1. This written submission focuses on the financial aspects of the Scotland Bill by responding to the key questions in the Committee’s Call for Written Evidence that are concerned with the financial proposals.

Introduction - the Scotland Bill’s Financial Measures

2. The measures in the Scotland Bill, based on the Calman Commission proposals, would increase the proportion of the Scottish budget raised in Scotland. Its main measures in relation to the financial settlement between the UK and Scottish Parliaments are:

- The UK and Scottish Parliaments would share the yield of income tax with the power to vary the standard rate of income tax in Scotland by 3p either way replaced by a new Scottish rate of income tax applying to the basic and higher rates. To bring about this the basic and higher rates of income tax in Scotland would be reduced by 10p in the pound and the block grant reduced accordingly, allowing the Scottish Government and Parliament to set rates for the Scottish income tax although the structure of the income tax system, including bands, allowances and thresholds would still be decided at Westminster.

- Stamp Duty Land Tax and Landfill Tax would be devolved to the Scottish Parliament with a corresponding reduction in the block grant.

- The block grant, governed by the Barnett Formula, from Westminster would continue to make up the remainder of the Scottish Parliament’s budget.

- The Scottish Government would be given new borrowing powers for capital and revenue spending.

3. The charts on the following page show the difference that the Scotland Bill would make when compared to the current situation. The first chart shows taxes devolved (and those retained by Westminster) as a proportion of all taxes collected in Scotland. The second chart shows the source of the Scottish Budget before and after the Scotland Bill. These charts show that the changes proposed are modest in the context of total tax receipts from Scotland and in the context of the scale of the Scottish Budget. Based on the latest figures available (Government Expenditure and Revenue in Scotland, 2008-09), the taxation measures proposed by the Scotland Bill would increase the proportion of the Scottish Budget funded from devolved taxes from 11% to 26% of the Scottish Budget.
Scottish & Westminster Tax Powers Before/After Scotland Bill (2008/09 GERS), £bn

Source of Scottish Budget Before/After Scotland Bill (2008/09 GERS), £bn
Key Question 1: The aims of the Scotland Bill and the White Paper (Strengthening Scotland’s Future) are that it will “enhance the financial accountability of the Parliament and Government in Scotland, improve working arrangements between Westminster and Holyrood Parliaments and Governments, and extend the powers and functions of the Scottish Parliament and the Scottish Government.” In your view, do the proposals in the Bill and the White Paper achieve these purposes?

A. The Scotland Bill acknowledges the weaknesses inherent in the current financial arrangements and accepts that the present system, based on a block grant determined largely by application of the Barnett Formula, must change. It is unbalanced because although the Scottish Government has control over 60 per cent of government expenditure in Scotland, it has very limited responsibility for raising the revenue required to meet those spending commitments other than the local taxes - council tax and business rates. This means that the revenue generated by taxation powers devolved to Scotland accounts for around 11 per cent of devolved spending (see Chart on previous page).

Reform Scotland has argued that the fundamental defect of the current devolution settlement is the Scottish Parliament’s lack of accountability and responsibility for the way in which it raises the money that it spends. The vast bulk of the Scottish budget comes in the form of a block grant from Westminster which:

a) provides no financial incentive to introduce policies which encourage economic growth and deliver value for money; and

b) denies the Scottish Government and Parliament the fiscal tools which they could use to increase economic growth and help sustain the economic recovery.

The Scotland Bill recognises the shortcomings of the current financial arrangements and the benefits of greater financial accountability and responsibility. It would give Holyrood control over a proportion of the income tax revenue raised in Scotland; Stamp Duty; Landfill Tax and new borrowing powers. However, the Aggregates Levy and Air Passenger Duty, which the Calman Commission recommended should be devolved, have not been included amongst those taxes devolved at this stage. In addition to the local taxation powers already devolved (Non-Domestic Rates and Council Tax), this would mean that just over a quarter of devolved spending would be funded by taxes decided and raised in Scotland (see Chart on previous page).

Having identified the problem with lack of financial accountability, the Scotland Bill does not provide any solutions. It is not reasonable to argue that increasing the proportion of the Scottish Budget that is raised from devolved taxes from 11% to 26% delivers financial accountability.

