This was a revenue-raising budget to fund investment in public services, but one that kicks some of the more difficult spending decisions into future years.

The economic backdrop

The first budget of the Scottish Parliament's new session was delivered against a challenging economic backdrop.

Scotland's growth rate over the past year to eighteen months has been around a third the rate of the UK as a whole.

Unemployment is now slightly higher in Scotland than in the UK, and the employment rate is about a percentage point lower (73.3% versus 74.4%).

How Scotland's economy performs relative to the rest of the UK is now crucial for future Scottish Budgets with major new tax powers being transferred from April next year.

Boosting economic growth

Against this backdrop, the budget contained a number of policies designed to boost economic growth. These include:

- Cuts to Non-Domestic Rates (business rates), including a reduction in the headline poundage, an expansion of the Small Business Bonus Scheme, and limiting the scope of the large business supplement.
- Confirmation of the launch of the £500m (3-year) Scottish Growth Scheme, providing access to finance to Scottish businesses.
- Investment in digital connectivity and house building.

But whether or not these measures are sufficient to cut the growth gap with the rest of the UK remains to be seen.

These new initiatives also come alongside challenging settlements for the Enterprise, Energy & Tourism budget line (primarily on capital) and higher education resource. We await detail on the underlying drivers of these changes, but it is clear that elements of these budgets, which many see as important for long-term growth, are likely to be under pressure next year.

Raising revenue

Notwithstanding the cuts to Non-Domestic Rates, this was a revenue raising budget with the aim of providing additional resource for public services.

The centre piece of Mr MacKay's Budget statement was confirmation that the Scottish Government plans to set a different income tax policy to the UK.

From April 2017, Scottish taxpayers will start paying the 40p higher rate of tax on incomes above £43,430, compared to a UK threshold of £45,000.

There are two ways to view this:

- On the one hand, the Scottish Government is not actually taxing people more than they were last year – provided their earnings rise with inflation – but instead they are choosing to avoid passing on a tax cut that is being implemented elsewhere in the UK.
- On the other hand, it is now the case that middle-to-high earners in Scotland will face a higher tax burden – of around £300 per annum (or just over £25 per month) – than people earning exactly the same amount elsewhere in the UK.

In 2017-18, this income tax policy is expected to raise an additional £79m for public services. This estimate will of course be sensitive to assumptions about inflation and earnings growth.

As a proportion of income, the income tax policy will hit those earning just above the higher rate threshold harder than it hits those earning substantially above the threshold. This is because the tax increase – relative to the rUK policy – is £300 per annum, regardless of whether one earns £50,000 per year or £100,000 per year. The policy will affect around 20% of full-time male employees and just over 10% of full-time female employees next year.

Whilst a relatively small change next year, the Scottish Government also announced their intention to continue with this indexation policy up to 2020-21, so the gap between Scotland and the rest of the UK will widen over time. By 2020-21, Scottish higher rate taxpayers are likely to be paying an additional £700 per year (or around £60 per month) more in income tax than the rest of the UK.

The other tax increase is the pre-announced plan to increase the Council Tax band multipliers on higher value properties in bands E to H, estimated to raise around £110m. This will increase the annual tax liability of properties in bands E, F, G and H by around £105, £207, £335, and £517 respectively.

Taken together, the income tax and council tax policies can be seen as generally progressive polices that raise revenue from relatively high income earners and those in relatively high-value homes. However, council tax remains a broadly flat tax and, in the absence of recent property valuation, the council tax policy is likely to be less progressive than in might be.

On their own, the income tax rises and council tax changes may appear relatively modest, but combined they represent a more decisive shift to raise income from middle to higher earners to fund public services. A family with one higher earner living in a Band G house will face a tax bill next year of around £600 as a result of the decisions taken today.

Portfolio spending

Overall there will be a 1% real terms increase in the Scottish Government's departmental resource spending next year.

In the table below we compare the likely final budgets for 16-17 with the draft budget for 17-18. Up until last year, only draft budget figures were prepared for comparison. Final budgets include in-year adjustments which stem from possible Barnett consequentials, transfers between portfolios and monies that may be unallocated at draft budget time but which will turn be re-distributed in year. For example, this year the draft budget figure for Finance and Constitution includes around £100 million of spending to support the delivery of Scotland's new fiscal powers. Final year budgets are however useful in that they show how much was actually spent in the current year relative to plans at the current moment in time.

The breakdown by portfolio is shown below.

	2016/17 RDEL Draft Budget	**2016/17 RDEL Budget**	**2017/18 RDEL Draft Budget**	**% change Budget to Draft Budget**
Health and Sport	£12,414	£12,330	£12,536	2%
Finance and the Constitution	£75	£96	£170	77%
Education and Lifelong Learning	£2,608	£2,676	£2,636	-1%
Justice	£2,438	£2,439	£2,453	1%
Economy Jobs and Fair Work	£231	£228	£243	7%

Communities Social Security and Equalities	£6,960	£7,034	£6,891	-2%
Environment Climate Change and Land reform	£162	£164	£162	-1%
Rural Economy and Connectivity	£1,382	£1,387	£1,438	4%
Culture Tourism and External Affairs	£260	£263	£289	10%
Administration	£180	£180	£177	-2%
Crown Office and Procurator Fiscal Service	£109	£110	£106	-4%
Total Scottish Government	**£26,819**	**£26,907**	**£27,101**	**1%**

Clearly within these numbers money will have shifted around quite significantly. We await the detailed Level 4 figures to scrutinise the numbers in more detail.

Local government

Finance Secretary Derek MacKay announced that spending on local government services would increase by around £270m in 2017/18 relative to 2016/17.

Unpicking this number is complex and there are a number of components to this increase.

On the one hand, the resource grant to local government will actually fall by £130m, whilst redistributed Non-Domestic Rate revenues will fall by £163m.

However, spending on local authority education will also receive £120m through the Attainment Fund. Local authority social care workers will also benefit from the £107m new investment in the health budget for Health and Social Care integration which, in part, will support the delivery of the Living Wage for care workers.

Local authorities will see their capital allocation increase by £157m. Crucially, they will now be able to retain for themselves the additional revenues from the increase in council tax bands E-H in their areas (raising £110m), and have the flexibility to increase council tax by 3% overall (raising £70m).

The net effect is that the Cabinet Secretary is able to say that the amount of money available to spend on local services could increase by up to £270 million but much of it comes with strings attached – such as the £120 million to be given to schools and the £107 million for health and social care – and an increase in local tax bills.

Clearly the debate over local government finance will continue for some time yet!

Looking to the future

The Cabinet Secretary arguably had a relatively straightforward task this year – with £700 million extra to spend through a combination of £500 million additional block grant and £200 million from his tax policies.

But we know that this pause in fiscal consolidation is temporary.

More difficult challenges will come in 2018/19 and 2019/20, which will see the budget being cut by 1.9% and 1.4% respectively in real terms (around £800 million). With commitments on childcare and health continuing to bite in those years, more difficult decisions await the Cabinet Secretary later this parliament