HOUSE OF COMMONS

Treasury Committee

Oral evidence: Proposals for Further Fiscal and Economic Devolution to Scotland, HC 760

Tuesday 20 January 2015

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Watch the meeting:

Members present: Mr Andrew Tyrie (Chair); Rushanara Ali, Steve Baker, Mark Garnier, Stewart Hosie, Mike Kane, Mr Andrew Love, John Mann, Jesse Norman, Mr David Ruffley, Alok Sharma, John Thurso

Questions 229 - 310

Witnesses: **Rt Hon George Osborne MP**, Chancellor of the Exchequer, HM Treasury, and **Sir Nicholas Macpherson**, Permanent Secretary, HM Treasury, gave evidence

Q229 Chair: Chancellor, thank you very much for coming to see us this morning. We will run into the afternoon. We are going to concentrate on Scotland and the Smith Commission proposals. The Smith agreement concludes, "There should be no detriment as a result of the UK Government and the Scottish Government's policy decisions post devolution". It then clarifies what it means by saying, "Where either Government makes policy decisions that affect the tax receipts or expenditure of the other, the decision-making Government will either reimburse the other if there is an additional cost, or receive a transfer from the other if there is a saving". Do you agree with the "no detriment" principle set out in Smith?

Mr Osborne: First of all, Mr Tyrie, thank you for inviting me and I should introduce the Permanent Secretary to the Treasury—familiar to the Committee—Sir Nicholas Macpherson. I should put on record my thanks to him and the Department for all the work they have done in getting us into a position where we are going to publish these draft clauses in two days' time.

To answer your question directly, yes, I agree with the "no detriment" principle that is enshrined in the Smith Commission. Of course, there is a huge amount of detail in how that works in practice. That is something for the next UK Government to negotiate with the Scottish Government, but I think Smith has given us a very strong principle around which to base our work and negotiations.

Q230 Chair: If you agree with it, you must have some idea what it means, Chancellor. I must admit I am struggling, having thought about it a bit. Do you think it is referring to the behavioural effect of a fiscal measure or is it referring to the whole economy effect of a fiscal measure?

Mr Osborne: This is precisely the kind of detail that we need to get into.

Chair: It is quite a bit of detail.

Mr Osborne: There is some precedent for this. In this Parliament we have introduced a Scottish rate of income tax and there, for example in the fiscal agreement we have reached with the Scottish Government, the behavioural effects are taken into account but the second round effects are not. That is the kind of negotiation we are going to need to have. I think the basic principles are clear. They are, first, that there should be no fiscal gain or fiscal loss to either Scotland or the rest of the UK on further devolution and, secondly, that basically—if I can put it like this—you have to live then with the consequences of your decisions once that devolution has taken place.

Of course you are quite right to say that how that works in practice is subject to interpretation, but I think those basic principles are quite clear. I think it is helpful that, as I understand it, there is agreement among all the political parties who have taken part in this process, both the Scottish Nationalists and the Westminster parties, that that should be the underlying principle. So we do not start with a disagreement about the principle. Of course, I suspect there is going to be lots of negotiation about the detail.

Q231 Chair: It is much easier to agree principles than give substance to them. Perhaps I could ask a question on substance. Suppose the Scottish Government decide on a substantial rise on the top rate of income tax, with positive effects on the rest of the UK if high-income taxpayers move from Scotland down to the rest of the UK and pay their tax there. If that were to occur, would you interpret the "no detriment" principle to mean that the rest of the UK should compensate the Scottish Government for its decrease in tax yield?

Mr Osborne: I should speak here in a personal capacity because, as I say, the UK Government will negotiate this in detail after the general election. My interpretation of "no detriment" is that, in the example you give, Scotland would live with the consequences of having imposed a punitive rate of income tax. If it imposed a punitive rate of income tax and, as a result, people moved from Scotland—partly to the rest of the UK and no doubt partly to other parts of the world—part of the concept of further devolution is that Scotland would live with the consequences of that action; would take responsibility for that action.

One of the exciting things in prospect here about further devolution is that Scotland is going to be responsible for raising its revenue or a great proportion of its revenue. I think that requires the Scottish Parliament and the Scottish Government, and the participants in Scottish politics, to take further responsibility for those spending decisions and take responsibility for the consequences of tax decisions.

Q232 Chair: So far I have asked you two specific questions: first whether the "no detriment" principle refers to the behavioural effect or the whole economy effect, and you have said that is something that needs to be worked out and we have not yet done it; and I have asked you whether devolved income tax, which results in a net gain to some nations at the expense of others, should trigger the "no detriment" principle and you have said no to that. If I put what you have just said alongside what I read out at the beginning, it does look pretty incompatible, "Where either Government makes policy decisions that affect the tax receipts or expenditure of the other, the decision-making Government will either reimburse the other if there is an additional cost or receive a transfer from the other if there is a saving". How can that be compatible with the "no detriment" principle?

Mr Osborne: Because I think the "no detriment" principle is principally around adjustments to the block grant connected with the loss or additional tax revenues that come from the first-round effects, and potentially the behavioural effects, but I think it is important—this is fundamental to what everyone is trying to establish with this further devolution—that people live with the consequences of their actions. I would not want the "no detriment" principle to anticipate and compensate, in the example you gave me, the Scottish Government for what I would regard as not very clever economic decisions.

Q233 Chair: Who is going to decide whether they are clever or not?

Mr Osborne: This is, of course, something that will have to be negotiated between the UK Government and the Scottish Government.

Q234 Chair: Are we going to have a so-called independent body to think about that?

Mr Osborne: A very important part of the arrangements we are going to have to come up with—and maybe you will want to question me more on this—is a robust, independent fiscal analysis of the public finances in Scotland. We have the OBR here for the UK and, although the Scottish Government have created their fiscal commission, I think that it could be more independent and more robust. Again, my view is that that will be part of the solution.

Q235 Chair: We might need an independent body or the existing body—

Mr Osborne: As somebody who proposed to the Westminster Parliament that we should have an Office for Budget Responsibility, I am in favour of independent fiscal commissions that produce fiscal forecasts. We do not yet have all of that in Scotland, although a significant advance has been made in Scotland. I am not criticising what has been done. I am just saying I think there is a potential to go further.

Chair: They have been very helpful answers. I think one would have to define them as a helpful lack of clarity.

Q236 Stewart Hosie: I have another question on the "no detriment". In plain English, just to get clarity here, should the Scottish Government use one of their devolved taxes or potential borrowing powers to grow the economy in a way that results in additional tax yield to a devolved tax and, therefore, potentially extra spending? Can you confirm that in that sense the successful use of limited tax or borrowing powers delivering additional spending would not be considered to be a risk to the UK or a detriment to the UK in itself?

Mr Osborne: I would say that, if the Scottish Government pursue policies—including tax and spend policies allowed to it under this Smith agreement—that improve the Scottish economy relative to the rest of the UK economy, then the benefit of that should accrue to the people of Scotland and its Parliament and its Government. I think that is at the heart of what we are trying to achieve with devolution. Of course, the reverse is also the case. If assessment decisions are taken that damage the Scottish economy relative to the rest of the UK then Scotland and, more to the point, Scotland's elected representatives, should bear the consequences of that and be held accountable for that. The principle is that the UK shares the UK-wide risks—of course, we are talking about Scotland within a United Kingdom that has a currency union, a social union and so on—and Scotland bears the Scotland-specific risks.

Q237 Stewart Hosie: That is extremely helpful. You appear to be saying that, in terms of living by the consequences of decisions, if they are net positive in terms of yield on the devolved taxes then that benefit stays with Scotland and that difference, in and of itself, would not be seen as a detriment to the rest of the UK.

Mr Osborne: Yes.

