

Response to the September 2014 'devo max' proposal

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1. The APPTG notes that the parties supporting 'Better Together' campaign have announced a proposal for further devolution to Scotland if it votes to remain within the UK. It welcomes that this proposal is extensively focused on greater fiscal empowerment for Scotland, involving "more tax powers, more spending powers, more powers over the welfare state", according to chancellor George Osborne, confirmed separately by shadow chancellor Ed Balls. The APPTG also notes that this proposal to include clearer details about the timetable and process for this proposed transfer, starting immediately after a 'No' vote in the referendum on 18 September, as outlined by 'Better Together' leader Alistair Darling. It believes that each part of the proposal requires further clarification, relying in part on the analysis it provided in its report *Achieving Autonomy: What the independence referendum means for Scotland's fiscal future*, published in November 2013.
2. *Taxation*. The APPTG believes that there is extensive scope for a truly radical increase in the taxation powers for which Scotland can take over responsibility. Using the various proposals published by Scottish Labour, Liberal Democrats, and Conservatives, as well as models from the Institute of Public Policy Research and Devo Plus, the APPTG suggests two levels of empowerment. The *stable maximum* represents the level of autonomy Scotland could be given if there are concerns regarding the adverse effects of: (1) revenue volatility on the sustainability of Scottish public finances; (2) high devolution of borrowing powers on the riskiness of Scottish profligacy for the UK Government's finances; and (3) administrative complexity on the efficiency of institutional operation of both Scottish and UK governance. The *technical maximum* represents the level of fiscal empowerment legally and practically compatible with maintaining the institutions of a political and social Union at the UK level.

Table 1: Two forms of Scottish fiscal empowerment

Version	Stable maximum	Technical maximum
Devolution model	Devo-max	Federalism
Devolved	Income tax	Income tax
	Employers' NIC	Corporation tax
	Local taxes	Employers' NIC
	Land taxes	Local taxes
	Vehicle excise duty	Land taxes
	APD	Vehicle excise duty
	Aggregates levy	Tobacco and alcohol duties
		APD
Shared	VAT (assigned)	Aggregates levy
	Corporation tax (excl. North Sea oil) (assigned)	VAT (assigned)
	Tobacco and alcohol duties (assigned)	Fuel and betting duties (assigned)
Reserved	Employees' NIC	North Sea oil revenue (geographical share)
	North Sea oil revenue	
	Fuel and betting duties	
Public expenditure funding model	75-85% devolved/assigned	75-85% devolved/assigned
	15-25% needs-based equalising grant, borrowing (current expenditure split)	15-25% fiscal transfer, borrowing (increased responsibility for social protection expenditure)

3. *Public expenditure.* The Scottish Government is currently responsible for c.67% of total Scottish identifiable public expenditure, the majority of which is allocated to healthcare and education. The remainder reserved to the responsibility of the UK tier, and accounted for by UK Government departments, is overwhelmingly attributable (up to c.95%) to 'social protection', i.e., welfare spending. The APPTG expects that all non-identifiable public expenditure, including defence, international services, and public sector debt interest, will continue to be the responsibility of the UK Government. It therefore notes that "more powers over the welfare state" are thus the primary way in which the 'Better Together' campaign can meaningfully offer Scotland greater responsibility over public spending. Scotland is currently responsible for c.25% of welfare expenditure, and the APPTG believes that this could be raised to c.75% without jeopardising the UK's social Union.
4. *Block grant.* After a 'No' vote, the Barnett formula for calculating changes to public expenditure in Scotland and the other devolved regions will need to be replaced. The APPTG follows the Holtham Commission in recommending a need-based equalising grant to supplement the Scottish Parliament's increased responsibility for raising revenue to fund its public expenditure budget. 'Need' should be defined in terms of seven indicators: (1) number of children, (2) number of older people, (3) ethnicity, (4) income poverty, (5) ill health, (6) sparsity of population, and (7) a 'London weighting' (inapplicable elsewhere). The APPTG also recommends adding to this a further indicator based on levels of regional economic performance, such as Gross Value Added per capita. The aim would be to cater to the needs of both regions and individuals for particular services and policy areas, with the intention to achieve regional prosperity, in the form of a steady rate of growth and development.
5. *Devo max commission.* The new consultation body to agree on extra powers has been characterised as a Scottish Convention by shadow foreign secretary Douglas Alexander. The APPTG sees this Convention as an opportunity for political leaders on both sides of the referendum debate to put into practice the stances to which they have committed themselves regarding Scotland's future autonomy. The APPTG therefore expects that these negotiations will be led by 'Yes Scotland' and 'Better Together'. But the Convention's settlement must be unanimous, plausible, and legitimate, and must consequently include representatives from across the spectrum of views on Scottish autonomy. The negotiations cannot therefore just be between the SNP Scottish Government and Scottish Labour, but should also bring in (among others) Scottish Socialists, Greens, and the Radical Independence movement for 'Yes', Scottish Conservatives and Liberal Democrats for 'No', as well as trade unions, religious groups, and other civil society organisations. If the proposed solution is to be genuinely federal across the UK, the other devolved authorities (Wales, Northern Ireland, and local government) should also be allowed to contribute to the consultations.
6. *Process and timetable.* The APPTG raised concerns in *Achieving Autonomy* regarding the haste with which the fiscal powers devolved in the Scotland Act 2012 were legislated for by the Scottish Parliament. If extensive transfer of fiscal powers is included in the next tranche of devolution, the timetable for this transfer must take into account the need for extensive consultation periods for each item of legislation, including sufficient scrutiny time for the relevant Scottish Parliament Committees (especially the Finance Committee). The APPTG notes that, so far, the Scottish approach to evolving the new tax powers has been careful and rigorous, but also recommends that the Scottish Parliament should consider bringing in expert support to help its Committees process future power transfers. The APPTG also sees a need for greater cooperation between the Scottish and UK Governments in future devolution negotiations, so that these do not drag out too long and needlessly take up Parliamentary time.
7. The APPTG believes that it is important to compare the 'devo max' proposals with Scotland's expected fiscal autonomy as an independent country. Under the plans put forward by 'Yes Scotland', Scotland's independence will not be absolute, but qualified in (at least) two major ways. First, there would be a pooling of Scottish economic sovereignty with the UK Government, by retention of a currency union with UK£. Second, there would be a pooling of political sovereignty with European institutions, as a result of the continued intention to secure EU membership. In each case, 'leaving the Union' would translate into autonomy in name only, and should be more accurately described as Scotland remaining within a more loosely conceived form of the existing Union, or as Scotland moving from one Union to another.
8. This situation is best characterised as '*double dependence*', as from the fiscal perspective, the effect of both a union with UK£ and EU membership is to significantly constrain an independent Scotland's room for manoeuvre. Any formal Scotland-RUK understanding on the use of UK£ would include tight budget balance rules, and

