The Scottish Parliament
Pàrlamaid na h-Alba

Official Report

DEVOLUTION (FURTHER POWERS) COMMITTEE

Thursday 26 February 2015

Session 4

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DEVOLUTION (FURTHER POWERS) COMMITTEE
6th Meeting 2015, Session 4

CONVENER

*Bruce Crawford (Stirling) (SNP)

DEPUTY CONVENER

*Duncan McNeil (Greenock and Inverclyde) (Lab)

COMMITTEE MEMBERS

*Linda Fabiani (East Kilbride) (SNP)
*Rob Gibson (Caithness, Sutherland and Ross) (SNP)
*Alex Johnstone (North East Scotland) (Con)
*Alison Johnstone (Lothian) (Green)
*Lewis Macdonald (North East Scotland) (Lab)
Stewart Maxwell (West Scotland) (SNP)
*Mark McDonald (Aberdeen Donside) (SNP)
*Stuart McMillan (West Scotland) (SNP)
Tavish Scott (Shetland Islands) (LD)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Professor David Bell (University of Stirling)
Bill Kidd (Glasgow Anniesland) (SNP) (Committee Substitute)
Philip Milburn (Investment Association)
Don Peebles (Chartered Institute of Public Finance and Accountancy Scotland)
John Swinney (Deputy First Minister and Cabinet Secretary for Finance, Constitution and Economy)

CLERK TO THE COMMITTEE

Stephen Imrie

LOCATION

The Mary Fairfax Somerville Room (CR2)

Scottish Parliament

Devolution (Further Powers) Committee

Thursday 26 February 2015

[The Convener opened the meeting at 09:01]

Decision on Taking Business in Private

The Convener (Bruce Crawford): Good morning, everyone, and welcome to the Devolution (Further Powers) Committee. As usual, I ask everyone to check that their mobile phones are at least in silent mode so that they will not interfere with proceedings. That is exactly what I am doing now.

We have received apologies from Tavish Scott. I think that Bill Kidd will join us at some stage as the substitute for Stewart Maxwell. No other apologies have been received.

Under agenda item 1, I seek the agreement of members to take agenda items 6 and 7 in private. Are we agreed?

Members *indicated agreement.*

Subordinate Legislation

Scotland Act 1998 (Modification of Schedules 4 and 5 and Transfer of Functions to the Scottish Ministers etc) Order 2015 [Draft]

09:02

The Convener: Item 2 is a draft Scottish statutory instrument. We have witnesses with us this morning. I welcome John Swinney, the Cabinet Secretary for Finance, Constitution and Economy and the Deputy First Minister; Stephen Sadler, team leader from the Scottish Government's elections and constitution division; and Neel Mojee, policy adviser in the elections and constitution division. I thank the Deputy First Minister, in particular, for coming to the meeting at such extremely short notice. We are very grateful that you are able to attend in the circumstances. I suspect that you wish to make an opening statement.

The Deputy First Minister and Cabinet Secretary for Finance, Constitution and Economy (John Swinney): Yes, if I can, convener.

I welcome the committee's invitation to attend the meeting and to present the draft order, which will transfer competence to the Scottish Parliament to extend the franchise to 16 and 17-year-olds in Scottish Parliament and local government elections.

The terms of the draft order that you are considering this morning have been agreed by the Scottish and United Kingdom Governments to give effect to the recommendation at paragraph 25 of the Smith commission report, which calls on the UK Parliament

"to devolve the relevant powers in sufficient time to allow the Scottish Parliament to extend the franchise to 16 and 17 year olds for the 2016 Scottish Parliamentary elections".

The powers that are to be devolved through the section 30 order, subject to agreement in this Parliament and at Westminster, are narrowly focused on enfranchising 16 and 17-year-olds. Full powers over Scottish Parliament and local government elections will follow later, through the proposed Scotland bill.

The Scottish Government is satisfied that the draft order that is before the committee will enable the Scottish Government to introduce legislation to lower the voting age for future elections for the Scottish Parliament and for local government elections in Scotland. The draft order also transfers the power to legislate to make provision about registration in order to give effect to any reduction in the minimum voting age. That will allow us to build on one of the key democratic triumphs of the referendum campaign.

As I indicated in the chamber on Tuesday, those of us who witnessed the engagement and enthusiasm of young people as they exercised their democratic rights saw the value of their participation in and their impact on the process. Since the referendum, I have been delighted to see unanimous support across the Parliament for lowering the voting age to 16, and I hope that that support will be demonstrated by agreement to this section 30 order in time for it to be considered by the Privy Council on 19 March.

At the start of the week, the House of Lords Select Committee on the Constitution published a report on the order. Prompted by your question on Tuesday about the report, convener, Parliament was given the opportunity to make its views known on the points that were raised by the House of Lords committee. The views that were expressed on Tuesday were clear and unambiguous: the decision on whether—and if so, how—to lower the voting age is one for the Scottish Parliament to make. Subject to parliamentary approval of the draft order, the Scottish Government will shortly produce legislation setting out detailed proposals to achieve that aim, and the parliamentary stages that the legislation will go through will provide Parliament with the usual opportunity to consider the details, to seek public views and to debate our proposals.

I look forward to discussing those issues with the committee.

The Convener: Thank you, Deputy First Minister. The committee now has a chance to make comments and ask questions, and the Deputy First Minister is free to involve his officials in the discussion. Does anyone have any comments or questions?

Rob Gibson (Caithness, Sutherland and Ross) (SNP): In article 5 of the draft order, there is an apparent lack of clarity regarding the extent of the functions to be exercisable by Scottish ministers concurrently with the Secretary of State for Scotland. Do you have any views on that, Deputy First Minister?

John Swinney: I have seen the report of what used to be called the Subordinate Legislation Committee—one day I will remember what that committee is now called. The powers in article 5 are to deal with something that is certainly not an issue from our perspective. There must be an understanding in the draft order that certain powers over registration, particularly individual electoral registration, will continue to be exercised by UK Government ministers. Article 5 contains a recognition that how we act on that issue must be compatible with the steps that UK ministers take. We have no issue with that and understand the requirement. As I have said, the article is focused on activities regarding individual electoral registration and the digital implications of all that.

Rob Gibson: Thank you.

Stuart McMillan (West Scotland) (SNP): Good morning, Deputy First Minister. In its report, the House of Lords Select Committee on the Constitution expressed concern that the extension of the franchise in Scotland goes beyond what the Smith commission recommended and highlighted that there had not been wide consultation on the order. Do you have any concerns about that?

John Swinney: No. On the point about translating the Smith commission recommendations into practice, the view that was settled on in the commission’s report about devolving

“the relevant powers in sufficient time to allow the Scottish Parliament to extend the franchise to 16 and 17 year olds for the 2016 Scottish Parliamentary elections”

is very clearly reflected in what is being taken forward in the order. The additional element is the devolution of responsibility for local authority elections, which the Smith commission provides for in other respects within its wider responsibilities with regard to full powers over Scottish parliamentary and local authority elections following in due course.

