The Scottish Parliament
Pàrlamaid na h-Alba

Official Report

FINANCE COMMITTEE

Wednesday 28 January 2015

Session 4

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FINANCE COMMITTEE
4th Meeting 2015, Session 4

CONVENER

*Kenneth Gibson (Cunninghame North) (SNP)

DEPUTY CONVENER

*John Mason (Glasgow Shettleston) (SNP)

COMMITTEE MEMBERS

*Richard Baker (North East Scotland) (Lab)
*Gavin Brown (Lothian) (Con)
*Malcolm Chisholm (Edinburgh Northern and Leith) (Lab)
*Mark McDonald (Aberdeen Donside) (SNP)
*Jean Urquhart (Highlands and Islands) (Ind)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Rt Hon Danny Alexander MP (Chief Secretary to the Treasury)
Lindsey Fussell (HM Treasury)
John Swinney (Deputy First Minister and Cabinet Secretary for Finance, Constitution and Economy)

CLERK TO THE COMMITTEE

James Johnston

LOCATION

The Mary Fairfax Somerville Room (CR2)

Scottish Parliament

Finance Committee

Wednesday 28 January 2015

[The Convener opened the meeting at 09:30]

Further Fiscal Devolution

The Convener (Kenneth Gibson): Good morning and welcome to the fourth meeting in 2015 of the Finance Committee of the Scottish Parliament. I remind everyone present to please turn off all mobile phones and other electronic devices.

Our first item of business today is to take evidence as part of our inquiry into the proposals for further fiscal devolution. There will be two separate evidence sessions. In our first session, we will hear from the Rt Hon Danny Alexander, Chief Secretary to the Treasury, and Lindsey Fussell, director of public services at Her Majesty's Treasury.

I warmly welcome you both to the meeting. We might have to communicate by semaphore, though, as you seem to be quite far away.

Rt Hon Danny Alexander MP (Chief Secretary to the Treasury): We are a long way apart, but only physically, and not in any other way.

The Convener: You know the drill. I will ask you some initial questions, then I will open it up to the rest of the committee. However, I understand that you want to make a brief statement first.

Danny Alexander: Yes. Thank you for having me. I think that I was the first Treasury minister to appear before the committee, and I have made regular appearances here since 2010. I hope that that has established a precedent and that, no matter who is in government next time round, the committee will continue to have access to Treasury ministers, because it is an important part of the dialogue between the Scottish Parliament and the United Kingdom Parliament and Government.

I am here to talk about the fiscal devolution recommendations from the Smith commission, but I am happy to answer questions on the other subjects that I know the committee has been looking at lately, if members want to ask about them.

The settlement that is set out in the command paper that follows on from the Smith commission offers huge opportunities for us in Scotland. It is a settlement that is built to last, because when it is all implemented it will make the Scottish Parliament one of the most financially powerful devolved Administrations anywhere in the developed world. In particular, for the first time, the majority of the Scottish Government's budget will be funded by taxation that is raised in Scotland rather than by a block grant. There will also be significant welfare devolution. I hope that we can all agree that that is very significant progress for Scotland within the United Kingdom and that the command paper delivers on what the Smith commission recommended, which was agreed by all five parties round the table, and on the promises that were made during the referendum campaign.

Although all the details still have to be worked through between John Swinney and me, and between the Scottish Government and the UK Government, it is important that we have in the command paper some clear principles about how the fiscal framework within which the new system will operate will be governed. In particular, there is the no detriment principle, which in a sense ensures that there is no gain or loss as a consequence of the fact of devolution to either Scotland or the rest of the United Kingdom, but which confers proper responsibility to each to bear the consequences of actions determined here and actions determined in the UK Parliament.

Significant further work needs to be done on the details of the fiscal framework, but the principles that are set out in the command paper and the fact that, for example, we have already been able to agree a good fiscal framework under the Scotland Act 2012 for the Scottish rate of income tax show that it is perfectly possible to come up with a fiscal framework that delivers on the principles.

The committee has a particular role in scrutinising the detail of the framework, but I hope that the debate in Scotland will move on to how the powers can be used, because they offer a significant suite of powers and responsibilities that can be used for the good of people here in Scotland.

The Convener: Thank you for that opening statement. I start by asking about the fiscal framework. Paragraph 2.2.7 of the command paper states:

> "the fiscal framework must require Scotland to contribute proportionally to fiscal consolidation at the pace set out by the UK Government across devolved and reserved areas."

In your view, how does that impact on the flexibility available to the Scottish Government to use its own economic levers? Would it not cause some constraint on those levers?

Danny Alexander: I do not think that it offers any constraint on the financial levers that are contained in the paper. If the Scottish Government wished to increase taxes in order to pay for extra investment in a particular area, that would have no effect on the overall fiscal balance across the UK, because extra spending has been matched and paid for by tax revenues. Likewise, if the Scottish Parliament decided that it wished, for example, to reduce air passenger duty—I know that that is being canvassed by some—that would be matched by a reduction in the money available for the Scottish Government to spend, so that is also fiscally neutral. The point that is being made, which is spelled out in the paragraph subsequent to the one that you quoted, is that in all devolved settings around the world there are fiscal rules to prevent a devolved institution from running up massive extra borrowing in an unconstrained way that then exposes the remainder of the country to having to take decisions to deal with those problems. It has no impact whatsoever on the flexibilities.

The Convener: If a UK Government of whatever colour decided to make significant cuts in public spending, there would clearly be an impact on the block grant, which will remain, so surely that would indeed have some impact on the ability of the devolved Administration to operate, as has happened in recent years.

Danny Alexander: In a sense, that would not change from the current situation, except to the extent that the block grant becomes less important as a proportion of the totality of the expenditure. At the moment, the block grant accounts for about 90 per cent of the expenditure; the remainder comes from business rates. Under the 2012 act, that would reduce to some extent, but once the fiscal framework is implemented in the early part of the next Parliament, the block grant determined by the Barnett formula will be responsible for around a third—the numbers vary, but it is 35 per cent or so—of the expenditure undertaken by the Scottish Government.

You are right to say that that continues to be determined by the Barnett formula—that has been agreed by everybody. The Barnett formula operates by allocating to Scotland, Wales and Northern Ireland a block grant in proportion to the overall expenditure that is determined in departments for England by the UK Government. That bit will continue and, with the much more substantial tax powers, the Scottish Parliament will have much more choice about whether it wants to maintain expenditure by asking people to contribute more or whether it wishes to stimulate the economy by cutting taxes and bearing the cost.

What you say is right, but it will become a less significant factor in the overall determination of the resources spent by the Scottish Government than it is now.

The Convener: We have a lot of areas to cover and I want to ensure that members of the committee get an opportunity to ask questions, so I shall move on to the block grant and the Barnett formula, which you have already touched on.

As you probably know, we took evidence from a huge range of academics with a variety of views on the entire process. One of them was Professor Trench, with whom you will be familiar. He has said:

"All key decisions regarding the working of the formula and the block grant and formula system are taken by HM Treasury."

There are real issues in terms of transparency with that.

Professor Heald suggested to the committee:

"There is a transparency deficit that is undesirable now and—unless removed—would make major devolved taxes unworkable."

Professor Trench has also stated:

"There are also very strong reasons to change the way the grant is administered and organised, so that fewer decisions are taken unilaterally by HM Treasury ... about the working of the formula and the funds allocated using it, and there is greater scope for impartial intervention".

That theme was continued by Professor McLean, who said:

"how the Barnett formula works is entirely in the hands of HM Treasury".—[*Official Report, Finance Committee*, 29 October 2014; c 36.]

He went on to state that it is not a statutory matter for the Scottish Parliament or the Scottish Government.

I could go on and on with those kind of comments, but I will finish with the views of Professor Trench. He questioned why

"our financing system essentially depends on an informal Treasury document that the Treasury drafts on its own."—[*Official Report, Finance Committee*, 19 November 2014; c 30.]

Elsewhere, he has argued:

"the Treasury was not merely judge in its own cause, with a jury from its side of the fence, but it wrote the rules as well!"

He suggests that

"At the very least, there needs to be an impartial mediator"

and that the devolved Administrations should have a role in drafting and agreeing a revised statement.

It seems that a variety of economists of various political persuasions have real concerns about transparency with regard to how the process is going to work, how the Treasury operates and the murky, byzantine process that is the Barnett formula.

I am sorry to be so verbose, but I think that we are dealing with a key aspect here.

Danny Alexander: I understand the question. I have not had a chance to study the evidence that you have described but, from the quotes that you have given, I would say that I disagree with it. Having been chief secretary for nearly five years now—I think that I am the longest-serving chief secretary not to have had a formula named after them, but maybe we can change that in the last few months of this Government—I have been responsible for this matter, and I cannot recall a single occasion when there has been a disagreement about the way in which the formula has been operated from any of the devolved Governments, except once, when a mathematical error was made on a spreadsheet.

Of course there are political arguments about the policy decisions that are made about public expenditure, which you hinted at in your earlier question. However, the way in which the Barnett formula operates is set out in a document called the statement of funding policy, which I am sure you are aware of. It sets out a range of ways in which the system works, including the comparability factors for different areas of policy and how they apply so that, when a spending adjustment is made in, say, the Department for Communities and Local Government in England, we can see how that will be reflected in the overall allocations. That is complicated, because there are lots of funding streams that, in many cases, have slightly different comparability factors and so on.

The population figures that are used are a matter of public record, and they are put together by the independent UK Statistics Authority. All the details of Barnett consequentials for any budget or spending review are, as a matter of course, shared between the UK Government and the Scottish Government and, if there is ever any wish to update the statement of funding policy—as I think we did in the 2010 spending round, and as we do when a new area of responsibility is devolved, because we have to establish the Barnett comparability factors for the area and add that to the statement of funding policy—that has to be done in consultation with the devolved Administrations in Scotland, Wales and Northern Ireland.

Although the way in which it operates is not simple—there are so many different elements that it is quite complicated—I do not think that there is any lack of transparency in the way in which the formula works, and the fact that there is a widespread political consensus among all parties in this Parliament and all parties in the Westminster Parliament, with the exception of the United Kingdom Independence Party, about wanting to continue with the Barnett formula suggests that there is widespread support for continuing to operate it long into the future. That would certainly be my view.

The Convener: Okay, but Professor McLean of the University of Oxford says:

"If the Scottish Parliament or the Scottish Government does not like what HM Treasury is doing, there are … no mechanisms to pursue that, except perhaps the joint ministerial committee."

He suggests that, similar to what happens in Australia, the block grant should be determined by a public body

"under the joint control of, say, the Scottish, Northern Irish, Welsh and UK Parliaments."—[*Official Report, Finance Committee*, 29 October 2014; c 36.]

There is a real issue around the fact that there seems to be no democratic accountability around this. That is what our academic colleagues are saying. Regardless of the political views of our witnesses, there seems to be concern about that. For example, Professor Heald has talked about Treasury gaming and so on. How do you deal with that issue?

09:45

Danny Alexander: I am not sure that I have much to add to what I said before. For the reasons that I set out, I do not agree with the points that have been made. There are a number of institutional structures that enable such matters to be discussed. In addition to the joint ministerial committee, which you referred to, under the 2012 act we established the Joint Exchequer Committee, which I know you are familiar with. It provides a forum for looking at a range of issues. In addition, we have regular so-called finance ministers' quadrilaterals, which are meetings between whoever holds the office of Chief Secretary to the Treasury and the finance ministers of the three devolved Administrations. In such meetings, which take place a couple of times a year, decisions have been made on some aspects of how budget exchange works in respect of the devolved Administrations. That is not part of the Barnett formula, but it is part of the financial framework. There are plenty of mechanisms for such things to be dealt with.

I am, of course, accountable to the House of Commons, which is one of Scotland's Parliaments, and John Swinney is accountable to this Parliament. There is democratic scrutiny through both of those channels, and we both have the opportunity, should we ever wish to do so, to make complaints or raise issues about how the system is operated.

The operation of the Barnett formula is a technocratic process and the outcome of the mathematical calculations can be and is scrutinised by officials in the Scottish Government, the Welsh Government and the Northern Ireland Executive. I can recall one occasion when a mistake was made on a spreadsheet, which was quickly picked up and corrected, but apart from that, I cannot recall any occasions when an issue with the operation of the Barnett formula—as opposed to a political argument about the policy decisions that provided the inputs—has been brought to my attention.

The Convener: There seem to be a lot of cobwebs around some of the committees that you mentioned. The Joint Exchequer Committee has not met since February 2013—that is two years ago—and there has not been a quadrilateral since November 2013, so I am not sure that they can provide effective scrutiny in the way that you suggested.

Danny Alexander: I think that the quadrilateral has met more recently than that, but I will check my diary and come back to you.

The Convener: Sure, but there is also the question of what is meant by the retention of the Barnett formula. Will it be retained as a population-based adjustment mechanism in combination with needs assessment? Will Scotland's relative per capita public expenditure share be maintained? The Barnett formula is a name, but what it means on the ground is what people want to know about.

Danny Alexander: There are no proposals from the UK Government—and I am not aware of any from any political party—to change any aspect of how the Barnett formula operates. What will change under the proposals of the Smith commission, as set out in the command paper, is that the block grant will become less important, relatively, in the totality of Scottish Government funding. In effect, the amount of money that will be available for the Scottish Government to spend will be the sum of the block grant, which comes out of the Barnett formula, minus adjustments for taxation—I am referring to block grant deductions of the sort that have been agreed on stamp duty and income tax under the 2012 act—plus allocations in respect of the welfare provisions under the new fiscal framework. That will add up to the total amount of funding that is available.

There are no proposals to make any changes to the way in which the block grant part of that equation is calculated, but because of the much greater degree of financial responsibility—as a result of the devolution of tax and welfare powers that is proposed under Smith—that will exist in the next session of the UK Parliament, we will move from a position in which the block grant provides about 90 per cent of the total amount of money that is spent in Scotland to one in which it provides more like 35 per cent or so of that. The rest of the money will come from taxes that are raised directly and so on.

The Convener: Let us move to the issue of borrowing. I have quoted a host of professors to you already—

Danny Alexander: You have.

