



The Scottish Parliament  
Pàrlamaid na h-Alba

## Official Report

### FINANCE COMMITTEE

Wednesday 13 August 2014

© Parliamentary copyright. Scottish Parliamentary Corporate Body

Information on the Scottish Parliament's copyright policy can be found on the website - [www.scottish.parliament.uk](http://www.scottish.parliament.uk) or by contacting Public Information on 0131 348 5000

---

**Wednesday 13 August 2014**

**CONTENTS**

	<b>Col.</b>
<b>DEVOLVED TAXES (BLOCK GRANT ADJUSTMENT).....</b>	<b>4597</b>

---

**FINANCE COMMITTEE**  
**23<sup>rd</sup> Meeting 2014, 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:**

John Swinney (Cabinet Secretary for Finance, Employment and Sustainable Growth)

**CLERK TO THE COMMITTEE**

James Johnston

**LOCATION**

The Mary Fairfax Somerville Room (CR2)



# Scottish Parliament

## Finance Committee

*Wednesday 13 August 2014*

[The Convener *opened the meeting at 10:00*]

### Devolved Taxes (Block Grant Adjustment)

**The Convener (Kenneth Gibson):** Good morning and welcome to the 23rd meeting in 2014 of the Finance Committee of the Scottish Parliament. I ask everyone present to please turn off mobile phones and other electronic devices.

We have received apologies from Gavin Brown, who has indicated that he is unable to be here for the start of the meeting but intends to join us as quickly as he is able to.

Our first and only item of business this morning is to take evidence on progress made towards agreeing the adjustment to the block grant for the devolved taxes. I welcome to the meeting John Swinney, the Cabinet Secretary for Finance, Employment and Sustainable Growth, and Jonathan Sewell of the Scottish Government's finance directorate.

Members have copies of a letter from the cabinet secretary updating them on progress since June, when we last considered this subject. A letter from the United Kingdom Treasury has also been circulated to committee members.

Before I move on to questions, I invite the cabinet secretary to make a short opening statement.

**The Cabinet Secretary for Finance, Employment and Sustainable Growth (John Swinney):** Thank you, convener. I welcome the opportunity to provide an update to the committee on the block grant adjustment for the devolved taxes. I last appeared before the committee on this subject on 7 May, when I presented the Scottish Government's second section 33 annual implementation report concerning the financial provisions in the Scotland Act 2012. Since then, work has continued with HM Treasury to consider the issue and to make progress towards being able to reach an agreement. I have emphasised that an agreement needs to be made in time to inform the Scottish Government's draft budget for 2015-16.

In my written submission to the committee I set out an update on progress since April. I will take this opportunity to quickly summarise that note. The position on the intended block grant adjustment for the devolved taxes is clearly set out

in the "Strengthening Scotland's Future" command paper as a one-off cash adjustment. However, because of the need to move the issue forward, I offered a proposal that the initial adjustment could be indexed to the gross domestic product deflator, as I indicated to the committee in April. That approach is simple and easily understood and it would maintain the value of the initial one-off block grant adjustment over time.

As the committee is aware, the UK Government has proposed an approach that applies an additional deduction to the block grant, coupled to a reduction in all future Barnett consequentials. We do not believe that that methodology has any basis in the command paper, as is demonstrated by the Treasury's need to refer to the Wales command paper, published in March this year, to explain the approach. In our view, the proposed Barnett abatement mechanism fails also on the principle of increasing the accountability of the Scottish Parliament, which the Scotland Act 2012 is supposed to improve.

Under the proposed approach, a substantial factor affecting the Scottish Government's spending power in relation to the devolved taxes will be the policy choices of the United Kingdom Government on growth in public spending, over which the Scottish Parliament has no influence. For example, in order for the Scottish budget to benefit from the tax choices that the Scottish Parliament makes, revenue growth would need to exceed growth in public spending, which would be determined by the United Kingdom Government.

Since I last met the committee, officials in the Scottish Government and in HMT have analysed how each mechanism might perform under a range of scenarios and have set out the implications for the Scottish budget. That work has proved useful in understanding how the different mechanisms may perform. The analyses have also highlighted further areas of concern.

