



UNIVERSITY of STRATHCLYDE
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Scotland's Budget 2019

The context and outlook for the Scottish Budget



November 2019





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The context for the Scottish Budget

Mairi Spowage



The Scottish Budget process

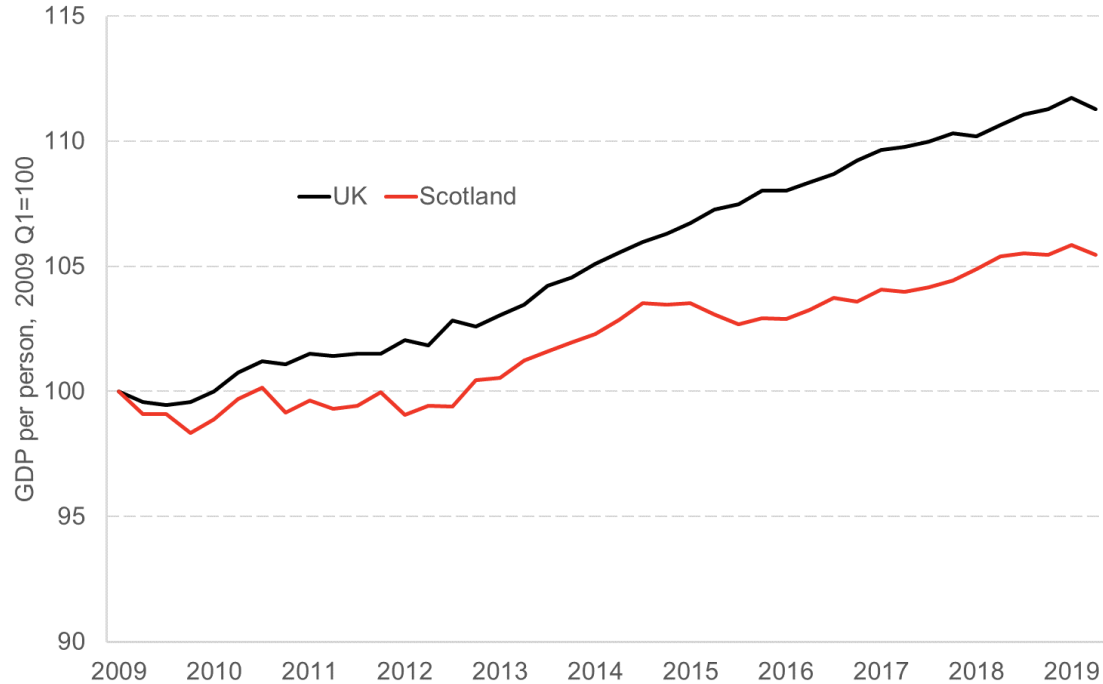


- › BGA: counterfactual estimate of tax revenues foregone by UK Government
- › What is this counterfactual? Growth in devolved taxes per head in rUK.
- › So, if Scottish revenues grow faster than BGA, Scottish budget is better off than without tax devolution.....and vice versa

A reminder... the fiscal framework

- › Even after all Smith powers have been incorporated into the Scottish Budget, the amount of money that Holyrood has to spend will still be determined predominantly by UK decisions
 - › However, with over £12bn of devolved taxes at their disposal, the performance of these Scottish taxes – and the economy that drives them – is also important.
 - › Under the Fiscal Framework, a deduction is made to the Scottish block grant to reflect the fact these taxes are devolved, the so-called Block Grant Adjustments (BGAs)
 - › What matters for the Scottish budget is how Scottish tax revenues are faring *relative* to these BGAs and, therefore, how quickly Scottish revenues per capita are growing *relative* to the growth of tax revenues in the rest of the UK.
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Economic Divergence



➤ The importance of relative economic performance makes the divergence in the growth rate an issue ...

