only one tax. Your argument is basically that a range or basket of taxes would allow the risk to be spread over different "investments". However, has not the reality over the period of the current recession been that income tax, corporation tax, VAT, stamp duty and inheritance tax have all gone down? There does not appear to have been much sharing of risk potential in the extreme financial recession that we have had over the past couple of years.

Professor Hughes Hallett: You are talking about a fairly short period of time between 2007 and 2010. That is half a cycle.

Robert Brown: But it would be a fairly major issue for a Scottish Government that was reliant on a wider basket of taxes to have to deal with.

Professor Hughes Hallett: I would expect some of the taxes to come back before other taxes.

Robert Brown: Right. It is in that context that the wider basket would give a degree of—

Professor Hughes Hallett: Yes. It is awkward if you have no borrowing, but the UK has borrowing. It is not a non-problem, but that eases the situation and we can afford to wait. In Scotland, you could not afford to wait—you would be at the bottom of the cycle right now, being made to cut further and exaggerate the cycle.

Robert Brown: So, part of the issue is dealing with the borrowing leeway in an adequate way to allow—

Professor Hughes Hallett: Yes. We can argue about whether it is big enough or small enough. I would argue that the leeway that you have is pretty small—that is, on the revenue side, not the capital side. If you did a quick calculation on past forecasting performance, you would find that you could not borrow what you needed about two thirds of the time. In that sense, it is restricted.

Robert Brown: I have a final point on the question of reliance on other things. Oil revenues come into the argument. I think that I am right in saying that, during the earlier part of the recession, corporation tax and the oil revenues take related to that went down by a substantial amount. We all accept that oil revenues are pretty volatile. Do you think that the Scottish budget should be more reliant on oil revenues than it is? Are there advantages and disadvantages in that? What would be the balance if, for the sake of argument, oil revenues were part of the basket of taxes that the Scottish Parliament had?

Professor Hughes Hallett: The advantage of using oil revenues in this context—we are talking about risk—is that they are not that correlated. The price of oil goes up and down; at the moment, it is $90 a barrel, plus or minus. If you look at how much income tax has fallen as a share of the budget between 2007 and 2010, you will find a drop of about 5 percentage points. To produce the same drop of about 5 per cent of the budget, the price of oil would need to drop from $90 to below $70 a barrel. That would be below the cost of production, so the price will not go down that far.

If you think about what has happened over quite some time, there has probably not been a large price drop sufficient for that sort of problem to arise since the early 1980s, which is what people talk about when they talk about the extreme volatility of oil revenues. As you say, the price of oil was down at the beginning of the recession because it was falling from a peak of $140-something a barrel the year before. It suffered something like a 30 per cent drop, which is a little bit bigger but not enormously so. Of course, if the Scottish budget does not get the oil revenues, it does not get the windfall gain. That goes back to a question that you asked much earlier about the positive side of risk—the reward side.

Robert Brown: I was making the point that for a smallish economy such as Scotland's, which is linked to the wider UK and European economies, such volatility is itself a disadvantage, because of the unpredictability of the revenues that will be available to the Government from year to year.

Professor Hughes Hallett: I understand that. My answer was that income tax has broadly the same characteristics, so we cannot get away from the issue. Norway is not in terrible trouble, because it has done exactly what Professor Kemp suggested. It has a geographical share of 100 per cent, borrowing and a sovereign wealth fund. That is a respectable way of dealing with the issue. It is not in the bill, of course.

Peter Peacock: I return to the question of revenue borrowing. In your paper, you express concern about whether the limits are too restrictive—an issue on which we have just touched. We have received a number of pieces of evidence that indicate that they are not sufficient to cover the wide fluctuations that have occurred recently. You say that if adverse shocks occur during the cycle, the lack of borrowing powers may adversely affect the prospects of growth thereafter and that there is a kind of compounding effect—because we do not have the scope to borrow, we will have to retrench a bit on expenditure and so on. Did you see the Treasury evidence that we received on the issue a couple of weeks ago?

Professor Scott: I am afraid that I have not read it.

Peter Peacock: Normally I would not put the words "Treasury" and "flexibility" in the same sentence but, to my surprise, the Treasury seems to be open to further discussion about the levels that are being talked about. In your paper, you say that one solution to the problem is simply to increase borrowing powers—on the revenue side, not on the capital side. Do you see that as a solution?

Professor Scott: I do not think so, because the problem that we identify arises when reconciliation takes place. Under the bill, you will have financial certainty for three years. However, if forecasts are above outturn, you will start to repay excess borrowing after 12 months. Our difficulty is that in the event that forecasts exceed outturn—in our evidence, we suggest that that tends to be a recurring theme—you will run out of borrowing space quite quickly. If you extend borrowing space, you will run out of it less quickly.

