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Scotland's new Budget Framework

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Just to recap

- Holyrood will soon oversee a budget of approx.: £40bn
- Around 40% of 'devolved expenditures' will be funded by revenues raised in Scotland – rising to 50% once around half of VAT revenues are assigned.
- Scotland's budget will now depend upon three key elements –
 - The remaining Westminster block grant as determined by 'Barnett Formula';
 - Tax policy choices of the Scottish Government; and,
 - The *relative* performance of Scottish devolved tax revenues.

The revenues being transferred

Tax	Date	Revenues (2015/16, £m)	Arrangement
Land and Buildings Transactions Tax	2015/16	£416	Fully devolved
Landfill Tax	2015/16	£147	Fully devolved
NSND Income Tax	2017/18	£11,214	Vary rates and bands
Air Passenger Duty	2018/19	£275	Fully devolved
Aggregates Levy	tbc	£53	Fully devolved
VAT	2019/20	£4,982	Partial assignment

Source: GERS, Scottish Government

Scotland's new welfare powers

- 3 sets of powers –
 - Flexibility in how certain elements of Universal Credit are paid
 - Devolution of benefits (worth around £3bn by 2020-21)
 - 1) Benefits tied to ill-health and disability
 - 2) Elements of the Regulated Social Fund
 - Top up existing UK Benefits and/or introduce new benefits

The Block Grant Adjustments (BGAs)



- Purpose of BGA: counterfactual estimate of tax revenues foregone by UK Government post devolution
- What is this counterfactual after year 1? Growth in devolved taxes per head in rUK.
- So, if Scottish revenues grow faster than BGA, Scottish budget is better off than without tax devolution.....and vice versa

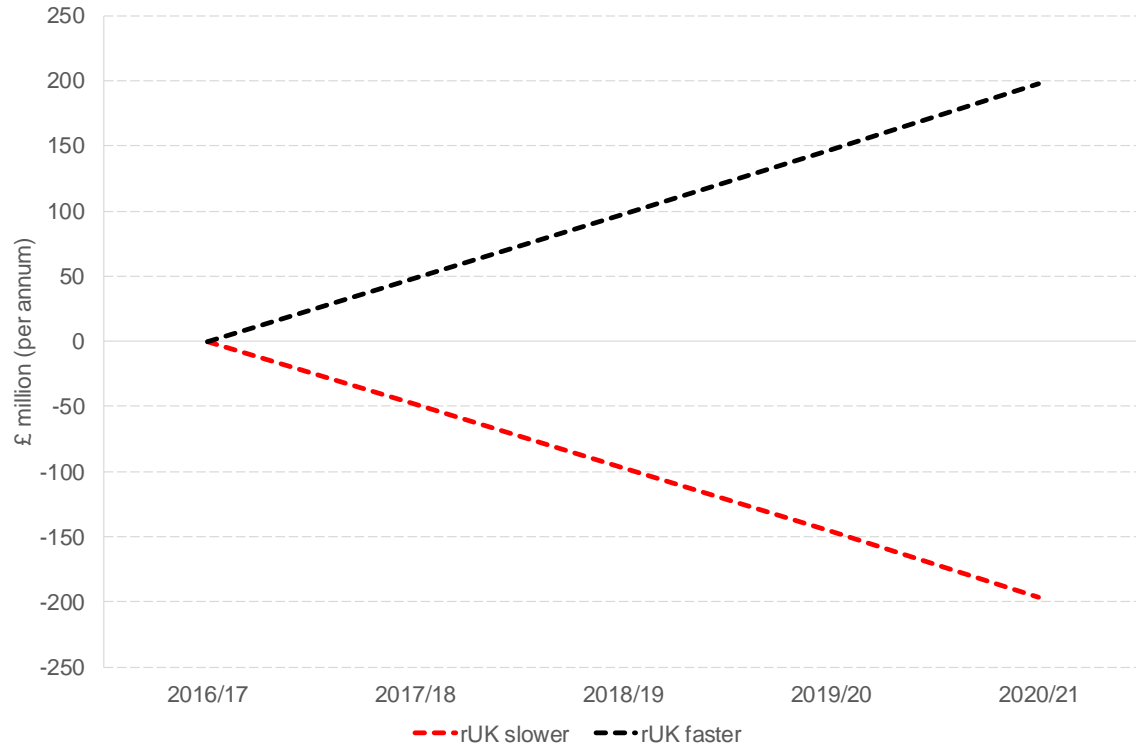
Issue 1: Operation of new framework – key things to watch for