Principally, I see a fundamental flaw in a central assumption in the Treasury's analysis. They have suggested that, on a set of assumptions produced by the Treasury on future tax revenue growth and on growth in UK public spending, there should be no cumulative gain or loss to the Scottish budget over a long period extending to 2030. It is the case that if devolved tax receipts outperformed those assumptions, then the Scottish budget could be better off. However, I have strong doubts about the validity of the assumptions used, especially around the likely path of taxes, as HMT has used the Office for Budget Responsibility's forecasts.

A further concern is the negative path that the HMT assumptions set the Scottish budget on following the end of the observed time period. That trend means that the longer the time period considered, the increasingly worse off the Scottish

budget would be. We also do not accept that there is a basis for implementing such a constrained approach. The command paper made no mention of such an approach.

Despite this disagreement over the analysis conducted, I am very aware that my draft budget for 2015-16 requires certainty over the block grant adjustment for the devolved taxes to ensure a complete budget.

To that end, I had a constructive discussion with the Chief Secretary to the Treasury last week, with positive engagement around the key issues in being able to agree a mechanism. There was an equally good understanding of the pressing need for an agreement and, to that end, the chief secretary and I agreed a number of issues, which my officials and Treasury officials will follow up on. Following the conclusion of that additional work, the chief secretary and I will have a further meeting to seek an agreement.

I previously made the commitment to seek the approval of this committee for the final choice of the block grant adjustment mechanism. I remain committed to doing that. In the meantime, I look forward to discussing the issues with the committee this morning.

**The Convener:** Thank you very much for that, cabinet secretary. I am sure that we all have a number of questions on some of the detail of this.

I notice that the letter from the Exchequer Secretary to the Treasury, David Gauke, dated 8 August states:

"the UK Government has no plans to impose an adjustment. Both sides remain committed to agreeing a timely and equitable solution."

That is obviously very positive, but, at the same time, a solution has to be arrived at and it looks as if there is still quite a considerable distance between both sides. He suggests that there could be an interim adjustment and that

"such an interim solution could use the OBR's forecasts for 2015-16, for example, but would be revisited once a permanent arrangement has been agreed."

Is that something that you would be willing to consider, or are you concerned that we might end up having an interim adjustment year in, year out if no permanent solution is found?

**John Swinney:** The first thing to say is that I am very happy to engage in these discussions to try to get to a reasonable solution. I think that the committee will understand that my position is anchored in what was in the command paper, because that is what informed the Parliament's deliberations on the issue and the passage of the legislative consent motion on the Scotland Act 2012.

It would be more desirable to have an agreement sorted out and to proceed with it, rather than having an interim arrangement. As we know from examples in other walks of life, such interim arrangements keep on recurring. It would be better to address the issue on the basis of the detail in the command paper.

**The Convener:** Thank you for that. Unfortunately David Gauke is not able to be here with us, although we did ask him. In his letter he states:

"it is also worth noting that officials have considered the impact of using a baseline deduction based only on actuals."

He also says that, according to Scottish Government officials, by using that approach the Scottish Government could gain £1.8 billion over the period to 2029-30, with expected gains thereafter. He basically says that that goes against the agreement that both sides would not really gain from this arrangement. What is your view of that?

**John Swinney:** The core of this goes back to the contents of the command paper, which was published in November 2010 and which states:

"When the smaller taxes are devolved, currently planned to be April 2015, there will be a one-off reduction which will then be deducted from the block grant for all future years."

I read that as saying that there should be one cash sum removed from the block grant and that that cash sum should be removed every year thereafter. I do not think that I am misreading that paragraph.

To be fair, the command paper then goes on to say that the process should be

"transparent, equitable to both the UK and Scottish Governments and Parliaments and based on the best data available, which will include outturn data on Scottish income tax receipts accrued during the transition period and independent forecasts of Scottish tax receipts published by the OBR."

There are obviously other considerations in all this, but, fundamentally, we come back to that one-off adjustment.

