

Commission on the  
Future Governance of Scotland





## INTRODUCTION

I firmly believe that Scotland will vote No on September 18, but in the event of a Yes vote to break up the United Kingdom this document will serve no purpose. The United Kingdom will have changed irreversibly. A No vote is a vote of confidence in the partnership that has united the interests of all the people of these islands for centuries. The question of separation will have been settled and politics in Scotland can move on to more constructive and fertile ground. This report is written on that premise.

As a nation, we must avoid future damaging and divisive debates on separatism. The political parties and the Parliament of the United Kingdom will need to grasp a No vote as an opportunity to build a stronger Union with clear divisions of responsibility and accountability. People in Scotland and elsewhere in the United Kingdom need more considered information on how the political union works and serves them. The relationship between Scotland and the rest of the United Kingdom is no longer at ease with itself. It needs to be if Scotland is to prosper. A No vote calls upon us to build a stronger Union with powerful institutions not just in

Scotland but right across the United Kingdom.

In 2013 I was invited by Ruth Davidson to chair a Commission that would look at the issues facing the Scottish Parliament, devolution and the relationship with Westminster. She asked us to produce ideas for the future governance of Scotland that could be brought forward in a Conservative manifesto for Scotland in the General Election of 2015 and beyond to the Scottish Parliamentary elections in 2016.

These proposals are our own. They are offered to the Party in the spirit in which they were commissioned – to provide a Unionist perspective on devolution and a direction in which constitutional policy can develop. Our aim is to make Scotland the best it can be. These proposals are offered as a basis for discussion with all those, including other political parties, who believe in a prosperous Scotland with a strong Parliament in a stronger United Kingdom.

### **Lord Strathclyde**

Chairman of the Commission  
Glasgow  
May 2014

## EXECUTIVE SUMMARY OF KEY RECOMMENDATIONS

Empowering the Scottish people to shape Scotland within the security of a United Kingdom sits at the very heart of what it means to be a modern Scottish Conservative. Everything we propose in this report is aimed at strengthening our ties and reinforcing our relationships.

The Scottish Parliament is a powerful body. It is responsible for the large majority of domestic spending in Scotland, running the health service, Scottish education, policing and criminal justice, as well as many more areas of public life. Our proposals point to a strengthened Scottish Parliament in a strong United Kingdom.

### Financial

- **The Scottish Parliament should become responsible for setting rates and bands of income tax throughout Scotland.**
- **A new Scottish Fiscal Commission should be created, independent of Government, and should be charged with producing official macro-economic and fiscal forecasts in Scotland.**

- **Scottish versions of the Personal Tax Statements should be issued by HMRC, highlighting taxes under the control of the Scottish Parliament.**
- **Responsibility for the state pension should remain with the UK.**
- **There is a case for devolving housing benefit and attendance allowance; additionally there is a case for conferring on the Scottish Parliament the power to supplement welfare benefits legislated for at UK level.**

### Parliamentary and Governmental Reform

- **New rules should be considered by the Scottish Parliament to improve legislative scrutiny with stronger checks and balances without a Second Chamber – for instance providing for Chairs of key Committees to come from the Opposition.**
- **Senior civil servants from Scotland, as part of their career progression, should be expected (and supported) to serve in other Departments of State in the rest of the United Kingdom.**
- **The centralisation of powers**

**from local to central government should be reversed and real devolution should be given to individuals with a greater role for civic society and local government.**

### The Future

- **A Committee of all the Parliaments and Assemblies of the United Kingdom should be created to consider the developing role of the United Kingdom, its Parliaments and Assemblies and their respective powers, representation and financing.**

# The Conservative Party is and always has been the party of the Union.

## 1. THE CONSERVATIVE PARTY AS THE PARTY OF THE UNION

The Conservative Party is and always has been **the party of the Union**. As Alan Trench has recently written for the IPPR, “The union is a Tory accomplishment – first under Queen Anne in 1707, then under Pitt the Younger (with Ireland) in 1801”. At root, each Union had – and still has – two fundamental goals: to create a larger economic market for jobs and enterprise and to assure the common security of everyone within the state.

The Conservative Party is and always has been flexible about how the Union should be encouraged to evolve. It was Lord Salisbury’s Conservative Government that established the Scottish Office in 1885, and it was a Conservative Prime Minister (Baldwin) who appointed the first Secretary of State for Scotland to the Cabinet in 1926.

We also have a long tradition of understanding that our Unionism embraces not only Scotland’s relationship with England but also her relations with Wales and Northern Ireland. In taking a proudly Unionist approach to issues of government in Scotland it is essential that we retain in view

the whole of the Union – and the whole of the United Kingdom – including the interests of Wales and Northern Ireland. For too long, conversations about Scotland’s future have proceeded on the false premise that it is only the relationship between Edinburgh and London, or between Holyrood and Westminster, that matters. We return to this point in the final Chapter of this report.