The only point of any substance that the House of Lords committee has made relates to the issue of consultation, which will be remedied by the legislation that we introduce. It is not as though this is the last word on the matter. A bill will have to go through the usual channels of analysis and scrutiny that any bill in the Scottish Parliament has to go through, and that will provide the opportunity for a range of stakeholders to make their contributions.

The practical, democratic point at the heart of all this is the Scottish Parliament’s intention to ensure that 16 and 17-year-olds can participate in elections for which we have responsibility. We have form on that, because we have legislated for it on previous occasions for the independence referendum and the pilot exercises for health board elections. I am happy with the agreement that we have reached with the UK Government, and the order will enable us to take forward the proposal in a practical form to reflect the Scottish Parliament’s democratic intentions.

Lewis Macdonald (North East Scotland) (Lab): The purpose and intent of the order are clear, and I think that they are, as you said, cabinet secretary, broadly supported. One of the points made by the House of Lords Select Committee on the Constitution highlighted what it regarded as a difference between provision in the draft clauses for future amendment of the franchise and provision in the order. Is that something that you recognise? If so, what are your views on it?

John Swinney: Again, those issues will be covered by the bill process that the Scottish Parliament will go through. The point that the House of Lords committee missed completely is that the Scottish Parliament will undertake a process of legislation in which it will explore all those questions with its usual rigour. My answer to the point that you raise is, therefore, that all issues will be properly captured by the bill process that we will undertake.

Lewis Macdonald: Would it be fair to deduce that the constructive engagement that you have had with the UK Government on the issue means that the bill will reflect the intention behind the draft clauses that the UK Government has published?

John Swinney: The focus of the draft clauses is on extending the franchise to 16 and 17-year-olds for Scottish parliamentary and local authority elections. That will also be the purpose of the legislation that the Scottish Government will produce.

Linda Fabiani (East Kilbride) (SNP): An apparent concern in the House of Lords committee report is about data protection issues for young people and vulnerable people. We covered that subject extensively in the Referendum (Scotland) Bill Committee, all the members of which had concerns about protecting people in that regard. Was the extensive work that we did in that committee taken into account by the House of Lords? Do you or your team have any concerns at all about how that issue was dealt with in the referendum process?

John Swinney: The issue was highlighted by stakeholders, first, then exhaustively considered by a committee of the Scottish Parliament, which influenced the legislation that the Government produced for the referendum. I have not had any representations from people who are concerned about the way in which the issue was handled for the independence referendum.

It is vital that the issues of data protection, privacy and the protection of vulnerable individuals are all absolutely and comprehensively addressed by the Scottish Parliament. No concerns about those issues were expressed to me in the aftermath of the referendum, which is a tribute to the strength of the scrutiny that was undertaken by parliamentary committees in advance of the referendum. There are lessons to be learned from that process, and there will be strong foundations on which our position should be based in taking forward the order and the forthcoming bill. However, we should not take the view that, just because we got it right in the run-up to the referendum, we will automatically get it right in the run-up to the Scottish parliamentary elections.

We should test the issues concerned with as much rigour as we did previously, and I encourage the committee to do so. The Government's interest will be the same as the Parliament's interest, which is to ensure that there is no breach of privacy and that the interests of vulnerable individuals are properly taken into account. That will be reflected in how the Government interacts with the committee on the question. I invite the committee to be very clear in its challenge to the Government around how we progress the legislation.

09:15

Linda Fabiani: Perhaps, the next time that you are down at Westminster, you can invite the House of Lords to take a look as well.

John Swinney: The concerns and issues that were raised in the House of Lords report about the process that had taken place—or about anything relevant to that—did not take into account the robust process that had been carried out by the committees of the Scottish Parliament and by the Scottish Government.

The Convener: This would be incredible, but if the House of Lords were not to pass the order today, what would be the impact of that on the ability to give 16 and 17-year-olds the vote and get the legislation passed in time?

John Swinney: I am not sufficiently familiar with the timetabling and circumstances of the interaction between the House of Lords decision and the meeting of the Privy Council. However, if the order is not passed satisfactorily and does not reach the Privy Council on 19 March, there will be no section 30 order before the United Kingdom election. In that context, I cannot see how it would be practically possible for the Scottish Parliament to legislate were a section 30 order to be passed at a later stage or, if we were to rely on the proposed Scotland bill taking its course, in time for 16 and 17-year-olds to exercise the vote in the 2016 elections. The crucial date to be reached is 19 March, when the Privy Council will meet—that is fundamental to enabling the Scottish Parliament to commence its legislative process.

The Convener: I understand that the Privy Council will meet on 19 March, so timescales are very tight. The Parliament will have to consider the order next week if we are to meet the deadline for the Privy Council.

John Swinney: If the order is not approved by the Privy Council on 19 March, I cannot see how

16 and 17-year-olds will be able to vote in the Scottish Parliament elections in 2016. The order will not have been approved, so we will not be able to start our legislative process. If we were to wait until after the UK election for another section 30 order to be approved, that would take some time and our window to successfully legislate and undertake the process of registration would be severely curtailed. Therefore, I think that that would be utterly impractical. It would be completely impractical for us to wait for a bill.

The Convener: I thank the Deputy First Minister on behalf of the Delegated Powers and Law Reform Committee—the clerk had to give me a note about that because I never remember its full name either.

I invite the Deputy First Minister to move the motion.

Motion moved,

That the Devolution (Further Powers) Committee recommends that the Scotland Act 1998 (Modification of Schedules 4 and 5 and Transfer of Functions to the Scottish Ministers etc.) Order 2015 [draft] be approved.—[*John Swinney*].

Motion agreed to.

09:18

Meeting suspended.

09:21

On resuming—

Borrowing Powers

The Convener: We recommence with item 4, under which we will take evidence from three experts on borrowing powers. I welcome Professor David Bell, professor of economics at the University of Stirling, Don Peebles, head of the Chartered Institute of Public Finance and Accountancy in Scotland, and Philip Milburn, investment manager at Kames Capital, representing the Investment Association.

We have timed this session to last until about half past 10. To get through things in a structured way, I think that we should look at three aspects: the principles that will underpin the framework to enable borrowing by a subnational Government and any specific challenges around that; further powers on revenue borrowing and capital borrowing and what the appropriate mix would be; and the overall fiscal framework and the institutional bits that will underpin it all. If we concentrate on those three areas, we can probably get through what we need to cover.

Members may direct some questions to an individual witness, but most questions will be addressed to everyone on the panel. I am grateful to the witnesses for coming along today to give us evidence that will help us in coming to our conclusions.