Q238 Stewart Hosie: That is extremely helpful. Can I move to a slightly more contentious area? The "Smith Report" does say in paragraph 75, "MPs representing constituencies across the whole of the UK will continue to decide the UK's budget, including income tax". Chancellor, do you agree that MPs representing Scottish constituencies should continue to decide income tax rates and bands, which apply to the rest of the UK, once they have been devolved?

Mr Osborne: I do not want to pre-empt the proposals that we are going to bring forward on English votes for English laws, as the concept is commonly known—but, of course, there are English and Welsh votes on English and Welsh matters as well—although I do think they will have to apply to areas connected with the Budget. What I would say is that there are clearly going to be elements of the income tax system that remain UK-wide, particularly the definition of "income" and many of the reliefs that attract income tax around savings or business losses or whatever. Clearly, it would not be right to exclude Scottish members from votes on those aspects of income tax, and that is how I interpret Smith's words.

Q239 Stewart Hosie: You have given a very detailed answer because this devolution is not all of income tax. It isn't the basic threshold. It isn't savings or dividend income. It is only bands and rates. It would be quite difficult to see how a proposal could stop MPs from Scotland from voting on those two narrow bits in a budget resolution. Would it be the intention—even speaking personally—to try to take out rates and bands from the budget setting and allow MPs to vote on every other aspect of the income tax system?

Mr Osborne: As I say, I believe that as a result of this further devolution we need to have a settlement that is fair to the rest of the United Kingdom as well and that, as part of that, Members of Parliament from England and Wales should be able to vote exclusively on matters that affect England and Wales. Indeed, as I understood it, the SNP has been an ally of this principle over many years. How that works in practice is something that we will set out in a relatively short period of time and before the general election, but that is the principle I hold to. I am merely observing that it is clear that Scottish MPs should continue to vote on the definition of income, the reliefs attracted to income tax and the like. How English votes for English laws or English and Welsh votes for English and Welsh laws apply to the Budget is something you will have to wait a little bit longer to hear my views on.

Q240 Stewart Hosie: What you are saying—and even reading the code it is very clear—does rather contradict what Lord Smith said in his report. I am taking it that the Government do not fully endorse that part of the report where he says all members should continue to vote on the Budget.

Mr Osborne: I take the words there in the "Smith Report" as applying to the things that are to do with the elements of income tax that are going to remain UK-wide. I think Smith has acknowledged in public that he did not have a remit to talk about the constitutional arrangements for the rest of the UK, or indeed for the House of Commons. Of course that is a matter for the people assembled in this room and our colleagues in the House of Commons.

Q241 Mr Love: It is clear from what you say, Chancellor, that there is a disagreement between what you have just said and what the Smith Commission recommended, yet your representatives on the Smith Commission signed up to that. How do you explain the difference?

Mr Osborne: I do not accept that there is a disagreement. As I say, it is clearly the case that we are not devolving those aspects of income tax—which, by the way, make up the vast bulk of income tax legislation in this Parliament, which is the definition of income, the various reliefs we have and so on—and it would be wrong to exclude Scottish MPs from discussions on those. But, Mr Love, as an English MP, I would have thought you would also want to say to your constituents that matters that affect them otherwise but are devolved to Scotland are not going to be decided on by Scottish MPs, that that would not be fair and it would be particularly unfair, of course, if Scottish MPs held the balance of power on these decisions in this Chamber.

I will make a broader observation. There is going to be a lot of hard negotiation on things like the fiscal framework, and I think it would be very unfair to the whole United Kingdom if we had a Chancellor of the Exchequer who was beholden to Scottish Nationalist votes in the next Parliament. That would not be fair for the rest of the United Kingdom and I think those who aspire to hold this office should make it very clear before the election that they would not be beholden to Scottish Nationalist votes.

Q242 Mr Love: The Smith report states, "MPs representing constituencies across the whole of the UK will continue to decide the UK's budget, including income tax". There is clearly a difference between what you have just said and what the Smith Commission is reporting. Your representatives signed up to that. Why is there now appearing to be a difference?

Mr Osborne: The remit of the Smith Commission as agreed by all the political parties, including the Labour party, was to look at the package of measures that should be devolved to Scotland. It involves Scottish political parties and the Scottish leaders of our political parties, but I think you, as a Member of Parliament, would be the first to say that you had not contracted out to the Smith Commission the decisions that the House of Commons needs to take about its voting arrangements and its procedures. That is a decision for us in this room and we should not duck that responsibility.

Q243 Mr Love: Can I come on to welfare? The Smith Commission proposes that the Scottish Parliament will have powers to "make discretionary payments in any area of welfare without the need to obtain prior permission from DWP". Does this mean that it has the power to make any part of the welfare system more generous than the rest of the United Kingdom?

Mr Osborne: I think the key there is the word "discretionary". The principle of discretionary payments already exists in our welfare system. We give local authorities here the power to make discretionary payments when, inevitably with a big welfare system, there are individuals whose particular circumstances mean that they are unfairly or harshly treated by the broad rules we set for the entire population. That is why successive Governments—Labour, Conservative and Coalition—have given local authorities discretionary payment powers.

I think Smith uses that phrase because the intention he has is that the Scottish Government should be able to make discretionary payments in particular circumstances when particular groups of people are affected, but he is very clear in his report that he is not proposing to devolve the power to create whole new welfare payments or whole new benefits, except in the area where that area of welfare is specifically devolved. It is clearly within the scope of the Smith agreement that new carers' benefits could be created; whole new benefits could be created for people with disabilities in Scotland. But they are reserved to the UK key benefits, like the state pension or universal credit. He has made it clear that those are not the kind of areas where he would envisage new benefits being created and there he talks instead about discretionary payments, and I think he draws that distinction for a good reason.

Q244 Mr Love: But does the fact that they are allowing discretionary payments in any area of welfare not amount to the total devolution of welfare spending, potentially, as long as the system remains at least as generous as that of the United Kingdom?

Mr Osborne: Of course this needs to be all spelled out in the detail, but I think the principle in the Smith Commission is pretty clear. He draws a distinction between devolving the power to create new benefits in an area where he has devolved responsibility, which in this case is principally around social care, disability and the like—although also housing—and he reserves to the UK things like working-age benefits and the state pension and only talks about a power to deliver discretionary payments. So he draws that distinction, and I think we should draw that distinction in the detail that we draw up with the Scottish Government.

Q245 Mr Love: The state pension is a reserved issue, yet you could use discretionary payments there to boost the pension system and make it more generous. What is to stop the Scottish Parliament doing that?

Mr Osborne: The implication of the word “discretionary” is that it is one-off or temporary. It is not a permanent feature of the system. That is how discretionary payments are interpreted here in our local authorities. Smith, in the Smith agreement agreed by all the political parties including the Nationalists, clearly reserved pensions to the UK, the state pension. We will have to wait for the detail, but it is certainly not within the spirit of the Smith agreement that you would create a second Scottish top-up pension. If the parties who signed the Smith agreement had wanted that to be the case, they clearly would have said that pensions were an area of devolved responsibility. They did not say that.

Q246 Mr Love: But you are depending on there being an agreement between all parties and the definition of what a discretionary payment is. That does not seem to appear anywhere in the Smith Commission report. Therefore, I put it to you that you could potentially have welfare claimants moving to Scotland because the use of discretionary payments made the welfare system so much more beneficial.

Mr Osborne: I think what people will see on Thursday, and what they have already seen with the Smith agreement, is that the three main Westminster parties—the Conservative party, the Labour party and the Liberal Democrats—have all lived up to the vow that was made before the Scottish referendum. That will be reflected in the paper that is published on Thursday. We have honoured that. In very short order we have turned that Smith agreement into draft legislative clauses. The next stage is then to negotiate a fiscal framework, the detailed agreement. As people see that, they will see that we continue to honour that commitment, but we have acted in good faith. I think the people of Scotland and the whole of the United Kingdom can see that we continue to act in good faith and to implement what has been agreed.

