Wednesday’s Spending Review will influence the size of the Scottish budget in 2020/21. But it is just one piece of the jigsaw – with the other pieces not becoming available until later in the year.

In normal times, the publication of a UK Government Spending Review would be a major moment in the political and public finance annual calendar. This week’s Spending Review however will be overshadowed by the ongoing mess that is the UK’s withdrawal from the EU.

But the Spending Review is important, and it will set out departmental spending limits for 2020/21 in key areas of the NHS, education, defence and other public services. However, the government’s previous aspirations to deliver a multi-year spending review have been jettisoned given ongoing uncertainty over Brexit.

The Spending Review will of course also have important implications for next year’s Scottish budget which Derek Mackay will present to parliament later on this autumn – most likely in December. The setting of departmental spending limits for UK departments will determine the size of the Scottish block grant.

To date, the UK Government has only set-out fairly high level departmental plans for resource spending. As a result, there is no official projection of the size of the Scottish block grant for 2020/21.

On the basis of the broad projections set out in the Spring Statement however, and some of the UK Government’s previously announced commitments, the Scottish resource block grant looked likely to increase in real terms by approximately 1.5% next year, equivalent to about £400m. This compares relatively favourably with recent years (the resource block grant in 2019/20 is broadly unchanged in real terms from 2016/17.)

All the indications are that this indicative position will improve further on Wednesday. Incoming Prime Minister Boris Johnson – clearly with one eye on a possible upcoming General Election – has pledged funding to increase police numbers in England and Wales, and to increase school spending in England.

Once fully implemented, these pledges might cost around £4bn-£6bn annually, although the necessity to roll them out gradually means that the increase in 2020/21 is likely to be closer to £2-£3bn. Assuming that this funding will come on top of the provisional spending plans set out by Phillip Hammond in Spring, this is likely to imply an improved outlook for the Scottish block grant, relative to what was indicatively pencilled in, taking the real terms...
increase in resource block grant to over 2%.

A real-terms increase in the block grant of over 2% would be the most generous for some
time.

Of course, even if the block grant were to increase by 2% or more next year, this doesn’t
necessarily mean that Derek Mackay’s resource budget will increase by as much as this.

The outlook for the Scottish resource budget depends not only on the block grant, but on
the revenues raised from Scottish taxes (more specifically, the difference between the
revenues raised from Scottish taxes and the infamous block grant adjustments – which are
basically estimates of the revenues that the UK Government would have raised from
Scottish taxes in Scotland if those taxes had not been devolved and the UK tax policy
applied).

We won’t know what the forecasts for these block grant adjustments are until the UK
Budget, which will include announcements of UK tax policy and tax forecasts, and which will
presumably be published sometime in November (Brexit and possible General Elections
notwithstanding). And we won’t know the Scottish forecasts until the Scottish budget is
published in December.

The latest forecasts (from May this year) imply a slight worsening in Scotland’s ‘net tax’
position compared to last year. But this could change, particularly if Boris Johnson follows
through with his pledge to cut income tax in rUK*.

One thing we do know with certainty is that the Scottish budget will be reduced by £204m
in 2020/21 as part of the income tax reconciliation process (reflecting the fact that income
tax outturn figures for 2017/18 were not as favourable to the Scottish budget as had been
forecast when the 2017/18 budget was set).

Tax policy, tax forecasts and income tax reconciliations complicate the picture, and mean
that the resources at Mr. Mackay’s disposal in 2020/21 could increase more or less quickly
than the block grant alone.

So whilst Wednesday’s Spending Review is of critical significance for the forthcoming
Scottish budget, as it sets the overall trajectory for the Scottish block grant, it is just the
first act of three that will determine the parameters of the Mr. Mackay’s budget for next
year.
* A cut in rUK income tax could result in further improvements to the Scottish budget outlook under the rules of the fiscal framework. If the UK Government were to cut income tax in rUK, this reduces the ‘block grant adjustment’, the estimate of what the UK Government would have raised from income tax in Scotland if income tax had not been devolved. And since the BGA is deducted from the block grant, this could improve the Scottish budget position, assuming the Scottish Government decides not to implement the same policy in Scotland.