I begin with a general question. The UK command paper containing the draft clauses is relatively silent on the borrowing powers that are to be devolved, indicating that that is a matter for agreement between the UK and Scottish Governments. Do the witnesses consider that legislation should be required in order to devolve powers in that area? In any case, what principles or structures should underpin the devolution of borrowing powers? That is for all three witnesses; I do not mind who kicks off.

Don Peebles (Chartered Institute of Public Finance and Accountancy Scotland): A useful comparator is the introduction of the prudential code for local authorities by the Local Government in Scotland Act 2003. Primary legislation was required to enable the significant change—which it was at the time—that introduced a more flexible framework. Our expectation was that there would almost certainly be some indication or some forward notification of change, but you are right to observe that the clauses are silent on borrowing powers—a point that we made in our written submission.

We are here to talk about borrowing powers, on which there has been much discussion since the publication of the Smith commission report, but there has been nothing firm and fast to indicate that there is certainty that enhanced borrowing powers will be introduced. I see no borrowing powers in the command paper. There are no clauses that indicate anything that even determines a forward requirement for enhanced borrowing powers in any way. That said, if there is an expectation about changes to primary legislation, if that is to come at a future point, the question is what that will actually look like. That is probably what we will go on to debate.

The change in primary legislation for local authorities, which came in all those years ago, removed the largely prescriptive framework, in which local authorities were advised how much they could borrow for capital expenditure, and replaced it with a framework that was significantly more flexible, allowing individual local authorities themselves to determine what was affordable and what was sustainable.

That has been the general debate so far. The expectation was that that kind of framework would be overlaid on Scotland, but we are silent on fact so far, and we are certainly silent on clauses. The useful comparison is with local authorities, for which, as I said in my written evidence, primary legislation was needed.

Professor David Bell (University of Stirling): There is quite a bit of discussion about the prudential code in the command paper. Borrowing powers are coming to Scotland through the Scotland Act 2012 and I guess that there is a real question about that, to which we will perhaps return: will those borrowing powers be sufficient, given the enhanced tax powers? I suspect that they will not be, for a variety of reasons.

In one sense, there might be a bit of a difference from the local authority issue, in that Scotland is relatively large compared with the average local authority in England. There is not necessarily a worry to the same extent that borrowing by local authorities would threaten the UK’s fiscal position overall. Probably, Scotland is still relatively small and that would not be the case. I think that local authority borrowing in England and Wales is around £83 billion at the moment, which, set against overall central Government borrowing of £1.2 trillion, is relatively small beer. It is also important to think about the capital borrowing on the one hand and the resource borrowing on the other; I guess that we will deal with that point.

The command paper contains some discussion, but there is nowhere near enough for us to go on or for us to be able to say how things are going to be. A lot is up for debate and there is a lot of work still to be done before we come up with a set of figures that could be agreed.

I mention in my submission that bailouts will be an issue, and I argue that difficulties between central and subnational Governments are relatively common. I guess that the Treasury will try to avoid difficulties where it might appear that the UK Government would bail out the Scottish Government if it got into difficulty. If the markets believe that that is the case—if there is a belief that there is a backstop—Scotland will be able to borrow at a slightly lower rate. I do not think that I am qualified to say whether that needs primary legislation, but there will be a lot of debate around that issue, I think.

Philip Milburn (Investment Association): Thank you all for your time this morning. I completely agree with Professor Bell. I see my role here as to say what the markets would want. The markets will always want as much certainty as possible. The stronger the framework and the stronger the legislation, the more the markets will understand and the less they will charge as a risk premium. Basically, strong legislation is what the markets generically—not me specifically—would look for.

09:30

The Convener: That is probably as good a place as any to start in terms of the institutional framework. I will begin a discussion about that and anyone who wants to come in can let me know.

What advice can the panel give us that will enable us to advise the Treasury or any incoming UK Government what that institutional framework might look like and how it would operate? That will be the thing that will underpin whether we get the credit ratings from Moody’s and Standard & Poor’s that we require, and at the level that we require. If you have any advice on that, now is the time to let us know. It is a big question, I know.

Professor Bell: I suppose that there is an institutional argument about whether there should be a third party that is holding the ring around this particular question, so that it is not all driven by the Treasury.

The issue will probably arise in relation to Wales and it might well arise in relation to Northern Ireland. For all we know, given yesterday’s developments with regard to Manchester getting control over national health service spending, it might arise in relation to some of the larger local authorities in England.

The whole framework is moving around at the moment and nobody is quite sure where it will settle. It is reasonable to ask whether there should be an external body that looks at borrowing and which has the confidence of the markets and can give some of the certainty that Philip Milburn was talking about.

Philip Milburn: I apologise in advance for the fact that my question probably raises more questions than answers—I am a typical financial practitioner.

There are quite a few questions that need to be answered. One of the most important is what will service the debt. Will it be the Scottish tax revenue or the Scottish tax revenue plus the remaining transfers from Westminster? Obviously, there will continue to be a mix, because of who collects. The assumption, generally, is that it would be all the tax-raising power that would service the debt.

The next question concerns where the interest payments will rank. Obviously, interest payments rank about equivalent to all other spending. We can take the Californian situation as an example. Admittedly, California was in a fiscal mess, which is why the system was set up this way. There, the interest payments are senior to many things, such as teachers' wages, pensions and so on. That is politically close to unpalatable in most countries nowadays but, again, it is to do with certainty. All that the markets want is to have interest paid on money that is loaned and to get that money back. There are almost institutional questions around that.

The other thing that I thought was quite interesting, which Don Peebles referred to, is that there is not a lot of explicit language in the command paper. However, all the numbers that we have seen are absolute numbers of potential debt raised, whether it is the £2.2 billion or the £5 billion that Don Peebles has modelled in his entries. I think that an ad valorem limit that uses a percentage of gross domestic product or something would—sorry to use dreadful English—future proof the system so that you would not have to go back and renegotiate legislation every five, 10 or 15 years and get into the same problems that the US does with its debt ceiling. An ad valorem limit would be preferable to an absolute limit.

Don Peebles: It is worth putting all this into context. We might have leaped headlong into detail, which might be the fault of us practitioners, as that is what we love to do.

David Bell was right to draw attention to the staggering size of the UK's outstanding debt, at £1.3 trillion. We started off speaking about local authorities. The outstanding level of debt in Scotland is £15 billion, and around £12 billion of that debt is local authority debt. It is important to keep that sense of scale.

It is also important to remember that, although risk is associated with debt and borrowing, borrowing is not a bad thing. It can be quite important for Government to implement borrowing policies on a short to medium-term basis, although there is a long-term consequence associated with that.

In managing that risk, it is right that there is a formal framework that will be a combination of primary legislation, regulation and professional practice, which we can see in other parts of the public sector. In operating all that, the point is to enable local or national government to generate the money necessary to implement policies. It is equally important to note that borrowing in itself will not give anybody any more money—not one penny more—because all we are actually doing is rescheduling tax receipts, so it is a timing issue. That means that the key concern is intergenerational impact—that is, the extent to which one generation benefits by expecting later generations to foot the bill. However, that should be seen in context.