The difficulty is not borrowing room but the fact that, if you run out of it, you will need to implement cuts in public spending quickly to repay the excess money. For example, in 2008-09 and 2009-10—which we agree are exceptional years—under the command paper description as presented you would have reached your borrowing ceiling in one year and would have had to repay significant amounts in the next budget. If you had a borrowing ceiling at double the level, you would get rid of the imminent problem, but you would not get rid of the debt, which you would still have to repay at some point. That would encourage you to economise or to raise taxes, in an environment in which public spending is already falling. That is the perfect storm about which we are worried.

Within the terms of the bill, the solution to the problem might worsen it, with public spending chasing down the income base, which chases down revenues, which chases down spending. That is the cycle about which we are concerned. You are right to say that if you raise the non-capital borrowing ceiling you delay and may ameliorate the cycle to some extent, but you do not get rid of the problem that arises from the underlying dynamic.

Peter Peacock: So it is a significant partial answer that is important in its own terms but will not necessarily address the whole point.

Professor Scott: It treats the symptoms, not the underlying cause.

Peter Peacock: In your paper, you make the point that raising the ceilings is one possible way of helping to deal with the issue. However, you go on to propose three preferred alternatives. The first is to increase the number of overall economic policy levers, through comprehensive devolution of fiscal policy. Secondly, to diversify risk, you propose that competence over additional taxes that are not vulnerable to the economic cycle be devolved. The third point is on capital borrowing, which we touched on in our earlier discussion. Your alternative seems to be to move down the route that Robert Brown talked about of greater fiscal autonomy—whether or not it is full fiscal autonomy. Is that your contention?

16:00

Professor Scott: That is one possibility. I will correct something, if I may. When we talk about a diversified tax base, we are not necessarily talking about increasing the amount of tax revenue. Let us say that £4.6 billion is the current figure for income tax revenue. You can still have £4.6 billion as own-resource taxes, but they could come from different sources. We are not saying that you necessarily have to add on more devolution; that is one way, but it is not the only way.

Peter Peacock: You do not increase the yield, you just increase the—[*Interruption*.]

Professor Scott: You spread the risk. That is the notion of spreading risk.

Peter Peacock: But your position is that we should move down the route that Robert Brown described: the route towards fuller fiscal autonomy. You think that that is a better argument than simply lifting all caps off borrowing.

Professor Scott: Our argument is predicated on that.

Peter Peacock: And that would contribute to improving growth or counteracting any reduction in growth. Helping to promote growth is the underlying argument for doing that.

Professor Scott: With a view to raising the tax base. Yes.

Peter Peacock: I am not an economist—everyone should be very grateful for that. In economic theory, does the devolution of taxes per se help to create growth or does the devolution of expenditure do that? Is tax or spend the principal driver of economic growth?

Professor Hughes Hallett: Principally, the devolution of taxes—

Peter Peacock: Revenue raising?

Professor Hughes Hallett: Revenue raising. Spending matters; it matters where you spend. It is also necessary to have enough money to do the spending. That is where gains come in. You can focus the revenues that you spend, but you can also focus the revenues that you raise, on the things that matter. In particular, you can use the revenue part to increase competitiveness—having lower costs relative to others. Germany is a great example of a country that has done that over the past few years.

Peter Peacock: I am slightly confused by that. I hesitate to mention your previous paper, given the reaction to it. I took the trouble to read it. In part, you talk about

> "fiscal decentralisation as measured by the share of government spending by the regional authorities in total government spending in that region".

You then go on to set out, as you said earlier, that

> "In contrast, increased devolution in ... developed countries appears to lead to systematically increased growth rates."

There you are talking not about revenue raising but about using discretion in spending on things such as education, transport and so on to raise economic growth. Now you seem to be saying something different.

Professor Hughes Hallett: No. I was saying that there, too.

Peter Peacock: The paper is explicit: it talks about

> "fiscal decentralisation as measured by the share of government spending".

It does not mention revenue raising.

Professor Hughes Hallett: It should do. All the studies are based on the share that regional government raises and spends. It is concerned with how big the budget the regional government has raised itself is—the total amount of money that is raised and spent in that economy. Obviously, it is a mixed economy.

Peter Peacock: With respect, that is not what the paper I took so long to read says. It goes on to talk in some detail about a policy area that I have been involved in in the past—education. You say that you

> "single out education as the primary source of the gains from decentralisation"

and give a set of examples. In the paper, you argue that the education bit typically gives rise to a greater proportion of economic growth.

Professor Hughes Hallett: Yes, indeed, but you have to raise the money in order to spend it. The question is—

Peter Peacock: Well, no—

Professor Hughes Hallett: It has to be raised. I am talking about cases in which a regional government did the raising.

Peter Peacock: Indeed, but there are a number of ways in which to get money. One way is to raise it yourself, as you indicated. Another is to get it in part—[*Interruption*.] The argument in the paper seems to be that the principal thing that drives growth is not raising taxes per se but deploying the spend on matters that raise growth.

Professor Hughes Hallett: Sure. That is obviously part of it, but it is also important that the money is actually raised. Whether things can be done depends on the size of the budget. That is why we make a distinction between fiscal autonomy, which just ensures that the money goes wherever somebody says it should go, and fiscal responsibility, which means that the taxes that are raised can be focused to affect the costs of business or whatever—to focus the spending. Both areas are wrapped up together.

