Taxation and Borrowing Seán Griffin

**A hamstrung Parliament with pocket money devolution**

One of the most significant missed opportunities of devolution at its founding was the failure to empower the Scottish Parliament with adequate fiscal levers over taxation and borrowing. At the time of the passing of the Scotland Act 1998 (the “1998 Act”), fiscal, economic, and monetary policy was specifically reserved to Westminster, and this included the issue and circulation of money, taxes and excise duties, and government borrowing and lending.[[1]](#endnote-1) There have of course been improvements since 1998 and the Scottish Parliament’s fiscal powers have been augmented to an extent since the time of its inception. However, the powers still fall far short of what is to be expected of powers fit for a Parliament.

If the aim is to create a Parliament able to suitably serve the people of Scotland, capable of fostering a more socially just and prosperous society, and sensitive to Scotland’s needs, the reasons for the deliberate enfeeblement of the Scottish Parliament in this way are difficult to understand. Whatever the rationale, the failure to devolve significant powers over taxation and borrowing have had two main consequences over the lifetime of the devolution settlement. Firstly, the paucity of financial and fiscal powers has hamstrung the Scottish Parliament in its ability to tackle Scotland’s industrial decline as well as its stubborn levels of poverty and cocktail of associated social problems including uniquely high levels of drug deaths and poor general health outcomes. Secondly, this arrangement has set up a constitutional mousetrap for Labour as it has facilitated the SNP narrative of the Westminster bogeyman and the UK economic model being to blame for all of Scotland’s social and economic ills.

It has created a kind of pocket money devolution whereby the Scottish Parliament cracks open the piggybank every year, freely chooses how to spend the money, but without taking responsibility for how the funds are raised. While this evasion of accountability may be attractive in adolescence, sooner or later the Scottish Parliament is going to have grow up and enter adulthood like the rest of us. Taking fiscal responsibility is not only important to enable the Scottish Parliament to create a more socially just and economically vibrant Scotland, but also it is important for democracy as it will make the Scottish Parliament more accountable and transparent to the people it serves and tear up the get-out-of-jail-free card played by the Scottish Government for too long in its denial of responsibility to Scottish voters.

It may be said in response, if financial responsibility and accountability are so important, why not opt for full fiscal autonomy or even independence. For socialists, it is important not to lose sight of the idea of powers for a purpose and we should have that purpose clear in our minds when considering changes to the constitutional relationship between Scotland and Westminster. The objectives of devolving more fiscal powers to the Scottish Parliament are two-fold: firstly, to enable the redistribution of wealth across society and to further the cause of social justice; and secondly, to ensure that the distribution of power across the UK is based on a principle of subsidiarity, so that power is exercised at the lowest level as far as is possible without compromising the redistribution of wealth and social justice.

From a class perspective, the redistribution of wealth and social justice necessitates that not all fiscal and financial powers are devolved to the Scottish Parliament. Full fiscal autonomy is unattractive because the consequences would be that the scope for achieving a redistribution of wealth across the UK would be severely diminished if not made impossible and the working class would be worse off as a result. It is therefore necessary to balance the subsidiarity principle with the maximisation of redistributive capacity. It is upon this principle we should consider what fiscal powers should be devolved to the Scottish Parliament.

**Tax raising and varying powers**

The Scottish Parliament currently has certain tax raising and tax varying powers in terms of the 1998 Act as extended by the Scotland Act 2012 and Scotland Act 2016. Scottish Landfill Tax and Land and Buildings Transaction Tax, for example, are fully devolved taxes in terms of ss.80I, 80J and 80K of the Scotland Act 1998, although they make up a relatively small proportion of the Scottish Budget. The Scottish Parliament is also now able to set non-savings, non-dividend income tax rates and bands for Scottish taxpayers for the first time, though it does not have power to adjust the personal allowance.[[2]](#endnote-2) Income tax is not a devolved tax and HMRC continues to be responsible for the collection and management of income tax in Scotland, which includes the identification of Scottish taxpayers. The Scottish Income Tax collected by HMRC is paid to the Scottish Government.