Q247 Mr Love: But you have not argued that there is not the possibility that benefit tourism will take place within the United Kingdom. Therefore, I come back to the point made by the Chairman, and indeed by Mr Hosie, about whether compensatory payments to Scotland would have to be made under the detriment principle.

Mr Osborne: First of all, to repeat myself, I think Smith does draw a distinction between discretionary payments and wholly new benefits that can be devolved. He makes that quite clear, and I think it is quite clear. To address your question, the second point is that if the Scottish Government were to greatly increase welfare spending they would have to bear the cost of that. The Scottish taxpayer would have to bear the cost of that and, by the way, that is a good thing. That is a consequence of devolution. It is a consequence of the Scottish Parliament being responsible for the decisions it takes. At the moment it takes a lot of decisions on spending, but it does not take many decisions on the taxes required to fund that spending and, as we are all aware as Members of Parliament here, handing out the money is usually a lot easier than taking it in. The difficult decision for Governments is how you raise money and that is more difficult than decisions about spending money.

Chair: I think one thing we are all agreed on around this table is that the vow must be honoured in full. I do not think there is any disagreement at all among us. I must move on, Andy.

Q248 Mr Ruffley: Chancellor, do you think the devolution of tax rates and bands is going to lead to tax competition?

Mr Osborne: Ultimately, it is a decision primarily for the Scottish Parliament and the Scottish Government whether they wish to pursue that or not. I think it is quite interesting that—if I may make an observation—off the back of the changes to stamp duty that we announced in the autumn statement the Scottish Government said that they would revisit their proposals on stamp duty. You could argue that that is a bit of tax competition in action.

Q249 Mr Ruffley: Yes. With that in mind, does HMRC or the Treasury plan to do an analysis of the possible risks to the income tax yield that you will receive as Chancellor in various scenarios of tax competition?

Mr Osborne: I think the short answer to that is no, I was not anticipating doing that. I guess there are any number of permutations. Clearly—

Q250 Mr Ruffley: Is that not worth doing?

Mr Osborne: Let us see what the Scottish Parliament does with these new powers. Clearly, if it pursues a particular direction of raising income tax or reducing income tax—to take the example that Mr Tyrie used—we would start to have to think about that as a Parliament and as a Government and do some forward thinking on that. But we are not there yet, we have to pass these into law and we have to get the agreement signed and the like. Of course, the Scottish Parliament has had the power to vary income tax for a number of years. Indeed, since its creation it has not used those powers. As of 2016, it will have new powers to vary the income tax rate, which we have given it in this Parliament—let us see if it uses those—and then it will get further powers through the Smith process.

Q251 Mr Ruffley: I do not want to drag you down the hypothetical path too much, but you did respond helpfully to the Chairman's hypothesis of a punitive rate being imposed in Scotland. What about the obverse of that? If Scotland were to be aggressively tax cutting by way of competition and wanted to get rid of or make less onerous the 45p band, would that not lead to quite a few English taxpayers seeking to move to Scotland or claim they were living in Scotland? That could be quite a risk to your income tax yield.

Mr Osborne: If I can generalise a little. If the Scottish Government were to pursue an aggressive policy of lowering taxes under this agreement, they would have to bear the first-round impact of that because obviously, in the first instance, they would potentially forgo revenue. This would be assessed under the system that I would envisage by independent fiscal councils and the OBR and the like. So they would lose money. Over time, if they gained money, as a result of a stronger and more entrepreneurial economy, then they should see the benefits of thE decision that they had taken.

It is always a fine judgment about the impact of different income tax changes. For example, the OBR looked at the decision we took to cut the 50p rate to 45p and said that cost the Exchequer £100 million, but that we had more than made that up with VAT receipts. Our independent OBR has made a judgment about the impact of that tax change and I guess you would have robust fiscal arrangements with the Scottish fiscal commission or the equivalent of our OBR. That is part of the detail we need to get right to make sure we would have an agreed—and I guess to make it agreed it probably has to be independent—evidence base that is offered to both the UK Government and the Scottish Government.

Q252 Mr Ruffley: That is very helpful. Edward Troup said to the Scottish Parliament Finance Committee that there were no legal powers to require people to tell us when they changed address. Does that not rely too much on individual taxpayer's honesty as to their main residence?

Mr Osborne: Of course, we always trust the honesty of our taxpayers but, just in case they are not being honest—

Mr Ruffley: For the avoidance of doubt.

Mr Osborne: —the HMRC does have pretty extensive powers given to it by this Parliament to go and investigate things and lock people up or fine them if they are not telling the truth. I do not anticipate that being a major problem and in recent years HMRC has become even better at dealing with tax avoidance. In this case it would be tax evasion if they were illegally declaring a false residence.

Q253 Mr Ruffley: Mr Troup went on to say in that evidence session, "A penalty for not telling us would not be an efficient way of getting people to tell us their address", so just a bit more on this. What would be the best means of encouraging people to be scrupulously honest in this respect?

Mr Osborne: Most taxpayers want to pay the taxes that are due. They do not want to break the law and—

Q254 Mr Ruffley: But there would be wider powers that HMRC had. That is the answer to this.

Mr Osborne: I think HMRC has all the powers it needs. If someone makes a compelling case to me that it does not, of course I will look very carefully at it. I do not know whether the Permanent Secretary wants to say anything, but a lot of the Smith process has been handled within the Treasury and we have not had this flagged to us. HMRC is pretty quick to tell me when it wants new powers, as this Committee will know. It has not on this occasion come forward with proposals.

Chair: Don't be too quick to say "yes" in all cases, Chancellor.

Q255 Mr Ruffley: A final question, Chancellor. If HMRC has to undertake a lot more compliance work and a lot more cost as a result, would the Scottish Government be obliged to compensate you on the "no detriment" principle?

Mr Osborne: As part of this, we would have to sign a further memorandum of understanding between the two authorities about the costs and, again, Smith is clear that the Scottish Government should pay for the costs of additional tax collection and the like. We would have to have that discussion, but I have to say that we have had a very strong and easy relationship up to this date between the two tax authorities, the Scottish Revenue Service and HMRC, so I do not anticipate that being difficult.

Sir Nicholas Macpherson: I would just emphasise that, since we have had income tax devolved to varying degrees to Scotland for the last 17 years, HMRC has had to think about these issues and it has to be in a position to determine issues like addresses.

Q256 Alok Sharma: Chancellor, can I clarify once more this "no detriment" principle? Would it be fair to say that, if the rest of the UK had lower levels of income tax and that meant that Scotland lost tax revenues because people moved across, the rest of the UK would not need to compensate the Scottish Government for that?

Mr Osborne: I have given my personal view, which is that authorities should live by the consequences of their actions. In that sense, I would regard people as living with the consequences of tax competition. Part of the principle of devolution is that Scotland has greater responsibility for raising its revenues. If it runs higher taxes than the rest of the UK and, as a result, suffers economically, it should bear the cost of that. Equally, if it runs lower taxes and sees an economic benefit then it gains that benefit. That is how I will approach these discussions. I guess it will be for other people who might be part of those discussions to say how they would approach them.

Q257 Alok Sharma: HMRC, of course, is going to continue to be responsible for collecting income tax and several other taxes on behalf of the Scottish Government. Is there a further tax devolution taking place? How sustainable is it that, at the end of the day, there is this memorandum of understanding and there is this client relationship? Is that sustainable?

