



The Scottish Parliament  
Pàrlamaid na h-Alba

## Official Report

### **FINANCE COMMITTEE**

Wednesday 2 December 2015

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**Wednesday 2 December 2015**

**CONTENTS**

	<b>Col.</b>
<b>DECISION ON TAKING BUSINESS IN PRIVATE .....</b>	<b>1</b>
<b>SCOTTISH FISCAL COMMISSION BILL: STAGE 1 .....</b>	<b>2</b>
<b>SUBORDINATE LEGISLATION.....</b>	<b>36</b>
Budget (Scotland) Act 2015 Amendment Regulations 2015 [Draft] .....	36
<b>BLOCK GRANT ADJUSTMENT .....</b>	<b>42</b>

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**FINANCE COMMITTEE**

**31<sup>st</sup> Meeting 2015, Session 4**

**CONVENER**

\*Kenneth Gibson (Cunninghame North) (SNP)

**DEPUTY CONVENER**

\*John Mason (Glasgow Shettleston) (SNP)

**COMMITTEE MEMBERS**

\*Jackie Baillie (Dumbarton) (Lab)

\*Richard Baker (North East Scotland) (Lab)

\*Gavin Brown (Lothian) (Con)

\*Mark McDonald (Aberdeen Donside) (SNP)

\*Jean Urquhart (Highlands and Islands) (Ind)

\*attended

**THE FOLLOWING ALSO PARTICIPATED:**

Professor David Bell (University of Stirling)

David Eiser (University of Stirling)

John Swinney (Deputy First Minister and Cabinet Secretary for Finance, Constitution and Economy)

**CLERK TO THE COMMITTEE**

James Johnston

**LOCATION**

The Robert Burns Room (CR1)



## Scottish Parliament

### Finance Committee

Wednesday 2 December 2015

*[The Convener opened the meeting at 09:30]*

### Decision on Taking Business in Private

**The Convener (Kenneth Gibson):** Good morning, everyone, and welcome to the 31st meeting in 2015 of the Finance Committee of the Scottish Parliament. I remind everyone present to turn off their mobile phones and other electronic devices, please.

Our first item of business is to decide whether to take item 6 in private. Do members agree to do so?

**Members indicated agreement.**

## Scottish Fiscal Commission Bill: Stage 1

09:30

**The Convener:** Our second item of business is to continue our stage 1 scrutiny of the Scottish Fiscal Commission Bill by taking evidence from the Deputy First Minister, Mr Swinney, who is joined by Alison Cumming and John St Clair of the Scottish Government. I welcome our witnesses to the meeting and invite Mr Swinney to make an opening statement.

**The Deputy First Minister and Cabinet Secretary for Finance, Constitution and Economy (John Swinney):** Thank you, convener. I welcome the opportunity to discuss with the committee issues in connection with the Scottish Fiscal Commission Bill, which delivers a long-standing commitment from the Government to give the Scottish Fiscal Commission a basis in statute.

The bill will secure a permanent role for the commission in strengthening the operation of Scotland's devolved fiscal framework through scrutinising the forecasts and projections that support the Scottish budget. The Scottish Government recognises that it is critical to the effectiveness and credibility of the Scottish Fiscal Commission that it is structurally, operationally and visibly independent of Government. Legislating for the commission further demonstrates that by formally safeguarding its independence.

We have sought to learn from international experience in designing our legislative proposals and have reflected on the work of the Organisation for Economic Co-operation and Development and the International Monetary Fund. That work recognises that there is not a one-size-fits-all model for fiscal councils. We have also considered the responses to our consultation earlier this year and the evidence that the committee has gathered over two previous inquiries and at stage 1 of the bill. I thank all those who have contributed to a thoughtful and thorough discussion of the issues at stage 1. The Government will reflect carefully on all the points that have been raised with the committee and any conclusions that the committee arrives at.

As it is for the non-statutory commission, the core function of the statutory commission will be to scrutinise and report on the Scottish Government's forecasts of tax revenues that are published in the Scottish budget. I have previously set out to the committee my view that the Scottish ministers should be responsible for the production of tax revenue forecasts and should be directly accountable to the Scottish Parliament for those

forecasts. Although I appreciate that there is a range of views on whether the commission should prepare official tax forecasts, I believe that the balance of stakeholder and international evidence supports the position in the bill: that the Government will prepare and the commission will independently assess forecasts. That approach maximises the transparency of the forecasting process.

The bill will also give the commission full freedom to determine how it scrutinises those forecasts, and it protects the commission from any actual or perceived direction or interference from the Government in carrying out that scrutiny. If the commission chooses to do so, it can prepare and publish alternative forecasts. Nothing in the bill prohibits it from doing that. It is solely for the commission to determine whether it considers the production of such alternative forecasts to be necessary as a tool to support its assessment of the reasonableness of the Government's forecasts.

The remit of the statutory commission is designed to reflect and be proportionate to the fiscal powers that are devolved to the Scottish Parliament under the Scotland Act 2012, but we recognise that the process of devolution is ongoing and that it is important to provide flexibility to amend the commission's remit in future to reflect any expansion of the Parliament's powers. Respondents to the committee's call for evidence have suggested potential additional functions for the commission under either existing or future fiscal powers. Some members of the committee have also made their own suggestions.

The Government will carefully consider all such proposals, but we are strongly of the view that the core purpose of the commission should be to maximise the integrity of the forecasts and estimates that have been prepared by the Scottish ministers to support the Scottish budget. We must also recognise that the commission is accountable to the Scottish Parliament and has a role in supporting Parliament in holding the Scottish ministers to account. Any proposals for new or different functions for the commission must be viewed in that context.

Taken together, the provisions in the bill and the resourcing proposals in the financial memorandum will create a statutory commission that is well equipped to assure the robustness of the tax forecasts that underpin the Scottish budget.

I look forward to answering the committee's questions.

**The Convener:** Thank you very much for that opening statement.

Obviously, you have been to the committee many times, so you will know that I will ask some

opening questions and my colleagues will then have the opportunity to ask questions.

Let us consider how the Scottish Fiscal Commission has been working to date. When the SFC published its first report, on the same day as the 2015-16 draft budget was published, it described its approach to its non-statutory powers as

"one of enquiry and challenge, followed by response, followed by further enquiry and suggested improvements."

In evidence to us, the Irish Fiscal Advisory Council emphasised that the challenge function should be carried out transparently. However, there is little detail, either in the SFC report or in the Government's methodology paper, about how the process of inquiry and challenge influenced the Scottish Government's methods in producing its 2015-16 forecasts. The committee will be interested in exploring that further as we progress our consideration of the bill.

Has the Scottish Government modified the methods for forecasting devolved taxes based on the SFC's suggestions?

**John Swinney:** The whole process was designed to ensure that we had a robust approach and methodology in place. The methodology that underpins the forecast has been published, with a comprehensive and transparent explanation of the methodological basis for the estimates that the Government has made, which have been challenged and then given assurance by the Scottish Fiscal Commission. In essence, the approach has been to ensure that the commission has the ability to arrive at a conclusion—which is that the estimates are assessed to be reasonable—by a process of detailed scrutiny, challenge and engagement, to establish that there is a sound basis for publishing the forecasts. I think that that serves the public interest.

**The Convener:** Transparency is an issue that the Finance Committee has discussed on myriad occasions. The figures for the initial forecasts were not provided, so it is not possible to ascertain how much they changed in response to the recommendations of the Scottish Fiscal Commission. If the SFC did not assess forecasts as being reasonable, what would be the Scottish Government's response?

**John Swinney:** You raised two points, the first of which is about the publication of one or more forecasts. I cannot see how it would serve the public interest to have a multiplicity of forecasts—I just do not see what the argument is for that. The forecast on which we settle is the one on which the budget is predicated, and I do not think that it serves the public interest for there to be doubt and debate about the robustness of that forecast. I

cannot see the rationale for having a multiplicity of forecasts.

On your second point, about what the Government would do if the commission was unable to certify a forecast as reasonable, the blunt answer is that the Government would have to change its forecast. I have rehearsed this ground with the committee. I would be in a pretty weak position if I stood up in the chamber and told Parliament that I did not have a certification of reasonableness for the forecasts that underpin the budget. I think that that would be the first line of weakness in any Government budget.

That is why my view is that the commission has, in essence, a veto over the forecasts of the Government. My view is that, until such time as the commission is prepared to certify a forecast as reasonable, the Government's forecast cannot be published. I am only ever going to want to publish a forecast that I can say the commission has judged to be reasonable.

**The Convener:** I appreciate the second part of your answer, but the first part was a response to a question that I did not ask, because I did not ask about a multiplicity of forecasts—I do not intend to do so, because I am sure that other members of the committee will explore the issue. My point was that, because the figures for the initial forecasts were not provided, it was not possible to identify how things changed.

Furthermore, it is not clear why the Scottish Fiscal Commission's recommendation on non-domestic rates income led to a change in the forecast while other recommendations that it made did not. Was the need for a behavioural analysis discussed in the challenge meetings between the SFC and the Government? If it was, what was the outcome of those discussions? That all relates to the issue of transparency about how some decisions were arrived at and why other decisions were not taken.

**John Swinney:** I answered the first part of your question in the way that I did because if both a starting position and a concluding position were published, there would inevitably be two forecasts, and I see no merit in there being two forecasts. If a change had been made as a consequence of the interaction with the Fiscal Commission—that was not the case; the commission did not make a change to the forecast that the Government put forward as part of the 2015-16 budget process—it is inevitable that we would have published two sets of numbers. I do not see what value there would be in debating two sets of numbers, when the budget is predicated on a particular assessment of the forecast, which has been judged by the Fiscal Commission to be reasonable.

In relation to the other points that you raised, for me the question is about the transparency of the methodology that we use. That is all published, so it can be scrutinised by anyone who wishes to do so. The Fiscal Commission will bring forward a variety of other challenge issues that will inform that methodology. Ultimately, that leads to the publication of the methodological statement, the publication of the estimates and the publication of the Fiscal Commission's view that the estimates are reasonable. In my view, a pretty comprehensive amount of information is conveyed about the manner of the discussion that has gone on in arriving at a conclusion whereby the Fiscal Commission certifies the Government's estimates as reasonable. I think that that is a pretty comprehensive explanation of the basis on which the estimates are arrived at.

**The Convener:** But it is curious that the SFC's recommendation on non-domestic rates income was acted on while others were not.

**John Swinney:** Some of the commission's recommendations on the forecast will be immediate, but others might be of a longer-term nature. The element of the process over which I have and should have no control is the commission saying whether it considers the estimates to be reasonable. That is the answer that I need to get for me to be able authoritatively to communicate a budget estimate to Parliament. That is clearly the outcome that I want because, as I said in my previous answers, I would be in a very weak position if I were to say to Parliament, "I have a forecast that underpins my budget, but the Fiscal Commission does not believe it to be reasonable." I invite members to consider how long I would last if I gave that explanation of the position to Parliament.

That is why the Fiscal Commission has a veto. It knows that I need it to say that the forecast is reasonable, and I must put forward a convincing argument to it that enables it to judge the forecast to be reasonable.

**The Convener:** I am still a bit puzzled about why some recommendations are accepted and some are not. You accepted the SFC's recommendation on non-domestic rates income, but you did not accept other recommendations that it made. For example, the SFC's report questioned the lack of any behavioural analysis in producing the forecasts for residential land and buildings transaction tax. Given that the Government decided that it was going to make changes to the forecast based on the SFC's recommendation on non-domestic rates income, I would have thought that it would have been better for the Government's position in the round if, at the same time, it had explained why it thought that the

SFC's recommendations in other areas should not be pursued.

09:45

**John Swinney:** We have not said that. What we have from the SFC in relation to the 2015-16 estimates is an assessment that they are reasonable forecasts. There are other recommendations that are more about the longer-term development of the capability for estimating taxes, which the Government is taking forward. We have not rejected them—we are taking them forward. The SFC said that it considered the 2015-16 estimates to be reasonable; that is the basis on which I accepted its view.

**The Convener:** Let us move on. Robert Chote of the Office for Budget Responsibility said that

“the whole point of independent scrutiny is to exert influence”,

and the International Monetary Fund noted that

“there is clearly a trade off between exerting influence and providing independent assessment.”

Where do you think the balance should be struck?

**John Swinney:** The questions of influence and independence are entirely related. The commission is free to exercise influence to ensure that a strong and robust approach is taken to the estimation of tax revenues and to the establishment of forecasts. However, it controls its independence—ultimately, it is the body that decides whatever it says about particular forecasts. The commission is in a position to push, challenge and influence to make sure that a robust position is established. If it is not satisfied that that is being done, its independence enables it to say, “This is not good enough.”

I understand the point that the IMF is making about the relationship between influence and independence. I do not think that there is any conflict between those two concepts. The influence and the challenge can be exercised but, ultimately, the commission alone is the guarantor of its independence and it can determine whether the actions that are taken are good enough as an acceptance of the views that it has expressed .

**The Convener:** Thank you.

The SFC proposes in its submission that

“it would have no contact with the Scottish Government during the period when it is developing its forecasts.”

There has been a wee bit of an issue concerning whether the SFC could be seen to be too close to the Government in terms of providing advice, but at the same time we have just talked about its ability to exert influence. There is a bit of a grey area. When should the SFC stop having contact

when forecasts are being developed? How early in the process should that be?

**John Swinney:** That is not a matter for me, convener—it is for the commission to determine what it considers to be appropriate. It would be wholly wrong for me to specify that. I do not think that there is anything wrong with the commission deciding whatever level of contact or communication it decides is appropriate—that is a matter for it.

On the question of advice, there is a difference here. I do not think that the word “advice” describes what the commission is doing—I think that the commission is challenging. My officials and I find the commission challenging, as we should. I do not feel that I am on the receiving end of advice from the commission; I feel that I am being challenged, as I should be. That is the purpose of the commission.

We need to avoid getting into a position where we say that there is something wrong with dialogue and conversation between the commission and the Government. In my experience, that dialogue and conversation is not cosy conversation; it is challenge, and we cannot have challenge unless we speak to each other. We could do it all by certified email but, given some of the complex issues that we are talking about, that is not really the best way. We have to be careful not to label the dialogue between the commission and Government officials and ministers as advice, because I do not consider it to be that; I consider it to be challenge.