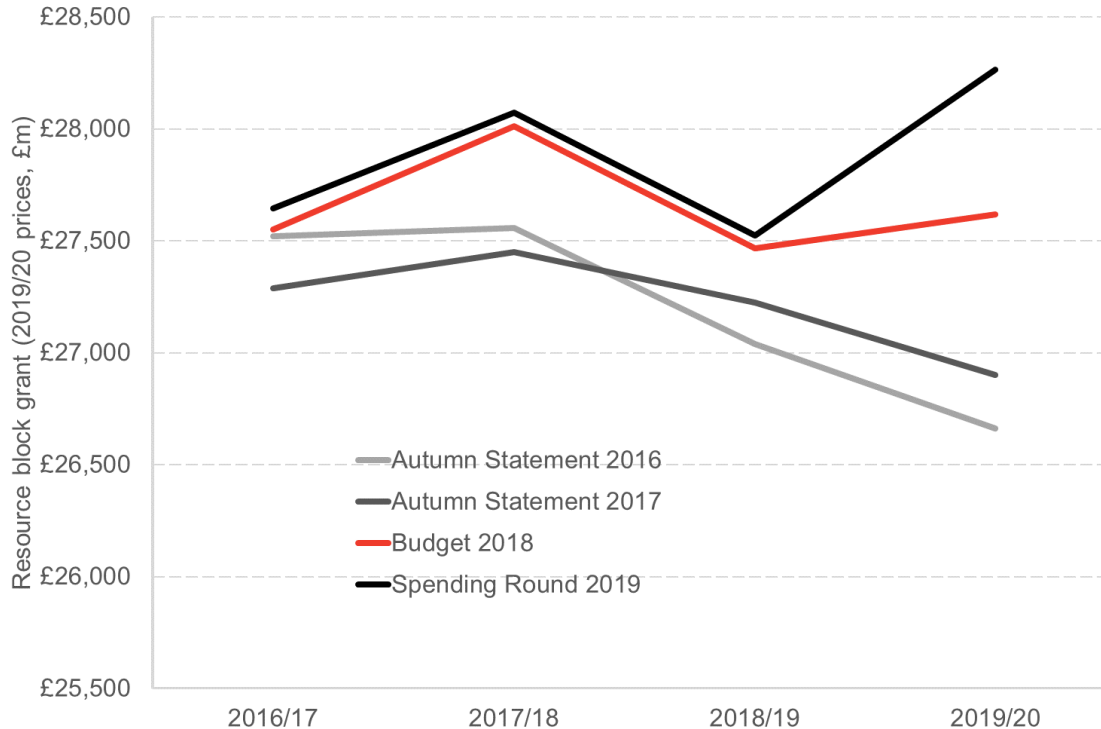
Risks to Scottish Budget

The Scottish budget is now exposed to two types of risk:

- › The risk that the Scottish tax base grows relatively more slowly than the equivalent tax base in rUK. The implication of this is that the Scottish budget is worse off than it would have been had tax devolution not occurred.
- › The risk of forecast error. This is the risk that a Scottish budget is based on a set of forecasts that turn out to have been too optimistic. If this happens, then a subsequent budget will need to address any shortfall.

Of course, there are upside risks too. Should forecasts be too pessimistic then the budget will be boosted in subsequent years.

