HOUSE OF LORDS

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The Select Committee on Economic Affairs

Inquiry on

THE DEVOLUTION OF PUBLIC FINANCES IN THE UNITED KINGDOM

Evidence Session No. 5 *Heard in Public* *Questions 47 - 55*

WEDNESDAY 9 SEPTEMBER 2015

3.40 pm

Witnesses: Lesley Riddoch and Peter Jones

Members present

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

Examination of Witnesses

Lesley Riddoch, Director of the Nordic Horizons Policy Group, radio broadcaster and journalist, and **Peter Jones**, freelance journalist

Q47 The Chairman: Thank you very much for coming. We will make a start, despite the traffic situation delaying Lesley. You have seen the list of questions that we have. We do not need to go through them one by one, but just pick out some of them. Clearly you are in the business of explaining things from a certain point of view and shedding light on issues that may not be fully appreciated by your audience.

Peter Jones: Hopefully, yes.

The Chairman: Transparency is at the heart of what you do. How would you characterise the current situation in terms of the public and the thinking public—I do not mean to be derogatory, but those who are concerned about the situation—and their knowledge and understanding of the situation? Is there enough information in the public domain for those interested to be able to form an opinion and to have a judgment, or has this all been rushed through behind closed doors?

Peter Jones: The process itself was certainly rushed through and came to certain proposals in the Smith commission which are flawed, in my view, and I have explained some of my thinking on that in the submission that I made. Since then, the UK Government has published draft legislation and an Explanatory Memorandum. That has been examined by the Finance Committee of the Scottish Parliament, with a degree of examination by the Commons, so there is plenty of information for anybody who wants to find it. My general experience is that the Scottish electorate or public should not be underestimated in their capacity to absorb quite complex information. The Smith commission itself received some 14,000 individual submissions and I think 250 from various organisations. I am certain that all those 14,000 people who submitted submissions will have followed the process as well. If you look at some of the blogs which are done by people of all sorts of descriptions, then there is a lot of animated discussion about the Smith commission proposals and how the UK Government is handling going on from there. I do not think there is any shortage of information. Whether the understanding is accurate or not is a different question and I could not give an assessment of that.

Q48 The Chairman: Your summary comes to rather a disappointing conclusion that in fact the arrangements could well weaken the UK, in terms of the devolution of income tax with greatly increased borrowing powers. Do you mean weaken it financially?

Peter Jones: Weaken it both financially and politically. Politically, I cannot see how near-complete devolution of income tax is compatible with implementing the EVEL principle, without creating the possibility of very severe tensions down the line. The difficulty is not just the political one of whether a UK Government also has a majority in England; it is also the problem of porosity of borders. England is 85% of the union or thereabouts and anything that it does has an effect on the other countries.

We have had very graphic examples already of how the Scottish Government has had to change proposals, with the introduction of the land and buildings transaction tax. When John Swinney first announced the proposals in October last year, the first innovation was to do away with the slab basis of the tax so that it became a much more marginal and progressive tax, which was a sensible innovation, but at certain points in the scale, particularly for properties worth above £350,000, the tax being raised by the new LBTT was significantly higher than the stamp duty that was raised. In December, in the Autumn Statement, Chancellor George Osborne changed stamp duty as far as land and buildings were concerned and made the charges somewhat lower for properties in what we would class broadly as middle-class households outside of central London—the £350,000-£550,000 range. Although properties are not moveable—you cannot shift a property around, unlike people—John Swinney, Finance Secretary, felt compelled to amend his proposals in January of this year and bring them much more into line with what George Osborne had proposed. He said this was specifically as a result of the amendments made by the Chancellor.

As I say, that is a tax on immoveable property. If you then introduce an income tax border as well as a property tax border, individuals are much more able to move. I think the scope for deviation, if you like, from the English norm under the English tax is extremely limited. I can see it only operating in a downwards direction as one or other country attempts to gain some kind of economic advantage. I cannot conceive of a circumstance where it would work with one jurisdiction moving it upwards and gaining some kind of advantage, either in human beings or working people or in economic gain. I cannot see it working that way; I do not see that it is a functional system.

