



HOUSE OF LORDS

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IN THE UNITED KINGDOM**

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2.40 pm

Witnesses: Dr James Cuthbert and Mrs Margaret Cuthbert

Members present

Lord Hollick (Chairman)
 Lord Kerr of Kinlochard
 Lord Lamont of Lerwick
 Lord Turnbull

Examination of Witnesses

Dr Cuthbert and Mrs Margaret Cuthbert

Q38 The Chairman: Thank you very much for joining us today.

Mrs Margaret Cuthbert: Thank you for having us.

The Chairman: As I explained, we have had several sessions already, including with the Finance Committee. One of the issues that has really come up is the lack of transparency in this process, and therefore the lack of awareness and understanding. It would be interesting to hear from you whether you agree with that assessment and, if so, what could be done to shed light on this both now and over the coming years so that whatever settlement is reached can be robustly reviewed and understood, not least by the Scottish electorate.

Dr James Cuthbert: Interestingly, Jim Sillars, as you may be aware, had a book launch yesterday. The book is a post-mortem on the referendum. I asked a question at the press conference for his views on what seems to be an outstanding paradox in Scottish politics just now, which is whether what was supposed to emerge from the referendum was a politically educated electorate in western Europe, as some people said. Nevertheless, the Smith commission reforms are going through without an outstanding furore over what is proposed. On the basis of our analysis, it seems to us what is proposed is absolutely disastrous. Part of that is technical and relates to modelling. You have got the paper I did, the Fraser of Allander Economic Commentary on the modelling, which shows there is an unstable system. Part of it is constitutional. We identified this effect called the “gearing effect” which is a problem that arises when decisions are made when whatever body is making decisions on the rest of UK’s devolved taxes makes decisions which have an effect on reserved services.

Lord Lamont of Lerwick: May I interrupt? You have alluded to the modelling of Barnett post-Smith and this Fraser of Allander paper. You have given us this paper but your view is that

the Holtham indexation will actually lead to public expenditure per capita in Scotland being driven down to what you call an unacceptable level.

Dr James Cuthbert: Absolutely.

Lord Lamont of Lerwick: Maybe you could just explain that.

Dr James Cuthbert: I do not know if you have had a chance to see it, but I did send a copy of that paper to your clerk.

Lord Lamont of Lerwick: I have not, no.

Dr James Cuthbert: The proposals were only produced in January this year so one is working continually on it. To put it in its crudest form, let us take Holtham indexation as it is proposed at present and let us suppose Scotland just matches the rest of UK's tax rates, in other words it just keeps tax rates the same as in the rest of the UK; suppose that population is growing in England relative to Scotland, which is the case—it has been like that for many, many years and will continue to be so presumably; suppose the tax base in England is growing relative to Scotland which, given the population is growing, will almost always be the case and will certainly be the case at times when the City is booming; suppose these three conditions are met, which are perfectly reasonable conditions, and suppose that if you look at the devolved services down south, let us say health and education, and suppose that the proportion of expenditure on health and education down south, which is funded by those taxes which are devolved up here, basically funded by income tax that remains roughly constant, which will tend to be the case, you have four eminently sensible conditions that will almost always be met. Under those conditions in the long run, if Scotland managed to grow its own non-devolved tax resources at all, ultimately Scotland would be better off under fiscal autonomy than under the financial settlement we have got here. Under the financial settlement we have got here public expenditure would eventually go negative and then tend off to minus infinity unless something changes. Obviously that cannot happen but that is saying you are in an impossible situation which is going to head towards the rocks under the financial model that is set up. It is as bad as that. I will justify that statement in a note I can send to you later.

Q39 Lord Turnbull: If you made one change to the Holtham indexation, which is on a per capita basis, how much of this system would you use?