Evolving Scottish Budget Envelope



› The outlook for the Scottish Budget is much more positive than thought in 2016

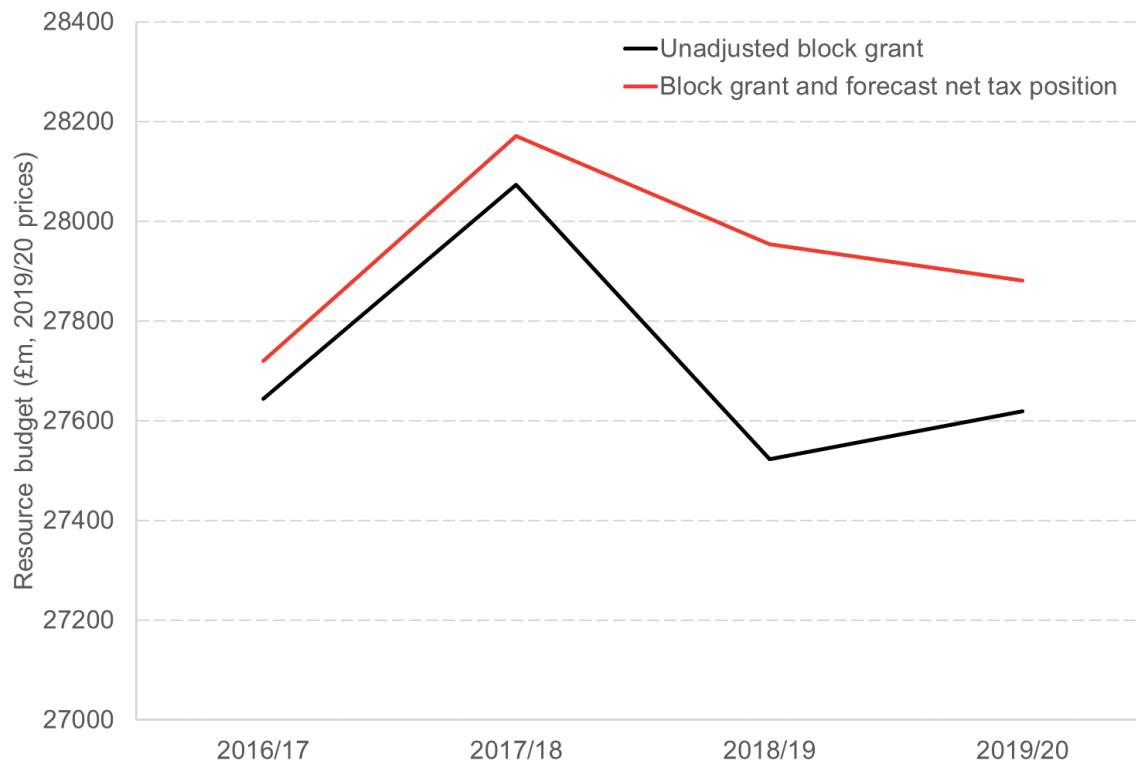
› Income Tax

- The decision to freeze the Scottish higher rate threshold in 2017/18 was anticipated at the time to raise around £100m in additional revenues;
- the introduction of the five-band structure in 2018/19 was forecast to raise just over £400m; and
- the freeze of the higher rate threshold in 2019/20 was forecast to bring in an additional £500m.

› LBTT – Change in Structure – more “progressive”

› Non-Domestic Rates – more “competitive”?

