

The 2018 budget was yet again underpinned by some fairly underwhelming projections for economic growth over the next few years – the outlook for which has not changed materially since spring.

But Mr. Hammond's budget was boosted by the fact that economic growth has proved relatively more 'tax rich' recently than had been forecast.

The Chancellor has spent all of this spending windfall, whilst achieving early his 'fiscal mandate' – that the cyclically adjusted deficit should remain below 2% of GDP from 2021, and his 'supplementary target' (that debt should fall as a percentage of GDP 2020/21).

From the perspective of the upcoming Scottish budget, which will be presented by Derek Mackay on 12 December, the UK Budget contained two major announcements.

The first of these had in fact been unveiled by the Prime Minister in June and was confirmed by Mr. Hammond today. The increase in funding for the NHS is expected to generate consequential for the Scottish budget of around £600m in 19/20.

The second big piece of news was on the tax side, with the announcement that Mr. Hammond will deliver on the Conservatives manifesto commitment to raise the income tax personal allowance to £12,500 and the Higher Rate Threshold to £50,000 one year prior to anticipated.

The increase to the Personal Allowance will apply in Scotland, representing a tax cut for the majority of Scotland's 2.5 million income taxpayers. But under Scotland's Fiscal Framework, this won't have a direct impact on the Scottish budget.

The increase to the HRT will not apply in Scotland. But the Scottish Government will face a dilemma in deciding how to respond to the increase in rUK. At £43,430, the HRT in Scotland is already significantly lower than the HRT in rUK (which is currently £46,351). This raises the Scottish Government useful revenue – over £300m – compared to setting the threshold at the UK rate.

But even if the Scottish Government were to increase the HRT in Scotland by inflation in 19/20 (taking it to around £44,500), the gap between the threshold in Scotland and rUK would be substantial. Whilst this would help boost the resources available to the Scottish budget, taxpayers earning £50,000 in Scotland would face an income tax bill more than £1,100 higher than rUK counterparts as a result of this difference alone. Moreover, Scottish taxpayers would face a very high marginal rate of earnings taxation of 53% over an

increasingly large proportion of income (employees with income between the Scottish HRT and the rUK HRT would be taxed at 41% by the Scottish Government, plus 12% for National Insurance Contributions; the employee NICs rate drops to 2% above the UK HRT).

So for every £100 of additional wages employees in this gap would earn, over £50 would be taken away by taxation.

Whilst the Scottish Government will face huge pressure to increase the HRT by more than inflation, this option is likely to be less palatable to the Scottish Greens, whose support to the government has been critical to getting the last two budgets through the parliamentary process.

There were other, smaller announcements today which will also have implications for the Scottish budget. The 2018/19 capital budget will be boosted by around £80m as a result of announcements of additional funding for fixing pot-holes and supporting schools maintenance in England. There will also be modest increases to the 2018/19 resource budget flowing partly from increases in social care spending.

There were also a number of small tax changes which may influence Derek MacKay's choices as he prepares the Scottish budget. Stamp Duty reliefs for first time buyers have been marginally extended but will not apply to Scotland's Land and Buildings Transactions Tax. And new reliefs in English business rates (in particular for smaller retailers) will result in small funding increases to the Scottish budget in 2019/20 - with which Mr. Mackay could choose to fund similar policies in Scotland, or something else entirely.

So is austerity over? The Scottish Government's resource block grant from Westminster will increase marginally in real terms in 2019/20 compared to 2018/19. And the block grant will be slightly higher in 2019/20 than it was at the end of the last parliament, in 2016/17.

So the outlook has definitely improved, compared to the position two years ago, when real terms cuts to the resource block grant of over 2.5% between 16/17 and 19/20 were pencilled in.

Beyond 2019/20, Phillip Hammond said that resource spending would increase by 1.2% in real terms in the next spending review period, and this level of increase will be expected to feed through - more or less - to the Scottish block grant.

How the Scottish Government chooses to distribute real terms increases in the budget in 2019/20 and beyond will be for it to set out. But it seems almost inevitable that the

## UK Budget 2018: Additional spending but tax dilemmas for the Scottish Government

consequential announcements announced today will be passed on to the NHS in Scotland, given political commitments made and the scale of growth in demand for health and social care services.

So whilst real terms cuts to the overall resource budget appear to have been consigned to the past, we are unlikely to have seen the end of real terms budget cuts to unprotected portfolios.

We'll discuss all of this and more in next week's Scotland's Budget: 2018 report.