Peter Peacock: I am slightly confused about this because that is not what I had hitherto understood. Can I just take this slightly further? Even accepting your qualification of what your previous argument appeared to be and that revenue raising has some impact, and just sticking for a minute with the expenditure side, I point out that although, on the face of it, we have had complete devolution of education spending for all of the current period of devolution—in fact, it could be argued that we had it for many years before that, as Scotland had a separate education system, but we have certainly had complete control of it since devolution—and policies have diverged quite substantially in certain respects from the rest of the country and we have had similar control of our transport policy, transport investment and so on, that has not given rise to the economic growth rates that might have been expected to be delivered according to your thesis.

Professor Hughes Hallett: You would expect, but you do not always get. The point here is that you have to raise the money. To take the education example, you can then spend the money on education, which is fine, but if you do not spend some money to improve the performance of the underlying economy, there will not be any jobs for the people that you are educating to go into. That is why I say that you need to have a focus on both parts. That is just an example.

Peter Peacock: I will defer to David McLetchie for the moment, convener, but I have other points that I want to come back to.

David McLetchie: Just to pursue this point, the paper to which Mr Peacock was referring is your report of March 2010, Professor Hughes Hallett. This goes to the heart of the Scottish Government's assertion in its argument in the paper that was published the other day: "Summary of Full Financial Responsibility & Independence". Your paper, Professor Hughes Hallett, says:

> "We find that a 1% point increase in fiscal devolution (share of local expenditures in total government spending for that region) generates additions of between 0.16% and 0.32% to growth rates. Translating that to Scottish data for 2007-08, and taking a mid-point estimate of 0.25%, this means a 1% point increase in fiscal devolution might be expected raise GDP by 1.3% after five years above what would otherwise have been the case".

That is the source of the assertion by the Scottish Government in its paper that

> "Analysis by Professors Andrew Hughes Hallett and Drew Scott suggests that 'a 1% point increase in fiscal devolution"—

interestingly, the Government then says in brackets,

> "[the proportion of revenue and expenditure devolved]",

which is not what you say in brackets—

> "might be expected to raise GDP by 1.3% after five years above what would otherwise have been the case'".

So, that significant difference between the two statements is the source of what Mr Peacock was referring to in his evidence. That is why those who read your original report would assume that the key issue here is devolution of a power of responsibility over expenditure, because that is what you said in March 2010, and not devolution of additional responsibility over taxes, because you do not say that.

The Convener: Which is it?

David McLetchie: So, which is it?

Professor Hughes Hallett: As I said just before, it is both.

David McLetchie: But you did not say that it was both on pages 37 and 38 of your paper and you did not say that it was both when you produced the 1.3 per cent figure, which the Scottish Government has now adopted as part of its "Gee whizzo, isn't this fantastic?" proposition for full fiscal responsibility, did you?

Professor Scott: With respect, we are back in a discussion about our paper, and the Scottish Government—

David McLetchie: Well, no, with respect, the questions that you, Professor Scott, and everyone else were asked to comment on, included this question:

"What further changes to the powers for the Scottish Parliament not currently in the Scotland Bill would, in your view, further help to achieve the purposes of the Bill and should be considered by the UK Government for inclusion?"

That is question 13 of the questions that the committee posed and invited comment on. Many people have produced answers to those questions. It is of course a debate in which both witnesses have been willing participants.

Professor Scott: To me, the nub of the question seems to be the devolution of tax-raising or taxation powers. Fiscal federalism is generally the study of the assignment of tax-raising powers in a multi-tiered governance structure. If we are in seminar mode, the question is whether we agree with that as a working definition. If so, what we are discussing in our work on fiscal autonomy is the proposition—and the evidence that supports and does not support that proposition—that devolving tax-raising powers or what might be called the levers of taxation will, under particular conditions, give a subnational Government the ability to raise the level of GDP and levels of employment. The debate is, as we speak, going on in the Northern Ireland Affairs Committee, in which, apart from one exception that I have found from the evidence, there is universal agreement that, for example, devolving to the Northern Ireland Assembly and Government powers over corporation tax will give them an additional lever.

The basic proposition is that although one does not have to use levers that one has at one's disposal, the more policy instruments one has and is able to use, the more objectives one can address through varying them. We are not saying that a reduction of X per cent in corporation tax will cause a Y per cent growth in the Scottish economy; instead, what we are saying is that a Scottish Government's ability to vary, for example, that particular tax—which is not, I should add, something that I am championing—gives it broader scope to address the economic difficulties in which it finds itself if, after proper analysis, it or the Parliament that presides over the jurisdiction decides that that is the policy instrument that ought to be used. We are not saying that devolving any tax will automatically boost GDP—I do not think that anyone would suggest that—but the constitutional act—

David McLetchie: Excuse me, but I am afraid that the Scottish Government has actually made that assertion.

Professor Scott: Then you should take that up with the Scottish Government.