**The Convener:** I will let in colleagues in a minute or two, but I first want to ask about potential additional functions. The bill is intended to reflect the existing legislative competence of the Scottish Parliament. Obviously, the Scottish Government expects the functions of the SFC to develop substantially to take account of the new fiscal powers under the Scotland Bill. The committee has recommended that the Scottish Fiscal Commission Bill should be amended to widen the functions of the commission to include assessing the performance of the Government against its fiscal rules and assessing the long-term sustainability of the public finances. At this stage, it might not be competent to legislate for additional functions, but there has been broad agreement among witnesses that the remit should be widened. What is your view on that?

**John Swinney:** I do not agree with the widening of the remit to cover the aspects that you talk about. We have discussed these issues in committee before. Many of those questions are, frankly, the responsibility of the committee and Parliament. It is the proper preserve of the Finance Committee and Parliament to scrutinise the decisions that ministers take and to assess the



robustness of the Government's financial judgments. That is undertaken regularly, whether it is through the Parliament's budget process, through the autumn or spring budget revisions—we will come on to the autumn budget revision later this morning—or through the periodic inquiries that are undertaken. To me, that is all the core responsibility of members of Parliament through the Finance Committee and the Parliament. I do not think that somebody else is needed to do that. In essence, that would be competing with the proper democratic role of members of Parliament in holding the Government to account.

**The Convener:** I do not know that we look at the long-term sustainability of the public finances. The Royal Society of Edinburgh and various academics feel that the Scottish Fiscal Commission should have a role in looking at where the Parliament might be in four or five years. We tend to work on almost an annual basis. For example, this year, we are unable to scrutinise the budget until 16 December, when we will get the figures for the forthcoming year. Although we can touch on some of the finances going ahead following the comprehensive spending review figures, we cannot devote the time that perhaps the Scottish Fiscal Commission could to looking at the long-term sustainability of the decisions that are made.

**John Swinney:** The Finance Committee has in the past undertaken inquiries on the sustainability of public finances. It is open to the committee to undertake such inquiries if it chooses. It is not for me to determine that it should do so. The constraints that exist on the availability of financial information, such as those that the convener has highlighted in relation to the role of the Finance Committee in the current budget cycle, would also apply to the Fiscal Commission. Up until last Wednesday when the Chancellor of the Exchequer stood up, the commission would not have been in receipt of any more longer-term information on the United Kingdom's public spending than any of the rest of us were. For me, the role of the Fiscal Commission is properly defined as that of focusing on the estimation of the Government's taxation forecasts and reporting accordingly. Obviously, the bill makes provision to expand the remit and responsibilities of the commission commensurate with any wider devolved responsibilities.

**The Convener:** Thank you. I will now open up the session to colleagues round the table.

**John Mason (Glasgow Shettleston) (SNP):** As you know, cabinet secretary, we have spent a lot of time thinking about forecasts, who forecasts and who does not forecast and all those kind of things.

I was struck by your comment that there is not a one-size-fits-all model for fiscal councils. Is it your feeling that we should launch the Scottish Fiscal Commission, that we and the commission should review the situation after a certain amount of time and that there might be a change of emphasis or priorities as we go ahead?

**John Swinney:** We should certainly be open to reviewing the Fiscal Commission's performance. I make it clear that that is part of the provisions, but I certainly think that we should be open to reviewing the arrangements that we put in place. We are obviously in new territory and we should be open to considering the implications in due course.

**John Mason:** A couple of us visited the equivalent body in Ireland. My feeling is that it started off not doing any forecasts, but it has gradually started to do a bit of forecasting as it has felt necessary as things have developed, which strikes me as quite good. The situation is not totally black and white—the Irish body does a bit of forecasting if it feels that it needs to. Would you feel comfortable with such a model?

**John Swinney:** I am not sure what you are suggesting.

**John Mason:** I am suggesting that the Fiscal Commission might do a bit of forecasting when it feels the need, but that we do not need to say right now in black and white that it must forecast or that it must not forecast.

**John Swinney:** I have tried to reflect two things in the bill. The first is the need for the Fiscal Commission to respond to the forecasts that are made by ministers, because I believe that it is right and proper that it is the role of ministers to make the forecasts of tax revenues and the role of the commission to challenge and to provide assurance about those forecasts. The second is the need for the commission to be able to undertake the additional work that it decides that it should undertake. Those are essentially the twin purposes of the commission. It would be up to the commission to determine what falls into the latter category.

**John Mason:** The budget for the SFC seems quite generous in comparison with the budget for the equivalent bodies in Ireland and Sweden, which are both independent countries with much wider powers than we have. Ian Lienert made the point that the

"estimates are generous relative to comparable small IFIs elsewhere".

Are we being a bit overgenerous with the finances, or do you think that the figures are justified?

**John Swinney:** I seem to remember that the last time I was here I was criticised for not being generous enough.

**The Convener:** Not by the same people.

**John Mason:** Probably by the same people.

**John Swinney:** We have engaged in dialogue with the commission. At the outset, when the commission was a non-statutory body, we formulated what we thought was a reasonably tight approach—maybe “tight” is the wrong word for a finance minister to use—as a reasonable starting point for it, and I got a fair amount of criticism that it did not appear as if we were giving the commission enough resources to enable it to exercise its functions properly. I have responded to that and, in discussion with the commission, have formulated a proposition that is there to be tested.

On the first question that Mr Mason asked, there is obviously the opportunity for review if that is judged to be necessary in due course, so we will be able to see whether the resources that we have put in place are actually required to fulfil the commission’s functions.

**John Mason:** To be frank, I was one of the people who thought that £20,000 was a little bit on the low side, but I wonder whether £850,000 is a bit on the high side. The point has been made that, if the commission took on more responsibilities, the budget might increase further, and yet it would still have fewer responsibilities than the bodies in Ireland and Sweden have. I suppose that I just want to put down a marker that I would not want the budget to go much higher than it is.

**John Swinney:** I am acutely aware of the challenges in public expenditure terms, so I do not take any of these decisions lightly. I give the committee the assurance that I will look carefully again at the financial estimates for later years. The estimate for 2016-17 is pretty much of the order that we will have to deliver, but I will look again at the estimate for 2017-18.

10:00

**John Mason:** Section 6 of the bill, which is quite short, concerns the independence of the commission. The committee has discussed with witnesses the degree to which we can legislate for independence and the degree to which the issue concerns having people on the commission who can openly challenge the Government and build up a reputation for independence. Do you think that we can legislate for independence or do you think that the issue concerns the reputation that the commission builds up over time?

**John Swinney:** I think that the issue is a combination of a number of things. First, it is important that section 6 contains the explicit statement that

“In performing its functions, the Commission is not subject to the direction or control of any member of the Scottish Government.”

That is an important protection for the commission. If it is ever necessary to do so, the commission can say to a member of the Scottish Government that section 6 applies and that they have no ability to direct or control the commission.

Secondly, there is the question of the wider approach to appointing members of the commission. For example, with regard to creating an atmosphere of independence around the commission, I took the view that it would be better for the commission members never to be dependent on a minister for reappointment. I took the view that it strengthened the credentials of the commission for the members never to have to think about their reappointment, because they could not be reappointed. That was my thinking—I volunteer that to the committee. I thought that that would really assure the wider community about the independence of the commission. However, I have seen some comments to the effect that that approach does not allow for a build-up of expertise in the commission, because it means that people cannot be there for more than one term. I set out the intention behind the approach in the bill, but I quite understand the view that giving people a couple of terms would allow for a build-up of expertise. However, it might constrict or constrain the atmosphere of independence.

Thirdly—this is the key point—we have to appoint people of capability and authority, whose reputations in their wider fields depend on their ability to exercise independence in the commission. For them to be successful in their other fields of activity and involvement, they have to be able to demonstrate that they have exercised independent judgment in the commission. That is, perhaps, one of the best safeguards that we have.

**John Mason:** You have mentioned appointments. Would the commission be more independent if, instead of ministers appointing people and Parliament effectively having a veto, Parliament made the appointments and ministers had a veto?

**John Swinney:** No, I think that that would be much worse. How on earth can I veto what Parliament wants to do? I do not think that that would be a healthy relationship. The arrangement that we have in place enables ministers to be involved in recommending propositions to Parliament and enables Parliament to undertake scrutiny and have the final say.

**John Mason:** You mentioned the issue of second terms. I totally agreed with you at the beginning of this process that having commission members serve only one term underlined their independence. However, we heard that in Ireland it was felt that there was not a huge degree of expertise out there—or, if there were people with expertise, they were perhaps not available because of other commitments and so on—and that having people serve only one term restricted the pool of candidates unnecessarily. That was one of the arguments for having a second term. Am I picking up that you are perhaps open to that argument?

**John Swinney:** I have set out honestly what my policy intention was, but I accept that it might have an unintended consequence. The point that Mr Mason makes is fair. A range of people could sit on the commission; whether they are available is a different matter. I have set out the basis of my thinking on this matter, but I am quite happy to consider what the committee concludes on it.

**John Mason:** Thank you.

On staff, there is a question about whether the commission members should have complete freedom as to who they appoint and how, and about how much involvement the Government and the Parliament should have. Section 18(3) says:

“The Chief of Staff and other staff are to be employed on such terms as the Commission may, with the approval of the Scottish Ministers, determine.”

Why did you involve the Scottish ministers in that regard, instead of giving the commission members complete freedom?

**John Swinney:** That was simply to enable ministers to be assured that the approach to employment policy that we consider appropriate for a non-ministerial department—which will be the status of the Scottish Fiscal Commission—is properly in place. We have to be satisfied that employment policy is consistent with what we would expect and with public pay policy.

**John Mason:** You used the word “reasonable” in your answers to the convener. In section 7, which is entitled “Access to information”, the words “reasonable” or “reasonably” come up quite a lot of times—four times in subsection (1), I think. The commission will have

“a right of access at reasonable times to any relevant information that the Commission may reasonably require”,

and it

“may require any person who holds or is accountable for relevant information to provide at reasonable times any assistance or explanation that the Commission may reasonably require”.

The word “reasonable” can be interpreted in different ways, so are the provisions solid enough?

Does section 7 give the commission enough clout?

**John Swinney:** I think that it does. When you quoted from section 7 you laboured the word “reasonable”, if I may say so—I know exactly why you did that. If I was looking at paragraphs (a) and (b) of subsection (1) together, I would focus on the word “require”, which is a hard word in legislation.

The commission will have

“a right of access at reasonable times”,

but to request, at 9 o'clock at night, a complete recasting of methodology by 8 o'clock the following morning would not be reasonable. However, the commission will be able to require information—I stress “require”. When we look at the two paragraphs together, I think that we can see a strong foundation for the commission to be able to get the information that it requires.

**John Mason:** Thank you.

**Gavin Brown (Lothian) (Con):** I want to follow up some of the convener's questions, because I think that some information remains to be teased out. The convener asked about what happens if the commission deems the Government's forecasts not to be reasonable. Let us say that the commission says that a forecast is not reasonable, so the Government has to make a change of some sort and present it to the commission again. Is it the intention that the initial forecast, the changes and the final forecast will all be published?

**John Swinney:** No.

**Gavin Brown:** What will be published?

**John Swinney:** The final forecast.

**Gavin Brown:** Just the final forecast?

**John Swinney:** Just the final forecast.

**Gavin Brown:** How is that in tune with the idea of transparency, if disagreements between you and the Scottish Fiscal Commission are never made public?

**John Swinney:** What matters is whether the Scottish budget is underpinned by a reasonable forecast of the tax income that will be generated. That is the piece of information that the public and the Parliament require. Therefore, the commission must be able to test and challenge the Government to the extent that, unless it is prepared to use the word “reasonable”, the Government knows that it cannot publish its forecast.

I come back to the point that I made to the convener, which I have made to the committee previously: I do not see the value in there being a multiplicity of forecasts. I have yet to hear it argued that that would be helpful or in the public

interest. I cannot understand why that would be of interest. What the public want to know is how much of the budget is underpinned by assessments of the tax revenue to be generated and whether they can have confidence in that number. I think that people are looking for that, rather than looking for a multiplicity of numbers floating about and thinking, "It could be this. It could be that."

Let us take as an example the issues around the OBR forecast for land and buildings transaction tax. For the last wee while we have been round the houses on that in Parliament—I am looking for a piece of information, but it seems that I do not have it with me. Essentially, in the space of a few months the OBR has taken its estimate of the amount of tax to be generated from land and buildings transaction tax in Scotland from £560 million in July to £427 million in November. My estimate all along was £381 million. What is the value of having a multiplicity of forecasts floating around when the one that matters is that the Scottish budget is underpinned by my forecast of £381 million, which has been verified as reasonable by the Fiscal Commission?

I can tell you what would have happened if we had all taken decisions based on a forecast of £560 million that we now find is £427 million—and I do not think that many members would have been queuing up to say, "Thank goodness for the OBR." Rather than debate possible scenarios, I am trying to get across to the committee the importance of what underpins our budget, because that is what public expenditure depends on.

**Gavin Brown:** I will resist the temptation to ask what would have happened if we had based our finances on £7 billion-worth of oil revenues.

**John Swinney:** We could have all sorts of distractions, Mr Brown.

**Gavin Brown:** Let me stick to the point, then.

**John Swinney:** I am making a serious point, which I ask the committee to consider. What is the point of having a variety of forecasts when the budget has to depend on a particular number? Which number do I settle on? My view is that I should settle on the number that the Fiscal Commission, established by statute, says is the number.

**Gavin Brown:** The point for me is one of transparency. The policy intention is not to publish anything other than the final result. Would you be hostile to or indeed block the publication of those discussions or initial forecasts by the SFC?

**John Swinney:** I will have a quick look at the bill because I suspect that I might be in conflict with section 6 if I was to block such a proposition,

although I would argue strongly against its desirability, for all the reasons that I have just put on the record to the committee.

**Gavin Brown:** Sure. We disagree, but I will not dwell on the point.

I was heartened by something that you said earlier, if I have written it down correctly. If the SFC wishes to, it can prepare and publish forecasts. Is that a fair summary of what you said?

