The Scottish Parliament
Pàrlamaid na h-Alba

Official Report

FINANCE COMMITTEE

Wednesday 4 September 2013

Session 4

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CONTENTS

FINANCE COMMITTEE
20th Meeting 2013, Session 4

CONVENER

*Kenneth Gibson (Cunninghame North) (SNP)

DEPUTY CONVENER

*John Mason (Glasgow Shettleston) (SNP)

COMMITTEE MEMBERS

*Gavin Brown (Lothian) (Con)
*Malcolm Chisholm (Edinburgh Northern and Leith) (Lab)
*Jamie Hepburn (Cumbernauld and Kilsyth) (SNP)
*Michael McMahon (Uddingston and Bellshill) (Lab)
*Jean Urquhart (Highlands and Islands) (Ind)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Rt Hon Danny Alexander MP (Chief Secretary to the Treasury)

CLERK TO THE COMMITTEE

James Johnston

LOCATION

Committee Room 2

Scottish Parliament

Finance Committee

Wednesday 4 September 2013

[The Convener *opened the meeting at 09:00*]

Decision on Taking Business in Private

The Convener (Kenneth Gibson): Good morning and welcome to the 20th meeting in 2013 of the Scottish Parliament's Finance Committee. I remind everyone present to turn off mobile phones, tablets or other electronic devices.

I take the opportunity to welcome our new independent budget adviser, Angela Scott, to her first committee meeting. I also welcome to the committee a new member of the clerking staff, Catherine Fergusson.

The first item on the agenda is to decide whether to take items 3 and 4 in private. Are members agreed?

Members *indicated agreement.*

Scotland Act 2012 (Implementation) and United Kingdom Spending Round 2013

09:01

The Convener: The second item of business is evidence on implementation of the provisions of the Scotland Act 2012 and on the implications of the 2013 spending round for Scotland. I welcome to the meeting the Rt Hon Danny Alexander MP, Chief Secretary to the Treasury, and Paul Doyle, from the devolved countries unit of HM Treasury.

I understand that, as the chief secretary has a flight to catch, the evidence session will have to be concluded no later than 10.30. I was going to invite the chief secretary to make a brief opening statement, but I understand that he has decided to waive that right.

Rt Hon Danny Alexander MP (Chief Secretary to the Treasury): Given the time constraints, it is better for the time to be taken up with the committee's questions. I will therefore waive that right so that we can get down to the meat of the discussion.

The Convener: That is great. We certainly appreciate that, as it gives the committee more time for questions.

As I intend to address the two topics separately and we will focus for the first hour or so on implementation of the Scotland Act 2012, I will ask members to ask questions on that topic first. When we have exhausted questions on that, I will invite members to ask questions on the impact of the recent spending round on Scotland.

In the usual fashion, I will ask some questions before I open up the questions to committee members. My first question is on the Scottish rate of income tax. Following devolution of the SRIT, there will be a transitional period of around two or three years, during which the United Kingdom Government will bear the risk of any deviation in outturn from the forecast. What would the effect be if the Scottish Parliament agrees to an SRIT either above or below 10p in the pound—for example, if the parliament agrees to a rate of 11p—and there is no reconciliation to outturn receipts from the forecast?

Danny Alexander: First, convener, thanks very much for inviting me to the committee. The implementation of the Scotland Act 2012 is a very important subject and it is fair to say that we are making very good progress, particularly on the Scottish rate of income tax.

The answer to your question is that, during the transition period, the UK Government bears the risks of deviation from the forecast, but if the Scottish Parliament chose to adjust the rate of income tax, the amount of money passed over would be adjusted to reflect that decision. If the Scottish Parliament decided to increase the rate, say from 10p to 11p, an amount equivalent to the additional revenue would be transferred during the transition period. Equally, if it chose to reduce the rate, say to 9p, the amount handed over would be reduced by an equivalent amount.

The Convener: Okay. Is that right? I would have thought that the adjustment would be the same; therefore, if we decided to charge a higher rate, the Scottish Parliament would get the extra money and, if we reduced the rate, the money that came to the Scottish Parliament would be reduced by an equivalent amount.

Danny Alexander: That is exactly what I said.

The Convener: Sorry.

Danny Alexander: I apologise if what I said was not clear, but I think that we mean the same thing.

The Convener: That is fine.

Danny Alexander: We have started the forecasting now to build up experience and to improve the forecasting methodology, but in the first two or three years—it remains to be determined between ourselves and our colleagues in the Scottish Government whether the transition period will be two or three years—we do not want the Scottish Government and the Scottish Parliament to bear the risk of forecasting fluctuations. However, clearly the amount received should be adjusted according to decisions made about the income tax rate. The Scottish Government would therefore receive more if it increased the tax rate and less if it cut the tax rate.

The Convener: Let us move on to forecasts. We have taken evidence from the Office for Budget Responsibility and we have real concerns about its forecasting, which appears to be based more or less on extrapolating UK figures. The OBR has said:

"We very much view the forecasts as work in progress for the time being. This is a learning experience, for us and for everybody."—[*Official Report, Finance Committee*, 28 March 2012; c 888.]

However, there are huge differences in forecasting. In March 2012, the OBR forecast £5,633 million as the figure for 2016-17. In December 2012, it forecast the figure for 2016-17 as £5,242 million, which was a fall of 13 per cent. The figure that it forecast in March 2013, again for 2016-17, was £4,976 million. That is a reduction in forecasting of some 17 per cent, or £657 million, from the original figure.

I am concerned about that because, under the Scotland Act 2012, the Scottish Parliament would be able to borrow only £200 million annually in terms of deviations with a total of £500 million. If we are getting forecasts that need such huge adjustment over a period of one year, that makes the Scottish Parliament extremely vulnerable to erroneous forecasting. How do we ensure that the Scottish Parliament—or indeed, from another perspective, the UK Government—does not end up losing significant sums of money because of errors in forecasting?

Danny Alexander: I shall make three brief points in response to that. First, it is precisely for that reason that the OBR has started the process of forecasting now, so that it can improve its forecast methodology. Secondly, a group of people are working to oversee that process. The Scottish Government is fully involved in all the discussions about the forecast methodology, working with the OBR to enhance and improve forecasting, so there is no sense in which it is a process that is divorced from the impacts that it could have.

However, the most important point is that the block grant adjustment methodology that we have chosen—the Holtham method, which has been agreed among ourselves and, as I understand it, welcomed by the committee—means that the Scottish Parliament would suffer a loss or a gain only if the change in forecast for Scotland is different from the change in forecast for the rest of the UK.

I do not have the equivalent UK figures, but I think that I am right in saying that the decline in the forecast to which you referred, amounting to around £650 million over two forecast rounds, simply reflects a decline in the forecast for the UK as a whole. In that case, there is no differential impact on Scotland, so there would not be a loss to the Scottish Parliament. That would happen only where the outturn in Scotland is different from that in the rest of the UK, and there could be a number of reasons for that, such as policy choices on either side, but the £650 million that has been mentioned would not be a cash loss to the Scottish Parliament at the time when the reconciliation takes place at the end of the year when the new system is up and running. That reconciliation looks at both the forecast for Scotland and the forecast for the UK as a whole. It is only where there is a differential impact that there could be a financial gain or loss to the Scottish Parliament.

I have not examined the figures in minute detail, but I think that in the case in question, where you saw the £650 million change, you would actually find that it would not cost the Scottish Parliament anything in the reconciliation, because we would also have seen a deterioration in the forecasts for the whole of the UK.