I refer to the minutes of the joint Exchequer committee from 27 September 2011. The paper that we discussed referred to the devolution of the small taxes. The minutes state:

"there will be a one-off reduction to reflect the devolution of Stamp Duty Land Tax and Landfill Tax which will then be deducted from the block grant for all future years."

Fundamentally, we go back to the point that that is what was in the proposition from the United Kingdom Government.

In order to try to address the issue of equity, I have accepted that the block grant adjustment—the one-off adjustment to begin with—should then

be the subject of an indexation measure by the GDP deflator. That is a pretty simple, transparent way of saying that an additional adjustment is made, we apply a factor of inflation and we get on with operating, collecting and determining the taxes that have been devolved to us.

The Treasury's thinking just now is such that we look to be going into ever-more constrained elements of how the adjustment is operated, with the point that there could be no gain and no loss over an extended period to 2029-30. I just do not think that that is anchored in the material that has come from the command paper.

**The Convener:** Your concern is obviously that the Treasury's proposals are becoming increasingly byzantine, given how they are arrived at.

How are we going to resolve the situation? We have been here three or four times already, and despite all the talk of everyone wanting to get a solution quickly, which we heard from the Chief Secretary to the Treasury last September, we seem not to have moved much further forward. It seems that neither side is budging, for want of a better phrase. How do we resolve the matter?

**John Swinney:** We simply have to continue the discussions to get to a point at which we can get to an agreement. I am signed up to that. I was anxious to have a discussion with the chief secretary about the issues, which I was able to have last week, and I will continue to press to resolve them.

However, I hope that the committee will understand that I feel a strong obligation to the basis on which the Parliament gave its support to the Scotland Act 2012, and I think that we are shifting more and more away from that basis. I have already moved with the indexation proposal. On the basis of the command paper, I have legitimately said, "Look, there is no basis for indexation under any circumstances", but I have moved to try to get some form of agreement. That is an indication of good will to get to a point of agreement.

I can certainly assure the committee that I will make my best efforts to resolve the matter. Of course, there is a point at which the discussion has to stop, because I have to set a budget and inform the Parliament what I expect the tax take from the devolved taxes to be. That is my responsibility as the finance minister, but a process of verification by the Scottish fiscal commission is required—that work is under way—and the block grant adjustment number is needed to make the budget complete. As the committee well knows, that process has to be concluded by 9 October.

**The Convener:** That relates to my next question. We are putting out a call for evidence today. What impact is the deadline having on the preparations? What is the deadline for resolving the matter before we are in real difficulties in relation to the draft budget?

**John Swinney:** There is no impediment to the fiscal commission, because I will make a tax forecast based on the decisions that I make about the tax rates and tax bands for the two taxes. We will do the workings on that and pass it to the fiscal commission, which will make a judgment on it. That is all in one compartment. Assuming that I get agreement from the fiscal commission that the estimate is reasonable, I will then have to consider what is to be deducted from the budget. I have to have knowledge of that when I am finalising the budget, which will be in the couple of weeks running up to 9 October.

**The Convener:** Thank you. I open up the meeting to colleagues round the table. The first two folk to ask questions will be John Mason, followed by Jamie Hepburn.

10:15

**John Mason (Glasgow Shettleston) (SNP):** My question is on timescales. In your letter, Mr Swinney, you say that

"there should be no cumulative gain or loss to the Scottish budget over a long period extending to 2030",

which is kind of what I thought we were looking at. However, Mr Gauke's letter says:

"So while a Fixed Real adjustment could be equitable from 15-16 to 29-30, beyond this point the Scottish Government would be expected to make substantial gains",

and so on. That suggests to me that there is room for compromise up to 2030, if that was all that we were looking at, but Mr Gauke's main concern appears to be what might happen after 2030, which seems to be incredibly far ahead. Do I understand that correctly?