The genius at the heart of the Anglo-Scottish Union of 1707 is that it allows both nations to blossom within a shared state. The Union was not and never has been an incorporating Union, requiring Scotland to assimilate as if she were nothing more than a northern region of England – or even an English colony. On the contrary, **the Union is founded on the principle that Scottish institutions maintain their distinctive identity**. Throughout the Union this has been true for the Church, for education, for Scots law and for the Scottish legal system. And, since devolution, it has been true also of the Scottish Parliament.

The Scottish Parliament was created under Tony Blair’s Labour Government but its powers and responsibilities have been considerably extended under David Cameron’s Conservative-led

Government. The Conservative Party is determined that the Scottish Parliament should succeed and thrive in the interests of all Scots.

These are not mere words: the Coalition Government has delivered on them. As explained in more detail below, the Scotland Act 2012 added to the already formidable powers of the Scottish Parliament and, for the first time in British history, it provides that a portion of income tax will from 2016 be the responsibility in Scotland not of the Treasury in London but of the Scottish Ministers in Edinburgh. The Prime Minister and Deputy Prime Minister wrote in 2010, “It is absolutely right that Scotland has a greater degree of fiscal autonomy ... We are determined to ensure that the Scottish Parliament is empowered to meet the needs of the Scottish people and that it is properly accountable to them”.

When these actions are taken within the context of Conservative policies on empowering individuals and decentralising power throughout the rest of the UK, it is clear that empowering the Scottish people to shape their own nation within the security of a United Kingdom is not just something we are willing only grudgingly to

We have based our recommendations on strong Conservative principles of responsibility, transparency and accountability.

accept, it is something that sits **at the very heart of what it means to be a modern Scottish Conservative.**

Our report builds on this tradition and provides a Conservative perspective on the challenges that today's arrangements present us with. In our deliberations, we examined the political, fiscal, social and institutional elements of the Union, offering considered proposals for improving each. Throughout our report, we have based our recommendations on strong Conservative principles of **responsibility, transparency and accountability**, which we believe are required for a sustained relationship of all four parts of the UK. Everything we propose is aimed at strengthening our ties and reinforcing our relationships.

The two fundamental purposes of the Union are creating a large, single and fully integrated economic market for jobs and enterprise and assuring the common security of everyone within the state.

## 2. SCOTTISH DEVOLUTION AND ITS CONSEQUENCES

The Scottish Parliament is a remarkably powerful body. Since its inception in 1999 it has been responsible for more than 60% of public expenditure in Scotland, with Westminster being responsible for the remainder. Indeed, there are very few such Parliaments anywhere in the world with greater spending powers than those which Holyrood has enjoyed since 1999.

Many of the matters of most concern to Scots are already the responsibility of the Scottish Parliament. It is worth highlighting that these are matters over which ministers in the UK Government have no say. This is true, for example, for health care in Scotland; for the Scottish education system, from nurseries and schools to universities and colleges; for Scottish criminal justice, including policing and prisons; for the civil justice system in Scotland; for Scottish culture, sport and tourism; for transport in Scotland; for the Scottish environment; for agriculture, forestry and fishing; and for local government in Scotland, including housing, regeneration and the local planning framework. In other words, nearly all **domestic policy**

in Scotland is now, and since 1999 has been, the responsibility of the Scottish Parliament.

Under devolution what the United Kingdom Government provides for Scotland is defence and security, international relations and foreign policy, social security and macro-economic policy, including the currency. The UK Pound in particular has been immensely successful. It has been a source of economic stability and security for Scots for centuries, allowing Scots and Scottish businesses to make saving and investment plans for the future with confidence. These are the areas that are linked to the two fundamental purposes of the Union mentioned above: creating a **large, single and fully integrated economic market** for jobs and enterprise and **assuring the common security** of everyone within the state, both in terms of defence and social protection. We strongly believe these are the policy areas that glue our Union together and are best provided at UK-level. Economic prosperity and collective security are two of the most fundamental reasons why, for more than 300 years, the Union has delivered for Scotland.

Twin hallmarks of Scottish devolution are its **flexibility** and its spirit of **mutual co-operation**.

Under the Scotland Act 1998, UK ministers can act to give greater effect to Acts of the Scottish Parliament and, where they deem it appropriate, Scottish Ministers may allow particular rules for Scotland to be made in Westminster. Examples of this flexibility and mutual cooperation stretch as far as legislation concerning the Commonwealth Games, dangerous dogs, adult care and the regulation of everything from financial institutions to the water we drink. In effect, the Scottish people currently have two governments acting in their interests and frequently they feel the benefit of the support of the UK Government legislating in support of the Scottish people.