The Convener: I am afraid that I am going to quote a couple more. Professor MacDonald argued that if the Scottish Government is being asked to take on more fiscal risk, it really needs more borrowing powers. His view is that borrowing should be done on the open market as that is

"the only clean and effective way to bring market discipline".—[*Official Report, Finance Committee*, 5 November 2014; c 8.]

Professor Muscatelli suggested that borrowing powers should be extended to

"allow each devolved part of the UK to smooth out"

asymmetric macroeconomic shocks, which temporarily affect tax revenues. Indeed, the Smith commission recommended that the Scottish Government should have

"sufficient, additional borrowing powers to ensure budgetary stability and provide safeguards to smooth Scottish public spending in the event of economic shocks, consistent with a sustainable overall UK fiscal framework."

What is your view on borrowing? You touched on the issue earlier, but is it something that you believe in and are keen to see implemented or would you like the existing framework to be retained?

Danny Alexander: I think that it is right that borrowing should be part of our discussions about the fiscal framework, precisely as Smith recommended. Also, where the Scottish Parliament is taking on greater responsibility for tax raising—as one of the professors whom you quoted said—there is the need to use borrowing as a way of smoothing out fluctuations in tax receipts.

The Convener: It was Professor Muscatelli.

Danny Alexander: That is an area in which, when you have more tax receipts, you potentially need more borrowing for smoothing purposes, so I can see that that is absolutely something that would be very much part of the fiscal framework that we would put in place. As you know, at the moment, under the 2012 act, there is a borrowing framework that includes borrowing for that smoothing purpose and borrowing for capital expenditure—both within limits. I can certainly see that, with greater tax powers, you would want greater borrowing powers to help with that smoothing.

On whether that borrowing takes place from the markets or from within the UK—from the Public

Works Loan Board, from the national loans fund, or whatever—as you know, we have taken steps to devolve the power to issue bonds to the Scottish Government. That then becomes a value for money judgment for the Scottish Government to make. Where does it want to borrow funds from? What are the issues around that?

Provided that borrowing takes place within the overall framework, which governs the way in which borrowing takes place, I can very much see Professor MacDonald's argument that a bit of market discipline is helpful. Equally, if that ends up being more expensive than, for example, UK gilt rates, you might have questions to ask about why the Scottish Government was choosing to pay higher interest rates. That is the judgment that would have to be made. I have no wish to influence that choice, which is already available under the current framework.

The Convener: Thank you. I have a question on one more area—the block grant adjustment—before I open out the discussion to colleagues round the table. One of the issues around the block grant adjustment has been transparency, and I am sure that others will explore that issue in depth, but I want to ask about the constraining factor. The Cabinet Secretary for Finance, Constitution and Economy said that the Treasury has sought to include a "constraining factor" within the block grant adjustment. That means attempting to calculate up to about 2029 or 2030 what the devolved taxes would generate and adjusting the block grant on that basis so that neither the UK nor Scotland would be better or worse off. The committee agreed with the cabinet secretary that that defeats the point of devolving the taxes, so we are raising the issue with you.

Surely the point about having these powers is that we stand or fall by the decisions that we make as a Parliament, within the framework of powers—whatever those powers are—that we are allocated. There is a concern that if, for example, the Scottish economy does better than the UK average, the block grant is clawed back and that if we do worse, that is our fault, so the UK should not really have to subsidise that. Can you clarify the position on that? It is a real concern that although we can enact whatever policies we want, at the end of the day it will not make a blind bit of difference if that constraining factor is implemented.

Danny Alexander: I agree with you on that. The framework is designed precisely to ensure, exactly as you say, that if the Scottish Parliament makes decisions that are beneficial and lead to higher tax revenues over time, that should benefit the resources that are available to the Scottish Government. Likewise, if mistakes are made that lead to the economy not growing so well, the consequences should be borne. That is the whole point of devolution: it is about devolving those responsibilities.

As Smith recommended, we need to put in place a fiscal framework that ensures that there is no detriment at the starting point, and which is indexed in a way that is appropriate to the fact of devolution. You would not argue—I hope—that the simple fact of devolution should lead to a financial gain or loss. You are arguing that the effect of policy should be felt either by the Scottish Government in respect of its policies or by the UK Government in respect of its policies, but that there is a degree of insulation between the two.

In that context, it is important to have an adjustment mechanism that is transparent and able to operate automatically as far as possible. One strength of the Barnett formula is that it operates automatically: the numbers are fed in and we get the outcome. It is not a matter for negotiation or haggling.

Likewise, when John Swinney and I agreed the financial framework for devolution of the Scottish rate of income tax under the Scotland Act 2012, we agreed a system of indexation as an appropriate mechanism that would ensure no detriment while enabling benefits or losses from policy choices to be felt in Scotland. That is what we need to do with the wider fiscal framework. Given that a bigger basket of taxes is involved, it is important that we get it right, but in some ways the greater amount of taxation makes the process more straightforward.

The Convener: Thank you. Mark McDonald will ask questions, followed by Malcolm Chisholm.

Mark McDonald (Aberdeen Donside) (SNP): My first question follows on from issues of transparency and the block grant adjustment. We have just gone through the process of implementing the land and buildings transaction tax. The Scottish Government had to set out its rates in October, and there was then a consultation period. However, the final impact on the block grant was not known at the time, and a conclusion in that respect was not reached until close to stage 1 of the budget process. Is that acceptable? Does it need to be addressed with regard to future devolution of taxation?

Danny Alexander: I think that it was necessary in that case. Stamp duty is a good example, because it is quite a volatile tax. A lot of work had to be done in Scotland and by the Office for Budget Responsibility on the forecasting of revenues and so on. The context was that we knew, but because of budget secrecy could not reveal, that we, too, planned to reform stamp duty; I have personally argued for that for many years. It therefore made more sense for John Swinney and I to agree the adjustment in that context.

In the context of the wider fiscal discussion off the back of Smith, the command paper and so on, we felt that it was sensible to agree the deduction—which we did very amicably—and the numbers for 2015-16. That allows us a bit more time to look at the evidence to decide how we can incorporate that element in a wider fiscal framework for the future. I think that the process was handled appropriately.

I will make one other point, in case it does not come up. We have agreed the headline deduction of £494 million in 2015-16, but there is some forestalling going on. John Swinney had to announce his rates well before they were implemented, which has caused some behavioural consequences.

10:00

One early application of the no detriment principle will relate to forestalling or, in other words, people bringing forward transactions and selling houses before the deadline, which would not otherwise have happened and which causes extra stamp duty revenue to flow to the Exchequer. It would not be appropriate for the Exchequer to be the beneficiary of forestalling against a policy that is made in Scotland. We do not yet know the amounts but, given that the forestalling has taken place as a consequence of decisions that were made here, the money should in due course be put back. Therefore, in addition to the £494 million, some money will come back because of forestalling. Then, quite reasonably, as the power is new and there is potential for small time lags between the power being implemented and money coming in, we will look at whether any cash support is needed through the first year to smooth those fluctuations.

In fact, John Swinney wrote to me this morning—I think that he sent the letter to the convener, too—to say that the Scottish Government is now content that it is ready to switch on the power at the beginning of April. There is a formal process that we have to go through. I can confirm that Her Majesty's Revenue and Customs is also ready, so that will happen. I do not have a view on whether the Scottish Government is ready, as that is for John Swinney to decide, but HMRC is ready. We will have an exchange of letters very soon and then the formal switching on of the powers, which will enable that devolution to happen precisely as planned.

Mark McDonald: You used the term "budget secrecy", which is an important issue in the context of our discussion. Obviously, in relation to the land and buildings transaction tax, the Scottish Government was required to consult on the rates ahead of implementation. Similarly, under the SRIT, there will be a requirement to notify the Treasury in, I think, November about the plans on the rates. Professor Heald suggested in his written evidence that that could leave the Scottish Government vulnerable to what he terms "gaming". That would apply irrespective of who holds the keys to the Treasury at the time. He said:

> "the UK budgetary timetable must be pulled forward; there has to be less opportunity for political theatre on the part of UK Chancellors of the Exchequer".

That refers to announcements in the budget of which no warning has been given in advance, particularly when they relate to taxation that is also dealt with at devolved level. Is there a need for changes to the internal fiscal rules? For example, the Law Society of Scotland has spoken to the committee about the need for some form of fair play clause or agreement on financial fair play in relation to the operation of Treasury rules on devolved taxes.

Danny Alexander: There were quite a lot of issues in there. First, there is no need to change the way in which budget decisions are made UK wide. How those decisions are made in Scotland is a matter for the Scottish Government. Naturally enough, John Swinney did not consult me on the rates that he was going to set for the land and buildings transaction tax or on how he was going to announce them. That is his business. He announced the rates, and they were devised by his officials in the Scottish Government and by him and his ministerial colleagues, which is entirely appropriate. Likewise, we spent time considering how to reform stamp duty at UK level, and we made those decisions and announced them in the normal way. We took the view that the changes to the rates should apply immediately, precisely to avoid the sort of forestalling that might otherwise happen. The Scottish Government may wish to take that view in future, although obviously in the first instance it was not able to do so for the reasons that you set out.

The idea of fair play is one reason why the fiscal framework and the no detriment clause are so important. If, for example, the UK Government decided to cut taxes in areas that are devolved, that would naturally result in a reduction in expenditure on services in other parts of the UK. However, the framework needs to ensure that it does not result in a reduction in expenditure here in Scotland. That is one of the issues that we set out in the command paper that needs to be looked at.

In respect of income tax, where we are using the same mechanisms, there are administrative time lags to ensure that collection can take place.

For example, we have made significant increases to the income tax personal allowance over the course of the Parliament—I have pushed that as the Liberal Democrat minister in the Treasury. Those increases have been announced either in the year before implementation or on some occasions in the autumn statement, four or five months before implementation; they have not been announced in the budget and then implemented 10 days later, precisely because the practical mechanisms do not allow such decisions to be implemented so quickly. HMRC needs that time to put its systems in place to have, for example, a higher personal allowance. It is not something that can be done overnight.

There are some things that we can do overnight. For example, we decided that it was necessary to reform stamp duty overnight, for wider economic reasons.

Mark McDonald: Sure. However, the point that Professor Heald was making in his evidence to the committee was that if the Scottish Government has to advise the Treasury of its intentions in November, and the UK budget is not set until April, that leaves a significant period between the Scottish Government setting out its position and the Treasury setting out its position. Professor Heald highlighted several instances—I will not go into detail on those, but I recommend that you read the evidence he gave to the committee—in which there could be what he refers to as “retaliatory instruments”, or gaming, by the Treasury in response to decisions taken by the Scottish Government.

Do you agree with Professor Heald’s analysis that the operational framework in relation to fiscal rules needs to be examined?

Danny Alexander: I do not want to say the same thing again. The suggestion about gaming is not right. I do not agree with it. There is no evidence to support it.

The purpose of the fiscal framework and the no detriment clause is to enable both the UK Parliament and the Scottish Parliament to take decisions in their own ways, with their own processes and to their own timescales, and—exactly as the convener said earlier—for each Parliament to bear the responsibility for its own decisions. That fiscal framework needs to be adaptable so that if there are changes in tax rates in different places, the kind of knock-on effect that you are implying will not happen.

The burden of the question falls on agreeing a fiscal framework that meets the terms that were set out in the Smith commission and in the command paper. I am totally confident that we can do that.

Mark McDonald: You have spoken about flexibility several times. The Scottish Parliament will soon have responsibility for a portion of income tax. The Smith commission and the command paper propose going further, but we will see how that process plays out. Beyond those taxes, land and buildings transaction tax and landfill tax, the other suite of taxes that are available to Governments as levers remain reserved competencies. Therefore, the flexibility that a Government has to react to any given situation is limited. You mentioned the impact on the block grant of continued austerity, for example, although it will be a small portion of the Scottish budget. The range of taxes at the Scottish Government’s disposal is quite limited in terms of where those taxes could be applied and who they would apply to in order to generate additional income. Do you accept that?

Danny Alexander: No, I do not accept that. In the future, taxes that are paid by Scottish taxpayers will fund more than half the expenditure that is determined here.

Where those are mainly taxes that have a broad base—for example, income tax has a broad base of the entire population of income tax payers and VAT also has a broad base—and where there is a significant incentive, such as that which was recommended by the Smith commission and which we are following through on VAT, in the sense that wise economic decisions that lead to more economic activity will lead to higher VAT revenues, which will lead to greater revenue at the disposal of the Scottish Government for it to use as it pleases, there will be a vast degree of flexibility.

Of course, some of the taxes have narrower bases. Stamp duty—or land and buildings transaction tax, as it shortly will be—has a narrower base because it relates only to property transactions. The same is true for air passenger duty, which relates to air travellers. However, a pretty wide choice of tax levers is available. That gives a lot more financial flexibility for the Scottish Parliament and Scottish Government to be much more financially self-sustaining and make decisions in the round. If the wish is to have higher public expenditure, plenty of tax levers will be available to achieve that.

The Convener: I ask Mark McDonald to hold on a second. I will let him in with one further question, but I will let Gavin Brown ask a supplementary first.

Gavin Brown (Lothian) (Con): It is a supplementary to the previous question.

The Convener: I realise that, but Mark McDonald charged on before I had a chance to let you in.

Gavin Brown: I am grateful.

I do not share Professor Heald's view on gaming, but he raises a fair point in that, as I understand it and as Mark McDonald said, the Scottish Government has to declare its intentions on income tax in the November prior to the start of the financial year, whereas the UK Government has in some cases set out its intentions a year or so in advance but in other cases has done so in the autumn statement, which has been in early December in recent years. The Scottish Government therefore has to declare its hand a month before the UK Government. In the fiscal framework that Mr Alexander is discussing, is there any logical reason for that to be the case, or could both Governments declare their hands at round about the same time?

Danny Alexander: The constraint is practical—it takes time for HMRC to implement decisions and ensure that the intention can be effected. If you want to increase the personal allowance or, in the future, change bands, HMRC has to make adjustments to its systems and inform taxpayers.

I do not think that there is anything particularly religiously important about November as opposed to December, and it would be perfectly good to talk with HMRC about whether there is a bit of flexibility. The budgetary cycle in the Scottish Parliament has always operated in October and November as opposed to December, so the date fits logically with the way in which you do business.

I am not aware of any practical constraints that would prevent you from changing the date to make it coincide with the autumn statement, for example, if you wanted to do that. However, if you held back your decisions until 25 March and HMRC could not implement them in time, that would create serious practical problems that could not be overcome.