Mr Osborne: I think that is sustainable. First of all, we are not the only country in the world that has sought to devolve some of its taxes. However, with this step—with the Smith agreement in its entirety—I think we are going further than almost any other country with the exception potentially of Canada and Switzerland in giving to one part of our country real control over revenue raising. Of course, one of the consequences of devolution is, by definition, that different decisions are taken and we have become used to that over the last couple of decades or so in lots of different fields of policy. So I think we can handle this as a country.

Q258 Chair: Of course, HMRC is accountable to the Westminster Parliament and not formally to the Scottish Parliament. Do you see some change in the way that that responsibility for accountability shifts over a period of time?

Mr Osborne: No. Of course, as a result of the referendum, Scotland has Members of Parliament sitting here in the House of Commons and continues, therefore, through those Members of Parliament to be represented in those decisions. As I say, as I understand it, the relationship between HMRC and the Scottish Revenue Service, and indeed the Scottish Government, has been a good solid one over recent years and I do not imagine that getting more difficult.

I should stress that, for most people in Scotland, if there is a different rate of income tax, that will not cause them any additional burden or complexity in terms of compliance with that additional tax rate, because it will continue to be collected through PAYE by HMRC. Any additional costs that are incurred as a result of that, the Scottish Parliament will pay for.

Q259 Alok Sharma: Of course HMRC is responsible for the scope and nature of compliance and anti-avoidance activities. What scope is there going to be for the Scottish Parliament to influence those two matters? It could be the case that the Scottish Parliament may have a slightly different view on what it should be focused on when it comes to anti-avoidance or compliance.

Mr Osborne: It comes back to the earlier discussion. When you look at income tax and when you look at what this House of Commons spends most of its time doing when it comes to income tax, it is around definitions of income and around reliefs. Although the rates and the thresholds get the most attention, and of course have an impact on people, they are relatively straightforward to administer and they are not where the pages of legislation come from. They are normally very simple clauses. The compliance work is usually around things like accounting for business losses or savings income and the like, or giving money to a charity.

All of those things will remain UK-wide responsibilities for this Parliament and Scotland, because it is part of the United Kingdom, is represented in this Parliament. I think that is why, more broadly, Smith gets the balance right between preserving our currency union, our social union, our defence union and the like—the things that make us a United Kingdom—while at the same time reflecting the fact that people in Scotland want greater control over some of the decisions that affect their lives. I think we have that balance right.

Q260 Alok Sharma: Just a final question from me. Should the cost of providing information and inquiry services in relation to tax devolution be borne by the Scottish Parliament or should that be borne by the Westminster Parliament?

Mr Osborne: Additional costs that are incurred because of decisions by the Scottish Parliament should be paid for by the people of Scotland.

Q261 John Mann: Chancellor, if the UK lowers VAT this would increase consumption and the revenue that Scotland is assigned. Would you expect the Scottish Government to reimburse the UK in such circumstances?

Mr Osborne: VAT would be a UK-wide decision, so the Scottish Government would be insulated from the fiscal impact of that decision. That is central to the underlying principles.

Q262 John Mann: So you are saying, no, they would not reimburse them?

Mr Osborne: If there was an impact on revenues they would be compensated for that. It comes back to the fundamental principles of Smith and the "no detriment" principle, which is that Scotland is not insulated from decisions it takes, but is insulated from decisions that are on a UK-wide basis. The UK bears the burden of UK-wide decisions and Scotland bears the burden of Scottish decisions.

Q263 John Mann: Sir Nicholas, the Smith Commission Secretariat and the Secretary of State for Scotland have different interpretations of paragraph 95.4 of the Smith Commission report, which is the detriment paragraph. Which one of them would you say is right?

Sir Nicholas Macpherson: In the absence of you—

John Mann: It is the "no detriment" paragraph. My question is: is there a problem with the paragraph?

Sir Nicholas Macpherson: I do not think there is an intrinsic problem about the paragraph. Obviously, a lot of detail still has to be worked through in implementing this framework, but I think it is pretty intelligible.

Mr Osborne: Another way of thinking about it, Mr Mann, is that if the VAT base of Scotland grows more quickly than the VAT base of England then Scotland benefits. If the VAT base grows more slowly than the VAT base of England it pays the price for that. For example, that might be because it is taking decisions on planning or transport or whatever is affecting development and the like. If it does not diverge from the UK base, whatever the rate is, it does not lose out.

Q264 John Mann: The reason I was asking Sir Nicholas is, of course, that, as the Secretary of State and the head of the Smith Commission Secretariat disagree on interpretation, if there is such a policy then the Treasury will have to take a view in relation to that and I merely ask whether you think that that paragraph as worded is crystal clear.

Sir Nicholas Macpherson: I think it is a very good basis for developing a framework. The whole challenge of developing a framework is that it has to be durable and it has to ensure there is no detriment. All of us have learned lessons from Barnett over the last 40 to 50 years, and this is a real opportunity to create a sensible framework that will last and, in my view, be acceptable both to Scotland and to the rest of the UK.

Q265 Chair: We perhaps should not have allowed this temporary arrangement to end up so entrenched.

Sir Nicholas Macpherson: No, I am merely saying that any formula is likely to be highly contested and it is important that we develop it in a way that people on both sides of the border regard as fair and acceptable.

Q266 John Mann: Sir Nicholas, if there was a lowering of income tax in Scotland, would that result in current Treasury borrowing projections going up or going down?

Sir Nicholas Macpherson: I do not do the projections. The OBR does. The other issue is that it depends whether Scotland was up against its borrowing limits because obviously, if it was up against its borrowing limits, there would potentially be no impact at all. So it depends on the circumstances.

Q267 John Mann: What would you say to that, Chancellor? If income tax lowers in Scotland would your borrowing projections go up or would they go down?

Mr Osborne: I have a general view, which might be different from yours, that higher taxes ultimately lead to slower economic growth and cause a country to end up having to borrow more than it would otherwise have to do, but in the specific case, it would be for the Office for Budget Responsibility or the Scottish Fiscal Commission to make a projection.

Q268 John Mann: You have talked of it being inappropriate for the next Government to be beholden to Scottish votes, and you talked about England and Wales. Would it be inappropriate for the next Government, whoever it is, to be beholden to Northern Ireland votes?

Mr Osborne: There is a very particular task for the next Government, which is to negotiate this fiscal framework that is hopefully going to endure for a long period of time. It is very important that that negotiation is conducted in a way that is fair to the whole United Kingdom. If you had a Chancellor of the Exchequer who could only get their way because they were relying on Scottish Nationalist votes—not Scottish votes, Scottish Nationalist votes—to get their way in the House of Commons, I do not think that would be fair to the rest of the United Kingdom. I do not know what your voters would feel in the East Midlands, but I am pretty clear that my voters in Cheshire and elsewhere in England would not be too happy with that.

Q269 John Mann: A final question. Why do the head of the Smith Commission Secretariat and the Secretary of State for Scotland disagree on their interpretation of paragraph 95.4 on detriment?

Mr Osborne: I have set out how I think everyone accepts that the Smith agreement will operate—

Q270 John Mann: Well, no, they don't. They disagree on it. Why do you think they disagree and is there a question of binding?

Mr Osborne: I am not aware of a disagreement because I think the principles that underline the Smith agreement are relatively clear—Scotland bears the responsibility for Scottish decisions and the UK bears the responsibility for UK decisions.

Q271 Mike Kane: Chancellor, I have a couple of questions about air passenger duty, but I am starting off with "no detriment" as well. As John Mann was saying, the Secretary of State in this instance says that there is no detriment principle when it applies to air passenger duty, that is no compensation would be paid by Scotland were the UK to lose revenue. Do you agree with that interpretation?