The reason I think it was introduced is that it derives from the Strathclyde commission, set up by Ruth Davidson, the Scottish Conservative Party Leader, and chaired by Lord Strathclyde. Its clear purpose was to deal with the political problem that the Conservative Party has in Scotland, which is that it is not gaining any ground whatsoever and is gradually declining. The major problem identified was that they cannot offer what is one of the mainstays of the Conservative programme, which is lower taxes, essentially, and therefore by shifting the entire block—by devolving all Scottish income tax—that opens a window of political opportunity for the Conservative Party in Scotland. I think that is its main purpose. Looking at the membership of that committee, there are absolutely no economists on it. There is no evidence that it has sought any advice from economic sources. It looks to me to be purely a political solution, and I think it is a very bad one economically.

Q49 The Chairman: Your conclusion is that there is very limited scope for different tax rates. I just wanted to follow up with a question. Is it the fact that there is no serious movement available on taxes because they are constrained by Scotland being part of the UK?

Peter Jones: There is no practical, serious freedom there. I imagine if you change band rates for example, that may well have a marginal effect. Although the UK Government is retaining control of the threshold of British taxes, I do not see what is in the legislation that would prevent the Scottish Parliament from introducing a zero-rate band, for example, which would effectively raise the threshold at which tax would be paid. I also think there are macroeconomic problems, which are written about in the paper, so I do not need to go into detail, but I think they potentially damage the UK's borrowing abilities in the longer term.

The Chairman: The possibility of greater borrowing powers is an invitation to increase borrowings to fund other programmes that which are covered by tax. Is that it?

Peter Jones: If you are going to devolve tax then you have to devolve borrowing powers, otherwise you leave the Scottish Parliament stuck with a balanced budget, which is bad economic management, by and large. It sounds good to the man or woman in the street, but it is economically very inefficient. Therefore, you have to devolve borrowing powers. Those have to be constrained, otherwise you end up with the mess that Spain got into when the central Government started reducing spending in order to meet the various European criteria and deal with a very serious deficit problem, the autonomous communities continued to borrow to fill the gaps and some of those communities got into the most horrendous difficulties and have had to be bailed out by the central Government. You do not want a position either where you can allow excessive borrowing to happen, which would impinge directly on taxpayers in the rest of the UK, because that is not the point of doing it.

Lord Lamont of Lerwick: So is your answer the sharing of tax revenue?

Peter Jones: Essentially it is.

Lord Lamont of Lerwick: You already have that with VAT, which they do not seem to like very much?

Peter Jones: Of course the Scottish Government does not like assigned taxes because it has no control over them, but to my mind there is an incentive there. If VAT is part of what you are getting, and particularly if indexation is introduced in some form or other as suggested by the Holtham commission, there is an incentive to grow the retail space or the buying power of the population so that you can recoup some of the VAT. I think it would be a very odd Government that did not see that there was some kind of incentive there that would give it benefit and the economy general benefit.

Q50 The Chairman: Ms Riddoch, welcome. Would you like give us your perspective on this and some comments on the twin principles of sticking with Barnett and the principle of no detriment? How do you see that working?

Lesley Riddoch: I should say first of all that I am not an economist and, unlike Peter, I have not made my trade the business of analysing economics. That was understood when I was asked here, which was at fairly short notice, so I have become an overnight expert on the business of Nordic devolution and the finance of that—while I know the generality of how some of the Nordic nations are funded, the specifics of it needed a bit of drilling down.

On the question of where we are at the moment in Scotland, I see Gordon Brown being quoted today as saying that the UK Government is falling short on delivery of the recommendations of Smith on Scottish devolution. I know that is not the question you asked, but from the point of view of where a lot of people are in Scotland, it really depends what your starting point is. I quite see that from the point of view of the British Government the status quo was a starting point; for 45% of the population of Scotland independence was a starting point; and possibly quite a few people in between had listened to comments about "near federalism", which was how Gordon Brown put it at one point, and I think "home rule" has been quoted several times by Danny Alexander. In general terms, because that is how people will approach any proposition, there is a sort of expectation that it would be beefy—and this really ain't beefy.

I think it also strikes people as being, if you like—and I exaggerate for effect—more of a lucky bag than a menu, because it does not look like a thought-through set of ingredients designed to create a wholesome meal. It looks more like a ragtag of heavily negotiated and bartered terms, which we know is the case because we heard what happened in the last stages of Smith. A bit like Russian dolls, each iteration of what is offered is slightly smaller than the last one. All of this does not leave anyone with great hope that we are getting towards something that is a generous settlement; rather that it is heavily caveated. That does not answer your Barnett point.

The Chairman: It is a very helpful perspective because we have heard in other sessions today serious misgivings about some of the ingredients of what is not a particularly beefy offer, the difficulty of reconciling the Barnett formula with the no-detriment principle and whether the powers are sufficient to allow the Scottish Parliament to have sufficient control to deliver economic prosperity and a different balance.