I am happy to investigate the matter. Unless we are told that there would be a particular practical consideration in respect of, for example, the Scottish rate of income tax or the full devolution of income tax in due course, I see no particular problem with what you suggest in and of itself.

Mark McDonald: Forgive me, Mr Alexander—I might have missed a clarification on this. The expectation was that the new borrowing powers that are to come post-Smith would be provided to augment the capital grant that the Scottish Government receives, but there was some indication that the command paper suggested that they would replace rather than supplement the capital grant. Will you clarify the Treasury's position on that?

Danny Alexander: Smith recommended a number of things on borrowing. The first is the point that we explored earlier, which concerns whether Scotland needs additional borrowing powers to deal with cash fluctuations in receipts. That will be part of the discussion on the fiscal framework, but I expect that borrowing powers would need to increase for that purpose, because you would have greater tax volatility, and borrowing would be necessary to help to manage that.

Smith said that we should consider introducing a prudential regime for capital expenditure in the Scottish Government. He did not definitely recommend going ahead with that but said that it was one of the options that we should examine. That will be investigated as part of the discussions between the Governments. I do not think that anyone has said that it is what they prefer, but we can have that debate.

10:15

There are positives and downsides to a prudential regime. Replacing the capital grant, which we have at the moment, could be difficult and I would have misgivings about that. Equally, there is already a prudential regime for local authorities, which most local authorities would say works reasonably effectively, so there might be upsides to look at. I do not have a view on that at the moment, but we should look into it. Smith did not recommend it and we are not saying that we will introduce it; we are saying that we will look at it, as Smith said, as part of the fiscal discussions.

Another option would be to have greater capital borrowing powers to reflect the greater devolution of taxation. All those things can and should be examined.

Malcolm Chisholm (Edinburgh Northern and Leith) (Lab): I will raise a couple of issues that have not been raised but, before I do so, I will pick up briefly on what has just been discussed. I tend to agree with you about the operation of the Barnett formula hitherto. In 16 years, I have not been aware of anyone in the Parliament having objected to how the formula operates. However, when we look ahead, there is concern about the relationship between the Barnett formula and the block grant adjustment. Will you say a bit more about that?

The committee's report on the draft budget expressed concern about the constraining factor, and we have heard a lot from you and John Swinney on your disagreements about the block grant adjustment for the taxes that we will get in April. We are reassured that you accept the principle that we should benefit if we have economic successes in Scotland as a result of our policies, but it would be helpful if you explained what the disagreement was and what the constraining factor is. As John Swinney presented it to us, it appears to be having a detrimental effect on the Barnett formula, which it should not have.

Danny Alexander: Are you talking specifically about stamp duty?

Malcolm Chisholm: Yes.

Danny Alexander: I do not think that there was a disagreement, exactly. We were both trying to achieve the same thing. We wanted to have an initial adjustment that would not operate to the advantage or disadvantage of Scotland or the rest of the UK and would then do exactly what you say regarding financial gains or losses.

I am sure that the Scottish Government believes that the new system that it is introducing will have positive economic effects. I dare say that that is one reason why it is putting the system in place. If that is the case and if the new system leads to extra revenue, that extra revenue should be fully to the Scottish Government's benefit.

In the work that we did, which was complicated because the evidence base is not very good and we needed to build on the existing evidence base, we tried to understand the likely level of stamp duty receipts. We had an OBR forecast, which took a top-down perspective, and the Scottish Government based its views on Registers of Scotland data, which took more of a bottom-up perspective. We tried to reconcile the two to come to what we both agreed was a fair amount. In the end, we were both quite happy to agree on an average of the two as a starting point. That was a workmanlike solution to a situation in which the data needed to be improved.

I hope that the committee will take on board an important point. Part of what will be needed as we put in place the new fiscal framework is a much more robust independent assessment of fiscal numbers. We have the OBR UK-wide, and the Scottish Fiscal Commission has been established—I hope that there is agreement that the commission needs to be robustly independent. The commission will aid the committee in its scrutiny of the Scottish Government.

I hope that having those independent bodies scrutinising tax receipts and so on will ensure that the two Governments do not end up arguing. To make the fiscal framework robust, it is important that, alongside a fully independent OBR, we have a fully independent Scottish Fiscal Commission that is resourced to carry out more detailed functions in the future.

Malcolm Chisholm: I was going to ask you about that—and I will do so—but I want a bit of further clarity first. We were told that the constraining factor involved calculating up to about 2029 or 2030 what the devolved taxes would generate. We were a bit puzzled as to why that was the case.

Danny Alexander: That work was done as an aid to understanding which of the sets of numbers was likely to be more accurate, to inform how the adjustment works. In the end, we settled on the figure for the 2015-16 financial year and agreed that we would do a bit more work and perhaps look at the issue in the broader context that Smith establishes. We have agreed the amount for this year. We have not agreed by what methodology the figure will be indexed in the future, to be fair. There is a further discussion to have about that.

Malcolm Chisholm: To go back to your earlier point, your command paper said that the Scottish Government

> "should bring forward proposals fully consistent with the OECD principles, and reflecting the UK experience with the OBR, to enhance"

the Scottish Fiscal Commission

> "as part of agreement to a new fiscal framework for Scotland."

Obviously, that is our decision, but what did you have in mind when that was written?

Danny Alexander: The UK has led the way on this area of economic policy making in the past few years. The Office for Budget Responsibility is fully independent and takes responsibility for economic forecasting, not just assessing and scrutinising numbers. I as a minister no longer have any say over what the economic forecast says. The economic forecast is really important, because it underlines the determinants. How much revenue do we expect to get next year? If massive economic growth was forecast for next year, we would expect stamp duty receipts, for example, to be stronger. If very weak economic growth was forecast, we would expect receipts to be weaker.

I understand that the Scottish Fiscal Commission does not have such forecasting responsibilities. As Scotland moves to a situation where forecasting tax receipts is a much more important determinant of the budgetary and spending decisions for the years ahead, having more robust independent work on that—so that it is not ministers who determine their forecast for the economy and tax receipts in future years—would help.

My experience in the past five years has been that, although that approach has sometimes been quite challenging for ministers—ministers might not always agree with the forecasts or might be challenged because a forecast is less good, which prompts discussions about whether decisions have to be taken in response to it—it is more open and transparent and, because it is independent, everyone has confidence in it. Something similar in Scotland, within the scope of the devolution that will take place in the next Parliament, would really help. The Organisation for Economic Co-operation and Development has set out some principles.

Malcolm Chisholm: You would like to see a forecasting role. Would that include forecasting income tax receipts?

Danny Alexander: Let me answer that by analogy, if I may. At each budget and autumn statement, the OBR has a forecast for the economy. It then works through what that means for the fiscal forecast, so it forecasts tax receipts—income tax receipts and so on. It scrutinises all the technical data that is presented to it by HMRC and officials and it reaches a judgment about what it expects to happen to income tax in future years. It is far better that that work is done independently, rather than being susceptible to influence by politicians.

Malcolm Chisholm: I agree. Forecasting in relation to the income tax powers that we are getting next year will be done by the OBR. Are you comfortable that there would be an equivalent Scottish body to do that for Scottish income tax?

Danny Alexander: I am not just comfortable; I encourage that.

Malcolm Chisholm: Okay—good.

My final question relates to VAT. We were slightly alarmed that there seemed to be no agreed way of working out what VAT receipts for Scotland would be. The two views were about determining that on the basis of VAT on consumption by final consumers in Scotland or on the basis of the VAT accounted for by businesses producing goods or services in Scotland. Which of those methodologies did the UK Government have in mind?

Danny Alexander: We want to discuss and agree that with the Scottish Government. We want a mechanism that fulfils what we have said that we will do in the command paper, which is that we will ensure that a share of VAT revenues that represents the first 10 percentage points of the standard rate, to which we have added the first 2.5 points of the 5 per cent rate, is allocated to Scotland, so if the Scottish economy is growing better and people are spending more money and paying more VAT, Scotland will get the benefit of that.

We need to agree the methodology. I would rather not leap in and say whether I prefer this or that methodology. The intention is simple: it is to make sure that Scotland genuinely gets that VAT. How we go about doing that is quite complicated and we need to work through that.

Jean Urquhart (Highlands and Islands) (Ind): I want to ask about paragraph 95(4)(B), which states:

> "Changes to taxes in the rest of the UK, for which responsibility in Scotland has been devolved, should only affect public spending in the rest of the UK. Changes to devolved taxes in Scotland should only affect public spending in Scotland."

Danny Alexander: Sorry, but which paragraph are you referring to?

Jean Urquhart: I am referring to paragraph 95(4)(B) of the Smith commission report.

That view is understandable. If there was an increase in income tax rates in the rest of the UK, that should not affect the level of public expenditure in Scotland.

Danny Alexander: That is precisely right. Additionally, if the UK Government decided to cut income tax and that led to fewer receipts, that should not cause a reduction in public spending in Scotland. Likewise, if the Scottish Government chooses to increase income tax, to get more revenue, that should not have an adverse consequence for the rest of the UK. Achieving that must be a key part of how the fiscal framework works.

We decided to do that with the Scottish rate of income tax in the 2012 act—which of course is not the whole of income tax; it is 10 per cent of the 20 per cent rate and so on—through a methodology that was recommended by Professor Gerry Holtham in the Holtham report, which was carried out for the Welsh Government a few years back. I think that you have had Gerry Holtham at the committee.

That methodology has an indexation against tax base. In order to fulfil the idea, we would need to agree what the appropriate indexation would be for the much wider devolution of the whole tax. The objective is precisely to fulfil that.

Jean Urquhart: I am a bit confused. If Westminster decides to spend an increase in UK income tax on reserved services, will we not then be faced with the stark choice of cutting our devolved services or raising the Scottish rate of income tax?

Danny Alexander: The way that I would think about it is that income tax will become a devolved tax. There are plenty of UK-wide taxes—corporation tax, national insurance and so on—that are spent in reserved areas. However, given that income tax will be collected separately in Scotland from the rest of the UK—and devolution of income tax is on the table as part of the Welsh discussions—you would not want the fact that people in England have paid less income tax to have an effect on the total amount of money available here in Scotland.

Jean Urquhart: I understand the point about tax collection. I am thinking about reserved matters, and the effect on the Scottish budget of policy on matters over which we have no control. That must have an implication for the Scottish budget.

10:30

Danny Alexander: No. We have to think about it in this way: under the Smith settlement, income tax will become a devolved tax, so revenues from income tax in Scotland will be spent in Scotland, and revenues from income tax in England will be spent in England, or that might apply to England and Wales, depending on the solution for Wales. We want the two systems to operate separately from each other so that the choices that are made in each system do not have an adverse—or indeed positive—knock-on effect on the other part of the country. That is what is being sought.

It is a big change for income tax, but income tax revenues in England are significantly less than the total amount that is spent on public services in England that are devolved, so I do not think that your worry will have any substance in practice.

Jean Urquhart: The OBR has given some forecasts on the impact of the elimination of the UK's public sector deficit, but that occurs mainly through cutting public expenditure. Given that that is likely to continue, do you believe that the Smith commission changes will allow Scotland to follow a different path?

Danny Alexander: Yes. Obviously, the block grant component of the resources that are available to the Scottish Government to spend will continue to be based on the Barnett formula. That means that expenditure decisions that are taken UK wide are reflected in the block grant, but a much greater proportion of the money that is spent in Scotland will be raised in Scotland.

That affords the Scottish Parliament the opportunity, if it wishes, to say, "We wish to have higher taxes to pay for more public expenditure," in whichever areas it wishes to spend more money. That decision is open to it.

There is also the responsibility to think about. The Scottish Government would—in precisely the way that the convener implied earlier—be thinking through the economic consequences of having higher taxes, and those would have to be assessed in the forecast. If the Scottish Government decided to raise tax in certain areas to fund higher public spending, we would have to consider what effect that would have on economic activity, business, incentives to work and so on. Those things would all have to be considered, but the set-up allows that opportunity, of course.

Jean Urquhart: When we discussed the stamp duty changes that you made in the autumn budget, you said that, for economic reasons, you decided that the change would happen overnight. What were those reasons? Did you consider what was happening in Scotland and think in advance about the reaction here?

Danny Alexander: Yes, of course. The reason for implementing the decision overnight as opposed to having a significant time lag was to try to avoid some of the economic distortions that would arise from people trying to bring forward house sales to avoid higher tax rates or from people delaying transactions to wait for lower rates. Those behaviours would have the effect of distorting the economy. We chose to implement the revisions overnight to avoid that sort of distortion.

In a devolved framework, those are UK decisions for the UK Parliament, and the way in which Scotland approaches such matters is quite properly a decision for the Scottish Parliament. It is perfectly possible for reasonable people to reach different views on how to handle those things. Under our reforms, about 98 per cent of transactions would attract the same, or a lower, rate of stamp duty. If we left a period of months before that was implemented, we would potentially blight the housing market for that period, which would have an effect on the construction sector. That was an economic effect that we wanted to avoid.

Jean Urquhart: But the Scottish Parliament did not have the privilege of that choice.

Danny Alexander: The Scottish Parliament is responsible for its decisions on how to handle land and buildings transaction tax, such as what rates to set. That is a matter for John Swinney. In the first phase, as the tax will not begin until April, that presented a particular challenge. There is a question about how that will be handled in future, but that is a matter for him and you to scrutinise. It is not a matter for me.

The Convener: This should be your final question, Jean, because a few other members are still to come in.

Jean Urquhart: Right. Given that the Smith commission proposals will not be decided on before the general election, how confident are you that they will be accepted by a Westminster Government in the form in which they have been presented?

Danny Alexander: I am 100 per cent confident that the proposals will be implemented. They have the strong support of the Labour Party, the

Conservative Party and the Liberal Democrat party. In my case, I have campaigned for many years for the measure of financial home rule for Scotland that I believe the package constitutes. There is no doubt at all that the commitments will be fulfilled. The only challenge comes from Scottish nationalists, who either wish to continue to prosecute the case for independence, despite the collapse in oil revenues, or want to change the proposals.

