



House of Commons
Scottish Affairs Committee

The Implementation of the Smith Agreement

Fourth Report of Session 2014–15

*Report, together with formal minutes relating
to the report*

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The Scottish Affairs Committee

The Scottish Affairs Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of the Scotland Office (including (i) relations with the Scottish Parliament and (ii) administration and expenditure of the offices of the Advocate General for Scotland (but excluding individual cases and advice given within government by the Advocate General)).

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Publication

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee are on the internet at www.parliament.uk/scotaffcom. A list of Reports of the Committee in the present parliament is at the back of this volume.

Committee staff

The current staff of the Committee are Rebecca Davies (Clerk), Jyoti Chandola (Clerk), Phil Jones (Clerk), Alasdair Mackenzie (Committee Specialist), Helena Ali (Senior Committee Assistant) and Annabel Goddard (Committee Assistant).

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Conclusions and recommendations

Conclusions are in plain text, recommendations are italicised.

Draft clauses

1. We are surprised that the Scottish Government did not raise its concerns when it was initially consulted over the draft text of the clauses but instead waited until after publication to air them. Lord Smith called for both Governments “to work together to create a more productive, robust, visible and transparent relationship”. Of course the timetable was tight but on this occasion the working relationship between the UK and Scottish Governments fell markedly short of Lord Smith’s aspiration. (Paragraph 14)
2. The idea that the draft clauses contain “twelve vetoes” is a ludicrous one and it is disappointing that the UK Government failed adequately to rebut such claims. We hope that a good working relationship between the two Governments will mean that consultation will be routine, agreement a formality, and that dispute will not arise. On such a basis some might question why requirements to consult are included in the draft clauses at all; in the interests of good governance and good legislation it is right that they are there, but we remain of the view that the UK Government should have been better able to explain the clauses and to have avoided the unnecessary conflict and confusion which was used to detract from the real substance of this legislative package. (Paragraph 18)
3. The recommendations on welfare confer broad powers that would allow the Scottish Government to increase any benefit and create new benefits in devolved areas. In effect, the only powers the Scottish Government will not have over welfare are the powers to cut or completely redesign benefits in reserved areas; this presents the Scottish Government with substantial powers to shape the welfare system in Scotland. (Paragraph 21)
4. *The Smith Agreement clearly states that the Scottish Government will have the power to make discretionary payments in any area of welfare so long as it is able to fund them. If the discretionary payments are to come out of the Scottish Government’s budget then it should be for the Scottish Government, not the UK Government, to set the terms and conditions under which those payments can be made. We recommend that draft clause 18 be amended to give the Scottish Government broader powers over the application of discretionary payments. Such a change will make it clear to the people of Scotland that they have the benefit of the security of the UK welfare state while, at the same time, the Scottish Government has the capacity to provide more generous welfare support should it wish to do so.* (Paragraph 24)

A revised fiscal framework

5. *The updated fiscal framework should account for circumstances where there might be a direct link between a particular tax and specific public spending. It would not be fair*

for Scotland to benefit from public spending in reserved areas that was directly based on revenues raised in the rest of the UK. We note, however, the recommendation of the Smith Commission that the UK Government has the power to levy a UK-wide tax if it is in the national interest to do so. (Paragraph 32)

6. The potential for grievance over the operation of the no detriment principle is enormous. If the Smith Agreement is to be an enduring settlement both Governments must work together in good faith and agree a mechanism to administer a policy of no detriment that is proportionate, fair and based on independently verified data. (Paragraph 35)
7. Whatever the mechanism decided upon, the new fiscal framework must have the support of both Governments and deliver a robust set of fiscal rules that are fair, transparent and which allow the Scottish Government the power to exercise its new responsibilities while bearing the consequences of its actions. (Paragraph 39)

Full fiscal autonomy

8. The collapse in the oil price is a stark reminder of the risks that face economies which rely on a volatile revenue stream to fund a large proportion of their public spending. The conclusion of the Smith Commission not to devolve such a volatile source of revenue, nor to recommend full fiscal autonomy, but instead to retain the system of shared benefit and pooled risk across the United Kingdom has already proved to be a wise decision, and one that is of obvious and immediate benefit to the people of Scotland. (Paragraph 52)

1 The path to further devolution

1. On 18 September 2014, Scotland held a referendum on the question “Should Scotland be an independent country?”. 55.3% of voters cast their ballot in favour of remaining part of the United Kingdom. The turnout was a remarkable 84.6%.

2. In the lead up to the referendum the three largest UK political parties pledged to devolve further powers to the Scottish Parliament in the event of separation being rejected.¹ The day after the referendum the Prime Minister invited Lord Smith of Kelvin to set up a commission to take forward that commitment and produce specific recommendations for the devolution of further powers.² In this Report we focus on the recommendations of the Smith Commission, particularly those on taxation and welfare, and the work of the UK Government in transposing those recommendations into draft legislation.³

The Smith Commission

3. The terms of reference for the Smith Commission were as follows:

To convene cross-party talks and facilitate an inclusive engagement process across Scotland to produce, by 30 November 2014, Heads of Agreement with recommendations for further devolution of powers to the Scottish Parliament. This process will be informed by a Command Paper, to be published by 31 October and will result in the publication of draft clauses by 25 January. The recommendations will deliver more financial, welfare and taxation powers, strengthening the Scottish Parliament within the United Kingdom.⁴

The Smith Commission consisted of 11 members; in addition to Lord Smith each of the five political parties with seats in the Scottish Parliament nominated two representatives to take part.⁵ The Commission heard representations from political parties, civic institutions

1 During the referendum campaign each of the main UK parties promised to deliver further powers to Scotland in the event of a no vote. This culminated in a ‘vow’, signed by the Leaders of the Conservative, Labour and Liberal Democrats parties, which was published on the front page of the [Daily Record](#) newspaper on 15 September 2014.

2 HM Government Press Release, [Scottish Independence referendum: statement by the Prime Minister](#), 19 September 2014

3 For analysis of the constitutional elements of the Smith Agreement see the work of the [Political and Constitutional Reform Committee](#).

4 Smith Commission Press Release, [Lord Smith of Kelvin announces details of his Commission at the Scottish Parliament](#), 23 September 2014

5 The SNP was represented by Scottish Finance Secretary John Swinney MSP and Linda Fabiani MSP. Scottish Labour put forward finance spokesman Iain Gray MSP and shadow work and pensions minister Gregg McClymont MP. Former Scottish Conservative leader Annabel Goldie represented her party, alongside Adam Tomkins, Professor of Public Law at the University of Glasgow. The Scottish Liberal Democrats were represented by former Scottish Secretary Michael Moore MP and former party leader in the Scottish Parliament, Tavish Scott MSP. The Scottish Green Party's co-leaders, Patrick Harvie MSP and Edinburgh councillor Maggie Chapman, were their representatives on the Commission.

and members of the public.⁶ The *Report of the Smith Commission for further devolution of powers to the Scottish Parliament* (hereafter referred to as the Smith Agreement)⁷ was published on 27 November 2014. Lord Smith confirmed to us that “all five parties signed up to every word that is in that document”.⁸ For the political parties to find unanimity from the range of views with which they entered the process is a significant outcome and we congratulate them and Lord Smith on their achievement.