**John Swinney:** That could be covered by section 2(3).

10:15

**Gavin Brown:** I am heartened by that.

Just for clarity, given what the Government and you personally have said about forecasts in the past, can you tell us whether you would be against section 2 being amended, through an amendment lodged by either the Government or a member that said in essence what you have just said—that, if it wished to do so, the SFC could prepare and publish forecasts? Would you be hostile to such an amendment?

**John Swinney:** Yes, because I do not think that it is necessary. I think that it is already covered by section 2(3). That is my explanation of the basis of the provision.

**Gavin Brown:** Given that you have said on a number of occasions that you do not want other forecasts, and that—as you have said again today—you do not see the rationale for additional forecasts, do you not think that stating that in the bill would give clarity?

**John Swinney:** No, because I think that the clarity is in section 2(3).

**Gavin Brown:** Let us go back to what happens in practice. I am concerned about the transparency issue, as I have indicated.

The SFC published a list of the meetings between you and it for last year's budget process. The report was finalised in the week beginning 6 October, which was the same week as the draft budget was published. In the week beginning 29 September—the week before that—we see the following item:

"Meeting with the Cabinet Secretary to present draft report and discuss logistics for release of the final version".

What was the nature of the presentation that was given by the SFC to you during that week?

**John Swinney:** That presentation of the report in September was designed to do two things. First, we wanted to fact check the contents of the report. It was the first time that it had all been done, and the Fiscal Commission was anxious to make sure

that the report was factually correct. Secondly, because it was the first time that we were going through the process, we had to have a conversation about choreography—to put it bluntly, we had to determine how it was to be done. What happened was what we agreed would happen. The Fiscal Commission's view—the reasonableness test—was published contemporaneously with my budget statement, but it was published by the Fiscal Commission, not by me. As I recall, they were published at the same time.

**Gavin Brown:** We are in a budget process at the moment. Will there be a similar meeting in the week before the budget this year?

**John Swinney:** There will be a meeting with the Fiscal Commission on Tuesday next week.

**Gavin Brown:** Is that meeting purely to fact check, as in the Audit Scotland process?

**John Swinney:** Yes, and for the commission to raise any issues that it wants to raise with me.

**Gavin Brown:** Let us move on to reasonableness. I am sure that you have read the evidence from our previous evidence sessions. Dr Angus Armstrong of the National Institute of Economic and Social Research said:

“I think that reasonableness is quite a low threshold, because there is a lot of uncertainty.”

He went on to say:

“Our first point is that the threshold of reasonableness is inappropriate—it is too difficult to say that something is unreasonable, because that is quite a strong requirement.”—[*Official Report, Finance Committee*, 18 November 2015; c 22.]

How would you respond to Dr Armstrong's comment that reasonableness is a pretty low threshold?

**John Swinney:** I think that it is an appropriate term. If we start going up the list of terminology, we get to terms such as “appropriate” and “reasonable”—which I would say are much of a muchness—or “precise” and “definite”. If anything was to be put to our friends at the OBR's on LBTT, “definite” would be nowhere to be seen.

I am not going to sit in front of the committee and say that I will be able to forecast precisely the revenues that I will generate. I will make a reasonable stab at getting it right. That is all that any commission will be able to say about the issue. If the committee thinks that there should be a higher threshold, I am willing to consider that, but if we were to go up from “reasonable” to “precise” or “definite”—those are perhaps the choices—it would get very difficult for anyone to sign up to that. I could not sign up to saying that something was a precise estimate.

**Gavin Brown:** That takes us on to my next point. Another point that Dr Armstrong and Professor Jeremy Peat made was that, rather than just choosing a different word, as you suggested in your answer, if the commission had the ability to forecast and then compare its forecast with yours, that would give a much better indication of the likely differences and challenges that we might face. Dr Armstrong said:

“the rigour of going through a forecast is important because, the more we look at the data, the more we realise where all the nooks and crannies are. Until we play with the data, it is hard to understand where a lot of the uncertainties lie.”—[*Official Report, Finance Committee*, 18 November 2015; c 22.]

You said that you cannot see any rationale for having different forecasts. That rationale was put to the committee by an economist, so I wonder how you respond to that.

**John Swinney:** I completely disagree with it. What matters is that there is a forecast that underpins the budget, because public expenditure depends on that forecast. The value of the Fiscal Commission and the extra scrutiny that it can provide is in exactly the point that Dr Armstrong made about getting into the “nooks and crannies” of the model. That is what the Fiscal Commission can do. It has an absolutely unimpeded opportunity to go wherever it wants to go on the methodology, the thinking, the analysis and the preparation of the forecast that we have come to. It can look at any bit that it wishes to look at. The public interest is best served by having that strength of independent analysis that the commission represents challenging and agitating about the Government's forecasts and the methodology that has been used to get there, so that whatever number comes out has been tested to such an extent that we can be as confident about it as we can be about any number.

To show the danger, let me play back the problem with the OBR's LBTT analysis, which is that it takes a subdivision of the UK market and arrives at its number. We take a different methodology that is based on actual housing transactions as charted by Registers of Scotland over many years, which builds up a profile of the housing market and the transactions market in Scotland, to which we apply a variety of economic variables. They are two different models. Unsurprisingly, they came up with two very different answers. One of them, six months ago, gave a figure of £560 million, whereas my one says £380 million, which is a difference of £180 million. That is a difference of nearly 40 per cent from my core LBTT estimate.

I do not see the value of having two competing models, because that is where we would end up. I would rather have a model that is absolutely shaken to bits by the Scottish Fiscal

Commission—which is what happens—to get us the strongest number so that I can say to Parliament that that is the number that we should go for.

**Gavin Brown:** Can the SFC in effect take the model away or have access to it at any time to run all the numbers and change the parameters, or does the commission have to ask you to run the model? Does it have full and independent access to the model at all times?

**John Swinney:** It has copies of the model, yes. The point that Mr Brown is raising has to be looked at on two levels. First, do the members of the commission have access to the model in their own time to put in whatever numbers they want to put in? Yes, they do.

Secondly, and more importantly, the Fiscal Commission has the ability to interrogate and challenge the detail of the model: not just the variables that are put in—the numbers that are put in, where the thresholds are put and where the numbers are put—but the workings of the model.

As regards the points that I laboured about how the model has been constructed, the commission members can explore and examine them all. I do not think that they can do that at their own behest, because we have to own the model so that it remains the model. However, the Fiscal Commission is able to ask, “Why do you not look at this, that or the next thing?” It is entirely appropriate that it should do that.

The commission’s role has to be seen not just in relation to its ability to look at different variants of what scenario A looks like against scenario B, but in relation to what it is all founded upon, which is the more important point.

**Gavin Brown:** I have just a couple more questions because I am sure that other members want to get in. The convener asked about the changes that you made to NDR as a consequence of comments from the Fiscal Commission, but you did not appear to make any changes in relation to behavioural impact, which was another point that the commission raised. Have you now changed the model, or changed your methodology, so that behavioural impact is factored into any forecast?

**John Swinney:** That remains a work in progress. There will be developments in the model that are designed to reflect that, but our understanding of behavioural factors will, in itself, be a developing part of our thinking.

We introduced a new tax in year 1. We know that there has been a forestalling effect as a consequence of changes in the UK regime, which will have created behavioural impacts. I would be very nervous about configuring the model based on that particular behavioural impact, but I accept

that there will be other behavioural impacts that will be relevant. We have to remain open to developments and changes that could be reflected as a consequence of behavioural changes.

**Gavin Brown:** Finally, why can the Fiscal Commission not just look at the overall forecast for non-domestic rates as opposed to looking at the buoyancy assumptions? Non-domestic rates are treated very differently in the bill, but the OBR will look at them in the same way that it looks at other taxes for the UK Government. Why can the Fiscal Commission not just look at the non-domestic rates forecast in the same way that it looks at other forecasts?

**John Swinney:** The key variable is about economic performance, where the commission can add value. Some of the other issues that underpin the NDR income forecast—appeals losses and debt—are issues that are essentially driven by performance in relation to payment of non-domestic rates. Those are less matters of judgment and more almost matters of fact about what underpins the changes in the design of the non-domestic rates system, so they are of a different character from the economic determinants, which is the area where we think that the Fiscal Commission has to challenge the Government’s judgment—and challenge it independently.

**Gavin Brown:** Is it your view that the Fiscal Commission could not add any value by looking at the overall forecast?

**John Swinney:** The element that we have identified is the area where I think the Fiscal Commission can exercise that independent challenge effectively.

10:30

**Jean Urquhart (Highlands and Islands) (Ind):** Some of the points that I wanted to raise have been teased out, but I want to ask again about clarity. When we were in Ireland we learned that they are absolutely comprehensive in keeping the detail of meetings, conclusions, figures, forecasts and so on in the public domain. They said that the reason was that if a freedom of information request comes in they have no work to do, because any information is readily available and can be produced at any point. There have been suggestions that things are not quite as clear as they might be and I wonder whether you are satisfied that that would be as easily done here?

**John Swinney:** Yes, because the FOI legislation will apply.

**Jean Urquhart:** The FOI legislation will apply, but are we content that the structure that we have provides clarity about what the Fiscal Commission

does, when it meets, what conversations it has, its workings out and whatever, so that that can all be accessed very easily?

**John Swinney:** Yes. The Fiscal Commission published a comprehensive report on the process that it went through to verify the estimates that we made for the 2015-16 budget; that was a comprehensive piece of work that was proactively put in the public domain at the time that they provided me with the assessment of the reasonableness of the forecast. That was done in an open and transparent way. There will obviously be full scrutiny of the implications of that decision as we move forward. The commission is structured to be accessible in that respect. I come back to my point about section 6 of the bill—a lot of those questions are for the commission to determine. It is not for me to specify how they organise and communicate.

**Jean Urquhart:** It may be a matter of semantics, but Ian Leinert was curious about the idea that the SFC was an independent assessor as opposed to an adviser. I remember an earlier meeting at which you were absolutely committed to the fact that, whatever the SFC outcome was, you would accept it. It seems to me that, because of your determination to accept the commission's forecast on your modelling, with all the challenges that it provides, you accept its advice.

**John Swinney:** We come back to some of the territory that I discussed with the convener earlier in the meeting. I do not consider the SFC to be an adviser—I consider it to be a challenger and an assessor. That is different from being an adviser.

I want to convey to the committee the nature of the relationship between the Fiscal Commission and the Government. The Fiscal Commission is there to challenge us, to push us and to make sure that we are coming to the correct answer, and its members will verify whether they think that we have come to the correct answer. I do not view the commission as an adviser and I would be very surprised if it viewed itself as an adviser to the Government. I think that it considers itself to be a challenger to the Government, as it should be.

**Jean Urquhart:** The lack of published findings from the commission in the public domain does not allow anybody else to be aware of what the outcome of those challenges was, because you automatically accept them. What if the commission is wrong?

**John Swinney:** What if it is wrong? The forecast is my forecast, so I own it, and the Fiscal Commission is able to challenge that. I have been clear that, to get to the point of satisfaction at which I could set out the numbers to the Parliament, I would have to address the issues that the commission had raised. We appoint

people to a commission because we believe that they have the capability and strength to provide that challenge function.

**Jean Urquhart:** Would you ever challenge the Fiscal Commission?

**John Swinney:** I have accepted that it essentially has a veto over my forecast. That is why I appointed it—to do that—so I have to accept its ability to challenge me to ensure that the numbers are robust and I have to accept the conclusions that it arrives at. I cannot foresee circumstances in which I would prefer to go to the Parliament and say that I think that the view from the commission is wrong and that my view is better.

**Jean Urquhart:** If the figures are never produced to the Parliament, how could it ever challenge you and say that they were wrong?

**John Swinney:** Because I would not have a certificate of reasonableness from the commission. I need to be able to stand up in the Parliament and say, "I have formulated an estimate of land and buildings transaction tax, I have put it to the Fiscal Commission and it considers that estimate to be reasonable." If I could not say that, I would have a problem on my hands and I would have to think carefully about going to the Parliament. I cannot envisage marshalling an argument that, in essence, I was dissociating myself from the commission's view. I appointed its members because of their expertise and to give us that challenge function.

**Jean Urquhart:** Thank you.

**Jackie Baillie (Dumbarton) (Lab):** I would like to pursue that point a little bit further, because it is not just about semantics. It is interesting to consider what you would do in those circumstances.

I preface my question with a comment. You are saying very carefully today that the Fiscal Commission would "essentially" have a veto. In a response that she made at last week's First Minister's question time, the First Minister said that it would have a veto. Can you point me to where in the bill it says that the commission has a veto?

**John Swinney:** It has a veto in the sense that we have established it to challenge and assess our forecasts. Essentially, the power in section 2(1) of testing the reasonableness of the forecast is where the commission has its veto.

**Jackie Baillie:** But it does not, with all due respect. I have read that very closely. It talks about the commission preparing reports and setting out its assessment of reasonableness, but it does not then say that the commission has a veto if the Government disagrees.

**John Swinney:** My reading and interpretation of what section 2(1) means conveys to me the concept of the veto that I have shared with the committee.

**Jackie Baillie:** As far as legislation is concerned, concepts and interpretation cause problems for people in the future. If you mean the commission to have a veto, it should be there in black and white. Do you intend to lodge an amendment to clarify that point? As written, the commission does not have a veto.

**John Swinney:** I think that the section adequately conveys that point.

**Jackie Baillie:** We will need to disagree, because there is no mention of a veto at all in there. I genuinely believe that you should spell it out in black and white if that is your intention.

My next question is about this veto and how it would be exercised. You said that you would think carefully—I would expect nothing less from you—but are you saying that, if the commission disagrees, perhaps not with the methodology but with the forecast, you would put off the budget process, and its strict timetable, indefinitely until you arrive at agreement?

**John Swinney:** No. I would reach agreement so that I delivered a budget that had a certificate of reasonableness.

I must be able to stand up on 16 December with a letter from the Fiscal Commission giving a certificate of reasonableness. I have a budget to deliver: I cannot stand up and say, “Sorry folks, we will have to come back next Wednesday”. That is the veto: the commission knows that I have to get there, which is why section 2(1) conveys the point.

**Jackie Baillie:** Leaving aside the politics for the moment, there is a practical point. If the methodology is not right, are you saying that, within the space of a week, you can change the methodology to reflect the concerns in order to get a certificate of reasonableness? People outside the Parliament, who are experts in the field, would have some trouble agreeing to that.