Lesley Riddoch: Or the different economic direction that the Scottish Parliament is trying to pursue in accordance with the will of the Scottish people. That is the problem. If we want to drive our car down that motorway slip road, we actually do not have the gears to do it. You have no doubt heard all of those worries about not having the minimum wage and not having job-creating powers. I do not know to whom you have spoken, but there were several comments that seemed to be fairly astute about this being something that could be very detrimental to the Scottish Parliament because basically it can only tax the middle classes. Not very many Governments see that as an appetising vote-winner. There is usually a range of things you might want to do before you start considering that. I think "transparent fiscal trap" was how one commentator put it and I think a lot of folk would agree.

The Chairman: For different reasons, there are those reservations in all quarters.

Lesley Riddoch: Maybe we will get on to this with the Nordic side of things, but it feels that there is not a direction of travel in which everyone has agreed they are going, founded on overarching principles from which some specifics are derived. It looks very much more that there were some specifics negotiated over and now the direction is not too clear. You ask one question—for example: "Is there a veto for Westminster over the creation of new benefit-raising powers?"—and you get two completely different stories from both Governments and from many experts. In terms of transparency, if the experts will not agree on such a critical question as that, and of course experts always have their agendas, we are not too sure as observers what the truth of it is.

Q51 The Chairman: From your quick study of the Nordic countries, what conclusions have you come to? What perspective does that give?

Lesley Riddoch: Particularly the Swedes, but to a lesser degree all of the different countries, have extraordinary tax-raising power at the very local level for everybody. By local I mean what seem to us tiny municipalities of an average of 14,000 to 20,000 people. The vast majority of taxes for Sweden are raised by those local government units, which have the power to vary local income tax rates. For Britain that is pretty mind-blowing. Sweden is at the other end of the spectrum, but when you come to individual islands, such as the Faroes or Greenland in particular, neither of those two regions is actually a member of the European Union despite the fact that Denmark is, and they were able to negotiate an opt-out mostly because of fishing—they did not want to be in the common fisheries policy. While Greenland entered with Denmark, they had a referendum soon after and voted to come out and special arrangements were found for them to be as they wanted to be. It seems that there is quite a lot of effort to be able to shape devolution. One thing which is also interesting is the way in which both Greenland and the Faroes in their agreements with Denmark have the ability to stage and phase the movement of powers according to the pace that both the Faroes and Greenland think is reasonable. The Greenland economic settlement which comes from Denmark is expected to reduce over the years as Greenland begins to make something of its huge potential for fossil fuel extraction. Again, what has been agreed will be at the pace of the Greenlanders. Again, to anyone looking at this it is quite an extraordinarily different world and a much less contested one.

Peter Jones: I am not sure how much the Greenland example is relevant, because one of reasons why the EU agreed that Greenland should not be part of the EU is that it is not actually part of the European continent.

Lesley Riddoch: I think the Faroes are though.

Peter Jones: The Faroes are, but they are a very small set of isolated islands. You cannot say the same about Scotland. Be that as it may, I think looking around the rest of the world, as

Lesley said, the Nordic example is worth looking at, although they have a very high tax regime.

Lord Lamont of Lerwick: Local devolution is worth looking at.

Peter Jones: Local devolution is worth looking at and how it is managed as well, but I would direct the Committee's attention to Canada, which operates as a federation. Moreover, if you are interested in maintaining the union and strengthening the union, then Canada as a union has managed to survive with the existence of Québec where there is a very strong separatist or sovereigntist party, as the Parti Québécois call themselves. It means an awful lot of complexity. I have set out, in the submission, some of the complexities of that. It does not look very appetising but the point is that it works, essentially.

Q52 Lord Lamont of Lerwick: I gather that you have been involved both in the community ownership of Rum and in the buy-out, if that is the right word, of Eigg. You have not thought about this devolution of tax to Orkney and Shetland, have you?

Lesley Riddoch: I appreciate, Norman, that you have a keen interest in this.

Lord Lamont of Lerwick: I never thought I would have the opportunity.

