The Fiscal Framework and the Scottish Budget Process: Some Thoughts

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Budget Process Review Group, 19/12/2016
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)

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

- 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?