- Highly complex – Budget Review Group reviewing scrutiny process
- Intergovernmental relations
- Institutional reform – Scottish Fiscal Commission
- Budget management – borrowing, cash-flow, Scotland Reserve
- Remember...still temporary: BGA to be reviewed in 2021

Issue 2: Economic uncertainties, challenges & opportunities

- Smith's principal aim was to give Scottish Parliament greater risk and reward
- Economic outcomes feed through to budgets – with this comes opportunities/risks and practical challenges
- Borrowing powers cover only forecast error....not disappointing economic results
- Exception are emergency borrowing powers....believed to be required on vary rare occasions.....but in play already for 17/18 given Scotland's sluggish growth rate

Effect on Scottish budget (£m) – just 0.3% point variation

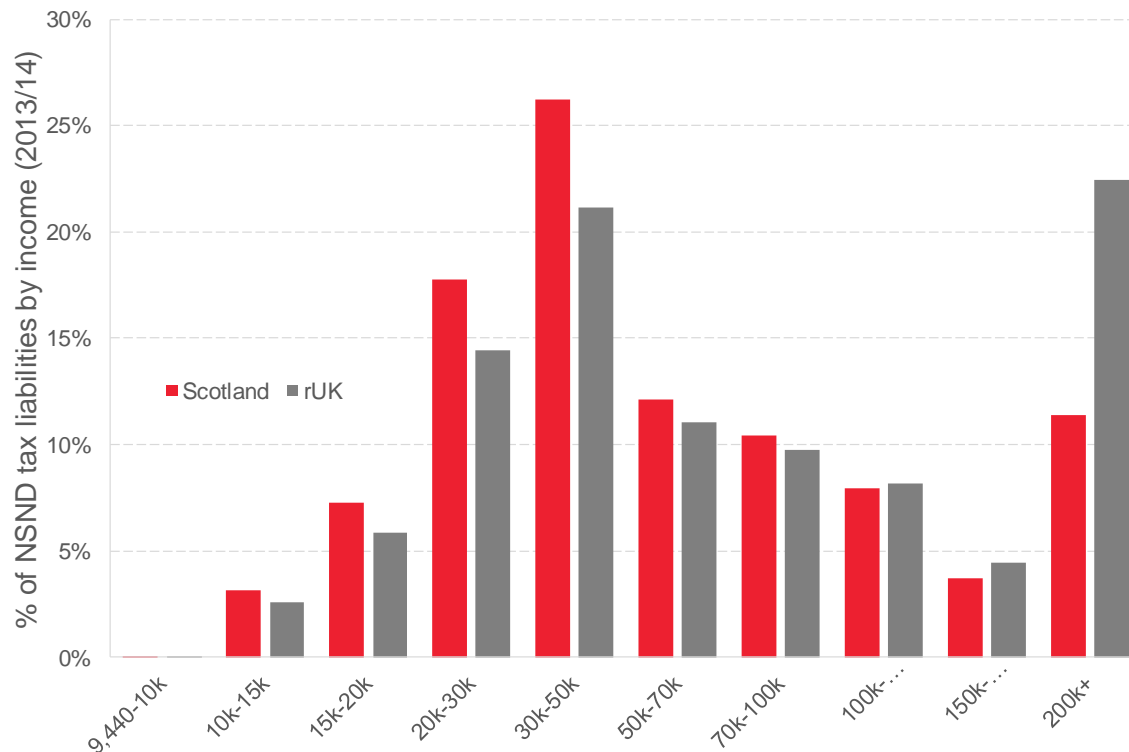


Source: FAI calculations based upon HMRC KAI Data, Policy and Co-Ordination. (2016). Survey of Personal Incomes, 2013-2014: Public Use Tape. [data collection]. UK Data Service. SN: 8044, <http://dx.doi.org/10.5255/UKDA-SN-8044-1>.

Issue 3: Using the new powers

- New powers give Scottish Government unprecedented power over tax and spend.
- What is our tax policy for Scotland? Do we know the effects of pulling ‘tax levers’?
- Three key policy uncertainties:
 1. How might policy change economic behaviour?
 2. How might policy change tax choices: e.g. incorporation, dividend income?
 3. How might identical UK-wide policies lead to surprising outcomes given differences in income distribution?