Professor Bell: On why the Treasury is very interested in the issue, my understanding is that for international agreements around debt, all public sector debt matters to the UK, not just central Government debt. That includes local government debt and it would include Scottish debt. Under the Maastricht agreement, a limit of 60 per cent of GDP is set for public sector debt, which would include the kind of debt that we are talking about.

Philip Milburn's point about the pecking order of interest charges is important. We are already spending close to £1 billion out of departmental expenditure limits on private finance initiative repayments. We have an interesting situation whereby around £2.6 billion of welfare spending might come to Scotland and we could make a case for some of that to go into DEL, but even welfare spending can come up against the question of where it would lie in the pecking order if there was an issue around interest charges and they had to be the first commitment that was met. Work needs to be done on the interaction between the different parts of the Scottish budget, because the introduction of welfare payments changes the landscape massively. How Scotland deals with that is extremely important.

Alex Johnstone (North East Scotland) (Con): I want to go back to a small point that was made earlier, so that I can understand it. Philip Milburn suggested that Scottish borrowing should be serviced exclusively from Scottish tax revenue rather than from global income, including the block grant. Is that the general view? Is that a strict rule that we ought to apply?

Philip Milburn: Sorry—I may have misrepresented the situation. The markets would need clarity about whether borrowing was serviced by purely Scottish taxes, the mix of which is changing, or taxes that include money raised in Scotland that goes to Westminster and comes back again. My assumption, which I think is reasonably safe, is that the debt will be raised on the whole amount of tax raised, rather than a split part of it, because by definition the larger the pool of tax-raising powers that you have a claim over, the less risky the debt is.

There is a definition aspect around how independent you want the debt to seem. On David Bell's point about whether the debt will be fully consolidated into the UK, if the answer is yes, then you might as well go for cheaper debt that is reliant on the whole tax base. However, if it is going to be non-consolidated or potentially non-consolidated debt, then you would go for the Scottish tax only.

Given what I do for a living, I am not legally allowed to give investment advice, so my personal opinion is: go cheap.

The Convener: We are not in private session, so—[*Laughter*.]

Alex Johnstone: You do not see the size of Scottish tax revenue limiting Scotland's ability to use its borrowing powers.

Philip Milburn: Correct.

Alex Johnstone: Other than in the most practical sense, which is that we can borrow only what we can afford.

Philip Milburn: Yes.

Professor Bell: If I can jump in, income tax will generate about £11 billion a year and half of VAT receipts will add another £5 billion or so. We are talking about the Scotland Act 2012 potentially giving us £2.2 billion to spend on infrastructure. The servicing costs on that would go nowhere near the revenue that would be raised from income tax and VAT together, so I do not think that, in the first instance, that would be much of an issue.

Don Peebles: Alex Johnstone is right. The key word is affordability. The likelihood is that a considerable raising of risk across the basket of all taxes would be expected. The consideration for policy implementation would be what is affordable and whether that is sustainable over generations.

Linda Fabiani: I am looking for clarification on an issue that was mentioned at the start of the discussion. It was quite clear from the Smith report that, with more borrowing powers, there would need to be a prudential borrowing regime. There was a lot of discussion around that matter on the commission and how that would be a sensible way forward. There was also a recognition that local authorities have more borrowing powers than the Scottish Government.

Paragraph 1.2 of the executive summary in the submission from Don Peebles says that there is a potential omission in that the enduring settlement document does not include the further borrowing powers that were called for in the Smith report. The "Borrowing for capital spending" section of the enduring settlement document recognises what the Smith commission agreement requested in that regard, but it then says:

> "The 2012 Act already provides the Scottish Parliament with specific powers for capital borrowing, as set out above."

I find that quite confusing. It is clear that we do not have a prudential borrowing regime—that is what was requested—but the document says that we have that power. What are your views on that?

Don Peebles: That is exactly right. As I said in my opening comments, the discussion and the recommendation from the Smith commission was for the introduction of a prudential borrowing framework. The expectation was that that would translate through to the clauses, but it is not there. The command paper discusses the issue as though there will be a prudential framework, but the trigger point, which would be a proposal for primary legislation, is not there. Therefore, we can talk about a framework, but we do not have one and we do not have the basis to enable one to be introduced.

Scotland's statutory borrowing power is capped at £2.2 billion. It is perhaps worth comparing that with the experience of local authorities a number of years ago, when central Government in effect prescribed a cap. The cap was removed and the introduction of a more flexible framework enabled public bodies—local authorities—to have regard to affordability, sustainability and prudence and to borrow at a level that was more akin to local need rather than central prescription. You can see how that similarity was expected to be overlaid here.

I reiterate that, as much as we are talking about borrowing powers, we do not have the infrastructure set out to enable us to have a meaningful discussion about borrowing powers. I see no proposal for borrowing powers.

Linda Fabiani: Therefore, we are no further forward.

Don Peebles: Statutorily, we must adhere to the £2.2 billion cap, plus the extra 10 per cent.

The command paper makes an interesting reference to the prudential borrowing framework not being

> "aimed at increasing the amount of capital expenditure".

That is an interesting indication. That may well be the case, but the aim was to introduce flexibility and it is that flexibility that Scotland as a country would be looking for.

Linda Fabiani: We would be able to administer rather than simply have powers to change.

Don Peebles: Yes, because the power to change is restricted—as it stands, the cap is £2.2 billion.

Linda Fabiani: Thank you.

Lewis Macdonald: I have two supplementary questions on related aspects. I would like to understand better the experience of the prudential framework, which is a code to which statute requires local authorities to have regard, which can have a weaker meaning in Scots practice than it does in England, as I understand it. How far has it been successful in delivering what was intended?

Philip Milburn said that the market will look for the strongest possible legislation and framework. From a market perspective, is there a significant difference between the borrowing provision in the 2012 act and the prudential framework?

09:45

Don Peebles: I will talk about the practical operation. There was a fairly seamless move from what those of us who are familiar with local authorities would call the section 94 regime into the prudential code. Under section 94, central Government specified to each local authority how much it would be allowed to borrow; local authorities were prescribed a level for capital expenditure, which was a proxy for borrowing and they would borrow up to and including that level. That changed with the introduction of the prudential framework on 1 April 2004 and we moved from central prescription to local flexibility.

Local flexibility was placed firmly on the shoulders of not only the chief financial officers, but the local politicians. Rather than being told specifically what they could afford to spend on capital, the responsibility was theirs, and it had regard to strategic planning and local needs. It was seen as a framework that was not only more flexible, but in keeping with a more strategic approach to how local services should be delivered.

The control mechanism was twofold: the regulations underlying the primary legislation and the professional code of practice. The code of practice—a prescribed code for professionals within local authorities—required the chief financial officer to report regularly to elected members. That placed responsibility, for the first time, on elected members to be aware of, have regard to and approve the capital plans going forward.