The spirit of mutual co-operation is one of the successes of devolution, even if for party political reasons that co-operation is not always broadcast. John Swinney in 2009 argued in the context of a Westminster Bill on the regulation of financial services that "There is no added value in separate legislation as Scottish interests are reflected in the [UK] Bill and a separate process would be complex and require further time and resources to achieve the same policy aim". Likewise Kenny MacAskill in 2010 argued in the

It is up to Unionist politicians across the political spectrum to ensure that Scots understand and appreciate just how powerful, effective and influential their Parliament is.

context of the reform of the law of bribery that “Uniformity across the UK would provide a more effective and workable framework than would be possible if separate bills were introduced in the two Parliaments”. **We agree.** Whilst there are many areas of domestic Scottish policy that are appropriately the responsibility of the Scottish Parliament, in other respects – as even SNP ministers recognise – it is in Scotland’s interest for matters to be dealt with at Westminster. These are further reasons why we continue to be better together and why Scottish independence would be contrary not only to the interests of the United Kingdom as a whole but also to Scotland’s national interest.

The Scottish Parliament plays a hugely significant role in the constitutional life of the United Kingdom. Its powers are substantial by any international comparator but they have not been clearly communicated to the Scottish people. As a result, the national conversation about devolution is often based on a false premise. Lord Ashcroft’s extensive polling (*Cameron’s Caledonian Conundrum: Scottish Voters and the Conservative Party*) found in 2013 that only 14% of Scots have a very good idea of the current division of powers

between Holyrood and Westminster; the annual Scottish Social Attitudes Survey reflects a similarly bemused picture.

We are in no doubt that **more needs to be done to explain** to the people of Scotland the extent of powers held by the Scottish Parliament. We do not expect the current Scottish Government to do this. It is up to **Unionist politicians across the political spectrum to ensure that Scots understand and appreciate just how powerful, effective and influential their Parliament is.**

### The ‘Fiscal Gap’

In our view, the key challenge is to ensure that devolved powers are used **more responsibly, more transparently** and with **far greater accountability to the Scottish electorate.** Whilst the Scottish Parliament has spending powers comparable with those enjoyed by the Canadian Provinces and greater than those of the German *Länder* and the Australian States, its powers to raise the money it spends are relatively limited. Whereas more than 60% of identifiable public spending in Scotland is the responsibility of the Scottish Parliament – its budget is approaching £36 billion – Holyrood is currently responsible for raising only a fraction of that sum. We refer to this as the ‘fiscal

**gap’** – the difference between what Holyrood spends and the revenues it is able to raise.

It is inevitable that there will be a fiscal gap of some degree. There is no federal system in the world in which the sub-state legislature raises *all* of the money it spends. Nevertheless, our aim should be to close it to some degree. Why? Because, seen from this perspective, devolution has not worked. In this respect, devolution has failed to achieve what was hoped for and anticipated: namely, a mature Scottish politics that was no longer based on the grievance culture of old. The sad fact is that, even after 15 years of devolution, it is still far too easy for Scottish Ministers to blame difficult financial decisions on others. This is both unhealthy for the Union and unattractive for Scotland. Closing the fiscal gap through the means of fiscal devolution would create a more responsible Scottish politics and would help to remove this grievance culture from it.

It is also, of course, core Conservative thinking that those who spend public money should do so **responsibly, transparently** and should be fully **accountable** for it. The Commission’s proposals are therefore based on those three principles.



## Financial Transparency

The contrast between UK and Scottish Government financial transparency could not be more striking. Within days of the 2010 election, the UK Government established the independent Office of Budget Responsibility to provide analysis and forecasts of public finances and to aid in the budget process. A Scottish equivalent is in the process of being established now – the Finance Committee of the Scottish Parliament is examining the establishment of a Scottish Fiscal Commission (not to be confused with the Scottish Government’s advisory Fiscal Commission Working Group). The precise remit and operation of this body is still being decided, although we strongly agree with the Finance Committee’s view that the Scottish Fiscal Commission must be **independent** from the Government and should be invited to **provide official macro-economic and fiscal forecasts** in Scotland. The Scottish Government already publishes ‘experimental’ data in its annual Government Expenditure and Revenue Scotland publication – including provisional Scottish GDP data. GERS methodology has been challenged on a number of occasions in the past. Consideration should be given to whether the newly-created **Scottish Fiscal Commission could take**

**responsibility for publishing the annual document, Government Expenditure and Revenue Scotland** (‘GERS’).

High-level statistics, however, will rarely reach individuals beyond the political bubble. Financial transparency has to be pursued on an individual level too. That’s why Chancellor of the Exchequer George Osborne announced that from October 2014 around 24 million people will receive a personal tax statement from HMRC setting out how much tax they paid in the previous year and how it contributed to public expenditure. We recommend that Scottish taxpayers receive a Scottish version of the statement, which could also **highlight taxes under the control of the Scottish Parliament**.

The Scottish Government has been characteristically opaque when describing Scotland’s fiscal position, especially in the run up to the referendum. Scottish Ministers are regularly using terms like “relative fiscal surplus” and highlighting Scotland’s yearly balanced budget as evidence of John Swinney’s prudent fiscal stewardship – by-passing the facts that the latter is a legal obligation and the former was in the context of an £8bn black hole in Scottish

public finances. These are just two examples of where transparency is urgently needed.