The Convener: If we look not at SRIT but at landfill tax, it is a different ball game, and that is a real issue that the OBR has not taken into account. We have raised the matter directly with the OBR in relation to the Scottish policy to move towards a zero waste strategy, which will reduce income from landfill tax quite significantly. We still have considerable concerns on that issue, and I am sure that colleagues will want to pick up on that.

Danny Alexander: I am keen to talk about that issue. We have agreed the block grant adjustment methodology for the Scottish rate of income tax. What we are talking about here is how that process works in practice and how we ensure the principles set out by both Parliaments to devolve tax powers equitably. There should not be a windfall gain or loss to either the Scottish or UK taxpayers. However, where policy or other factors result in an improvement in Scotland, Scotland should take the gain from that.

We have not concluded the discussions with the Scottish Government on how the block grant should be adjusted for the minor taxes, such as stamp duty land tax and landfill tax. We are aiming for something that meets that principle of equity and the commitment that we made in the Scotland Bill command paper for a one-off adjustment that is simple to implement. There are small amounts of money involved, so we do not necessarily want to have the complexity that we have with the Scottish rate of income tax, which is necessary in that case because the sum of money is large.

The Convener: When do you hope to conclude the discussions?

Danny Alexander: John Swinney and I discussed the matter prior to this meeting. There are a range of options about how to work through the issues. We have asked officials on both sides to go away and work together to illustrate in more detail some of the different options. We hope to resolve the matter in the next few months. Clearly, that needs to happen because time is marching on.

The Convener: Indeed. I have one more question to ask before I let in my colleagues. The block grant adjustment mechanism provides incentives for the Scottish Government to grow the income tax base. There are concerns about how we look at comparable adjustment. The committee's previous budget adviser, Professor David Bell, said that

"indexation should be based on 'comparable' adjustment to the UK income tax base."

However, it is not clear what is meant by the term "comparable". For example, the adjustment could be indexed against a growth in comparable income tax receipts in the rest of the UK. Another interpretation is that it could be indexed against a growth in the level of income subject to income tax in the rest of the UK. Will you clarify the matter for us?

Danny Alexander: It is the latter—the growth of income that is liable for income tax. We seek to collect all that income tax but we do not always completely succeed. That is the proper definition of what the tax base is. It is exactly right that Scotland gains or loses depending on whether it grows its tax base compared to the rest of the UK or its tax base shrinks. Recent history shows that, in the past 20 years or so, there has been very good employment performance in Scotland—slightly better than in the rest of the UK. It has also had slightly better gross domestic product growth performance than the rest of the UK. There are reasons to be encouraged on that front. The whole purpose of devolution is our shared belief that, by passing over such levers, additional levers are created that will help to grow the economy.

The Convener: Thank you for that. Michael McMahon has a question.

Michael McMahon (Uddingston and Bellshill) (Lab): I will follow up the convener's point on the landfill tax and the block grant adjustment. As the convener rightly said, there is no specific figure for landfill tax revenues available from Her Majesty's Revenue and Customs. The convener mentioned that we have had concerns about the accuracy of the OBR's figures. Even if we set to one side that issue and accept that its figures are right, are there not real concerns about the principle of using figures that are based on an assumption of a constant share of UK figures, rather than looking at the specific level of the revenue obtained by the Scottish Government via the landfill tax? There must be inherent dangers in not having a specific figure and using an extrapolation of UK figures.

09:15

Danny Alexander: That is an important question, but that is part of the reason why we are still working on what the block grant adjustment methodology should be for the smaller taxes. In the case of the two taxes that we are talking about, it looks like the tax base for landfill tax is gradually declining UK-wide, whereas stamp duty land tax, although subject to quite a lot of volatility, is historically a tax base that has been growing and which is forecast to grow. We will need an adjustment methodology that is able to take account of both those facts in a way that is fair to both UK and Scottish taxpayers. We do not want a block grant adjustment methodology that leaves either a windfall gain or a windfall loss to either Scotland or the rest of the UK; rather, we want a methodology that creates opportunities for the Scottish Parliament to build the tax base and therefore grow its revenues, if that is what you and your colleagues decide to do.

For example, I have real problems with the idea of having a one-off adjustment purely in cash terms. Clearly, with inflation, the value of such a one-off adjustment would erode over time and would therefore cause a windfall gain to the Scottish Government and a windfall loss to the UK taxpayers over quite a number of years. In considering what an appropriate methodology would be, we need to move beyond looking at a simple cash figure that would depreciate over time to consider other options precisely in order to take account of the facts that you mentioned.

However, I guess that there is then a choice—this relates to your question—whether to take landfill tax and stamp duty land tax together or to have one adjustment that applies to both taxes lumped together. It would be possible to have adjustments differentiated between the two taxes, but it is probably simpler to take the two together because any growth or shrinkage in each tax base could be offset by shrinkage or growth in the other.

Michael McMahon: The Cabinet Secretary for Finance, Employment and Sustainable Growth has predicted a reduction in landfill tax revenues, which he predicts will drop from about £107 million in 2015-16 down to £40 million in 2025. That is a fairly significant change. Our committee regularly hears that, in matters of taxation, those involved in business—regardless of what sector they are in—do not like shocks. If there was a significant drop of around £60 million that was not adjusted accurately, that could create such a shock, which would not be considered favourably by the business community, especially those businesses that operate in these areas. These things need to be ironed out well in advance, so that we do not have disparities that would create problems for those who operate within the regulations for those industries. I understand the principle about the need to equalise things out, but there would still be a problem if the change in the landfill tax revenue was significantly greater than that in the land and buildings transaction tax revenue. Given that we foresee that, should it not be possible for us to address it?

Danny Alexander: That is a fair point, but let me say two things. First, the sorts of forecasts that we see for Scotland and for the rest of the UK are broadly similar. I do not think that there is a particular divergence in forecast landfill tax revenues between Scotland and the rest of the UK. We would want an adjustment methodology that reflected the facts on both sides. In other words, if landfill tax were not being devolved, those revenues would be declining UK-wide and for good reasons—the whole point of landfill tax is to dissuade people from sending material to landfill. One might say that the fact that the revenues are declining is a success of an environmental policy, albeit that they were forecast to decline. However, the OBR's forecast of Scottish taxes in March 2013 forecast a broadly flat picture on landfill tax.

On stamp duty land tax, which provides a much larger revenue stream than landfill tax, at that stage the OBR was forecasting that revenues would increase from £275 million in 2011-12 to £509 million in 2017-18, so we are also seeing a growth in the stamp duty land tax base that would far outweigh any decline or flatness in the landfill tax base. As such, I would say that that is not a shock but something that can clearly be forecast and which needs to be taken into account in the methodology that we choose.

Michael McMahon: The evidence that we have heard on the two separate taxes suggests that the revenue from land and buildings transaction tax—the equivalent of the stamp duty land tax—would remain reasonably constant. The difference is that the drive for a zero waste strategy in Scotland appears to exceed the expectations for the rest of the UK and, therefore, over time there will be a greater reduction in revenue from landfill tax in Scotland, which would not be accounted for if we just made assumptions across the UK and built in the mechanisms that you are suggesting, whereby we look at the two things together and extrapolate out from there. Unless we look at the disparity or the divergence between landfill tax revenue here and in the rest of the UK, we could lead ourselves into a problem when it comes to the adjustments.