However, even if the changes proposed by the Scotland Bill were to encourage politicians to increase the focus of political debate on improving economic performance, the Bill does not provide the tools that would allow it to introduce fiscal policies to improve the economy. That would require a broader base of taxes to be devolved, including corporation tax and other business taxes. It is interesting to note the strong lobbying from Northern Ireland (including from the CBI and the wider business community) to devolve corporation tax to the province so that policies to improve the competitiveness of the economy could be introduced.
Q2. What is your view on the approach proposed in the Scotland Bill to substituting the revenue from taxes levied by the Scottish Parliament for some of the grant from the UK Government which presently supports the Scottish budget?

A. The principles of increasing the proportion of the Scottish Budget that come from devolved taxes is welcome. However, the scale of the proposals is too modest to make much of a difference.

Q3. What is your view of the proposal in the Scotland Bill for a Scottish rate of income tax levied on all income tax bands, and the reduction of UK income tax in Scotland by 10p in the pound accordingly? How would this work, are the proposals effective and are the proposed inter-Governmental mechanisms adequate?

A. Reform Scotland welcomes the increase in devolved taxes and, as Reform Scotland’s papers on Fiscal Powers have shown, there are many examples of income taxes being shared between central or federal and regional or state governments.

However, due to the small number of taxes that are to be devolved by the Scotland Bill (all of the other taxes make very small contributions to overall tax receipts) the income tax proposal would make the Scottish Budget more reliant on income tax revenues than the UK Budget. Income taxes are volatile across the economic cycle and as a result of frequent changes in policy (the most recent example is the UK Government decision to increase income tax allowances).

Q4. How would the framework have performed over the recent downturn, particularly in the light of the significant shocks to tax revenues? Is the system robust to cope with such challenging periods and return Scotland to economic growth – if not, what frameworks are in place to address this?

A. One of the weaknesses of the proposal framework is that the revenues associated with the Scottish rate of income tax will be based on tax receipt forecasts, which are notoriously unreliable. Variation from the forecasts are then added or subtracted in future years. During the recent downturn it is likely that the Treasury would have over-estimated income tax receipts in advance of the recession, which would have meant that in the second year of the downturn, the Scottish Budget would have been disproportionately cut, just at the time that most developed countries were increasing spending to create a fiscal stimulus for recovery. The Scottish Government would have had no option but to cut spending at a time where an increase would have been more appropriate.

Q5. What is your opinion of the proposals to create devolved taxes, Stamp Duty Land Tax and Landfill Tax, and the power to create new devolved taxes?

A. The devolution of these taxes is welcome.

Reform Scotland particularly welcomes the power to create new devolved taxes. This enabling power presents an opportunity to deliver the kind of change advocated by Reform Scotland.
Q6. Do you have a view on the proposed new borrowing powers set out in the Scotland Bill?

A. Reform Scotland welcomes the fact that the borrowing powers in the Scotland Bill go beyond those advocated by the Calman Commission.

However, the proposed borrowing powers are modest in the context of the scale of tax receipts and the size of the Scottish Budget and would not be sufficient to allow for fiscal policy in Scotland to vary from the UK’s overall fiscal framework.

Q7. What is your assessment of the plans for the implementation of this new financial system and the risks and costs associated with that and have the UK Government adequately quantified these? How would the proposals to revise the system of funding work in practice? Is there sufficient information provided yet to enable a full assessment of the proposed funding arrangements? What key decisions remain to be taken?

A. The main risk associated with the proposed system is the narrow tax base on which the Scottish Budget will become increasingly reliant.

It would be reasonable to expect the UK Government to provide additional analysis of the financial proposals and their implications for the Scottish Budget. It should, for example, be possible to provide analysis of what the implications for the Scottish Budget would have been in each of the years since devolution had the system proposed by the Scotland Bill been implemented in 1999.

Q8. How do the proposals fit with systems from other jurisdictions – particularly in relation to more federal or quasi-federal countries?

A. The UK has one of the most centralised taxation systems in the world. It is common practice for regional and local governments to have fiscal powers in most other developed countries. Examples include Canada, the United States, Germany and Spain.

