How might increases in spending on NHS England impact the Scottish budget?

The UK Government is due to announce today a substantial increase in funding for the NHS in England. But what might the announcements mean for the Scottish budget – and how will they change the financial outlook for the Scottish Government which it set out in its Five Year Fiscal Strategy last month?

Any additional spending on the NHS in England will have a consequential effect on the Scottish Government’s budget via the Barnett Formula. (The Barnett Formula allocates Scotland a population share of changes to equivalent spending in England).

Under existing plans, spending on the NHS in England was around £114m in 2018/19, and forecast to increase to £116m in 2019/20 and £119m in 2020/21 (slightly above inflation).

The latest expectations are that Theresa May will today announce that the NHS England budget will increase by around 3.4% – 3.6% per annum in real terms. The Table below considers what these sorts of funding increases would mean for cash terms spending increases by the UK Government, and the consequential Scottish block grant increase.

Real terms increases in NHS England spending of 3.6% imply an additional £4bn spending on the NHS in England in 2019/20 relative to plans, rising to an additional £16.7bn by 2022/23. The implied consequentials for the Scottish budget would be around £400m in 2019/20, rising to £1.65bn in 2022/23. (Clearly there is some uncertainty over exactly how much NHS England spending will increase by, and to which elements of the English health budget it will apply).

Table 1: The effects of an uplift in NHS England spending on the Scottish budget (£bn)

<table>
<thead>
<tr>
<th>Current plans</th>
<th>Additional cash spending required (relative to plans) in order to achieve real terms increase of...</th>
<th>Scottish Government consequential</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>3.4%</td>
<td>3.5%</td>
</tr>
<tr>
<td>2018/19 114.3</td>
<td>4.0</td>
<td>4.1</td>
</tr>
<tr>
<td>2019/20 116.1</td>
<td>7.0</td>
<td>7.2</td>
</tr>
<tr>
<td>2020/21 119.3</td>
<td>11.1</td>
<td>11.5</td>
</tr>
<tr>
<td>2021/22 121.7</td>
<td>15.6</td>
<td>16.2</td>
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</table>
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**Scottish tax implications?**

We won’t know until the Autumn Budget to what extent these funding increases by the UK Government will be funded through additional borrowing or tax increases. But this decision could potentially have further implications for the Scottish budget.

If an increase in UK Government health spending in England is funded through additional borrowing (the UK Government could afford to borrow the additional sums mentioned in the chart above without breaking its self-imposed deficit rule), then the Scottish budget would benefit from the consequential uplift in full. Likewise, if the increase in spending is funded in part through an increase in rates of reserved taxes (such as an increase in National Insurance Contributions, or a cancellation of planned Corporation Tax cuts) then the Scottish budget would also benefit from the consequential in full.

However, if an increase in spending on the NHS in England is partially funded by an increase in the rate of tax for a tax that has been devolved to Scotland, then things get slightly complicated.

Imagine for example that an increase in spending on the NHS in England is part-funded by an increase of 1p in the basic rate of income tax. The additional revenues raised by the UK Government would result in an increase in the Scottish Government’s ‘Block Grant Adjustment’ – the sum that is deducted from the block grant to reflect the revenues that the UK Government has foregone as a result of transferring income tax to Scotland.

In this hypothetical case, although the Scottish block grant would get the same Barnett consequential from the UK Government’s decision to increase spending on the NHS, the fact that this was being partially paid for by a tax increase that did not apply in Scotland would result in a higher block grant adjustment.

The effect of this, broadly, is to reduce the increase in the Scottish consequentials by the extent to which the increase in spending on the NHS in England has been funded by income tax changes that do not apply to Scotland. It would then be up to the Scottish Government whether or not to ‘follow’ the rUK tax increase. In effect of course, the Scottish Government has already partially increased the basic rate of income tax in Scotland. How would it respond to an increase in the rUK rate?

The scenario of an increase in the basic rate of income tax in England is arguably unlikely. But it is possible that the spending increase might be funded in part by a freeze in the Higher Rate threshold in England. If so, this may incentivise the Scottish Government to
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freeze the Higher Rate in Scotland.

Alternatively, the UK Government may fund the spending increase in part by freezing the Personal Allowance. The Personal Allowance is not devolved to Scotland, so the UK Personal Allowance would apply in Scotland. However, the Scottish Government can set a higher ‘effective Personal Allowance’ in Scotland by setting a 0% tax band. The Scottish Government has previously committed to increase the Personal Allowance to £12,750 by 2021/22. If the UK Government were to freeze the Personal Allowance, the Scottish Government would then have to decide whether to set a higher ‘effective Personal Allowance’ in Scotland, costing it revenue, or to stick with the UK Government policy – which would lead to questions about its intentions regarding one of its manifesto commitments.

It is clear therefore that if the spending increases of the UK Government are funded partially through income tax changes, this will pose dilemmas for the Scottish Government in setting its next budget.

Spending implications

Notwithstanding these complications about income tax, how would additional resources for the Scottish budget of the broad magnitude discussed above influence the outlook for different elements of the Scottish budget?

In its Five Year Financial Strategy, launched at the end of May, the Scottish Government stated that its commitment in relation to health spending was to increase health spending by £2bn over the course of the parliament, and to pass on all health related consequentials.

A strict interpretation of this commitment would be that all the additional consequentials announced today will be passed onto health spending in Scotland. If this happens, the NHS Scotland will see average annual real terms increases of around 3.1% during this parliament (and 4.2% annually over the next three years), more than double the implication of its existing plans, which envisage average annual real terms increases on the NHS over the parliament of around 1.4%.

This would mark a firm break from the 2010/11-2016/17 period, when health spending increased around 1.4% annually. But passing on all additional consequentials to the health budget would mean that unprotected areas of spend face no less of a squeeze following today’s funding announcements than had been set out in the Financial Strategy last month.