Much has been made of North Sea oil and gas receipts over the last few decades. Whilst we know that even at its highest North Sea revenue did not cover even the Scottish welfare bill, the impression remains in some quarters that a huge source of revenue is exploited by Westminster and denied to Scotland. It is in fact the strength of the United Kingdom that allows for such significant investment in the North Sea, which is underlined by the independence concerns recently expressed by some of the biggest energy companies in the world – BP and Shell.

Latest GERS figures show that Scottish oil revenues dropped from £10bn in 2011/12 to £5.5bn in 2012/13. The £4.5bn drop is the equivalent of the entire Scottish schools budget. This revenue volatility (ranging from £4bn to £12bn in recent years) is self-evidently better absorbed in a larger entity and makes it unfeasible for devolution. However, **clearly communicating Scotland’s fiscal balance sheet** might go a long way to address the misperceptions that currently exist.

While block grant adjustments will always be complicated, we need to ensure that devolved policy choices have a direct link to the money available to the Scottish Exchequer. It must be the case that good governance and policies that drive prosperity are felt by the population that elected those decision makers. Otherwise all efforts to establish fiscal accountability are wasted. **It must be a condition of any further fiscal devolution that a robust and stable long-term mechanism is devised, which will demonstrate a clear link between Scottish fiscal policy choices and expenditure in Scotland.**

#### Recommendations:

- The Scottish Fiscal Commission must be independent from Government and should be invited to produce official macro-economic and fiscal forecasts in Scotland.
- Consideration should be given to whether the Scottish Fiscal Commission could take responsibility for publishing the annual document, Government Expenditure and Revenue Scotland.
- Scottish versions of the Personal Tax Statements should be issued

by HMRC, highlighting taxes under the control of the Scottish Parliament.

- Scotland's fiscal balance sheet should be clearly communicated to the public.

## The SNP centralise; Conservatives decentralise.

### 3. DECENTRALISATION

Devolution has been a core Tory value for decades. It is central to Conservative thinking that **power should be devolved away from governments and Parliaments to people and to communities**. Since the 1980s our right-to-buy policy has empowered almost half a million people to buy their homes in Scotland. Likewise, our reforms to employment law devolved power away from trade union barons and gave it directly to individual trade union members. In the present Coalition, the localism agenda has pioneered the devolution of more powers to councils and neighbourhoods, giving local communities far greater control over local decisions.

Local government in Scotland, however, is a devolved competence under the Scotland Act 1998 and the contrast of Conservative localism in England and Wales with the way local government in Scotland has been centralised under the SNP could not be more striking. Whereas under the Conservatives voters in England now elect their own local Police and Crime Commissioners, under the SNP the police and fire services in Scotland have been centralised and made accountable

not to local communities but directly to Alex Salmond. This is typical of the way the SNP have sought to govern: they seek to hoard power in Edinburgh whereas we seek to distribute it down to the lowest possible level. The **SNP centralise; Conservatives decentralise**. For the SNP the only power centre that matters is the Scottish Government; Conservatives seek to drive power down to individuals, to neighbourhoods, and to local communities. There is a paradox in the Scottish Government's clamour for more powers for itself whilst ignoring the very same calls from local authorities across Scotland.

Throughout our deliberations we have been eager that our recommendations will aid growth and prosperity in Scotland. Our vision is for an energised and prosperous Scotland, fit to compete with the best in the 21st century, where all have a stake. The devolution of powers to citizens is a vital part of this process.

The Coalition's City Deals programme, which is planned to include Glasgow as well as many others across the United Kingdom, is another example of how significant powers can be devolved closer to citizens. Whilst City Deals vary from city to city, each is

based on the idea of co-operation across different levels of government, with borrowing powers for infrastructure investment programmes, outcome-based fiscal incentives or local skills funding models being put in place across UK cities.

Localism means devolving power as close to people as possible. The Coalition Government has introduced widespread reforms to community bodies and their powers to take over unused assets or to challenge the council to take over service delivery. Further reforms have been introduced to strengthen the role of local communities in the planning system. The Community Right to Bid and Community Right to Challenge are now finally being considered in Scotland as well. Localised planning reforms, however, are not on the Scottish Government's agenda.

In 2010 the UK Government published a paper on *Building the Big Society*. It said:

*"We want to give citizens, communities and local government the power and information they need to come together, solve the problems they face and build the Britain they want. We want society – the families, networks,*

## We consider that the future of devolution should embrace not only devolution to Scotland, but also devolution within Scotland.

*neighbourhoods and communities that form the fabric of so much of our everyday lives – to be bigger and stronger than ever before. Only when people and communities are given more power and take more responsibility can we achieve fairness and opportunity for all”.*

This is what Conservatives understand by devolution: not the centralisation of power in Edinburgh, but its effective distribution throughout all the communities that make up this great country. Unlike the Scottish Government, we consider that the future of devolution should embrace not only devolution **to Scotland**, but also devolution **within Scotland**.

It is not our remit to offer detailed proposals for reform of local government in Scotland, but we believe the issue must be examined under a clear set of principles. If the relationship between Westminster and devolved legislatures is to be based on responsibility, transparency and accountability, so should the relationship between devolved legislatures and local tiers of government.