Danny Alexander: The purpose of devolving taxes is to increase financial accountability and to put additional levers into the hands of the Scottish Parliament. If the consequence of a policy choice made here, quite legitimately, is to erode a tax base more quickly—the fact that that choice is made for good reasons, which I incidentally support, is irrelevant—that cost should quite properly be borne by the Scottish Parliament, because devolution of the tax promotes greater accountability in that policy area. The block grant adjustment methodology needs to take into account the forecast and the forecast UK wide, but it should not be saying, "Let us in the adjustment methodology pass the cost of a policy choice made here to the UK taxpayer." That is not what we should be seeking to do.

Jamie Hepburn (Cumbernauld and Kilsyth) (SNP): There is a convention—in fact, I think it is an agreement—that where expenditure is incurred through a decision taken by the Westminster

Parliament, it bears the cost and where expenditure is incurred through a decision taken here, the Scottish Government will bear the cost. Do you think that that is a sensible arrangement?

Danny Alexander: Yes, it is well established in the statement of funding policy, which is updated every full spending review. Costs of devolution are borne by the Scottish Government, but costs of decisions or requirements made by the UK Government are borne by the UK Government. It is quite proper that the Scottish budget should bear the cost of getting the systems ready to apply a Scottish rate of income tax, for example.

Jamie Hepburn: It is interesting that you said that, because that is exactly where I wanted to go. The Scottish rate of income tax comes from the provisions set out in the Scotland Act 2012, if I am correct. That is an act of Westminster, not of this Parliament. Why should the Scottish Government be expected to bear the burden of implementation costs?

Danny Alexander: All devolution is a consequence of choices made by political parties and politicians here in Scotland but enacted through the Scotland Act as it has evolved over time. That is exactly the principle that has been applied in other areas. It is set out in the statement of funding policy. It is the way in which costs were borne in earlier phases of devolution. It is appropriate that that should continue. This Parliament has also passed a legislative consent motion to accept and welcome the tax powers that are being devolved. I hope that I have interpreted that correctly. It is a well established convention that the Scottish Government would then bear the cost of implementing those things, because they are then devolved responsibilities of the Scottish Government.

Jamie Hepburn: So Westminster decides and the Scottish Government has to pick up the tab. The UK Government is estimating the cost, though, so you are in control of the costs and your estimate was some £40 million to £45 million for implementation. To be fair, your officials have previously told the committee in evidence that they hoped that the expense would be significantly less than £45 million. Can you update us on that?

Danny Alexander: I do not have any update on costs to give the committee, although that is the sort of thing that we can include in our annual reports to keep people updated. It is essential—and it is a fact—that the Scottish Government has a seat on the programme board that is implementing the Scotland Act 2012, so that it is involved in all the key decisions and is able to challenge those decisions and the costs attached to them as appropriate. There is a memorandum of understanding between HMRC and the Scottish Government that sets out precisely how those things will work and how costs are apportioned, and that memorandum of understanding makes it clear that HMRC will consult the Scottish Government at each stage, as well as give it the option of third-party scrutiny, if it wants that, on costs and particularly on information technology costs, because a lot of the cost will be for IT systems that need to be built to implement the Scottish rate of income tax.

On the costs, the systems are transparent to the Scottish Government, which has a seat at the table and a degree of power and the ability to challenge—all the things that you would expect. It is definitely not the case that someone in London is deciding what the costs are and just sending a bill to Holyrood. It is a much more discursive and iterative process.

Jamie Hepburn: To be fair, they are the UK Government's estimates. It is not the Scottish Government that has come up with those figures; it is HMRC.

Danny Alexander: What I am saying is that, at each stage, the Scottish Government is involved in the choices about how to go about the implementation, and those decisions determine what the costs are. It also has the ability to challenge at each and every stage—not just to give challenge itself, but to bring in independent advice, if it wishes to, to give further independent challenge to costs, precisely so that there is no perception that the costs are being determined somewhere else and the bill sent to Holyrood. That would not be right. It needs to be a much more open and discursive process than that.

Jamie Hepburn: I want to explore something that you said about the block grant adjustment as it relates to LBTT and landfill tax. You clearly set out in previous evidence your opposition to a one-off adjustment in cash terms, because the mechanism might be the same but the sum in cash terms could be different from year to year. Do you not accept that most people would question whether that truly is a one-off adjustment, if it is going to be different year on year?

Danny Alexander: Let me give you an example that is well established, not from taxation but from other spheres of devolution.

When a new responsibility is passed to the Scottish Government—a few years back, for example, the responsibility for some areas of transport policy was devolved under the previous Westminster Government and the previous Scottish Government—a one-off adjustment is made to the block grant and also to the comparability factors in the Barnett formula, so that future changes reflect the policy change that has taken place. That kind of adjustment is made once. It happens at the time at which the spending responsibilities are devolved, and it ensures both that the amount of money that is passed over properly reflects the new responsibilities and that the mechanism for adjusting spending in future reflects the fact that that decision has been made.

That is the one-off adjustment that takes place on the spending front. One option—one of many options—would be to construct a parallel methodology for the two smaller taxes that you mentioned. To my mind, that is plainly a one-off adjustment.

The issue that I was referring to in cash terms was well illustrated by Mr McMahon’s questions. When there is a relatively buoyant and growing tax base and you make a one-off adjustment in cash terms, the value of which is reduced year on year by inflation, there is an increasing divergence between the two that is not related to policy choices, to economic accountability or to the decisions of the Scottish Government. Quite properly, there should be an opportunity to grow tax revenues in such circumstances, but it would simply be a windfall gain on the basis of the adjustment methodology that is decided.

09:30

Both Governments and both Parliaments have, I think, enthusiastically accepted the principle that the process by which devolution of tax powers takes place is not one that should, as a feature of the process, be to any detriment or gain to either Scotland or the UK. Once the powers are devolved, it is a matter for the Scottish Parliament to decide how it exercises the powers. If it wants to make choices to grow the tax base or to increase rates, it is quite proper that Scotland should gain revenues from that; if it wishes to cut taxes, Scotland should lose revenues.

Jamie Hepburn: I may be paraphrasing slightly, but you said that we are seeing steeper growth in LBTT than in landfill tax.

Danny Alexander: That is the forecast.

Jamie Hepburn: That is exactly the point: you said that we are seeing it, but we are not seeing it unless we are psychic and have a crystal ball. It is a forecast and it is subject to adjustment all the time.

If I heard correctly, you said that it would be important to include forecasts as part of any adjustment mechanism but, given that they are forecasts, it would surely make much more sense to look at the reality of the collection of taxes and perhaps use an average of actual figures. Would that not be much fairer and clearer than using forecasts that are, as we know, subject to change? Everybody would know where they stand.

Danny Alexander: The point that I was making about stamp duty land tax is that if, let us say, you went back over the past five years, you would be looking at a period of unprecedented economic challenge when revenues have been particularly depressed. If you went back over a longer period of time, you would get more of a sense both of the fluctuations and of the heights that the revenues can reach and the depths to which they can fall.

When you look at the figures over time, you also get a sense of a tax base that is, when you look through the volatility, gradually increasing—I do not think that that is contested. With a growing population, demographic change in household formation and so on, you see greater transaction volume over time, and you need to reflect that.

Precisely the correct period to calculate that over is a matter for debate and discussion, but I think that the methodology needs to take into account not only what has happened recently but the prospects for the taxes, because the block grant adjustment methodology is a one-off thing—once a decision is made it will be implemented and will keep going for many years. I think that Robert Chote made the same point to the committee about how SDLT revenues have been particularly depressed over the last period and that, therefore, to take only a five-year historical figure—

Jamie Hepburn: I do not think that I said anything about five years; I just said over a period.