Mr Osborne: Look, again, it comes into how we are going to exactly interpret "no detriment". My personal view is that tax competition is something that we should allow. That is one of the principles of devolution. You and I represent either end of the second runway at Manchester airport—I think our constituency boundary is somewhere in the middle of the runway—and we are well aware of the concern in Manchester, particularly the concern in the north-east of England, around the potential impact of giving Scotland control over air passenger duty. I think the best approach to dealing with this concern, which I think is perfectly legitimate, is to cross the political boundaries of our two parties to try to find a solution that helps these regional airports that can be affected by an air passenger duty decision north of the border.

HMRC has done some work on this and I think it anticipated that Manchester airport would lose around 3% of its traffic and Newcastle could lose around 10% of its traffic. That was work carried out a couple of years ago, but in Newcastle's case, its traffic was up 12% last year, so I think these are manageable. But I think you and I—I made the same offer to Ed Balls—could work to help regional airports in the north of England if the Scottish Government were to go down the road of dramatically cutting its air passenger duty.

Q272 Mike Kane: Yes, I agree. Our boundary is a two-hour drive time to the Scottish border, which makes me think about the work—

Mr Osborne: Not always on the M6.

Mike Kane: Not always on the M6. But it makes me think of the work of the northern powerhouse in particular, and I am worried—and I just want to see if you are worried too—that we will be trapped in some pincer movement. Say in a few weeks Davies commissions a third runway. A staggering public sector subsidy would be needed for that, which would make the investment into the northern powerhouse look like a drop in the ocean, combined with the Scottish Government's commitment to first halve air passenger duty and then abolish it. They are the biggest drivers of economic regeneration in the north of England, and we would be caught in this pincer movement.

Mr Osborne: I accept half of the argument. Personally, I do not think the north of England suffers when London and the south-east grows and is successful. I think it benefits our whole country. What we have to do is make sure the north is stronger still, and that is part of the powerhouse argument. I have been a big supporter of Manchester airport in all the years I have been the MP there and I think it is great for the region. Indeed, our intention is to try to bring High Speed 2 through Manchester Airport and connect it up.

But where I will go with you is that you can envisage a big fall in air passenger duty in Scotland having an impact on passenger numbers, particularly in the north-east of England, but also in the north-west. We should look—I do not think this is particularly politically contentious between our two parties—at what we can do to support those regional northern airports to make sure that they do not suffer a loss. But I think that is a responsibility for the Government here. It is not something we should necessarily expect the people of Scotland to pay for.

Q273 Mike Kane: Indeed. Can I just ask Sir Nicholas, in terms of having such a different tax regime right next door, would we have to think about regearing APD? A revenue-neutral way forward would be holidays or turning it into a congestion tax.

Sir Nicholas Macpherson: We keep all taxes under review. Personally, I think a bit of tax competition is quite healthy; obviously, it depends precisely on the area. Just as we have seen with the reforms on stamp duty, I think we will see a degree of iteration. If Scotland were to cut APD hugely, they will bear quite a big cost in the short run and will have to make good that cost, either through higher taxes elsewhere or through lower spending. I see this potentially as a bit of a laboratory where can we learn more about the effectiveness of tax and spending.

Q274 Rushanara Ali: Chancellor, earlier on you mentioned the need for robust, independent fiscal analysis. There is currently insufficient data for the OBR to properly forecast future macro-economic forecasts to drive its forecast of Scottish tax receipts. Does that concern you?

Mr Osborne: Clearly the OBR, if it feels it needs more information, can go out and get that information. If it feels it needs more resource to collect that information, it would come to us and I would be certainly keen to support it in its work. I agree with you that this is going to be a significant change and it is going to require us to make sure that our institutions are prepared for that change.

Q275 Rushanara Ali: How do you feel the Scottish Government can make responsible fiscal plans on the basis of a lack of sufficient information and forecasting?

Mr Osborne: I think the Scottish Government could improve its current forecasting by making its Fiscal Commission even more independent and hand over to the Commission the responsibility for producing the forecast. That is my personal view. It is a decision for the Scottish Parliament, but it has worked here for the UK.

I think going forward, at the heart of any fiscal agreement has to be, first of all, a shared evidence base—that comes from having independent fiscal commissions—and second, an agreed set of fiscal rules, so that we will have confidence that the Scottish Government will be able to live within the new arrangement and not get itself into a situation where it needs to be bailed out by the UK taxpayer. That is fundamental to any fiscal agreement, and, as far as I understand, the Scottish Government accept that fiscal rules will have to play some part. There are already fiscal rules in place, agreed by my predecessors and the Scottish Government, on running a balanced budget and making use of a borrowing buffer. We already have some fiscal rules in place, though we will need new fiscal rules to take into account the new arrangements.

Q276 Rushanara Ali: Can I just turn to the Scottish Fiscal Commission? You mentioned the need for greater interdependence and there has clearly been some controversy about the appointment of some of the members. How detrimental do you think that is? What do you think are the effects of not having an independent forecaster for Scotland as well as the rest of the UK?

Mr Osborne: Yes. Look, I think it clearly needs to be more robust, because it is going to have a lot more responsibility. I think it should be responsible for the forecasts that are produced in Scotland. We are in an unusual situation where the UK forecasts are produced by the independent body, but the Scottish fiscal and economic forecasts are produced in Scotland by the Scottish Government at the moment.

Inevitably, one is drawn to the completely incorrect forecast about oil revenues. From memory, the Scottish Government forecast that they would receive £20 billion of revenues in the coming three years from oil and, if oil taxes were devolved, I think it would be probably around a third of that. That was the most recent forecast we published and of course the oil prices have fallen further since. They do not have a particularly great track record, and of course, if the people of Scotland had voted for independence and believed the SNP's promises, they would not have been able to deliver on those promises because of their wildly optimistic—and that is a polite way of putting it—forecasts about oil tax. I would say one of the great benefits of the United Kingdom is that we can help each other when things like the oil price change dramatically. That is one of the benefits of being together.

Q277 Rushanara Ali: I could not agree with you more on that point. In that context, are you concerned that the Smith Commission does not explicitly propose an independent official forecaster of the public finances in Scotland?

Mr Osborne: It is for Lord Smith to explain the content of his report, but my reading of it was that he was pretty clear he wanted a robust, independent forecaster of the Scottish public finances and Scottish economy, and that having a robust mutually agreed evidence base was pretty important to making his report work. I will let him choose his own language, but I think his intent is pretty clear.

Q278 Steve Baker: Sir Nicholas, how would you anticipate the administration of no detriment working out?

Sir Nicholas Macpherson: This is one of the challenges for the coming period. First, we have to develop the specific proposals on no detriment and the next stage is to decide how you are going to administer it. As the Chancellor said, I think it is going to be an important role, certainly for independent forecasters, and it is going to be an interesting question whether you seek to make this work through a series of bilateral deals between the Scottish Government and the Treasury or whether you develop some sort of wider independent commission. That is a matter for Ministers and for Parliament.

Q279 Steve Baker: From an administrative point of view, will it not be a sea of uncertainty, full of counterfactuals and unknown data, and indeed, political manoeuvring in order to try to demonstrate that some harm has been imposed that should be compensated?

Sir Nicholas Macpherson: Maybe I am hopelessly optimistic, but I think this is all perfectly doable. Obviously, the first thing to get right on the no detriment issue is the initial deduction you do from the block grant. If you can get that right, you are off to a good start. Let's face it, we have already addressed some of these issues with the 2012 Scotland Act.

The next issue is: how do you make no detriment work in a dynamic context? I think that, provided the approach that Parliament agrees is sufficiently concrete, we can manage this.

Q280 Steve Baker: Chancellor, we had a drama with the EU where a technical calculation resulted in monies falling due.

Mr Osborne: I remember.

Steve Baker: I thought you would. Will this not result in a whole range of reruns of this phenomenon, whereby a set of calculations result in monies falling due in either direction, politicians seeking to manoeuvre around the edges, a continuous sequence of these dramas?