**John Swinney:** That is a fair understanding. In my view we are getting into artificiality in the process when we start talking about having absolutely no gain or loss until 2029-30, because we start getting into predictions of what stamp duty land tax would generate 14 to 15 years after it has been abolished in Scotland. We can all make projections of all sorts of things, but that is getting into an element of real speculation. We are abolishing taxes and will have to be in a constrained environment of no gain or loss. My proposal—of linking the adjustment to the GDP deflator—is a reasonable suggestion. It says: "There's a one-off adjustment, you put on a GDP deflator and then everything else on these taxes is up to you. Get on with it."

I am not saying that we must absolutely have the command paper position. The committee could quite rightly tell me that I should be saying that, because that what is in the command paper. However, in trying to get a balanced position between what the command paper said and the need for equity—for both the UK and Scotland to be treated fairly—I think that the GDP deflator approach gives a measure of change that relates to economic performance and the general management of economic issues. That is a reasonable test to apply.

When we start getting into living within constraints over the period to 2029-30, I think that things become too contrived.

**John Mason:** It seems to me that there are many other factors that could have an impact before we get to 2030. Almost anything could happen in the next 15 years. For example, I would like to see a flatter system in Scotland, in which incomes and house prices were less diverse. If that were to happen, it would have an impact on stamp duty land tax or land and buildings transaction tax. It seems that there are too many factors.

**John Swinney:** We would also be making what I would consider to be a contrived comparison with what stamp duty land tax would be in 2026; it will be abolished in 2015. We are getting into too contrived an exercise if we are looking at all that.

**John Mason:** I quoted Mr Gauke's letter, which states:

"the Scottish Government would be expected to make substantial gains"

Have you or the UK Government calculated what those figures would be? What amounts are we talking about? They are not major taxes, so I suspect that the amounts would not be major.

**John Swinney:** They are not major taxes; they represent about 1.6 or 1.7 per cent of our block grant, so the adjustment does not affect a vast part of the block grant. However, the further out we go in time, the more assumptions we must make about performance and the likely tax take. We would have to make assumptions about the growth of stamp duty land tax; that would involve predicting the housing market many years hence, which is subject to a host of variables, none of which we know now.

**John Mason:** Can you give any idea what kind of figures the UK Government, or you, are talking about?

**John Swinney:** I do not have in front of me any detail beyond that period, but if we can help the committee with any further analysis that is available, we will certainly do that.

**John Mason:** That is great. Thanks very much.

**Jamie Hepburn (Cumbernauld and Kilsyth) (SNP):** In his letter to the convener, Mr Gauke says that

"The UK Government has ... been consistently clear"

on the block grant adjustment, which was a bit of a surprise to me because we would not necessarily be here if that was the case. What is your view on the UK Government's consistency of clarity on the block grant adjustment?

**John Swinney:** We have gone through three phases on that. One was the command paper, which—as I have already said to the committee—talked about a one-off reduction that would be applied in all future years, although I accept for completeness that there was the caveat that the reduction would have to be equitable. We then moved on; the Barnett abatement proposition was added as part of the development of the position. Thirdly, we now have the constraint analysis being applied, which says in essence that, over a defined period, we are to be no better and no worse off as a consequence of the process. A developing position has emerged from the UK Government.

**Jamie Hepburn:** When Mr Gauke was here, I put it to him that the Barnett abatement mechanism that the UK Government proposes is an altering of the Barnett formula which, of course, the UK Government said it would not do. He said in response that it is not an alteration; it is just tweaking it. Is that just semantics from Mr Gauke?

**John Swinney:** The mechanism is an alteration to the Barnett formula.

The committee has discussed with me before the comparison that the UK Government makes when it says that the matter is similar to when business rates were devolved and the only thing that was changed was that a 100 per cent comparability factor in the Barnett formula went to zero because of devolution of the entirety of business rates. I do not accept that analysis because, when business rates were devolved, there was a budget line on which there was comparability. I accept that when relevant powers are devolved to the Scottish Parliament, there will be a change to comparability factors within the Barnett formula—for example, that happened when transport functions were devolved. That is not a change to the formula, however; it is a change to the distribution of responsibilities, and the internal workings of the Barnett formula simply catch up with that devolution of responsibilities.