David McLetchie: But it has cited you. Let us get this on the record: when the Scottish Government takes your analysis and asserts that

"a 1% point increase in fiscal devolution",

as it defines it,

"might be expected to raise GDP by 1.3% after five years above what would otherwise have been the case",

without any qualification about the policies that would be pursued under a particular regime, such an assertion is false and inaccurate and is not a fair representation of your position. Is that or is that not correct?

Professor Scott: If you will give me the quotation, I will go through it for you. However, in so far as I can gauge from having had it thrown at me, I think that that is a fair representation of our interpretation of the empirical record—full stop. I do not want to discuss our interpretation of the empirical record. I am not in a court of law, so I reserve my right to revisit the issue once you have given me the quotation and have allowed me to discuss it in some quiet place. I would say, though, that it is a fair reflection of our interpretation of the evidence. You might well quibble with our interpretation, but my immediate response is that I think that that is a fair reflection of it.

David McLetchie: Of an interpretation of past empirical evidence.

Professor Scott: Absolutely.

David McLetchie: So, going forward, you do not agree with the Scottish Government's assertion that conferring further fiscal powers on this Parliament would of itself generate growth.

Professor Scott: If you were to tell me that there was some magic formula to ensure that bestowing a power would in and of itself create economic growth, I do not think that I would agree with you.

David McLetchie: I would not agree with me either. We are of one accord, then, but unfortunately Mr Salmond and a whole lot of other people think that what I have said is the case.

Professor Scott: As I have said, I do not want to speak on behalf of anyone except ourselves, particularly with regard to an interpretation of a piece of text that I have not read. I would find that difficult.

16:15

The Convener: I understand that, so let me ask you to comment exclusively on your own view. Your paper says that what matters is control over local spending, and it makes no reference to how local revenues are raised. Is that still your position? We have heard something different today. Your paper says that what matters is share of local spending, and it makes no reference to revenues—which the Scottish Government does when it quotes you. What is your position on fiscal autonomy?

Professor Scott: My—

The Convener: Is it expenditure as stated in the paper, or is it a mixture of expenditure and revenues, as Professor Hughes Hallett has said but which is not mentioned in your paper? It is a fundamental point, given that we have had control of expenditure for a dozen years now.

Professor Scott: If the question—

The Convener: Do you stand by the paper, or is fiscal autonomy based on expenditure and revenues?

Professor Scott: With respect, I am not going to stand by or deny a paper. It is an academic piece of work.

The Convener: What matters?

Professor Scott: Let me clarify. An index of devolution, by its very definition, comprises a number of elements. If you are saying to me that Scotland is utterly fiscally devolved just now, it is a non sequitur to argue for more fiscal devolution. If you understand fiscal devolution to be about nothing else than the autonomy to make spending decisions, in your definition we have fiscal autonomy.

I doubt that there is anybody in the world of my academic life who would agree that Scotland has entire fiscal devolution. Fiscal devolution comprises the power to spend money and the power to raise money. The UK finds itself at the bottom of any index of fiscal autonomy, such as that produced by the OECD fiscal federalism network, which provides on-going snapshots of where we are. By your own statement, convener, an increase in tax-raising powers for the Scottish Parliament will add to fiscal autonomy. By definition, it will move us along the spectrum that we discussed earlier towards something more autonomous than before.

I apologise if you have taken our work to suggest that we can get more fiscal autonomy than 100 per cent. Self-evidently we cannot.

The Convener: No.

Professor Scott: That is fine, because you seemed to say, “We have total spending autonomy, so how could we get more autonomy?” Well, we cannot if that is your definition of fiscal autonomy.

This is an interesting academic footnote—we may have to footnote the point and say that we have to revise our terminology in what is an academic paper rather than a piece of legislation. I am very happy to do that, but I repeat my earlier remark. I would be delighted to invite you all to a seminar based on our paper, but it does not actually comprise the legislative proposal that we have before us.

The Convener: Your paper suggests that what matters is share of expenditure. When the Scottish Government quotes you—

Professor Scott: We need to footnote that. Thank you—it is an interesting point. We will footnote that to say that we are talking about fiscal autonomy in the broader sense of tax-raising powers as well as spending powers. It would be a non sequitur to say that fiscal autonomy is only about spending when we know that Scotland—

The Convener: The paper says that that is where the relationship exists.

Leaving that aside, will you clarify for us whether you agree that the academic evidence is mixed on whether there is a link between greater fiscal decentralisation and growth?

Professor Scott: There are different views on the academic evidence—I agree. However, if you choose to investigate it and strip out the countries that I would not deem to be comparable to the UK, you can start to look at what happens in comparable OECD countries and compare like with like. If you do that, you see that, as Professor Hughes Hallett might mention, there is a very clear relationship between GDP and devolution of fiscal autonomy—

The Convener: Where is that very clear relationship?

Professor Scott: If you let me finish—

Professor Hughes Hallett: Let me comment. Convener, you cut me off earlier, rather abruptly, when I was providing that information. You said that you did not want it, but now you are going to get it.