Danny Alexander: Five years is a suggested period that has been floated in the debate. Given that the recent period has been extraordinary, a calculation based on it would not give a reflection of the prospects for revenues from SDLT that is fair to both Scotland and the United Kingdom.

Jamie Hepburn: Can I ask a final quick question, convener?

The Convener: Please be brief.

Jamie Hepburn: I appreciate that, convener; I will be brief.

Mr Alexander, it is interesting that you suggested that it is indicated that there will be gradual growth in SDLT receipts over a period. Would you define growth from £275 million in 2011-12 to £509 million in 2017-18—as is forecast—as gradual growth?

Danny Alexander: No, that is pretty sharp growth. That reflects the—

Jamie Hepburn: And that is what you want to base the adjustment on.

Danny Alexander: No, I did not say that. I said that we are still discussing with the Scottish Government precisely the right way to make the adjustment. My point is that a one-off cash adjustment, which depreciates over time, is not a fair reflection of a tax base that has grown steadily over time and is forecast to grow over the next few years.

We are still discussing the issue with the Scottish Government. I will be interested to see the committee's conclusions about what it thinks the fairest methodology is. All I would say is that it is essential to me—I hope that it will be essential to the committee, too—that the choice of adjustment methodology does not in itself either advantage or disadvantage the Scottish Parliament or the UK Parliament.

Jean Urquhart (Highlands and Islands) (Ind): The UK Government report "Strengthening Scotland's Future" has a really good title. We would agree that having more devolved taxes and powers would be strengthening Scotland's future—although, of course, independence would strengthen it absolutely.

We therefore approve of the title, but in the report you talk about

"Increasing the financial accountability of the Scottish Parliament".

Does that mean accountability to the Scottish people or to the UK Government?

Danny Alexander: First, I do not accept the premise of the question that independence would strengthen Scotland's future, but perhaps this is not the appropriate time to debate that. We will all be debating it over the next 12 months, but I just put on the record that I disagree rather strongly with that particular assertion.

The Scottish Parliament is accountable to the Scottish people, and financial accountability means that the Scottish Parliament bears the financial consequences of its decisions. For example, to go back to Mr McMahon's questions, if you choose a particular policy on waste that leads to absolutely zero landfill and zero landfill tax revenues, that is a choice that has financial as well as environmental and social consequences, and all those things need to be taken into account together.

That is the whole purpose of the measure. Scotland is part of the United Kingdom and we have a well-established system of allocating a block grant. Part of the purpose of the 2012 act is to shift the balance of financing from the block grant approach to a more self-financing approach. That is appropriate, but we must ensure that the block grant part is handled in a way that continues to be fair to UK taxpayers as well as to Scottish taxpayers.

Jean Urquhart: Given that new Scotland-specific taxes are subject to agreement by the UK Government, does the Scottish Parliament really have the freedom to exercise the new fiscal powers on the scale that the UK Government articulates in "Strengthening Scotland's Future"? It is clear that it wants to show that the Scottish Government is in control but, really, the UK Government is in control.

Danny Alexander: We have not yet had any proposals from the Scottish Government for new taxes to be created, but I look forward to hearing them.

The 2012 act gives a great deal of freedom. The provision requiring the Treasury's approval is not intended to inhibit the Scottish Parliament from coming up with or implementing proposals. For example, there are some fairly strict European Union rules about not taxing the same tax base twice. The UK is the member state of the European Union, so the UK Government needs to assure itself that, for example, any proposal would not break European law because, in the end, the UK Government would be the party that is pursued through the courts or through whatever the appropriate action would be at European level.

There is no intention at all to prevent the Scottish Government from coming up with new taxes and implementing them. The whole point is that, if there are new tax bases, the Scottish Government is free to put forward ideas for taxes and then to implement them and, of course, to be accountable to the Scottish people for those choices.

Jean Urquhart: To quote the same document, what would constitute

"clear evidence that the arrangements for forecasting Scottish income tax receipts and the new tax collection arrangements are operating effectively"?

Danny Alexander: Do you mean in relation to the Scottish rate of income tax?

Jean Urquhart: Yes.

Danny Alexander: In a sense, the evidence will be clear. It will be that the tax is being collected effectively, that the money is being passed over effectively and that HMRC is delivering its side of the bargain, according to the memorandum of understanding and the agreed policies. That will be reported on regularly to both Parliaments, so there will be plenty of opportunities for both of them to look at the evidence of progress and, once the taxes are implemented, to see the information.

In addition, the Scotland Act 2012 makes it clear that the National Audit Office will have a clear role in the matter, as it does in examining public expenditure according to the test that it applies. The Scottish Parliament will be keen for the National Audit Office to carry out its functions properly. The NAO has been clear with us that it wants a particular legislative base for its reports.

That will be put in place, and I hope that the National Audit Office's work will give a proper degree of assurance on the evidence to the committee and the Parliament.

The Convener: Last question, Jean.

Jean Urquhart: It is my last question, but it is a big one. Although you did not want to talk about independence, Mr Alexander—

Danny Alexander: I am delighted to talk about independence, but I am not sure that it is the purpose of the meeting. I am happy to trespass on other territory if the convener would like me to.

Jean Urquhart: There are regular declarations that, should Scotland not vote yes, the Scotland Act 2012 would be strengthened—that you would offer the Scottish people further fiscal autonomy and tax-raising powers. What would those look like or when will you declare that?

The Convener: Jean, that is not what we are here to discuss, unfortunately, although I am sure that we would like to. We are short of time, so we need to move on.

John Mason (Glasgow Shettleston) (SNP): Mr Alexander, when you answered Jean Urquhart you said that European legislation would not allow us to tax the same base twice. Is that not what the Scottish rate of income tax will do?

Danny Alexander: No, because the collection will all take place through HMRC, as agreed, and because we are reducing the rate at UK level and creating the Scottish rate of income tax. That is all legislated for through the UK Parliament, so it is a well-established mechanism. Other countries have different rates of income tax at different levels of Government.

John Mason: My point is that there is scope for taxing the same base twice.

Danny Alexander: If the Scottish Government proposed to introduce a new tax that sought to raise money from an area that was already taxed at a UK level, that could be in breach of EU requirements, but each case would have to be examined.

John Mason: Okay. That is probably something that other people can consider in more detail.

Chapter 1, I think, of the first annual report, which is signed off by Michael Moore, talks about devolving further existing taxes and creating new devolved taxes. That is the kind of area that we are in just now. One example that has been floated is air passenger duty. At what time would the UK Government be open to discussing devolving air passenger duty?

Danny Alexander: Given the uncertainty of the potential impact of devolving APD on the UK as a whole, we took the decision not to devolve it in the Scotland Act 2012. We are now focusing our efforts on implementing the powers that have been legislated for, which is the main subject of this evidence-taking session—as it has already illustrated, there is a complex and serious set of challenges.

We have not put a timescale on the matter at all. Without wishing to go over the subject that the convener quite rightly ruled out of order, there is to be a referendum on Scotland's constitutional status and, clearly, that issue needs to be dealt with one way or another before further decisions can be taken.

John Mason: With all due respect, we are looking at the act, which talks about other devolution. So, if we forget about the referendum for a minute, if that is allowed—

Danny Alexander: If you wish to, that would be very welcome.

John Mason: For the purposes of this committee, we can forget about it.

The changes that we are talking about are not going to be implemented until about 2020, when we will have gone through the process of looking at income tax and how that will work its way through. Would you say that we are not looking at any other taxes, or even more control of our income tax, until at least 2020?

