



The Scottish Parliament  
Pàrlamaid na h-Alba

## DEVOLUTION (FURTHER POWERS) COMMITTEE

### AGENDA

10th Meeting, 2016 (Session 4)

Thursday 3 March 2016

The Committee will meet at 9.00 am in the Mary Fairfax Somerville Room (CR2).

1. **Scotland Bill and Fiscal Framework:** The Committee will take evidence from—

John Swinney, Deputy First Minister & Cabinet Secretary for Finance, Constitution and Economy, Sean Neill, Acting Deputy Director of Finance, and Gerald Byrne, Constitution and UK Relations Division, Scottish Government;

and then from—

Rt. Hon David Mundell, Secretary of State for Scotland, Scotland Office, Rt. Hon Greg Hands, Chief Secretary to the Treasury, HM Treasury, and Francesca Osowska, Director of Scotland Office, UK Government.

2. **Scotland Bill and Fiscal Framework (in private):** The Committee will consider the evidence heard earlier in the meeting.

Stephen Imrie  
Clerk to the Devolution (Further Powers) Committee  
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Edinburgh  
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The papers for this meeting are as follows—

**Agenda Item 1**

Written evidence submissions

DFP/S4/16/10/1

PRIVATE PAPER

DFP/S4/16/10/2  
(P)

## **Devolution (Further Powers) Committee**

### **Fiscal Framework - Written evidence submissions**

#### **Introduction**

1. The Clerks contacted all witnesses who have given evidence on the Scotland Bill, since the publication of the Committee's Interim Report published in May 2015, and all witnesses who have given evidence on the fiscal framework. Annexed below are the responses that have been received to date from:
  - Professor David Bell, David Eiser and David Phillips (in a joint submission);
  - Professor David Heald;
  - Professor Anton Muscatelli;
  - Professor Paul Spicker;
  - Child Poverty Action Group Scotland;
  - Professor JD Gallagher and Professor IS McLean, Nuffield College Oxford;
  - Scottish Association for Mental Health (SAMH); and
  - Scottish Federation of Housing Associations.
2. It is likely that further responses will be received in advance of the meeting on Thursday. These responses will be e-mailed to Members and hard copies of any responses received will be available in hard copy at the Committee meeting.

#### **Action/recommendation**

3. Members are invited to take these submissions into account during their questioning of the witnesses.

**Clerking Team  
February 2016**

## ANNEXE

**JOINT SUBMISSION – PROFESSOR DAVID BELL, DAVID EISER AND DAVID PHILLIPS**

*David Bell is Professor of Economics at the University of Stirling  
 David Eiser is Research Fellow in Economics at the University of Stirling  
 David Phillips is Senior Research Economist at the Institute for Fiscal Studies  
 David Bell and David Eiser are both members of the Centre on Constitutional Change*

David Bell, David Eiser and David Phillips have been extensively involved in the analysis of key issues related to Scotland's new Fiscal Framework since the publication of the Smith Commission report. Our work has focussed most heavily on the question of the Block Grant Adjustment (BGA), notably through the publication in November 2015 of our first major report on the options and their effects<sup>1</sup>, and an update<sup>2</sup> on positions of the governments on the eve of the agreement being signed. David Bell has specifically commented on the funding of welfare powers within the Fiscal Framework<sup>3</sup>. We welcome the opportunity to provide a joint evidence submission to the Devolution (Further Powers) Committee outlining our views on the Fiscal Framework Agreement that has been reached between the two governments. Further detail will be published in our forthcoming report, due to be launched on 22 March in Edinburgh (we would be more than happy for committee members to attend this event, although we recognise it will take place after this inquiry has been completed).

**Block Grant Adjustment**

*The initial baseline adjustment to the block grant*

The initial baseline deduction for devolved tax (other than for the already devolved Landfill Tax and Stamp Duty Land Tax) will be equal to UK Government's receipts in the year immediately prior to the devolution of powers. This is a pragmatic and simple approach. There remain two unanswered questions:

- First, given that revenues in the year prior to devolution are likely to differ from those in which devolution occurs, how might any eventual

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<sup>1</sup> Bell, D., D. Eiser and D. Phillips (2015), 'Adjusting Scotland's Block Grant for new Tax and Welfare Powers: Assessing the Options', IFS Publication, available at: <http://www.ifs.org.uk/publications/8060>.

<sup>2</sup> Bell, D., D. Eiser and D. Phillips (2016), 'Adjusting Scotland's Block Grant: The options on the table', <http://www.centreonconstitutionalchange.ac.uk/sites/default/files/papers/Adjusting%20Scotlands%20Block%20Grant.pdf>.

<sup>3</sup> Bell, D. (2016). 'Funding Scotland's welfare powers', [http://www.scottish.parliament.uk/Papers\\_20160121.pdf](http://www.scottish.parliament.uk/Papers_20160121.pdf)

discrepancy between revenues in the year prior to devolution be reconciled with actual outturn revenue figures once these are available?

- Second, what would happen should the year in which powers are devolved turn out to be an exceptional one in respect of Scottish revenues *relative* to those of rUK; presumably any subsequent changes would need to be negotiated by the two governments.

No forestalling effects will be taken into account (other than SDLT reduction in baseline by £20m). This means that, for example, if the Scottish Government were to announce that income tax were to increase in the year that it was devolved and this resulted in Scottish individuals bringing forward income into the previous year – thereby increasing Scottish revenues and hence the initial block grant adjustment – this effect would not be taken into account. Pre-announced tax increases may therefore lead to permanent increases in the BGA, and pre-announced tax cuts, permanent decreases in the BGA for taxes where the tax base can be shifted over time. These effects should be reasonably small, with two notable exceptions: SDLT (for which an explicit allowance is being made), and the top (additional) rate of income tax (for which no allowance is being made). Estimating the degree of forestalling is notoriously difficult however, so it is not clear that these issues could be easily resolved.

The initial baseline addition to the block grant for devolved welfare will similarly be based on the UK Government's spending on these areas in Scotland in the year immediately prior to the devolution of powers. This is again pragmatic and simple, with the same caveats made above regarding tax (i.e. about reconciling spending in the year prior to devolution with outturn expenditure).