Dr James Cuthbert: If you take out the heading “off to minus infinity” aspect of it, what would tend to happen then would be that what would kick in would be what is actually

formula 4 in the Fraser of Allander paper, which you have, which would say that under reasonable conditions public expenditure per head in Scotland would tend to a limit relative to public expenditure per head in England but that limit would be about 50%. Although the thing is more stable, and it will diverge less rapidly, it will head towards a position—

Lord Turnbull: How much of this would happen in five years, 10 years?

Dr James Cuthbert: Not in five years. I always thought that talking constitutional change you were talking generations and that was the whole tenor of the referendum. Certainly major effects will occur within a notable time period. Again I would refer you to the Fraser of Allander paper. There are a couple of charts in that which show, first of all, the sort of things that happen under reasonable assumptions under crude Holtham indexation and then what happens if you do the adjusted Holtham indexation. It is much more stable but it is still making big changes and ultimately is heading up to around the 50% limit, which would be untenable. So it does seem to us that as it stands it is completely unstable and intolerable. Modified as we suggested it is still unacceptable. One asks the question why one is putting in place a system which effectively brings in an active penalisation of Scotland under crude Holtham unless we grow our tax base as fast as England, and under adjusted Holtham unless we grow our per capita tax base as fast as England. Obviously if one is going down the basic route we have got in Command 8990 you have these abatements and you have to grow them in some way.

There are alternatives. One alternative would be the index in line with the growth in the Scottish tax base, but that is nonsense because that puts you straight into moral jeopardy; it gives no incentives to Scotland to grow its tax base at all. It does seem to me that there is a middle course, which is that you do not index relative to anything that is happening in the tax base in England or the rest of the UK but one sets an absolute standard. So you would say, “Right, we will index the abatement in line with a modest assumption on the absolute growth in the tax base, if you grow your tax base in real terms at 2% per annum”. We do not know how the Scottish economy is going to behave—we have got limited powers—so I would be in favour of a very modest assumption, maybe just keeping it constant in real terms initially and then adjusting as the thing beds down. That does not actively penalise Scotland if we fail to grow as fast as the rest of the UK, but does give Scotland a positive incentive to grow its economy: the more it grows its economy the better, and if it fails to grow its economy it suffers. You are not setting this completely artificial penalisation in, you

are giving a proper incentive. Then in due course one would hope that there would be adjustment mechanisms. Another point we make in our papers is that you cannot run a monetary union without revisiting periodically the question of fiscal transfers, and one would hope that that could be done in a mature fashion from time to time. If Scotland was indeed zonking ahead and you had said, "Grow your economy at real terms 2%, or your tax base at 2%, and you are actually managing 3%, we will up the indexation to 2.5%", so you have still got an incentive. It could be adjusted in due course. That would take out a lot of the active penalisation.

Lord Turnbull: Could you just clarify again what we should be indexing to? You went quite quickly over it.

Dr James Cuthbert: I would say give a fairly modest absolute target. So you would say, "We will index your Holtham abatement, at least the bit of it relating to tax—"

Lord Turnbull: Indexing the abatement?

Dr James Cuthbert: We could come back to that in a bit more detail later because there is more than one kind of abatement. What is going to happen is that Scotland will get what it would have got under the Barnett formula, there would be a chunk taken off that in year zero because Scotland will be getting income tax receipts directly, so there will be a neutral amount taken off in year zero, and that abatement will then grow through time. It is perfectly reasonable it should grow through time. What they said in a very cavalier fashion in Smith and Command 8990 was, "Increase that abatement in line with the growth in the overall English tax base"—and that just sounds horrendous. Even the per capita adjustment is still bad. Why not say, "Okay, Scotland, we are going to index that abatement at 1%, 2% growth in real terms: grow your tax base faster than that, you are quids in, you get to keep the difference. Grow slower than that, you suffer. We will revisit the whole thing periodically in line with the processes that should be involved in any monetary union for periodically reassessing fiscal transfers".

The Chairman: Did you explain this in detail to the Finance Committee and the Smith commission?

Dr James Cuthbert: We have had no contact with the Smith commission. We put in evidence to the Smith commission along with 800 other people.

The Chairman: Along these lines?