09:45

Danny Alexander: Not necessarily. I would say, though, that that is not included in the act, so any such decision would require political consensus and would have to be legislated for, and then it would require its own implementation timetable.

With the implementation timetable for the Scotland Act 2012, you are looking at devolved taxes coming into force in 2015-16, so it is only a couple of years away. With the Scottish rate of income tax, there is obviously a significant transitional period, which I think is a sensible precaution to protect the Scottish Government from undue volatility in the early years. However, I would certainly not present that as something that is not happening until 2020—quite the reverse. It is something that is coming at us pretty quickly down the track.

John Mason: In one of your answers to the convener on the Scottish rate of income tax, you said—if I understood correctly—that there would be a loss to Scotland only if there was a differential change in the forecast between the UK and Scotland. I would like to clarify that in my own mind a little bit.

Let us say that the forecast was overoptimistic for both the UK and Scotland to the same extent, and that income tax receipts were then less than expected. Are we saying that in those circumstances there would be no particular loss to Scotland? Even under the old system with the block grant, the block grant would have been cut because the UK had less income. Is that roughly what we mean?

Danny Alexander: The block grant is a consequence of spending decisions to which the Barnett formula is applied. Generally speaking, the UK does not adjust its spending in year according to tax receipts—we use our borrowing powers and so on to smooth that over time—so under the current arrangements you would not see an adjustment to the block grant in year, or even in a subsequent year, because of a weakness in one type of receipt.

At the moment, we are going through a substantial fiscal adjustment that is based on a large gap emerging between what we raise and what we spend as a consequence of the financial crisis under the previous Westminster Government, and that gap has to be filled.

What I am saying is that the methodology that we have in mind is one that means that, in the circumstances that you describe, where the forecast for Scotland and the rest of the UK turns out to be equally overoptimistic, there would be no cost to Scotland through the block grant adjustment methodology. Likewise, if the forecast for Scotland and for the UK had been equally pessimistic and there were extra receipts but no differential between them, the same would apply in the opposite direction. One of the beauties of the Holtham methodology is that you do not see unfair divergence in that way.

John Mason: Maybe I can press you on that a bit more. At the moment, as you have correctly said, the block grant does not immediately respond to changes in income tax receipts, or other tax receipts, at UK level. Will the block grant adjustment not respond more quickly to those receipts?

Danny Alexander: It would if there was a differential between the receipts against forecast in Scotland and the receipts against forecast in the rest of the UK. The basic idea is that, when there are fluctuations in the tax base or in tax receipts UK-wide, there should not be a particular additional cost to Scotland, but that, if Scotland has taken steps to grow its own tax base, or indeed has shrunk its tax base, the tax hit or gain should be something that applies to Scotland. When the entire UK economy is facing difficulties, it would be wrong to penalise Scotland in particular through a block grant adjustment methodology for those circumstances.

John Mason: Because the whole place would be penalised, in effect.

Danny Alexander: That is exactly correct.

Of course, it may well be the case that, if that problem continued for a period of years, the UK Government would need to make fiscal adjustments. Those fiscal adjustments would be reflected through the overall block grant, exactly as happens at the moment, but the methodology for adjusting the block grant as part of the Scottish rate of income tax would not have that effect in Scotland.

In fact, that is a very important point about the methodology that we have collectively chosen: it offers real protection against those sorts of problems, which would not necessarily have been available under the previous proposed methodology.

John Mason: Finally, going back to Mr Hepburn's point about implementation costs, I follow the logic that if Scotland introduces a new land and buildings transaction tax we should bear the cost of that. However, I find it slightly harder to understand the logic behind our bearing the costs of switching off the previous UK stamp duty land tax. I had thought that under the Scotland Act 2012 we would write the cheque for costs incurred here and Westminster would write the cheque for costs incurred as a result of decisions made there, but that does not seem to be working out in practice.

Danny Alexander: I think that it is. Decisions on the apportionment of costs follow the exact methodology for previous sets of decisions and the policy set out in the statement of funding policy, and the Scottish Government has a good deal of protection through its involvement in all of those decisions and its ability to scrutinise the costs.

That said, in the case of income tax, responsibility is being handed to the Scottish Parliament, and with such an adjustment there will be additional costs with regard to HMRC's tax collection systems and providing the IT necessary to differentiate between revenues from Scotland and those from the rest of the UK. It is appropriate that those costs are borne by the Scottish Government. Equally, I accept that if we were to insist that the process be done in a particular way—perhaps because we wanted a further adjustment on top of what had been agreed as necessary—one could raise a legitimate question about costs.

The basic construction of the Scottish rate of income tax is exactly like devolution in other areas, and I think it appropriate for those costs to be borne by the Scottish Government. It is, if you like, another aspect of financial accountability.

John Mason: Even if we are talking about switching off UK taxes.

Danny Alexander: Yes, if it is to enable a Scottish tax to take place.

Gavin Brown (Lothian) (Con): I have a couple of questions on the block grant adjustment mechanism for the landfill tax and the land and buildings transaction tax. Is there an argument for having a different method for each of those taxes, given that one tax base is shrinking and the other is growing? I also think that the policy objectives behind the two taxes are different. After all, the UK and Scottish Governments both want more activity in the housing and commercial property markets and less going to landfill. Would it be possible to have a different method for each tax?

Danny Alexander: We and the Scottish Government have not discussed that issue so far, but I would be open to considering such ideas, if they were put forward.

On the one hand, I take your point that the forecast growth in revenues for those taxes is quite different and that they have different objectives and are on different trajectories. On the other hand, however, we are talking about relatively small sums of money, particularly with regard to landfill tax, so you do not want an overly complicated adjustment method to deal with them. The two things have to be balanced. Thus far, we have considered an approach that takes the two taxes together, but I am very happy to consider other ideas.

As I have said, we still have not reached agreement with the Scottish Government on the best way of handling the problem. On the one hand, we must ensure that this is a one-off adjustment and, on the other, the adjustment needs over time to remain equitable to Scottish and UK taxpayers. What you are suggesting could be a way through that.

Gavin Brown: According to the most recent Office for Budget Responsibility projections, landfill tax receipts will go from £98 million in 2011-12 to £95 million in 2013-14. I guess that the first two years—at least, the first year—of those projections are actually outturn, but I note that from 2013-14 to 2017-18 the receipts are projected to rise from £95 million to £108 million. To me, the figures for the first three years feel right and are sort of what I would anticipate, given the shrinking tax base that we have talked about. However, to project a move from £95 million to £108 million over a five-year period just instinctively does not feel right to me. Do you have a view on that? Of course, it is a forecast, but can it be examined in more depth to ensure that it is as accurate as possible and takes in all the likely political factors?

Danny Alexander: That is a good point. That is an OBR forecast, and I would not wish to question the forecasting methods of the OBR—I am not sure that it would be appropriate for me to do so. However, it is a good question for you to ask the OBR; indeed, it is a good question for the Scottish Government, which is part of the discussions on forecasting, to consider. You are right to want to ensure that the forecasting method is based on as accurate a representation of the factors at play as possible. The forecast might be related to the growth forecasts and the possibility that more landfill activity could take place as the economy grows, although I do not know. I am afraid that I do not know what lies behind the forecast, but it is a good test of forecasts to consider whether they feel right and, if they do not, to go back and look again at the method.