The exception to this is in relation to Cold Weather Payment. Given the volatility of expenditure on the Cold Weather Payment, the initial baseline addition will be an average of the UK Government's spending in Scotland from 2008/9 to the year prior to devolution. Further clarity is required on how the effects of inflation might be taken into account in such a calculation.

#### *Indexing the Block Grant Adjustment: tax*

Paragraph 17 of the Agreement states that 'the Governments have agreed that the block grant adjustment for tax should be effected by using the Comparable Model (Scotland's share), whilst achieving the outcome delivered by the Indexed Per Capita (IPC) method for tax and welfare'.

This is a slightly unusual form of words. To refer to the methods as 'models' implies that they are something more complex than they actually are: they are relatively simple calculations. Thus it doesn't particularly make sense to say that one calculation will be performed but then 'reconciled' to give the result of a different calculation. Implicitly, the Agreement seems to say that Scotland's Block Grant Adjustment will be calculated using both the 'Comparable Model' (which we have previously referred to as the Tax Capacity Adjusted Levels Deduction or TCA-LD method) and the Indexed Per Capita method (which we have previously referred to as the Per Capita Indexed Deduction or PCID

method), but that it is the outcome of the PCID calculation which will actually be used to adjust Scotland's block grant over the course of the next Scottish Parliament. The main purpose of calculating Scotland's Block Grant using the 'Comparable Model' will be to allow an analysis of how different the Scottish budget would have been, had that method been the one actually used.

However, there is a potentially interesting timing effect. We understand that Scotland's block grant adjustment will be calculated initially using the TCA-LD method. If it turns out that Scotland's population has grown more slowly (or quickly) than rUK's, an adjustment to Scotland's grant will be made subsequently, once population figures are available. If Scotland's population is declining relative to rUK's, this could mean that the TCA-LD approach takes off 'too much' from Scotland's Barnett determined block grant, but that the 'shortfall' is not corrected until the following year (or perhaps longer). Although the amounts involved are likely to be small, this may have implications for borrowing.

But overall, over the period to 2022, Scotland's budget will be protected from the risk that its population grows relatively more slowly than that of rUK. If Scottish revenues per capita grow more quickly than those of rUK, the Scottish budget will be better off than it would have been in the absence of tax devolution; if Scottish revenues per capita grow more slowly, the Scottish budget will be worse off than it would have been without tax devolution (relative to a Barnett-Formula only counterfactual).

The Scottish budget will be better off under PCID than under TCA-LD, unless Scottish population grows more rapidly than rUK population. Based on current projections, this is unlikely to happen.

The method for adjusting Scotland's block grant in respect of devolved taxes will be reviewed by an 'independent report presented to both governments by the end of 2021'. The Agreement provides no information as to who will deliver this report, nor what might happen should the two governments fail to agree an indexation method at that point.

It would have been useful for the Agreement to specify more robustly the actual calculation that is implied by both the 'Comparable Model (Scotland's share)' and the Indexed Per Capita (IPC) method. The PCID approach in particular has been subject of some differences in interpretation, and it is important that the meaning of any particular approach is clearly understood. Paragraph 114 of the Agreement states that the more detailed aspects of the Fiscal Framework will be published 'as soon as possible'. This Annex must be available to both Parliaments for scrutiny.

#### *Indexing the Block Grant Adjustment: welfare and employability programmes*

For welfare, the change in Scotland's block grant each year will initially be determined by the Barnett Formula in a manner akin to "Levels Deduction" (which one might term "Levels Addition"). Thus the Scottish budget will receive a population share of changes in aggregate spending on the comparable

benefits in the rest of the UK. However, for an interim period until 2022, this calculation will be reconciled with the Indexed Per Capita method.

Spending on the benefits to be devolved is 20% higher per capita in Scotland than in rUK. Given that eligibility for these benefits is determined by UK-wide eligibility criteria, presumably this reflects genuinely higher need for spending on these benefits in Scotland than in rUK. As is now well known, a property of the Barnett Formula is that it results in convergence in per capita spending over time between Scotland and rUK, regardless of need. This means that use of the Barnett formula to determine the funding for the devolved welfare benefits would tend to bring per capita spending in Scotland on these benefits closer to the UK level than at present unless resources are found elsewhere in the Scottish budget. Of course, as is more generally the case with the Barnett Formula, the rate of convergence is reduced if Scotland's population grows relatively more slowly than rUK's.

So the 'Levels' approach does not account for Scotland's higher initial spend per capita, and it does not fully account for relative population change (although, if Scotland's population falls relative to rUK's, this failure to fully reflect population change works to Scotland's advantage).

One rationale for the "Levels Addition" approach chosen may be that in recent years, per capita spending on the benefits to be devolved to Scotland has grown less quickly in Scotland than rUK (i.e. relative, although not absolute, spending has declined in Scotland). This reflects the changing pattern of disability benefit recipients – who are becoming younger, more likely to be female, less concentrated in former industrial areas, and more likely to be claiming for mental as opposed to physical health reasons. If this (national rather than Scotland-specific) trend were to continue, an approach without a 'squeeze' may involve the UK government transferring more resources than it is saving itself from devolving these responsibilities to Scotland. There is no guarantee that this trend will continue: if Scotland's welfare spending 'needs' stops converging towards those of the UK as a whole, the 'squeeze' under the Barnett Formula / "Levels Addition" approach may reduce the Block Grant Addition close to, or even below, the costs derived from an objective needs assessment of the transferred welfare responsibilities.

In the same way that the block grant adjustment for tax will be reconciled with the Indexed Per Capita method over the period until 2022, the block grant adjustment for welfare will also be reconciled with the Indexed Per Capita method until 2022. The Indexed Per Capita method does not have a convergence property built into it.

Note however that on the spending side, if Scottish population is falling relative to that of rUK, the 'Levels' approach is likely to provide a more favourable outcome for the Scottish budget than the Indexed Per Capita method. This is because the Levels method only accounts for Scotland's falling population in respect of the change in the block grant in the past year, whereas IPC accounts fully for Scotland's relatively declining population.