Mr Osborne: I think it would be extraordinary if there were never any disagreements. That is not the nature of politics in a democratic country, but I hope they will take place within clearly-agreed rules and I think we are off to a strong start. We have agreed the Smith report with the Nationalist party of Scotland. We are going to deliver on the vow to put a report into draft legislation. Whoever forms the next UK Government, we have all committed that we will legislate for these clauses. The fiscal framework will be constructed around an agreed principle of no detriment, which I think is straightforward, and we also accept that at the heart of it there needs to be a robust evidence base that is independent and there need to be fiscal rules. I think a lot is there that is agreed. I am sure that lively political debate will continue to happen within these islands, and I certainly hope it does, but the principles for making this work are there.

I think, as Sir Nicholas says, we anticipated a lot of drama about trying to get an agreement on how the new Scottish rate of income tax would work from next year. We did that in a pretty smooth way. We have just agreed the assignment of revenues for the first year of the devolution of stamp duty, so we can achieve these things.

Sir Nicholas Macpherson: Let me just give an example: 20 years ago, I had the great privilege of being responsible for the Barnett formula—I had a spreadsheet in which I would put all the numbers in a cell—and there was a degree of controversy about how the Barnett formula operated. There was continual debate with the then Scotland Office, subsequently the Scottish Government, about which proportion of English programmes should be subject to the Barnett formula. There would be endless debate, but in the end we always managed to find agreement. As I say, I am an optimist about this. I think that, provided people want to make it work, it can be made to work.

Q281 Steve Baker: I am glad that you mention this, because if I was to summarise what my constituents said to me in the course of the referendum campaign, their great objection was the sense that they were subsiding benefits for people in Scotland that they did not receive in England. Perhaps we could turn to the block grant and its reduction. The IFS told the Committee that the way in which you adjust the block grant is very intimately linked to the aims and objectives or what you are trying to get out of tax devolution, and yet the Commission did not consider how the block grant should be adjusted, saying merely that it should be, "Indexed appropriately". Do you think the Commission overlooked this issue—a critical issue in the devolution framework for how practically to adjust the block grant?

Mr Osborne: I think again Smith has given us the principle, which is indexation, and there is a debate about exactly how that indexation will operate. Whether it is indexed against revenues or against the tax base is going to be an important decision for us as we draw up this fiscal agreement, but again, it is trying to deliver in practice a principle that is agreed, which is that Scotland bears the responsibility for its decisions.

Q282 Steve Baker: With that very much in mind, just thinking about the block grant adjustment, will it not affect the level of risk and volatility in the Scottish public finances and so should this issue not also be considered very closely with the issue of borrowing in Scotland?

Mr Osborne: Yes, is the short answer to that. We have accepted that additional borrowing powers will be required to manage that volatility and we will have to set out in the agreement we reach with the Scottish Government exactly what that is, but in this Parliament we have already agreed additional borrowing powers to the Scottish Government in two respects. One is to manage volatility and current receipts and the second is to allow them to make capital investments. I think we have demonstrated in this Parliament that we can achieve that agreement and I am confident that we can find that agreement in the next Parliament as well.

Q283 Steve Baker: Can you rule out a situation in which the UK Government—in other words, English taxpayers—end up further subsidising Scotland as a result of the kind of volatilities that will arise?

Mr Osborne: The short answer to that is, yes, I think the heart of this agreement is that the different nations of this island should not be fiscally better off or worse off as a result of this devolution. Of course the block grant, once this devolution is fully in place, only provides 35% of Scotland's funding. That is a reduction of two-thirds from the current situation, so the Barnett formula and the block grant become a less important part of Scotland's revenues. It takes more responsibility for raising its taxes. That is what devolution is all about. By the way, I think it is also what those who believe in lower taxes and people taking responsibility for their public expenditure decisions should also be supportive of.

Q284 Steve Baker: For the sake of brevity in coming to a conclusion, when can we expect more detail to emerge about the indexation of the block grant?

Mr Osborne: This is one of the decisions to be taken by the next Government, so it is part of the agreement between the next UK Government and the Scottish Government.

Chair: It is certainly going to be extremely important and Smith is virtually silent on it, which is why I suspect Jesse Norman might have more questions on it.

Q285 Jesse Norman: It is kind of you to bring me in, Chair, thank you. Chancellor, just to pick up something you said earlier about oil revenues, the IFS has concluded that the reduction in the Scottish revenues will be £7 billion as a result of the fall in oil revenues, so doesn't this attest to the great wisdom of the Scottish people in deciding not to become independent, since this would have kicked an enormous hole in their budget?

Mr Osborne: First, it reminds everyone of the risks of independence and the exposure that Scotland would have had to the big fall in the oil price. Secondly, I think it reminds us of the benefits of the United Kingdom. We can pool our risks. If there is something that particularly impacts one industry—such as the oil and gas industry in Aberdeen and elsewhere in Scotland—as the UK we can step in and help. Let me say something about the oil and gas industry: it is an incredibly important industry for the whole UK. It is not just important to Scotland. I think we recognise that across this country.

I took decisions in the autumn statement to reduce taxes on North sea oil, anticipating the pressures that the fall in oil price would have on the industry. I am sure we are going to have to take further steps in the Budget, but we can only do that because we are a united kingdom and we pool our risks. The fall in oil price, which has generally been a good thing for the UK and a great thing for British consumers, has of course hit the oil and gas industry hard.

Q286 Jesse Norman: Just to be clear on that—it is very interesting—you are giving a hint that the Budget might contain some support for the oil and gas industry to try to cushion some of the blow that we have seen over the last few weeks?

Mr Osborne: Looking at the impact of the falling oil price, as I say, while I think that has broadly been a good thing for the UK economy, it has had a hard impact on the oil and gas sector. We want to make sure we maximise investment in the North sea, that we get the maximum amount of oil out of what is a mature basin. I can see we are going to have to take further steps to support that industry. That is why we are a united kingdom. We pull together when one part of our country has a challenge.

Q287 Jesse Norman: The loss to the Scottish people from becoming independent is not just the loss in revenue, it is also the loss of the flexibility and further support you might be able to give the industry in the Budget in future.

Mr Osborne: Obviously, an independent Scotland would be much more vulnerable to a big fall in the oil price and I guess would have had to institute very severe cuts in public expenditure, or substantial increases in other taxes, to make up for a hole that would have appeared in its budget. In the scheme of the UK Budget, first, the oil and gas revenues, while significant, are relatively small compared to other tax revenues, and secondly, while we lose money through oil and gas taxes, we can gain money elsewhere through the increased economic activity that happens when energy prices fall like this.

Q288 Jesse Norman: Thank you. Just to nail down the point that I think was raised by Rushanara Ali, if the Fiscal Commission is not fully independent, there is the risk, is there not, that post a devolutionary settlement, a Scottish Government could essentially game the numbers through the Fiscal Commission in a way that exploited that devolutionary settlement to their benefit financially?

Mr Osborne: Our responsibility—mine and yours—will be to make sure that the whole UK is treated fairly. I do not think we would enter into an arrangement where we thought that the numbers could be gamed and we would—

Q289 Jesse Norman: But that is the danger of that political control. That is the danger, isn't it, Chancellor?

Mr Osborne: It has not been unheard of, even in the UK, when Chancellors were in charge of making public finance forecasts, for them to game the numbers a little, which is why I handed that decision over to an independent Office for Budget Responsibility.

Q290 Jesse Norman: One recalls that so well. Thank you. Sir Nicholas has pointed out that he was responsible for the Barnett formula and, as such, I am afraid his name will be mud in Herefordshire because we do so badly out of the system. Lest we forget, Scotland gets £10,152—

Mr Osborne: Sir Nicholas has given long and distinguished public service to Herefordshire and, indeed, the rest of the United Kingdom.