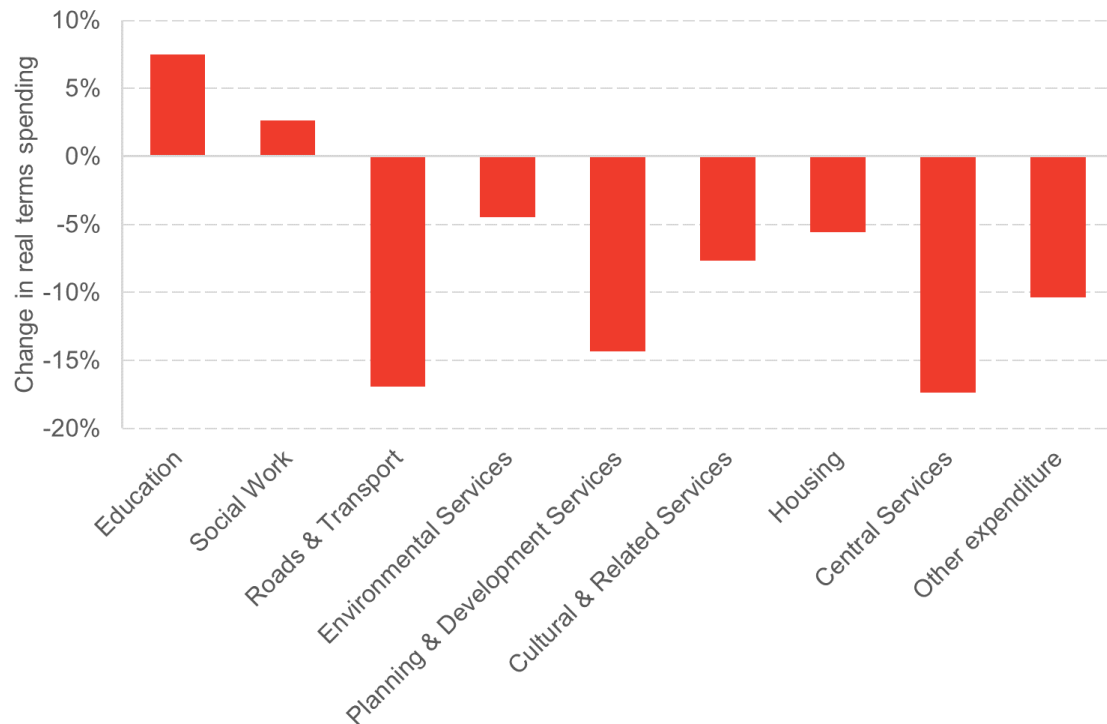
Effect of tax policy decisions



› These policy decisions have meant that there are more resources available to the Scottish Government at Budget time than otherwise would have been the case...

- › Scottish Government resource spending has increased by £1.05bn in real terms between 2016/17 and 2019/20:
 - Increase for Health: £780m in real terms, or 5.2%
 - New social security and employability responsibilities account for £350m
 - Therefore spending on non-health, non social security has fallen since 2016-17
 - LG has taken the biggest hit, with a 2% fall in funding
 - Other areas, such as higher education, also squeezed
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Local Government Spending Changes



› Changes in LG spending between 2016/17 and 2019-20 in real terms



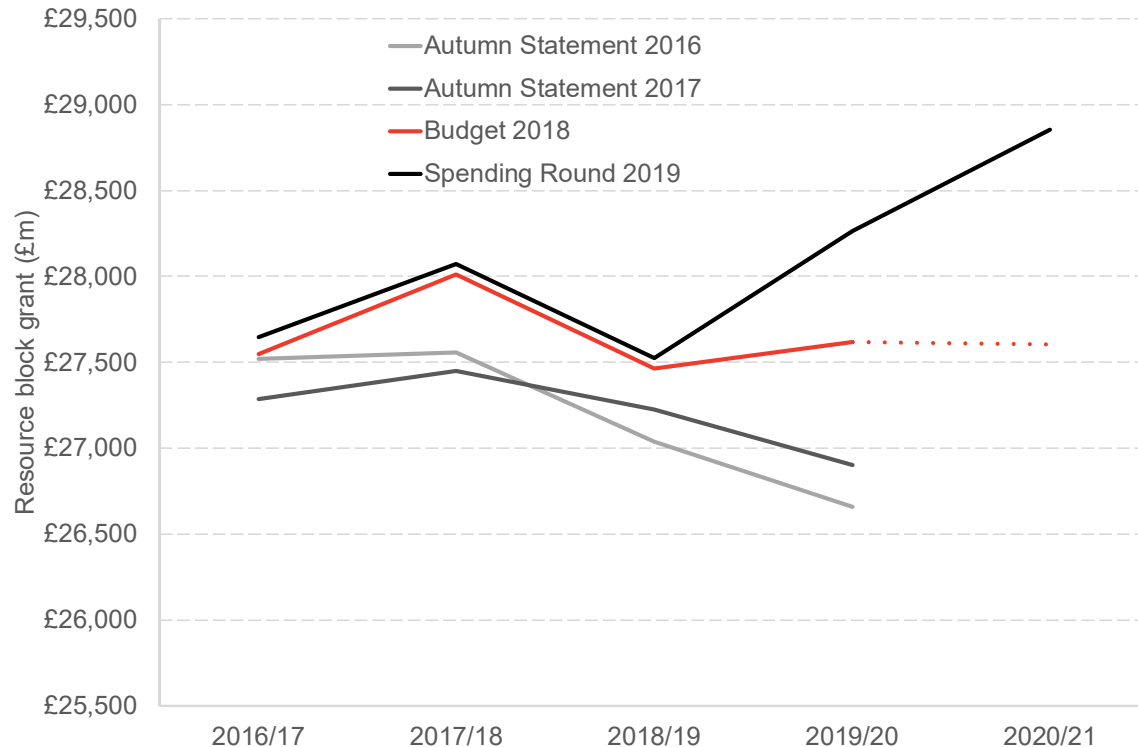
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The outlook for the Scottish Budget