4. Amongst the recommendations put forward by the Smith Commission were proposals for the Scottish Parliament and Government to be made permanent,⁹ for the Scottish Parliament to have increased powers over taxation and spending, including the power to set income tax rates and bands¹⁰ and the ability to create new benefits in devolved areas and make discretionary payments in any area of welfare,¹¹ and for the voting age in Scottish elections to be extended to include 16 and 17 year olds.¹²

5. On 22 January 2015, the UK Government published draft legislative clauses, which make provision for those measures included in the Smith Agreement which require legislative change. In the Command Paper accompanying the draft clauses,¹³ the UK Government, as well as providing background information on the clauses, also discusses those areas of the Smith Agreement that do not require legislation, most notably the requirement for a new fiscal framework for Scotland. The new framework must meet the Smith Agreement’s principle of “no detriment”, i.e. that neither Government should suffer financially as a result of the new settlement. However, while the Command Paper discusses the implications of such a principle it stops short of offering a definite answer on this most crucial of issues.

6. The three main UK political parties have committed to take forward the draft clauses, as part of a new Scotland Bill after the General Election in May 2015. Such a Bill would make legal provision to enable the powers proposed by the Smith Commission to be devolved to the Scottish Parliament to a timetable agreed by the two Governments. One aspect of the Smith Agreement is being progressed outside of this timetable via a Section 30 Order. The legislative power to allow 16 and 17 year olds to vote in future Scottish Parliament elections

6 Over a period of five weeks, over 400 submissions were received from organisations and groups and over 18,000 emails, letters and signatures on petitions from members of the public (source: The Smith Commission website www.smith-commission.scot).

7 [Report of the Smith Commission for further devolution of powers to the Scottish Parliament](#), 27 November 2014, hereafter referenced as The Smith Agreement.

8 Q1

9 The Smith Agreement, para 21

10 The Smith Agreement, para 76

11 The Smith Agreement, para 54

12 The Smith Agreement, para 25

13 HM Government, [Scotland in the United Kingdom: an enduring settlement](#), Cm 8990, 22 January 2015

is expected to be transferred from the UK Parliament to Holyrood in March 2015.¹⁴ The separate timetable was agreed by both the UK and Scottish Governments as an exception from the rest of the Smith Agreement, so that the power could be devolved in time for 16 and 17 year olds to vote in the 2016 Scottish Parliament elections.

14 HM Government News Story, [UK Government to fast-track Holyrood votes for 16-17 year olds](#), 19 January 2015; The draft order will give the Scottish Parliament the power to legislate to reduce the minimum voting age to 16 at elections to the Scottish Parliament and to Scottish local government elections. See also HL Deb, 26 February 2015, Col 1766 and the Constitution Committee of the House of Lords Ninth Report of Session 2014-15, Draft Scotland Act 1998 (Modification of Schedules 4 and 5 and Transfer of Functions to the Scottish Ministers etc.) Order 2015, HL 119

2 More control over taxation and spending

7. Since its creation in 1999, the Scottish Parliament has been responsible for more than 60% of public expenditure in Scotland but has not been responsible for raising the vast majority of the revenue to fund this expenditure. Only Council Tax and Business Rates—approximately 7.5% of total revenues—have been within the control of the Scottish Parliament.¹⁵ The Scotland Act 2012 slightly reduces this imbalance. The Act made provision for the devolution of responsibility for two additional taxes, Landfill Tax and Stamp Duty Land Tax, and control over a proportion of Income Tax.¹⁶ Together, these taxes are forecast to increase Scottish Parliament control to approximately 16% of revenues. No further spending powers were devolved as part of the Scotland Act 2012.

8. The Smith Agreement seeks to increase the powers of the Scottish Parliament on both the spending side and, in particular, the revenue side. In doing so, the Smith Agreement claims “there will be a corresponding increase in the Parliament’s accountability and responsibility for the effects of its decisions and their resulting benefits or costs”.¹⁷ For the first time there will be a direct relationship between the taxes levied in Scotland and public expenditure in Scotland. Under the Smith Agreement the Scottish Government will receive all Income Tax paid by Scottish taxpayers on their non-savings and non-dividend income, the first ten percentage points of VAT raised in Scotland (half of VAT revenues at the current rate), and Air Passenger Duty (APD) and the Aggregates Levy will be fully devolved. Together these new powers will mean that the majority of money spent by the Scottish Parliament, will come directly from revenues raised in Scotland.¹⁸ On the spending side the Scottish Parliament will control an additional £2.5 billion of benefits and will be given “new powers to create benefits in areas of devolved responsibility”, “new powers to make discretionary payments in any area of welfare without the need to obtain prior permission from DWP” and the ability to vary the housing cost elements of Universal Credit.¹⁹

9. In terms of revenue and spending powers, the Smith Agreement clearly represents a significant transfer of power to the devolved Government in Scotland. Professor David Bell and David Eiser note that relative to sub-central governments in OECD countries,

15 [Government expenditure and revenue Scotland 2012-13](#), March 2014, p28. Total revenues are taken to include a geographical share of North Sea revenue, in 2012-13 this was £53.1 bn.

16 For further discussion of the Scotland Bill see the Scottish Affairs Committee Eighth Report of Session 2010-12, [The Scotland Bill](#), HC 775

17 The Smith Agreement, p4

18 HM Government, [Scotland in the United Kingdom: an enduring settlement](#), Cm 8990, 22 January 2015, Preface. In 2012-13, the revenues that will be devolved to the Scottish Parliament post-implementation of the Smith Agreement totalled approximately £20 billion (See Professor David Bell and David Eiser’s post, ‘[The Scottish budget under the Smith Proposals](#)’) while the Scottish Government’s Total Managed Expenditure for that year stood at £33,862 billion (See the Scottish Government’s [Draft Budget 2012-13](#), p46). Devolution under the Smith Agreement of a further £2.5 billion in welfare powers would increase Scottish Government spending to around £36.5 billion.

19 The Smith Agreement, para 54

“implementing Smith will mean that, in terms of fiscal federalism, Scotland will be closer to Canadian provinces and Swiss cantons, which are at the extreme end of the spectrum of devolved fiscal powers among OECD countries”.²⁰

10. It is disappointing therefore that on the day the Smith Agreement was published, rather than embrace the new powers that will make the Scottish Parliament the third most powerful devolved legislature in the world,²¹ the Scottish Government chose instead to deride what had been agreed by the five parties at the negotiating table. The First Minister, Nicola Sturgeon, commented that “it is not so much the home rule that was promised, in so many respects it is continued Westminster rule.”²²

11. In our view, the Smith Agreement successfully achieves two things: it respects the views of the majority of the people of Scotland—that Scotland should continue to enjoy the benefits of pooled resources and shared risk that comes with being part of the United Kingdom—and it delivers recommendations that will create a more powerful, and more accountable, Scottish Parliament. Such an achievement should not be readily dismissed. We look forward to the Scottish Government setting out how it expects to use these new powers to the benefit of the people of Scotland.

Draft clauses

The requirement to consult

12. On 22 January 2015, the UK Government published draft legislative clauses for consultation. Opinion on the draft clauses ranged from them being viewed by Danny Alexander MP, Chief Secretary to the Treasury, as “the faithful fulfilment of the Smith Commission”²³ to claims from the First Minister, Nicola Sturgeon MSP, that they represented “a significant watering down” of the Smith Agreement, “imposed restrictions on the recommended devolved powers and would hand a veto to UK Ministers in key areas”.²⁴ John Swinney MSP, Deputy First Minister, set out the areas where the Scottish Government believed there to be “vetoes”:

There are a total of 12 instances across key areas such as welfare, Universal Credit and fuel poverty, where we will have to consult UK Ministers before acting and in eight of these ‘permission’ from the Secretary of State must be sought: a veto.