One of the strengths of the package is that it was agreed by all five parties in this Parliament, and the three main UK parties, the party leaderships and the finance spokespeople—in my case, I am the finance spokesman for the Liberal Democrats as well as Treasury minister—have all made strong commitments to the proposals. It is not just that they will be delivered in the next Parliament. Everyone has said that the bill will be one of the first to be introduced in the first session of the next Parliament, so people can have 100 per cent confidence not just that the settlement is built to last but that it will be delivered very quickly.

Jean Urquhart: Yet the evidence in *Hansard* from the debates that have happened shows that, in fact, a lot of people are not content. You will admit that it is not the case that 100 per cent of people at Westminster think that the proposals are a great idea.

Danny Alexander: Well, on everything, there are noises off. I suspect that you even have that in the Scottish Parliament from time to time. However, the overwhelming majority of MPs and, crucially, the leaderships of all the parties and all the people who might conceivably hold high office in the UK Government in the next Parliament in any combination strongly support the proposals.

Richard Baker (North East Scotland) (Lab): I return to the issue of borrowing. I sat on the Scotland Bill Committee earlier in the current session and, even then, when we discussed the issue, we had cross-party agreement that the Scottish Parliament's borrowing powers should be increased. Chief secretary, you said that you agree that, with the new powers through the Smith commission, there should be another look at the Parliament's borrowing powers.

In the Scotland Bill Committee, the idea that we had was for the borrowing to be in addition to current capital borrowing powers, rather than a replacement for the prudential borrowing regime. In the interest of ensuring that whatever new limits or powers are proposed can be scrutinised properly by both Parliaments, what timescale are you looking at for establishing what the new powers should be and their extent and what the new borrowing limits should be?

Danny Alexander: That is a good question. The answer is that borrowing is part of the discussion about the fiscal framework. Smith recommended, and we have said in the command paper—I think that John Swinney and his colleagues agree, too—that the fiscal framework needs to be agreed between the two Governments, and that needs to be done at the same time as the proposed legislation is advanced through the House of Commons.

I anticipate that the framework is likely to be concluded by the next UK Government rather than the present one. The discussions would need to be concluded early in the next Parliament, not least so that the House of Commons and the Scottish Parliament, in their consideration of the proposed legislation, can have information about the fiscal framework.

It is obviously important for people to see that that is being done fairly and with no detriment. The no detriment issue is important here, and it is also important to members of Parliament in the House of Commons from other parts of the United Kingdom, as well to MPs from Scotland. It is one of the things that I get quizzed about down there as well as here. I anticipate that the framework will be established early in the next UK Parliament, alongside the introduction of and debate on the proposed legislation in the House of Commons.

Richard Baker: That is helpful information.

Would the principle of a Scottish cash reserve also be part of those discussions? On the same issue, the committee previously looked into a proposal from the UK Government that, in the use of funds from such a reserve, priority must be given to dealing with potential future deficits or outstanding debt. However, the Cabinet Secretary for Finance, Constitution and Economy has argued that there should be flexibility to spend surplus tax receipts as part of Government spending in other ways. There may be sound economic reasons to do that. What is your view on the degree of flexibility that there should be? How would the discussions take place to establish such a reserve?

Danny Alexander: We have already established a Scottish cash reserve, which was agreed under the 2012 act—I am sure that that is why you were debating it previously. There is not currently any money in the reserve, because it comes into force in April, I think, alongside the tax powers that are being devolved.

The idea is that the cash reserve is an in-year financial management tool to ensure that the Scottish Government can deliver its planned spending, even if tax receipts turn out to be a little bit less than forecast. You want to ensure that there is money there. Let us say that you have built your budget on the basis of X hundreds of millions of pounds of stamp duty receipts, but they turn out to be 25 per cent less, for whatever reasons. The cash reserve is there to manage that volatility. It is important to build up the cash reserve so that it is available for that purpose.

In recent years, we have had a bad experience in this country of money being spent in good times and not then being available to help with economic problems when they emerge. I would be reluctant to go down that route, although it can of course be debated as part of the discussions on the financial framework.

Richard Baker: We could debate that for some time, but I will move on to my final question.

We have had some discussion about whether the Smith proposals go far enough, and we have talked about the detailed proposals. As members have mentioned, proposals have been made in the debates at Westminster and in the wider political sphere that the proposed legislation needs to go further. The Scottish Government has also expressed that view. Has there been any official dialogue by the Scottish Government with the UK Government about what it sees as the deficiencies of the proposals and the Scottish Government's specific proposals on where the legislation should go further?

Danny Alexander: The Scottish National Party representatives on the Smith commission made arguments that they wanted to go further in some areas, but they also signed up to what was agreed.

There have been some specific but misconceived comments about the content of some of the clauses. I am not aware of any formal representations that we have received about specific further powers to be included in the process since the publication of the command paper. There has been a lot of political rhetoric—I am not complaining about that, as we are all politicians—but I am not aware of any representations being made for further things to be included.

In a sense, the whole point of the Smith commission process was to have a cross-party dialogue to hear all the arguments and to reach a way forward. The commission's report is a strong and radical plan for Scotland. I just hope that we can all get on with implementing it now, and that we do not keep picking away at it.

There are one or two elements of Smith that have not yet been followed through. Lord Smith made some personal recommendations in the report, as well as what was agreed on a cross-party basis. To my mind, the most important of those is about the devolution of power within Scotland.

Naturally enough, the process in the command paper is about the devolution of financial and other powers from the UK level to the Scottish level. To my mind, there is a danger to Scotland from the fact that we have become one of the most centralised places in the world, with a lot of power concentrated here in Edinburgh. You may all agree with that. I think that there is a strong case for seeing how some of that power—including the financial powers—could be distributed to local authorities, regions and different parts of Scotland. I hope that this Parliament and this committee will want to take a leading role in pushing that through.

10:45

Jean Urquhart: We often talk about the five political parties being in a room and everybody baying and so on, but 17,000 comments and concerns were sent to the Smith commission from members of the public and other organisations. At what point did you consider those? Do you feel that they should be recognised? There are a lot of concerns about the Smith commission, and issues that were raised by literally thousands of people were not taken up. How do you address that?

Danny Alexander: I understand the point, and I recognise that you do not speak for anyone who was in that room, as you are an independent MSP and therefore have a different status. I fully respect that.

It was for the Smith commission to consider all the representations that it received when it drew up its recommendations. Although there was a short timescale, I know that Lord Smith and the other commissioners spent quite a lot of time in that process engaging with civil society in Scotland and engaging in consultation. The report was presented as being the conclusions that they reached off the back of all the work that they did. We have sought to take that forward and we have produced draft clauses. Of course, we very much welcome engagement and comment on those precise clauses and, if there are ways in which they can be improved, that is all to the good. However, it was for the Smith commission to listen to the representations that it received and consider them before making its recommendations.

John Mason (Glasgow Shettleston) (SNP): Good morning.

Danny Alexander: Good morning. It is good to see you.

John Mason: It is good to see you too.

I want to build on a number of issues that have been raised already. The idea of there being no detriment has been mentioned once or twice. The issue of forestalling in relation to LBTT sounds good; it is a commonsense and positive thing to do. However, there have been issues in the past. For example, the introduction of the SRIT was, I think, a Westminster decision, yet all the costs of that fell on the Scottish Parliament. The situation has been a wee bit patchy. Are you confident that, going forward, we can be clear about the no detriment issue?

Danny Alexander: Yes, I am. It is helpful that the Smith commission was clear about what it meant by no detriment, including on the subject of how administration costs should be handled.

Of course, there is a lot of detail behind that, and that detail has still to be worked on, but the principles that are set down are clear. In the command paper, we have usefully expanded on those principles and explained how they could work.

John Mason: There is concern in the north of England that some passengers who might otherwise use airports there would choose to fly from Scotland if we had a lower rate of air passenger duty. At the moment, a lot of Scots fly from Manchester airport because there are more flights from there. If we can get some of those people back, there would be a detriment to Manchester airport. Personally, I think that getting those people to fly from Scotland would be a good thing, but Manchester airport might find that fewer people used it. Would we be expected to compensate it?

Danny Alexander: The Scottish Government and the UK Government have to agree how the financial framework will work. We have not spent a lot of time debating the issue that you raise, but I would say that economic consequences of that sort, should they arise, are just a feature of the modest degree of tax competition that would be introduced by Scotland having a lower rate of air passenger duty. That would be for the UK Government and the relevant local authorities and so on to work through.

A lot of calculations have been done. Indeed, back in 2012, I think, HMRC published work on air passenger duty. It looked at the effect on Newcastle and Manchester if APD was reduced to zero in Scotland, and the forecast effect was a 10 per cent reduction in traffic at Newcastle and a 3 per cent reduction in traffic at Manchester.

You will have to decide what you do with the air passenger duty powers once they are devolved but, so far, I have not heard proposals from any party that APD would be reduced to zero. In other words, I suspect that the effects would be much more modest. Equally, if the Scottish Government put in place more generous provision under its new welfare powers and people moved to Scotland to claim those benefits, the Scottish Government would have to make those payments. That would be a consequence of its decisions.

John Mason: You are not anticipating loads of payments, counterpayments, compensation and so on going backwards and forwards.

Danny Alexander: No, I am not.

The issue raises a good point that I should have been clear about. It is important that we come up with a framework that is as simple and automatic as possible. The less need there is for daily or weekly intergovernmental negotiations, the better.

John Mason: Okay—fair enough.

Danny Alexander: We cannot eliminate such payments completely, but the more that we can eliminate them, the better.

John Mason: You have said that income tax is a devolved tax, but it is not as devolved as landfill tax. I guess that the power is, in a sense, hybrid. We would have control over the bands and the rates, but not over the personal allowance. Some people have said that, because the personal allowance is effectively a zero-rate band, it would be logical to include that, too.

Danny Alexander: You are right to say that what Smith recommended and what we are implementing is full control over the rates and bands and all the revenues from that. That is not a hybrid; it is full devolution.

You are right that aspects such as the tax base, the reliefs and the personal allowance will remain at the UK level. There is a combination of reasons for that, including efficiency of tax administration, which is important for all taxpayers, and the particular role that the personal allowance plays in wider economic incentives in the labour market. It would be open to you to decide to have a zero-rate band. That is an option. You would not be able to reduce the personal allowance—you would not be able to say that people should start paying income tax at a lower rate in Scotland—because the personal allowance is reserved. However, it would be open to you to decide to have a 0 per cent band above that.

John Mason: What is the underlying logic behind our not being able to reduce the personal allowance and have such a zero-rate band, yet being able to increase it?

Danny Alexander: In a sense, the logic is that that is what the Smith commission recommended, so that is what we are implementing.

In a sense, the overall economic logic is that the smooth operation of the labour market and the single economic market across the UK is an economic asset that Scotland gets by being part of the UK. I would not want to see changes that would undermine Scotland's ability to play a part in, and fully benefit from, a wider UK single market. That is one of the strengths that we get from being part of the United Kingdom. We might disagree about that, but that is my take on the situation.

The level of the personal allowance—the amount that someone must earn before they start to pay income tax—is part of what determines the incentive to work in the UK, which is why I have advocated the big increases in the personal allowance that we have seen over the course of this Parliament. That is a Lib Dem policy that is being implemented to the benefit of most Scots. The logic is that that starting point gives people a strong incentive to work and helps to create jobs. Indeed, it caused the strong job-creation performance that we have seen in Scotland and across the UK over the past few years. Therefore, reducing the personal allowance would reduce that incentive to work and would have an impact on the effective operation of the UK labour market. I was not part of the Smith commission, so I do not know what discussions it had on the issue. However, from my point of view, that is the argument for keeping a UK-wide personal allowance.

John Mason: If we accept your argument that the personal allowance is part of the fundamentals, along with other allowances and various other things that are being reserved, would it not be logical, as has been mentioned, for all that to be decided first and for the rates and bands to be decided afterwards? We are in danger of having to decide the rates and bands here first, with other things to do with income tax perhaps having to be changed later on. The Liberal Democrats have always been keen on modern government, for which I respect them. Is there no room for Westminster to modernise things?

Danny Alexander: As I said in answer to an earlier question on the subject, the timing can be looked at. In practice, however, the administrative reality is the other way round. For reasons that I cannot claim to understand but which I am sure Lindsey Fussell could expand on at length in our remaining three and a half minutes, it is much simpler for HMRC to change the rates than to change the personal allowance, because the personal allowance affects people's tax code. Therefore, in practice, we cannot change the personal allowance in the budget and implement that change within 10 days or two weeks or whatever, although we can change income tax rates in that way. What is being devolved is the part of the system in which there is more flexibility—the rates, for example. Changes to the personal allowance take longer to feed through into the system.

John Mason: I will leave that one just now.

Malcolm Chisholm mentioned VAT. You said that you have not fully made up your mind about that. To use an example that I have used before, I have a biscuit factory—

Danny Alexander: I did not know that.

John Mason: It is not mine personally—it is in my constituency. A lot of the biscuits that it makes go south.

Danny Alexander: They would—that is a good reason for keeping the UK together, in my humble opinion.

John Mason: If the system was based purely on the final consumer, we would get very little from that whereas, if we get the VAT on the added value that comes from making the biscuits in Glasgow, that would boost the economy and reflect how well the Government is doing. Do you at least accept that the issue is worth looking at?

Danny Alexander: It is worth looking at, but it is also worth looking at the fact that lots of biscuits will come from south of the border and that people in Scotland will consume them and pay VAT on them. That is the other side of the equation. We might say that we want to ensure that the VAT that is paid by people in Scotland comes here, which is an argument for a system that is based on some way of assessing the VAT that is paid, rather than the added value. Those are different approaches to the issue and we should assess both. The commonsense understanding of what Smith recommends is that the VAT that is paid by people who live in Scotland ought to fund the expenditure of Scotland's Parliament. However, there are a number of ways of organising that. I certainly think that the point that you raise is worth considering.

Lindsey Fussell (HM Treasury): It is probably worth saying that, as I am sure members are aware, a number of countries assign VAT, such as Australia, Spain and Germany, and they all have slightly different ways of doing it. We have some good experience of different methodologies on which we can work with the Scottish Government.