On IMF data, the UK has an income level per head of $36,300, and on OECD data—there is a paper on tax administration—it is 10 per cent decentralised. We can compare that with Switzerland, which has an income level per head of $67,000 and is 70 per cent decentralised. That is 60 percentage points more decentralised than the UK, so what would you expect its income to be? Based on the 0.6 figure, its GDP per head should be 36 per cent higher, but it is actually 84 per cent higher.

Another example is Sweden, where the GDP per head is $47,500 and it is 34 per cent devolved, which is 24 percentage points higher than the UK. The GDP per head is 31 per cent higher than that in the UK, although we would expect it to be 24 per cent higher. The same thing applies in Canada. We would expect the figure to be 25 per cent, but it is 26 per cent. We could go on through those numbers. There is some evidence that is outside what you complained about, as those are OECD countries.

The Convener: I am asking whether there is any published paper anywhere that backs your claim that a 1 per cent increase in fiscal decentralisation leads to a 1.3 per cent GDP rise over five years. Is there any academic paper anywhere that validates that claim?

Professor Hughes Hallett: Yes.

The Convener: Where?

Professor Hughes Hallett: Look through the references in the Lars Feld paper of 2007, which show where he drew the studies from. You will find that, if we take out the OECD countries and look at them, that is the result. That is why the figure is there.

Professor Scott: We are back on to interrogating our paper, rather than the Scotland Bill.

The Convener: I am happy for you to write to us on the academic paper that backs up that claim.

Professor Hughes Hallett: You can look it up yourself.

The Convener: Do members have any other points?

Brian Adam: Now that we have finished with the academic ping-pong, which was not getting us anywhere—

David McLetchie: We beg to differ.

Brian Adam: We have focused on a detail in a paper. I think that we have treated the two witnesses shabbily. Personally, I would like to apologise to them for the way in which they have been treated this afternoon.

Professor Scott: We have thick skins.

Brian Adam: I accept that robust exchanges should take place and that evidence that is brought before the committee needs to be tested but, given the way in which that was done today, I am ashamed that I am a member of the committee.

Let us move on to the Scotland Bill and its details. Beyond the effect of the cuts that Professor Scott detailed in his opening remarks, will the witnesses give us an idea of the impact that might be expected of the fiscal changes that are proposed in the bill, particularly on jobs?

Professor Scott: We have done no precise forecasting on the direct impact of the bill on jobs. We have alluded to the work that others have done and to what I would say is the broad consensus in the British economic profession—although I hesitate to use such a grand statement—that Scotland stands to lose jobs significantly between now and the end of the current UK Parliament. Those are independent forecasts. I am not privy to the detailed assumptions, but I take them at face value. That work implies that the tax base or employment base on which the new tax will be levied will be significantly lower come 2015 or 2016 when the proposed system goes live. Once it goes live, the employment base of the Scottish economy will be the source of a significant part of income that comes to the Scottish Parliament. That is our concern.

Based on past data, the publication by Scottish Government economists detects an £8 billion deficit. That could be an underestimate or an overestimate, and I can explain why it could be an underestimate in due course. However, we know that over many, many years income tax revenues grow less slowly than public spending. That is why we have a national debt—because revenues are short of spending. We regularly have a budget deficit precisely because of the trend in those two variables that spending grows faster than revenues. Our concern, which we hoped to be able to discuss with the committee today, is that, based on the past, there is a big risk that relying on Scottish income tax as a source of revenue will lead to what we call a deflationary bias, which means Scottish public spending being lower than it would be under the current regime and/or taxes in Scotland on income being higher than they are under the current regime.

Our concern is that, based on the evidence of the past, we are heading towards a deflationary bias in the new funding regime, and that will impact on jobs. How much it will impact on jobs depends largely on two things: the scale of the deflationary bias—the change in the rates of growth of the two variables that determine the Scottish budget and the difference between them—and the public spending cuts that are coming down the line. We are concerned, and we want to share that concern with the committee and to suggest that it may want to consider it in its deliberations.

Brian Adam: So is it your contention that the job losses that will be a result of the spending cuts will feed through to a lower income tax revenue to the Scottish budget and that that deflationary bias will inevitably lead to even more jobs cuts and/or increases in the income tax level that is levied in Scotland?

Professor Scott: That is our concern. The way to alleviate that concern is to ensure that from day one of the new system, the share of the Scottish budget that is funded by income tax is as small as humanly possible. I know that how that share is determined and whether that should be done on the basis of one year's tax take or five years' tax take is an issue that the committee has discussed. Our advice is to ensure that the share of the Scottish budget that comes from income tax is as small as humanly possible. In our view, it would be perfect if it were zero—if, in other words, we stayed with the present system—because if income tax revenues grow more slowly than public spending Barnett consequentials, there will be a deflationary bias. That proportion should be kept as small as possible. You cannot influence directly the rate of change of the two variables, but you can certainly influence the year in which the new system begins.