For example, the proposals on welfare do not allow us to vary Universal Credit without the permission of the UK Government. That means—under

20 Professor David Bell and David Eiser’s post, [‘The Scottish budget under the Smith Proposals’](#), published on www.futureukandScotland.ac.uk

21 Q437

22 BBC News Online, [Scotland should set own income tax, says Smith commission](#), 27 November 2014

23 The Press and Journal, [Danny Alexander: ‘We will deliver on vow we made to the people of Scotland’](#), 22 January 2015

24 The Guardian, [Nicola Sturgeon: draft bill ‘waters down’ Smith commission promises](#), 22 January 2015

the current proposals—we will not have the independence to take action to abolish the bedroom tax.²⁵

13. Given the concerns voiced by the First Minister and Deputy First Minister we asked Rt Hon Alistair Carmichael MP, Secretary of State for Scotland, whether the Scottish Government had been consulted as the draft clauses were being prepared. The Secretary of State explained that the clauses were shared with the Scottish Government once they had been approved by Parliamentary Counsel, and after officials from both governments had reached a shared understanding of the Smith Agreement:

They were shown them. In some cases they would come back and say, “Have you considered this, that or the other aspect?” It might be fairly technical, at which point we would be able to agree with them. In some areas they would express a wish to take a different approach, but there was nothing that was the subject of substantial disagreement between the Governments.²⁶

14. We are surprised that the Scottish Government did not raise its concerns when it was initially consulted over the draft text of the clauses but instead waited until after publication to air them. Lord Smith called for both Governments “to work together to create a more productive, robust, visible and transparent relationship”. Of course the timetable was tight but on this occasion the working relationship between the UK and Scottish Governments fell markedly short of Lord Smith’s aspiration.²⁷

15. It would clearly be against the spirit of the Smith Agreement if the UK Government were able to veto the Scottish Government’s use of any of the powers conferred by the Agreement. We pressed the Secretary of State on whether any of the draft clauses, if enacted in their current form, would allow the UK Government to impose restrictions or veto decisions made by the Scottish Government. He was adamant: “There are no such vetoes”.²⁸

16. The Secretary of State suggested that the Scottish Government had confused the need for consultation between governments, a basic requirement for good governance within a framework of devolved and central government, with the idea that the UK Government could impose restrictions.²⁹ In the words of the Secretary of State, “they have sought to invent vetoes where, candidly, none exist”.³⁰ Where the agreement of the UK Government is required, for example, within the clause on Universal Credit, it is in regard to the start date from which Scottish Ministers can exercise that particular function, not whether they can exercise the function itself and the date of commencement “cannot be unreasonably withheld”. The Secretary of State explained that the date needed to be agreed for practical

25 Scottish Government Press Release, [Demand for urgent re-think of twelve vetoes](#), 25 January 2015

26 Qq397-8

27 In this report conclusions are in bold text and recommendations are in italicised bold text.

28 Q403; an outline of the alleged vetoes and the UK Government’s response is appended to this report.

29 Q409

30 Q396

reasons such as changes to computer systems and that the requirement to consult went in both directions. He told us that:

In a number of places, there are areas where consultation must take place; for example, on any action relating to Universal Credit there is a duty to consult that goes in both directions. Therefore, any changes envisaged by the Scottish Government must be the subject of consultation with the UK Government, but the same works in the opposite direction. Any changes anticipated by the UK Government must be the subject of consultation with the Scottish Government.³¹

17. On the Scottish Government's particular claims that "under the current proposals we will not have the independence to take action to abolish the bedroom tax",³² the Secretary of State was clear:

Nonsense. The Scottish Government have been boasting for months that they have already done exactly that, and now they say that because we have given them more powers they cannot do it. It just does not make sense.³³

18. The idea that the draft clauses contain "twelve vetoes" is a ludicrous one and it is disappointing that the UK Government failed adequately to rebut such claims. We hope that a good working relationship between the two Governments will mean that consultation will be routine, agreement a formality, and that dispute will not arise. On such a basis some might question why requirements to consult are included in the draft clauses at all; in the interests of good governance and good legislation it is right that they are there, but we remain of the view that the UK Government should have been better able to explain the clauses and to have avoided the unnecessary conflict and confusion which was used to detract from the real substance of this legislative package.

Welfare powers: a narrow interpretation?

19. The referendum result demonstrated that the majority of people in Scotland want to continue to enjoy the benefits of being part of the United Kingdom. One of those benefits and, as Lord Smith told us, a key part of the union, is a shared welfare system.³⁴ The Smith Commission concluded that the majority of welfare, such as pensions, child benefit and the bulk of Universal Credit, should remain reserved as a key feature which preserved the integrity of the UK state. However, the Smith Agreement also recommended the devolution of powers over £2.5 billion of benefits including those associated with long-

31 Q405

32 Scottish Government Press Release, [Smith clauses give Westminster veto in key areas](#), 22 January 2015. The Committee considered the Scottish Government's powers to abolish the bedroom tax in Scotland in the Fourteenth Report of Session 2013-14, [The impact of the Bedroom Tax in Scotland: Devolving the DHP cap](#), HC 1292

33 Q410

34 Q106

term disability and sickness,³⁵ benefits which comprise the Regulated Social Fund³⁶ and the Work Programme. Given that social care policy is already devolved to the Scottish Government, devolving those benefits associated with the provision of care and which support people with a disability will mean that the Scottish Government has the opportunity to develop integrated policies to serve them better.

20. The Scottish Government will also gain the ability to vary the housing costs of Universal Credit, including the ability to vary the bedroom tax, local housing allowance, eligible rent and deductions for non-dependents.³⁷ One of the most controversial areas during the period of the referendum campaign was a question on the Scottish Government's ability to abolish the bedroom tax. The Command Paper accompanying the draft clauses confirms that the Scottish Government will have the power to abolish it in Scotland:

This clause [clause 20], in addition to giving powers to determine when direct payments may be made to landlords, will enable Scottish Ministers to vary the housing costs covered by Universal Credit for people in rented accommodation, including varying or removing the under-occupancy charge, and deductions for non-dependents.³⁸

21. Perhaps the most significant of the Smith Agreement recommendations on the spending side are the powers to create new benefits and top-up reserved benefits. The Smith Agreement states:

The Scottish Parliament will have new powers to create new benefits in areas of devolved responsibility, in line with the funding principles set out in paragraph 95. The Scottish Parliament will also have new powers to make discretionary payments in any area of welfare without the need to obtain prior permission from DWP.³⁹

The recommendations on welfare confer broad powers that would allow the Scottish Government to increase any benefit and create new benefits in devolved areas. In effect, the only powers the Scottish Government will not have over welfare are the powers to cut or completely redesign benefits in reserved areas; this presents the Scottish Government with substantial powers to shape the welfare system in Scotland.

22. Since the publication of the Smith Agreement there has been some debate on what "discretionary" means in the context of the Agreement. Discretionary payments are usually lump sum payments used to alleviate hardship in individual cases, but recently they have

35 Those powers are: Attendance Allowance, Carer's Allowance, Disability Living Allowance (DLA), Personal Independence Payment (PIP), Industrial Injuries Disablement Allowance and Severe Disablement Allowance.

36 The benefits which comprise the Regulated Social Fund are the Cold Weather Payment, Funeral Payment, Sure Start Maternity Grant and Winter Fuel Payment.