This contrasts with Scottish Landfill Tax and Scottish Land and Buildings Transaction Tax which are now collected by Revenue Scotland, a non-ministerial department of the Scottish Government. Also, unlike those taxes, Scottish income tax represents a considerable share of the overall Scottish Budget. The Scotland Act 2016 also devolved Air Passenger Duty.[[3]](#endnote-3) However, on 23 April 2019, the Scottish Government deferred the introduction of the Scottish replacement to Air Passenger Duty, Air Departure Tax, beyond April 2020 until issues have been resolved regarding the tax exemption for flights departing Highlands and Islands airports. Air Passenger Duty will continue to apply to flights departing Scottish airports, and HMRC will continue to have responsibility for administering APD in relation to Scottish flights.[[4]](#endnote-4) The Scotland Act 2016 also devolved the Aggregates Levy.[[5]](#endnote-5) However, the timetable for devolving the tax to the Scottish Parliament is dependent on the conclusion of the current EU and domestic legal proceedings around state aid in relation to the UK Aggregates Levy.[[6]](#endnote-6)

It is suggested that devolution of further tax powers could be made as part of a new Scotland Bill. In certain areas it will be necessary to retain powers at Westminster to preserve uniformity across the UK, and to avoid tax competition between parts of the UK and a subsequent race to the bottom. In that regard, it is suggested that the personal allowance element of income tax should be reserved to Westminster as is currently the case, corporation tax should also be reserved, and VAT and the capital taxes should also continue to be reserved. National Insurance Contributions should also continue to be reserved to Westminster. Not only will reserving these taxes to Westminster avert damaging tax competition between different parts of the UK but will also ensure that a future Labour government at Westminster is not hamstrung to deliver redistribution of wealth across the nations and regions of the UK.

However, there are a number of specific changes to the tax system that could be made to give more financial responsibility to the devolved institutions and would enable a radical Labour-led Scottish Government to pursue important social objectives. Firstly, it is suggested that excise duties which apply to alcohol and tobacco should be devolved, but not those which apply to road fuels. This would allow the Scottish Parliament to increase the cost of alcohol and tobacco products to benefit public health, while ensuring fuel prices are relatively stable across the UK. Secondly, it is suggested that betting and gaming levies should also be devolved to enable to the Scottish Parliament to deal with the issue of problem gambling in Scotland. Thirdly, in terms of s. 80B of the Scotland Act 1998, the UK Government has the power to specify new devolved taxes, and this can be a tax of any description. The UK Government should exercise this power to create a new Scottish Wealth Tax, and to devolve the setting and administration of the tax to the Scottish Government. This would allow a Labour Scottish Government to introduce its wealth tax plan of a 1% windfall tax on the wealthiest 10% of individuals in Scotland.[[7]](#endnote-7)

**Public sector borrow in the UK**

Even more frustrating than the lack of tax powers is the current Scottish Parliament’s inability to borrow to an adequate level from the financial markets, and the Scottish Government’s timidity to use current borrowing powers to their fullest extent.

At present in the UK, there are several different types of borrowing powers available to the public sector at different levels of government, from central UK Government, to devolved institutions, to local authorities. Firstly, bonds are used by the UK Government to finance medium-long term borrowing. In the UK, bonds constitute almost all UK government borrowing. Bonds are interest bearing certificates of UK Government liability in sterling. These can be bought from the UK Debt Management Office (“DMO”), which issues them on behalf of HM Treasury, and investors managing pension funds typically buy them. The attraction of bonds to buyers is their security: governments can choose to raise taxes or print money so interest, and principal payments, on bonds are almost always paid.

Secondly, Sterling Treasury bills are used by the UK Government to finance short term borrowing. Alongside gilts, they play an important role in managing cash requirements. These are zero coupon debt securities which can be bought from the DMO and do not pay interest, but instead are issued at a discount and redeemed at face value upon maturity. Similar to bonds, Treasury bills are attractive to buyers because of the low risk of default.

Thirdly, the UK Government uses the National Loans Fund (“NLF”) to lend money to local authorities and other prescribed bodies. It is operated by the Public Works Loan Board, which sits within the DMO. Loans are offered at low interest rates, compared to those offered by commercial banks, and are provided with either a fixed rate or a variable rate of interest. Fixed rate loans have a maximum repayment period of 50 years, with repayments due at half-yearly intervals. Variable rate loans have a maximum repayment period of 10 years and repayment intervals are chosen when the loan is issued.

Lastly, within UK public authorities there has been rapid growth in the use of private borrowing to finance capital investment. Typically, in private finance projects (PFPs), a private sector consortium forms a special purpose vehicle (SPV), which enters a contract with a public authority. The SPV usually agrees to build and maintain a capital project, e.g. a bridge or a hospital, over a fixed period of time in return for fixed annual payments or user charges when construction is complete.