Lesley Riddoch: Particularly the Faroes, and to a lesser degree Greenland, have their own currency. It is pegged at a 1:1 rate with the Danish krone, but technically it is their own currency, so I suppose it is quite possible that we could at some incredibly advanced stage move towards that. As Peter is saying, there is an overall philosophy that certain areas have. Federal countries have made a decision that they are going to try to have very clearly separated and autonomous layers of government. Germany is the most successful economic powerhouse of Europe, which was probably created by British civil servants after the war who went in and decided to make sure that there was no way that one evil man could pull off all the goodies. Just deciding to lob a few powers to Orkney and Shetland, or indeed to lob some powers to Scotland, is not the same as a thought-through, coherent way of running something. That would be true hugely of the federal countries but also of the Nordics, most of which did not really have colonies so do not have the wider problem, although Denmark still has that. Norway, just while we are at it, has the Finnmark area, which has been basically handed to the Sami people—they have a 51% ownership of the Finnmark property, which owns a huge area half the size of Denmark. Again the population is negligible but if you are talking in terms of principle, these countries are all able to find ways to make something that works and seems to make sense to both ends.

Peter Jones: I would add that what I would have hoped to come out of the Smith commission and the UK Government's response to it was a system that was capable of being extended to other parts of the UK, whether it is Wales, Northern Ireland or the north of England or Cornwall. This does not meet that criterion in any sense whatsoever.

Q53 Lord Kerr of Kinlochard: I agree strongly with that. I agree very strongly with the point about ragbag rather than ingredients to match a recipe. I think there are limits to what even the potentates of the House of Lords can do to change what is in the Bill for the present but, looking to the future, should we not be thinking of recommending institutional solutions that might produce further steps in devolution with a better rationale? If you travel across America, you pay a different sales tax rate state by state. People understand that and the sales tax is seen in the public mind as a way of financing local services. You pay the same rate of income tax whichever state of the United States you live in and that goes to the Internal Revenue in DC. There is a fundamental logic about that. This ragbag of taxes that we are playing with, particularly income tax—I had forgotten that Strathclyde is the guilty party—seems to me to lack all rationale and to make the situation worse, because it is not going to be easy for the man in the street to think, "This part of my taxes is going to finance these services and this part is going down there to London to finance defence and whatever". There is not going to be any obvious link between the taxes that are devolved and the expenditure decisions that are devolved. Am I right? Is that the problem?

Peter Jones: Yes. I think that in Scotland, if the Smith commission proposals are legislated in the way set out, people will think, "Our income tax finances the Scottish Parliament and nothing of our income tax goes to the rest of the UK". That weakens the connection between the electorate in Scotland and the UK Government. Depending on your point of view, you might think that was a good or a bad thing, but what are you left with? You are then left with VAT, which people do not think terribly much about, although half of it goes to the Scottish Government, and then corporation tax, which seems to be a dwindling revenue source, both as the UK Government reduces it and as companies find ways of avoiding paying it. The utility of corporate income taxes as revenue-raising seems to be in general decline, not just in the UK but elsewhere. I cannot see where people are going to think that they are paying taxes to finance the UK Government and its major activities, whether it is defence, foreign affairs, overseas aid and all these other things that Scottish taxpayers will be contributing to—the transparency of the contribution I think is going to be almost nil.

Lesley Riddoch: I agree with all that Peter has just said. The big difference between all the places that we have cited and the United Kingdom is that nearly all of them have a bottom-up approach to democracy, never mind tax paying and all the rest of it, but actually that flows from it. For example, if we were in Sweden, only people who earn more than £35,000 a year pay any tax at all to central government. Everybody else pays all their tax to their local municipality. Nobody is in any confusion about the idea, none the less, that they are financing central government through corporation tax and higher-rate earners. Here we have had a very top-down way of financing everything, so the average punter in Scotland sends all their income tax south to get a little bit, through gritted teeth, back to Edinburgh, to get another bit, through gritted teeth, back to councils, which are the largest in Europe and generally speaking nobody knows any of the people that are on them. We call that local democracy. We are already a bit stuffed and now we are trying to divvy something up in a modern way, but I would submit that we are not really working in a modern way altogether in terms of how we approach the direction of travel for cash and authority and democratic validity.

Q54 The Chairman: Given that we are where we are, given that there is the Smith commission and given that the legislation is going through, what changes could be made to address some of the misgivings that you both raise, obviously to meet the genuine concerns, which are likely to make it more difficult for it to work effectively as was intended?

Peter Jones: You have already mentioned the no-detriment principle and I mentioned the indexation principles that I understand are likely to apply to the VAT take. At the moment these are going to be negotiated behind closed doors between officials of the Treasury and the Scottish Government and eventually some sort of agreement will be reached and announced. Nobody will have the faintest idea of how the principles came to be.