### Recommendations:

- Consideration of Scotland’s constitutional future must embrace devolution and decentralisation within Scotland, as well as Scotland’s relationship with the rest of the United Kingdom.
- Initiatives such as City Deals, enhanced local accountability of public services and public servants, and other means of revitalising local democracy are essential to good governance in Scotland.
- Powers over matters such as planning controls should be driven down to the lowest possible level of community government.

## 4. INSTITUTIONAL REFORM

It is 15 years since the Scottish Parliament's first meeting in May 1999. It is an institution that is maturing, but one that is not without its faults. The Commission therefore took an opportunity to examine the institution itself as well as its relationship to Westminster, as part of our work.

### Scottish Parliament

A Parliament exists for many purposes but one of the most fundamental obligations is to hold the incumbent government to account. That responsibility falls to MSPs, from all parties and from none. But even the most able and assiduous MSP will be frustrated in the task if the structures and processes within the Parliament fall short of what is required to achieve that aim.

Since the start of the Parliament in 1999, devolved government has comprised 8 years of Lab/Lib Dem Coalition, 4 years of SNP minority government and 3 years of an overall SNP majority. The democratic right of an overall majority party or a coalition to form a government is undisputed. A coalition by its very nature has its own checks and balances as does a minority administration. However, a government with an

overall majority raises significant issues in terms of transparency and accountability in a Parliament with no revising chamber.

That may be partly mitigated if government backbenchers are individually minded and prepared to challenge party orthodoxy or controversial proposals. Recent experience in this respect has been discouraging. One exception in February 2014, notable because of its rarity, was the willingness of the Justice Committee, by majority, to question the highly controversial Scottish Government proposal to abolish corroboration. Despite the leadership of the SNP Convenor, who was strongly opposed to the proposal, the SNP committee members declined to support her.

It is our view that the Scottish Parliament needs procedural reform in order to strengthen its ability to hold the government of the day to account. This strengthening of accountability is particularly important as the Parliament matures and secures greater power within the Union.

The Parliament's shortcomings would not be addressed by more MSPs. Instead, we need to make more effective the procedures and processes available to the existing number of MSPs. We believe that

reform of how committees operate and a review of how Parliamentary Questions function could make significant improvements.

Most importantly, committees should be encouraged to consider their obligation to the Scottish Parliament and the public. It is notable that select committees at Westminster divide along party lines only rarely: committee members tend to leave their party loyalty in the corridor. Committees are at their best when they act in the Scottish Parliament's interests and in the interests of the public rather than in the interests of parties. If necessary, the rules of the Scottish Parliament should be changed to ensure this.

### Recommendations:

- Convenors of mandatory committees such as Finance and Public Audit should be elected by committee members from one of the opposition parties.
- In the selection of questions for the Parliamentary Oral Question Sessions, the principal opposition spokespersons should be guaranteed slots in the portfolio questions.
- General Questions should be allocated to parties on a basis

proportionate to the size of the group.

- Where for good reasons, a questioner is unable to lodge a question, discretion should be given to the Presiding Officer to permit a colleague of the questioner to lodge a question.
- The Monday noon deadline for submission of questions to the First Minister on the following Thursday should be deferred to noon on Tuesday.

### Civil Service

Civil servants obviously play a key role in the development and commissioning of policy. We believe that the Scottish Government and Parliament should be able to call upon the best and brightest from across the Civil Service UK wide. We also believe that the rest of the UK would benefit from a Scottish view and accordingly recommend that **civil servants who expect to reach the higher echelons of their profession in Scotland should spend a part of their career development in other parts of the UK. The Civil Service should operate a scheme to ensure that not only is this possible but attractive for Scots to spend time in Departments of State outside Scotland.**

### Inter-Parliamentary Relations

The Calman Commission examined the relationships between devolved and central institutions at length. We are inclined to agree that inter-governmental relations have been exercised more or less successfully in the 15 years of devolution. The Memorandum of Understanding between the United Kingdom Government, the Scottish Ministers, the Welsh Ministers and the Northern Ireland Executive reflects the benefits of mutual cooperation. The Joint Ministerial Committee as well as bilateral departmental relations (sometimes underpinned by concordats) exist to further cooperation on an executive level.

Inter-parliamentary relations, however, are unsatisfactory. Granted, the Sewel Convention (Holyrood giving formal consent to Westminster legislation affecting Scotland) is a mechanism that is used frequently, but few other formalised relationships between the two Parliaments exist. The Calman Commission recommended a **joint liaison committee** be established and we believe this proposal should be re-examined after the General Election.

Furthermore, there are institutions (e.g. Electoral Commission) which operate across the UK, with their

services 'commissioned' by each of the four countries, the institutions being accountable to multiple legislatures. A joint committee could tighten these relationships, and open the door for expanding this approach to other areas in the interest of efficient and expert service delivery.