Gavin Brown: I have a question about the land and buildings transaction tax block grant adjustment mechanism. Two options have been presented so far. One is the initial UK Government position of looking at forecasts, although I suppose that the downside to that is the danger of volatility. Certainly, the initial OBR forecasts were very different from the ones that we had 12 months later. The Scottish Government has suggested a retrospective approach. That would have the benefit of certainty, but the cabinet secretary suggested a five-year proposal and, as I think you said earlier, that would pick probably the five years with the lowest economic growth in decades.

Danny Alexander: That is a perfectly reasonable negotiating position, if I may say so.

Gavin Brown: It is. However, clearly, both approaches have disadvantages. Is there a magic Holtham mark 2 way of doing it that would satisfy all the criteria that everyone has laid down, or are negotiations on how we resolve the issue at a pretty early stage?

Danny Alexander: I do not think that there is a Holtham mark 2 on the issue because, for what I think are good administrative reasons, we have been looking for something that is simpler than the Holtham method for the smaller taxes. By the way, my view is not necessarily that the mechanism should be based on forecasts—that is just one option. Another option would be to look back over a much longer period so that we get a sense of where the revenues have been going historically, and then roll that forward.

You are right that there is quite a lot of volatility. Of course, it is not the purpose of the block grant adjustment mechanism to take account of volatility; there are other mechanisms in the Scotland Act 2012, such as the Scottish cash reserve and the current borrowing powers, which exist precisely to give the Scottish Government tools to manage receipt volatility. Receipt volatility is a problem that faces any Government that collects taxes, and managing that volatility is part of the responsibility that is being devolved. I hope that, with the cash reserve and the borrowing powers, the necessary tools are there.

I am more concerned about ensuring that, whatever method is eventually decided on for the block grant adjustment for stamp duty, it reflects the fact that the tax base has been growing over time, and that therefore the amount by which the block grant is adjusted does not gradually build up a loss to UK taxpayers because they are paying more block grant than they should be. That might happen, for example, because a cash-terms adjustment erodes over time, whereas the tax base grows over time, which would not be fair to UK taxpayers. Beyond that, I am happy to look at any number of options to work out what is fair and simple and is a one-off adjustment that fundamentally is done on the basis of there being no detriment to either UK or Scottish taxpayers.

10:00

Malcolm Chisholm (Edinburgh Northern and Leith) (Lab): I, too, want to ask about the block grant adjustment, which I think is the key issue politically, as well as financially, for the devolved taxes and for future fiscal devolution. I will be brief, because the landfill tax and the land and buildings transaction tax have been dealt with in detail.

I noticed that you did not, understandably, want to criticise the OBR. Also, you talked quite openly earlier about the shrinkage of the revenue from landfill tax, which is the opposite of what the OBR has forecast. On stamp duty land tax, although I take your point that the last five years have been extraordinary, one could equally say that the five subsequent years will be unusual or extraordinary because they might compensate for what has gone before. I suppose that part of my conclusion from that is that, although I accept the principle that neither Government should benefit, the idea of looking at trends over a longer period of time might, in fact, be more politically acceptable as well as more financially accurate.

Danny Alexander: I think that there is a lot of merit in that. Looking at long-term trends is a way to look through the short-term fluctuations, so I think that that would make some sense. This may be an area where we want to have periodic reviews that enable these things to be updated. I take your basic point that we should not use any particular short period that has short-term volatility to determine what happens in perpetuity in the future.

Malcolm Chisholm: The income tax adjustment is perhaps far more significant not just in financial terms but because the indexation may be significant for further fiscal devolution. Professor Holtham has been quoted more than once this morning, but I notice that he also said that it

"is not in the devolved territory's interest if its own tax base is inevitably slower growing than that of the UK."

In a way, I am attracted to what is proposed on the basis that the Government's action can influence the tax base, but are there circumstances in which the tax base of one country—the rest of the UK—inevitably grows faster or slower? I suppose that the thing that people in Scotland might be worried about is whether there are inevitable things that are outwith Government control that mean that the tax base of the rest of the UK might grow more quickly than that of Scotland.

Danny Alexander: I do not think that there are factors that lead to that being inevitable. As you will have seen, as part of our Scotland analysis programme, we published yesterday quite a lot of data about the macroeconomic and fiscal performance of Scotland and the rest of the UK over the past few decades. That information shows things that might determine the growth of the income tax base, including GDP growth, on which Scotland's performance has marginally exceeded that of the rest of the UK for the past 20 years, and employment, on which although in the 1970s and 1980s Scotland fell behind the rest of the UK, in the 1990s and 2000s Scotland marginally exceeded the rest of the UK. I hope that those recent data give a degree of reassurance on that point.

Malcolm Chisholm: On the income tax forecasts being wrong, I take your point that Scotland would not be disadvantaged more than the rest of the UK, but I suppose that, if the forecasts were significantly out, the UK Government's massive borrowing powers could cover that, whereas Scotland will have very limited revenue borrowing powers. Could there be an issue there if the forecasts were significantly wrong?

Danny Alexander: I suppose that in theory there could be an issue, but in practice there would be an issue only when the forecast was both significantly wrong and significantly wrong for Scotland in a way that differed markedly from the rest of the UK. In other words, it seems to me most likely that, when the forecast goes wrong, that is as a consequence of macroeconomic conditions changing and affecting the whole UK, so we would not be likely to see differential wrongness, as it were, emerge as a consequence of the way that the forecasts are conducted. Therefore, I would say that the combination of the Scottish cash reserve and the current borrowing powers that are legislated for is more than sufficient to meet differential fluctuations from the forecast that might apply to Scotland. However, that is clearly something that we need to keep a close eye on as the system beds in over the years and decades to come.

Malcolm Chisholm: Clearly there has been progress on borrowing in the Scotland Act 2012, although no doubt there will be discussions about whether the powers in the act are adequate.

An interesting point in that regard is that capital borrowing is very tightly controlled. The Scottish Government says that it would probably be able to borrow about £240 million annually, whereas local government has had considerable freedom in prudential borrowing for a decade or so—I do not know the macro figure—which is constrained by the ability to service that borrowing. There seems to be a discrepancy there. It is obvious that the Treasury is taking a hard line on Scottish Government borrowing, but is there not some inconsistency? In the future, would not it be safe to give the Scottish Government greater borrowing powers, on the basis that it will inevitably be constrained by its capacity to repay what it borrows?

Danny Alexander: I would not say that a particularly hard line is being taken. This is the first time that legislation has enabled Scotland to have borrowing powers. The Scotland Act 2012 is a hugely significant piece of further devolution. It is the first time that tax powers of this order have been devolved within the United Kingdom.

We set out in the spending round that capital borrowing powers in 2015-16 will be £296 million. The figure is derived from capital spending, so as capital spending increases over time, the amount that can be borrowed will increase, in step with that. That should offer some reassurance. Over a 10-year period there is a limit, but at the moment that would be about £2.2 billion, and of course that, too, can rise over time.

Such sums are sufficient to carry out major projects—I would like to see the money used to accelerate the dualling of the A9, but I am sure that people from different parts of Scotland have different views.

We should put in place the powers and see how they work. They can be looked at as part of a discussion about the next phase of devolution—assuming that we will be in a constitutional position in which we can have that discussion.

The Convener: I want to ask about borrowing before I segue into the next topic. I accept some of what you are saying, but there is an issue that concerns me. Local authorities can borrow from the Public Works Loan Board, whereas the Scottish Government must borrow from the national loans fund. From 1 November, local authorities in England will be able to access borrowing for approved projects at 40 basis points below the PWLB's standard rate—about 0.4 per cent. Scottish local authorities will not be able to access such favourable borrowing, and neither will the Scottish Government. Why is that?