Q291 Jesse Norman: Yes, of course, I am sure, and that would be recognised, but the fact is that the Barnett formula gives Scotland—the second-richest part of the country after the south-east and London—£10,152 a year and England £8,529, that is £1,600 less. There are parts of England, notably my own county, which do much worse and it is certainly nothing like as rich as Scotland in the scheme of things. How is that fair?

Mr Osborne: All the political parties in the UK have committed to the Barnett formula over many decades. This was a formula agreed in the 1970s and has been supported by Conservative, Labour and Coalition Governments since. The way I look at it is that we live in a united kingdom where monies are transferred around our country. That is part of who we are as a country, that we support all of our citizens.

Q292 Jesse Norman: On the basis of need, Chancellor, not just on the basis of funnelling money into parts of the country that are already quite rich. Isn't there a danger in this set-up that what is going to happen is that the Barnett formula, which is now allowed to evolve in the way it has, is going to be locked in via the Smith Commission settlement, with a tax settlement for Scotland that allows Scotland to do extremely well, both in the amount that it has received historically and in the capacity then to index its new taxes to that amount?

Mr Osborne: Scotland brings great strengths to the United Kingdom: look at the financial services industry in Edinburgh, look at the oil and gas industry in Aberdeen and the north-east of Scotland. Indeed, if you look at the Scottish economy, I think it has performed closer to the UK average than any other part of the UK. It is part of the strength we have as a united kingdom that we have Scotland as part of it. As I say, I think we all accept around this table that there are clear needs in parts of Scotland that you would not necessarily find in the wealthiest parts of London, so we have that transfer of resources around our entire united kingdom. That is part of who we are as a united kingdom.

Q293 Jesse Norman: Right, but you recognise the danger that I am describing of a very good deal in the Barnett formula being locked in via the new settlement. Could I just ask that in the negotiations for the new settlement some aspect of need be taken into account, because it is a profound moment in the shift of the funding of these two parts? The system at the moment is not fair.

Mr Osborne: The political parties made a commitment and made a vow, and we honour that commitment and we honour that vow, including in respect to the Barnett formula. However, this Smith agreement will see the Scottish block grant fall by two-thirds, so the significance of the Barnett formula to the funding of Scotland will become less as Scotland takes greater responsibility for raising its own taxes. I think that is something that clearly the majority of the people of Scotland want to see—greater powers and responsibility for Scotland. I suspect that the rest of the United Kingdom will also welcome the two-thirds fall in the block grant.

Q294 Jesse Norman: Yes. Chancellor, you have made your view clear that moral hazard is a real issue here and that there needs to be a hard budget constraint.

Mr Osborne: Yes.

Jesse Norman: Indeed, you have called that the fundamental principle in your earlier remarks here. I absolutely concur with that. Isn't the corollary of that that essentially there may be detriment, but self-inflicted detriment post the allocation is for the Scottish Government to bear—

Mr Osborne: Yes.

Jesse Norman: —and self-inflicted benefit is for them to bear?

Mr Osborne: Absolutely, and for the Scottish people to hold their politicians to account for it.

Q295 Jesse Norman: That is very helpful. So the problem with paragraph 95 is not so much that it is incomprehensible—although it is quite incomprehensible—as that it is empty because it does not talk in any detail about what the process of deduction is going to be, apart from saying that there needs to be some form of deduction. You said, very helpfully, that you think an index deduction approach is the right way.

Mr Osborne: Yes. Look, first of all, I think it is extremely helpful that we have started with an agreed set of principles—this is not to be underestimated—between the unionist parties and the nationalist party, so that is the first thing I would say. Secondly, this is not a completely blank canvas. We have already taken, in the last four and half years in this Parliament, decisions on a new Scottish rate of income tax, a substantial devolution of power that has already taken place as a result of the Scotland Act and how the fiscal framework is going to operate that. We have indexed it to income tax revenues. I think the question going forward is whether you are going to stick with the revenue indexation or you are going to index against the tax base, the difference being that when you devolve any part of income tax, as is the case with the 2011 Act, it is simple to index yourself against revenues, because you know exactly what the revenues of that tax are—because you are collecting half of it and Scotland is collecting the other half under the current rates. When you completely devolve a tax, you may want to move more to indexation against the tax base, which may be easier to measure. But that is an observation. The actual negotiation and detail will have to be resolved in the next Parliament.

Q296 Jesse Norman: Just to be clear, the block grant is supposed to have deductions for establishing landfill tax under the Scotland Act 2012. As far as I am aware, those have not been settled yet. That does not give enormous comfort going forward.

Sir Nicholas Macpherson: They have been agreed for the year ahead.

Q297 Jesse Norman: That is public, is it, Sir Nicholas?

Sir Nicholas Macpherson: That is.

Mr Osborne: I think what happened there—so everyone is aware—was that we were going to conclude an agreement with the Scottish Government but I knew that we were going to make substantial changes to stamp duty in the autumn statement, so I did not think it would be fair to the Scottish Government to agree something when I knew that only a few weeks later there was going to be a substantial change.

Jesse Norman: That is helpful.

Mr Osborne: So we delayed it for a few weeks, without telling Alex Salmond and Nicola Sturgeon all my plans in the autumn statement. Then after that, we have been able to say, “Look, let us agree to hand over the revenue attributable to Scotland from stamp duty for the coming year. Going forward, let us park this into the Smith process of agreeing a more lasting and permanent arrangement for all of the taxes that are being devolved”.

Q298 Jesse Norman: But just to be clear that that means—

Chair: Be extremely quick, Mr Norman.

Jesse Norman: Sorry, just to be clear, that means we should not read across from the delay on the landfill tax and stamp duty to the delays that would occur in negotiating the block grant?

Mr Osborne: No, the delay was caused by me knowing something that I could not tell the Scottish nationalist leadership about, but that I knew would affect this decision. I do not think it would be fair to have made that decision in possession of the knowledge I had.

Q299 Chair: You said earlier, Chancellor, that it was very helpful that we had these principles on the basis of which to work. The trouble with these principles has been that they are in places pretty vacuous, not least the no detriment principle. You have filled the vacuum a little by saying that authorities should live by the consequences of their actions and that, therefore, the no detriment principle is set aside where a Government have taken a particular decision and they should live by those consequences. Also on point about budgetary powers for the UK as a whole, there is reference to income tax. You have said that that should be the case, except where those particular powers have been devolved, and that was a point you made in relation to questions from Stewart Hosie.

Another big area where this whole report seems a little vacuous or silent is not just the block grant, which we have raised, but also borrowing powers. Do you agree with Lord Smith when he said, "To me, it is inconceivable—and I think to anyone in these islands it is inconceivable—that a UK Government would allow a devolved Scottish Government to go bust because it over-borrowed"?

Mr Osborne: Yes, but I would hope that we had agreed—indeed, I would be pretty insistent that we had agreed—fiscal rules that would prevent that happening. That is why I think fiscal rules are going to be a very important part of this arrangement that the UK stands behind its citizens wherever they live. The fiscal credibility of the UK is one of our most precious assets and we have had lots of debates in this Parliament about how we preserve that credibility. Of course we would not allow Scotland to go bust, but in order for that situation not to arise we will have to agree fiscal rules, independently verified, that make sure that that does not happen, so that we never reach that situation where the sovereign backstop has to be deployed.

Q300 Chair: Unlike the fiscal rules and agreements that we have had over many years for the UK as a whole, which have turned out to be somewhat elastic—in fact, they have been set aside whenever the pressure has mounted at an awkward point in the economic cycle—in this case what we need is something that is also backed by a credible deterrent. Has any thought been given to what that deterrent might be? Otherwise, at a time of crisis, the Treasury would find itself in the impossible position, if the Scottish Government breached its borrowing limit, of having to allow the Scottish Government to go bust, and you have just said that is not possible.