I am not aware of any qualification to the financial accounts of a local authority in the 11 years since the prudential framework was introduced. Audit Scotland is in the process of finalising a report, which will probably come out next month, about borrowing and treasury management in local authorities. From the information that I have—not only from Scotland but throughout the UK, where the prudential code is in operation—my feeling is that it is successful and has operated as expected in allowing local flexibility and freedom to be utilised fully by local authorities.

Lewis Macdonald: Without oversimplifying, would it be fair to describe the 2012 act provision as parallel to the section 94 provision?

Don Peebles: Yes, that is a fair comparison.

Professor Bell: That may be true, but not all local authorities are borrowing at triple A—it is a little more expensive than for central Government. It is not triple A any more, although it is nearly triple A.

The Convener: Do you have anything to say, Philip?

Philip Milburn: No, I have nothing to add.

Lewis Macdonald: I wanted Philip Milburn's view from a market perspective on whether there is a difference between a prudential borrowing regime and one that is capped and directed from the centre.

Philip Milburn: It would be nuanced enough that it would be considered, but it would be way down the list of priorities. I imagine that most people would gloss over that in comparison with other issues.

Lewis Macdonald: Right.

Duncan McNeil (Greenock and Inverclyde) (Lab): In an attempt to simplify, because much of this stuff is pretty difficult for me, I will go back to a recurring theme that I have raised when we have dealt with each of the issues that have come out of the Smith commission. Reading the papers and the evidence, are we at the stage where we need to get the institution and framework in place—those understandings—and take into account the UK and European influence, before we get to any of the other issues about the level of borrowing?

If we get in place the framework that deals with risk, the level of borrowing and the security of the markets and the financial institutions, will that give us the potential to address how we service the debt, how we issue bonds, for goodness' sake, and all that? Is it chicken and egg here? Do we need to settle those issues?

Professor Bell, you expressed little interest in institutional frameworks in your submission, but is having such a framework not the foundation from which everything else will flow?

Professor Bell: The simple argument is that if that framework is not in place, the markets will take it out on you. If there is uncertainty associated with issues such as how the block grant adjustment will work, which is hugely important for Scotland, how the welfare moneys will be transferred and whether any short-run adjustments will be made to grants for political reasons, as may be going on in Northern Ireland at the moment, everyone will pay a little bit more for the debt than they need to. It seems to me that that is what will happen until the markets see a clear framework.

It is necessary to go beyond the prudential regime. We are now talking about the macroeconomics of Scotland and the UK as a whole, because the borrowing positions that are taken by local authorities do not matter hugely, but the position of the country as a whole matters for borrowing purposes and for all kinds of things. We are in the present austerity regime largely because our borrowing got out of control towards the end of the last decade.

Don Peebles: That is true, but it is worth bearing in mind that the national borrowing limit stands at £2.2 billion, whereas the outstanding debt for local government is £15 billion, in effect. Therefore, it is possible to come to the conclusion that, even now, local authorities have considerably greater powers than the national Government.

It is worth reiterating—I could not agree more with Duncan McNeil's point—that we have to have the framework in order to know what we are talking about. Otherwise, the three of us will revert to type and start talking about the concerns, the risks and the problems associated with having borrowing powers. We must come back to why it is a good thing. The point of borrowing powers is to enable you as politicians to have available the full suite of fiscal powers that you need to deliver positive policies to benefit the people of Scotland. That is what the issue is about. It should not be a technical issue. We can handle that, but you must have the tools to enable you to do your job and to make your decisions.

Philip Milburn: Don Peebles has got to the heart of the matter. My assumption is that the framework will be put in place at some stage if there is the political desire and will to do so. That might be a bold assumption. Once that framework has been put in place, the question will be whether there is a desire to use it—there is not much point in putting it in place if there is no desire to use it—and what the interest cost and the intergenerational cost that Don Peebles talked about will be.

Duncan McNeil: I mentioned the European agreements that we are involved in and the relationship that needs to exist at UK level if we are to secure some of that money. Is there an issue with the whole of Scotland's debt that we need to have some discussion with local authorities about? Do we need to make sure that central Government will not use up all the borrowing, as a consequence of which there will be less borrowing for local authorities?

Don Peebles: My understanding of the way in which the debate has gone is that the intention of the flexibilities that have been discussed is to enhance rather than to limit any existing powers. I would not anticipate—

Duncan McNeil: But Professor Bell says that we can double the present cap, if we get the frameworks right, so I would describe the cap as low. That needs to grow.

Professor Bell: If you are thinking about all of Scotland's debt, one issue is what proportion of the PFI debt should be brought on to the balance sheet. That has been a very contentious issue for the UK as a whole over the years. As I have said, around £1 billion is going out each year just to service that debt.

There is a good argument for having a total view of the indebtedness of all the public bodies in Scotland because there is the question of what happens if something goes wrong. Who will bear the cost of that? Suppose that one of our local authorities failed to abide by the prudential regime and got into trouble. Who would bear the cost of that? Would the Scottish Government do so? One might expect that that would be the case, but who knows? At least I do not know the answer to that question. Assuming that things will always work out is quite a strong assumption over time.

The Convener: Something is not barking here. The Scotland Act 2012 talks about a limit of £2 billion. The Scotland Bill Committee sensibly came to a conclusion that the figure should be £5 billion, I think. Do the three of you support the idea that the figure should be closer to £5 billion? Why should that be? I would like to get that on the record.

Professor Bell: If there is a continuation of the capital grant element as part of the spending review, the DEL will be allocated for the next two or three years ahead. There is normally a resource component and a capital component, and transfers can be made from resource into capital but not in the opposite direction. Therefore, it seems to me that the borrowing power would be conditional on how much money is received from that source through the block grant. Arguably, too little has been spent on infrastructure in recent years. There is a multiplier argument that money that is spent on infrastructure has a more long-run beneficial effect on growth. Unfortunately, I do not think that I can give the committee an answer on the amount until I know how much capital is coming through DEL.

Don Peebles and Philip Milburn mentioned the intergenerational burden. We have to be very confident that we are in a position to make decisions so that our grandchildren will say, “That was the right decision to make. We’ve got ourselves into this much debt, but we have assets, such as the new Forth road bridge, that offset that and those are things that the last generation did for us.”

Don Peebles: The answer to the question, in effect, is what you as politicians will want to do. What are your priorities? How do you want to deliver them? If an investment in infrastructure is a priority, that might necessitate an increase from somewhere around £2.2 billion to a figure that is closer to £5 billion.

Ultimately, it will be about what is affordable and sustainable. Talking about fixed numbers almost takes us into the realm of credit card limits, whereas we are looking at a system in which there is flexibility for the Scottish Government to enable it to take decisions, depending on economic circumstances and the policies that it wants to implement. As I have said, it is about the Scottish Government having to hand a suite of fiscal tools to enable it to take all the necessary decisions.