The SPV finances its construction by borrowing (usually 85–90%) and owners’ equity (10–15%). There are now about 800 PFPs in being in the UK, with a capital value of about £64 billion.[[8]](#endnote-8) PFPs cover all forms of public-private partnerships (PPP), with the most widely used model being the Private Finance Initiative (PFI). Other models have been used more recently as alternatives to PFI including the non-profit distribution (NPD) model. The cost of debt for PFPs pre-credit crunch was typically about one percentage point above the nominal cost of government borrowing.[[9]](#endnote-9) The higher cost of debt reflects risks carried by the private sector and a margin for profit. Since the credit crunch, the cost of private finance has risen significantly.

Commercial banks are a key source of finance for PFPs, but not the only source. For example, the European Investment Bank, which lends on a not-for-profit basis, is a very significant finance provider and has lent €3–4 billion of funding for PFPs in the United Kingdom since 2005. The financial crisis has increased the EIB’s attractiveness as a source of funding.[[10]](#endnote-10)

**Scottish Government borrowing powers**

The Scottish Government can borrow for capital and resource purposes. Capital spending is on assets that last for a number of years (such as infrastructure or vehicles). Resource spending concerns expenditure on things that are used up (such as salaries, grants, public services, administration).

Generally speaking, resource borrowing is available for cash management of the Scottish Government’s budget – including dealing with volatility in devolved tax receipts – rather than allowing for more to be spent on services than the income received from HM Treasury and tax receipts. Put another way, resource borrowing cannot be used simply to run an unbalanced budget.

Scotland’s borrowing powers are set out in its [fiscal framework](https://www.gov.uk/government/publications/the-agreement-between-the-scottish-government-and-the-united-kingdom-government-on-the-scottish-governments-fiscal-framework).[[11]](#endnote-11) Capital borrowing is covered in [paragraphs 54-60](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/503481/fiscal_framework_agreement_25_feb_16_2.pdf#page=12) of the fiscal framework document, and resource borrowing in [paragraphs 61-70](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/503481/fiscal_framework_agreement_25_feb_16_2.pdf#page=13). Scotland has an annual capital borrowing limit of £450 million and total (accumulated) capital borrowing limit of £3 billion.

The Scottish Government can borrow a cumulative total of £1.75 billion for resource purposes. Annually it can borrow up to £600 million for the following specific reasons:

* up to £500 million for in-year cash management
* up to £300 million for forecast error of devolved taxes, welfare spending and the block grant
* up to £600 million to manage Scotland-specific economic shocks

Borrowing for Scotland-specific economic shocks will be available when annual growth in Scottish GDP is less than 1% and is also 1% point below UK GDP growth. This applies to either actual growth data or forecasts. The borrowing will be available in the financial year in which it was triggered and the two following years. The resource borrowing powers are summarised in the table below from Audit Scotland:



Audit Scotland’s report into Scotland’s new financial powers gives a good summary of the borrowing powers (see [paras 37-44](https://www.audit-scotland.gov.uk/uploads/docs/report/2018/briefing_181016_financial_powers.pdf#page=16) for capital borrowing and [paras 45-46](https://www.audit-scotland.gov.uk/uploads/docs/report/2018/briefing_181016_financial_powers.pdf#page=17) for resource borrowing). The report covers the use of the powers. Scotland’s resource borrowing must be funded from the NFL. Capital borrowing can be funded from the NLF, commercial loans or the issue of bonds.

By the end of 2018/19 the Scottish Government had accumulated capital debt of £1.46 billion, which is within its £3 billion limit.[[12]](#endnote-12). [Analysis](https://sp-bpr-en-prod-cdnep.azureedge.net/published/2018/12/14/Scottish-Budget-2019-20/SB%2018-84.pdf#page=27) from the Scottish Parliament Information Centre (SPICe) suggests that the Scottish Government could continue to borrow the maximum of £450 million per year until 2022-23 before it would breach the £3 billion limit, assuming that the repayment terms for future borrowing are similar to those for existing borrowing.

The Scottish Government has not had need to use its resource borrowing powers. This is not necessarily surprising, as the borrowing is restricted to very specific circumstances – largely to do with cash management and volatility – and does not detract from the requirement for a balanced Scottish Budget each financial year.[[13]](#endnote-13)

Although the Scottish Government has capital borrowing powers via the NLF, commercial loans and the issuing of bonds, capital borrowing has been made by the Scottish Government only via NLF. The Scottish Government planned to draw down approximately £450 million from the NLF in 2019/20, as it did in 2017/18. Although it planned to draw £450 million from the NLF in 2018/19, the Scottish Government in fact drew down £250 million.