In some areas of the Barnett formula, we have 100 per cent comparability on functions; on others, we have 10, 20 or 30 per cent comparability. Factors can change, depending on how



responsibilities are set out. The difference with stamp duty land tax and landfill tax is that there is no relationship to the Barnett formula—none whatever—and the Barnett abatement mechanism has been created to amend the Barnett formula to accommodate that, where there was previously no relationship.

**Jamie Hepburn:** In his letter, Mr Gauke says that the Scottish Government's position, which you have articulated,

"wouldn't be consistent with the UK Government's aim of increasing the Scottish Government's accountability."

However, equally, you are saying that the proposed Barnett abatement mechanism fails on the principle of increasing the Scottish Parliament's accountability. Will you talk a little bit more about your perspective on that?

**John Swinney:** The point that I made a moment ago in response to Mr Mason's question was that the GDP deflator example was helpful because it acknowledges a relationship to a point of performance over which the Scottish Government has some degree of influence, which is the performance of the Scottish economy. There are things that we do that influence the Scottish economy's performance, so the GDP deflator would be a reasonable factor to influence.

Decisions about UK public spending are taken by UK ministers; they are not taken by me or by the Scottish Parliament. Therefore, there is a fundamental disconnect between the objective of the Scotland Act 2012, which is to increase accountability to the Scottish Parliament, and the operation of the block grant adjustment mechanism.

**Jamie Hepburn:** From what you have said, cabinet secretary, it sounds as though the Scottish Government has been reasonable and has tried to accommodate the UK Government's perspective. In what way is the UK Government moving towards accommodating the Scottish Government's perspective?

**John Swinney:** We have not reached agreement. The command paper says:

"there will be a one-off reduction which will then be deducted from the block grant for all future years."

I could have held out for that and said, "Look, that is it. One sum. One number, which does not change. For ever. Done." I could have legitimately sustained that position, although I do not think that that would have got us to an agreement. However, in the interests of transparency and equity, and to try to reach agreement, I have accepted the application of an indexation factor.

What I am concerned about is that having gone into indexation territory we are now going into constraint-analysis territory. I see no basis for that

whatever, because we will be back to trying to work out what stamp duty land tax would have been in 2030 had we not abolished it. Forgive me, but that is an inappropriate basis on which to make the judgment.

**Gavin Brown (Lothian) (Con):** I apologise for missing the beginning of the meeting. If my questions have been asked and answered, please say so, so that there is no duplication.

From my point of view, the key thing is the schedule for moving matters forward. When will officials next meet to discuss the issue? There was a ministerial meeting fairly recently; when will the next one take place?

**John Swinney:** The intergovernmental assurance board met on 31 July and discussed the issue, and there was follow-up between officials after that. The Chief Secretary to the Treasury and I had a conversation last week, and officials are back in touch as a consequence of our discussion. The discussions between officials are on-going, and as we see work emerging from those discussions the chief secretary and I will speak again. There is no date for that at this stage. Our conversation will be the product of the discussions that officials are taking forward as a matter of priority.

**Gavin Brown:** In his letter, David Gauke said that in the event that agreement on a permanent arrangement cannot be reached in advance of publication of the draft budget, there could be some kind of "interim solution", I presume for year 1. At what point do the UK Government and Scottish Government say that they cannot reach agreement and need to decide on an interim arrangement? Is there a backstop date, by which you will need certainty if you are to produce your budget?

**John Swinney:** I covered some of that earlier. I will require to know the size of the block grant adjustment no later than the last week in September. I think that that is the absolute backstop if I am to finalise a budget that has in it an agreed number for the block grant adjustment.

10:30

**Malcolm Chisholm (Edinburgh Northern and Leith) (Lab):** I tend to agree with your approach on the GDP deflator, but I am a bit constrained because I do not totally understand the constraint analysis approach. To help me to understand that, can you say whether there are any circumstances in which the UK Government's approach would result in a financial benefit to the Scottish budget in certain years, or would it always be negative?