## The Scottish Parliament should be responsible for setting the rates and bands of personal income tax in Scotland.

### 5. TAX

#### Scotland Act 2012

The Scotland Act 2012 creates a new duty to set a Scottish rate of income tax. Under this scheme the basic and higher rates of income tax will be set by Westminster at ten percentage points lower for Scottish taxpayers than for other taxpayers in the UK. It will then be for the Scottish Parliament to decide whether to make up the difference fully (so that income tax rates will be the same in Scotland as for the rest of the UK) or by a lesser amount (so that income tax rates will be lower in Scotland) or by a greater amount (so that income tax rates will be higher in Scotland than in the rest of the UK).

Under the 2012 Act the power will be subject to the “lock-step”: whatever decision the Scottish Parliament makes for one rate of income tax will have to be made for the others as well. So, rates could be put back to 20%, 40% and 45%, or could be set lower (e.g. at 19% and 39%) or higher (e.g. at 21% and 41%), but under the Act the Scottish Parliament has no power to adjust the rates differently: it could not set the lower rate at 19% and the higher rate at 42%, for example (nor could it set the lower rate at 20%

and the higher rate at 38%). The Scotland Act 2012 does not devolve to the Scottish Parliament powers over the setting of income tax allowances or thresholds.

The Scotland Act 2012 additionally devolves two further taxes to the Scottish Parliament: Stamp Duty and Landfill Tax. From 2015 the new Land and Buildings Transaction Tax and the new Scottish Landfill Tax will be collected by a new body, Revenue Scotland. The Scottish rate of income tax, by contrast, will be administered and collected by HMRC.

There is one final feature of the fiscal provisions of the Scotland Act 2012 to note. The Act introduces an important new power enabling further taxes to be devolved in the future by Order in Council: i.e. without the need for fresh primary legislation. This is a highly significant power, which we return to below.

#### Income Tax

When considering fiscal devolution beyond the Scotland Act 2012, much of the focus has been on income tax. One reason for this is that the big three taxes (VAT, income tax and national insurance) together account for

60% of domestic tax revenue (excluding North Sea revenue). Another reason is that it is a high-visibility tax. People notice it and income tax has a high degree of political salience. Elections can be won or lost on the basis of what political parties say about income tax.

The Scottish Liberal Democrats’ Home Rule and Community Rule Commission concluded in 2012 that “Income tax paid by Scottish taxpayers should be almost entirely the responsibility of the Scottish Parliament”. The Devo Plus group has likewise stated that the Scottish Parliament should have “the freedom to set the rates across all bandings of income tax in Scotland”. And the IPPR have found that “The case for outright devolution of personal income tax ... is a strong one”. **We agree: the Scottish Parliament should be responsible for setting the rates and bands of personal income tax in Scotland.**

Since 1999 the Scottish Parliament has had extraordinary freedom to spend public money. Its budget is large and the rest of the United Kingdom imposes no constraints on how the Scottish Parliament spends its budget (within the limits of its legislative competence). We consider that it is time for

## There should be serious examination of the case for a share of VAT receipts raised in Scotland being assigned to the Scottish Parliament.

Holyrood to enjoy a similar freedom with regard to its tax-raising powers. Conferring on the Scottish Parliament as much freedom as possible with regard to the setting of income tax rates is a bold move. It is a huge step in the development of the Parliament's powers. And that we are proposing it without reservation is a sign of our confidence in the maturity of the institution.

This does not mean that the United Kingdom Government would have no role as regards income tax paid by Scottish taxpayers. The definition of 'income' for the purposes of the Taxes Acts should remain consistent across the United Kingdom, for example. Likewise, income tax on investments, dividends and savings should remain a matter for UK Ministers, for practical reasons and in order to safeguard the integrity of the UK's single market in financial services. We also consider that allowances such as the personal allowance – i.e. the threshold at which income becomes taxable – should continue to be set for the whole of the UK by the UK Government. But, beyond these fundamentals, the key decisions as to the rates at which the income of Scots should be taxed and income tax banding should be for the Scottish Parliament.

### VAT

Devolution of VAT is unlawful in EU law (which requires each Member State to set a uniform rate across its territory). This is unfortunate, as VAT – like income tax – is in principle suitable for devolution. Sales taxes are commonly decentralised – even down to local level – in countries such as Canada and the US. Further, VAT is a growth tax, which supports the sorts of services devolved governments provide. **Were it not illegal under EU law, we would have been inclined to recommend that VAT be devolved to the Scottish Parliament.** However we recommend that, as an alternative, there should be serious examination of the case for **a share of VAT receipts raised in Scotland being assigned to the Scottish Parliament.** This would mean that Scottish Ministers would get the benefit of any increase in economic activity in Scotland and would thereby reap a fiscal reward were their economic policies to prove effective.