John Mason: My final point is on the Scottish Fiscal Commission and the OBR. Danny Alexander suggested that it is better to have the forecasts done independently, whereas, I presume, the other model is to have the forecasts checked independently, which is more like the SFC model. Ultimately, as long as somebody independent looks at the forecasts, does it actually make a huge amount of difference if they are checked independently rather than produced independently? Another possibility would be to have Audit Scotland do a lot of checking, but it already has quite a strong voice.

Danny Alexander: I think that it does make a difference, actually. Any degree of independence is better than no independence—

The Convener: Indeed!

Danny Alexander: —but I would say that the more fully independent the fiscal assessment is, the better, because, on your model of checking, politicians would still be responsible for originating the forecast. That is a discussion that you have to have here, but I would strongly recommend to MSPs, and particularly to the Finance Committee, that having forecasts generated independently offers you the opportunity to give greater scrutiny to what the Scottish Government then decides to do. You have to decide your view on that.

The more you can take politicians out of the economic forecasting business, the more credible the system will be, particularly if you are thinking about borrowing from the markets, as implied in earlier questions, as opposed to borrowing from within the UK system. The markets will look carefully at the credibility of the institutions and at how genuinely robust the framework that governs all of that is. As one of the people responsible for implementing the OBR, I can say that one of its advantages, apart from improving decision making, has been the extra market credibility that it has brought.

11:00

John Mason: As a final point, I got the impression from HMRC that it feels that it is doing the bulk of the work anyway and that bringing in the OBR has not made a lot of difference.

Danny Alexander: HMRC is responsible for collecting taxes—the OBR would never take that on—and I would say that it does an extremely good job in that respect. It brings in hundreds of billions of pounds a year at a relatively small cost. It is one of the most cost-effective parts of Government, which is good. HMRC produces the raw data, but it is then for the OBR to assess what the data means. An economic forecast looks at what has happened up to now and makes judgments about what is likely to happen in the economy in the future and the tax receipts that we expect to receive. HMRC does not do any of that. It used to be done by the Treasury under the direction of ministers, but it is now done independently by the OBR, which is a big improvement to policy making. I respectfully suggest that that approach would be a big improvement to policy making here, too.

Gavin Brown: How do we ensure that the block grant adjustment for 2016-17 is agreed before the draft Scottish budget? Are there any practical steps that could be taken?

Danny Alexander: How you do it is a matter for you. There is a strong recognition, both in the UK Government and in the Scottish Government, that, having started in this sensible, workmanlike way, we have a responsibility to make the next decisions in a timely way for your budget processes. If the committee were to recommend that, that would be helpful, but it is your call, not mine.

Gavin Brown: The block grant adjustment for 2015-16 has been broadly agreed. You mentioned the element of forestalling that is still under discussion and said that you are not in a position today to put numbers on it, although the OBR has given its broad thoughts for 2014-15 and 2015-16. What will the mechanism be for agreeing that? Will you wait until the end of the year and then work out what actually happened, or will you sit down with the Scottish Government and say, “This is our best estimate of the situation, so we will take a view now, and this is the extra funding you will get”? Do you know how it will work?

Danny Alexander: I am not absolutely certain. The more logical thing to do would be to sit down relatively early in the next financial year and look at what has actually happened. Obviously, the Scottish Government will want to use the money for whatever purposes it chooses, so there is a perfectly good argument for getting that done early in the next financial year. However, we would want a bit more evidence on the reality of what has happened. We are seeking to make a judgment about how much extra money we have received in practice through forestalling, and we need evidence to make that decision.

Gavin Brown: I want to raise a narrow point that the Law Society of Scotland and the Institute of Chartered Accountants of Scotland brought to us about the annual tax on enveloped dwellings, or ATED.

Danny Alexander: ATED is one of my achievements in the Treasury and I am very proud of it.

Gavin Brown: You will be able to assist us, in that case. It was obviously brought in to try to cut down on tax avoidance around stamp duty land tax. The Law Society asked whether, if SDLT is being devolved, as it obviously is, ATED should remain in Scotland, and whether thought has been given to how that would work in practice. At the moment, with the threshold at £2 million, it has not affected Scotland terribly much in practice. As that threshold drops to £500,000, it is more likely to have an effect. What is the UK Government’s view on ATED?

Danny Alexander: At the moment, we think that it operates pretty effectively as a UK system. In effect, it is an anti-avoidance provision. I saw John

Swinney's letter to the committee, in which he implied that he felt that the system was perfectly acceptable. The issue of enveloped dwellings—it involves people who buy a house through a company rather than as individuals in order to avoid paying stamp duty—has been a problem in the housing market in London and the south-east in particular. The evidence is that it has been much less of a problem here. The revenues that we have received so far have, to a vast extent, been predominantly from London and the south-east. I am happy to keep the issue under review and to talk to the Scottish Government about it should it have any views.

I have a worry, however. In putting in place measures to prevent avoidance, we do not want there to be different anti-avoidance systems, because we might create loopholes that people can manipulate when they are choosing where to put their money. It would be better to keep the system as simple as possible.

ATED operates as an annual charge on properties. As the threshold reduces, we will need to keep an eye on where the revenue comes from. In effect, it is a mansion tax for tax avoiders. Should we be successful in the general election, I hope to bring in, in the next Parliament, a system of additional taxation on high-value property that is equivalent to the stamp duty system more generally.

Gavin Brown: I will not comment on that—I will leave it there.

The Convener: I, too, will resist the temptation to comment.

That concludes the questions from the rest of the committee, but I have one or two questions to wind up the session. In response to Gavin Brown's questions about the block grant adjustment, you said that you hoped that matters would be resolved in a timely fashion, but it took about two and a half years for the block grant adjustment that was announced a few days ago to be agreed. In response to Richard Baker, you said that an agreement on VAT would be discussed with the Scottish Government, and you talked about the whole fiscal framework being negotiated at the same time as the legislation is progressed in the next Parliament.

I am concerned—I sure that I am not alone in this—that the process seems to be very open ended and that, one, two or three years down the line, we might be still negotiating some of these issues. Have any proposals been made to impose a timescale and set a realistic date by which the process could be concluded? If no timescale is imposed, we will have a mañana process, which will result in people saying, "We'll discuss how to resolve that next month."

Danny Alexander: That absolutely cannot happen and it will not happen, because a timetable has been set out. All parties have made a commitment that the legislation to implement the Smith proposals will be passed in the first session of the next UK Parliament—in other words, in the first year after the election. The legislation will need to be introduced and passed during the course of that session of Parliament. It is clear that, in considering the legislation, the UK and Scottish Parliaments will want to know what the fiscal framework is. That creates a natural timescale, which means that, over the course of the next few months, we must make progress on and agree the fiscal framework.

I view recent experience as being more encouraging. Although the block grant adjustment on stamp duty land tax—which, in the scheme of things, is a pretty small tax—took time, the block grant adjustment on income tax, which is a much chunkier part of the system, was agreed very smoothly and quickly on the basis of the Holtham methodology that I described previously. Because, under the Smith proposals, we are dealing with a large basket of taxes, I think that the block grant adjustment methodology will be quite simple to agree. It was only because there was a lot of fiddly detail and poor information around SDLT that the block grant adjustment took time to agree.

It is essential that the fiscal framework is agreed by the Governments so that the House of Commons and the Scottish Parliament can hear about it when they consider the bill to implement the Smith plan.

The Convener: Thank you for that.

I have one final point to raise. HM Treasury produces a document entitled "Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly: Statement of Funding Policy". Paragraph 2.25 states:

> "The Government recognises that this Statement of Funding Policy may need to be revised in response to these proposals in due course."

That document has not been updated for five years. Are there any proposals to update it? Will the devolved Administrations be consulted?

Danny Alexander: Yes, they will definitely be consulted. The document is generally updated around the time of spending reviews or when a significant episode of devolution takes place. It was last updated as part of the 2010 spending round. That process involved consultation and discussion with all the devolved Administrations. I give an absolute undertaking that any further revisions will involve full consultation, as has been the case in the past.

The Convener: Why was it not updated following the passing of the Scotland Act 2012?

Danny Alexander: I cannot remember exactly. I can check this and get back to you, but I think that it was because no big areas of further expenditure were devolved under the 2012 act. Basically, the statement of funding policy describes how the Barnett formula works, how adjustments are made and so on. I do think that there were new departments or new areas of policy with funding attached; generally, where changes were made, they were quite modest. Therefore, it was not necessary to update the statement of funding policy; the changes were just agreed in a more low-key way.

Lindsey Fussell: We discussed the timing of the update with the Scottish Government and there was mutual agreement that the sensible time to update the statement of funding policy would probably be in advance of the next spending round, partly for the reasons that the chief secretary set out and also to take account of the devolution that will take place when the next Scotland act is implemented.

The Convener: That completes our questions. Are there any further points that you would like to make before we finish the session?

Danny Alexander: I do not think so. We have not talked about the Crown Estate, on which I had a few things that I wanted to say, but perhaps that is not part of the committee's remit.

The Convener: You can say them if you want to.

Danny Alexander: I am a strong supporter of the devolution of the Crown Estate. On Monday, I announced allocations from the coastal communities fund to coastal communities around Scotland and other parts of the UK. I think that the coastal communities fund has been a good innovation. I have not yet heard from the Scottish Government whether it intends to continue with it; I hope that it will and that, when the Crown Estate is devolved, there will continue to be a system that allocates a large chunk of the revenues from the marine resources that the Crown Estate is responsible for directly to coastal communities in Scotland. That fund, which operates on a bid process and is administered independently, has had some advantages for communities that previously found it hard to find sources of funding for projects whose aim is to make a difference. I hope that the Scottish Government can give an undertaking that the present round will not be the last round of the fund in Scotland and that it will continue—albeit under a devolved framework—in future.

The Convener: You never know—John Swinney will be giving evidence to the committee in a few minutes, so maybe someone will ask him about that.

Danny Alexander: Thank you. I welcome the chance to appear before the committee. I doubt that I will do so again before the election. For me, it has been a real advance in the relationship between the Treasury and the Scottish Parliament to have these sessions, and I hope that my successors, whoever they are—I do not exclude the possibility that I might be back—will continue the relationship. I hope that such engagement is as valuable to the committee as it is to the UK Government.

The Convener: We certainly find it valuable, and we really appreciate your making the time to come and answer our questions. Thank you very much.

I call a brief suspension to allow for a changeover of witnesses and a break for members.

11:13

Meeting suspended.

11:20

On resuming—

The Convener: We continue our consideration of further fiscal devolution by taking evidence from John Swinney, the Deputy First Minister and Cabinet Secretary for Finance, Constitution and Economy. He is accompanied for the item by Sean Neil of the Scottish Government's finance directorate. I welcome them both to the meeting.

Before questions, I invite the cabinet secretary to make a brief opening statement.

The Deputy First Minister and Cabinet Secretary for Finance, Constitution and Economy (John Swinney): Good morning, convener, and thank you for the opportunity to meet the committee to address its questions on further fiscal devolution.

Yesterday, I set out to the Parliament the Government's view on last Thursday's publication of the command paper and associated draft clauses, and I stated that they are another important step in providing the Parliament with further levers to improve the lives of people in Scotland. We must all look to move forward and develop a bill that commands broad support. I will touch briefly on four areas of the command paper.

On tax-raising powers, the Smith report presents scope for a total of 29 per cent of tax revenues to be fully or partially devolved to the Scottish Parliament. We whole-heartedly approve of the intention behind that somewhat limited figure. It is encouraging that there are areas in the draft clauses in which the initial drafting is already close to what should be in the final bill.

Some 14 per cent of welfare provision in Scotland will be devolved. However, it is not just the numbers but the substance of the powers that will be important to Scots in the years to come.

On capital borrowing powers, the Smith commission advocated that the Chief Secretary to the Treasury and I should be in discussions about a prudential borrowing regime for the Scottish Government that would identify an appropriate set of indicators that financial experts, or even capital markets, might advocate as being sensible rather than simply going with the limit that the UK Government has set. I am keen to pursue that discussion with the chief secretary sooner rather than later. The commission also envisaged that the capital borrowing powers to which it referred would be additional to existing capital facilities for the Scottish Government.

I have discussed the block grant adjustment with the committee on a number of occasions. Committee members will remember that I have been keen to reach agreement on a permanent mechanism that would be robust, sustainable and fair to Scotland. I have written to the committee to confirm that we have finalised a one-year adjustment for 2015-16 at £494 million. Issues remain outstanding on the effect of forestalling and the time lag in tax collection. At this stage, I am unable to confirm when those issues will be resolved. I had to reach a one-year agreement with Her Majesty's Treasury, as it became ever more important to have certainty for the Scottish budget and that was the only solution that I could see being available in the timescale that was provided.

The negotiations on the fiscal framework will be more complex than those on the block grant adjustment for the Scotland Act 2012, although we can build on that experience. There are new factors, such as the no detriment policy, which will seek to identify the relative costs and benefits of different policy decisions, and the block grant adjustment approach for the assignment of VAT revenues. I welcome the UK Government's acknowledgement that we must move forward by negotiation and agreement on the many important issues that the fiscal framework will cover. There is clearly much to do to construct an agreed new fiscal framework that reflects the needs and interests of people in Scotland.

The Convener: Thank you very much for that helpful opening statement. Most of my questions will probably be centred on it; we will then go round the table, when colleagues will have the opportunity to ask their own questions.

Let us talk about the fiscal framework. You talked about it being more complex than the block grant adjustment, on which, as we know, there has been a very long drawn-out process. We spoke to the Chief Secretary to the Treasury before you. He said that he expected the negotiations on the fiscal framework to be tied up within, in effect, the first year of the next UK Parliament. Do you think that that is a realistic or deliverable timetable?

John Swinney: I think that it is a realistic timetable because, frankly, these discussions can be as long or as short as anyone wants. On the block grant adjustment, there were two and a half years of evidence gathering, different discussions, different research processes and so on, but it was sorted out in a 15-minute conversation between the Chief Secretary to the Treasury and me when we agreed £494 million. I simply illustrate the contrast in timing—two and a half years and 15 minutes—to show that, if there is a will and a necessity to agree these issues, they can be agreed within a reasonable timescale.

What influences the timescale that you mentioned, convener, is the wider context within which the fiscal framework is set, including the other changes that are envisaged by the Smith commission proposals and the draft clauses. If there is to be any commencement of legislative provisions arising from the Smith commission proposals, the fiscal framework should be agreed by that time to enable everybody to know where they stand on some of these fiscal judgments.