**John Swinney:** That is not what would happen.

**Jackie Baillie:** What would happen, then?

**John Swinney:** The Fiscal Commission has been looking at the methodology for some time. We will get to a point at which the commission has no more issues to raise and we are agreed on the methodology. That process has been going on for some time; it went on last year in the formulation of the model.

We get to that point of agreement on the methodology weeks before the budget, and then we introduce the numbers. I say, “This is what I want to do”. The commission tests that to see

whether the numbers and propositions that I am suggesting, when applied through the methodology that has been prepared, are robust.

**Jackie Baillie:** The convener gave the example of the caveat on the LBTT methodology in relation to modelling human behaviour in the face of a changed market. Though the commission said that the assumptions made were reasonable, it did caveat that by saying that it was unconvinced by the assumptions made about behaviour.

As far as we were aware, there was silence from the Scottish Government as to whether you accepted or rejected that point. I understand that you said earlier this morning that you had accepted it and are doing further work. None of that was self-evident.

**John Swinney:** I can check what we have said publicly about that.

The key point is to make the distinction between that and the most important part, as I said in my answer to Mr Brown, which is the commission interrogating and challenging the model to make sure well in advance that it is a robust model for generating the numbers that need to go into the budget.

**Jackie Baillie:** I accept that. But where the commission caveats its response to that model—the case of LBTT is one example—there does not seem to have been any corrective action. What I am trying to do—

**John Swinney:** Well, if there had been some factor of significance that the commission judged to be of sufficient merit, the commission should not have given me the certificate of reasonableness.

**Jackie Baillie:** Perhaps it will bear that in mind next time.

It did caveat that certificate of reasonableness by talking about behaviour. What is interesting is that it would appear that the commission has been proved right.

It would be very useful to understand how the Government is going to reflect and negotiate with the Fiscal Commission if it says that it is not reasonable or it caveats the certificate of reasonableness in the way that it did with LBTT.

**John Swinney:** I do not follow the point that Jackie Baillie makes about the commission being proved right.

**Jackie Baillie:** It would take us down a side track but I am happy to talk to the cabinet secretary afterwards—

**John Swinney:** Where comments of that sort are put on the record and I challenge them, it is not appropriate for the point not to be explained.



**Jackie Baillie:** It can be explained. In relation to LBTT, as you probably know, there are a number of people sitting in larger properties with a particularly significant value who have decided not to sell.

Their behaviour has been a consequence of changes made to LBTT. Whether we agree with that or not, it is happening. That is what the commission pointed to in saying that there was no modelling of behaviour. I hope that that is sufficient explanation.

10:45

**John Swinney:** I do not think that the evidence bears that point out. We will have much more debate about those particular points. Essentially, the commission judged our forecast to be reasonable, and it must have felt that it was sufficiently clear to be able to offer that in 2015-16.

**Jackie Baillie:** So, in summary, you would keep putting off finalisation of the budget until you had that forecast, or an agreement that the forecast was reasonable.

**John Swinney:** I have said nothing of the sort. I said that I have a budget date of 16 December, upon which I have to sign a budget. The veto that the Fiscal Commission has over me lies in the fact that it knows that I have to set out a budget on 16 December—it cannot be delayed. I have to come to some form of agreement with the commission, to its satisfaction. That is the veto that the Fiscal Commission has. There is a budget date a fortnight today, and the commission can look at everything that I have put on the record about the fact that I cannot come before the Parliament without an assessment of reasonableness from the commission.

**Jackie Baillie:** There is still not a veto in the bill. I am sure that we will debate that further.

I wish to follow up John Mason's question. John spoke about the Parliament appointing and ministers having a veto. I would chop the end bit off. What is wrong with the Parliament appointing? The Parliament already appoints in a number of areas without ministers having to recommend and it does so in accordance with all the frameworks that have been laid out. Has that been rejected for a particular reason?

**John Swinney:** The difference lies in the fact that the Government has a particular involvement. The Government has no involvement in some areas of activity with regard to many of the parliamentary appointments that Jackie Baillie talks about, whereas the Fiscal Commission has an integral part to play in the Government's budget process and it has to verify the estimates of taxation that are made by the Government.

The Government plays an integral part in the process. We have to have the confidence that the people who are put forward for approval by the Parliament have the necessary capability to perform a function that is absolutely material to the budget process.

**Jackie Baillie:** The Children and Young People's Commissioner Scotland, for example, has a clear role in commenting on legislation and practice regarding children and young people, which is the preserve of the Government. Why is that substantially different?

**John Swinney:** The Children and Young People's Commissioner has a much broader policy perspective, which is not just about the Government. The role of the Fiscal Commission is to examine the Government's estimates of taxation. It is on that basis that the Government must be confident in the capability of those who are selected and approved by the Parliament to undertake that role.

**Jackie Baillie:** I do not want to put words in your mouth, but are you in effect saying that you do not think that the Parliament is up to ensuring that the people who are selected would meet the tests that are set out?

**John Swinney:** Those are most definitely not my words, and they are most definitely not to be put into my mouth. What I am trying to say to the committee is that this is a shared area of activity, where the Government has a legitimate interest in ensuring that technical capability is in place. That is why the Government should be making the nominations for the Parliament to approve.

**Jackie Baillie:** Let us move on to forecasting, an area that has been touched on by many members of the committee. I think it is the case—I am sure that the cabinet secretary will point it out if I am wrong—that there are no avenues of independent, alternative forecasting in Scotland. We just do not have the institutions that do that, as would be the case elsewhere, notably in Ireland. Does the cabinet secretary think that it is useful for benchmarking purposes to have that kind of basket of different forecasts? If he does not find that useful, could he point to any other fiscal commission anywhere in the world that has a lack of access to alternative forecasting?

**John Swinney:** I do not have an encyclopaedic knowledge of every other jurisdiction in the world—

**Jackie Baillie:** Is there not one such commission—anywhere at all—that you can point to?

**John Swinney:** —so I will not comment on that.

There are institutions in Scotland that look at different areas of public policy and estimation of

the public finances. The Fraser of Allander institute is one such example, as is the institution that Professor David Bell is involved in. I can think of numerous other examples around the academic community where such expertise lies. Of course, some of the members of the Fiscal Commission are appointed to it because of their expertise in the area of fiscal predictive activity.

**Jackie Baillie:** It is those very experts, some of whom you pointed to, who suggested that having access to a basket of forecasting that is independent would be quite useful for benchmarking purposes. As you cite them, I assume that their evidence has validity, too.

**John Swinney:** My position is pretty clear—I think that the budget must be predicated on a reliable and robust estimate of what is likely to be generated from the taxes that we levy, and that that must be scrutinised and challenged to the maximum degree. Those are exactly the legislative arrangements that I am putting in place.

**Jackie Baillie:** I have a final question, for the purpose of clarity, because what is written in legislation does not always mean the same thing to different people. Section 2(3) talks about the commission being able to

“prepare reports setting out its assessment of the reasonableness of such fiscal factors (other than those mentioned in paragraphs (a) to (d) of subsection (1)) as it considers appropriate.”

In layperson’s terms, are you saying that section 2(3) explicitly allows the Fiscal Commission to commission forecasting for benchmarking purposes? In response to a similar question, you referred my colleague Gavin Brown to that subsection.

**John Swinney:** I think that section 2(3) speaks for itself when it comes to the scope that the commission has to decide of its own free will what reports it wishes to produce. Given the contents of section 6, it would be inappropriate for me to specify what the commission should decide to do under section 2(3).

**Jackie Baillie:** I am not asking you to instruct the commission to do anything; I am asking you whether section 2(3) confers on the commission the ability to forecast independently, if that is what it wishes to do.

**John Swinney:** I think that it could probably do that under section 2(3) or under section 2(5).

**Jackie Baillie:** I am looking for an answer rather than a reference to another bit of the bill, which I have read through.

**The Convener:** He has given you an answer.

**John Swinney:** Forgive me, convener—I have just referred the member to sections 2(3) and 2(5),

which would provide for exactly what she is talking about.

**Jackie Baillie:** What I am looking for, for the purpose of clarity, is an indication on the record—it just requires a yes or a no; it is that simple—whether section 2(3) would explicitly allow the Fiscal Commission to forecast for benchmarking purposes.

**John Swinney:** If Jackie Baillie wants a specific on-the-record comment, I say to her that she would be better off looking at section 2(5), as I have said already.

**Jackie Baillie:** I have done. Section 2(5) is one line that talks about something different.

**John Swinney:** Well, that is my answer, convener, and I have given it courteously several times.

**Mark McDonald (Aberdeen Donside) (SNP):** I have got the impression during the bill process that there seems to be a view afield that the absence of an institute for fiscal studies or similar body outside the sphere of Government has led to a yearning on the part of some people for the SFC to fill that vacuum by producing a forecast that they can look at alongside the work that the Scottish Government produces. Is that a fair reflection of where we are? Would there be any merit in that?

The commission members seemed to suggest that if the commission were to produce forecasts, that would lead to some difficulty in respect of their challenge and scrutiny role, because they would be wedded to those forecasts rather than being able to provide a sober analysis of what the Scottish Government had provided.

**John Swinney:** There is a fundamental issue about the Fiscal Commission’s purpose. It is not to become an IFS. There may be an appetite for such a body in Scotland, but that is for others to sort out: it is not for me to sort out and it is definitely not for the Scottish Fiscal Commission to undertake such a role. The statutory role is set out clearly to enable the commission to prepare reports on the reasonableness of the forecasts that the Government makes and on which its budget is predicated.

**Mark McDonald:** Last week, Lady Rice spoke of

“forecasting with a capital F and forecasting with a little f”—*[Official Report, Finance Committee, 25 November 2015; c 45.]*

She said that, although small-scale forecasting would be done to test the robustness of the models that the Scottish Government had produced, that was different from producing the entire forecast that will lie behind the

Government's budget. Is it a question of terminology and how it is applied, rather than of the role that the Fiscal Commission will undertake of probing the model and ensuring that the figures are reasonable?

**John Swinney:** That is the function that the commission must undertake because the function that Parliament and the public interest require is that we have a robust estimate in which we can place a great deal of confidence. I want the commission's expertise and capability to be deployed to ensure that that number is the most robust number it can be. If the commission spends its time developing another forecast, I will be left wondering what the right forecast is. I want the commission to challenge our forecasts so that we get to the number upon which Parliament's budget can most reliably be predicated. I do not understand—this underpins all my evidence to the committee this morning—the point of having another number out there because, when that happens, it creates confusion. It also creates the potential for estimates that others make to damage our public finances and the judgments that we make.

**Mark McDonald:** The bill specifies no term length for commissioners. Will you expand on the reasoning behind that? Staggering the terms so that not all the commissioners serve the same term length from the same starting point has been suggested. Is there a reason why the bill does not specify minimum or maximum term lengths?

**John Swinney:** I said earlier that one of the purposes of independence is to ensure that individuals are able to say what they like and to make inferences as they want without fear of how that might affect their reappointment. I feel that the best way of guaranteeing that is to stagger the length of service of individual members of the commission over time so that new people would be brought in and we could retain continued expertise in the commission. The code of practice for ministerial appointments to public bodies says that no individual should hold public office for longer than eight years, so I suppose that that is a maximum. However, we will work to try to minimise the degree to which individuals' terms of office do not work in sync in order to ensure that we maintain expertise in the commission.

**Mark McDonald:** Another point about the length of term and reappointment—forgive me, but I cannot remember where the evidence came from—involved discussion around trying to ensure that the electoral cycle does not coincide with appointment periods or interfere with them, in order to ensure that the Fiscal Commission can sit outside the politics of potential future changes of Government. Should it just be taken as read that that approach will be taken or does it need to be

underpinned either in the legislation or in the guidance that lies behind it?

11:00

**John Swinney:** I am sure that we can organise that in a fashion that does not require that it be put on the face of the bill.

**Richard Baker (North East Scotland) (Lab):** I have two very quick questions. First, there has been some debate about whether the SFC's report should go to the Government a few days before its publication or on the same day as it goes to everybody else. Do you have any strong views on that?

**John Swinney:** I think that an approach that is consistent with the basis on which we receive reports from Audit Scotland would be appropriate—if memory serves me right, we get them about four days before publication.

**Richard Baker:** So, the Government should get the report about four days before publication.

**John Swinney:** Yes.

**Richard Baker:** For clarification, I take it that you would not expect to have much dialogue with the Fiscal Commission about the content of the report and that it would simply be a matter of the Government receiving it for information.

**John Swinney:** Yes.

**Richard Baker:** I do not want to labour the point about forecasts because it has been debated before, but do you accept that in other countries—for example, Sweden—there are a multiplicity of forecasts, which does not seem to diminish the quality of analysis of the economy, or of debate in Parliament but, rather, seems to enhance it?

**John Swinney:** I certainly acknowledge that different approaches are taken in other countries. I question the value of having several forecasts, because we need to make a judgment based on the most reliable forecast for our public finances.

**Richard Baker:** I shall spare the cabinet secretary from having to go back round the houses on this issue.

**The Convener:** You might, but I will not.

That concludes questions about the Fiscal Commission, but I want to wind up on forecasts, which I did not touch on in my opening questioning because I wanted colleagues to have the opportunity to explore the issue more deeply, which they have done.

I listened carefully to all that you said, cabinet secretary. You made it clear that you do not want "a multiplicity of forecasts" and that there is no point in having another number. However, a key

point that a lot of witnesses have made is that if there is going to be only one number, it should not come from the Scottish Government. For example, the Royal Society of Edinburgh is

“firmly of the view that the SFC should be able to originate its own independent forecasts of the future fiscal revenues”

and that

“to fulfil its functions the SFC will need to be able to produce independent forecasts.”

The Scottish Property Federation suggested that if the SFC

“is only able to verify Scottish Ministers’ assessments then it may be difficult to convince the wider world that it is truly an independent body.”

You will recall, Deputy First Minister, that at First Minister’s question time, the leader of the Opposition made—in my view—a quite disgraceful slur on the individual integrity of Fiscal Commission members by calling the commission “a pup”. Clearly, though, if the Scottish Government is producing forecasts and others—namely, the Fiscal Commission—are commenting on them, we are likely to hear that kind of rhetoric in the future.