### National Insurance

National insurance ('NI') comprises two taxes: employees' contributions and employers' contributions. Devolution of national insurance is unattractive for a variety of reasons. Employees' NI contributions are

closely linked to the UK-wide welfare state. Given that we recommend (subject to certain exceptions considered below) that the UK's social security system should continue generally to operate at UK-level, this would militate against the devolution of employees' national insurance contributions. Devolving employees' NI contributions would also risk making the Scottish Parliament's budget overly reliant on employment income. To devolve employers' NI contributions would be possible in theory but difficult in practice. It would involve a significant change to the operation of the NI system and would impose additional burdens on employers, particularly on large businesses that employ people both in Scotland and in the rest of the UK. For these reasons, **we do not consider that national insurance should be devolved.** We note that the Scottish Liberal Democrats and the Devo Plus group reached the same conclusion, as did the Calman Commission.

### Corporation Tax, Capital Gains Tax and Inheritance Tax

We do not recommend the devolution to the Scottish Parliament of Corporation Tax, Capital Gains Tax ('CGT') or Inheritance Tax ('IHT'). Each of



these taxes should remain the responsibility of the United Kingdom. This is for a variety of reasons. Numerous studies have noted that Corporation Tax is the least suitable of all taxes for devolution: it is not economical to collect on a small scale; it relates to activity that can easily be transferred across borders; it is highly volatile; and it does not generate a reliable yield. In any event its devolution would be complex in law, not least because of issues relating to the EU law on state aid.

CGT and IHT are low-visibility taxes. Most citizens never encounter them. Neither is a high-yield tax in Scotland. For these and other related reasons, these taxes are not suitable for devolution.

#### **Smaller taxes: Air Passenger Duty; Climate Change Levy; Excise, Fuel and Vehicle Duties, etc.**

These are relatively minor taxes, responsible between them for raising less than 10% of tax revenues in the UK. Even if they were devolved in their entirety this would make only a modest contribution to the task of closing the 'fiscal gap'. Some of these taxes and duties relate to activity that is highly mobile (e.g. fuel duty and betting duties) and are for this

reason unsuitable for devolution. The devolution of alcohol and tobacco duty, leading to the possibility of differential rates in different parts of the UK, could trigger an increase in illicit trafficking. That they are levied at the point of production or importation, rather than at the point of sale, also militates against their devolution: if devolved they could be, at best, only an indirect means of advancing public health policies in Scotland.

It may be, however, that there are equally (or more) powerful arguments to be made that go the other way, and that a number of the UK's smaller taxes, levies and duties could be considered for devolution. Indeed, we consider that **Air Passenger Duty should be devolved**. Originally conceived as an environmental measure, Air Passenger Duty is site-specific to airport location. We believe that Scotland, with a relatively small number of airports, would be better able to manage this tax locally. In our judgement **there is no need for fresh legislation in order to allow this to occur**. We referred above to the provision of the Scotland Act 2012 which allows further or new taxes to be devolved to Holyrood by Order in Council. This requires the agreement of the Scottish and UK

Governments but it does not require a fresh Act of the UK Parliament. The White Paper, *Strengthening Scotland's Future*, published by the UK Government in 2010, explains how the power to devolve further taxes by Order will work. The process is straightforward. We see no reason why it should not be used where the Scottish Ministers are of the view that the UK's smaller taxes and duties should be devolved. It is an important part of the flexibility of our devolutionary arrangements which has already been legislated for.

## There is a case for building greater flexibility into the way the Scotland Act 1998 deals with social security schemes and welfare benefits.

### 6. WELFARE

As we have seen, the Union is a flexible and pragmatic coming together of four distinctive parts of the United Kingdom sharing in collective security and a single market. This includes social security and the state pension. Our social union underpins economic union and we believe it is important that the two are not detached from each other. That workers in Gateshead and Glamorgan contribute through their taxes to the benefits paid to jobseekers in Glasgow – and vice versa – is hugely important to what glues us together.

By far the largest share of the welfare budget is taken up by the state pension. To provide for the state pension in Scotland would be a very significant burden on Holyrood's budget. Further, the Scottish Social Attitudes Survey strongly suggests that there is little appetite in Scotland for the state pension to be different in Scotland and the rest of the UK. There are two additional arguments against devolving the state pension. Were this to be done it would increase the 'fiscal gap' (because it would vastly increase the spending for which the Scottish Parliament is responsible). We are concerned that the fiscal gap should

decrease, not grow even larger. Further, there is a powerful argument rooted in the UK's single market that pension provision should remain at UK level and should not be devolved. It is an important component of freedom of mobility within the UK that citizens should be free to retire wherever they wish: there is no expectation that people should retire where they have worked. Finally, we note that even in highly decentralised or federal systems, the centre usually remains responsible for social security and pensions provision. For all of these reasons **we consider that responsibility for the state pension should remain with the UK.**

It is a key plank of our social union that social security payments are paid according to need, and not geographical region. The Calman Commission referred to a need for 'fairness' across the United Kingdom and we agree. In our view social security payments should generally remain at the UK level. We note that the Liberal Democrats and the Labour party are likewise agreed that social security provision should continue largely on a pan-UK basis. We detect no public appetite in Scotland for jobseekers' allowance, for maternity pay, for disability living allowance or for

the state pension to be substantially different in Scotland from the rest of the United Kingdom.