Dr James Cuthbert: No, not along these lines because, as I said, this is a moveable feast.

The Chairman: What about the Finance Committee?

Dr James Cuthbert: I explained to the Finance Committee in considerable detail the problem with crude Holtham indexation but not in the stark terms as I just explained to you. I had not then thought through what an appropriate way would be which give proper incentives. You are the first people to hear this idea of indexing in line with—

Q40 Lord Lamont of Lerwick: In your answer when you were talking about the incentive, you mentioned the incentive to grow the economy. There is an assumption there that of course it is within the gift of the Scottish Government to grow the economy faster than they have hitherto.

Dr James Cuthbert: It is not actually because they have very few economic powers. In an ideal world we would like to see the Scottish Government having more economic powers and an incentive to grow the economy and getting on with the job. We have issues about whether in fact the Scottish Government have made optimal use of the powers they have at present, for example in relation to the way they use public procurement. But they have very limited economic powers at present. The phrase we coined to describe one aspect of the whole Smith reforms was that this was “responsibility without power”. You have got responsibility for living within your tax resources. In fact, you have got responsibility for keeping up with what is happening with taxpayers in England or you will be actively penalised, but you do not have the power to do anything about it. The popular phrase we coined was “responsibility without power”. I have probably spoken enough.

The Chairman: Do you want to add anything to that?

Mrs Margaret Cuthbert: Mine is much more on the practicalities of the matter. I wrote in my note that the foundation of the Barnett formula, which is one of the things that would still be going on, has not been looked at. We have not had the Treasury funding statement since 2010. When you look at that Treasury statement, which is the basis for Barnett, you want to be connecting up that expected spend with what actually happened in the PESA document, which is the country regional analysis of how the different parts of the UK spend their money. There is no obvious connect. Despite many years of asking, there is no way that the two can connect even in the titles of the different headings on the way down. When you look at the Public Expenditure Statistical Analysis, you find that what is allocated to Scotland is a rule of thumb in so far as under the renewable heating incentive, for example, we have 18.79% of the total UK spend. It goes on like that. Among some of the research councils—

and Scotland has always been told that our universities are extremely good because they bring in a lot of money—when you actually look at the percentages year after year and across the different research councils there is a uniformity about it to the second decimal place which suggests that things are not right. Over the years we have asked through the Treasury to get the departments themselves to do that. It is a big task. Some of them have been fixed but a lot have not. All of these things add to transparency and our understanding of what benefits we are actually getting from the non-devolved services and therefore how it is going to be affecting the Barnett formula and the amount of money we get in the future.

The Chairman: Do you plan to publish this shortly?

Mrs Margaret Cuthbert: The paper that Jim did is already published except for this new bit.

Dr James Cuthbert: The Fraser of Allander paper is already published.

Mrs Margaret Cuthbert: This type of detail is ongoing background research which other things have taken precedence over.

Dr James Cuthbert: I will drop you a note on the point I made relative to fiscal autonomy.

The Chairman: That would be very helpful.

Dr James Cuthbert: We will put that on our website in due course. I said that the model that has been set up would mean that Scotland will always be worse off in the long run than under fiscal autonomy, if Scotland manages to grow its non-devolved taxes at all. I would not want you to take that as my saying that we should have fiscal autonomy. There are all sorts of problems in defining fiscal autonomy because in a monetary union there are obviously going to be various agreements and concords about what freedom you would have, how you would pay for debt, what share of debt you would pay for, how you would pay for common services, et cetera. To my mind it is quite difficult to define what fiscal autonomy is. More importantly, the idea of having fiscal autonomy with relatively limited powers in a monetary union strikes me as a recipe for ending up like Greece. So I am not advocating fiscal autonomy. What I am saying is that, although this does not appear to be noticed, the Smith commission set up an own goal when it put forward a settlement that will always be worse than fiscal autonomy no matter how badly the Scottish economy is doing.