37 The Smith Agreement, para 45

38 HM Government, [Scotland in the United Kingdom: an enduring settlement](#), Cm 8990, 22 January 2015, para 4.2.4

39 The Smith Agreement, para 54

used been used more widely in Scotland to offset the impact of the bedroom tax for all those affected by it. It is our understanding that it was this more general use of discretionary payments that was being conferred by the Smith Agreement. We are concerned that it is not clear that the clauses as drafted would allow the Scottish Government to top up a reserved benefit for everyone who received it without first assessing the circumstances of each individual. The Command Paper accompanying the draft clauses states:

These payments can be made in any area of welfare, though the Smith Commission Agreement is clear that they must be discretionary. For this reason, the clause [18] provides for a power to make a payment to meet a short term need to avoid risk to the well-being of an individual. This means that the Scottish Government will be able to make payments to individuals on a case-by-case basis, but will not have the power to create permanent entitlement to any new payments beyond the scope of the devolved benefits described earlier.⁴⁰

23. The Smith Agreement does not define what a discretionary payment is and we are not persuaded of the need for the UK Government to do so in clause 18. We sought clarification from the Secretary of State on what is meant by “short term”; he told us:

Short term clearly has to be something that is not indefinite, so it will be time-limited. That is not to say that, if you made provision which lasted for a finite period, you could not then revisit that and renew it, as indeed we would do routinely with most expenditure within Government anyway.⁴¹

We also questioned the Secretary of State on whether the application of discretionary payments would allow the Scottish Government to top up a reserved benefit for everyone who received it:

Mr Carmichael: They [the Scottish Government] would need to define those who were going to receive the discretionary payment, as they would be obliged to do in any event. It is not a straightforward top-up, but I am sure you could achieve the same end without too much creativity. [...]

Chair: So that we can be clear for our report, every single benefit in Scotland under the proposals coming forward from yourself could be doubled or tripled if the Scottish Government wanted to do so.

Mr Carmichael: If they want to put the resources into it.⁴²

24. The UK Government accepts on the one hand that the Scottish Government should be able to increase any reserved benefit yet, on the other, states that the Scottish Government may have to be ‘creative’ to achieve such an outcome, for example by using the winter fuel

40 HM Government, [Scotland in the United Kingdom: an enduring settlement](#), Cm 8990, 22 January 2015, para 4.3.11

41 Q522

42 Qq453-4

payment as a means of providing additional support to pensioners rather than via a discretionary payment on top of the pension itself.⁴³ Not only should such complexity be avoided, but it appears unnecessary, particularly if the UK Government is relaxed about the final outcome—that of the Scottish Government increasing a particular benefit. *The Smith Agreement clearly states that the Scottish Government will have the power to make discretionary payments in any area of welfare so long as it is able to fund them. If the discretionary payments are to come out of the Scottish Government’s budget then it should be for the Scottish Government, not the UK Government, to set the terms and conditions under which those payments can be made. We recommend that draft clause 18 be amended to give the Scottish Government broader powers over the application of discretionary payments. Such a change will make it clear to the people of Scotland that they have the benefit of the security of the UK welfare state while, at the same time, the Scottish Government has the capacity to provide more generous welfare support should it wish to do so.*

25. We acknowledge that there is a risk that if certain reserved benefits such as Job Seekers’ Allowance were higher in Scotland then people might choose to claim them for longer. This would not only increase the cost to the Scottish Government - who would be funding the top up - but also to the UK Exchequer who would continue to fund the basic payment. However, the Smith Commission puts forward a solution to this problem in the form of a principle of no detriment, underpinned by a system of compensatory payments. In this scenario, the Scottish Government could be required to compensate the UK Government if the policy led to a higher welfare bill for the UK Exchequer. Such a system would mitigate some of the risk associated with giving the Scottish Government greater autonomy within the area of welfare. We discuss the Smith Commission’s recommendations on a revised financial framework between Scotland and the UK, including the principle of no detriment, in the next section.

A revised fiscal framework

The transfer of powers

26. Arguably the most complex parts of the Smith Agreement to deliver are those that do not require legislative change, namely the fiscal rules that will govern the operation of borrowing powers, adjustments to the block grant, and the principle of no detriment. Michael Keating, Professor of Politics at the University of Aberdeen, observes that there are two aspects to the no detriment rule:

The first concerns the initial transfers of powers and adjustment of the block grant so that nobody loses out in the process. It is straightforward in principle but requires some very difficult calculations and predictions in practice.

The second is that in future neither government should suffer financially from policy decisions made by the other. A reverse variant is that each government should get the full benefit from its own policy decisions. While fair in principle, it is a minefield.⁴⁴

27. According to David Phillips of the Institute for Fiscal Studies, adjusting the block grant to take account of the transfer of power should be “relatively easy” in the first year:

When a tax is devolved, the block grant should be reduced by the amount of revenue that is being transferred to Scotland. When further spending powers are devolved, then Scotland should receive additional money to account for that.⁴⁵

However, David Phillips argues that what happens in subsequent years is more difficult to determine. The Smith Agreement states that future reductions or additions to the block grant should be “indexed appropriately” but offers little explanation as to how such a system should work.⁴⁶ The Command Paper which accompanies the draft clauses also stops short of providing a definite answer to this problem,⁴⁷ and the Chancellor confirmed to the Treasury Committee in January that it will not be until the next Parliament that more detail will be published on how the system will operate in practice.⁴⁸ At the same meeting the Permanent Secretary to the Treasury, Sir Nicholas Macpherson—to whose department falls the responsibility for developing a new fiscal framework—offered an encouraging view of the Smith Agreement:

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.⁴⁹

28. The implementation of the Scotland Act 2012 demonstrates that both Governments are able to work together and agree a mechanism to govern the relationship between devolution and the block grant. This gives us reason to be optimistic that a revised fiscal framework governing the first part of the no detriment principle is achievable. For devolution to work the initial deduction and subsequent indexation must be fair. If this

44 Post by Professor Michael Keating, What is detriment?, 22 January 2015, available at <http://futureukandscotland.ac.uk/blog/what-detriment>

45 David Phillips, [The Smith Commission’s Proposals – Big issues remain to be resolved](#), Institute for Fiscal Studies Briefing Note, 18 December 2014

46 The Smith Agreement, para 95

47 HM Government, [Scotland in the United Kingdom: an enduring settlement](#), Cm 8990, 22 January 2015, para 4.3.11

48 Oral evidence taken before the [Treasury Committee](#), 14 January 2015, Q229

49 Oral evidence taken before the [Treasury Committee](#), 14 January 2015, Q279

fails to be the case, as has been suggested regarding the devolution of business rates, then the financial consequences might be huge and any agreement may end up unwinding.⁵⁰

29. As we will come on to discuss, the second part of the principle of no detriment is potentially much more complex. However, it is worth noting that once the Smith Agreement is fully implemented, the block grant will only provide 35% of Scotland's funding, a reduction of two-thirds from the current situation.⁵¹ While still significant, the scale of the block grant's importance will be markedly reduced.