Brian Adam: Historically, the Scottish economy has not always followed the UK economy. Quite often, we have been later in going into and in coming out of recessions. Given that we are not in the same cycle, what impact would that have, at least in the short term, on the revenue for the Scottish budget? Do you agree with my assessment that we are not in a unitary economy?

Professor Scott: I agree, but that is a problem that we face at the moment. The bill may well exacerbate it, but it will not create it ab initio. The fact that, historically, there have been quite significant differences between growth in different parts of the UK means that it is unlikely that a single policy will be fit for purpose in every part of the single area that we are looking at. I agree that the bill could exacerbate that problem, but it will not create it—I think that we have lived with it for many years.

Brian Adam: Yes, but could it help? You suggested that it could exacerbate the problem, but could it help in any way? Is there a potential upside or just a potential downside?

Professor Scott: The only potential upside would be if you could ensure that income tax revenues grew faster than the Barnett consequentials would have done and that Scotland's financial position improved year by year. In that case, Scotland would be better off, relatively speaking, but the difficulty with that is that we have found no evidence that leads us to believe that Scotland's income tax revenues will grow faster than the Barnett consequentials that they are to replace. Those are the numbers, if you like.

Brian Adam: You also suggest in your submission that even if the income tax powers that the bill proposes are never used, they could have negative consequences. Could you spell out what they would be? Under the bill's proposals, the obvious default position is that the powers would have to be used, unless a zero rate were adopted in Scotland, which would be an extremely brave decision.

Professor Scott: I think that that is right. We discussed the issue because there is a presumption that as long as the powers are not used, they will be neutral. The computations that we have undertaken demonstrate that in the current recession a fortiori but, broadly, over long periods of time, the proposed tax powers would need to be used. Their effects would not be neutral. In our view, they would be negative. That is based on the evidence of the rate of growth of the two variables. Therefore, doing nothing is not an option unless you are prepared to raise taxes or to cut spending. Not using the powers would have a consequence. I think that they would have to be used. Our view, which I am entirely comfortable for the committee to contest, is that it would be necessary to raise taxes to maintain public spending or to reduce public spending to maintain taxes.

16:30

The Convener: You make a persuasive point in your paper that the share of income tax in total tax take on a global basis has tended to drift down, and that is the driver of the deflationary bias. Would it be right to say that any federal country that has income tax as a shared tax base suffers from that deflationary bias in the income tax take?

Professor Scott: If the evidence from those countries shows that, as you are asserting. I do not know whether it does, so I cannot comment. We must be clear that we are talking about the comparative: the status quo ante versus the Scotland Bill. If any country is in a situation in which it derives its entire resources from public spending from a central Government, and it substitutes part of that public spending, which grows faster than the part for which it is substituting, the answer is yes.

To qualify that slightly, that is one of the reasons that every fiscal jurisdiction we can look at has a wide range of taxes that are shared between central and sub-central Governments, in order to insure—or at least partly insure—that risk away.

As a further qualification, most of those federal fiscal systems also retain an income distribution model, so there is still equalisation provision. They have a backstop. One of the difficulties with the bill as it stands is there is no backstop. There is no point at which the UK Government—or indeed the Scottish Government—can say, "Whoa. These divergences are now tripping over a certain degree. If they do, whether they are positive or negative, we need to reconsider the power, as it is triggering unanticipated effects".

One might be more content with that type of assurance, or the UK Government in its command paper could have given us criteria by which it would deem the situation to be efficient before introducing the power. We are told that there are implicit criteria, but we do not know what they are.

The Convener: Let us talk about the widening of the tax base, because you make the point about the need for a basket of taxes. Given that stamp duty and landfill tax have grown faster than total spending in Scotland, they presumably have—although it is very small—an inflationary bias.

Professor Scott: I would not use the term "inflationary"; you mean that they—

The Convener: You said that income tax is deflationary because it has grown slower than spending.

Professor Scott: I prefer "disinflationary".

The Convener: Those two taxes have grown faster, so presumably—

Professor Scott: That will offset part of the risk, and there are other taxes in the smaller tax range that one could seriously—

The Convener: That is what I am coming to. Presumably, the consequence of having council tax is that there has been a deflationary impact on Scottish spending in the past four years, rather than if we had simply secured that income from the Barnett formula.

Professor Scott: I am sorry, but I do not understand that argument.

The Convener: Well, it is because council tax has been frozen and is therefore a smaller part of the total tax take in Scotland. Is that also a deflationary bias?

Professor Scott: No. That should be the opposite—it has been frozen.

Sorry, I beg your pardon; yes, if you are asking me about the total revenue to local authorities—not the council tax level, because my understanding is that the revenue to local authorities is buttressed by direct payments from the Government. I have not done the maths on that, so I cannot give you an answer as to whether—

The Convener: Council tax is a devolved tax.

