The Smith Commission Submission

Introduction

Fiscal Affairs Scotland is a not-for-profit charity, regulated by OSCR. Its educational and community development purpose aims to provide objective, politically-neutral briefings and reports on Scotland's public finances and the performance of the Scottish economy.

In contributing to The Smith Commission's consultation process on what powers should be devolved to the Sottish Parliament, we do not offer thoughts on the merits of devolving any particular powers but instead outline a general framework within which the selection of any such powers should be assessed.

Framework for selecting additional powers

There are a number of key questions that need to be addressed in determining the additional powers to be transferred to the Scottish Parliament, the answers to which will help clarify those actually best suited for further devolution.

What is the purpose of devolving any individual power and what evidence exists that its devolution will result in a positive contribution to its achievement?

A clear purpose should be articulated for the devolution of any power. Examples might be to encourage greater economic growth in Scotland, reduce Scotland's levels of inequality or possibly both.

However, articulating the means by which such an improvement might come about should also be highlighted. In particular, what positive evidence exists in relation to the increased effectiveness of such a power at a more devolved level of government, and how strong is this evidence?

What evidence exists that reflects the strength of public support for the devolution of any individual powers, regardless of the potential economic consequences?

It may be that Scots are more interested in gaining control of some powers, even if evidence exists that points to potential negative consequences. Indeed, this rationale could turn out to be particularly relevant should the available evidence on the economic impact of proposed changes prove to be quite weak.

Even if the impact of devolving individual powers may prove to be positive, what might their collective impact be?

The devolution of a number of tax powers may be attractive but their wider, collective, impact may have negative consequences, for both Scotland and the UK. For example, a weakening of the UK's fiscal stability, as perceived by the markets, could affect the UK's bond rating and associated borrowing costs which, longer term, could also prove to be detrimental for Scotland.

Furthermore, and as the Governor of the Bank of England, Mark Carney, has recently stated, monetary unions appear to work best when central government has responsibility for a significant part of tax revenue, as well as responsibility for a substantial part of public spending. If the negotiated settlement fails to meet these conditions then the possibility of negative impacts on the currency union needs to be considered.

What are the distributional impacts of any changes?

Devolving powers to Scotland from Whitehall will lead to varying distributional impacts. These could relate to, for example, differences across income groups or between generations, differences geographically across the UK, or differences geographically across Scotland.

Accepting there will be such distributional differences, it will also be important to understand what support might be needed to provide transitional relief for those who are negatively affected. An obvious example here concerns the Barnett formula and how it might need to be adjusted in light of the further powers being devolved.

Trade-offs

A wider concern from the further devolution of powers relates to the issue of trade-offs, inevitable in any negotiated settlement.

Risk sharing

Key amongst these will be how increasing autonomy and fiscal responsibility reduces the size and coverage of the risk sharing currently available between Scotland and the rest of the UK. The referendum result suggested a desire for more responsibility/autonomy (45%) but also for retained sharing (55%), with an unknown proportion of those voting No also wanting an, unspecified, degree of additional autonomy.

How much risk sharing does Scotland give up to reflect the degree of autonomy chosen? Full fiscal autonomy means Scotland will lose a lot of this risk sharing arrangement, a 'Needs Assessment' based solution means very little and Barnett is somewhere in between.

There is no right answer to this issue but, for future accountability, the rationale for the final negotiated solution needs to be clearly stated.

Political versus economic

An equally important trade-off issue relates to how political and economic concerns are resolved. The key here will be to avoid the sort of problems that emerged with the euro, where legitimate economic concerns were effectively ignored in order to achieve a political objective, despite being highlighted in advance as critical.

In the current case, most political parties favour a single monetary policy, but not all favour a single fiscal policy. In the longer term such divergence could lead to problems and the potential for future tensions should be highlighted at this early stage.

It is incumbent on those searching for an agreed settlement to ensure any such trade-offs are fully understood to assist the debate in the Scottish and UK Parliaments and to ensure a stable long term outcome.

Conclusion

The answer to the questions posed above may prove uncomfortable for some. However, if we choose not to address them now, the economic implications may be all the more uncomfortable once the decision to devolve has been taken.

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