**John Swinney:** If our performance on generating stamp duty land tax and landfill tax

receipts exceeded the growth in public spending and exceeded the constraint analysis factor, which would be set by the UK Government, there is the possibility that we could gain against the block grant adjustment. However, we would have to gain against those two tests. I can live with one factor of indexation. To go back to the original interpretation of the command paper, I do not think that I should have to live with one, but I am prepared to do so. To live with two, however, is, I think, not acceptable.

There is an artificiality about the constraint analysis. The Barnett abatement mechanism that the UK Government is talking about is, in essence, a mechanism over which I and the Scottish Parliament have no control or influence, because it is related to the growth of UK public spending. I am trying to find a mechanism that works in the interests of accountability and transparency. We need to settle on a factor such as the GDP deflator, the performance of which I think members would accept we have some influence over. That would give us the ability to answer some of the issues that the Treasury has raised in the process.

**Malcolm Chisholm:** Another way to ask the question would be this: what is your explanation for the motivation of the UK Government? Why do you think that it is going down its route rather than accepting your proposal?

**John Swinney:** I do not quite understand the rationale. One purpose of the Scotland Act 2012 was to increase the accountability and responsibility of the Scottish Parliament for the decisions that it takes. However, I see that being undermined by the Barnett abatement mechanism and the constraint analysis. In essence, that would constrain what we can do. It would not be saying to the Scottish Parliament, "Here are a couple of tax responsibilities—you go off and implement them and you take the risks and the rewards from your decisions." It is all being put into a very contrived analysis, which to me contradicts the purpose of the Scotland Act 2012.

**Malcolm Chisholm:** Is that the reason why the UK Government is doing it, or do you think that there is some other reason that is not being stated?

**John Swinney:** I think that that is probably the reason why the UK Government is doing it. There is a sense that the UK Government, having given out the responsibilities, wants to hem them in at the same time.

**The Convener:** Will the calculations for the initial block grant adjustment be based on the actual figures for 2013-14?

**John Swinney:** That is another issue. When I was at the committee previously, I said in answer

to Mr Brown, I think, that we cannot agree the basis of the one-off sum of money for the block grant adjustment without taking into account the wider debate on other factors. There are different ways of calculating the block grant adjustment. Obviously, we have actual data up to the end of 2013-14, and there will be estimated data for 2014-15, which will be confirmed shortly after the close of the financial year.

As we have discussed, we have set out arguments about the timeframe for an historic analysis that would look back over maybe five years, or even 15, to see a much wider range of performance over a number of years. We are open to discussion on what the analysis could look like. Another factor that could be part of the analysis for the one-off adjustment is the extent to which we project tax receipts for 2015-16. However, as I said, those points have not yet been agreed.

**The Convener:** We knew that you were considering using the average over five years. Has progress been made on at least that issue?

**John Swinney:** The answer that I gave to Mr Brown, I think, when I was at the committee previously, stands—all this is to be agreed as a one-off package.

**The Convener:** In other words, that particular aspect remains in the mix.

**John Swinney:** Yes.

**The Convener:** As the committee has no further questions, I thank the cabinet secretary.

The committee will not meet for the next few weeks. Our next meeting is scheduled to take place on Wednesday 1 October.

*Meeting closed at 10:36.*

Members who would like a printed copy of the *Official Report* to be forwarded to them should give notice to SPICe.

---

Available in e-format only. Printed Scottish Parliament documentation is published in Edinburgh by APS Group Scotland.

All documents are available on  
the Scottish Parliament website at:

[www.scottish.parliament.uk](http://www.scottish.parliament.uk)

For details of documents available to  
order in hard copy format, please contact:  
APS Scottish Parliament Publications on 0131 629 9941.

For information on the Scottish Parliament contact  
Public Information on:

Telephone: 0131 348 5000  
Textphone: 0800 092 7100  
Email: [sp.info@scottish.parliament.uk](mailto:sp.info@scottish.parliament.uk)

e-format first available  
ISBN 978-1-78457-854-1

Revised e-format available  
ISBN 978-1-78457-868-8