Therefore on the welfare spending side, one cannot say with any particular certainty whether the Scottish budget would be better off under the UK Government's initial 'Levels' method, or the subsequent 'reconciliation' to Indexed Per Capita. Indexed Per Capita certainly does not have a convergence property built into it (i.e. it takes account of Scotland's higher initial spend per capita), but it fully adjusts for Scotland's declining relative population. The Levels method does not account for Scotland's higher initial spend per capita, but it only partially adjusts for Scotland's relatively declining population.

The Barnett Formula will also apply to Employment Programmes being devolved. In some ways this is preferable to determining spend according to some Payment by Results approach: it means fewer constraints in the way in which the Scottish Government can use these funds, and a greater degree of certainty on the level of funds. The level of funding now associated with these programmes is so small that the question of the adjustment mechanism is not of huge importance.

### **Value Added Tax**

The methodology to be used for calculating Scotland's assigned VAT revenues is still to be developed. The methodology is to be developed jointly by the two Governments. The Agreement states that the methodology for estimating Scotland's assigned revenues will be tested during a transitional period, prior to the formal assignment of VAT revenues to Scotland. This is a sensible approach.

### **No detriment due to policy spillovers effects**

The Agreement identifies two types of policy spillover effects:

- Direct effects; and
- Behavioural effects.

The Agreement states that all 'direct effects' will be accounted for, i.e. will be subject of a resource transfer. So for example, an increase in Scottish rates of income tax, which may increase rUK liabilities for Universal Credit payments in Scotland, would be an example of a 'direct effect' that the UK Government would seek compensation for. Presumably, a reduction in Scottish income tax, which may reduce the UK Government's Universal Credit liability in Scotland, would be subject to a transfer the other way.

Behavioural effects of tax policy changes will not generally be taken into account. In reality, the vast majority of policy spillover effects are related to behavioural responses, so the Agreement implicitly plays down the importance of this element of the Smith principles. This seems sensible given that many behavioural impacts would likely be small, and nearly all will be difficult to estimate, subject to significant uncertainty, and therefore open to contention.

However, the Agreement leaves open the possibility that behavioural effects are accounted for where they are material. The Agreement provides no indication



as to what level of financial spillover effect might be considered 'material', so this will be entirely a matter for each Government to decide on a case-by-case basis. This could open the door to further dispute between the Scottish and UK governments.

Assessment of causality and of the scale of financial impacts of policy decisions will be based on a 'shared understanding' of the evidence. Of course, this leaves open the question of how this shared understanding will be arrived at. Presumably both governments will undertake their own analysis of the fiscal impacts of any behavioural effect, and negotiate as to the scale of effect when their respective analyses disagree (the Agreement does not seem to predicate any arrangement for the Scottish Fiscal Commission in such issues). Economists find causal impacts extremely difficult to calibrate: effects have to be measured in the real world, where many other factors are at play, and not in the controlled environment of a laboratory. Estimates are likely to be subject to significant uncertainty, and there is no third party to adjudicate disputes over such evidence.

We leave it to others to comment on the appropriateness of arrangements for inter-governmental negotiation.

The Agreement makes no mention of the 'taxpayer fairness' principle. By choosing the PCID method, if the revenue from increased tax rates in rUK is spent on 'comparable' spending, the Scottish budget will increase. Less will be taken away from the block grant than will be added via the Barnett formula. Similarly, cuts in rUK income tax that result in equivalent cuts in comparable spending will have a detrimental effect on the Scottish budget. It is not clear whether these types of policy changes would be considered 'direct effects' and subject to equalising transfers.

### **Administration and implementation costs**

The Agreement envisages a one-off transfer of £200m to the Scottish Government to support the implementation of new powers, in addition to a baselined transfer of £66m to cover the ongoing administration costs.

The £200m one-off transfer seems broadly reasonable in the context of the debate about the set-up costs for a welfare system if an independent Scotland.

The Agreement states that the baselined transfer will be 'indexed through the normal application of the Barnett Formula; but it is not clear how comparable spending in this regard is defined.

### **Borrowing**

Our paper to be launched on 22 March will include an assessment of the arrangements for current borrowing powers set out in the Agreement.

## **Fiscal scrutiny and forecasting**

The agreement specifies that forecasts for tax revenue and welfare expenditure will be used to determine the block grant. The Scottish Fiscal Commission is to develop these forecasts. The Scottish Government had previously argued that it should make the forecasts. This is a welcome development, which should remove any doubt about political interference with the forecasting process.

In addition, the Scottish and UK governments have agreed that “appropriate and reciprocal information-sharing agreements” will be put in place to enable the governments, the OBR and the Scottish Fiscal Commission to carry out their duties.

However, it is not clear what the agreements between the governments, the OBR and the Scottish fiscal commission might comprise. Neither does the agreement specify how the Fiscal Commission and the OBR might work together.

One of us has previously commented to the Finance Committee on the forecast process as it might apply in Scotland<sup>4</sup>. This paper describes how OBR and HM Treasury interact during the forecast process. It also discusses the difficulties that may arise around the timing of the forecasts and how the forecast process is carried out. It indicates that the Fiscal Commission will be operating in a much weaker data environment than the OBR, increasing the difficulty of forming accurate forecasts.

Not only does will the Fiscal Commission have to deal with these statistical difficulties, it will also have to confront the many challenges associated with the design and execution of a transparent process for forecasting Scotland’s tax revenues and welfare benefits that will command public confidence. The agreement says relatively little on this issue: perhaps a mechanism for designing this process could be established drawing on a broader range of expertise than the Scottish Government and HM Treasury.

## **Summary**

The block grant indexation mechanism selected for use until 2022, the so-called Per Capita Indexed Deduction (PCID) is likely to provide the most favourable outcome for the Scottish budget, based on current projections for population growth.

It will be important that the Annex to the Heads of Terms is available very soon, to ensure clarity on exactly how each indexation method has been defined, and to understand further detail underlying other elements of the Agreement, notably the process by which forecasts and outcomes are to be reconciled.