Example: Surprising results of Personal Allowance increases or UK-wide 50p tax rate



More (and richer) AR tax payers in rUK vis-à-vis Scotland

50p rate across UK (exl. behaviour effects) will increase Scottish tax revenues by less than in rUK.

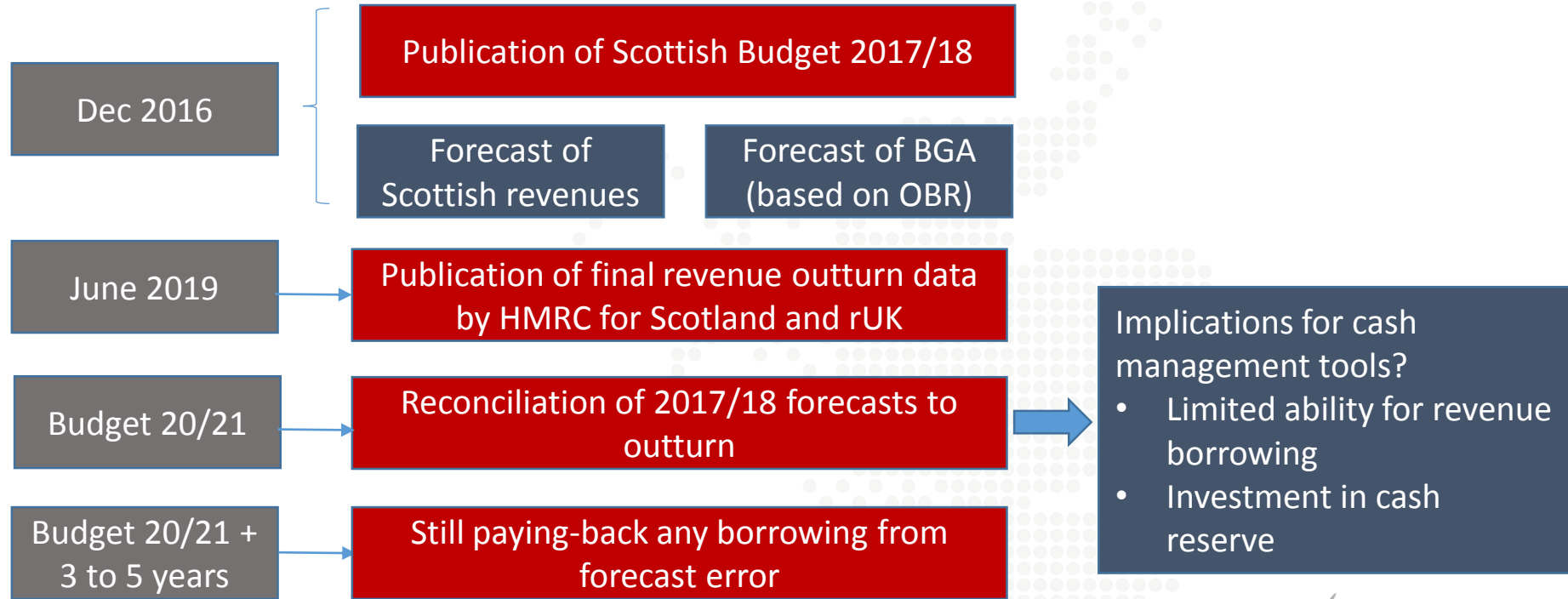
BGA > Scottish tax revenues

Offset if rUK revenues are spent on health

Issue 4: Forecasting, reconciliation and accountability

- Annual budget cycle will now be heavily dependent upon forecasts made by Scottish Fiscal Commission and OBR – for taxes, welfare spending and the BGAs
- Forecasting isn't easy – even in normal times!
 - Economic uncertainties
 - Data
 - Methodologies and institutional capacity

Issue 4: Forecasting, reconciliation and accountability



Conclusions

- New fiscal powers provide SG greater ability to pursue different policies to rUK and capture fiscal benefits of good policy
- Fiscal framework adds a significant degree of complexity to Scottish budget process
- Alongside opportunities come risks - exposes Scottish budget to forecast error, volatility & differential growth in tax-base that may be unrelated to policy
- Will potential benefits outweigh the risks?