The second point I would like to make is picking up something you said earlier. We have been talking about indexing the abatements to the Barnett formula under these proposed arrangements. There are two types of abatement. There is the abatement we have been talking about where the Barnett formula block grant has been reduced because of resources

that are going directly to the Scottish Government, but because of the no-detriment principles in Smith there is also another type of abatement. The second no-detriment principle says that neither England nor Scotland should benefit or gain from decisions made by the other party on devolved matters. That means that there will have to be a range of abatements to the settlement to do with adjusting—cancelling out the Barnett consequence. Suppose that down south the rest of UK's income tax was raised and that was spent on devolved services or Barnett consequences of that, then what is set out in Command 8990 is that there would need to be a downward adjustment in Scotland's block grant to compensate for that so that public expenditure in Scotland did not rise because of the decision on the rest of UK income tax. You have got that whole range of abatements coming in as well.

Those abatements raise very difficult technical issues. Take income tax, for example. When in most years the thresholds in income tax are uprated for inflation, is that just housekeeping or is that a policy adjustment that you would want to do an abatement for? If some years you do not do that, is that a policy decision? You are in the paradox situation that you have not done anything and yet that is potentially a positive decision for which there should be an abatement. You have got all those sorts of things. Secondly, however you index those abatements it cannot be in line with the overall growth in the tax base. Imagine the decision down south was to bring in a 10p tax band. The financial consequences of that will grow in line with the number of taxpayers, not in line with the overall growth in the tax base. Any temptation to index this second class of abatement in line with Holtham indexation would be nonsensical. Thirdly, however you index it you would want the thing to be self-cancelling. If a change was made in tax down south and then subsequently reversed, you would want to end up where you started. However, it is very difficult to think of ways you could do that. The technical issues surrounding the second type of abatement seem to completely escape scrutiny and yet are actually horrendous.

Q41 The Chairman: May I just stop you there for a second? When we had our meeting this morning with Finance Committee members, they made the point that they had looked long and hard at the second principle of no detriment going forward and concluded it was extremely difficult to model it and very difficult to make it work. They would like to see it as a high-level principle which was then reviewed on an annual or biannual basis so that changes could be made on a fair and reasonable basis. In other words, it is like kicking the

can down the road and looking at the facts as they then were, rather than trying to come up with a formula that would work. In that sense I think they said they were recognising the dangers that you have raised.

Dr James Cuthbert: That was an area that I did cover in considerable detail with them when we gave evidence to them.

Mrs Margaret Cuthbert: On that specific point, looking again at the Barnett formula and what has happened in the past as far as these negotiations would go as to how we should deal with things, there are very few negotiations at all on the Barnett formula at one level. In other words, the Treasury, or someone, decides that the London Olympics will not be taken into account in the Barnett formula whereas, for example, the Glasgow Commonwealth Games were taken out of Scotland's share. The Channel Tunnel was not included in the Treasury funding statement. The Queen Elizabeth Hall was not included within it. The decisions are made like Juncker making the decisions and the rest of us have to follow. I really do not see that what the Finance Committee thought we will get is likely to happen, because decisions are imposed, not negotiated.

Q42 Lord Kerr of Kinlochard: A consistent thread throughout all the evidence we have got today is the need for more transparency. Yet nobody seems to want the outside world to know about the negotiations that are going on now behind the scenes. On a continuing basis, annually, what you say about no documentation since 2010 is new to me and cannot be right. We may be unable to avoid rows but at least the rows would take place on the basis of agreed fact.

Mrs Margaret Cuthbert: Absolutely.

Dr James Cuthbert: There is another reason why transparency is extremely important, which is that one of the problems which the Scottish Government will have in setting up the new Scottish Fiscal Commission, which will almost certainly be charged with modelling and forecasting of the finances of the Scottish Parliament, is that you cannot do that unless you thoroughly understand how you got to where you are. Unless the whole process of setting the block grant is completely open and there is a great deal of openness about future assumptions made down south about growth in the tax base and things like that, and unless there are as few arbitrary judgments in the process as possible—as Margaret was saying, up to date the whole process of calculating Barnett has been riddled with arbitrary Treasury adjustments which could go one way or another—how can you forecast if the process is in

riddles? The whole thing needs to be more open and less subject to arbitrary judgments or it is going to be impossible for the Scottish Fiscal Commission to forecast.