I know that that is perhaps an unsatisfactory answer in that I am not giving a specific figure.

The Convener: It is not unsatisfactory.

Don Peebles: However, we are looking at flexibility. Whether the figure is £2.2 billion, £5 billion or greater than that is irrelevant compared with what politicians will want to do on a national basis.

10:00

Philip Milburn: I alluded to this earlier in talking about an ad valorem limit. I would try to avoid a hard limit, be it £2.2 billion or £5 billion. I would veer towards a form of percentage of Scottish GDP—obviously, it would need to be negotiated—so that a countercyclical measure can be put in place. If you assume there is a downturn in recession and GDP shrinks by 2 to 3 per cent, that starts to be a sensible area.

My answer to the second question is exactly what Don Peebles said. The issue is the serviceability of the extra debt, or the service cost of it, and the effect that that has on the following years as well. That said, I would always look at using a percentage in order to ensure that the limit that is set could last for the next 10, 20 or 30 years, assuming—as everyone does—that the Scottish economy should grow nicely over that period.

The Convener: That seems to be a progressive and sensible way to go about it. Of course, the Treasury might not see it that way, because it wants to put limits on it; that is why it wants to have the discussion.

Stuart McMillan: The question that I was going to ask has been partly answered in the past couple of minutes, but there is another element to it. The words “certainty” and “uncertainty” have been used. It could be argued that the £2.2 billion limit would provide an element of certainty about what the Government could do, whereas the use of a percentage of Scottish GDP, which Mr Milburn suggests, would present an element of uncertainty about what the Government could borrow if there was an economic downturn.

Philip Milburn: I completely agree—you are right. The absolute cap of £2.2 billion provides certainty. Please do not take this comment as flippant in any way but, in the context of the international market, £2.2 billion is such a small amount of money that it would be implicitly assumed that, if the Scottish Government got into borrowing difficulties, there would be some form of bailout from the UK Government. That would be implicitly but not explicitly assumed by the markets.

Stuart McMillan: Another element is that economies are cyclical. In a hypothetical situation, if the £2.2 billion limit had been in place over the past seven years, the Scottish Government would have had certainty and the flexibility to invest. However, if we had had a percentage of GDP limit, the Government’s opportunity to stimulate the economy, particularly through infrastructure investment, would have decreased when the economy went down. Am I correct in that?

Philip Milburn: I would like to go first on that question. This is not any comment on the Scottish Government whatsoever; Governments around the world often talk about balanced budgets and have their debt-to-GDP and fiscal deficit ratios, such as the Maastricht 3 per cent fiscal deficit and 60 per cent debt-to-GDP limits. What Governments around the world always forget to do is pay back the debt in the good times, so they find themselves banging up against the limits exactly when they should be spending.

As you say, Governments might want to spend when they cannot because of a limit, but the idea is that they should show prudence and pay back the debt in the good times. That is the hardest bit. It is good fun spending money, and building infrastructure is a popular thing to do. Paying money back is the hard bit. I would argue that the GDP limits are sensible, provided that there is a framework or agreement to make sure that budgets are balanced through the cycle, so that

Governments have the flexibility to use the firepower in the downturn.

Professor Bell: People might want the limit to be a share not of current GDP but of cyclically adjusted GDP. In that way, the cyclical effects are taken out. Of course, that opens up a bunch of arguments that have been played through in the past decade on what exactly the cyclically adjusted level of GDP is, which is certainly an issue.

We have in the past few minutes glossed over the borrowing powers under the Scotland Act 2012. The £2.2 billion is for infrastructure; the act does not say that it is for combating the effects of recession. There is provision for resource spending, which is really about getting tax revenue forecasts wrong. My paper says what would be the worst-case scenario for getting it wrong. That would create an immediate problem, as it did in the UK in 2009-10, when income tax revenues went way below what had been forecast. There is a piggy bank to deal with that issue as well as the longer-term capital infrastructure issue. The enduring settlement document tries to make that distinction fairly clear.

Lewis Macdonald: I will pick up on David Bell's point about the assumption that the Scottish Government or the UK Government would bail out a local authority that borrowed irresponsibly. Does that comment imply that some sort of statutory back-up is needed? Would the same point apply to the UK Government bailing out a Scottish Government that got it wrong financially and found itself in such a situation?

Professor Bell: The view could be taken that the Scottish Government can borrow as much as it likes as long as it is absolutely clear that the UK Government will not bail it out if it gets into difficulties. Countries find it incredibly difficult to stick with a no-bailout clause. We have seen that in play this week with Greece. It thought that there was a no-bailout clause and the Germans were very strong on the issue, but ultimately, another compromise was found. That is an extraordinarily difficult thing to deal with.

Lewis Macdonald: I presume that that is because, as long as Scotland is part of the UK and part of the UK's public sector borrowing profile, it is in the UK's interests to bail it out.

Professor Bell: There is the too-big-to-fail argument, but it does not matter whether Scotland is too big; it is not in the UK's interests for Scotland to get into fiscal difficulties. That is absolutely clear and it might affect the market thinking about debt.

Don Peebles: On the point about local authorities and the possibilities that could transpire, under the 2003 act there is a reserved power for the Scottish Government that means that it can revert to central control, in effect. The primary legislation that is coming along might have a similar protective clause.

The Convener: I was going to go to Mark McDonald but, to keep a political balance, I will call Alison Johnstone first.

Alison Johnstone (Lothian) (Green): I will pick up on Lewis Macdonald's question. David Bell's paper suggests that bailouts might be more likely when the central and subnational Governments are of the same political persuasion. Is there international evidence to back that?

Professor Bell: I am happy to share the paper from which I drew that evidence. There seems to be no regularity in the fiscal arrangements that exist between national Governments and subnational Governments. The researchers who looked into that did not find that a particular form of federal system resulted in the need for bailouts. However, they found that, when the subnational Government and the central Government shared the same political allegiance, a bailout was more likely. The argument was not that the subnational Government was too big to fail; it was about whether it was formed by the same party.

Alison Johnstone: But bailouts occur when the Governments do not share the same political beliefs.

Professor Bell: They do. I was quite surprised by the countries that I listed. Sweden, Germany and Australia were three of them, and we assume that those countries are fiscally responsible.

Alison Johnstone: I would appreciate seeing the paper.

I return to Linda Fabiani's line of questioning. The issue is the lack of a clause, if you like. Professor Bell said that borrowing powers are an essential part of any fiscal framework and Don Peebles suggested that

"The draft clauses ... do not however provide for an extension to the existing borrowing powers".

Are you surprised? Has there just been an oversight? Is it a surprising oversight?

Don Peebles: I assume that that is an omission or that a key consideration of the command paper's draftsperson is that they are looking for some other arrangement. The language of a prudential framework is used in the command paper, and readers could be forgiven for thinking that a prudential framework of enhanced borrowing powers will come along, but there is no substance to that—nothing points us in that direction. In the absence of anything else, I assume that that is an omission.