Compensatory payments

30. As well as “no detriment as a result of the decision to devolve further powers”, the Smith Agreement also states that there should be “no detriment as a result of UK Government or Scottish Government decisions post-devolution”.⁵² According to the Smith Agreement such a principle will be underpinned by a system of compensatory payments:

Where either the UK or the Scottish Governments 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. There should be a shared understanding of the evidence to support any adjustments.⁵³

31. The majority of discussion around compensatory payments is likely to focus on the interaction between the tax and welfare systems, the relationship between income tax and Universal Credit being one example. Entitlement to Universal Credit is based on net income so if the Scottish Government were to cut income tax rates or increase the personal allowance (by introducing a higher zero rate) then claimants would be entitled to less universal credit. The Scottish Government would be reducing its own tax take but the UK Government would benefit financially via reduced public spending on welfare. Calculating the benefit to the Treasury might be reasonably straightforward in this example, but there are any number of instances where the policy decision of one Government may affect the other, as David Phillips explained:

Putting up the top rate of tax to 50p. That could have knock-on effects for the UK. On the one hand, if they put up the top rate to 50p and people work less in Scotland, it does not just mean less income tax; it means less national insurance, which is a UK tax. Should the Scottish Government have to compensate the UK Government for that lower national insurance? On the other hand, those people might shift their income into dividend income, which is a UK tax so the UK Government gain money. Should the UK

50 David Phillips, [Business as usual? The Barnett formula, business rates and further tax devolution](#), Institute for Fiscal Studies Briefing Note, 12 November 2014

51 Oral evidence taken before the [Treasury Committee](#), 14 January 2015, Q283

52 The Smith Agreement, para 95

53 The Smith Agreement, para 95

Government compensate the Scottish Government? These things are very complicated and they arise all over the place.⁵⁴

32. Further complications include scenarios where the UK Government might increase income tax to pay for UK-wide concerns such as defence, deficit reduction or pensions. Under these circumstances Scotland would benefit from the policy decision but the rest of the UK would pay for it. The Secretary of State for Scotland explained to us that the Treasury does not hypothecate taxes and that they all go into the Consolidated Fund, so that it would not be possible to make such a direct link between tax and spending.⁵⁵ The examples of business rates being notionally incorporated into the Communities and Local Government departmental budget to fund local government and the link between National Insurance payments and welfare suggests that there might be exceptions to this rule. *The updated fiscal framework should account for circumstances where there might be a direct link between a particular tax and specific public spending. It would not be fair for Scotland to benefit from public spending in reserved areas that was directly based on revenues raised in the rest of the UK. We note, however, the recommendation of the Smith Commission that the UK Government has the power to levy a UK-wide tax if it is in the national interest to do so.*

33. That one government should not suffer detriment as a result of a policy decision of the other might sound sensible in principle but, in Professor Michael Keating's opinion, determining what should count as detriment will be "politically contentious and technically complex".⁵⁶ David Phillips told us that implementing such a system would be fraught with practical difficulties meaning that compensating transfers will only be practical in a few simple cases otherwise the system could quickly become unworkable.⁵⁷

34. We agree that it would be impossible to design a system that could capture every knock on effect and calculate accurately any detriment caused. For the "post-devolution" principle of no detriment to work, both Governments must agree areas where sizeable knock on effects are likely and focus the system of compensatory payments on these.⁵⁸ They should accept that in other areas there will be circumstances where Scotland loses or gains and others where the UK Exchequer loses or gains, these are likely to balance each other over time. Such a system could be revisited periodically if there are clear examples of large effects not being captured.

35. The potential for grievance over the operation of the no detriment principle is enormous. If the Smith Agreement is to be an enduring settlement both Governments must work together in good faith and agree a mechanism to administer a policy of no detriment that is proportionate, fair and based on independently verified data.

54 Q339

55 Q471

56 Post by Professor Michael Keating, What is detriment?, 22 January 2015, available at <http://futureukandscotland.ac.uk/blog/what-detriment>

57 David Phillips, [The Smith Commission's Proposals – Big issues remain to be resolved](#), Institute for Fiscal Studies Briefing Note, 18 December 2014

58 The Smith Agreement, para 95 (4)

Fiscal framework

36. A fiscal framework is the set of rules and institutions that are used to set and coordinate sustainable fiscal policy. The rules can include short-term and medium-term targets for debt and for borrowing, as well as rules restricting borrowing or encouraging saving. In the context of the Smith Agreement they are also likely to include provisions governing issues of detriment.

37. How the administration of the revised devolution settlement will work remains to be set out, but what is certain, as frequent arguments over “Barnett consequentials” illustrate,⁵⁹ is that there will be disagreements between the two Governments along the way. It is therefore crucial that there is a clearly agreed framework of fiscal rules within which disputes can be settled, and independently verified evidence on which decisions can be based. Indeed, the Smith Agreement recommends that the Scottish Government “expand and strengthen the independent scrutiny of Scotland’s finances”, something with which the Chancellor agrees, as he told the Treasury Committee:

A very important part of the arrangements we are going to have to come up with [...] 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.⁶⁰

38. The fiscal framework needs not only to deal with the question of no detriment and adjustments to the block grant but also with the broader issues of increased Scottish borrowing powers to insulate against volatility in the Scottish public finances and the health of its economy in general. Robust fiscal rules will be required to ensure the Scottish Government runs a broadly balanced budget and to prevent it from over-borrowing. When questioned on whether the UK would allow Scotland to go bust the Chancellor was clear:

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.⁶¹

59 The House of Lords Select Committee on the Barnett Formula described consequentials as follows: “When making spending decisions for a project or event in England the Treasury has to decide whether that expenditure is “UK-wide” or “England only”. The decision to categorise spending in England as “England only” requires an exercise of judgment by the Treasury triggering a ‘consequential’ payment through the Barnett Formula to the devolved administrations. By contrast categorising expenditure as “UK-wide” does not trigger a ‘consequential’ payment.” The Committee’s Report ([The Barnett Formula](#), First Report of Session 2008-09, HL 139) offered a number of examples where the application of the Formula has been subjective including the London Olympics, Crossrail and the Forth Road Bridge.

60 Oral evidence taken before the [Treasury Committee](#), 14 January 2015, Q234

61 Oral evidence taken before the [Treasury Committee](#), 14 January 2015, Q299

It is equally important that the Scottish Government and Parliament should bear the consequences of, and be accountable, for their decisions. If those decisions result in a positive yield on the devolved taxes then the benefit must stay in Scotland, but the fiscal rules must also allow the reverse to be true.

39. We look forward to the next UK Government delivering a revised fiscal framework to govern the relationship between a more powerful Scottish Parliament and Government and the United Kingdom Government. Sir Nicholas Macpherson suggests “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.”⁶² **Whatever the mechanism decided upon, the new fiscal framework must have the support of both Governments and deliver a robust set of fiscal rules that are fair, transparent and which allow the Scottish Government the power to exercise its new responsibilities while bearing the consequences of its actions.**

62 Oral evidence taken before the [Treasury Committee](#), 14 January 2015, Q278

3 Protection from shocks

40. The Smith Agreement devolves substantial new powers while allowing Scotland to continue to pool risk and share resources with the rest of the United Kingdom. It does not deliver full fiscal autonomy to Scotland. Indeed, the benefits of pooling risk and resources would be lost under full fiscal autonomy, as it would have been had Scotland opted for separation. The financial security of being part of the United Kingdom is perhaps one of the main reasons why the majority of the people in Scotland voted against separation and why the Smith Commission rejected full fiscal autonomy as an option.⁶³

Full fiscal autonomy

41. In an interview with the BBC which focused on potential negotiations in forming the next UK Government, the First Minister and leader of the SNP, Nicola Sturgeon MSP, outlined her position:

I want full fiscal autonomy for the Scottish Government. I want us to be responsible for raising our own revenues and deciding how those revenues are spent.⁶⁴

Under full fiscal autonomy, the Scottish Government would receive all revenues raised in Scotland and be responsible for almost all public expenditure in, and for the benefit of, Scotland. Only certain UK services such as defence, intelligence and foreign affairs would remain delivered at a UK level—the Scottish Government would pay the UK Government for these services. There would also need to be agreements over borrowing powers and debt repayment.