Danny Alexander: I would have to double-check the Public Works Loan Board and national loans fund rates—I think that they are the same. The Public Works Loan Board was established by statute to facilitate borrowing by local authorities. It is a subset of the national loans fund, so in that sense great store should not be set by the institutional difference.

The Government increased the Public Works Loan Board rate in the 2010 spending round, and we subsequently put in place a lower rate for certain sorts of projects, which is known as the project rate. There is a limited pot to encourage local authorities to take forward particular major infrastructure projects. John Swinney has not raised with me the question whether Scottish local authorities should be able to benefit from the project rate; I would be happy to talk to him about that if he raised it.

The Convener: Should Scottish local authorities be able to access the rate? You are a Scottish MP, apart from anything else.

Danny Alexander: I would be happy to look at that. I think that I would have to look at the matter in the context of the overall borrowing environment in Scotland, but it seems to be a perfectly reasonable point, which I will happily take away from the committee.

The Convener: Good. The point that I am making is that Scotland should not be disadvantaged in relation to borrowing, either at Scottish Parliament or local authority level.

Danny Alexander: The Scottish Parliament will not be disadvantaged. The rates that are available reflect the historically low gilt rates that the UK is able to command as a consequence of the fiscal credibility that we have built up and retained under this Government. The rates are considerably lower than many other countries are able to command in the markets. I venture to suggest that they are considerably lower than the rates that the Scottish Government would be able to command if it were to borrow commercially. I understand the point that you are making, but I have to say that the proposals are relatively advantageous for Scotland.

The Convener: Okay. We will not go into the loss of AAA rating and so on.

I will move on to the budget announcement. Colleagues can indicate to me whether they want to ask any questions—I have Jamie Hepburn down first. Why was the decision taken in March to take away £107 million of resource about 10 days before the start of the financial year? Was the Scottish Government consulted on that before the decision was made?

Danny Alexander: Those decisions were, as it were, Barnett consequentials of wider decisions on public expenditure. What was basically going on there was a shift at UK level in the balance between current and capital spending. Perhaps Paul Doyle can remind me, but I think that I am right in saying that there was a small loss of resource, which you have described, but there was also a much greater gain in capital spending. Over the time that we have been in office, our Government and I have sought whenever we can to switch funding from current to capital spending. By and large, that switch has been encouraged by Scottish ministers. The net effect on the Scottish Government's budget was positive.

The Convener: Surely it is about how you interpret that; it is replacing a resource of hard cash with a loan. If I was to say to you, "I'm going to replace your salary with a loan", I do not think that you would be very happy about it, because you would have to pay it back. How can you possibly say that it was advantageous when the money has to be paid back and the resource has been lost permanently?

Danny Alexander: It is advantageous in two senses. First, taking the Barnett consequentials of those decisions in the round, the gain on the capital side was substantially greater than the loss on the resource side. Part of that gain was, as I think that you are implying, through so-called financial transactions. Those transactions are a serious tool in the economic armoury of a Government. The way in which they can be used is different, but I do not see them as being sort of second class compared with traditional capital spending—far from it.

The approach has enabled the Scottish Government, if it wishes, to intervene to support the housing market, for example, in precisely the way that the financial transactions at UK level are being used to support the help to buy equity loans scheme. It is interesting that on budget day the chief executive of Homes for Scotland welcomed the move and encouraged the Scottish Government to follow it. I hope very much that the Scottish Government will choose to follow it and will use the positive consequentials to the good of the Scottish economy, because that is what they are there for.

The Convener: We are still losing hard cash, which is being replaced by loans that have to be repaid. Surely that is not advantageous, because even the loans have to be repaid from the resource. You are cutting the resource initially and then you are having to cut it a second time to pay back the loans that you have so generously given us.

Danny Alexander: The financial transactions are designed to be repaid by the recipients. Certainly in the case of the help-to-buy equity loans scheme that the UK Government has constructed, we fully expect that to happen. That is part of the accounting for that scheme. If what you want—this is what I want and I am sure it is what the committee wants, too—is to support economic growth, a shared equity scheme to enable construction to take place and to increase the volume of purchases of new-build homes is a good thing for the economy, from which the whole of Scotland will benefit not just now but in the future. I am afraid that I do not see things in the way that you are describing.

The Convener: Indeed. So, was the UK Government wrong to cut our capital budget by 26 per cent over three years?

Danny Alexander: If you look at what we did in the spending round in 2010 and subsequently, you will see that at every stage we sought to shift money from current to capital spending. When we came into office we faced public expenditure plans that took a greater reduction in capital than that which was set out in the 2010 spending round.

10:15

Equally, we face one of the most challenging fiscal positions that is faced anywhere in the world, so we have to take difficult decisions. That is why, at each fiscal event since the 2010 spending round, we have switched money from current to capital. Over that period, the Scottish Government has benefited from those adjustments to the tune of £1.7 billion—that is the amount of additional capital spending that has been made available over and above the 2010 spending round.

We have maintained those increments in the spending round for 2015-16, which we announced in June. At UK level, over the 10 years for which we have now set out capital spending plans, capital spending as a share of our national income is greater than it was over the period of the previous Westminster Government.

I am the first to acknowledge that this country faces a very challenging fiscal position and that we have had to make some very difficult spending decisions as a result, but I think that the economic priority that we have attached—wherever we have been able to—to switching money to capital spending is right for the long-term future of the economy. That includes financial transactions to support the housing market.

The Convener: I ask for brief questions, folks.

Jamie Hepburn: I want to look at welfare reform and the impact that it is having on Scottish budgets. We are seeing the impact that welfare reform is having on my constituents, Mr Alexander's constituents and people across the country. Of course, the Scottish Government has introduced the Scottish welfare fund, which it has supplemented with £9 million of its own funding, and it has had to plug a £40 million cut in council tax benefit—I note in passing that that is around the cost of implementing the Scottish rate of income tax.

Will the money that the Scottish Government is having to channel in to mitigate the effects of welfare reform as a consequence of decisions by the UK Government be considered by the UK Government in future budgets and spending reviews?

Danny Alexander: Those are choices for the Scottish Government. The Scottish Government has a block grant, which comes under the Barnett formula and is calculated automatically as a consequence of UK spending plans. The Barnett formula is not adjusted as a consequence of spending decisions that the Scottish Government takes. Likewise, some local authorities have set aside money from their budgets for the same purpose.

In addition, at the end of July, the UK Government announced that we would make additional funding available in Scotland and other parts of the UK for discretionary housing payments, precisely because we wanted to ensure that local authorities had the resources available to manage the impact of some of the welfare changes.

Jamie Hepburn: So, when the UK Government chooses not to support vulnerable people, the Scottish Government will just have to pick up the slack.

Danny Alexander: What we are seeking to do is to ensure that, at a time when we have to make adjustments across all areas of public spending, the welfare budget—which is a highly significant part of public expenditure in the UK—is focused in a way that is fair to and supports vulnerable people and is fair to the taxpayer more generally.

Our reforms are aimed at getting more people off benefit and into work. I was encouraged by the recent figures that showed a decline in the number of economically inactive households, as more people move off benefit and into work. That is a positive thing, but it is also important to ensure that those changes are implemented sensitively, and that is why we made additional resources available for discretionary housing payments in July.

Gavin Brown: The point about financial transactions came up at the time of the spending round and it has been mentioned again today. Am I correct in thinking that there were financial transactions in 2011-12 and 2012-13 that did not attract the same amount of criticism as the most recent ones?