Alison Johnstone: Is the intention unclear?

Don Peebles: I thought that the Smith commission was clear. The command paper picked that up, but it does not have the obvious corollary of a clear clause setting out what would happen, which I thought it would have, given the direction of everything else.

Professor Bell: I agree with Don Peebles, but I wonder whether the issue was just a victim of the hurried drafting and the fact that agreement could not be reached in the time available.

Alison Johnstone: Does Mr Milburn have a view?

Philip Milburn: I will stick with what the experts say, if that is okay.

Alison Johnstone: That is fine.

Mark McDonald (Aberdeen Donside) (SNP): My question follows on nicely from Alison Johnstone's. At the moment, a capital grant is provided to the Scottish Government. Additional borrowing powers had been expected to supplement that, but it has been suggested that those powers might be a replacement, which would restrict flexibility over capital investment. How are things likely to go regarding that capital grant?

Professor Bell: The wording of the enduring settlement document was not entirely clear on that point. Don Peebles explained what happens with local authorities. The big question is what would happen to the block grant if there was a change in the status of its capital DEL element. Would the block grant stay the same and would Scotland get to decide on the allocation issue?

The allocation between resource and capital is always set up by the Treasury in the spending review. Each department gets a resource allocation and a capital allocation and it cannot reduce the capital allocation. I am afraid that that is another uncertainty: we are not absolutely clear about not only whether Scotland might go to a prudential regime approach but what that might mean for the size of the DEL grant. To take away the £2.3 billion or so would be pretty drastic.

Mark McDonald: So in your consideration, that £2.3 billion would become part of a lump-sum resource allocation, and it would be open to a future Scottish Government to make an allocation from resource to capital. The Scottish Government can make resource-to-capital allocations at present, but a capital DEL element is identified. Will that identification go, which would leave it to the Scottish Government to decide its own capital allocation from within a resource budget, or are you suggesting something different?

Professor Bell: I am just speculating, but what you suggest is a possible outcome. Depending on what happens with the political outcomes in May and the spending review that follows, further cuts might be made and the Treasury might decide to allow departments to determine DEL and resource limits, but that is just speculation on my part.

10:15

Mark McDonald: Sure—I understand that.

I would be grateful for input from Mr Peebles and Mr Milburn on the point; in regard to future planning, it concerns me that there appears to be a lack of clarity about it. From this committee's perspective, we need to determine whether what comes to Scotland matches up to what was agreed by the Smith commission and we need to determine its appropriateness for use. Do you agree that, as things stand, further clarity is needed on what happens to the capital grant allocation?

Don Peebles: Against the background of the whole consideration of borrowing and capital expenditure, there has to be clarity. In effect, you have to be clear about why you want it. I come back to the point that it is a positive thing. We do not necessarily want to get caught up in the technicalities of terminology in the HM Treasury letter—there is not a lot that we can do about that. You need to ask what you are actually looking for. You are looking for the fiscal tools to enable you to deliver effective government.

Depending on the state of the economy and on the policies of the day, it may well be that in certain years the Government borrows more than it has previously or shifts money from one resource to another. That is the kind of freedom that you are looking for. Your choices will be wholly dependent on what, as politicians, you decide that you want to do, rather than on another department deciding what you should be doing.

I come back to the comparison with the move from section 94 of the Local Government (Scotland) Act 1973 to the prudential borrowing framework arrangement in local authorities. The whole point of that change was that it clearly shifted central prescription from Government to the local arrangement in Scottish local authorities. A similar shift could be undertaken from central Government to the Scottish Government.

Philip Milburn: I reiterate that currently the big unknown is what the size of the block grant will be over the next couple of years. A lot of the taxing ability is already known; the big unknown is what the compensatory decrease in the block grant will be. That is the bit that needs nailing down first—forgive the terminology—before you can know whether you need or want to borrow.

I echo the earlier comments that, even once you have your steady state and know roughly how much you have to spend each year, having flexibility around it is a necessary power so that you have local tools at the Scottish level to make countercyclical or infrastructure investments.

My personal view is that as well as having the on-going amount—the amount that you know you have to spend year on year—having extra power over capital allocation, in order to be able to implement big projects if one so desires, is a necessary tool to provide the additional flexibility that is desired.

Mark McDonald: If it were to go the other way from what Professor Bell has suggested might happen—if that £2.3 billion were to be removed and essentially had to be replaced through borrowing—the concern would be that we would be borrowing £2.3 billion just to stand still before we could then exercise further borrowing powers.

Philip Milburn: It is actually worse than that, in that you would be borrowing to stand still and then the interest on that borrowing would start to compound. It is that bad.

The Convener: There are a couple of quick supplementaries on this issue, and then I want to get into a couple of other areas before the end of the session.

Linda Fabiani: My supplementary might be a confusing one, but something struck me when Mark McDonald was talking. If we have only the admin power and not further fiscal power, and if we are relying on flexibility within that admin power, how does that then affect things such as the Treasury clawback rules on end-year flexibilities, which were changed a few years ago? Would we have to set up particular types of purely draw-down borrowing? Would that be taken into account in the annual calculations?

The Convener: I think that David Bell mentioned that in his paper.

Linda Fabiani: Yes, David mentioned the changes to end-year flexibility in his paper.

Professor Bell: Those changes took place because the Scottish Government successfully argued that Scotland was building up a considerable underspend in its department expenditure limit budget. There was a clear case that that should be spent in subsequent years, and it was.

The issue goes back to the need for clarity. As I point out in my submission, on the one hand, there is the possibility of errors in forecasting the taxes that may be generated. If we make the kind of errors that were made in 2009 and commit to spending on that basis, there will be an immediate need to borrow for that reason. On the other hand, there is a spending risk, which I do not think people have really noted in the current debate. We may not spend in a year what the plans say we are going to spend.

There is a forecast risk and there is a spending risk, and a short-term facility is needed to deal with that. That would have to be determined by the framework that we are all talking about, but it does not exist and we are not really sure what it means. One would think that errors of a short-term nature would have to be dealt with in two or three years, whereas the borrowing for capital reasons would be longer-term borrowing and it might go to the markets.

All that I am doing is adding to the uncertainty—sorry about that. That reveals further the need for a clear framework, which we have all been talking about, so that all the issues can be discussed together. I suspect that that has to be done at UK level, because it is not only Scotland that is in this game. It might well involve Wales, if it gets income tax power, and Northern Ireland, if it gets corporation tax power.

Philip Milburn: One important factor that Linda Fabiani identified is the clawback of underspend at the end of the year. In any future regime, it would be prudent not to have that clawback as such, because you will want to be able to hang on to that money for future years. One could almost target an underspend each year, because it is much easier to solve an underspend than an overspend.