Professor Scott: With respect, the interesting point there is that the Scottish Government takes a view of equalisation, and it tries to top up council revenues with an appropriate grant from central Government. The analogy, of course, is that the UK Government would take a view of the outturn and say, for example, "Ah—we have to top up the revenues to the Scottish Parliament because the outturns have been unacceptable." The analogy is very interesting, because it suggests that having a big brother or sister who can wade in with a top-up is a necessary part of the system—although not necessarily as efficient—to avoid it going into some pathological state.

If you were saying to me that council tax had been frozen and there had been no compensation by the Scottish Government for that, you would be absolutely right: public spending by local authorities would have collapsed. It is only by dint of the compensation that it has not. We do not know whether it is entirely offsetting the deflation—we have not done the calculation.

The Convener: What I am trying to get from you is the basket of taxes that we should have under the Scotland Bill. You have found income tax in other federal countries. We have council tax, non-domestic rates, landfill tax, stamp duty and land tax. Some of those will be inflationary or deflationary in the way in which they move in relation to public spending. Some will rise faster than public spending and some will rise slower. How would you augment them? What should the first two or three additional taxes be?

There is a danger of talking about income tax as having a deflationary bias, in that I am not aware of any federal country that does not share or devolve the part of the income tax that is truly federal. Presumably the argument is not to remove income tax but to augment it. What are the other taxes that you want to see in the Scotland Bill to give diversity beyond council tax, non-domestic rates and so on?

Professor Scott: I think that we both want a shot at that question, so I will be brief. Canada, for example, has natural resource and sales taxes. Germany has corporation tax.

The Convener: Would a sales tax be possible in Scotland?

Professor Scott: It is possible to share the revenue from a sales tax. Under EU rules it is not possible to change the rate at which it is levied, but it is perfectly possible to have a tax-sharing agreement.

The Convener: So your first two bids would be—

Professor Scott: No, those are not my bids. Please do not misunderstand.

The Convener: So how do we improve the basket of taxes?

Professor Scott: I am trying to give you an answer by looking at what other countries do. Corporation tax and a natural resource tax might be the first two bids. A sales tax could be a bid, but we are limited in how far we can do that. There are also fuel duty and excise duty.

I could go on and on about this, but I counsel great caution in introducing new taxes. Under the Scotland Bill, we cannot replace taxes. We cannot get rid of one that we do not like and introduce another one. We can only add taxes. I urge people not to go away with the idea that we can add to the tax burden of visitors to the country, consumers or producers. That would be a bad judgment call.

The conditions under which a new tax can be introduced are also incredibly restrictive.

The Convener: What amendments would you like us to make to the Scotland Bill to widen the basket of taxes? Which taxes would be first and second on your shopping list?

Professor Scott: I just want to get the terms of the discussion correct. Are we talking about adding to the tax share or replacing income tax with something else?

The Convener: I am inviting you to tell us how you would amend the Scotland Bill.

Professor Scott: I would like excise duty and fuel duty to come more under the control of the Scottish Parliament because they are policy instruments that we could use. I would like a natural resource tax to be under our control, or partial control, and ditto with corporation tax.

The Convener: Should income tax stay in?

Professor Scott: Income tax, per se, is not the complete problem—although it is pretty close to 100 per cent. The problem is that, as history tells us, income tax does not grow as fast as public spending in Britain and in most countries, apart from China, that have significant outstanding stocks of national debt. That is how we get a debt problem, and we fund it by borrowing.

The Convener: The amendments should be to seek excise and fuel duties and a natural resource tax. That would improve the bill.

Professor Scott: That would improve it, absolutely. I do not know whether we have already said that, but I agree.

Professor Hughes Hallett: That situation is particularly awkward in the UK's case, because income tax grows more slowly, which is peculiar to the UK. The other countries in the OECD do not have that characteristic to anything like the same extent. It is a particularly difficult issue in the UK, which is why additional taxes would be particularly useful in the situation that we are discussing.

Robert Brown: I will pursue that point briefly. The analysis is based on what has happened in the past. We identified earlier that part of the equation between income tax on the one hand and public spending on the other was accounted for by a change in the bands and a movement to indirect and non-income-tax taxes, such as the recent increase in national insurance, together with increased public borrowing. In the immediate future, the direction of travel is going to be towards less public borrowing, so that aspect will have to be taken out.

There is a no-detriment clause under the agreement with the UK Government on the other bit of the grant arrangements. I accept that there are issues around getting the mechanisms right and having some sort of arbitration arrangement as well. Is that approach not capable of countering any future deflationary bias, which might not exist if we do not follow the track of the past?

Professor Hughes Hallett: The answer to that question is yes. That approach is capable of producing some countering, but we will have to sit down and work on whether it will be enough. That has not been done, although it could have been.

Robert Brown: It is being done with respect to the no-detriment clause, which has to be worked through to some degree. One would accept that there is vagueness and that there needs to be clarity. If the grant that we are talking about is the balancing mechanism, can you give us any further guidance on the technical improvements that the committee should concentrate on? You rightly touched on the issue of forecasts against the reality of tax yields, for example. That gives us some difficulty. Will sorting that out and getting a balancing point make a significant contribution to dealing with the problem?