Lord Kerr of Kinlochard: Immediately it is announced, it will be denounced.

Peter Jones: Yes, precisely. It will become a very hot political potato. The no-detriment principle is fine at the point of devolution, but to apply it thereafter to changes makes absolutely no sense. It is quite beyond the power of econometrics to work out whether a change in behaviour is due to a tax change or a shift in world trade or whatever. Therefore, it should apply only at the point of devolution. The other difficulty is in the indexation principle. If VAT revenues rise by 5% in Scotland and they rise by 6% in England through indexation, then the Scottish take for VAT will drop because we have not matched the retail growth in the rest of the UK. People simply will not understand that; it will look like a straight money-grab by the Treasury from the UK Government on the Scottish take. One change that I would make is that there should be some kind of body that works on an independent basis and is charged with dealing with both the no-detriment principle and the indexation issues. Rather than set up another body somewhere, a relatively efficient way of doing it would be that it should be a joint task force from the Office for Budget Responsibility and the Scottish Fiscal Commission which has been set up. Whatever arguments both Governments want to make, they feed into that body, that body then publishes its proposals and it will be for politicians to dispose of them.

The Chairman: But the facts would be in the public domain?

Peter Jones: The facts would be in the public domain.

Lesley Riddoch: I suppose coherence is the only thing you might hope for out of this. That will be hard to achieve and will not please either side particularly, I would imagine. Whatever is going to occur will be immediately, as you say, rebuffed, particularly by the Scottish Government and by an awful lot of Scottish people because, in much the same way as during the independence referendum, the attention and focus were quite rightly on the proposition that we could be independent, and huge scrutiny was put on that. Huge scrutiny will now be put on the offer, and while it is better than nothing, still people will pick holes in whatever there is that seems to be incoherent and gives rise to some of the problems that Peter has described. To do what? To not really address, most people would feel, the demand for home rule that Scotland seems to be clearly trying to state. I would not be hugely optimistic about what you can do from hereon in that is worth a candle.

Peter Jones: I have set out alternative propositions for how a devolved system might work based on the Canadian model. It is basically to do with the sharing of corporation tax and other similar duties and revenues on an assigned basis, which gives a greater balance to how a budget might move in the future. I would strongly urge the UK Government to go beyond Smith and consider some of those elements.

The Chairman: You refer to them here. Could you send us the work that you have done on that—you have written an article? That would be helpful.

Peter Jones: It is in my submission. It is set out on pages 7 and 8, with a table as to how it might work.

Q55 The Chairman: So in a sense are you both saying that this needs to be moved forward and that it needs to become much more compelling?

Peter Jones: You have to bear in mind—and it may not seem obvious to you because you spend most of your time in London, although I know that Lord Kerr comes up to Scotland an awful lot—that the broad mindset of the Scottish electorate is that Scotland has had a raw deal from the union essentially. That is why 45% voted yes in the referendum. The SNP in particular has fostered the view, and one of the reasons that it got so far as 45% was that its people and yes supporters said constantly, "Scotland is a wealthy country". In the middle or just coming out of a recession, a lot people said, "Well, I'm not wealthy. Why is that? Where has all this wealth gone?" Answer: "It has gone down there somehow or other and it is in Westminster". There were some quite ludicrous speeches by Alex Salmond in which he talked about money being stored in vast caverns in the Treasury but, none the less, people accepted and agreed with that because the general description of Scotland as a prosperous, wealthy country does not fit with their own circumstances. You can say that is true almost everywhere. You can find that in London. You would call London a wealthy city but you can find an awful lot of very poor people, but in London you do not have a nationalist party which is proposing independence for London; in Scotland you do.

The Chairman: I apologise profusely but we have to dash.

Lesley Riddoch: Can I just say one sentence to mitigate that slightly, because as someone who voted yes that is not my perception of it? My perception is that Scotland has the same inequalities of wealth as the rest of the United Kingdom but keeps voting for parties that want to minimise them, and that is the difference. Scotland wants to go, in a general sense, in a social democratic direction. It seems to have been voting for that for 100 years, with a few exceptions, and the difficulty is that there are no levers here to take that new route. I am not blaming England or London for too much—it is quits—but from hereon in I would like to be free to pursue a new direction, and we cannot with this.

The Chairman: That is very clear. Thank you very much. I am sorry this has been such a short session but we have a tram ride ahead of us—if we can find the tram, that is.