Lord Kerr of Kinlochard: We were playing with the idea—at least I was playing with the idea—of some sort of new independent institution which would be tasked with presenting the facts. Of course, Chancellors and Cabinet Secretaries can still wish to have a negotiation but it would be rather good if the public saw that negotiation taking place on the basis of agreed facts. Do you think there is a case for putting alongside the OBR and the Scottish Financial Commission a new UK institution to take some of the tasks of both?

Mrs Margaret Cuthbert: Our view is that the OBR works as an extension of the Treasury. It is not independent. We have written on this subject before. Its views have tremendous weight way beyond what they should have because it is still an arm of government, despite Robert Chote being there.

Dr James Cuthbert: Perhaps I can just say that I am not sure about a UK institution because the problem of forecasting the finances of the Scottish Government is not just a question of taking an OBR forecast and disaggregating it. That is the sort of thing that was done in the referendum and it produced forecasts of the public finances for Scotland: not very good forecasts, but they were forecasts of the public finances for Scotland. What we are talking about is the public finances of the Scottish Government, who are only responsible for half the expenditure and will only be getting income tax and an element of VAT: the other half of their finances will come through the complicated adjusted Barnett formula. So forecasting the finances of the Scottish Government is almost a separate question from the OBR-type forecasts. To do that kind of forecast would be very difficult. To get an idea of the difficulty, that is the area I dipped my toe into in my Fraser of Allander paper and the algebra is quite complicated if you look at it. It is a very difficult problem, quite distinct from what the OBR is doing, and will depend upon decisions that have been taken in government. It is not a question of looking at facts about the economy. The key thing will be looking at facts about what the Treasury was doing in working the Barnett formula, working out these abatements, working out the indexation of the different kinds of abatements, et cetera. An outside body would only be able to do that (a) if it was well resourced, (b) if it had its hooks right into the Treasury, the OBR, HMRC and so on, and (c) if it was getting access to the assumptions that these bodies were making. If indexation is based upon the growth in the English tax base, you need to know what assumptions are being made about the growth in the English tax

base. So it is not obvious that an independent body is well placed to do this kind of work. It is work that critically needs to be done, and difficult work that will be so resource-intensive that you do not want to duplicate it. So whoever does it—and presumably the Scottish Government will want to do that work—maybe you want an independent body that can validate what it is being done and is in a position to do variants if it wants. There is a real problem here to which there is not an easy solution.

Q43 Lord Lamont of Lerwick: Could you talk to us a little about what you call the “gearing problem” where you described a scenario where the UK Government cuts a tax that has been devolved to Scotland and this has impact on reserved services such as like defence? You say the eventual effect would be a disproportionate cut in public spending in Scotland.

Dr James Cuthbert: In its crudest form, imagine that whoever was setting the rest of UK income tax decided to make a cut in income tax and fund that by cutting services across the board—defence, social security and devolved services in England. If there was a significant cut in income tax stemming from that, the Scottish Government would broadly have to follow suit. Scotland is not going to be able to get too much out of line on income tax or the economy will collapse. It will have to fund that cut over the smaller base of devolved services while down south it is funded over the larger base. There will be a disproportionately larger cut in those services in Scotland. That is why we called it the “gearing problem” because of that gearing effect. That is a basic problem.