Professor McGregor and Professor Swales have said that it

“would seem sensible ... to aim gradually to build internal forecasting/analytical capability”

in the SFC.

Professor MacDonald prefers a similarly evolutionary approach, and believes that the SFC should initially use the Scottish Government’s forecasting model rather than seek to develop its own, but should take on responsibility, as its role evolves, for producing official forecasts.

Given the evidence that we have received and the politics around the issue, if there is to be only one forecast I foresee the commission being continually derided by Opposition members as being, in effect, a subset of the Government, irrespective of whether it is or not. Given all that, would it not be better—in the Scottish Government’s interests and in the interest of producing robust financial forecasts—if the official forecasting body was the SFC?

**John Swinney:** Let me walk my way through all of this, if I may, convener. The starting point for answering your question lies in the central choice that has been exercised by the Government in the bill. The choice was whether the forecast of the revenues to be raised should be undertaken by the Government or put out to an independent body such as the Fiscal Commission. Who should produce the forecasts and tell the Government what they are?

The Scottish Parliament information centre report on the Scottish Fiscal Commission Bill—I cannot see a date on it—has a very handy graphic that shows the number of countries in which forecasts are originated by an external body. There are three: the United Kingdom, the Netherlands and Belgium. In another column, the purple blocks show all the other countries where an independent fiscal institute assesses the official forecasts. They include Australia, Austria, Canada, Croatia, Denmark, Finland, France, Ireland, Italy, Sweden, Spain, Slovenia, Slovakia, Serbia and the United States—a load of them.

It is evidenced by international judgement that you can go either way on the question—a Government forecast or a forecast that has been farmed out to an independent fiscal institute. The choice of principle that we made on that question is to have a Government forecast that is challenged by an external institute. We then had to see how best we could be confident that that institute has the expertise to challenge the forecast by the Government. We have been over the appointment process—how members are chosen and their skills and capabilities.

Because of the nature of the statute that we have put in place, the Fiscal Commission’s purpose is to be absolutely focused on testing to make sure that the forecast is reasonable, because that forecast will go into the budget and our public expenditure will be dependent on it. That should give the public and members of Parliament reassurance that we have recruited capable external opinion to challenge the Government’s forecast, and that the commission will, ultimately, be able to say that it does not think that the forecast is reasonable. I cannot be clearer than to say to the committee that, if the Fiscal Commission were to say that it thinks that our forecast is not reasonable, I would have to produce a different forecast.

I am trying to convey to the committee the importance that I attach to having a strong challenge function on what the Government sets out in its tax forecasting proposition.

**The Convener:** I accept that and I am sure that many of my colleagues accept it. Do you not accept, however, from the evidence that I read out to you, that the perception will be somewhat different, regardless of the high standing and integrity of the individuals in the commission, if it comments on the Scottish Government’s forecast rather than producing its own forecast as an official forecaster, and that that will be detrimental to how it is perceived outside these four walls? Do you not accept that it would be better for the Scottish Government, for Parliament and for all concerned if the Scottish Fiscal Commission were to produce the forecasts, because that would

mean that there could be no mudslinging claims that the commission is part of the Scottish Government and not independent or, as we heard at FMQs, “a pup”—as unfair as that is?

**John Swinney:** No. I think that I have given the committee a lot of reassurance on that point. I have gone through it in detail.

The IMF’s written evidence to the committee in October 2015 said:

“There is no need for the SFC to present its own forecasts. The key requirement is that it is able to provide an independent assessment of the official forecasts.”

I would have thought that the International Monetary Fund’s strength of authority would give reassurance in addition to what I have said to the committee this morning.

**The Convener:** I will allow Jackie Baillie to come in briefly on that point.

**Jackie Baillie:** We are painting the situation as a decision between two options: either you forecast or you do not. There is a third way—yes, I dare to say that—that would involve enabling the Fiscal Commission to commission forecasting against which to benchmark the Government forecasting.

**John Swinney:** I have laboured the point considerably: there is nothing to prevent the Fiscal Commission from commissioning forecasts if it wishes to do so. However, with regard to the statute that is to be put in place, it is important that there is a Government forecast that the commission can use its energy and resources to challenge. That will give the public—who, we must remember, depend on our judgments being correct—confidence that the commission’s expertise is being deployed to provide the maximum possible assurance about the reasonableness of the estimate.

**The Convener:** John Mason wants to come in with a brief comment.

**John Mason:** Is there a danger that there would be a great deal of duplication and waste of resources, were the SFC to forecast? We are a relatively small country and we have only devolved powers. It seems that some people—I do not know whether you will agree with this, cabinet secretary—just want us to ape the UK and copy the OBR because they are in thrall to what goes on in London. What we want is something different. Ireland is a much better model than London for us to copy.

**John Swinney:** There is a real danger that there would be duplication and that misconceptions would be created. I can, for example, confidently say that the OBR’s estimate of £560 million to come from land and buildings

transaction tax in July is excessive and will not be realised. I do not know what good it serves to have that number floating around out there. Of course, it has been revised down by more than £130 million in the space of four months.

I am trying to convey to the committee that the public finances require rigorous challenge of the number that we produce, because our public expenditure depends on it. The Fiscal Commission will provide the independent authority to enable that challenge to take place.

**The Convener:** To be fair, the duplication issue was covered by the Chartered Institute of Taxation and the Institute of Chartered Accountants of Scotland, which take the same view.

Mr McDonald, are you wanting to come in with a brief supplementary?

**Mark McDonald:** I will, if you will be lenient enough, convener.

**The Convener:** You will be the last one.

**Mark McDonald:** I wonder whether another point has been overlooked. If we had gone with the OBR estimate at the outset, that would have dictated the block grant adjustment that would have taken place. In other words, if we had gone with a significantly overoptimistic estimate at the beginning of the process, there would have been knock-on consequences for the block grant as well as consequences further on for the public finances in terms of income from LBTT.

**John Swinney:** Mr McDonald is correct. I am pretty sure that I have the numbers correct in my mind, but I do not have them right in front of me, so I ask the committee to forgive me if I am wrong. The estimate that I had for the devolved taxes to be generated was at that time £461 million. The OBR estimate was £526 million, and the UK Government initially took the view—I was going to say that it was keen, but that is perhaps not fair—that it should go with the OBR estimate for the block grant adjustment.

The former Chief Secretary to the Treasury, Danny Alexander, accepted—to his credit—that we had a potentially valid alternative estimate, so we settled on a block grant adjustment of £494 million, which—if my recollection of the numbers is correct—is mid way between the two numbers. Mr McDonald is absolutely correct: we could have had a much higher block grant adjustment; that is one of the key points. It matters that we put all our resources into trying to get the most reliable estimate possible, because our public expenditure depends on it.

**The Convener:** I was going to add a further comment, but I will ask just one other question instead. It is on a different subject, which I touched on in my opening questions.

The fiscal framework will set out the role and responsibility of the Fiscal Commission and the OBR with regard to devolved taxes. Has a wider remit been discussed as part of the negotiations on the fiscal framework?

**John Swinney:** Wider issues could emerge from the fiscal framework, which may have implications for the contents of the Scottish Fiscal Commission Bill.

**The Convener:** Thank you for answering questions, cabinet secretary.

The cabinet secretary will join us again for the next evidence session. I suspend the meeting briefly to allow for a change of witnesses.

11:16

*Meeting suspended.*

11:24

*On resuming—*

## Subordinate Legislation

### Budget (Scotland) Act 2015 Amendment Regulations 2015 [Draft]

**The Convener:** Our next item of business is to take evidence from the Cabinet Secretary for Finance, Constitution and Economy on the draft Budget (Scotland) Act 2015 Amendment Regulations 2015. Mr Swinney is joined by Scott Mackay of the Scottish Government. I welcome our witnesses to the meeting and invite the Deputy First Minister to make an opening statement.

**John Swinney:** This is the first of two planned, routine in-year budget revisions. The second and final revision will be the spring budget revision, which will be laid in January 2016. As in previous years, a pattern of authorising revisions to the budget in autumn and spring is required as the detail of our spending plans inevitably changes from when the budget bill is approved.

The changes proposed in the autumn budget revision result in a net increase in the approved budget of £87.5 million from £37.3221 billion to £37.4096 billion.

The material adjustments to the departmental expenditure limit budget reflect the changes announced to Parliament at stage 3 of the 2015-16 budget bill on 4 February. In addition, the autumn budget revision reflects Whitehall transfers and Her Majesty's Treasury allocations in respect of energy efficiency measures as part of the green deal, a payment from London interbank offered rate—LIBOR—fines to Scotland's Charity Air Ambulance, savings in costs for the devolved taxes, and a payment related to the costs of converting civil partnerships to marriages.

There are a few significant transfers between portfolios that occur on an annual basis, primarily between health and education and between justice and health. Those budgets are initially allocated to the portfolio where the policy lies and then transferred to the portfolio where the spending occurs at the in-year budget revision. The significant transfers of this nature are the transfer of £54 million from health and wellbeing to further education for nursery and midwifery training and £30.4 million from justice to health and wellbeing in respect of drug treatment and prevention.

Members may wish to be reminded that, for the purposes of the Scottish budget, only spending that scores as capital in the Scottish Government's or direct funded bodies' annual accounts is shown as capital. That means that capital grants are shown as operating in the document. The full

capital picture is shown in table 1.7 of the supporting document.

There are no further new announcements or initiatives appearing in the figures that the committee is scrutinising today as the revisions reflect decisions or announcements that have already been made.

The “Brief Guide to the Autumn Budget Revision”, prepared by my officials, sets out the background to and details of the main changes proposed. I hope that colleagues have found the guide helpful. As I mentioned, the 2015-16 spring budget revision will be laid in January 2015; that is a little earlier than in previous years in order to complete the process before the Parliament is dissolved in March. In line with past years, that budget revision will be informed by on-going in-year budget monitoring.

I am happy to answer any questions from the committee.

**The Convener:** Thank you for that, cabinet secretary. I will ask some opening questions, to be followed by questions from my colleagues.

You touched on the transfer from health and wellbeing to further education and lifelong learning for nursery and midwifery training. That transfer has been made in the autumn budget revision every year since 2008-09. Given that it seems to be a recurring transfer, why has it not been incorporated into the draft budget plans at the outset of the yearly budget process?

**John Swinney:** I covered this to some extent in my opening remarks, convener, but the principle is that the money is allocated to the originating policy area, and then the transfer is made for a delivery purpose at a later stage. That is the rationale. However, you are correct to say that it has happened every year since I have been finance secretary. I am happy to look at whether there is a better way to do that in future.

**The Convener:** Given that you know that the transfer has to be made, from a budgetary point of view it would seem more sensible and tidier to deal with it initially rather than putting it in the autumn budget revision every year. Notwithstanding what you have said, the current arrangement does not seem to make any practical sense.

As you have pointed out, the funding changes in the autumn budget revision arise from a combination of Barnett consequential and what the Scottish Government describes as an

“internal robust monitoring process ... to ensure that we maximise the budget available in 2015-16 through some reprioritisation of spending.”

It is not made clear in the accompanying document what that method means in practical terms. Why is the split between the Barnett consequential and reprioritisation of spending not specified?

**John Swinney:** Essentially, we specify the new moneys coming into the budget settlement and then any other internal changes that we are making. It would be difficult for us to categorise what is uniquely funded by Barnett consequential and what is uniquely funded through reprioritised expenditure.

The details listed under each of the budget headings convey exactly what changes have been made. That is the more important question, given that we have specified the overall impact on the financial envelope that is available to us as a consequence of the new money received.

11:30

**The Convener:** Three of the changes were not mentioned in the stage 3 debate on the 2015-16 budget bill: the Scottish independent living fund of £16.5 million, the release of funding for justice and the Inverness justice centre. Why was that the case?

**John Swinney:** That arises from funding changes that have emerged from the UK Government: we are simply applying those changes to make sure that the resources can be deployed through the health, wellbeing and sport portfolio.

**The Convener:** Resource to capital transfer has been an on-going issue for the Finance Committee for some years, and it has been raised in relation to previous autumn budget revisions. The Scottish Government has said:

“We propose it is most appropriate to report on these aspects as part of the in-year revisions and the outturn report”.

The draft budget included an intention on the part of the Scottish Government to transfer £58 million from resource to capital, but that was not reflected in the resource to capital numbers. Are the planned transfers on track to be delivered in 2015-16, and what capital projects will they fund?

**John Swinney:** When we construct the capital programme, we use a number of different resource streams: capital DEL, some borrowing facilities from 2015-16 onwards, proceeds of asset sales, and resource to capital transfers. A mix of factors come together to create the capital pot that we then allocate.

Capital projects are not linked to the source of the money—for example, resource to capital transfers. We do those exercises quite separately to create a total capital pot that is then allocated. It

would be impossible to say that because of a resource to capital transfer we are funding a particular project. That would be a contrived analysis.

We will be able to update the committee in June about the extent to which that resource to capital transfer has taken place. We will look at the pattern of capital projects, how those capital projects are performing, whether the money is required this financial year, and a variety of other factors.

**The Convener:** So you look to optimise the capital resource rather than see what can be taken from the resource budget to allocate to specific projects to enable them to happen.

**John Swinney:** In the formulation of our capital plans, we have assumed a resource to capital transfer of £58 million. As we go through the year, we will be determining through our constant budget monitoring the extent to which that transfer is required. More may be required, depending on the circumstances that prevail. We are best to report on that once the financial year is concluded.

**The Convener:** There is a transfer from police central government to the Scottish Police Authority of £57.6 million operating and £10 million capital expenditure. All of the capital element of the transfer appears to have gone into operating expenditure. It is not clear how that fits in with the convention of not switching money from capital to operating spend.

**John Swinney:** It is to do with the point that I made in my opening statement about the fact that, for the purposes of the Scottish budget, only spending that scores as capital in the annual accounts of the Scottish Government or directly funded bodies is shown as capital.

Therefore, because of the Scottish Police Authority's status as a non-departmental public body, the money shows as resource but remains as capital. The currency does not change; it is just that, in the presentation of the information for the Scottish budget process, only the capital of the Scottish Government or directly funded bodies is shown as capital.