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<sup>4</sup> Bell, D., (2011) "The Scotland Bill Proposals for Forecasting and Reconciling Income Tax Receipts", [http://s3.amazonaws.com/zanran\\_storage/www.scottish-parliament.tv/ContentPages/2472494430.pdf](http://s3.amazonaws.com/zanran_storage/www.scottish-parliament.tv/ContentPages/2472494430.pdf)

The notion that the UK Government's preferred 'model' for adjusting Scotland's block grant for tax is being used until 2022 seems somewhat disingenuous. Until 2022, the per capita indexed deduction method is being used to index the block grant in respect of devolved tax powers: it overrides the other 'model', albeit with a short lag. After 2022, nothing has been agreed (or ruled out).

Funding associated with devolved welfare powers will be allocated to the Scottish budget on the basis of the Barnett Formula, but again, this calculation will then be 'reconciled' with the PCID calculation. On the spending side however, it is not *a priori* clear whether this reconciliation to PCID will provide a more, or less generous outcome for the Scottish budget than the 'levels' approach would have done.

The Agreement downplays the scope for inter-governmental transfers in respect of the behavioural effects of policy changes, which seems sensible. But in practice, agreeing which behavioural effects of policy changes to take account of could be a source of discord.

The agreement places the responsibility for forecasting tax revenues and benefit spending in Scotland on the Fiscal Commission rather than on the Scottish Government. This is a welcome decision. Nevertheless, the construction of both the process and the statistical capability to generate forecasts that command public confidence needs further consideration.

**PROFESSOR DAVID HEALD, UNIVERSITY OF GLASGOW**

**Cultivating illusions, while kicking fundamentals into the long grass**

1. The published February 2016 Agreement between the UK and Scottish Governments results in the Scottish Parliament having to take a decision on whether to pass a Legislative Consent Motion for the *Scotland Bill 2016* on the basis of inadequate information. The document (HM Government and Scottish Government, 2016) will have a still-to-be published annex (para. 114).
2. I have provided extensive evidence on these matters to Committees of the Westminster and Holyrood Parliaments, so I will not be comprehensive here. The reason why the negotiations took so long and the outcome is unsatisfactory is that there is a clash between:
  - a) A long-held view at the Treasury and at Westminster that Scotland is over-funded through the Barnett formula;<sup>5</sup> and
  - b) The view in Scotland that it would be disastrous for the credibility of tax devolution if the act of so doing automatically reduced the size of the Scottish budget.

The February 2016 Agreement does nothing to address this clash of perceptions, but pushes executive action beyond two Scottish Parliament elections and definitely one Referendum, and possibly three.

3. The United Kingdom has not learned how to ‘do’ constitutional politics, which are inevitably problematic for it because of the asymmetries of country size, institutions and powers. The policy process has been inadequate, *inter alia* for the following reasons:
  - Commitments have been entered into, notably through the Vow and the Smith Commission, without analysis of the implications or evidence that proposals fit coherently together
  - The Barnett formula has been transformed in Scottish debate from being inherently damaging to Scotland – remember the ‘Barnett squeeze’ – to being a cornerstone of the Union. During the 2000s’ period of public expenditure plenty, opportunities to review, refurbish and re-legitimise the formula were ignored (Heald and McLeod, 2002)
  - Rather than relevant documents being published early in the Fiscal Framework process, negotiations have been quasi-diplomatic, supplemented by a media war between proxies
  - The Scottish Parliament has been presented with a *fait accompli*, with a strong possibility that the UK Parliament would never pass comparable legislation should the Scottish Parliament or its successor not pass the Legislative Consent Motion
  - Northern Ireland and Wales have been excluded from negotiations which are likely to have fundamental implications for them, damaging Scotland’s

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<sup>5</sup> Calls for a needs assessment across the United Kingdom often seem to be premised on this assumption.

interest in the three Devolved Administrations developing common positions in relation to the Treasury. This has amplified the strains created by the Smith Commission being focused solely on Scotland; England can also claim to have been excluded.

4. Just as alarmingly, false characterisations of the post-*Scotland Act 2016* Fiscal Framework are becoming conventional wisdom through the force of repetition:

- *Scotland will have one of the most powerful devolved Parliaments in the OECD (or in the world)*: this illusion rests upon the proportion of expenditure notionally financed by own taxes and assigned revenues, yet this calculation is irrelevant if the political and fiscal architecture means that devolved tax powers are rendered unusable and those powers atrophy<sup>6</sup>
- *The Scottish Parliament will have powers to significantly affect relative economic performance and relative demographic growth*: this illusion neglects that most economic levers remain with the UK Government, that demographic trends date back as far as the Act of Union, and that there are Scotland-specific risks connected with the oil and finance-related sectors. Moreover, any use of powers to deviate from UK policy seem likely to be greeted with a chorus of disapproval from the UK Government and its proxies, in order to magnify the political and economic costs of usage, and to bolster future claims that economic and demographic trends are the fault of the Scottish Government
- *The Scottish Government will be responsible for virtually all income tax*: this illusion misses the points that:
  - The definition of the tax base is not devolved. This would be undesirable in the UK context, but a common tax base means that there should be intergovernmental consultations, not unilateral action by the UK Government
  - The personal allowance is not devolved, in part because of interactions with the UK social security system. There could be a Scottish zero-rate band, which would be equivalent to increasing the personal allowance, but that could not be reduced below the UK level. This issue is profoundly important because there are differences in the distribution of taxable income across the four countries, which leads to differential reductions in their tax base whenever the personal allowance is increased (as has dramatically been the case since 2010)<sup>7</sup>

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<sup>6</sup> I suggested to the Scottish Parliament's Finance Committee in November 2014 that devolved tax powers could be constrained or neutralised by malicious actions or malign neglect on the part of the UK Government (Heald, 2014, para. 13). The danger is that the new taxation powers will atrophy, as did the tartan tax powers, though the latter was in the context of the block grant growing rapidly because of rapid increases in expenditure on education and health in England. A design fault in the *Scotland Act 1998* was that the Scottish Parliament did not have to take a decision to set the tartan tax rate variation at zero. It is likely that a design fault in the *Scotland Act 2016* will be the issue of the uniform personal allowance, in the absence of co-determination procedures.