Although Smith did not spell that out, clearly they were aware of it because they came up with this second, no-detriment principle—the people who wrote Command 8990 were completely aware of it—and they said, “We will solve this by this principle that decisions taken south should not be able to affect what happens”. For example, if down south it was decided to raise income tax and spend that money on reserved services—the example that we gave when we wrote this was Trident, because that is popular in Scotland—because a reserved service is regarded as benefiting the whole of the UK, overall public expenditure in Scotland would go up by Scotland’s population share of the increase in UK public expenditure and, according to Holtham’s second, no-detriment principle, you then need to adjust Scotland’s block grant down by a corresponding amount to compensate. You would now be in a position where a decision taken down south on income tax and on reserved services would force either a tax rise or a cut in services on Scotland, which is entirely counter to the principle that we were led to believe we were getting of greater autonomy

and freedom of decisions under Smith. Instead, we are a bit like a puppet at the end of a chain that can be jerked.

My own view is that you can only get round this by some sort of federal system where you separate out decisions on the rest of UK income tax from decisions on spending on reserved services. If it is the same people making those decisions, effectively you get a residual problem and you have not solved it. A solution to the problem would be to have an overarching federal Government making decisions about the allocation of a block grant to the different parts of the UK, and then English MPs would take their block grant and make a decision about the rest of UK income tax and what they were going to spend on health and education. That would be fine.

That system would have another huge advantage as well. It would completely sweep away the difficulties we have been talking about with the various forms of abatement. We are in the ridiculous position at present where we are saying, "Okay, we will have a hybrid system where public expenditure down south depends on decisions made on the rest of UK income tax by English MPs. That affects overall public expenditure, which affects the Barnett formula, which affects Scotland's spending, but we must correct that". That is nonsense. If each party just got a block grant, then you could have a Barnett formula relating the block grants to the different parts of the UK. What they did on top of that in the different parts of the UK by way of income tax would be fine; it would be an entirely internal matter and there would be none of these consequences working their way through the Barnett formula as at present. Federalism would not merely be workable to my mind but the only workable way of approaching this. It would also sweep away these horrendous complications we have at present. That seems to me to be the second big fault line.

The Chairman: That is where we are.

Dr James Cuthbert: I appreciate that while your Committee may be able to make strong recommendations on technical aspects, you are unlikely to be able to sell federalism to Westminster. There is a fundamental problem there about the whole thing.

The Chairman: Putting words into your mouth, and going back to your Jim Sillars remark, we are far from reaching calm water.

Dr James Cuthbert: Why are the crowds not out in the street saying, "How do they solve that"?

The Chairman: This will become apparent as each year passes.

Dr James Cuthbert: We are actually in a worse position than Greece, with a financial settlement that actively penalises us if we fail to grow as fast as the rest of the UK and with far less powers than Greece. Greece went through its initial honeymoon and then things hit the fan. This will happen exactly like that in Scotland.

Mrs Margaret Cuthbert: There are a couple of other points I would like to make, one of them I made in the paper. As we get more fiscal powers in Scotland, the trend—it has been apparent since Scottish devolution—of UK departments which are partly looking after devolved services but partly looking after UK services is increasingly that those looking after UK services are thinking that Scotland is looking after itself. For example, it would be entertaining for you if you looked at the Department for Culture, Media and Sport and looked up tourism. It has responsibility throughout the United Kingdom and says it spends 7.79% of its budget in Scotland. You would be hard pushed to see any mention of Scotland in any of its publications, other than the financial one; in any of its promotions we just do not exist. That is not uncommon. That is a worry as more gets devolved. Smith only looked at the finance. They should also have been looking at the services which are not devolved to make sure that no harm was going to be happening there.

Q44 The Chairman: Are you suggesting in that particular case that the 7.79% that is mentioned in the DCMS report is in fact not finding its way to Scotland?

Dr James Cuthbert: I think that would be educational.

Mrs Margaret Cuthbert: Part of it will be finding its way because part of it, for example, will be that we can go and use promotions overseas. What I am saying is they are not doing enough. UK Trade & Investment is exactly the same. Today if you looked up events in various parts of Britain to see what UKTI was supporting and looked up Scotland, it would say, “Oops, sorry, there’s nothing happening in Scotland”. It has been like that since the end of March when I wrote to them and to the Minister to complain that what it said for March was, “The Commonwealth Games in Scotland”, which were last year. That gives you an idea of what people are seeing on the websites as to what UK Government departments, which are looking after UK interests, are doing for Scotland right now. That was the first point.