**The Convener:** Page 48 shows a reclassification of £7.5 million from direct capital to indirect capital in the housing and regeneration budget. What does that mean?

**John Swinney:** That is a revenue-neutral proposition that relates to the way in which the budget is shown in relation to the expenditure that we undertake versus expenditure that external bodies undertake. It is similar to the issue that you just raised with me about the Scottish Police Authority budget.

**The Convener:** Thank you for that clarification.

**Jackie Baillie:** I apologise to you, convener, and to the cabinet secretary because I will have to leave straight after my question.

I agree with the convener's comments about the transfer from health to education since 2008-09 not being reflected in the budget. It would certainly be helpful and aid transparency if those figures could be reallocated, and I am pleased that you are considering that, cabinet secretary.

The convener has done a comprehensive job of asking questions, so I will home in on the Scottish independent living fund. My understanding, which stands to be corrected, is that the fund was capped. It was devolved last year, so I am curious to know whether the £16.5 million is simply the amount that was devolved or whether there is any addition. The Scottish Government has been consulting on the fund and we are waiting to see what plans are in place to disburse it and how it will operate. Therefore, I am keen to interrogate the figure a little.

**John Swinney:** It is the agreed transfer from Westminster.

**Jackie Baillie:** Are you aware of the plans to disburse it?

**John Swinney:** My colleagues will set out the approach on that. Indeed, I think that some information already be in the public domain. However, I would need to check that because I am not absolutely sure about it.

**Jackie Baillie:** That would be helpful.

**John Swinney:** Obviously, the transfer enables that spend to be undertaken so, to respond to the points that Jackie Baillie raises, communication of information on the fund is certainly possible, given the fact that the Parliament will, I hope, authorise the transfer.

**Gavin Brown:** Cabinet secretary, the last line of the top table on page 37 of the budget revision document contains the heading "Release of funding for reprioritisation", under which £1.9 million of capital from the Scottish Prison Service budget is reprioritised. Is there any explanation for that? Is it savings in a number of projects or one? Is it due to cancellation? Is there any detail behind that number?

**John Swinney:** It will be a sum within the Scottish Prison Service capital programme. We operate a rigorous process of challenge, particularly about capital budgets, because the last thing that we want to find as the financial year goes through is that we have capital budgets sitting in places where they cannot be used. Therefore, organisations are challenged about resources that they require. In the later stages, the prisons capital expenditure is looking at £40.8 million. I would think that that £1.9 million relates



to elements of the programme that are not required and, because there is no need to allocate that expenditure, we can use it for other projects in the Government.

**Gavin Brown:** I refer to page 33 of the budget revision document. You might not be able to give me an answer now—you may need to get back to me—but I ask you to look at the bottom table on that page, where the “Legal Aid Administration” budget is given as £11.6 million. I compared that with the draft budget, where it is £10.6 million for the same budget line. I am a bit nervous about admin costs going up, in high percentage terms if not in giant cash terms. Is there an obvious explanation that you can offer, either now or in writing later?

**John Swinney:** We had better give the committee a note about that. There may well be issues there: there is no process point that will have changed, but there may well be a classification issue that affects the matter that means that the number is presented differently in the document before us compared with the budget document that Mr Brown has. There could be an issue of that nature, which has had that effect.

There could be some non-cash issues, but there might also be issues around the implementation of the Children’s Hearings (Scotland) Act 2011 and the work on supported activity in relation to advice standards. Some other minor issues may be associated with that. I suspect that it may be to do with the “Miscellaneous minor transfers” that are listed in the top table on page 33. We will check that.

**Gavin Brown:** I am grateful—thank you.

**The Convener:** We appear to have concluded all our questions on the autumn budget revision.

We therefore move to item 4, which is the debate on motion S4M-14961. I ask the Deputy First Minister to move the motion.

*Motion moved,*

That the Finance Committee recommends that the Budget (Scotland) Act 2015 Amendment Regulations 2015 [draft] be approved.—[*John Swinney.*]

*Motion agreed to.*

**The Convener:** Thank you for your appearance and for answering the committee’s questions, Deputy First Minister.

11:42

*Meeting suspended.*

11:44

*On resuming—*

## **Block Grant Adjustment**

**The Convener:** Our next item of business is to take evidence on the block grant adjustment. I welcome Professor David Bell and David Eiser of the University of Stirling—my alma mater, of course. Members have received copies of the executive summary of a recently published report examining the issue. I invite one of our witnesses to make a short opening statement before we move to questions from the committee.

**Professor David Bell (University of Stirling):** Thank you. This seems a bit like déjà vu—it takes me back to 2012, when I wrote a report for the committee that mentioned the block grant adjustment quite extensively and covered the various issues that seem to be coming to the fore once again.

The approach that I took was the same sort of approach that the Holtham commission took, which was to look at issues of risk and incentives for the Scottish Parliament once new tax powers had been devolved. It is difficult to see the same kind of narrative as one goes through the Smith commission report. The block grant adjustment had been left somewhat as an afterthought, but it is now widely acknowledged that it is a critical part of the overall settlement. In our paper, we go through three possible mechanisms that might be used for the block grant adjustment, which I am afraid are rather nerdy. Also, there is an error—which we will correct—in one of the equations that we use to describe the different mechanisms. I am sure that the committee has noticed it. Essentially—

**The Convener:** Excuse me for interrupting, but I am going to point randomly to a member of the committee and ask them to describe the error in the equation. They can all sit there looking nervous until I have fingered one of them for that.

**Professor Bell:** We can go through the different issues in different ways, but we are finding it difficult to determine one clear and simple mechanism for arranging the block grant adjustment, while holding on to the Barnett formula, that seems simultaneously to satisfy all the so-called principles in the Smith commission report, such as taxpayer fairness and the no-detriment principle, which we may well end up discussing. Those are the general issues that we see, some of which our paper attempted to elucidate. One of our main conclusions was that it was very difficult to satisfy all the principles that Smith apparently set down.

It is an issue of risk and reward. Scotland will not necessarily do significantly worse as a result of particular mechanisms. Our paper shows that Scotland would have done relatively well with one of the mechanisms. Had the block grant adjustment started in 1999, Scotland would be more than £1 billion better off, rather than worse off. We have seen some stories in recent weeks about how Scotland might be worse off. It is a question of what risks Scotland faces and how the Scottish economy performs, particularly in relation to the amount of tax revenues that it generates.

**The Convener:** I thank you and David Eiser for an excellent paper. Most of the questions that I would have asked are answered in the paper but, for elucidation, I will ask some of them anyway. In the second paragraph of the executive summary, you say that

“the precise way in which the”

block grant adjustments

“are indexed over time could mean differences of over a billion pounds a year in the Scottish Government’s budget after a relatively short period of time.”

I take it that the short period of time that you are talking about is 16 years. Thank you for your elucidation of that point in your introduction, because I was going to ask over what period you had assessed it. You also say that

“analysis suggests that the Smith Commission’s principles may not be workable and are not mutually compatible.”

**Professor Bell:** David Eiser can add to what I am about to say. I was at the committee about a month ago discussing behavioural responses to—

**The Convener:** —the Scottish rate of income tax.

**Professor Bell:** Yes. On whether the evaluation of behavioural responses, which may form part of the imposition of the no-detriment clause, can be consistent with simple, mechanistic, year-on-year adjustments to the block grant, which will not require a great deal of negotiation between the parties concerned, I would say that that does not seem to add up.

**David Eiser (University of Stirling):** A number of different principles are set out in the Smith commission agreement, some of which are not particularly compatible in a number of ways. David Bell spoke about the principle of no detriment in relation to policy decisions, which recognises the interdependencies between the policy decisions of one Government and the revenues of another and implies that there should be some sort of compensating payments between the Governments where a policy decision by one Government affects the revenues of the other. Working out what those compensating payments might be would be subject to a great deal of

contention and uncertainty. Satisfying that principle at the same time as satisfying the principle that the fiscal framework should be simple, fair and largely rules based will be a challenge.

There are other sets of tensions between some of the no-detriment principles. For example, there is the principle that there should be no detriment from the decision to devolve. There is likely to be tension between the block grant indexation mechanism by which we might choose to achieve that principle and the no-detriment principle that relates to taxpayer fairness and how a tax rate change by the UK Government might affect the revenues through the block grant that is available to Scotland.

**The Convener:** Thank you for that. You have said that, in future years, the block grant adjustments will have to be indexed to account for inflation and likely economic growth and that they should be indexed appropriately.

In your submission, you refer to the three methodologies that could be used—indexed deduction, per capita indexed deduction and levels deduction. You go into some detail on the pros and, in many cases, the cons of those basic approaches.

I take it from the analysis in your submission that although we do not know whether the per capita indexed deduction method would be the best method going forward, it would seem on balance—certainly based on figures for the past 15 or 16 years—to be the best methodology. Is that a reasonable suggestion?

**Professor Bell:** That method has some attractions. Again, to use the language of risk and reward, it takes out the risk of differential population growth because it works on a per capita basis. One could make the case that Scotland does not control immigration policy and therefore does not have the political levers to fully affect the size of Scotland’s population; a case could therefore be made for making per capita adjustments on that basis.

The third method is the so-called levels method, which is the most symmetric as far as the Barnett formula is concerned. As you know, under the Barnett formula, Scotland gets its population share of spending increases in Westminster.

According to the levels method, the block grant adjustment would increase by Scotland’s population share of the increase in tax revenues at Westminster. That is symmetric with the Barnett formula in the following way. If there was an increase in comparable spending of say £100 million south of the border, which was financed by an increase in income tax of £100 million south of the border, the net effect on the Scottish budget

would be zero. Scotland would get its population share of the spending increase, which would be offset by its population share of the tax increase. They would be the same—it would be £100 million in each case. There is symmetry there.

The reason why Scotland might well do worse under that method is that Scotland's per-head level of tax receipts is lower than levels in the rest of the UK. We keep getting adjustments to the block grant adjustment that do not compensate in the same way as the per capita indexed deduction, which is measured over the whole grant, as opposed to the change in the grant.

One way of thinking of it is that the levels method increases the rate of convergence, which we talk about in relation to the Barnett formula. The levels method would increase that rate of convergence towards level spending per head in Scotland and in the rest of the UK, as opposed to the current situation where per capita spending per head is somewhat higher in Scotland than it is in the rest of the UK.

**The Convener:** You say in your paper:

“There is a lack of consensus, or even debate, about the type of fiscal risks and incentives Scotland ... should face.”

That is why we are discussing these issues now. You continue:

“Should Scotland face risks associated with relative population change? Should it face risks associated with differential demographic or economic change, over which the Scottish Government might have only limited control. Without such a debate it is difficult to recommend a particular form of BGA as these are intimately linked to the type of fiscal risks and incentives a Scottish Government will face.”

However, you are suggesting that the per capita indexed deduction method is the least worst option.

**David Eiser:** If you were to assume that, for the foreseeable future, population growth is likely to be slower in Scotland than in the rest of the UK, you would probably go for per capita indexed deduction as the mechanism for indexing your block grant adjustment, because it protects you from the risk that your population grows relatively slowly.

I suppose that one of the arguments against that is to do with how the Barnett formula works on the spending side. It effectively rewards Scotland for relatively slow population growth, because it only adjusts for that relatively slow population growth on the margin of the new spend. The rate of convergence that we would expect to get through the Barnett formula is offset on the spending side if Scotland's population grows more slowly. Why, then, should we have per capita indexed deduction protecting Scotland from relatively slow population growth on the revenue side?

**The Convener:** Indeed. As you say in your paper, that would perhaps mean that there would be no incentive for Scotland to grow its population. Even if Scotland tried to grow its population, London would still remain a magnet for people across the world, and it would be difficult to compete with it as an entrepot. That is not so much about the rest of the UK; it is about London in particular.

You have also said:

“Scotland's Barnett-determined block grant will clearly need to be adjusted to reflect both the new tax-raising powers and new expenditure responsibilities being devolved.”

I want to press you a wee bit on how that should be adjusted.

12:00

**Professor Bell:** Given that £2.5 billion will be added to Scotland's budget to cover the new responsibilities in relation to welfare, there is a question about how that should be adjusted. There are different potential approaches. Do we adjust on the basis of population or do we make some adjustment for need? The latter would be pretty difficult, given that a variety of different needs are covered by the different welfare powers that are being transferred, such as the carers allowance, attendance allowance, disability living allowance and so on. You could try to fine tune the adjustment for the new welfare powers in relation to the particular benefits that are being covered, but if Scotland decides to have a different benefit system, it will be increasingly difficult to figure out what we call the counterfactual—what would have been spent in Scotland on the powers that are being transferred if they are no longer being used by the Scottish Parliament.

**The Convener:** I know that you are being cautious and putting out various options but, if you were making the decisions, given what is going to be further devolved, what would your approach be? When I say “you”, I am referring to the whole panel.

It is unfortunate that David Phillips is not here. Do you have to be called David to be a member of your group of authors?

**Professor Bell:** Yes.

**The Convener:** I thought so.

**David Eiser:** Again, it is partly a question of trade-offs between the different principles in the Smith commission agreement and which principles are thought to be the most important. Another question is consistency in adjusting the block grant in relation to tax.

If the block grant adjustment for devolved taxes is to be indexed on the basis of indexed deduction—that is, the percentage rate of growth of tax revenues in the rest of the UK—there is an argument for using the same approach to index the block grant adjustment in respect of the devolved welfare powers. That means that the block grant adjustment for the devolved welfare powers would be indexed on the basis of the percentage change in total spending on those welfare benefits in the rest of the UK.

There is an argument for symmetry in how the block grant is adjusted for tax and how it is adjusted for welfare, but there is also a question of trade-offs between the principles in the Smith commission agreement that are thought to be the most important. That influences which indexation method is thought to be the most appropriate.

**Professor Bell:** On the spending side, Scotland's block grant would be adjusted on the basis of changes in spending down south. If you go for the per capita indexed deduction for the block grant adjustment, you are adjusting on the whole of tax revenues south of the border. As David Eiser said, there is already asymmetry in those approaches. If something different again was introduced for welfare powers, you would end up negotiating over different mechanisms for different bits of the budget, which would undoubtedly slow the agreement process.