The proposals of the Scotland Bill are more limited than those that exist in other countries in two main ways. First, the proposed tax base is narrow and, secondly, regional governments in other countries tend to have power over the underlying law which allows more flexibility (for example, over allowances as well as tax rates).

Q10. Additionally, do you have any specific views on the proposed changes to speed limits, drink driving limits, air-weapons and other matters (e.g. Scottish Crown Estate Commissioner, BBC Trust etc.)?

A. The role of the Scottish Crown Estate has potentially important financial implications. Although the scale of the revenues are not significant in the context of the scale of the overall Scottish Budget, the powers relating to the licensing of activities off the Scottish coast, including renewable energy generation, are important.

Devolving responsibility for the Crown Estate would, therefore, give the Scottish Parliament more powers to facilitate and encourage the development of the offshore renewable energy sector, which has the potential to be a source of comparative advantage for Scotland and, therefore, a driver of future economic prosperity.
Q13. What further changes to the powers for the Scottish Parliament not currently in the Scotland Bill would, in your view, further help to achieve the purposes of the Bill and should be considered by the UK Government for inclusion?

A. Reform Scotland believes that the issue of the financial responsibility of the Scottish Parliament needs to be resolved as a priority. Reform Scotland believes that the Scottish Parliament should be responsible for raising the money that it spends.

The measures in the Scotland Bill do not provide the necessary level of financial accountability and responsibility to ensure that public money is spent effectively. The finances of the Scottish Parliament would also rest too heavily on income tax and do not give the Scottish Government and Parliament control over a sufficiently wide range of taxes.

There are a range of alternative options available, including fiscal devolution and fiscal autonomy.

The graph below shows the taxes raised by the different levels of government at the minute, under the Scotland Bill proposal, under Reform Scotland’s proposals for fiscal devolution and under fiscal autonomy. The graph is based on statistics from the latest Government Expenditure and Revenue in Scotland (GERS) report, for 2008/09.

**The Options: Taxes Raised by UK, Scottish & Local Government (2008/09 GERS), £bn**

Reform Scotland has published two reports on this issue ‘Fiscal Powers’ in November 2008 and an update in October 2009. Our proposals go much further than those in The Scotland Bill and set out a workable scheme to enable the Scottish Government to raise the money it spends while remaining within the United
Kingdom. The details of our proposals are available on our website www.reformscotland.com and would give Westminster control over taxes which would enable it to raise its 40 per cent share (around £22 billion in 2008/09) of government spending in Scotland. Likewise, Holyrood would have control over taxes which would raise the 60 per cent (around £33 billion in 2008/09) of public spending in Scotland for which it is responsible and would also have borrowing powers.

This would create a link in Scotland between economic performance and the revenues accruing to the Scottish Government and would change the whole nature of the debate in Scotland for the better. Further, it would give the Scottish Government the fiscal tools to improve the growth rate of the Scottish economy.

There has been much debate since the publication of the Scotland Bill and the debate stimulated and facilitated by the Campaign for Fiscal Responsibility about whether increased fiscal powers would improve Scotland’s economic performance. While there are several academic studies that have looked at this issue, it is not possible to provide a definitive answer to that question based on the experience from other countries and regions. This is because economic performance is based on the interaction between a large number of factors and so it is difficult to isolate one factor and attribute a country or region’s economic performance to that.

However, as the research quoted by Professors Hughes-Hallett and Scott shows, there are many examples of successful regions with substantial devolved fiscal powers. Where regional governments have such powers, they tend to use them to the benefit of the economy of their region.

Reform Scotland’s view is that fiscal powers do not, in themselves improve economic performance. However, increasing the fiscal powers of the Scottish Parliament would:

- provide the tools that could be used to improve economic performance;
- deliver the financial accountability required to provide the incentive to do so.

The Scotland Bill does not provide sufficient financial powers to give either the incentive to focus on economic performance nor does it provide the tools that are required.

Reform Scotland is an independent, non-party think tank that aims to set out a better way to deliver increased economic prosperity and more effective public services based on the traditional Scottish principles of limited government, diversity and personal responsibility.

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