42. In comparison with the Smith Agreement, full fiscal autonomy would deliver additional powers and responsibilities, but it would also expose Scotland to greater risks. It would allow the Scottish Government to shape the tax and welfare systems in Scotland without having to work within a framework set by the UK. Scotland would also benefit directly from any increase in Scottish revenues. However, under full fiscal autonomy, Scotland would also bear the consequences of a reduction in any revenue stream as well as any unexpected increase in public spending.

43. The current constitutional arrangements mean that a shock to the demand for welfare within Scotland would be met by the resources of the whole of the United Kingdom. This safety net is carefully preserved in the Smith Agreement. By contrast, under full fiscal autonomy, to cover any unexpected increase in an area of public expenditure, Scotland would have to raise taxes, increase borrowing, or cut spending elsewhere. Similarly, any unexpected drop in revenues would have to be covered by Scottish finances, either through higher taxation, reduced spending or increased borrowing, all of which would impact on

63 HC Deb 22 October 2014, Col 894

64 Andrew Marr Show, BBC One, 25 January 2015, [transcript](#)

attempts to grow the Scottish economy. Currently, any drop in revenues in areas that, under the Smith Agreement, are to remain reserved would be absorbed by the UK's larger and more diverse tax base: the UK economy's ability to absorb the fluctuations of the oil price is a good example of this.

Oil revenues and Barnett

44. In the run up to the referendum, the Scottish Government predicted that “production in Scottish waters could generate approximately £48 billion in tax revenues between 2012-13 and 2017-18 based on industry estimates of production and an average cash price of \$113 dollars per barrel.”⁶⁵ Since the Scottish Government made those predictions the oil price has collapsed, at one point trading at less than \$50 dollars per barrel. Table 1 shows the difference between the Scottish Government's most recent central projections⁶⁶ and those of the OBR (the OBR's figures are based on an oil price of \$85 per barrel, the Scottish Government's are based on \$110 per barrel).⁶⁷

Table 1: May 2014 Scottish Government forecast and OBR autumn 2014 forecast (figures in £billion)

	2014-15	2015-16	2016-17	2017-18	2018-19	Total 2014-15 to 2018-19
Scottish Government	£5.8	£8.3	£6.9	£7.3	£6.0	£34.3
OBR*	£2.8	£2.2	£2.4	£2.6	£3.1	£13.1

* Figures are for the UK. Scottish receipts are approximately 90% of the UK total.

45. North Sea oil and gas revenues make up a much smaller proportion of overall UK tax revenues than Scottish revenues. In the past five years revenues from tax on offshore oil and gas receipts have averaged less than 2% of total UK revenues, while, for the same period, they would have averaged 15% of total Scottish revenues.⁶⁸ The sudden reduction in oil revenues therefore has less of an impact at a UK level than it would at a Scottish level if oil revenues were devolved, or if Scotland had full fiscal autonomy. Dr Mark Carney, Governor of the Bank of England, told the Treasury Committee earlier this year that:

The change in the oil price is net positive for the United Kingdom economy. It is a negative shock to the Scottish economy, but it is a negative shock to the Scottish economy that is substantially mitigated by the fiscal arrangements that exist in the United Kingdom—the automatic stabilisers that exist: less revenue taken out of Scotland, more spending into Scotland—and by the nature of the economic and financial union that exists in the United Kingdom and continues to exist.⁶⁹

65 Scottish Government White Paper, *Scotland's Future: your guide to an independent Scotland*, p510

66 Scottish Government, *Oil and Gas Bulletin*, May 2014

67 Office for Budget Responsibility, [Economic and Fiscal Outlook 2014](#), December 2014, p112

68 HM Government, *Scotland analysis: fiscal sustainability*, Cm 8854, May 2014, p21

69 Oral evidence taken before the Treasury Committee, 14 January 2015, Q163

An erratic tax base would also make it more difficult to plan public spending and more borrowing powers would be required to mitigate any shocks to revenues.

46. The volatility of the oil price is in stark contrast to the more predictable stream of funding that is transferred to Scotland via the Barnett formula and block grant. The Barnett formula is the Treasury mechanism which calculates the amount of public expenditure allocated to Scotland, Wales and Northern Ireland for devolved services. Under this system Scotland enjoys higher public spending per capita than the UK as a whole; in 2012-13 this amounted to an additional £1,364 per person which meant Scotland received an additional £7.25 billion in funding for public services.⁷⁰

47. The existing fiscal arrangements also mitigate the impact of Scotland's per capita tax revenues being lower than the UK average.⁷¹ In 2012-13 non-North Sea revenues in Scotland were £8,947 per person compared with £9,096 for the UK, a gap that amounts to £792 million.⁷² Taken together, the difference between Scotland's per capita expenditure and revenues and those of the UK demonstrates that Scotland benefits from around £8 billion in additional funding. To put that into context, David Phillips told us, "£8 billion is about 14% of overall public spending in Scotland. It is about 18% of tax revenues in Scotland, so it is a sizeable amount."⁷³

48. The Smith Agreement leaves the Barnett formula and block grant in place. Without them, if Scotland were fiscally autonomous, there would be no such transfer of funds from the UK Exchequer and the Scottish Government would have to look elsewhere to address the shortfall.⁷⁴ In boom times the oil industry would be the obvious place to find such revenues. Professor John McLaren explained to us that:

Scotland benefits from being part of the UK at the minute by about £7 billion to £8 billion in terms of transfer [...] that is what North Sea revenues would have to be. In 2011-12 it was £11 billion, so it was well above; this year it is expected to be £3 billion, which clearly is well below. Even at the time of much of the debate around the referendum, I think the Scottish Government's top scenario for North Sea revenues, scenario six, was about £8 billion. Even at the top scenario, it was only just breaking even"⁷⁵.

49. In its December 2014 *Economic and Fiscal Outlook* the OBR predicted oil tax revenues from Scottish waters to be less than £12 billion for the five years between 2014-15 and

70 According to the HM Treasury publication *Public Expenditure: Statistical Analyses 2014*, p115, identifiable public spending on services per head in 2012-13 was £10,152 in Scotland and £8,788 for the UK. The difference between these figures multiplied by Scotland's population of 5.314 million gives the figure of £7.25 billion in additional funding. GERS also notes that total public expenditure in Scotland was an estimated 9.3% of UK public sector expenditure, higher than its 8.2% share of population and higher than its non-North Sea revenues which were an estimated 8.2% of total UK non-North Sea revenues.