Prior to this, the Scottish Government reached an agreement with HM Treasury that allowed it to use its capital borrowing limit to accommodate the impact of some classification changes made by the Office for National Statistics (ONS). This did not involve the Scottish Government actually borrowing, as is [explained by Audit Scotland](https://www.audit-scotland.gov.uk/uploads/docs/report/2018/briefing_181016_financial_powers.pdf#page=16), as in 2015/16 and 2016/17 the Scottish Government used its capital borrowing limit to accommodate the impact of decisions by the ONS to reclassify some major Non-Profit Distributing investment projects as public-sector projects. The Scottish Government agreed with HM Treasury that these amounts would be recorded against its capital borrowing limit.

This notional borrowing was £283 million in 2015/16 and £333 million in 2016/17. This notional borrowing will be treated as if it is being repaid over 30 years for the purposes of the overall limit. As no actual borrowing occurred, no repayments need to be accommodated in future year’s budgets.[[14]](#endnote-14)

Therefore, the Scottish Government is not utilising the borrowing powers available to it to their full extent. In an era of austerity and restraints on public spending, the Scottish Government is refusing to exhaust all of the borrowing powers available to it to mitigate the worst effects of austerity. Much more could be done now by the Scottish Government with the current powers available to it to invest in the Scottish economy, to stimulate economic growth and create jobs but it refuses to do so, instead blaming Westminster and the UK for all of Scotland’s economic woes.

**Reform of Borrowing Powers**

In order to give real financial responsibility to the Scottish Parliament and the Scottish Government, the restrictions on resource and capital borrowing should be lifted in their entirety. Without the ability to issue its own bonds uncapped by Westminster, the Scottish Government will not take responsibility for its finances, and there is significant moral hazard latent within the Scottish devolution settlement that the Scottish Government can act in any way it chooses, and always be bailed out by Westminster if disaster happens.

The Scottish Government should therefore be given an ability to borrow and issue bonds for both resource and capital spending without any restriction. In addition, consideration may be needed on whether borrowing via the National Loans Fund should be restricted for the Scottish Government, in order to encourage borrowing via the issue of bonds or commercial loans. This will further increase financial responsibility at a devolved level rather than hiding behind the UK Government.

As the Fiscal Framework is up for renewal between the UK Government and Scottish Government, this is a fortuitous moment to make the argument for greater tax and borrowing powers for the Scottish Parliament. Such changes will not only allow a radical Scottish Government in the future to invest in the Scottish economy to stimulate economic growth, create jobs and tackle poverty across the country but also it will vanquish the SNP narrative that Westminster is to blame for all of Scotland’s social and economic ills and their perennial denial of responsibility to the people they serve. The devolution of tax and borrowing powers as outlined above will at long last deliver fiscal powers fit for a Parliament.

[[15]](#endnote-15)

1. Scotland Act 1998, Schedule 5, para. A1 [↑](#endnote-ref-1)
2. Ss. 80C-80HA, Scotland Act 1998 [↑](#endnote-ref-2)
3. S. 80L, Scotland Act 1998 [↑](#endnote-ref-3)
4. <https://www.revenue.scot/air-departure-tax> [↑](#endnote-ref-4)
5. S. 80M, Scotland Act 2016 [↑](#endnote-ref-5)
6. <https://www.gov.scot/policies/taxes/aggregates-levy/> [↑](#endnote-ref-6)
7. Leonard, Richard, *How We Will Rebuild Scotland by redistributing power and wealth*, <https://scottishlabour.org.uk/media/how-we-will-rebuild-scotland-by-redistributing-power-and-wealth/> [↑](#endnote-ref-7)
8. UK Parliament House of Lords Select Committee on Economic Affairs, 2010 [↑](#endnote-ref-8)
9. National Audit Office, 2009 [↑](#endnote-ref-9)
10. <http://www.parliament.scot/ResearchBriefingsAndFactsheets/S4/SB_11-37.pdf> [↑](#endnote-ref-10)
11. The agreement between the Scottish Government and the United Kingdom Government on the Scottish Government’s fiscal framework, February 2026 [↑](#endnote-ref-11)
12. See: [Scottish Government’s Fiscal Framework Outturn Report](https://www.gov.scot/publications/fiscal-framework-outturn-report/pages/6/) [↑](#endnote-ref-12)
13. House of Commons library, July 2019 [↑](#endnote-ref-13)
14. House of Commons library, July 2019 [↑](#endnote-ref-14)
15. [↑](#endnote-ref-15)