<sup>7</sup> The Wales Governance Centre (2016) has drawn attention to the way in which increases in the UK personal allowance means that a higher proportion of Welsh income taxpayers drop out of the tax base. The Welsh First Minister has stated that no future Labour administration in Wales would increase income tax rates, but has not ruled out cuts (Murray Brown, 2016). This illustrates how devolved tax powers can be eroded, even before their actual creation.

- Savings and dividend income remains taxed at the UK level
- There are likely to be issues concerning the conversion of taxable income in Scotland into dividends, capital gains or corporate income taxed at the UK level
- *There appears to be a widespread assumption in Scotland that devolution of some welfare powers will mean more spending without increases in taxation: the talk is of top-up, not of cut-down.*

Such illusions carry severe risks of disillusionment when the realities bite. Future UK spending cuts will affect Scottish public services through the Barnett formula and there seem likely to be further cuts to existing benefit levels.

5. The issue that delayed the publication of the Fiscal Framework was the indexation mechanism to revalue the initial reduction of the block grant at the time of the transfer of tax responsibilities. The issues are explained by Eiser (2015) and Muscatelli (2015), particularly in relation to differential rates of population growth.
6. My understanding of what has been agreed is that the UK Government's preferred method of Block Grant Adjustment (Levels Model) has been modified to take account of differences between Scotland's population share and its revenue shares of relevant taxes (HM Government and Scottish Government, 2016, para. 18). This is now called the Comparable Model. This will be the base calculation, but for six years the result will be further modified in a way that generates the result which would have been obtained from use of the Scottish Government's preferred method (Per Capita Indexation). Two issues arise:
  - This does nothing for intelligibility and transparency and, while there might be some presentational benefits for the two Governments, this exposes the Agreement to ridicule
  - Such a time-limited over-ride requires a default position: what will happen in 2022-23 when what the Agreement (para. 17) labels the 'transitional period' has ended?<sup>8</sup> There is a long tradition in intergovernmental grants of using safety nets to stretch out in time the impact of adverse changes, but the assumption is always that the safety net is temporary. Future significance may be attached to the fact that the Comparable Model is first used, then its effects eliminated during the transitional period, rather than there being a direct application of Per Capita Indexation during that period. This may lead to the argument that the Comparable Model is the implicit default, which a future UK Government may impose.

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<sup>8</sup> The independent review is to be presented to the two Governments by the end of 2021 and the Joint Exchequer Committee 'will jointly agree conclusions, recommendations and revisions of the review' (HM Government and Scottish Government, 2016, para. 112). Therefore 2022-23 is the first year in which there could be new provisions in place.

7. In my academic writings on UK devolution finance and in my submissions to Parliamentary and Governmental inquiries, I have consistently called for greater transparency about the operation of the Barnett formula. Success has been limited, particularly with regard to the timing of updates to the Statement of Funding Policy, the publication of data on comparable expenditure in England, and the publication of the arithmetical application of the Barnett formula at Spending Reviews and other budget events. Full transparency of the block grant calculations is imperative in the context of the Scottish Government setting income tax bands and rates. The Agreement does not make clear what will be regularly published.
8. In terms of the application of the Smith Commission's No Detriment principles:
  - I remain of the view that an indexation mechanism that leads to an automatic reduction of Scotland's budget is likely to discredit tax devolution, leading to claims that the Fiscal Framework has been a trap. Therefore, the first No Detriment principle is important to uphold, so tax devolution is not associated with block grant reductions (see para. 2 above)
  - While I understand the motivation for the second No Detriment principle, my view is that implementation is not feasible. The circumstances in which the Agreement indicates that it will apply will lead to controversy about calculations and whether compensation should be paid. A further level of complexity will be added to the Barnett formula system, one of the original attractions of which was its simplicity.
9. The critical issues that must be addressed before the Legislative Consent Motion is passed are:
  - Future arrangements for data transparency which past experience demonstrates cannot be taken on trust
  - Clarity about the default position from 2022-23

Otherwise the finances of the Scottish Parliament and its Welsh and Northern Ireland counterparts will be even more vulnerable to the UK Government's deficit reduction and state shrinkage objectives.

**Professor David Heald**  
**29 February 2016**

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**PROFESSOR ANTON MUSCATELLI, PRINCIPAL, UNIVERSITY OF GLASGOW**

Additional Evidence to the Devolution (Further Powers) Committee on the Fiscal Framework, by Professor Anton Muscatelli

The following comments are offered to the committee on the Fiscal Framework Agreement published by the UK and Scottish governments and published on 25 February 2016.

Overall, this is a welcome resolution of the Fiscal Framework negotiations between the two governments. As I shall outline below, the outcome is a good one for both Scotland and the UK, especially in relation to the area which involved the most intense negotiations, namely the block grant adjustment (BGA) mechanism.

*Block Grant Adjustments for Tax and Welfare*

The arrangements for the initial baseline adjustments (par. 11-14 in the Agreement) seem entirely appropriate.

The decision in par. 16 to use Barnett as the formula for the indexation mechanism for welfare with a 100% comparability factor seems appropriate given the nature of the welfare devolution envisaged in the bill.

Paragraphs 17-19 describe the block grant adjustment indexation mechanism for tax. The compromise reached is that the 'Comparable Model' will be used 'to effect the BGA'. In essence this is a modified version of the levels deduction (LD) method described in previous evidence I have given to the Committee, but modified by a factor which reflects Scotland's differential share of the UK tax pool for each of the devolved taxes, as set out in the Table below par. 18. This is outlined in detail in the evidence provided to the Committee by Bell et al. ([http://www.scottish.parliament.uk/20160223\\_BellPhillipsEiser.pdf](http://www.scottish.parliament.uk/20160223_BellPhillipsEiser.pdf)). Indeed Bell et al call this modified LD 'tax-capacity adjusted levels deduction' (TCA-LD). In essence this BGA mechanism moves some way to take account of the Scottish Government's concern that LD exposes Scotland to additional risk by reducing the adjustment in the block grant in those taxes (like income tax) where Scotland has a lower share of the UK tax pool than its population share.