The Convener: The Chief Secretary to the Treasury suggested that once Smith is fully delivered the block grant would be only 35 per cent of the Scottish budget. Is that a figure that you agree with?

John Swinney: I do not recognise that number, convener.

The Convener: I was surprised by it myself. What would you put the figure at?

John Swinney: In terms of revenues under our control, the devolved taxes as a percentage of total revenues would be 29 per cent post Smith. Devolved and assigned taxes as a percentage of total revenues would be 37 per cent. The highest number that I could get devolved and assigned taxes to as a percentage of expenditure in Scotland, taking into account all the changes under Smith, would be 48 per cent. That would leave the block grant at 52 per cent.

The Convener: There is quite a significant difference between the two figures.

John Swinney: That is my rough-and-ready response to your point. If you will allow me, I will look again at what I have said in the *Official Report*, but that is how it feels to me.

The Convener: I would be very interested in that. I think that it would be wise of the committee to write to the Chief Secretary to the Treasury as well to ask him to explain his figures. We are not talking about 1 or 2 per cent here; we are talking about very significant margins.

Let us move on. Obviously we have had the publication of the command paper and draft clauses. The Chief Secretary to the Treasury is obviously of the view that Smith is a settled agreement with five parties. He said that no formal representations have yet been made. It is obviously early days for the clauses, but does the Scottish Government plan to make any representations on extending the powers? Is that under consideration?

John Swinney: I saw the exchanges with the chief secretary. I think that it is important that we are very clear about what we are talking about. There was a process in the Smith commission, which five political parties in Scotland took part in, and an agreement was reached. Without rehearsing all that I have said on behalf of the Scottish Government and the Scottish National Party, a one-sentence summary would be to say that, although we support what Smith delivers, it does not satisfy our ambitions.

Our duty now in the Scottish Government is to work constructively to translate the Smith commission proposals into legislative and practical form as a consequence. There have been a number of representations made to the UK Government about the design of the clauses. I went over some of that ground yesterday in Parliament. Even before the publication of the command paper, we put points and comments—some of which were accepted and some of which were not—to the UK Government on areas where we felt that the clauses could be improved to effect the conclusions of the Smith commission.

11:30

We raised particular issues, but I will single out one issue, which is whether there is a veto over our ability to undertake changes to universal credit. The UK ministers have insisted that there is no veto. However, in clause 24 there are two bases, on timing and on practicability, on which consent can be withheld.

To go back to the point that you have just raised, convener, I would say that I have already lost two years of my life on the block grant adjustment. People say that timing cannot be used an excuse, but I have lost two years of my life on the block grant adjustment, as have many of my officials and Treasury officials, yet it was resolved in a 15-minute conversation with the Chief Secretary to the Treasury prior to Christmas. To people who say that the clause does not contain real caveats or difficulties and does not amount to a veto, I point to our experience over the past couple of years and invite them to come to their own conclusion.

Your final comment was on the Smith commission. I will summarise what I have said. The Scottish Government will work to make sure that the Smith commission proposals are translated into clauses that will have a practical and legislative effect. On the question of making further representations to the United Kingdom Government about further powers, of course we want further powers beyond the contents of the Smith commission. Those issues will be pursued in the normal course of parliamentary and political life. The terms of that debate will be set by the outcome of the UK general election in May.

The Convener: I appreciate the stresses and strains of the block grant adjustment process, because I seem to remember that you had a full head of hair two years ago.

John Swinney: I would not go that far, convener. [*Laughter*.]

The Convener: In terms of intergovernmental machinery, the Smith commission stated:

> "the current inter-governmental machinery between the Scottish and UK Governments, including the Joint Ministerial Committee (JMC) structures, must be a reformed as a matter of urgency and scaled up significantly to reflect the scope of the agreement arrived at by the parties".

I pointed out to the Chief Secretary to the Treasury that the Joint Exchequer Committee has not actually met for two years and the quad has not met for 15 months. How concerned is the Scottish Government about that? Are you pressing for those committees to be put on a sounder footing in order to be able to deliver the Smith proposals promptly?

John Swinney: My observation would be that the dialogue has to be meaningful. The fact that the quad has not met for 15 months does not mean that there has been no dialogue between ministers on different issues. The chief secretary and I—and other UK ministers—are in touch on a variety of issues, and we resolve issues bilaterally.

On one occasion, a real discussion involving the four Administrations about the establishment of a budget exchange mechanism was resolved at the finance ministers' quad. The UK Government intended to withdraw the facility and the three devolved Administrations said that we were not prepared to agree to that, and we achieved an outcome that we considered satisfactory. I can therefore think of one major element of our financial architecture that was well constructed out of the finance ministers' quad.

On the whole, the joint ministerial committee, the Joint Exchequer Committee, and even to an extent the finance ministers' quad, are a bit formal and mechanical about what they are doing. I am not sure that they are particularly meaningful except for in the example that I gave on the budget exchange mechanism. Most business is transacted bilaterally, because an issue that affects me in the Scottish Government might not affect my counterpart in Northern Ireland. We all reserve our right to pursue the issues about which we are concerned bilaterally.

The experience of the Joint Exchequer Committee, which was added to the arrangements post Calman to try to resolve some of the financial issues, has failed. It has proved no useful function in relation to the agreement for the block grant adjustment.

The Convener: I understand what you are saying about those formal meetings, but how do you ensure accountability and transparency if things are done on an informal basis? You spoke about your 15-minute conversation on the block grant adjustment. During our evidence taking, numerous professors—I quoted about eight different ones in my exchanges with the chief secretary—all stressed the importance of accountability and transparency across the entire process. How do you ensure that?

John Swinney: I agree with that. I am always prepared to consider carefully what the Finance Committee says about how things have been handled, but without compromising the necessary ability to undertake a negotiation with the UK Government—as I think the chief secretary has confirmed this morning, these issues are actively negotiated by both Governments—I try to ensure that the committee is advised of as much information as I can provide as timeously as I can provide it about the sequence of measures that we are taking.

I am a fairly frequent attender at the Finance Committee, and the committee has been able to ask me on different occasions about progress on the block grant adjustment. I have given an accurate assessment of where we are in the process on every occasion. When I have had the opportunity to advise the committee about the level of the block grant adjustment that has been agreed, I have done so as timeously as I could.

There is a general point about accountability and transparency, which, given the sensitivity of the issues that we are now dealing with, has to be reflected strongly by both Governments.

The Convener: I have one further point to make before opening up the discussion to colleagues around the table. When I invited the chief secretary to make any further points to the committee, he was enthusiastic about the devolution of the Crown Estate. He asked us a rhetorical question—it was rhetorical to us, but it was one that I am sure he was keen for me or one of my colleagues to ask you—whether consideration will be given to the continuation of the coastal communities fund. Do you have any thoughts on that at this stage?

John Swinney: The Government has taken no detailed decisions about it, but the coastal communities fund is a very good initiative and we were supportive of its establishment. I can see no reason why the Scottish Government would not continue that fund.

The Convener: Thank you for that clear answer.

The first colleague to ask questions will be Richard Baker.

Richard Baker: I want to follow up on one question, cabinet secretary. The convener raised the issue of dialogue with the UK Government on powers beyond what has been proposed by the Smith commission. Reflecting on your response to the convener, is it fair to represent your view—please tell me if this is not fair, as I would not wish to be unfair to you—by saying that it is the Scottish Government's intention to make representations after the next UK election for the further devolution of powers through the proposed legislation to the extent of full fiscal autonomy?

John Swinney: Let me try to explain again the difference in the context of what I was trying to say to the convener.

The Government—in fact, it was the Scottish National Party—signed up to the Smith commission. Since we have a Scottish National Party Government, we have a Government that will implement the terms of the Smith commission and which will participate to enable that to happen. The Government's approach will be to ensure that the terms of the Smith commission agreement are translated into legislative and practical form in the spirit of what was envisaged by the commission.

We will not try to use the process of the Smith dialogue to get extra powers, because there was an agreement that has to be translated into reality. However, the dynamics of the United Kingdom general election will create a political scenario that is likely to be very different to the one that we face just now. In that context, the Scottish Government has made no secret of the fact that we believe that the Scottish Parliament should acquire more powers, and we will seek to use the political process to enable us to secure such powers. The Scottish Government's belief is that Scotland will be best served by exercising full fiscal autonomy.

Richard Baker: Is the Scottish Government in a position at this point to say what those powers should be, or is it something that you are going to leave for a later date?

John Swinney: Any reading of the Scottish National Party's submission to the Smith commission is by its nature a summary of the Scottish Government's position.

Malcolm Chisholm: In your letter to the convener of the committee of 19 January 2015, you said that, if stamp duty land tax applied in Scotland next year, it would raise £198 million; that is the revenue forgone by the UK Government next year. In your letter to us of 22 January 2015, you said that you would raise £235 million from land and buildings transaction tax next year. I am puzzled by the discrepancy between the two figures. If you are pursuing a policy of revenue neutrality, one would have expected the two figures to be the same.

John Swinney: If that was the case, we would have had a block grant adjustment of £461 million, but we do not have a block grant adjustment of £461 million; we have a block grant adjustment of £494 million. That is the fundamental difference between the two figures. The figure of £198 million that Mr Chisholm quotes is what we believe would be realised by the application of the UK Government's stamp duty proposals post autumn statement in Scotland in 2015-16, and that is part of a total amount of tax raised from stamp duty and landfill tax of £461 million.

That was my estimate of what would be raised, but the UK Government's estimate was much higher, at £524 million. The Chief Secretary to the Treasury and I eventually agreed to split the difference and have a block grant adjustment of £494 million. The tax figures that I have shared with the committee are predicated on revenue neutrality being anchored around about £494 million.

Malcolm Chisholm: Why have you put all that difference on to residential land and buildings transaction tax? I would have expected you to split the difference on all three elements of the taxes that are relevant to the block grant adjustment.

John Swinney: I have no reason to change my estimate on non-residential transactions. I set out the estimate on that basis, and I have no basis for changing that or for changing the landfill tax element of the proposals. The only one that has changed is residential transactions on land and buildings transaction tax.

Malcolm Chisholm: You do not agree with the UK estimates for any of those three elements, so why have you just adjusted it for one?

John Swinney: I have confidence in the estimates that I have made on the other factors. The only one of the taxes that is changing is the residential element of LBTT.

Malcolm Chisholm: But you do not have confidence in your estimate of £198 million for land and buildings transaction tax.

John Swinney: I have confidence in the estimates that I have made, and I have set a tax to realise that sum of money.

Malcolm Chisholm: In general, is it your personal belief that people will be paying more in land and buildings transaction tax than they would have done if stamp duty land tax had continued in Scotland next year? You said that it was your personal belief that that would have raised £198 million, but you are now saying that your taxes will raise £235 million.

John Swinney: The estimates are all very well, but I have to aim against the block grant adjustment. If I want to maintain revenue neutrality, I have to raise £494 million. If I raise £461 million, I will not deliver revenue neutrality; I will deliver a tax reduction of £33 million, which is not my intention and I never said it was to Parliament. I said that I would deliver revenue neutrality.

Essentially, if I have confidence in the component numbers that get to non-residential transactions of £146 million, and if I have confidence in my estimates that landfill tax will deliver £117 million, the only number that will have changed is that for residential taxation, so that is the number that I have to achieve to deliver revenue neutrality.

11:45

Malcolm Chisholm: So you are not really confident that you will raise £235 million. That is just the compromise that you have had to come to with the UK Treasury. Is that right?

John Swinney: I have had to set a tax rate that will deliver revenue neutrality, which was specified in my agreement with the UK Government of a block grant adjustment of £494 million. The Scottish Fiscal Commission has certified as reasonable my assessment of all the tax estimates, whether they be for landfill tax, for non-residential transactions or for residential transactions.

Malcolm Chisholm: We will reflect further on that.

You said that you listened to what the chief secretary was saying. Our report expressed concern about the block grant adjustment based, to a large extent, on your evidence. He said that he accepted the principle of our getting the benefit of whatever we do to boost the economy. That is obviously one of the founding principles, if not the founding principle, of fiscal devolution.

I still seek clarity about the point of difference. You said that the constraining factor would have a negative effect on the Barnett formula and the chief secretary more or less denied that. It is a bit confusing for us to know exactly what is the fundamental point of dispute about the block grant adjustment for landfill tax and land and buildings transaction tax.

John Swinney: There are a number of points to make in my answer. Forgive me if I go through some of the detail, because it might take a little bit of time.

The 2010 command paper said that there would be a one-off cash adjustment to the block grant in relation to what are called the smaller taxes—stamp duty land tax and landfill tax. That was it. On the Scottish rate of income tax, the command paper contained a one-off adjustment and an indexation factor. So the indexation point for the Scottish rate of income tax was put into the command paper, but it was omitted for stamp duty land tax and landfill tax.

When I started negotiations with the UK Government, indexation was suddenly added to the smaller taxes. At the meeting of the Joint Exchequer Committee, the entire discussion involved me resisting agreement about indexation being applied to that initial block grant adjustment, because I was concerned that the Scottish Parliament had approved a legislative consent motion on the Scotland Act 2012 on the basis of the statement in the command paper that there would be a one-off cash adjustment with no indexation.

After some time of making no progress, I accepted that there could be an indexation factor. When we started to discuss that, we suddenly started having a discussion about indexation, and I suggested that we should also index the gross domestic product deflator so that it would rise with changes in the economy over time. The Treasury proposed what was essentially a constrained model. We would try to predict stamp duty until 2029-30, which would specify how much tax we envisage would be raised, and then we would calculate an index mechanism that would enable Scotland to be no better or no worse off after all that calculation out to 2029-30.

The committee will not be surprised to hear that that was going to happen over my dead body. If the UK Government was not able to predict in 2007 the collapse of stamp duty in 2009, how on earth was anyone going to be able to tell us what would happen in 2021, let alone 2029 or 2030? It was an absurd proposition.

We have not heard much about all that for a while, but that is because we have done just a one-year deal. I warn the committee that, when we get into looking at wider issues about the fiscal framework and where this is all going to lead, particularly the design of the no detriment principle, our friend the constraining factor might make a reappearance.