71 Not including revenues from oil which we discuss separately.

72 The difference between Scotland and the United Kingdom multiplied by the population of Scotland

73 Q288

74 [Evidence](#) to the Smith Commission submitted by Fiscal Affairs Scotland

75 Q285

2018-19.⁷⁶ This is over £22 billion short of the most recent central forecast from the Scottish Government for the same period and £28 billion short of £8 billion per year in higher funding that is currently delivered by the Barnett-based block grant. The OBR's autumn 2014 forecast was based on an oil price of \$85 per barrel and already looks optimistic; Fiscal Affairs Scotland report that for the first half of 2014-15 revenues from oil amounted to just £1.1 billion; figures for the second half of the year are likely to be worse.⁷⁷ In 2015 the oil price has not been above \$63 per barrel and for most of January it was around \$50. The Secretary of State told us that at \$55 per barrel oil revenues would be in the region of just £1 billion per year and that a \$1 fall in the oil price would equate to a fiscally autonomous Scottish Government having to deal with £100 million less in revenue.⁷⁸

50. The oil price rose in February 2015 and by the end of the month stood at \$60 per barrel, at this price tax revenues might be expected to deliver approximately £1.5 billion per year, still over £5 billion short of the Scottish Government's average forecast of £6.8 billion per year and nowhere near enough to offset the loss of the £8 billion in extra funding that Scotland currently benefits from. As we have previously stated, if Scotland were fiscally autonomous then any drop in revenues would have to be covered by Scottish finances, either through increased tax revenues, cuts in public spending or increased borrowing.⁷⁹ A cut in public expenditure of £6.5 billion per year⁸⁰ equates to over half of Scotland's health budget or three quarters of Scotland's spending on education and training.⁸¹ Were the £6.5 billion shortfall to be recouped via income tax then the Scottish Government would need to increase the basic rate of income tax in Scotland by 17 points in pound.⁸²

51. The fall in the oil price does not just affect revenues from petroleum tax. It is predicted that if the oil price stays at its current level then between 10,000 and 35,000 jobs could be lost from the oil industry, many of them based in Aberdeen, the centre of the UK's oil industry.⁸³ The loss of jobs from the sector could have a knock on effect for other areas of the local economy. The Smith Commission's decision to broadly retain a shared welfare system means that were there to be increased demand for welfare in Scotland as a result of

76 Office for Budget Responsibility, [Economic and Fiscal Outlook 2014](#), December 2014, p112

77 Fiscal Affairs Scotland Press Release, October 2014

78 Letter from Rt Hon Alistair Carmichael MP, Secretary of State for Scotland to the Chairman of the Committee, 12 February 2015 and Q285

79 In evidence to the Treasury Committee the Chancellor stated that the revised fiscal framework being drawn up to implement the Smith Agreement would require the Scottish Government to run a balanced budget. At the very least, this is likely to mean Scotland not being allowed a deficit that is greater proportionately than that of the UK. Scotland currently has a fiscal deficit of £17.6 billion (14% of GDP) without including oil revenues. Including oil revenues of £1.5 billion brings the deficit down to 12.8% of GDP. In contrast, the UK position is around 7% of GDP. Therefore, in order to bring Scotland's deficit down to UK levels under full fiscal autonomy the Scottish Government would need to address the £8 billion shortfall we have identified.

80 The loss of £8 billion mitigated by the addition of £1.5 billion in oil revenues.

81 [Government expenditure and revenue Scotland 2012-13](#), p23

82 Letter from Rt Hon Alistair Carmichael MP, Secretary of State for Scotland to the Chairman of the Committee, 12 February 2015: "The IFS estimated that an increase of 1 percentage point in the basic rate of income tax would raise around £365 million, and the same increase in the higher rate would increase tax revenues by around £60 million."

83 Q325

a downturn in the oil industry then the cost would be borne by the broader shoulders of the UK tax base. As Professor David Bell of the University of Stirling explains:

The case for not devolving Universal Credit might be based on the argument that supporting labour markets in areas that have been hit by adverse economic events underpins both political and macroeconomic stability and therefore must be controlled from the centre.⁸⁴

52. The collapse in the oil price is a stark reminder of the risks that face economies which rely on a volatile revenue stream to fund a large proportion of their public spending. The conclusion of the Smith Commission not to devolve such a volatile source of revenue, nor to recommend full fiscal autonomy, but instead to retain the system of shared benefit and pooled risk across the United Kingdom has already proved to be a wise decision, and one that is of obvious and immediate benefit to the people of Scotland.

53. Were the Scottish Government to move towards full fiscal autonomy, it would mean Scotland losing £8 billion in additional funds that are delivered via the Barnett formula and block grant. This could put the existing level of public spending in Scotland at risk.⁸⁵ Furthermore, the Scottish Government would be replacing the security of Barnett with oil revenues which are volatile and not within the Scottish Government's control. The majority of the people of Scotland voted to retain the safety net of the UK's broad tax base, and the Smith Agreement respects that decision. The Scottish Government's pursuit of full fiscal autonomy does not and, as recent events have shown, would expose Scotland to increased financial risk and an immediate hole in its budget of £6.5 billion.⁸⁶ We cannot see how Scotland benefits from such a scenario.

84 Professor David Bell, '[Why Scotland is unlikely to become a welfare paradise](http://www.futureukandscotland.ac.uk)', available at www.futureukandscotland.ac.uk

85 [Evidence](#) to the Smith Commission submitted by Fiscal Affairs Scotland

86 This figure is based on Scotland losing the £8 billion in higher per capita public spending delivered by the Barnett formula and block grant but only gaining £1.5 billion in oil tax revenues based on the current oil price of \$60 per barrel.

4 Conclusion

54. The Smith Agreement represents the best of both worlds. It presents Scotland with much greater powers over taxation, meaning for the first time the majority of the money the Scottish Government spends will be paid for by its own taxation. This will make it more fiscally accountable to the people of Scotland for how it spends their taxes. On the spending side significant powers over welfare will be devolved including a potentially important power to increase each and every benefit. At the same time, Scotland will continue to benefit from pooling risk and resources across the wider tax base of the whole of the United Kingdom, which will protect it from any shocks in Scottish revenues or expenditure.

55. As our analysis of full fiscal autonomy, an alternative option to the Smith Agreement, makes clear, while it would deliver additional powers and responsibilities to Scotland it would also expose the country to greater risks. Under full fiscal autonomy Scotland would benefit in full from any better than expected revenues from taxes that are currently reserved but it would also have to bear the consequences were such revenues to collapse. As the recent fall in the oil price demonstrates such a scenario is not fanciful and without the protection of the wider and more diverse UK economy the consequences for Scotland would have been disastrous. The Barnett formula gives Scotland more resources than its share of population currently warrants: in 2012-13 this was worth £8 billion to the Scottish Government, equivalent to approximately £1,500 per person. Full fiscal autonomy would result in the loss of this transfer and, without sufficient oil revenues to mitigate such a loss, a sizeable fiscal gap would be created that would need to be filled by increased tax revenues, cuts to public spending, increased borrowing or a mixture of all three.

56. The collapse in the oil price is a stark reminder of the risks that face economies which rely on a volatile revenue stream to fund a large proportion of their public spending. The conclusion of the Smith Commission not to devolve such a volatile source of revenue, nor to recommend full fiscal autonomy, but instead to retain the system of shared benefit and pooled risk across the United Kingdom has already proved to be a wise decision, and one that is of obvious and immediate benefit to the people of Scotland.

57. It is clear that the Smith Agreement faithfully fulfils the “vow” to devolve substantial powers that unionist party leaders made in the lead up to the referendum.⁸⁷ It is now important to focus on its implementation and the draft clauses are one further step in that process. Tougher and more complicated negotiations will follow, particularly in developing an effective fiscal framework to govern the new economic relationship between Scotland and the United Kingdom Exchequer. With fiscal rules in place that are fair, robust and transparent, and which allow Scotland to bear the consequences of its decisions, then the Smith Agreement has the potential to be an enduring settlement. Get them wrong and the potential for grievance, from either side, will be huge. We look forward to both Governments working together constructively and in good faith to deliver a new

87 The ‘vow’ was published on the front page of the [Daily Record](#) newspaper on 15 September 2014.

devolution settlement for Scotland, one that devolves significant powers to the Scottish Parliament and Government and does not cause detriment to either Scotland or the United Kingdom.