The second point I wanted to make was, within the course of Smith being looked at, if you remember the VAT position was changed. When this comes into being it will take some time to work out the VAT position. This is going to take a long time because VAT, as you know, is assessed and then various amendments are made to it as the process goes on. As for the

amount of VAT that the Government thinks should be collected and the amount that is actually collected, there is at least an 11% difference between the two. They have no idea how that allocation should be across the country so they use a formula to separate it out. All of this will have to be looked at. Since it has taken them years of not looking at it, I have no idea how long the process will take. We are embarking upon a process like the VAT where we really have not a clue what the figures will be because they have never been worked out and at the same time they are putting the existing Barnett formula at threat.

Dr James Cuthbert: I would like to comment on what Margaret said about the powers. There is another side to the coin of whether English departments or UK departments are exercising the reserved responsibilities for Scotland properly. If Scotland has only a relatively restricted set of policy clubs—at present it has very few economic powers—that is potentially very damaging. You often hear particularly opposition politicians in the Scottish Parliament saying, “The Scottish Government should be getting on with the important matters of health and education”—in other words, “Get on with your domestic powers”. In one sense that is true but, on the other hand, if the main thing you can do about the economy is to seek to improve the skills and education of your workforce and you are not able to do much about seeking to improve the demand for those skilled people, all you are doing is educating people to emigrate.

I mentioned earlier this question of relative population growth. The population over many years has consistently grown faster in England than it has in Scotland. It was only relatively recently that I dug out the corresponding ratios for Wales and Northern Ireland and was absolutely staggered to find that their populations have tended to grow in most of the recent past relative to that in Scotland. That is quite bizarre, particularly given the economy, et cetera.

The Chairman: Growing faster?

Dr James Cuthbert: The populations have been growing relatively faster, yes. One possible explanation for that is the vaunting of the Scottish education system, that we have been putting too much into education and too many people through university for whom the world is their oyster and they are off to the detriment of the Scottish economy.

The Chairman: You are exporting talent.

Mrs Margaret Cuthbert: Yes.

Dr James Cuthbert: We are exporting talent. If it is true, that is a classic example of the kind of policy bias you get when your main policy levers are concentrated on only one part of the toolbox.

Q45 The Chairman: So are you arguing that the powers and taxes that are being devolved are inadequate for the purpose of having a balanced fiscal strategy and control over the levers which are necessary to grow the economy?

Mrs Margaret Cuthbert: Absolutely.

Dr James Cuthbert: There are two separate questions. There is the question of which taxes have you got. The major tax we have got any control over is income tax, which, as we explained in our paper, is a poor tax for that purpose because our distribution of earnings is quite different from that in the rest of the UK, with many fewer at the higher end of the scale, which means that we are going to grow at different rates at different points of the economic cycle. It is a poor choice of tax and too limited a set of tax powers we have got. The other thing is: what non-tax powers have you got, particularly what powers have you got in the economy? There is a whole swathe of things there that we do not have. The overall thing is we do not have the powers to grow the economy and we will concentrate on those things we can do, which in a perverse way could have a detrimental effect rather than a positive effect.

Mrs Margaret Cuthbert: For example, VAT is just a handout of a percentage. We have no control over those. If you go to France or any European country, while adhering to the overall EU regulations they will have different systems of VAT. In France, when you are paying your hotel bill, that money will go to the local council, which will use the money to boost tourism in the area—that might be putting in flowerbeds or training or whatever. If they feel there is a need for improvement of people's housing—as there certainly is in Scotland in many places—that will not be subject to VAT. Once you have the full power over VAT, within the European Union you can change various aspects of it. We have no such powers.

The Chairman: So you would be in favour of a block grant and allowing that money to then be spent—obviously it is set at an adequate level—to iron out some of the imperfections that you describe and allowing the devolved parts of the United Kingdom full powers as to how they should invest it and what they should do with it.