David Eiser



The block grant: an improving outlook

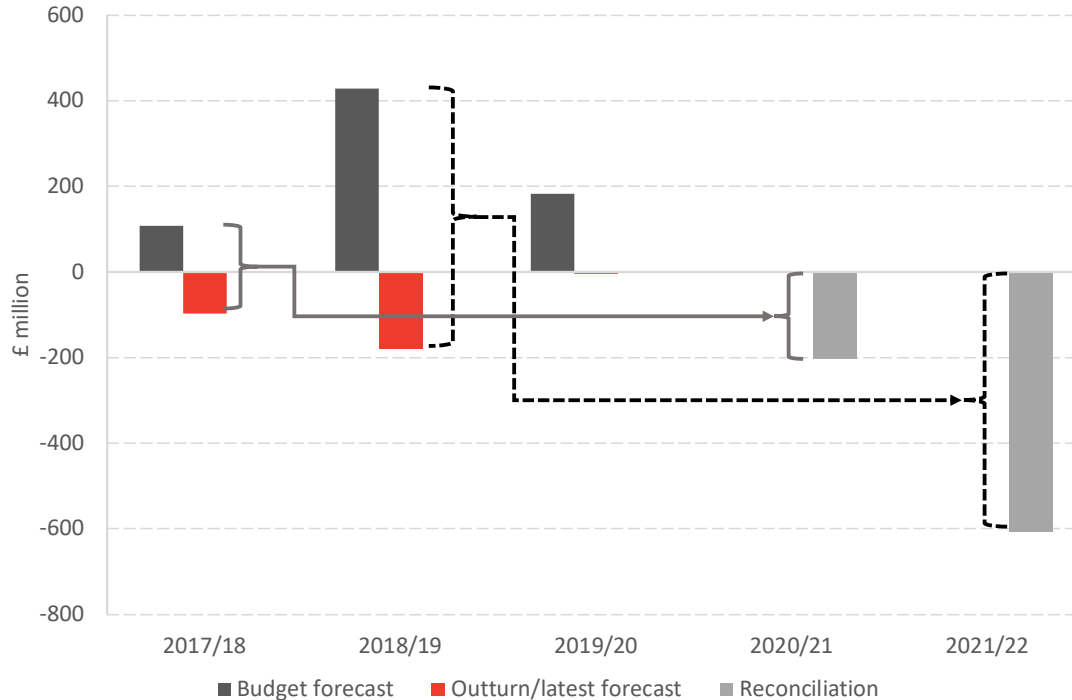


- › Block grant will increase £1.1bn next year (2.1% real terms)
- › On basis of existing UKG spending commitments, and UK parties' proposed fiscal rules, similar rate of increase in 2021/22 seems likely