Unlike Level Deduction (LD) the TCA-LD mechanism addresses the problem of Scotland initially having a lower share of UK tax revenues, but it still does not protect Scotland's block grant from the additional demographic risk due to Scotland's population growth being slower than that in the rest of the UK. The detriment relative to the 'no-devolution case' of adopting TCA-LD is shown in Table 1 in Bell et al.

However, par. 20 in the agreement in essence overrides this BGA mechanism by saying that the outcome until 2021-22 will be that the BGA will shadow the per-capita indexed deduction method (PCID), which is the Scottish government's preferred method. The Committee will recall that in previous

evidence I supported PCID as the best and fairest method to achieve the first 'no detriment' principle in the Smith Commission Agreement, and to avoid the BGA mechanism eroding the Barnett formula on expenditure, which is a cornerstone of Smith.

In essence, the TCA-LD method will be a shadow formula which is not operational during the initial duration of this Fiscal Framework Agreement (i.e. until 2021-22), during which *de facto* PCID will determine the BGA.

The key question is what happens after 2021-22. This is set out in par. 20-23 and which was clearly one of main sticking points in the negotiation.

The agreement makes it clear that there will be an independent review which will inform the two governments' views. The governments will decide, through a new negotiation, post-2021 what the future indexation mechanism should be. In effect this is a sunset clause for the BGA indexation mechanism post 2021-22. The important point is that there is no presumption that a particular method will be used. The agreement does not specify what might happen if a methodology is not reached in time for 2021-22.

I have suggested that this agreement by the two governments is good for Scotland and for the UK. The reasons for this are the following:

1. For Scotland, it ensures that PCID is *de facto* used to determine the BGA, thus avoiding additional demographic risk.
2. For Scotland, it is important that the first 'no detriment' principle as embedded in the PCID method is still operative and does not automatically lapse after 2021.
3. For the UK, although PCID does not, during the period until 2021-22, deal with the issue of 'tax-payer fairness' (the second part of the second Smith 'no detriment' principle) it ensures that this principle is not forgotten, and will be part of the 2021 review. It is important to stress that TCA-LD would not have dealt with the 'tax-payer fairness' principle either, whilst LD would have. As I set out in my evidence to the House of Commons Scottish Affairs Committee, and in a recent lecture at the University of Glasgow, a modified version of PCID might have addressed the 'tax-payer fairness' principle more directly, by adjusting the block grant further whenever additional income-tax changes are made by the UK government to reflect changes in devolved spending.
4. For the UK, the use of PCID in the next few years will not impact greatly on the 'tax-payer fairness' issue, as the period until 2021-22 is likely to be a period of continued fiscal consolidation, which means that the issue of the UK government raising additional income taxation to fund additional UK spend in devolved areas such as NHS and education is unlikely to be substantive issue. Indeed the Finance Act 2015 included the UK Government's 'tax lock commitment' which notionally prohibits the UK government increasing income tax rates during the current parliament. This further limits any 'unfair' benefit from UK taxes to Scotland.

5. For both Scotland and the UK, the period until 2021-22 provides a period in which we will learn more about the *actual* economic and demographic risks that emerge from the framework without having to rely on modelling assumptions and forecasts.
6. For both Scotland and the UK as I stressed in earlier evidence it is important that the Agreement provides a stable framework. It is important that the different spending and taxation policy proposals for the 2016 election can be evaluated against a Fiscal Framework which will not trade off changes in taxation and welfare spending decisions which would be swamped by an unstable block grant due to demographic effects. This Agreement provides that stability by taking away the issue of demographic risk, violating the first 'no detriment' principle.

### *Other measures*

The measures on commencement dates and transition periods in par. 24-29 do not seem controversial.

The measures on the administration costs (par. 30-39) would have been a matter of intensive negotiation from press reports. I do not have particular expertise in the estimation of these costs and hence will not comment on this section.

On the assignment of VAT, it is interesting that both governments recognise (par. 40-43) the need to develop the methodology of estimating VAT receipts more fully. I would endorse this approach.

On the issue of no detriment from any spillover effects, it is interesting that both governments do feel that this is an important issue (par. 44-53). In earlier evidence I and other commentators had said that this 'compensation principle' in the 'no detriment' clauses in Smith would be difficult to apply in practice. It is interesting that both governments agree that direct effects should be accounted for, but not behavioural effects unless they are material. The issues will be handled through JEC and if required dispute resolution. The main issue will be whether the two governments will always agree what a direct effect is and what a behavioural effect is, or what 'material' represents in the context of behavioural effects.

The capital borrowing limits (par. 54-60) set limits for capital borrowing which are *very* prudent relative to the overall UK fiscal framework. It may be worth the two governments reviewing this in future to determine if the limits proposed are appropriate given the additional Scottish tax base.

The clauses on resource borrowing and the Scotland Reserve (par. 61-78) would seem to provide adequate smoothing of expenditures and taxation given the volatility of the income tax base.

The independent fiscal scrutiny envisaged in par. 79-83 is in the spirit of the Smith Commission agreement and will require appropriate resourcing of the Scottish Fiscal Commission (par. 84-88). It is positive to see the collaboration

which will be required between the SFC and the OBR. This does not go as far as the suggestion of an independent fiscal arbitrator which I raised in my previous evidence, although as noted above there will be an independent review of the BGA mechanism. The proposals for the governance, review and dispute resolution (par. 97-113) are consistent with the continued reliance on seeking consensus around the framework.

The proposals on welfare (par. 89-90) are consistent with allowing Scotland to make adjustments to welfare payments without these leading to conflicts on benefit caps.

I do not have any particular comments on the Crown Estate provisions (par. 91-96) as they lie outside my area of expertise.