Mr Osborne: Except that I think it is different. We set our fiscal rules as a sovereign, and if we choose to break those rules then we come to the House of Commons and account for that and then we are able to borrow. Here this is an arrangement between a devolved Administration and the Sovereign and some form of balanced budget rule—not, I suspect, requiring a balance every year, but some form of balanced budget rule, which by the way operates in plenty of other countries and we operate with local government in England. It should be something that will operate and will be very solid and robust.

Q301 Chair: Are you drawing on the precedent in the United States for state level legislation of that type for the balanced budget rule?

Mr Osborne: I think in theory in the States they allow the states to go bust, California being an example. Most state legislatures—of course it is a different arrangement, they do not have to do bilateral negotiations between the states and the Federal Government—have passed balanced budget rules in order to prevent themselves getting into a situation where they go bust. Here the parallel would be some form of balanced budget rule. I think some of the states have an annual balanced budget rule; I am not sure that that would be necessary here, but some form of balanced budget rule would be agreed between the UK Government and the Scottish Government.

Chair: That is very helpful.

Q302 John Thurso: I want to ask a couple of questions on the Crown Estate. Before I do so, since everybody else has had a crack at detriment, can I stick my tuppence-worth in as well? First of all, I must put it on record that since Smith has delivered home rule, far from being a vacuous report, I regard it as an excellent heads of agreement to enable us to deliver the vow that we all made campaigning north of the border.

Chancellor, coming to you first, Smith sets out at paragraph 7 his basic set of principles and, in paragraph 6 there, the simple principle that home rule should cause neither the UK Government nor the Scottish Government to gain or lose financially simply as a consequence of the devolution of a specific power. That basically informs paragraphs 93, 94 and 95 and so forth that we have been discussing. Isn't the clear intention that respective Governments of the two nations or of the different parts of the United Kingdom bear the consequences of their decisions for which they are responsible and that their electorates can call them to account for that? For example, the rate of VAT that was prayed in aid is not devolved and, therefore, does not even begin to fall within this. Is it not a question that electorates can hold to account the people who are making the decisions for which they have responsibility? That is the one overriding core principle and all the rest is flim-flam.

Mr Osborne: Yes, I think that is the principle of devolution. It is a positive thing that the Scottish Parliament is going to be more responsible for raising the revenue that it then spends. I think that will change the nature of the Scottish political debate in a positive way and, of course, the people of Scotland can hold their Scottish parliamentary representatives to account for those decisions, just as they can hold their Members of Parliament to account for the decisions that are taken on a UK-wide basis.

The case with VAT I think is a very clever arrangement. This is not devolving the rate of VAT, but, if Scotland took a set of planning decisions or housing decisions or transport decisions that led to more commercial and retail activity in Scotland and VAT went up relative to the rest of the UK, then Scotland would get the benefit of that because of the assignment of the revenues.

Q303 John Thurso: Sir Nicholas, a question for you: you will lead the Civil Service team that is responsible for turning this into cogent legislation. Are you confident about the instructions that you have been given?

Sir Nicholas Macpherson: Yes.

John Thurso: Thank you. Can I now turn to the Crown Estate, one of my—

Mr Osborne: I am not sure what I would have done if he had said "no", but—

John Thurso: Nor am I.

The Crown Estate is being devolved, as they used to be two separate Crowns and two separate estates that were brought together relatively recently. There is no great problem in the principle of that, but one area that seems to be at odds is exactly where the Crown Estate begins and ends with regard to the seabed. I ask this question, obviously, because of my interest in marine renewable energy. The Secretary of State is of the opinion that the Crown Estate goes for 12 nautical miles from the shore and that, therefore, that is all that can be devolved. I think the Scottish Parliament takes the view that it can go out to 200 nautical miles on the basis of the Crown Estate's devolution. Which side of that argument is the Treasury on?

Mr Osborne: The Treasury always has the right answer, and our understanding is that the Crown Estate is responsible for the management of the foreshore and the seabed out to 12 miles, and then for certain economic activities within the UK's exclusive economic zone, which is out to 200 miles. There are greater responsibilities for the 12 miles, but there are some responsibilities out to 200 miles, and all of that will be devolved to Scottish managers.

Q304 John Thurso: It is basically the 12 miles, plus those things for which the Crown Estate has responsibility beyond that?

Mr Osborne: Yes.

Q305 John Thurso: Thank you very much indeed. One practical point: as the Treasury is responsible for the Crown Estate, a great investment is currently going into renewable energy in the Pentland Firth and Orkney waters, including the attraction at the moment of private investment. Clearly there are concerns that that private investment could be put off if there is a lengthy transformation. Would it be possible for the Treasury and the relative Ministers in Scotland to agree the plan, say, out to 2021, for renewable energy so that the market can be reassured that its investments will follow the current plan?

Mr Osborne: We have already made commitments as a Coalition Government to invest in renewable energy for many years ahead, so that there is that certainty and you can have that pipeline of investment. I do not think I would want to come up with a specific set of commitments relevant only to Scotland. I think there should be commitments for the renewable industry across our UK. The Crown Estate clearly is an important—

Q306 John Thurso: I am referring to the plans already published and being enacted, which may be brought to a screeching halt if the market is not reassured by Ministers on both sides that the plans will be implemented.

Mr Osborne: I would hope that there was not any great disagreement about how those resources were managed. The Scottish Government say that they are in favour of greater renewable energy in Scotland, and so are we in the UK Government. The Crown Estate has an important role in this, and that is recognised in the Smith agreement. He talks about reaching an agreement on energy interests between the UK Government and the Scottish Government. We can get on with that. I should also mention that there are important defence interests as well, in which the Crown Estate is an important player, and we would want to secure those as well.

Q307 John Thurso: Obviously, with the Crown Estate devolved, the Crown Estate's revenues will go to the Scottish Government and the investments that it is able to make will come from the Crown Estate within Scotland. What assessment has been made of both the revenues and the investments in that regard?

Mr Osborne: To get this into context, this is only 3% of the whole Crown Estate, so I think it is around £260 million of assets. So it is clearly important and important to many Scottish communities, particularly coastal communities, but in terms of the management of the entire Crown Estate, this is a relatively small part of it.

Q308 John Thurso: Will there be an adjustment to the block grant, if needed, or will this be outside it?

Mr Osborne: This falls into a slightly different category, because here we will be devolving assets and liabilities, so I do not think there needs to be an adjustment to the block grant. It is a subject we will have to look at in detail. But that is my instinct on this. As for the sums of money, again, we are in the very low millions so it is not a huge source of income.

Q309 John Thurso: The final question: the sovereign grant comes out of the Crown Estate. Will you expect a part of that now to be paid for out of the Scottish Crown Estate?

Mr Osborne: The sovereign grant is indexed to the Crown Estate revenues and growth. Under the arrangements that—

John Thurso: In other words, 3%.

Mr Osborne: —George III agreed with this Parliament, the revenues of the Estate are handed over to the Exchequer and in the old days we paid a civil list to the Royal family, now we pay a sovereign grant, but it all comes out of general revenues. We would of course want to make sure that the Queen and her family were not losers as a result of Scottish devolution.

Q310 John Thurso: I think I heard you just say that the sovereign grant will be unaffected, even if Scotland did not contribute to it.

Mr Osborne: We would make sure that it was unaffected if there was any risk that it would be affected.

John Thurso: Thank you very much.

Chair: Thank you very much, Chancellor, and Sir Nicholas, for coming to give evidence to us today. Your answers have been detailed and have translated a number of principles in Smith that are capable of meaning a good range of things—in fact, some might say almost anything. You have given some substance to those principles, and we are grateful to you for that clarification.