



The Fiscal Framework and the Scottish Budget Process: Some Thoughts

David Phillips

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Coming up

- Operation of the fiscal framework
 - Who forecasts what
 - Initial adjustments and reconciliations
- Transparency of operation of fiscal framework
 - Publishing full breakdown of BGAs
- The timing of the Scottish Government's budget
 - Barnett Consequentials and tax forecasts
- Brief comment on Welsh Fiscal Framework

Operation of FF

- OBR is responsible for forecasting rUK revenues and BGA
- Scottish Fiscal Commission responsible for forecasting Scottish Revenues
 - Its forecasts are used to pay over Income Tax from HMRC
- What if their forecasts of revenues / welfare differ?
 - BGA and payments of Scottish revenues from HMRC differ because of differences in forecasts of overall UK revenue outlook
 - Not because either side thinks Scottish revenues will under or over-perform relative to UK revenues

OBR's Forecasts and BGA

- Year 0 = Year before a tax is devolved
- Year 1 = Year it is first devolved
- Year 2 = Following year, and so on
- *Initial* BGA for Year 1 based on Year 0 revenues increased by OBR's Autumn Year 0 *forecast* per capita revenue growth in rUK in Year 1
- Actual *outturns* for revenue growth in rUK in Year 1 become available in Year 2
- And BGA in Year 3 then incorporates a reconciliation for Year 1 to account for discrepancies between Year 1 *forecasts* and *outturns*
- *Initial* BGA for Year 2 based on *Initial* BGA for Year 1 increased by OBR's Autumn Year 1 *forecasts* for growth in rUK in Year 2
- Subsequent reconciliation required for both *Initial* BGA for Year 1 and *forecasts* for growth in rUK in Year 2 being wrong

SFCs Forecasts and Revenues

- Year 0 = Year before a tax is devolved
- Year 1 = Year it is first devolved
- Year 2 = Following year, and so on
- SFC forecasts Year 1 revenues at Draft and Final Budget stage in Year 0; latter is used to determine what HMRC pays over
- Outturns for Year 1 revenues become available in Year 2
- Adjustment made in Year 3 to account for differences in what HMRC paid over in Year 1 (based on forecasts) and outturns
- Process repeated for Years 2, 3, 4, etc

Transparency (I)

- Change in BGA in any year will include
 - Impact of forecast growth in rUK
 - Impact of reconciliations
- Reconciliation also required for HMRC-collected taxes when outturns differ from forecasts
- As much information about make up of the BGA and Tax Revenues accruing to Scottish Govt should be made as possible
 - Is BGA going up or down because of changes in revenues/spending in rUK or because of reconciling previous forecasting errors
- At a minimum should publish full BG, BGA and net BG separately
 - Is net BG falling because of rUK cuts or rUK revenue growth?
 - Is Scotland losing because of cuts to full BG or its revenues not keeping pace with rUK and the BGA?

Transparency (II)

Funding Source	2019-20
Underlying block grant	30,000 million
Block Grant Adjustment (BGA)	- 10,000 million
<i>Of which</i>	
Initial BGA wrt 2019-20	- 9,890 million
Reconciliation of 2017-18 BGA	- 110 million
Scottish Revenues	+ 10,400 million
<i>Of which</i>	
Forecast revenues for 2019-20	+ 10,450 million
Reconciliation of 2017-18 revenues	- £50 million
Overall Budget	30,400 million

- In principle, should do BGAs by tax and spend item, perhaps in an annex

Transparency (III)

- FF says BGAs will be ‘effected using the comparable model while achieving the outcome delivered by the indexed per capita method’
 - Clearly nonsense
 - Just means IPC method will be used
- How prominent make separate BGAs according to both IPC and CM methods?
 - Additional figures cause confusion?
 - But good to show how Scotland would fare under CM method to facilitate understanding in advance of renegotiation?

Timing of Budget (I)

- Analysis undertaken by D Eiser for group addresses key issues for considering timing of Draft Budget
 - Revisions to rUK forecasts (underlying and policy) affect BGA
 - Extent to which similar forecasting changes in Scotland, offset impact on overall budget
 - Already risk related to changes in Barnett block grants
 - Trade off between time to scrutinise general direction/priorities revealed in Draft Budget, and accuracy of underlying budget envelope and therefore specific allocations
- Since his analysis, announcement of UK Autumn Budget as main fiscal event from next year
 - More scope for policy changes than in Autumn Statement, impacting BGAs?
 - No offsetting impact on Scottish revenues if policy rather than underlying forecast changes

Timing of Budget (II)

- Recent years, bigger policy changes in Budgets (Income Tax personal allowances)
- If the “Spring Statement” genuinely a pared back ‘update’ might expect importance of “Autumn Budget” to be even greater
- If so, risk of bigger changes before and after Autumn Budget than before or after Autumn Statement
- Stronger case for delaying Scottish Draft Budget?
- Question: Would it be possible for SFC to forecast BGAs based on early-Autumn data to facilitate early Draft Budget?
 - If SFC and OBR basically agree on underlying rUK revenues, likely better than relying on OBR March figures
 - If SFC and OBR forecast differently, maybe less good
 - And does not address policy change issue

Welsh Fiscal Framework (I)

- ‘Barnett floor’ to prevent convergence in spending to English levels
 - Barnett consequentials to be multiplied by 1.05
 - If/when level of comparable spend falls to 115% of England level, factor for multiplication of consequentials increase to 1.15
- BGAs indexed using the comparable model, meaning Wales bears revenue cost of slower-growing population
 - Separate BGAs by tax band for income tax: aim of reducing risk due to changes in inequality or policies affecting different parts of distribution
- Capital borrowing of £1 billion, relative to devolved revenues around twice Scottish level
- Good financial deal for Wales, but less good in terms of ‘logic’ and accountability

Welsh Fiscal Framework (II)

- UK Govt boosted Welsh budget (via Barnett formula changes) to get Welsh Govt. to accept comparable model
 - Looking ahead to renegotiation/review in Scotland?
- Similar deal probably not so good for Scotland
 - Needs-based assessment likely to be ‘challenging’ for Scotland
 - Cost of comparable model greater given much larger revenues devolved to Scotland
- Prepare for a battle over the Per Capita Indexed Method?