Professor Anton Muscatelli  
University of Glasgow  
28 February 2016

**PROFESSOR PAUL SPICKER, ROBERT GORDON UNIVERSITY****Professor Paul Spicker****The Fiscal Framework and the delivery of welfare benefits**

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1. Thank you for the invitation to comment on this issue. The central difficulty of doing so is that few of the details or estimates of costs have been put in the public domain. The framework document lacks a technical annex and few figures are available for consideration.

**Reforms to the benefits system**

2. The terms of the fiscal framework state that “The block grant to the Scottish Government will be adjusted to reflect ...the transfer of responsibility for welfare.” (*The agreement ... on the Scottish Government’s fiscal framework*, Feb 2016, para 9) This makes important assumptions. The Scotland Bill does not directly transfer responsibility for the administration of benefits. Once the Bill is passed, the Scottish Parliament will have a shared competence in relation to some specified areas of activity. If for any reason that competence is not exercised, the activity will remain in the remit of the UK Parliament and the Secretary of State for Work and Pensions.

3. The Scotland Bill can be taken to represent a potential transfer of authority for ten or eleven existing benefits:

- Disability Living Allowance
- Personal Independence Payments
- Attendance Allowance
- Severe Disablement Allowance (legacy cases)
- Industrial Injuries Benefits
- Welfare Foods (Free milk and vitamins)
- Cold Weather Payment (being supposed to include Winter Fuel Payment)
- Funeral Payments
- Sure Start Maternity Grant and Carers Allowance.

The Scottish Parliament already has responsibility for four other benefits, all operated at local authority level:

- Financial aid in social work
- The Scottish Welfare Fund (including crisis grants and community care grants)
- Council Tax Reduction  
Discretionary Housing Payments.

4. Some of the terms in which benefits are identified in the Scotland Bill are not fully consistent with existing benefits. The terms in which disability benefits are

defined are not directly equivalent either to Disability Living Allowance or its replacement by Personal Independence Payment. The current operation of Carers Allowance is anomalous, because in many cases it is not actually paid to claimants, but instead shapes the entitlement to premiums in other benefits. Although there has been a general assumption that Winter Fuel Payment will be transferred, as the Smith Commission recommended, the wording of the Scotland Bill refers only to cold weather, which is the criterion for a completely different scheme.

5. It is not self-evident that the Scottish Parliament will wish to use all the powers granted in the Scotland Bill. The provisions for altering rules in Universal Credit are restricted and may be prohibitively expensive to operate. Severe Disablement Allowance closed to new applicants on 6th April 2001; there were still 163,000 claimants in Britain in 2014/15, but the current estimate of all those people who will still be entitled in by 2017 is 24,000. That probably translates to less than 3000 people in Scotland. The main effect of transferring responsibility for the payments would be to carry forward an anomalous situation with the potential to disrupt the income flow of a very small number of vulnerable people with severe disabilities. Among the options that the Scottish Government has been reviewing are agency arrangements whereby UK agencies will operate specific benefits.

6. It may be misleading to think about the issues only, or even primarily, in terms of transfer. The Scotland Bill is concerned only with the establishment of powers - no responsibilities are removed from the existing authorities - and the powers that are being granted include three particularly significant opportunities for doing things differently. The first of these is the power to create new benefits, in section 26 of the Bill. The second is the power to top up benefits, in section 22 - there are long-standing precedents in this field, and restriction to 'discretionary' provision does not mean that such provision cannot be regularised and rule-based. The third is to redefine and reintegrate benefits with other aspects of the system in Scotland - including potential new developments in health, social care and the legal system.

### **The costs of implementing benefit schemes**

7. The proposals to date imply four kinds of cost:

- the immediate cost of transferring responsibility and setting up alternative benefit systems
- the cost of the benefits themselves, covered by the block grant
- the continuing cost of managing benefits, and the implications of the 'no detriment' rule.

8. *The cost of transfers.* The First Minister's note to the Prime Minister on February 17th gave an initial estimate of £400-£660 million. In the fiscal framework those costs have been bundled together with other aspects of the transfer of responsibilities, and it is explained that "Both Governments have agreed that the UK government will provide £200m to the Scottish Government

to support the implementation of new powers.” (para 31) I am not privy to the details and cannot assess whether or not this figure is adequate.

9. The costs of transfer will in most cases be the responsibility of the Scottish Government. The framework states that “All other demonstrable and jointly agreed net costs to the UK government wholly and necessarily incurred as a result of the devolution of powers will be met by the Scottish Government” (para 38), implying that all residual and unspecified costs fall on one party to the agreement. This may prove problematic. By way of illustration, this passage comes from an Audit Scotland Report, *Implementing the 2012 Scotland Act*, paragraph 26:

“HMRC has charged the Scottish Government £0.73 million for it to stop collecting Stamp Duty Land Tax. HMRC charges the Scottish Government for costs associated with the devolution of Stamp Duty Land Tax, the UK tax that LBTT replaced. It estimates this will cost £1 million, most of which is for changes to its IT systems. For the period up to the end of 2014/15, HMRC has invoiced the Scottish Government for £0.73 million.”

Every transfer of responsibility benefit carries the implication that there will be a change in administrative practice by DWP or HMRC. There could then be further costs, identified by the UK government and wholly beyond the control of the Scottish Government, nested within any potential reform.

10. *The block grant.* The amount that is to be allocated for the payment of social security benefits is explained as follows: “The initial baseline addition to the block grant for devolved welfare payments will be the UK government’s spending on these areas in Scotland in the year immediately prior to the devolution of powers” (para 13) The allocation will be reviewed in 2021.

11. The Northern Ireland Assembly had full powers and authority over its benefit system, but was paid proportionately to the costs of benefits in the rest of the UK. During the recent dispute over welfare reform, the Treasury calculated that the amounts distributed relating primarily to Employment and Support Allowance and Personal Independence Payment should be reduced and the Assembly had substantial payments deducted from its allocation because of its failure to introduce equivalent legislation. The calculation was particularly questionable in relation to PIP, which has been introduced very slowly in the rest of the UK and retains the responsibility to pay for the needs that have led to increasing costs to date. The example seems to imply that, regardless of the devolution of powers, the UK government may demand future conformity with its own policies and priorities.