Throughout this report, however, we have highlighted the flexibility that is built into Scotland's devolution arrangements, and we have argued that aspects of this flexibility should be used to engineer greater tax devolution. We consider that **there is a case for building greater flexibility into the way the Scotland Act 1998 deals with social security schemes and welfare benefits.** At the moment, what the Act calls 'social security schemes' are reserved to Westminster. This means that the Scottish Parliament has no legislative competence regarding social security schemes. In contrast to the flexible way in which tax devolution has started to develop under the Scotland Act 2012, the 1998 Act's strict reservation of social security schemes to Westminster is rather rigid. It may be that a better approach would be for the Scottish Parliament to have the power to supplement existing welfare benefits legislated for at the UK level. Everyone in the UK – wherever they live – should be entitled to at least the social security provided for in UK legislation at Westminster. But, if the Scottish Parliament were to

## Where a particular cash benefit is closely related to a devolved policy area there is a stronger case for its devolution.

take the view that, from its own resources, the UK entitlement should be supplemented in Scotland, it may be that Holyrood ought to be able to legislate accordingly.

In addition, **where a particular cash benefit is closely related to a devolved policy area there is a stronger case for its devolution.**

Examples include housing benefit and attendance allowance. Housing is devolved, and we can see the case in favour of the proposition that controlling housing benefit may play a role in the development of housing policy. A counter-consideration, however, is that under the Welfare Reform Act 2012, housing benefit is to become one component of the new Universal Credit ('UC'). It is likely to be administratively highly complex (and expensive) to disentangle the housing benefit element of UC for Scottish recipients in order to devolve responsibility for that one component of UC to the Scottish Parliament. None the less, if it can be done **there is a case for devolving housing benefit.**

Likewise attendance allowance. This is a benefit paid to disabled people aged 65 or over who need help with personal care. Social care is devolved, as is health.

**Given that attendance allowance is closely related to these devolved functions, it should be considered for devolution.**

## We therefore call for the creation of a Committee of all the Parliaments and Assemblies of the UK.

### 7. THE FUTURE POST-2015 GENERAL ELECTION AND BEYOND

This report is written in the expectation that Scottish people endorse the United Kingdom on 18 September 2014. While we take nothing for granted, we are confident that Scots will grasp the chance to give their support to our 300-year long partnership of nations.

Faithful to the brief we were given, our focus has been on Scotland. Our recommendations can be implemented as soon as the result of the 2015 General Election is known. But the Commission believes that a No vote in September should be the impetus for a re-examination of what devolution and the Union mean beyond Scotland: i.e., in England, Wales and Northern Ireland. In recent decades our relationships have been considered too much in silos, without sufficient regard of the effects of constitutional change in one part of the country on the remaining ones. The time has come for this to stop.

The West Lothian Question, in particular, looms large at Westminster: what should be the role of Scottish MPs in debates and votes on matters which, in Scotland, are the responsibility of Holyrood? The McKay Commission undertook

extensive work on the West Lothian Question, reporting in 2013. **We urge the Government to explore the ways in which the recommendations of the McKay Commission may best be implemented.**

In our view, it is important that any sense be resisted that MPs for Scottish, Welsh or Northern Irish constituencies somehow perform any lesser a function than MPs representing seats in England. The establishment of stable constitutional arrangements for the future of the UK must address this. It would be unfortunate if the feeling were to gain ground that there were two classes of MP. Even under a scheme of enhanced devolution, such as we have proposed in this report, MPs for Scottish constituencies will continue to have significant responsibility for safeguarding the interests of those whom they represent. Scottish MPs are and must remain as qualified as any other to hold high government office, including the offices of Prime Minister and Chancellor of the Exchequer.

We believe there is a case for a renewed and stronger Union. However, it may be that once our proposals and recommendations have been implemented, we will have reached the end of devolution on a unilateral basis. Further

development of our constitutional settlement beyond that which we have proposed in this report will need to be considered on a UK-wide basis. Westminster will need to be included but so, too, will the other legislative bodies of the United Kingdom and the different parties and political traditions represented therein. We believe that by so doing we will discover that the ties that bind us are far stronger than those that wish to pull us apart. **As a final recommendation, we therefore call for the creation of a Committee of all the Parliaments and Assemblies of the UK.** This new Committee would examine the role and central importance of the Parliament of the Union and how to build on the respective powers, representation and financing of the devolved bodies in a manner which is fair to all parts of the United Kingdom.

We expect assurances from all political parties (including the SNP) that this Committee should be set up soon after the General Election and there is no reason why some preliminary work could not be carried out before that. However we set no timetable on its deliberations but believe that a free process of thought and debate will provide the right kind of constitutional framework to suit all the people of the United Kingdom for very many years to come.

## ACKNOWLEDGMENTS

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The Commission is very grateful to all who engaged with us throughout our deliberations, particularly to those who sent in written submissions, spoke to us personally and attended our evidence-taking sessions. Our special thanks go out to our advisors, Professor Tomkins and Professor Trench, whose expertise helped guide us through this process.