Those are, in a nutshell, the areas of dispute. I know that I sometimes get accused of being obstructive for the sake of being obstructive, but the arguments that I am making are actually about protecting the financial wellbeing of the Parliament and Scotland. Anyone who had signed up to that constraining approach would not have been signing up to a deal that was in Scotland’s best interests.

Malcolm Chisholm: I am sure that we will continue to take a close interest in that issue. We might well follow it up with the chief secretary, because it is difficult to match what you are saying with what he said.

John Mason: I want to touch on the subjects that I raised with the Chief Secretary to the Treasury. My first question relates to the no detriment issue, which you have just mentioned. It sounds quite positive that the UK Government is willing to talk about forestalling and compensation with regard to land and buildings transaction tax, but we have had other not-so-positive experiences. For example, as I understand it, although the UK Government took the decision on the Scottish rate of income tax, we still have to pay the entire HMRC costs. That does not strike me as following the no detriment principle.

Of course, that is in the immediate cost circle; I also asked the chief secretary about APD and whether if Manchester airport, say, lost passengers, we would be expected to compensate it. Are you confident about what is meant by no detriment and that it will not be a problem as we move forward?

John Swinney: The best way that I can sum up the phrase “no detriment” is to say that it is not well defined at the moment. Simply expressed, it is the concept that the Scottish Government or the UK Government should be no better or no worse off as a consequence of the act of devolution. That is I what I think is the headline summary. I think that, when we attempt to turn the principle into reality, we will have a few years like those that we had with the block grant adjustment, because it will be material to determining some of the issues that Mr Mason raised with the chief secretary about compensation with regard to APD. I have to say that I completely reject that particular argument, because, as far as I am concerned, the no detriment principle as applied to APD means that there will be a block grant adjustment that will leave us no better and no worse off as a result of the devolution of APD. It is then up to us what we do with APD and what we do with the proceeds and the benefits or, indeed, the challenges.

John Mason: Another issue is the timing of changes to the Westminster budget compared with our budget. Mr Alexander seemed quite relaxed about which happened first, and he said that income tax will be a devolved tax. First of all, I do not know whether you would agree that income tax will actually be devolved. It seems to me that a lot of its underlying rules will be set at Westminster, and it would make more sense for the outline principles to be fixed before we made our decisions on the rates and bands. Are you concerned about that?

John Swinney: First, let me say that I do not have a copy of the Smith report in front of me, but my vivid recollection—[*Interruption*.] One has just been passed to me.

Paragraph 75 of the Smith commission agreement says:

"Income Tax will remain a shared tax".

That is what the Smith commission said, and I think that that is the only way that one can consider that issue. Certainly, there was a clear view in the Smith commission—with which I disagreed—that some elements of income tax had to remain shared for there to be a remaining United Kingdom. I think that it might have had something to do with English votes for English laws. However, for me, the Smith commission report makes clear that it will be a shared tax and not an entirely devolved tax. We will not have control over the whole of income tax, so how on earth can it be a devolved tax?

On the interaction about budget decisions, the budget process in this Parliament is fundamentally differently constructed to that in Westminster. The process here is a product of the openness and transparency of this institution, and it is founded on the need for dialogue. When I publish a budget—normally by 20 September, as is required by agreement with the Finance Committee—that is called a draft budget. It is the subject of consultation before Parliament legislates for it in detail, as we will do later this morning, at stage 2. We interact on the details and the specifics.

The Westminster budget process is completely different, as we saw with stamp duty land tax. The Government here is sometimes criticised for a lack of adequate consultation on certain issues, but something that is announced at 12.25 in the afternoon that becomes effective at midnight does not involve much scope for consultation. That is the Westminster system. That is how Westminster was constructed, but this institution was constructed differently.

John Mason: You would not like to copy that model.

John Swinney: No, I do not think that it is a particularly desirable model.

The other side of the coin is that, when we go through our legitimate processes, which are a product of the nature of this institution, that is inevitably different from what happens in Westminster, and that exposes us to the risks that we faced as a consequence of the Chancellor's actions in December, when he changed stamp duty after we had undertaken a well-consulted reform that we had been talking about for a considerable amount of time. We completed the process and announced our proposals and then found, further down the track, that the Chancellor was able to use the pantomime of the Westminster system to do something different and for it to have effect much more quickly than we could bring our proposals into effect.

John Mason: Can that be changed, or is that inevitable?

John Swinney: That is a question that is predicated on reform of the United Kingdom Parliament and its budget process, which I would be fundamentally pessimistic about for all time, given my experience.

John Mason: The third area that I asked the chief secretary about was VAT. Our witnesses had different ideas about how the VAT would be split up. One suggestion is that it would happen at the end of the process—that is, when the consumer buys something, that bit of the VAT would stay in Scotland or England. However, the other idea involved the fact that, by definition, VAT concerns value added at different stages, and that, for example, a factory in Scotland might successfully export a lot of things to England and elsewhere, and that Scotland should get a share of the VAT that is added there. Do you have a view on that question?

John Swinney: I do not have a definitive view. The Smith commission agreement obliges me to engage in discussion with the UK Government on those points, as part of the fiscal framework discussions. However, I think that the issues that Mr Mason raises are material to ensuring that we end up with what the Smith commission agreement required of us, which was an assessment that is based on a verified basis that is agreed between the UK Government and the Scottish Government. We should be open to the various elements of academic opinion that are clearly expressed in the debate, so that we can reflect that in our discussions.

12:00

John Mason: The final area that I asked about was the OBR and the Scottish Fiscal Commission. Mr Alexander suggested that the OBR is a better model because it is more independent, although we have heard different views on that. For example, HMRC does most of the work, so the OBR is not that independent, while the Scottish Fiscal Commission is independent although it does not produce the forecasts; it comments on them. What is your view?

John Swinney: We went through most of those issues when Parliament considered the arrangements for the establishment of the Scottish Fiscal Commission and the committee was immersed in that process. We will look at them again when we legislate for the Scottish Fiscal Commission, which will be in the parliamentary year 2015-16. That will give us another opportunity to reflect on those points.

The current arrangements are entirely satisfactory. The Scottish Fiscal Commission has a veto over my forecasts. If it does not believe my forecast to be valid, it will say so, and I have no doubt that it will do so. Our approach is the more honest and transparent one. We do the numbers and hand them to the Scottish Fiscal Commission, which looks at them and, if it is satisfied with them, it says so. If not, it vetos them.

We hear all this stuff from the UK about the OBR's uber-independent process, when HMRC does most of the legwork. That is not an open, honest and transparent process. HMRC does most of the work behind the scenes and gives the data to the OBR, which does not do anything with them that is much different from what the Scottish Fiscal Commission does with our numbers. I dare say that, if the OBR says to the Treasury, "That number is ridiculous. You can't have that," the Treasury would have to respond.

The Scottish Fiscal Commission will be provided with the Government's numbers, it will consider them, and if it has confidence in them, it will say so and, if it does not, it will veto them.

Gavin Brown: I will stick with the Scottish Fiscal Commission, as we are talking about that. You said that the Government will legislate during the parliamentary year 2015-16. I presume that you will introduce the bill in September this year. Can some work be done in advance of that? At the moment, the Scottish Fiscal Commission looks at business rates, but primarily at landfill tax and LBTT. Do you envisage it having a role in relation to the Scottish rate of income tax from April 2016? If so, work on that would have to begin a bit earlier than September.

John Swinney: We have gone over some of this territory before and I rehearsed it in my closing speech in the parliamentary debate on Wednesday last week. I might have picked up the question wrongly, but I thought that I was operating within the spirit of the Finance Committee's line of questioning before we established the Scottish Fiscal Commission. I got the strong sense that the committee did not want me to create a fiscal commission that would run away with itself and do all sorts of things that lie beyond the responsibilities of the Scottish Parliament.

I set up the Scottish Fiscal Commission on the basis of getting it to look at some of our historical responsibilities, such as national non-domestic rates income, and some of our new responsibilities, such as land and buildings transaction tax and landfill tax. As new powers come along, we intend to expand the Scottish Fiscal Commission's remit. That is exactly what I set out to Parliament and it is exactly what we will do.

As new powers begin to emerge, that will take its course, although, as Mr Brown knows, on the Scottish rate of income tax, we will be in a shadow period for some time before the full formal responsibility for our element of income tax comes our way. That will now have to interact with what the Smith commission has produced, because the income tax powers under the Smith commission are different from the proposals that were enacted in the Scotland Act 2012. The Scottish Fiscal Commission's remit will expand to take other developments into account.

I should add that we are not just waiting until September. The route to legislation will start before the summer recess with the publication of a consultation paper on the fiscal commission, so it will be possible to consider all those issues properly in that context.

Gavin Brown: I agree with most of what you said, cabinet secretary, but is there not some work that the fiscal commission could usefully do in advance of the shadow period to April 2016?

John Swinney: Certainly, there is. It was always envisaged that the commission's responsibilities would develop further as we got more responsibilities. However, I took the view that it was important that we got our preparation for the new taxes absolutely correct. We did that with the fiscal commission and we have worked our way through the process. The commission has now given us two accreditations of our headline forecasts.

We have taken the same approach with Revenue Scotland. As I advised the convener this morning, I have now had clearance from the intergovernmental assurance board that Revenue Scotland is ready to assume its practical functions for 1 April. I am delighted about that and I announced it publicly this morning. It is exactly as I expected would be the case.

We have taken the steps in an orderly fashion to introduce the taxes as they were devolved to us.

Gavin Brown: You mentioned Revenue Scotland, and I have seen your press release. Without getting into too many technical details, are you basically saying that all the computer testing and other stuff that the committee heard about in December has happened and been signed off and that, although Revenue Scotland does not need to start operating next week, it is good to go if it had to, or are you saying something else?

John Swinney: I am saying that we have had clearance from the intergovernmental assurance board that all the necessary preparations are now in place and arrangements can be made to introduce the devolved taxes. That is me getting to the point of formal sign-off and saying that the old taxes can be switched off at the end of the financial year and that we will switch on the new ones. We are ready to do that.

Gavin Brown: Do you have a view on which extra taxes or powers should go to Revenue Scotland as more powers come in or have you not formed views on that yet?

John Swinney: It is part and parcel of the Smith agreement that HMRC will continue to collect income tax. I have not establish the precise and detailed mechanism for the collection of air passenger duty and the aggregates levy, but I envisage that Revenue Scotland would collect them. That is my plan.

Gavin Brown: On forestalling, there is obviously some discussion to happen about the block grant adjustment. My understanding from the chief secretary's answer earlier is that there will be a discussion in the early part of the next financial year about what will happen until early April. However, am I right in thinking that, whatever happens in those discussions, the actual cut to the block grant should theoretically end up being lower than £494 million, or is there a scenario in which it could end up being higher?

John Swinney: The block grant adjustment could not be higher than £494 million. It could be lower, but it might not be, because I might get nothing from forestalling.

Gavin Brown: So it depends on the discussions.

John Swinney: I add that the early part of the next financial year feels a bit late to me.

Gavin Brown: I merely repeated what was said in evidence.

John Swinney: You quoted it accurately, Mr Brown.

Gavin Brown: From your answer to John Mason, you are obviously unhappy with the Westminster system of announcing tax changes that take effect at midnight or the next day.

John Swinney: Do not interpret it as unhappiness. I was simply characterising the system as I see it.

Gavin Brown: Does that mean that you would rule out ever announcing changes to the bands or rates of LBTT that would take effect at, for instance, midnight or the next day?

John Swinney: I suppose that we should never say never, but I would have a bit of a job persuading this Parliament that I had been consistent with what is expected of me in the budget process. At different stages, when we have previously discussed when I would make announcements about particular tax rates, I have stuck firmly to the view that the right and proper place for me to make announcements about tax rates is with the budget, because the budget is predicated on what revenue I would raise out of that taxation.

At different stages, some parliamentary colleagues have wanted me to announce rates prior to that. I resisted that because I felt that it would exacerbate what we have experienced already. I felt that the right thing to do was to link all the provisions with the budget, because the budget was dependent on the tax revenues raised. I might have a try at it if I really felt that I had to do it, but I would find it quite difficult to explain to Parliament that, somehow, having argued the line about everything being integrated in the budget process, I had decided on 28 February to change it all in a certain way.

That is just me following the architecture of the financial management of the Scottish Parliament, which I absolutely respect. I was a member of the committee when the Public Finance and Accountability (Scotland) Act was put into statute back in 2000 and I feel as if I have been in with the building blocks or the foundations of our approach to financial management. I would have to have a very good reason not to respect that.

Gavin Brown: You talked about constraining factors and you gave your view that you are firmly against them. You said that they have not come up for a while. Do you genuinely think that it is potentially a live issue? The committee was certainly against constraining factors, as you will have seen in our report.

My interpretation of what the Chief Secretary to the Treasury said this morning—I guess that you listened to most of his evidence—was that his current view is that constraining factors should not be in there. He seemed to agree with the convener's argument that they would almost defeat the point of devolving the taxes. Do you believe it is still a live issue?

John Swinney: I hope that it is not a live issue. The basic point that I come to with all these things is that, when a tax is devolved to us, it should be devolved to us neither to our advantage nor to our disadvantage—it should be devolved as neutral. It is then up to us to take the gain or the risk. That is how it should work. There should be no inhibiting of our ability to take the gain and we should have adequate provisions in place to deal with the risks.

Constraining factors create a false architecture around the changes and they defeat the fundamental point, which Mr Mason pursued with the chief secretary—if we are successful in implementing the taxes, we should be entitled to retain the proceeds without any negative net adjustment. If we do not get it right, we have to live with the consequences.

Mark McDonald: Earlier, the convener asked the Chief Secretary to the Treasury about timescales for agreement of the fiscal framework. Given that you have just outlined your loss of two years in relation to the block grant adjustment, are you keen to have a defined timescale for the negotiations on the fiscal framework so that we do not go through the same process in respect of that?

John Swinney: Something of that nature would probably help. We have to tie that to the enactment of the legislation. We have to be able to see the route plan that gets us towards implementation of the new provisions and arrangements, and we have to have a fiscal framework that goes with that and is satisfactorily agreed in that process. The linking together of all of that is essential, and a disciplined timescale would help us to resolve those issues.