Don Peebles: The reason why we use terms such as “end-year flexibility” and “clawback” is because Scotland does not have the power to hold reserves as such. The current system is part of HMT’s overall look on an annual basis and is not based on a long-term view. One recommendation that we made to the Smith commission was that part of a significant fiscal suite would be the power to hold reserves. There is reference to a small reserve in the command paper but not to the full powers that we are looking for and that we think are necessary.

Alex Johnstone: We have got into the area that I was going to go into. It is great fun to have capital borrowing powers, because we can spend money on stuff and put it on tick, but good housekeeping requires us to address the revenue issue. As you mentioned, there is no power to hold a reserve. What proportion of Scotland’s borrowing ability will have to be held in reserve in order to ensure that we can overcome any tax volatility year on year?

Don Peebles: You are right to refer to volatility. As power over the income base increases, volatility will be more of a consideration and it will have to be factored into any calculations on affordability and long-term sustainability. Looking ahead, the Government will have regard to that and will consider the extent to which the revenue resources are utilised in a single year.

What I think might happen economically is that the Government will set aside some of those revenue resources to build up a reserve from which it can draw down in future. There is no statutory requirement or specific requirement in guidance about the percentage of reserves that should be held. Again, that is down to local determination and consideration of the economic circumstances and other information at the time.

Alex Johnstone: Would it be fair to say that the risk of tax volatility is relatively low in the proposals compared with what it might have been if, for example, oil and gas revenue had been devolved? In that case, the risk of volatility would have been so big that the borrowing powers to cover that year on year would have been disproportionate and it would have been virtually unachievable.

Don Peebles: I am afraid that I have no evidence to give on that specific question.

Philip Milburn: This is not a political point, but on the basis of pure economics the answer to your question is yes. If oil revenue were to be devolved, it would, of course, add to volatility—good volatility in the up years and bad volatility in the down years.

I do not have any rough numbers in front of me—I am sorry about that—but under what is being devolved in the command paper the tax take in Scotland will become more geared to Scottish economic growth than it was before and it will go up from roughly the high single-digits pence in the pound to mid-teens pence in the pound. The issue is the amount of extra spending power Scotland has for every extra 1 per cent that Scotland rather than the UK grows, and including oil in that would have added enormous volatility.

Professor Bell: In my submission, I try to work out a worst-case scenario for income tax volatility based on the error that was made in the budget forecast for, I think, 2008-09—or it might have been 2009-10—and what actually happened with income tax revenue. If you translate that across to Scottish income tax take—if, indeed, Scotland gets all of that take—you will find the cost to be in the high £400 millions or that kind of area. I suppose that that is the worst post-war shock to income tax revenues that has been experienced.

The Convener: I suppose that if investment is made in the right places in the good years, if things are managed properly and if there are sufficient reserves in the system, that kind of volatility can be managed out.

In your submission, Philip, you suggest two different ways of treating expenditure in Scotland: first, a "balance sheet for Scotland"—[*Interruption*.] I am sorry—I meant Don Peebles's submission. I could see Philip starting to wonder, "Did I say that in my paper?"

In your submission, Don, you talk about a "balance sheet for Scotland" approach and a "'whole of Scotland' accounts" approach. Which is better?

Don Peebles: What we are actually interested in is accountability. If we are getting new powers to do different things with expenditure and income, is the old form of accountability going to be appropriate? In some cases, it might be, but if we think about the proposals as a country, the fact is that we do not necessarily report as a country.

We report on statistics as a country, but not on audited accounts, and we heavily favour having a balance sheet for Scotland that would form part of whole-of-Scotland accounts that would allow us to assess the overall performance of the country and its public services. At the moment, we cannot do that without aggregating the audited financial statements of the nearly 200 public bodies that exist. We therefore favour whole-of-Scotland accounts.

The Convener: I think that, this time, I am right to ask Philip Milburn this question. As Scotland begins to get these powers, the markets' knowledge and interest will begin to emerge. From where I am sitting, I do not have enough information to know whether the markets are being informed about what Scotland is going to get. Should the Scottish and UK Governments begin to warm up the markets to ensure that we enter into this process in an easier and smoother way?

Philip Milburn: The short—[*Interruption*.] Excuse me—I must have lost my voice in shock.

The short answer to your question about the need to keep in touch with the markets is yes. I should emphasise that the amount of debt that can be raised—if it turns out to be just £2.2 billion—is, in international terms, very small compared to the £1.3 trillion of UK debt. However, the market loves certainty, and the more information that you can give it and the more you stay in constant contact with it, the better.

10:30

As for the nuances of the question of how, if this goes ahead, the Scottish issuing entity will be able to issue debt, it might be better to take the necessary steps in that respect once all the other bits of the framework are in place. However, a simplified version would be: get together a presentation pack; trot round Edinburgh, London and a few other centres; and show people the balance sheet that Don Peebles has talked about.

You need to give people information that allows them to judge the strength of the institutions, the legal system and so on—all of which, by the way, Scotland will score very well on. The issue is then the strength of the fiscal position. None of that is particularly Scotland-specific—it is just another country or, in this case, another sub-national issuing entity that wants to issue debt to the markets—so the more information, the better.

In a lot of this, we are arguing about an odd half a per cent of cost on the debt here or there, not about the difference between 2 and 10 per cent. This is nothing more than an estimate, but for 10-year debt we would be arguing about the difference between 2.5 and 3 per cent in interest costs if we primed the market with information.

Professor Bell: I want to support Don Peebles's comments about getting accounts for the whole of the public sector in Scotland. There are accounts for the whole of the UK called whole-of-Government accounts, which take into account state and public sector pension liabilities. Actually, I am not absolutely sure whether the state pension is taken into account.

The Convener: It is not.

Professor Bell: In any case, if you are going to take a view on what will be affordable, you might find those accounts quite salutary with regard to forthcoming commitments that people have not quite figured out yet.

The Convener: Thank you very much for what has been a helpful evidence session. As has been said, all that you have done is raise more questions and concerns, but that is still important.

Stuart McMillan: Can I come in, convener?

The Convener: I am sorry, Stuart, but we have to end this discussion.

I want to set our witnesses some homework, if that is okay—and, indeed, if you have the time to do it. I realise that I am borrowing on you a bit, to use that terminology. An issue that was raised at the beginning of the discussion and which has been touched on the whole way through is the institutional framework from a budgetary and regulatory perspective: what the new regime will be, who will borrow, regulate and scrutinise and how the markets can be reassured. If you have some time, gentlemen, it would be useful to get written advice on such matters. That would be helpful not only to us but to the Finance Committee at a later date. It might well be asking you the same questions, so you will forgive me if that is the case.

I thank the witnesses very much for their attendance and evidence. That brings our evidence session to an end, and we will move into private session. Before we do so, I should tell members that the committee's next meeting will be on Thursday 5 March, when we will take evidence from a range of experts on the draft clauses on the Crown Estate.

10:33

Meeting continued in private until 11:21.

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