**The Convener:** As if the process was not slow enough the last time a block grant adjustment was made.

You said:

"The Smith Commission says that the UK government should bear 'economic responsibility' for its own policies, and the risk of any shocks that affect the whole of the UK, and the Scottish Government should bear the 'economic responsibility' for its policies",

but that the Smith commission

"says nothing about who should bear the underlying revenue or spending risks in Scotland."

**David Eiser:** This is taking a step back, but it is probably worth remembering that the block grant adjustment in year 1 is simply the level of taxes that are raised in Scotland in that year. We want to index the block grant adjustment over time to some measure of how taxes change in the rest of the UK.

We want to index to the changes in those tax revenues in the rest of the UK to protect Scotland from fiscal shocks that hit the whole UK. If revenues fall in the rest of the UK, there will be an offsetting reduction in the block grant adjustment. The argument is that, over time, if Scotland's revenues grow relative to the counterfactual—that is, what we would have expected to happen to Scotland's revenues had they not been

devolved—the Scottish budget will benefit from the difference between the block grant adjustment and the actual growth in revenues in Scotland.

The paper makes the point that it will not be possible in reality to ever know to what extent differential growth in Scotland's devolved revenues is due to specific policy decisions of the Scottish Government that have caused revenues to grow above the block grant adjustment and to what extent it is due to factors that are beyond the control of the Scottish Government or the UK Government. There is an area that falls between risks that are insured by the UK Government and rewards that are directly due to Scottish Government policy.

**The Convener:** I will touch on one final area—borrowing—before opening up the session to other committee members. David Phillips previously pointed out to the committee that the method for indexing the adjustment of the block grant

"will have major implications for the scale of current borrowing powers required."

Will you talk to us about the relationship of the three potential indexing methods to borrowing?

**Professor Bell:** The issue as far as borrowing is concerned relates to uncertainty about the forecasts for tax revenue growth in the rest of the UK. If that is forecast badly, the block grant adjustment will be forecast badly. The consequence might be that the Scottish budget is out of line with what the reality turns out to be.

The question then is whether it is more difficult to forecast the change in taxation or to forecast the overall level of taxation. You would think that they must be the same, but uncertainty is associated with tax revenues in the UK as a whole, even a year and a half after they were supposed to have been collected.

Under the indexed deduction or per capita indexed deduction method, the size of errors could be greater. The consequence is that greater borrowing powers would be needed. We would need to consult a spreadsheet and make assumptions about the kinds of errors that might turn up before we could commit to a number. I worked out an example in a paper for the committee when we discussed borrowing powers earlier this year. It showed that the proposed powers to borrow £300 million to cover current revenues, which is essentially what we are talking about, would not have protected Scotland at the time of the financial crisis. The implication is that the change in the block grant adjustment would have been substantially bigger than that.

**The Convener:** I open up the session to colleagues around the table.

**Richard Baker:** Gentlemen, I ask you to imagine that you are speaking to a layperson—somebody who might not have immediately identified your inaccurate equation. It seems that the concerns that we have seen in the media about the impact on the Scottish budget have related to the indexed deduction, as you describe it in your paper, and that the dangers and risks of that are substantially, if not entirely, compensated for by the per capita indexed deduction. Whatever the merits or otherwise of that approach, there is a lot of protection for the Scottish budget in it.

**Professor Bell:** As David Eiser said, it is a question of which risks Scotland should take. I went back to Holtham's paper on the initial discussion about the block grant adjustment for Wales. It clearly considers different risks and the implications for the block grant adjustment. It is regrettable that the Smith commission did not have sufficient time to examine risks and incentives as far as the Scottish Parliament and Government are concerned.

In the indexed deduction, we take the risk that Scotland's tax revenues will grow more slowly than those in the rest of the UK. They could do that if productivity growth per capita in Scotland was, say, less quick. We do not know that that is the case, but we might surmise that it is; it is a possible forecast. We also take the risk that the number of taxpayers in Scotland could grow more slowly than in the rest of the UK.

With the indexed deduction method, we have both those risks. If we do the per capita indexed deduction, we take out the population part of that and are left with only the question whether revenues per head will grow more slowly or more rapidly in Scotland than they do in the rest of the UK. Therefore, it removes part of the risk.

The population projections show Scotland's population growing more slowly than the rest of the UK's up to 2060. Population projections are not always right, but they are indicative. As I said earlier, we could certainly argue that Scotland does not have full policy control over the size of its population.

**Richard Baker:** We are debating future tax levels in Scotland with the new powers, but there has been little indication from the Scottish Government or others of whether, with those powers, there will be any big move to cut tax rates to attract more people into Scotland. The committee has heard evidence that it would be difficult to guarantee such a population flow into Scotland by cutting tax, because the international evidence seems to be sketchy about whether such changes make people behave in that way.

**Professor Bell:** I go back to the evidence that I gave about a month ago on the behavioural

response to changes in tax rates. It is not clear that the powers under the Scotland Bill would allow Scotland to follow the kind of policies that seem to have an effect. It is also difficult to translate lessons that are learned in other cultures, where there are different attitudes to taxes, into something that allows one to make a strong prediction about what would happen in Scotland. On that basis, the Scottish Government should be cautious in the first instance.

**Richard Baker:** Given that, and given that the Barnett formula currently protects Scotland for its lack of population growth relative to the rest of the UK, what are your further thoughts on why the per capita indexed deduction system does not pass the test of taxpayer fairness?

Further on in your paper, you discuss reforming the Barnett formula with a formula akin to the PCID approach. You also state that none of the systems

"fully satisfy ... 'taxpayer fairness' ... in all circumstances."

Why is that true specifically for PCID?

12:15

**Professor Bell:** David Eiser can speak about taxpayer fairness, and then I will come back in.

**David Eiser:** I will try to. The issue of taxpayer fairness that we discuss in our paper was raised in the Smith commission report, which argued that, if the UK Government were to change income tax rates once they had been devolved to Scotland, the change in rates in the rest of the UK should have no bearing on spending in Scotland.

As we have touched on, the Barnett formula operates by calculating the change to Scotland's grant as a population share of changes in levels, whereas the indexed deduction and the per capita indexed deduction both work on percentage changes. Ultimately, that means that there is not a balance. If the UK Government were to increase income tax rates and spend that money on comparable services in England, the Scottish Government would benefit through the Barnett consequential by more than the amount by which its block grant adjustment would be increased, because of the increase in tax revenues in England. That is because of the difference between a levels approach on the spending side and a percentage approach on the revenue side. There is an issue with the taxpayer fairness principle in that respect.

**Richard Baker:** Would that approach be unfair to the rest of the UK, in effect?

**David Eiser:** Yes.

**Richard Baker:** Fine. That may not be the—

**David Eiser:** I am sorry—I will just clarify that. If tax revenues were increasing in the rest of the UK, the situation would be unfair to taxpayers in the rest of the UK, but things would work the other way round if there was a cut in income tax rates in the rest of the UK.

**Richard Baker:** Right.

**Professor Bell:** I will make one point in relation to the Barnett formula. The adjustment methods that are being proposed are contingent on the existence of the Barnett formula. There must be a block grant that is determined in the way that it currently is in order to have a potential set of adjustments to that grant.

As I think that Jim Cuthbert and Anton Muscatelli have argued, there is a possibility of a big divergence between where Scotland might have been if the Barnett formula had just continued as is and the situation that would arise if the adjustments were to take place. We have shown that, in recent history, Scotland has done relatively well, but I am not necessarily arguing that that predicts where it might go in the future. It all depends on relative economic performance. The argument is that, potentially, there is no end point to the adjustment. Jim Cuthbert made the point fairly clearly that Scotland's block grant could, in certain circumstances, wither away entirely.

None of the modelling that has been done so far has captured the following point. Let us suppose that tax revenues in Scotland were growing substantially and consistently less rapidly than those in the rest of the UK. Scotland's grant would be falling but, in the Scottish economy at large, real wages would not be keeping up with those in the rest of the UK. There would come a point when investors in the rest of the UK noted that, as Scotland was a relatively cheap place to invest in, they could increase their investment here. To some extent, that would offset the difficult scenarios that other commentators have portrayed.

**Richard Baker:** So we are in a world of multiple hypotheticals.

**Professor Bell:** Yes.

**The Convener:** Indeed. We are now a small but perfectly formed committee of five, given that Jean Urquhart has abandoned ship.

**Gavin Brown:** You have set out three options—ID, PCID and LD. To what extent have the three of them been tried anywhere else, at any point? If they have been tried, to what level of success or otherwise have they been utilised in other scenarios and countries?

**Professor Bell:** David Eiser can chip in on this, but my understanding is that, because no one else

has anything that is equivalent to the Barnett formula, there is no equivalent to the block grant adjustment.

Most other jurisdictions work on some measure of ensuring that parts of the state that are relatively poor can provide a given level of public service. They do that in two ways. First, they make transfers to increase the spending power of the poorer areas. Secondly, they adjust tax revenues where the taxable capacity of an area falls below that of the state as a whole.

The Barnett formula is different from those mechanisms. However, in recent months, a potential floor on the Barnett formula has been introduced in relation to Wales. That says that, because the Barnett formula ultimately means convergence to equal spending per head across the UK, convergence has been very slow. However, as far as Wales is concerned, convergence will not go below a given level. That says implicitly that Wales has a certain level of need relative to England, Scotland and so on. In that instance, the Barnett formula is being adjusted for need; at the minute, it does not do that at all.

That was a very long-winded answer, which could have been made much more simple by saying that nobody else has the Barnett formula, and there is nothing else like the indexation methods that we are talking about.

**Gavin Brown:** I would describe that answer as interesting, as opposed to long-winded. Does Mr Eiser have anything to add?

**David Eiser:** No—I would make the same points.

**Gavin Brown:** That is helpful. So, basically, there is no precedent and we are in uncharted territory.

An agreement will be reached at some point. We are told that that will happen after the Scottish budget process. I do not know whether that will be in January, February or thereafter, but an agreement will be reached. Presumably, the preference is for the agreement that is reached to be of at least medium-term duration so that we are not revisiting it every year.

Once an agreement has been reached, would there be merit in having a system in place whereby every 10, 15 or 20 years—whatever the number of years ought to be—there is a formal review of the mechanism? Obviously, doing that every year would defeat the point of devolution, but would there be merit in having a longer-term system of formal review?

**David Eiser:** There is certainly a case for periodic review, although quite how that would be

written into legislation I am not sure—that is not what I am an expert in.

**Professor Bell:** It seems to me that intergovernmental arrangements will have to be ramped up to make the system work. There are cogent arguments around whether the Treasury should be both judge and jury in determining what the block grant adjustment will be. It sets the statement of funding policy, which has had a significant impact—David Eiser has written about this—on Scotland’s DEL allocation for the next four years, as was announced in the spending review last week. There have been changes in non-domestic rates. It is a Treasury-only document that determines the block grant, and that has knock-on implications for the block grant adjustment.

Aside from getting an agreement on the indexation mechanism, there has to be an agreement about how it will be administered and what level of intergovernmental co-operation is necessary to make it work effectively.

**Gavin Brown:** On page 5 of your executive summary, you say:

“The ‘compensation principle’ set out by the Smith Commission will be impractical to fully implement.”

That is perhaps something of an understatement. Are we kidding ourselves that it can actually be implemented?

You speak about

“isolating the effect of government policies”

and trying to work out and consider the knock-on effects and so on. To some extent, I do not think that the compensation principle has been discussed as widely and deeply as it might have been across the UK. Do you think that there is some way of implementing it, or are we kidding ourselves?

**David Eiser:** For a given policy change by one Government, there could be any number of knock-on effects. Were the Scottish Government to increase income tax rates, that may affect RUK revenues on non-devolved taxes in Scotland, or it could affect spending on non-devolved benefits in Scotland. The real question is about how far we want to take the compensation principle.

We cannot imagine that we can estimate and calculate the effects of every knock-on effect imaginable, no matter how small, although there is possibly a case for saying that particularly large effects could be calculated. There will always be contention around such effects, even if there are some pretty major ones.

Given the trade-off between that no-detriment principle and some others, there is a decision about how important the no-detriment principle is.

It is particularly unusual in the context of other devolved systems. There is an argument for saying that it undermines some of the point of devolution if we take that principle very far, so perhaps we should not take it very far and we should prioritise some of the other principles.

**Professor Bell:** The House of Lords Economic Affairs Committee took evidence from Mr Cottarelli from the IMF. He studies fiscal federalism across the world, and he was asked whether the no-detriment principle had a parallel elsewhere. He could not readily find an example of a similar approach.

As David Eiser said, it seems almost impossible to follow through all the ramifications for the two jurisdictions of one party changing taxation or spending, along with the implications for other taxes and the knock-on effects on benefits and so on throughout the UK. It would be well beyond the existing expertise in the OBR, for instance, to follow the money through that.

**Gavin Brown:** I take it that you are not planning to dedicate a paper to that single issue?

**Professor Bell:** Not immediately, no.

**Gavin Brown:** Thank you.

12:30

**John Mason:** This is quite a complex area. You mentioned that the Barnett formula was intended to bring convergence to expenditure per head throughout the UK, although that has not happened. Is that because the Scottish population has not grown in line with that of the UK, which was not foreseen at the time?

**Professor Bell:** No, I do not think so. When the Barnett formula was first thought of in 1979, it was felt that it roughly represented levels of need in different parts of the UK. I am not sure whether it was a rough rule of thumb that seemed convenient at the time or if people had thought through its convergent properties. Nevertheless, it is true that, particularly as a result of Scotland’s slower population growth, the convergence has been very slow. The same is true in Northern Ireland, but perhaps less so in Wales, which is now closer to the UK average.

**John Mason:** When we say, as the Smith commission did, that Barnett is being continued, are we referring to the literal mathematical side of it or also to the principle of Scotland being rewarded for its population not growing?

**David Eiser:** By retaining the Barnett formula, we are keeping both the mathematical property, with everything that that entails about relative population growth and convergence, and the existing starting point. That is what I interpreted

the Smith commission to mean in saying that we will retain the Barnett formula as the starting point and adjust from there.

**Professor Bell:** The same calculation, which is Barnett determined, will be done each year. That implies convergence over time and the calculation is also adjusted by the issues that we have talked about today. The principle of Barnett remains.