But a weaker outlook on income tax

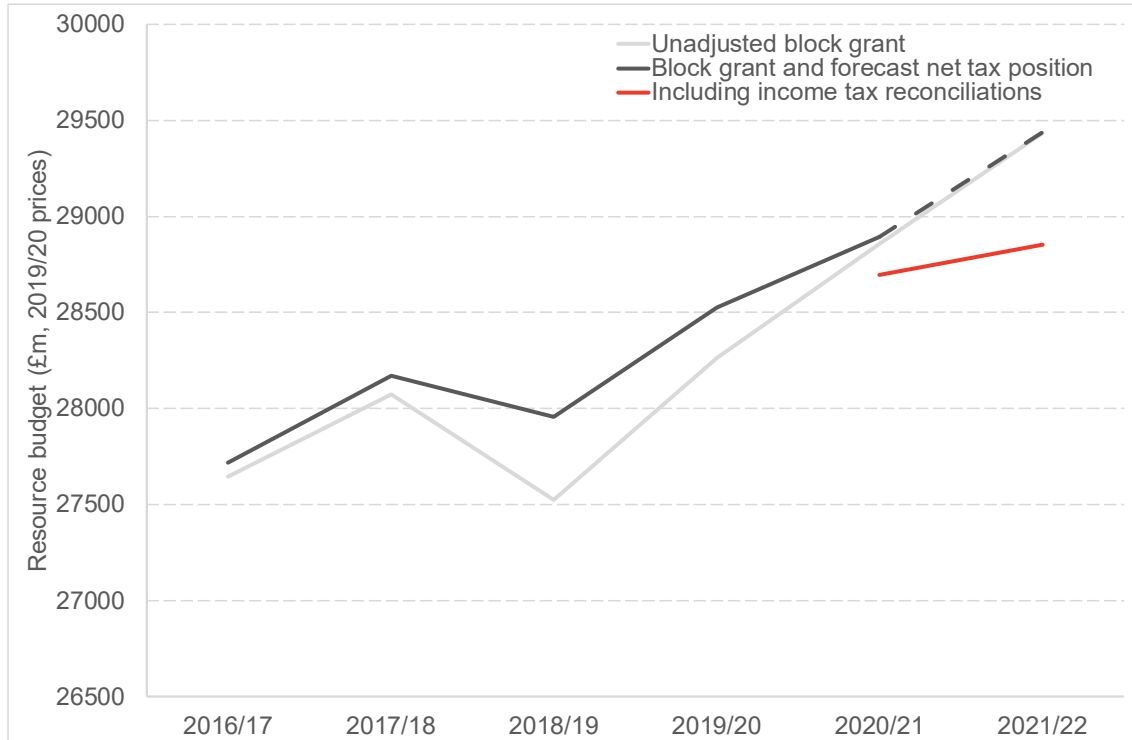
- › But two factors relating to income tax will offset this positive story:
 - The first is that the block grant in 2020/21 (and 2021/22) will be reduced to reflect lower than forecast Scottish tax revenues in 2017/18 (and 2018/19).
 - The second is that – on the basis of the latest forecast – Scottish income tax will contribute less to the next two budgets than was the case in the last two years.
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Forecast error and reconciliation...



- The 2017/18 budget was planned on an assumption that SG would have £204m more resources available to it than we now know to be the case
- Downwards adjustment of £204m (reconciliation) will apply to the 2020/21 budget to reflect this forecast error
- Much larger reconciliation in 2021/22?

...results in a weaker overall outlook



- › Latest forecasts for 2020/21 and 2021/22 imply a continuation of slightly weaker growth in income tax base (earnings)
- › Offsetting 'revenue boost' of tax policies
- › Implication (of latest forecasts/projections) is that budget will grow <1% per annum next two years

Social security payments: major new fiscal risk

Forecast expenditure (£m)	2020-21
Carer's Allowance (inc. supplement)	£344
Discretionary Housing Payments	£66
Best Start Grant	£16
Funeral Support Payment	£7
Attendance Allowance	£530
Cold Weather Payments	£16
Disability Living Allowance	£628
Industrial Injuries Benefit	£82
Personal Independence Payment	£1,607
Severe Disablement Allowance	£8
Winter Fuel Payment	£168
Total	£3,472

- › Full administrative control and policy autonomy for new social security benefits will rollout gradually to 2024/25
- › But financial responsibility will transfer in full in April 2020
- › ...exposing Scottish budget to new spending risks