Dr James Cuthbert: Not full powers—obviously they would have to be constrained.

The Chairman: With central responsibility for defence, security and things like that.

Dr James Cuthbert: In any practical union there would have to be some oversight which would limit tax competition, et cetera.

The Chairman: That is a very long journey from where we are.

Dr James Cuthbert: It is very long.

Q46 The Chairman: Cutting to the chase, if I can put it that way, it would be very helpful indeed for you to give us the benefit of your additional work and an explanation that we can then discuss amongst ourselves and share with our readers. What would also be very helpful is to know, given that we are where we are, what steps and what measures can be put in place to address the perverse outcomes that you have described. I think you are also describing a situation in which some perversities exist because that is just the way that the dust has accumulated over the years.

Mrs Margaret Cuthbert: Yes, but they actually add to the problem now because they are not being dealt with.

The Chairman: I accept that. I think it would be very helpful to be able to read and understand what your remedies are.

Dr James Cuthbert: Can I raise one other issue which you mentioned in your questions but I do not think we have touched on yet, which is the question of needs assessment? I think that periodically the nation would have to revisit the question of adjustments of finances in different parts of the monetary union. Any monetary union that is going to be a success has to do that. Probably some form of needs assessment would be part of that. When I was a civil servant I took part, from both the Treasury and the departmental side, in previous assessments of needs, which are pretty hairy exercises. What was coming out was there was greater need in Scotland. A figure of 10% seemed to be what stuck. It did strike me, and it strikes me now, that that sort of exercise, while difficult, is only part of the story. It should not just be about need for public services that you are talking or thinking about; there should also be an element of needs assessment which looks at the distribution of what might be called economic pressure across the country. We are profoundly bad at that at present. We have got pressure cooker south and south-east, while Scotland is pegging along in the middle at present but will soon drop back, and parts of the north and so on are really suffering very badly. Evening out that economic pressure should surely be a part of any future needs assessment exercise.

Mrs Margaret Cuthbert: For example, although many of our ports are private companies and they can choose where they would like to settle themselves around the country, it is our infrastructure that determines where they think it is a good idea. For example, the Peel Group in Liverpool is expanding their huge container base, but it is the same Peel Group that own Clyde port authorities and have interests in a number of others. You can see easily that, where that is the case, on such an important matter of infrastructure, other areas of Britain could lose out. We need a system where it is not just a needs assessment but where we are looking at the whole infrastructure and the physical things that make it a United Kingdom, which is presumably what is intended at the end of the day, despite both of us being interested in independence. These things need to be put in place.

The Chairman: When you raised this at the book launch, you said that far from a period of calm we were getting into a period of great turbulence.

Dr James Cuthbert: What I raised was the paradox that we were not in a period of great turbulence just now.

The Chairman: Moving from calm to turbulent.

Dr James Cuthbert: The turbulence should be now to get a decent settlement in place.

The Chairman: How was that message received?

Mrs Margaret Cuthbert: Jim Sillars agreed.

Dr James Cuthbert: He agreed very much. One of the concerns in the academic community is they are not shouting this from the rooftops. We have not talked to any civil servants first hand but one hears second-hand rumours trickling back, “Oh, they don’t think it’s workable. It won’t happen like this. It can’t”. It is very bizarre.

Mrs Margaret Cuthbert: In the past we have had regular meetings with civil servants and when this paper was produced there was utter silence. There have been no papers produced commenting on the work done. There have been no academic papers—maybe David could correct me—published on commenting on the work done. We know that it went round the Treasury with notes and we have had no feedback from the Treasury.

Dr James Cuthbert: We know the Treasury did an internal briefing on the modelling paper. We have not seen it.

Mrs Margaret Cuthbert: So you cannot comment.

The Chairman: Thank you very much indeed for a very interesting session.

Dr James Cuthbert: We will send you a note.

The Chairman: If you could do that, that would be very helpful. Thank you very much indeed.