**John Mason:** Towards the end of the executive summary to your paper, you refer to

“what the UK’s fiscal union is for”

and to having

“a proper debate about these issues.”

Is that in the longer term, beyond where we are at the moment and the block grant adjustment?

**Professor Bell:** Yes. There is no time to get those wider issues debated sufficiently to influence the current tide of events. If the arrangements in the Smith commission report, which then fall into the Scotland Bill, receive the consent of the Scottish Parliament, they will somehow have to be made to work.

**John Mason:** Would I also be right in saying that, whatever method we choose, depending on what happens to the relative populations, in one scenario that method would benefit Scotland and in another scenario it would benefit the rest of the UK? Is that almost inevitable?

**Professor Bell:** Yes; absolutely. In the short to medium term, the changes in relative population take place at a relatively slow pace. It is by no means as variable as, say, economic growth.

**John Mason:** Therefore, depending on relative economic growth, one or other part of the UK will benefit.

**Professor Bell:** Yes. That is so in the short run, unless we have massive short-run changes in population, which I do not think that we envisage.

**John Mason:** You talked about the tax per head in Scotland being lower than in the UK and higher rate taxpayers tending to live in the south-east of England and so on. If either the UK or Scotland becomes flatter or more equal—whatever the term might be—would that have an impact on how Barnett works? One of the arguments that we have been given is that if we make tax fairer, we will get less tax, because the rich people pay the most and if we cut their incomes, we will get less tax—even if it were shared out more equally. Is that part of the equation? If we were to make Scotland fairer, would that inevitably hurt our tax base and therefore affect the Barnett formula?

**David Eiser:** I do not think that it is inevitable. That is part of the responsibility that comes from the devolution of the taxes. Once income tax has

been devolved to Scotland, it will be up to the Scottish Government to have whatever tax rate structure it wants. If, by changing the tax rate structure, it increases its revenues relative to the block grant adjustment, its budget will be in a better position than it would have been without the devolved revenues. If, on the other hand, it changes the tax rate structure and as a result, the revenues are lower than the block grant adjustment, its budget will be worse off.

There is no guarantee that any particular tax rate change will result in any given revenue change. That is not what we have modelled in the report. The point is that the power—the responsibility—is devolved, so that you get the rewards for whatever tax policy you choose to implement. There may well be a trade-off between the tax policy that maximises revenue and the tax policy that achieves the level of redistribution that you want. That decision will have been devolved.

**John Mason:** Thank you.

The convener quoted from your executive summary, in which you say:

“The Smith Commission says that the UK government should bear ‘economic responsibility’ for its own policies”,

and that the same should apply to the Scottish Government. Does that make a difference between an assigned tax, such as VAT, and a partially devolved tax, such as income tax? Is it harder to measure? We could vary income tax differently from the UK, which I assume would make it harder to measure, but could we say that almost everything that happens to VAT is the responsibility of the UK Government, or is that not clear?

**Professor Bell:** VAT is an assigned tax, so Scotland gets its share of 10p-worth of the VAT revenues from Scotland, but it has no power to vary the structure of that tax—that power rests entirely with the UK Government. The UK Government will have to bear the consequences of any changes as far as VAT is concerned.

As you suggest, income tax is more complex, because Scotland can take decisions over which it has to assume responsibility and the UK Government can make its changes and it accepts responsibility in relation to those. You must then think about the interaction between changes that are made at the different levels. That is where the no-detriment principle comes in and trying to calculate whether the other Government has been made better or worse off as a consequence of any changes.

**John Mason:** So VAT is more closely linked to what the UK Government does than income tax. Ultimately, if the UK Government mismanaged the economy and VAT fell, for various reasons, should



the UK Government compensate us for the reduction in VAT revenue, or do we just get exactly half of what the UK Government collects?

**David Eiser:** There is an added level of complexity with VAT. When we have been talking about the block grant adjustment in relation to income tax, we have been talking about tax revenues, whereas when you talk about the adjustment for VAT, you are probably talking about a tax base, for the reason that Mr Mason has described.

For example, if the UK Government were to cut the rate of VAT, you would not want there to be an impact on the Scottish block grant, because the rate of VAT would also have been cut in Scotland—Scottish taxpayers would also be experiencing the lower rate of VAT. Therefore you would not want the adjustment to be based on revenues. By making the adjustment on the tax base, rather than on revenues, you would avoid that linkage, because the base does not change when the VAT rate changes.

**John Mason:** That is helpful, thank you. My final point is that we are struggling at this committee to really understand all this—

**The Convener:** Speak for yourself.

**John Mason:** —apart from the convener. You folk are experts. It seems to me that the public are very unlikely to really get into the nuances; I do not mean to insult them. Must we choose some fairly simple method, accept that it will not be perfect and then, as Gavin Brown suggested, review and revise it every five or 10 years? That is not as pure an answer to the issue as I would like, but in practice do you think that that is where we have to be?

**Professor Bell:** I certainly suspect that that is the case. I think that by making the fiscal framework a sort of addendum to the Smith commission report—a relatively minor part of the overall report—you are not exposing the Scottish public to any real debate about the issue that, it seems to me, this should all be about. That is the question of the balance of risk and incentives. Should Scotland be protected from an economic shock that hits the whole of the UK? Should it take the risks and the rewards that are associated with the policy decisions of the Scottish Government?

If the debate had been framed in that way from the outset, rather than it just being a question of going through a list of taxes and saying, “You have this, you have that,” and doing the same for welfare benefits, people would have had a better understanding of what is going on. That is not to say that it would have been simple.

I agree that you will probably have to make do for a certain period of time and then review the

situation a bit down the line; I do not know how far down the line—maybe five years.

**John Mason:** That is helpful; thank you.

**The Convener:** I hope that we will end up with the best method rather than the simplest one.

**Mark McDonald:** Most areas have been touched on. You have spoken about the second no-detriment principle. I think that most people have now accepted that that principle is extremely complicated to fathom, if not virtually impossible, given how far into the future we can project behavioural responses to a tax change, and how much we can directly link it to that decision versus other factors.

However, your paper seems also to cast doubt on the first no-detriment principle—the principle of no detriment at the point of devolution—particularly where it says that we cannot, in essence, have that and the element of taxpayer fairness. Do you want to expand on that?

**David Eiser:** The two principles are no detriment from the decision to devolve, and taxpayer fairness.

To address the no detriment from the decision to devolve principle, we have an indexation method that, in effect, tries to ask what the UK Government would have raised from the taxes that have been devolved had they not been devolved—like a counterfactual. It seems to us that the most sensible way of producing that counterfactual is to base it on some measure of the percentage growth in revenues that are devolved to Scotland. For example, if the income tax revenues grew by 10 per cent or by 10 per cent per capita in the rest of the UK, there would be an argument for saying that we would expect those revenues in Scotland to have grown by 10 per cent or by 10 per cent per capita—whichever of those methods we choose.

12:45

Take a simple example: assume that there is one taxpayer in England and one taxpayer in Scotland. The taxpayer in England pays £100 and the one in Scotland pays £90. That is the kind of situation from which we start. If revenues in England were to increase by 10 per cent, the figure would go from £100 to £110. If we were using one of the indexed deduction methods—either the per capita indexed deduction or the total indexed deduction—that would imply that we assume that the revenues in Scotland would also grow by 10 per cent, so we would go from £90 to £99. The adjustment would be £9. However, if we used the levels deduction method and the increase in England was from £100 to £110, the population share of that increase would be £10 for

Scotland. We get a difference between what the adjustment would be if we used the percentage approach, which would be £9 in Scotland, and if we used the levels approach, which would be £10 in Scotland. That is what we mean when we talk about the tension between percentages and levels and why we get a trade-off between the two principles.

What is better to use as an assumption about how Scotland's revenues will grow over time? It seems that the percentage principle is the fairer. The levels approach seems to be a bit unfair to Scotland because it assumes that, in percentage terms, revenues in Scotland have to grow by even more than they do in England just to keep up. However, the levels approach gives us symmetry if there is a tax-rate change in England that funds spending on comparable services.

**Mark McDonald:** The passage that leaps out from your submission—it is in bold, so I suspect that it is designed to do so—is the one that says:

"it is impossible to design a block grant adjustment system that satisfies the spirit of the 'no detriment from the decision to devolve' principle at the same time as fully achieving the 'taxpayer fairness' principle".

You have described the tension that exists. We are all fumbling in the dark until we see the detail of the fiscal framework, but do you get the impression that the tension that you highlighted is on the radar in the discussions that have been taking place?

**David Eiser:** I have no doubt that it is on the radar.

**Mark McDonald:** We have seen the messages from the likes of Professor Muscatelli and the Scottish Trades Union Congress about the potential pitfalls, depending on how the fiscal framework is drafted. Do you get the impression that work has been done, or is being done, in the fiscal framework discussions to offset pitfalls? I am particularly interested in work that is being done from the Treasury perspective, as most of the commentary that I have seen was about potential detrimental impact on Scotland, rather than on the Treasury.

**David Eiser:** Obviously, we are not party to the discussions. I have no doubt that plenty of analysis of the implications for the Scottish budget and the Treasury under various different scenarios is going on on both sides. It gets complicated quite quickly because, depending on what we assume about how population changes relative to how revenues and spending change, we get different answers about which adjustment mechanism might favour the Scottish budget or the Treasury's budget over a period. Quite how all that analysis will come together to arrive at a chosen method, I do not know.

**Professor Bell:** The exercises that we have done show that the outcome may depend quite a lot on the year when we start the calculation. There is an argument for considering an average over a two-year or three-year period, initially. If the no-detriment principle applies at the point of devolving the tax, the decision could be taken to average that out over two or three years. Then, I think that—

**Mark McDonald:** I am sorry to interject. You are quite right that the received wisdom has used the point of devolution. Using the point at which the decision to devolve is made sets things slightly differently. In your paper you say that there could be, depending on the indexation that is used, an attritional factor over the longer period, which could be construed as part of the decision or the point of devolution if there is an acceptance, at that stage, that the indexation that is used will lead to that attritional factor. Could you trace that back and say that that violated—for want of a better term—the no-detriment principle at the point of devolution if you knew that that attritional factor was built in?

**Professor Bell:** If it is possible to do a counterfactual from the year when devolution takes place, it will always be possible to do the counterfactual from alternative years round about then, or from whatever point in the future. That will cause one party or the other to regret that the decision to devolve was not made at a point in time that was more favourable to their particular case.

It is difficult to know how the negotiations will go—obviously, they are closed. It is not clear that there is any agreement about what should be the underlying principles on which the decisions that govern the design of the block-grant adjustment are based. I guess that, as David Eiser said, both parties are trying to make the best guess about which index would give the best outcome for their particular budget—the Treasury or the Scottish Government—over the medium to long term.

That reinforces the point that, without a set of principles guiding that decision and if—horror of horrors!—a compromise were to be reached between the levels method and the per capita index deduction method, the matter would probably need to be revisited in the medium term, say after five years, to ascertain where the mechanism is leading as far as public spending in Scotland and the growth of the Scottish economy are concerned. We would all, however, struggle to understand what such a compromise might be.

**Mark McDonald:** I entirely take your point about the counterfactual. You were all blessed with 20:20 hindsight on these matters.

You have comprehensively outlined the risks that are attached to certain types of indexation and the likelihood of detriment, depending on which indexation is applied. It could therefore be reasonably assumed that, if the type of indexation that was being applied was known at the point of devolution, and if there was a comprehensive analysis saying that, as a result of that indexation, there would be an attritional detrimental element to the revenues, the no-detriment principle was, arguably, not being complied with at the point of devolution. I realise that there are some caveats built into that. One could always factor in future counterbalances, such as improved economic performance or unexpected population growth, which could spike that. If it were known at the beginning that there would be potential detriment if nothing changed and the indexation were applied as a rule, that could be construed as the point of devolution.

**Professor Bell:** That is an interpretation of no detriment and it is a line that could be pursued. There is nothing against that argument, in principle. That interpretation of what the second no detriment principle means does seem—

**Mark McDonald:** I am referring to the first principle. We have worked out that it is virtually impossible to come to a conclusion on the second principle.

If, hypothetically, we get the income tax powers, according to your paper,

“Scotland does lose out somewhat under the ID approach”

but

“under the LD approach it loses out even more”.

Your paper suggests that Scotland will lose out if those methods are applied.

**David Eiser:** That will depend on how circumstances evolve. Under the levels deduction method, tax revenues fall over time. That is likely to be the best method for Scotland. We are trying to select a method up front and then allow Scotland to retain whatever revenues it raises over the baseline that is determined by that method. It would be difficult to look backwards and say that, because Scotland’s revenues have not done as well as they would have done under a counterfactual, we are going to try to recoup some of that through a no-detriment argument. That would defeat the purpose, which is to decide on an indexation method, and agree that, if Scotland’s revenues grow by more they can be retained, and if they grow by less its budget suffers the consequences.

**Professor Bell:** My interpretation of what you said is that, if in retrospect the adjustment that was made in year 1 was incorrect because of what has happened to the Scottish economy or to Scottish

tax revenues, we should have had a different adjustment and should be compensated for that over time. That argument would be symmetric: the Treasury might say that the method had not worked out in the way that it had expected, that it was falling short on revenue and therefore wanted to be compensated for the start point. That would be very difficult to evaluate and would have the potential for further contention.

**The Convener:** Thank you. You are saying that we cannot have our cake and eat it.

Professor Bell has said a number of times that Scotland has to decide what risk it should take. We are not, however, in a bilateral situation like the Basque Country in Spain is, as we found out when we were there. Ultimately, the Treasury will take the decision. Although the Scottish Government will negotiate with the UK Government, we do not have the whip hand. We hope to get a system that has been negotiated, but that will not necessarily be the case.

**Professor Bell:** The case has certainly been made in the Finance Committee and other committees that there ought to be a third party involved that does not have an iron in the fire and that can look at the issues dispassionately. Its role should be accepted as being objective.

**The Convener:** If you have no further points to make, we will wind up. It is now five seconds from one o’clock, so it is probably a good time to finish our meeting: that is the end of our public deliberations. Thank you to both our witnesses.

13:00

*Meeting continued in private until 13:01.*



This is the final edition of the *Official Report* of this meeting. It is part of the Scottish Parliament *Official Report* archive and has been sent for legal deposit.

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