12:15

Mark McDonald: You mentioned the experience of the stamp duty land tax changes. When you announced the initial rates for LBTT in the draft budget, you did not know that those changes were likely to occur in the autumn statement, and there was no indication at that stage of what the block grant adjustment was going to be. How constraining a factor was that? Do we need to learn from that experience, particularly when it comes to further devolution and the introduction of SRIT in the not-too-distant future?

John Swinney: It definitely did not help that I had to make an estimate in the budget in October of what I thought would be generated by a stamp duty system that has now been abolished, in order to fulfil my commitment to revenue neutrality. I made an assessment that the UK Government obviously disagreed with. We have different ways of forecasting property transactions in Scotland and we have designed a model in which I have confidence. It would be of assistance if the information was made available to ministers in the Scottish Government in an orderly fashion so that we could make what we think is the right judgment and advise Parliament accordingly.

Mark McDonald: Professor Heald has given evidence to this committee and the Devolution (Further Powers) Committee on his concerns about the potential for gaming, although the Chief Secretary to the Treasury rejected any notion of gaming or of the Treasury taking steps after the Scottish Government had informed it of its intention to set certain rates.

I think that you have to notify the Treasury on SRIT in November. A question was raised about the time that that gives the UK Government to react to what the Scottish Government is planning to do. What is your take on that? Do you echo some of the thoughts that have been expressed to the committee? The Law Society of Scotland is keen that there be some financial fair play clause or something along those lines to prevent the rug from being pulled out, as it were.

John Swinney: The answer to the fundamental question is that we have seen an example of that already. We have not even got the power yet—we are within the scope of being delivered the power—but, after I announced a particular approach in October, we have seen a competing and different proposition advanced by the UK Government process. Professor Heald's fundamental point that that could happen has been demonstrated by the fact that it has already happened in the past couple of months. Anyone who denies that that could happen has not been paying attention for the past couple of months.

The Law Society's argument about the need for some financial fair play clause is an interesting one. The idea sits closely alongside the concept of no detriment, whereby the actions that are taken by one Administration should not be undertaken so that, by the nature of the exercise of the power, a difficulty is created for the way in which another Administration exercises the same power.

Mark McDonald: I will finish by touching on borrowing powers. I asked the Chief Secretary to the Treasury for his take on what the command paper sets out and where the UK Government is going. The expectation was that the Scottish Parliament would perhaps achieve additional borrowing powers on top of the capital grant that comes from the UK Treasury at present, but there has been an indication that such powers may replace rather than supplement the capital grant.

What is your interpretation of where things are? The Chief Secretary to the Treasury appeared to indicate that he was open-minded on the issue, which I presume is a relatively promising position to start from.

John Swinney: The Smith commission believed that the Scottish Parliament should have additional borrowing powers in two respects—first, to deal with the greater degree of fluctuation to which we will be exposed in revenue terms, because more of our finance will be dependent on revenue judgments and revenue raising, and secondly, that we should have capital borrowing powers in addition to our capital budget. I am firmly of the view that any erosion of our capital budget by the application of borrowing powers would not translate the Smith commission proposals into practical effect.

Mark McDonald: I presume that that will be the basis on which the Scottish Government enters into the discussion with the UK Government.

John Swinney: That is correct.

Jean Urquhart: I want to ask the cabinet secretary the same questions that I asked the Chief Secretary to the Treasury about taxes that are raised in the rest of the UK and spent on reserved matters. I cannot see that that would have anything other than a detrimental effect on Scotland. If we are then faced with the stark choice between cutting our devolved services and increasing taxes, are we not having to be reactionary to any decision about the tax-raising powers for the rest of the UK?

John Swinney: I return to the point that the convener made at the outset about what proportion of our budget is dependent on the block grant. I told the convener that devolved and assigned taxes as a percentage of the post-Smith revenue and spending package would be about 48 per cent, so 52 per cent would still be dependent on a block grant. If a UK Government was exercising an approach that restricted the public expenditure that drove that block grant, we would obviously have the implications of that within our public finances.

The key point—this is a direct consequence of the referendum—is that our public finances are still operating in Scotland within a UK framework. Macroeconomic issues and issues of the strategic nature of the public finances remain reserved, so UK Government decisions with which we may profoundly disagree on the approach to public spending could still be applied and have an effect on the Government in Scotland.

Jean Urquhart: Do you agree, therefore, that Scotland should be able to follow a different path on the austerity programme? The OBR is predicting that most of the payments to reduce the deficit in the United Kingdom are coming from public services, so can you see opportunities for Scotland to reverse that?

John Swinney: As a Government, we do not take the same approach to the management of the public finances that the United Kingdom Government takes. We try to do things that are designed to improve the performance of public services and to improve the policy propositions that are available to people in Scotland. In so far as we can within our areas of competence, we will endeavour to continue to do that.

The challenge, of course, is that we will still be operating within a UK fiscal framework. As members will know, I have had to wrestle with a 10 per cent real-terms reduction in our budget over the course of the spending review period since 2010, and we will not somehow be set free from that framework as a consequence of what is envisaged in the command paper.

Jean Urquhart: One of the issues raised by the Scottish Trades Union Congress was that any change that we might want to make to welfare will still be at the hand of the Westminster Government. Can you confirm that?

John Swinney: Very much so, yes.

Jean Urquhart: Thank you.

The Convener: That brings us to the end of the evidence session. Does the cabinet secretary have any further points to add?

John Swinney: I have nothing to add.

12:25

Meeting suspended.

12:28

On resuming—

Budget (Scotland) (No 4) Bill: Stage 2

The Convener: Agenda item 2 is consideration of the Budget (Scotland) (No 4) Bill at stage 2. Members have a note by the clerk with their papers. For this item we are joined by the Cabinet Secretary for Finance, Constitution and Economy, who is accompanied by Terry Holmes of the Scottish Government's finance directorate. I invite the cabinet secretary to make an opening statement.

The Deputy First Minister and Cabinet Secretary for Finance, Constitution and Economy (John Swinney): Thank you, convener. I begin by welcoming the Finance Committee report on the 2015-16 draft budget. As I informed Parliament last week, I will respond in full in advance of the stage 3 debate.

This session of the Finance Committee focuses on the content of the bill itself, as approved in principle by the Scottish Parliament. As members of the committee are aware, there are a number of differences in the presentation of budget information between the draft budget and the budget bill.

To assist the committee, I will explain the main differences, with reference to table 1.3 on page 4 of the supporting document. Column A sets out the updated portfolio budgets for 2015-16 following the announcement by the First Minister of the new responsibilities on 21 November 2014. To ensure a transparent read-across from table 3.01 draft budget document published in October, table 1.2 of the supporting document provides a reconciliation between the portfolio budget published in the draft budget and the revised portfolios.

12:30

Column I in table 1.3 sets out the draft budget as it is required to be restated for budget bill purposes. Columns B to G provide details of the adjustments, including the necessary statutory adjustments to meet the requirements of the parliamentary process.

There are two substantive changes to the spending plans outlined in the draft budget that I wish to take this opportunity to highlight.

First, the budget bill confirms the deployment of £127.4 million of health consequentials flowing from the UK autumn statement on 3 December 2014. That is in line with the Government's commitment to pass on resource consequentials in full to the national health service in Scotland.

In addition, to ensure that budgets align with the latest available information, there is an adjustment of £345.3 million to the annually managed expenditure budget provision for the teachers and NHS pension schemes. That reduction to the draft budget 2015-16 number reflects the Treasury update to the discount rate applied for post-employment benefits announced in December 2014.

The other adjustments set out are the exclusion of £151.7 million non-departmental public body non-cash costs, which do not require parliamentary approval—these are mainly in relation to depreciation and impairments in our NDPB community; the exclusion of judicial salaries and Scottish Water loan repayments to the national loans fund and the Public Works Loan Board, which again do not require parliamentary approval; and the inclusion of police loan charges to be approved as part of the budget bill. There are technical accounting adjustments to the budget of £124.5 million reflecting differences in the way in which HM Treasury budgets for these items and how we are required to account for them under international financial reporting standards-based accounting rules that apply in respect of the Government financial reporting manual. I remind the committee that the budget conversion to an IFRS basis is spending power neutral.

There are adjustments to portfolio budgets to reflect the requirement that a number of direct funded and external bodies require separate parliamentary approval. Those include the National Records of Scotland, the Forestry Commission, Food Standards Scotland, the Scottish Court Service, the Office of the Scottish Charity Regulator, the Scottish Housing Regulator, Revenue Scotland and the teachers and NHS pensions schemes. There is the restatement of specific grants included in the overall 2015-16 local authority settlement that remain under the control of the appropriate cabinet secretary with policy responsibility. Full details of all grants that are treated in this way are included in the summary table on page 42.

I again make clear that those are essentially technical adjustments and do not change in any way the budget that has been so far scrutinised by this and other committees and approved in principle by Parliament.

I also remind members that for the purposes of the budget bill only spending that scores as capital in the Scottish Government or direct funded bodies' annual accounts is shown as capital. That means that capital grants are shown as operating in the supporting document. The full capital picture is shown in table 1.4 on page 5.

As I made clear to Parliament last week, I remain committed to an open and constructive approach to the 2015-16 budget process and continue to seek consensus on a budget that will meet the needs of the people of Scotland. I look forward to discussing that with the committee.

The Convener: Thank you very much for that comprehensive opening statement. I have one question to put to you about the Barnett consequentials. You received £211 million to the Scottish budget following the autumn statement and, as you have pointed out, the budget bill has allocated £127.4 million to health—the amount arising from increases proposed for health in England. Will you give us some information with regard to the rest of the consequentials?

John Swinney: In resource departmental expenditure limit for 2015-16, the Government received £200.8 million, £120 million of which has been allocated to health. Some £11 million has been allocated to match the business rate poundage south of the border, which I announced in my statement to Parliament on the local government financial settlement. We have conveyed £5 million of ring-fenced grant from the UK Government in relation to the Glasgow School of Art.

That leaves a resource DEL uncommitted number at this stage of £64.8 million. There was £26.3 million in capital DEL consequentials that came to the Government. A sum of £7.4 million has been allocated to health, and £15 million has been conveyed as part of the Glasgow city deal—a UK Government contribution, to which the Scottish Government contribution is additional—and that leaves uncommitted capital DEL of £3.9 million. There is £4 million of unallocated financial transactions into the bargain.

The Convener: Just for the record, when are you going to decide on how those resources will be committed?

John Swinney: I am considering those issues in preparation for stage 3 of the budget and will conclude my discussions at that time.

The Convener: Thank you for that clarification. Do members have any questions?

Gavin Brown: If the cabinet secretary is going to respond to our report in advance of stage 3, will that be this week or next week, or is he not sure at this stage?

John Swinney: I suspect that it will be at the start of next week.

Gavin Brown: I am trying to work out how much Scottish Water is projected to borrow in 2015-16. In the bill, paragraph 4 of schedule 3 refers to

"Section 42 of the Water Industry (Scotland) Act 2002 (Scottish Water)",

and the amount next to that is £150 million. On page 132 of the draft budget, there is £80 million against the line "Voted Loans", and on page 61 of the supporting document that you published alongside the bill, there seems to be capital for Scottish Water of £132 million. I am trying to work out the three different figures. Can you square the circle and explain how they match?

John Swinney: Whether I can explain how it all matches is a moot point. In my comments to the committee today, I said that Scottish Water loan repayments to the national loan fund and the Public Works Loan Board do not require parliamentary approval, so that is why some of the numbers look different. The simplest way to express it is that I expect the borrowing requirement of Scottish Water to be £80 million in 2015-16.

Gavin Brown: The £150 million is presumably some kind of maximum limit.

John Swinney: There will be two factors that influence it. There will be gross versus net, and there will be what requires parliamentary approval and what does not.

Gavin Brown: You anticipate £80 million, though. Is that your best estimate?

John Swinney: Yes.

Gavin Brown: My last point is that I would like you to explain the different figures in the draft budget versus the supporting document for the Queensferry crossing. Page 122 of the draft budget has a figure of £219 million for 2015-16 for the Queensferry crossing, but page 65 of the supporting document has a figure of £269 million for the Queensferry crossing in 2015-16. What is the explanation for the difference between those two figures?

John Swinney: The difference is the payment back to the Treasury of the pre-payment that we received on the Forth replacement crossing back in 2011-12, probably. We secured an agreement with the Treasury to enable us to wrap up expenditure on the Forth crossing when we did not have budget capacity to do so. I have a feeling that that was over two financial years, which would probably be 2011-12 and 2012-13, but it was on the basis that it would be repaid, which accounts for the difference. If it is £219 million in one document and £269 million in the other, that is right. I think that there were two instalments of £50 million—£100 million in total.

Gavin Brown: Thank you.

Malcolm Chisholm: Most of my question has been answered; it was about the unallocated consequentials, which you gave a very full account of. You said that £64.8 million resource DEL was unallocated and £3.9 million capital DEL was unallocated. I take it that we could add to that some of the health consequentials that have not been allocated to a particular line. Can you tell us how much health capital and resource has not been allocated to a particular health line?

John Swinney: It is £22.5 million resource.

Malcolm Chisholm: Is there any unallocated capital?

John Swinney: I am not aware that any capital announcements have been made.

The Convener: That has concluded the committee's questions. We now turn to formal proceedings on the budget bill. We have no amendments to deal with, but we are obliged to consider and agree to each section and schedule and the long title. We will take the sections in order, with schedules being taken immediately after the section that introduces them, and the long title last. Fortunately, standing orders allow us to put a single question when groups of sections and schedules are to be considered consecutively and, unless members disagree, that is what I will do.

Section 1 agreed to.

Schedule 1 agreed to.

Section 2 agreed to.

Schedule 2 agreed to.

Section 3 agreed to.

Schedule 3 agreed to.

Sections 4 to 11 agreed to.

Long title agreed to.

The Convener: That ends stage 2 of the Budget (Scotland) (No 4) Bill. I thank the cabinet secretary for coming.

12:41

Meeting suspended.

12:42

On resuming—

Subordinate Legislation

Scottish Tax Tribunals (Eligibility for Appointment) Regulations 2014 (SSI 2014/355)

The Convener: The next item of business is to consider a negative Scottish statutory instrument. Do members agree not to make any comments on the regulation?

Members *indicated agreement.*

The Convener: That was the final agenda item. I thank everyone for their contributions this morning.

Meeting closed at 12:42.

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