Appendix

List of the draft clauses which the Scottish Government allege contain twelve vetoes and the UK Government's response.⁸⁸

- **Clause 6–Elections (franchise and registration)**

Regulations to make any changes to the digital service (individual electoral registration arrangements)

UK Government explanation: The draft clause gives powers to the Scottish Parliament over the franchise and registration arrangements for local government elections in Scotland and the Scottish Parliament elections. Scottish Ministers will have the power to create a system to facilitate registration for these elections. The UK Government has a digital electoral registration service which remains reserved. If Scottish Ministers want to use this reserved service for devolved Scottish Parliamentary local election registration, then they need the agreement of UK Ministers.

- **Clause 20–Universal Credit: costs of claimants who rent accommodation**

Regulations to determine the liability of claimants in respect of accommodation costs

- **Clause 21–Universal Credit: persons to who, and time when, paid**

Regulations relating to the person to who, or time when, Universal Credit is paid

UK Government explanation: Paragraph 43 of the Smith Commission Agreement is very clear that Universal Credit (UC) should remain a reserved benefit. All five parties to the Agreement signed up to that. The clauses devolve powers to Scottish Ministers to make alternative payment arrangements in relation to UC. Draft clauses 20 and 21 require consultation as to the practicability of proposed arrangements and agreement as to the date on which any changes brought in by the exercise of the new devolved powers come into effect, so that DWP (which will continue to administer UC) can make the necessary practical and IT changes. Consultation is reciprocal between UKG and the SG.

- **Clause 27–Road: traffic signs etc.**

Power to give Ministerial direction about road signs

- **Clause 28- Road: speed limits**

Power to make an order relating to speed limits

⁸⁸ Scottish Government Press Release, [Demand for urgent re-think of twelve vetoes](#), 25 January 2015; Letter from Rt Hon Alistair Carmichael MP, Secretary of State for Scotland to the Chairman of the Committee, 12 February 2015

- **Clause 28- Road: speed limits**

Power to give Ministerial directions on speed limits

- **Clause 29–Roads: procedure for regulations and interpretation**

Regulations on speed limits for certain types of vehicles or temporary speed limits

UK Government explanation: In one single state with no internal border controls, it is common sense for both Scottish Ministers and the UK Government to consult each other on changes, and to communicate clearly with people moving across the border. Again, the consultation requirement is reciprocal.

- **Clause 38–Fuel poverty: support schemes**

Regulations to make schemes relating to fuel poverty support

- **Clause 39–Energy company obligations (promotion of reductions in carbon emissions: gas suppliers)**

Regulations to impose obligations on gas suppliers to reduce carbon emissions

- **Clause 39–Energy company obligations (promotion of reductions in home-heating costs: gas suppliers)**

Orders to impose obligations on gas suppliers to reduce home heating costs.

- **Clause 39–promotion of reductions in carbon emission–electricity suppliers**

Orders to impose obligations on electricity suppliers to reduce carbon emission

- **Clause 39–promotion of reductions in home heating costs–electricity suppliers**

Orders to impose obligations on electricity suppliers to reduce home heating costs

UK Government explanation: The clauses require consultation and agreement to give full effect to the recommendation in the Smith Commission Agreement (para 68) which states that the proposal will be implemented in a way that is not to the detriment to the United Kingdom, or to the ability of the UK to meet its international obligations and commitments on energy efficiency and climate change. The reserved powers focus on the overall cost and scale of the obligations to ensure that the obligations continue to operate appropriately within the single GB market and prevent competitive distortions that could disadvantage some consumers. That disadvantage would occur if costs in Scotland were disproportionate (whether high or low) as those costs are spread across GB consumers.

Formal Minutes

Wednesday 4 March 2015

Members present:

Mr Ian Davidson, in the Chair

Mike Crockart

Graeme Morrice

Iain McKenzie

Pamela Nash

Mark Menzies

Mr Alan Reid

Draft Report (*The Implementation of the Smith Agreement*), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 57 read and agreed to.

A Paper was appended to the Report.

Resolved, That the Report be the Fourth Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned till Tuesday 17 March at 2.00 pm]

Witnesses

The following witnesses gave oral evidence. The evidence is available on the Committee's website at www.parliament.uk/scotaffcom

Wednesday 3 December 2014

Question number

Lord Smith of Kelvin KT and **Jenny Bates**, Head of the Smith Commission Secretariat

[Q1-163](#)

Tuesday 16 December 2014

Rt Hon Alistair Carmichael MP, Secretary of State for Scotland, and **Laura Crawford**, Deputy Director, Scotland Office

[Q164-265](#)

Wednesday 14 January 2015

David Phillips, Senior Research Economist, Institute for Fiscal Studies, and **Professor John McLaren**, Honorary Professor of Public Policy, Adam Smith Business School, University of Glasgow

[Q266-394](#)

Tuesday 3 February 2015

Rt Hon Alistair Carmichael MP, Secretary of State for Scotland, and **Laura Crawford**, Deputy Director, Scotland Office

[Q395-524](#)

Published written evidence

The following written evidence was received and can be viewed on the Committee's inquiry web page at www.parliament.uk/smith-commission-inquiry. SCD numbers are generated by the evidence processing system and so may not be complete.

- 1 Alistair Carmichael MP, Secretary of State for Scotland ([SCD0003](#))
- 2 Alistair Carmichael MP, Secretary of State for Scotland ([SCD0004](#))
- 3 Alistair Carmichael MP, Secretary of State for Scotland ([SCD0005](#))

List of Reports from the Committee during the current Parliament

All publications from the Committee are available on the Committee's website at <http://www.parliament.uk/scotaffcom>.

The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

Session 2010–12

First Report	Postal Services in Scotland	HC 669 (HC 884)
Second Report	Video Games Industry in Scotland	HC 500 (Cm 8067)
Third Report	UK Border Agency and Glasgow City Council	HC 733
Fourth Report	The Scotland Bill	HC 775
Fifth Report	Student Immigration System in Scotland	HC 912 (Cm 8192)
Sixth Report	The Referendum on Separation for Scotland: Unanswered Questions	HC 1806
Seventh Report	The Crown Estate in Scotland	HC 1117
Eighth Report	The Referendum on Separation for Scotland: Do you agree this is a biased question?	HC 1942

Session 2012–13

First Report	A Robust Grid for 21 st Century Scotland	HC 499
Second Report	The Referendum on Separation for Scotland: making the process legal	HC 542
Third Report	The Referendum on Separation for Scotland: a multi-option question?	HC 543
Fourth Report	The Referendum on Separation for Scotland: Terminating Trident—Days or Decades?	HC 676 (HC 861)
Fifth Report	The Future of HM Coastguard in Scotland	HC 583
Sixth Report	The Referendum on Separation for Scotland: The proposed section 30 Order—Can a player also be the referee?	HC 863
Seventh Report	The Referendum on Separation for Scotland: Separation shuts shipyards	HC 892
Eighth Report	The Referendum on Separation for Scotland: How would Separation affect jobs in the Scottish Defence Industry?	HC 957 (HC 257)
Ninth Report	Blacklisting in Employment: Interim Report	HC 1071

Session 2013–14

First Report	Reemploy Marine Fife	HC 454
Second Report	The Referendum on Separation for Scotland: The Need for Truth	HC 828
Third Report	The Referendum on Separation for Scotland: A Defence Force for Scotland—A Conspiracy of Optimism?	HC 842
Fourth Report	The impact of the Bedroom Tax in Scotland: Interim Report	HC 288
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