Danny Alexander: You are exactly right. In fact, financial transactions have been part of the spending landscape for very many years. Since devolution, the Scottish Government has enjoyed the Barnett consequentials of those financial transactions in each and every year.

To be honest, I found the reaction somewhat surprising and a wee bit bogus, because financial transactions are a way to support the economy—they are an additional tool for the Scottish Government and one that the house-building sector in particular has strongly encouraged it to use.

Gavin Brown: Have you had an explanation from the Scottish Government of why it seemed to accept financial transactions previously but is now strongly against them?

Danny Alexander: No. I get the sense that the Scottish Government is now working to find the best way to use the money, as it should—that is the proper response. I certainly have not had the sense that it wants to send the money back.

John Mason: Some reports have shown that the welfare reforms are disproportionately affecting women and children. I think that we are all committed to the Child Poverty Act 2010, which is meant to abolish child poverty by 2020. Do those two aspects tie in together?

Danny Alexander: It is often said in relation to the child poverty debate that, for people who can work, work is the best way out of poverty. That is why the focus of our reforms has been on strengthening the incentives to work and the support for people to get back into work.

A recent example that will benefit families across the whole UK, including families in Scotland, is the additional support that we will make available for childcare costs, which are a significant barrier to entry into the labour market for many families. I hope that that support will help to increase labour force participation further.

John Mason: There is a lot of evidence that people who are in work are also in poverty. It has been suggested that an extra million people are now between the minimum wage and the living wage, so work is not always the way out of poverty, is it?

Danny Alexander: I would be surprised if you did not accept that, for anyone who can work, working is the best way to improve their position.

That is certainly my view and it is the UK Government's policy. I think that supporting people into work is also the Scottish Government's policy.

We also need to help people to progress in work and to ensure that the returns for work are fair. That is why one of the policies that I have been most actively involved in implementing in the UK Government and of which I am proudest as a Liberal Democrat is the lifting of the income tax personal allowance to £10,000. That precisely ensures that people who work for low incomes—as you implied, there are a significant number of them—can keep more of that money for themselves and pay less of it to the Government in income tax.

Malcolm Chisholm: We have only eight minutes left, so we are a bit restricted—otherwise, I would challenge some of what you said about child poverty and the effect of your childcare changes on lower-income families. I will stick to discretionary housing payments, which you mentioned, and I will try to get in all my points in one question, in case I am cut short.

The Convener: We will not cut you short.

Malcolm Chisholm: Do you accept that discretionary housing payments need to be increased? I understand your arguments in favour of the bedroom tax, but I totally oppose it. In Edinburgh and many other places, the people whom you want to move into smaller houses are incapable of doing so, because there are no smaller houses. Should you not at least increase discretionary housing payments to such people?

We might agree on my next point, as we both want further fiscal devolution. I have always supported the devolution of housing benefit, which might deal with the problem that we are talking about. Would that still be possible after the implementation of universal credit? If not, would that give you concerns? I suspect that you might favour such further devolution.

Danny Alexander: The additional discretionary housing payments that we provided were based on evidence that we received about the first few months of the removal of the spare-room subsidy. The necessary sums of money were provided to mitigate the most difficult cases and implement the policy sensitively. Particular issues in sparsely populated remote areas have been drawn to my attention, which is why a sum of money was attached to addressing that. We continue to monitor the implementation. I know that the Department for Work and Pensions is in regular discussions with local authorities.

I am in favour of further devolution of tax and potentially other areas in the future. As a Liberal Democrat politician, I will continue to make the case for that. However, there is a strong argument for a common welfare system across the whole UK because of the need to maintain a single labour market; indeed, that very argument was made in the Calman commission report. I have not particularly advocated further devolution in that area, but it is a perfectly good argument to have.

Michael McMahon: Again on welfare reform, my understanding is that if any local authority or indeed the Scottish Government tried to find a way of resourcing or mitigating sanctions against individual benefit claimants, it would face penalties. If the Scottish Government decided to find an additional sum of money to mitigate the impact of the bedroom tax, would your Government consider such a move to be worthy of a financial penalty?

Danny Alexander: As I said in response to an earlier question, what the Scottish Government does with its block grant is a matter for the Scottish Government. I was previously asked whether the block grant would be enhanced as a result of the Scottish Government's policy choices, and the answer to that question is no, because the block grant is determined by the Barnett formula. Within that, however, devolution means that when John Swinney sets out his budget he is free to determine the allocations.

Sanctions are applied only when someone has broken the conditions of their benefit, most particularly in relation to taking the action necessary to try to get back into work. Conditionality is, quite properly, applied in the welfare system because, in the end, the system is based on the strong obligation on those who can—and I appreciate that many are not in a position to go into work—to do everything they can to get back into work as quickly as possible.

Michael McMahon: That is not quite true, though, is it? Once a DWP manager decides that someone should be investigated, their benefits are stopped. If, ultimately, it is considered that their benefits are an entitlement, the issue is looked at again. However, the money stops before the DWP makes a decision. If a local authority or the Scottish Government wanted to support someone during their period of suspension, given that the sanction is imposed before a decision is made, you would penalise them.

Danny Alexander: In my experience as a constituency MP, most of the sanctions that I have come across have been decided at the front line—as it were—and have been based on a person not carrying out the appropriate job search activities. If benefits are paid on the condition that someone actively seeks work and the person in question does not do so, it is reasonable for taxpayers to expect sanctions to be applied as a last resort.

Michael McMahon: You call it a last resort, but is it not the case that the penalty is applied before the formal decision is made?

Danny Alexander: I believe that that can be the case, but I would have to look at that further.

The Convener: Jean Urquhart will ask the final question of the session.

Jean Urquhart: My question is on the same theme because, as I am sure you will know, one of the most important issues facing Scotland is the effect of welfare reform legislation. What is your view of the mismatch between, on the one hand, zero-hours contracts and people's insecurity in work and, on the other, the welfare system's extreme rigidity?

Danny Alexander: One of the motivations behind the implementation of universal credit, which I think is one of the most positive reforms of the welfare system that we have seen in many years, is to make the amount of benefit that is paid very responsive to the amount of income that someone receives. The real-time information software that lies behind the system means that, instead of someone who moves from benefits to work—perhaps part-time or low-income work—experiencing a break in their benefits through having to apply for different benefits and then waiting for the money to be paid, there is a consistent stream of monthly payments and the amount that is paid can vary according to the income that someone is actually receiving. I hope that, for the kinds of conditions that you have described, the system will improve and strengthen incentives to work.

After all, one of the problems with the welfare system going back for years now is that often it has not been clear whether some people would have been better off in work than on benefits. We need a welfare system in which everyone is clear that they are better off in work. Moreover, if people are able to work only part-time or if their hours fluctuate, the need to constantly go back with new information can create administrative difficulties. Universal credit will transform that environment. It is coming to the Inverness jobcentre in the Highlands in the autumn, and I hope that you will spend a bit of time examining how it is working—I certainly will—and that you will see that it marks a positive change with regard to work incentives and individuals themselves.

The Convener: Thank you very much, Jean. I see that it is 10.31, so we are on time.

I thank the chief secretary for his evidence and colleagues for their questions, particularly the very brief, concise and to-the-point ones that we had in the second slot. I very much hope not only that you catch your flight, chief secretary, but that we see you again at the Finance Committee before too long.

Danny Alexander: Thank you very much for your time and for meeting my timetable. I look forward to coming back soon.

The Convener: That ends the public part of the meeting. As agreed, we will take the next two items in private.

10:31

Meeting continued in private until 10:47.

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