Implications for spending

- › Government has existing spending commitments on health, police, educational attainment, and childcare
 - › Together with ‘new’ commitments on social security (including Carer’s Allowance Supplement and new income supplement)
 - › Implication of these commitments given latest projections is that other areas of spending could see real terms spending declines
 - › Size of spending constraint on ‘other’ areas will depend on size of reconciliation in 2021/22, extent of resources in Scotland Reserve, and UKG fiscal choices
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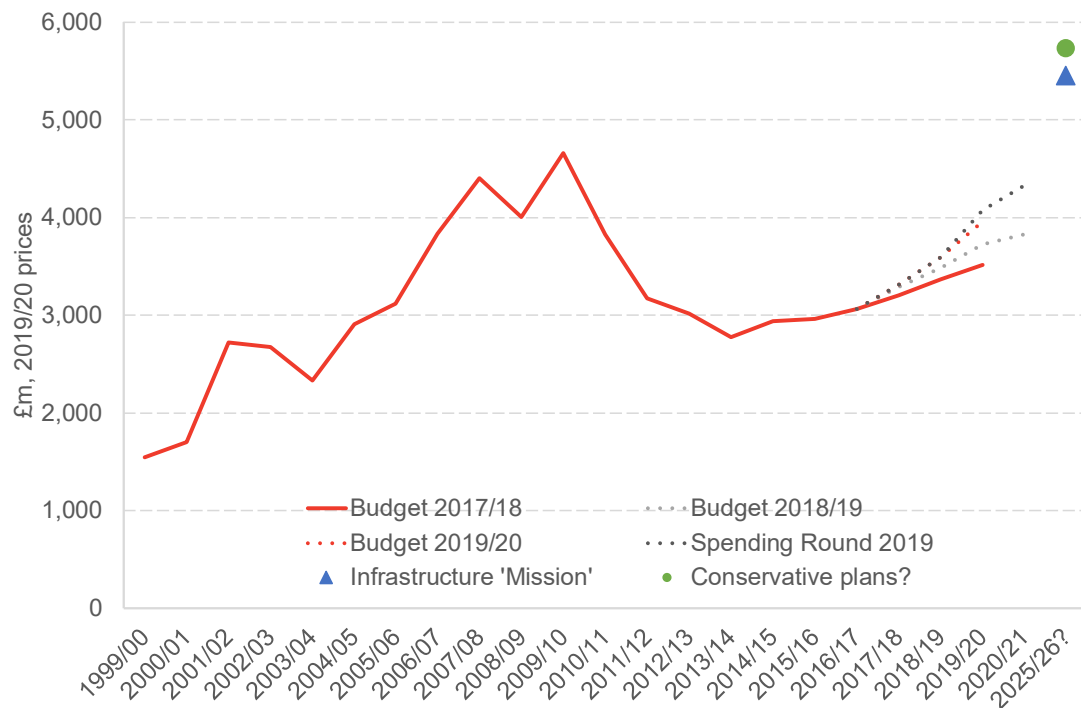
Uncertainties (1): UKG tax and spend

- › Budget depends on UK spending decisions – which affect the block grant – and how these are funded
 - › UK tax policy changes – for taxes that are devolved to Scotland – can affect the size of the block grant adjustment...
 - › Potentially constraining SG policy choices but also potentially creating opportunities
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Uncertainties (2): The economic outlook

- › Growth of Scottish tax base (e.g. earnings) relative to rUK critical in determining size of Scottish revenues relative to BGA (the 'net tax' position)
 - › Latest forecasts imply relatively weak growth in Scottish earnings over coming years.
 - › But 'latest' forecasts already 6-8 months old
 - › Some more recent economic data paints a slightly more positive story
 - › Budget outlook depends on how forecasters interpret this in light of longer-term trends
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Outlook for capital spending



- › Programme for Government 2018 announced infrastructure 'Mission' to increase capital spend by £1.5bn by 2024/25
- › Seemed ambitious at time, but given UK parties' election commitments, could be achieved without need for any further borrowing or 'innovative' finance

- › Changing fiscal responsibilities and mechanisms
 - New social security powers
 - Replacements for EU funding
 - The fiscal framework review
 - › Fiscal pressures and challenges
 - Fiscal challenges of demographic change
 - Fiscal roles and responsibilities of local government
 - › The way in which budgets are and budget decisions are made
 - A wellbeing budget?
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- › Austerity 'over' but remains a challenging outlook
 - › Substantial uncertainty, both in terms of:
 - The financial outlook... (block grant, BGAs and tax revenues – outturn and forecasts)
 - ...but also in terms of evolving nature of budget responsibilities, risks and challenges
 - › Timing of the Scottish budget
 - Implications for scrutiny and transparency?
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