Professor Hughes Hallett: It would be a significant contribution if we were able to sort that out.

Robert Brown: Can you make any other suggestions that will help us with the sort of things that we should be banging the Treasury's head about with, if I may put it that way?

Professor Scott: There is the interesting issue of £127 million and 0.5 per cent. If the forecast error is less than 0.5 per cent, you find it yourselves. A sum of £127 million may not sound like a lot of money, but it can provide a few hospitals. I found that provision in the bill rather strange, and would certainly want to pursue it.

I would love to see the Treasury carrying the can for any excess forecast that it had mistakenly made. In other words, I would love to see it giving us money that it had not forecast and not taking money from us that it had forecast. There is a false comfort that income is secured for the comprehensive spending review period. It is not, really. The difficulty is that the cash reserve seems to be another shiny bauble, but if there is a persistent tendency for forecasts to be wrong and tax revenues to be overestimated—I suggest that that is the real problem—there will not be a cash reserve, we will always be in debt, and we will always be running ever faster eventually to claw back the excess money that has been given and return it to the Treasury 12 months later. Of course, taxes cannot be raised at that point because the decision to raise taxes lags by at least a year.

The mechanics have a certain elegance about them, but I question whether they are dynamically stable. That is the source of our concern. With the time or resources that we have, we cannot model how things might play out or the critical values of growth in the tax base. Fiscal drag has been discussed before. The conditions under which we get a glide path to stability will be quite precise, and one of our issues is that nobody has attempted to investigate the properties that give a glide path to stability. One of our objectives in producing evidence was to suggest that a lot more information is needed and a great deal more analysis needs to be done by the very best before we can be confident and comfortable that the system, which will not affect the Parliament in this session or the next session but in the session after that, will not cause us problems. In a sense, our only purpose in coming to today's session, which has been interesting, was to encourage members to seek that information. To be frank, the analysis that has been done to accompany the bill is not actually analysis—members obviously feel the same about ours. In defence of the Calman expert group, it did not look at that matter. There is a note in the Scotland Office's impact assessment of the bill that the analysis has been done by the Calman expert group, and it stands by that. Analysis of the dynamic properties of the type of model in question, with the borrowing requirements and thresholds, was not done. That analysis now has to be done before people can be comfortable that a very difficult financial settlement will not be bestowed on the Parliament in future.

Robert Brown: That is very helpful. Thank you.

Peter Peacock: Robert Brown has helpfully covered most of the relevant points, but I would like to take things slightly further. It is rather intriguing that there is almost an assumption that, at some point in the next two or three years, we can come to a precise answer that will last us for a very long time. It seems to me that, if we look at the evidence on how federal or quasi-federal states operate, there is never an absence of debate about whether the answer is right.

Not all parties at any one time would agree that the settlement is perfect, but tensions, arguments, discussions and negotiations build until we find an appropriate adjustment to the settlement and then move on. Is that not a normal part of a maturing federal system?

16:45

Professor Scott: Without wishing to quote the American military, the distinction here is between known unknowns and unknown unknowns, and there are a number of known unknowns that we have to take a view of.

There are also a number of unknown unknowns in the bill's accompanying documentation, and they are the ones you need to know about. In providing our evidence, we are trying to indicate what we see. We do not see any evidence that the UK Government or indeed—actually, I have not been following the committee's deliberations so I cannot really say what I was going to say. The UK Government could do a lot more.

My final point is one that I made earlier. I cannot drum up an analogue fiscal regime in which we are cut loose, as we would be under the proposed legislation, with such a narrow base of taxes without the possibility of bail-out or some equalisation when things go wrong. The insurance clause is lacking, as is the detailed statement of the criteria that the UK Government will use to decide that the legislation is working. What does the Government mean by "working"? If Professor McLean is right, it would mean that public sector spending was falling, but I do not necessarily recognise or advise using that criterion.

The Convener: Notwithstanding that the bill is far from perfect in your view, does it represent a step forward in so far as it moves for the first time to the principle of shared tax bases, which has hitherto been unknown to the British system?

Professor Scott: Undoubtedly it represents a constitutional step. In economic terms—the only terms on which I am prepared to comment—the bill, as drafted, is a potentially erroneous step. The cost of constitutional progress, which one might say is the argument that is being proposed, might be economic dislocation or disadvantage. That is my only comment. I cannot say whether the bill will make the situation better or worse; I am not in a position to do that. Economically, the bill has a significant downside and the committee needs to do more investigation into that, but whether it represents progress in another normative sense is entirely a value judgment. It will have very serious economic side effects and I urge the committee to look at those.

The Convener: Thank you. The committee has been equally robust with contributors from all sides. One of the things that characterises the debate is the fact that commentators are keen to criticise the other side and a bit more reluctant to defend their own proposals—that has characterised the evidence from all sides. That said, I am enormously grateful to both professors for their time today. If they wish to share any further evidence with the committee, we will be delighted to receive it.

We now move into private session and I invite everyone who is not staying for this part to move on.

16:49

Meeting continued in private until 17:15.

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