would leave Scotland without its own lender of last resort or financial regulator, putting it at the mercy of the trajectory of RUK monetary policy. Even with its own currency (Scot£), Scotland would have to operate a tight fiscal policy post-independence in order to establish its creditworthiness, and demonstrate the stability of its new monetary and fiscal institutions. Meanwhile, EU membership would subject Scotland to an incremental trend towards fiscal harmonisation, deriving from European attempts to mitigate the tensions experienced between maintaining a common market and political union, and allowing inter-state fiscal competition. A looser relationship with Europe, such as EEA or EFTA membership, would also pull Scotland into a 'ratchet effect' of EU-like harmonisation, without the ability to have a meaningful input on this trend through representation in EU institutions. The effects on the components of Scottish fiscal policy are thus as follows:

Table 2: Summary of the expected fiscal effects of the 2014 referendum

Outcome	No	Yes
Institutional model	Federalism	Confederalism
Supranational body membership	UK (EU?)	EEA / EU
Currency	UK£	UK£ (Scot£ peg?)
Income tax	9-11% SRIT operating range	±1% at each income tax rate level
NIC	Fixed at UK rates	1-3% below UK rates
Corporation tax	12.5-17% operating range	12.5-17% operating range
North Sea oil revenue	Earmarked for eventual devolution	Full geographical allocation to Scotland
VAT	20% (UK rate)	15-25% operating range
Excise duties	Part-devolved, part-assigned/reserved	Scottish authority but EU harmonisation
Other taxes (local, land, APD, aggregates levy)	Fully under Scottish authority	Fully under Scottish authority
Public expenditure funding model	75-85% self-responsible 15-25% block grant	100% self-responsible

9. The domestic and international constraints operating on Scotland and the RUK result in a strong degree of similarity between the expected effects of each referendum outcome on the various components of fiscal policy. The 'double dependence' form of autonomy that obtains under current independence plans, and the high extent of fiscal empowerment compatible with the maintenance of a social Union between Scotland and the RUK, lead the expected outcomes under both 'Yes' and 'No' to *converge* towards a mid-point between the *status quo* and full fiscal independence. The extent of this convergence will depend on what precisely is placed within the remit of consideration of the independence negotiators in the case of 'Yes', or the Scottish Convention in the case of 'No'. However, the APPTG notes a trend in the UK as a whole towards greater devolution, and argues that a truly radical 'devo max' proposal should consider *all* the possible options for Scottish fiscal empowerment.

Conclusion: At its most radical, the proposal for federal 'devo max' for Scotland after a 'No' vote matches the level of fiscal autonomy Scotland would have under the current vision of independence after a 'Yes' vote.