12. *The continuing cost of managing benefits.* It is not clear whether the block allocation will be an amount for benefits paid, or whether it will also be expected include administrative costs; the financial statements in the current DWP annual report do not attribute a proportion of administrative costs to specific benefits. It is difficult to estimate the costs of administration because much of the core information has been withheld from the public. The DWP currently claims a general administrative cost of about 3.5% a year, but that lumps together high

cost benefits like Employment and Support Allowance with low cost ones like the State Pension. The DWP Annual Reports used to carry a breakdown, but in recent years the specific details of administrative costs have been excised. It is possible however to find roughly comparable data in earlier reports. In 2007-08, the administration of working-age benefits cost 6.3% of the cost of those benefits, being £2.98bn, on expenditure of £47.3bn. Pensions cost £220m for £97.8bn benefits, equivalent to 0.23% of the cost. The administration costs of some benefits will have increased in the intervening period - that is the result of personalisation, conditionality and assessment.

13. The benefits being devolved to Scotland are not like pensions - they are mainly more expensive and more complex. The value of benefits currently being devolved to Scotland is just below £2.7 bn, so the Scottish Government's initial estimate of £200m per annum looks like an administrative cost in the region of 6.9% (that is, £200m out of £2.9bn.) 6.3% of costs would be closer to £183m. I have here to add a word of caution: these figures are pointers at best, pieced together in the absence of adequate information.

14. *The implications of the 'no detriment' rule.* Para. 45 states that "where either government makes a policy decision that affects the tax receipts or expenditure of the other, the decision-making government will either reimburse the other if there is an additional cost, or receive a transfer from the other if there is a saving." If either the Scottish parliament or the UK government takes steps which impose costs on the other administration, compensation should be paid. One of the examples given in the 2015 White Paper, *An enduring settlement*, concerned the Vehicle Excise Duty paid by people with disabilities: if Scottish rules were to certify that more people were disabled, the Treasury would want to get the money back. Similarly, decisions related to Carers Allowance will have implications for other benefits, because Carers Allowance offers an 'underlying entitlement' to some claimants for premiums on means-tested benefits.

15. The framework document states that "The Governments have agreed that any new benefits or discretionary payments introduced by the Scottish Government must provide additional income for a recipient and not result in an automatic offsetting reduction by the UK government in their entitlement elsewhere in the UK benefits system." (para 89) It does not however say how this effect is to be achieved, and the situation is unclear. As things stand, if the Scottish Parliament were to introduce a top-up to the State Pension, it would reduce entitlement to Pension Credit and Housing Benefit: para 89 of the framework agreement only refers to such income not being included in tax calculations. Other decisions to introduce a new benefit or a top-up benefit may affect the calculation of existing means-tested benefits, including Universal Credit and Pension Credit. One option is for Scottish benefits to be treated as exempt income for the purposes of income assessments: this could be done through appropriate regulations. The alternative would be for there to be cross-charging for the 'direct and mechanical' effects of interaction with other benefits, a procedure requiring the specific agreement of both governments (para 52).



Paul Spicker  
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February 26, 2016

## CHILD POVERTY ACTION GROUP SCOTLAND

### Initial Questions relating to the Fiscal Framework

#### Timescales

The fiscal framework does not contain any information about when social security powers will be transferred.

#### Implementation and Administration Costs

#### **How were the figures for implementation (£200m) and ongoing cost (£66m) arrived at? (para 31)**

Development of an effective, efficient and well administered social security system in Scotland is vital. Evidence shows that a large proportion of income crisis and food bank use is triggered by administrative problems with the benefit system. It is therefore essential that funds allocated for implementation and ongoing costs are adequate to allow for the development of a high quality, user-friendly benefit system in Scotland.

(We note that Professor Paul Spicker has highlighted in a recent blog it is difficult to calculate the cost of administering the benefits likely to be devolved because of a lack of comparable information available from the DWP. Spicker notes, however, that more complex benefits, such as disability benefits, can often be the most expensive to administer effectively. For more information see: <http://blog.spicker.uk/> )

#### **Are Scottish Ministers satisfied that the resources transferred are adequate to establish national Scottish delivery of benefits e.g. through a Scottish Government core directorate or a new national executive agency?**

CPAG believes resources need to be available to cover the cost of enabling a national delivery body to ensure consistency and uniformity of delivery across Scotland, clear accountability and a clear line of command, fairness and equality of access for claimants. National delivery standards could be developed, allow delivery practices to be relatively reactive to the Scottish Government's policy intention and allow for ongoing change and continuous improvement.

#### **Given that the first review is not scheduled until 2020/21, should there be an emergency trigger in case of unforeseen difficulties in managing devolved benefits within the initial estimates for implementation and administration?**

**Transition period**

**Is it clear how newly devolved benefits will operate in the transition period (when the Scottish Parliament has the power to legislate for the delivery of newly devolved benefits but has not yet done so)?**

**Could the UK government continue to deliver devolved benefits in the interim, until a Scottish framework for delivery is established? Is there any indication of what the UK government would charge to deliver devolved benefits on the Scottish Government's behalf?**

**How will the cost of these services be calculated by HMRC/DWP etc?**

**Topping up reserved benefits**

**It is feasible that if the Scottish Government decided to top-up a reserved benefit (such as child benefit or child tax credit) it might ask that this top-up be administered by the UK department administering the that benefit in return for an administrative charge? Should there be commitment that UK government will ensure any charged administrative costs are reasonable and proportionate so as 'top up' powers can be used in practice? (para 34)**

**What mechanism are in place to ensure that the administrative and programme costs of e.g. topping up UK benefits are reasonable and proportionate?**

**Ongoing funding arrangements**

**Are we correct in understanding that the amount transferred to Scotland through the Barnett formula will reflect ongoing and future cuts at UK level to devolved benefits? Does this mean that ongoing and subsequent cuts to spending on PIP at UK level, for example, will be directly reflected in the block grant in the following year? (para 14-16)**

**Does this reflect the spirit of the Smith agreement which talks about transfer of the 'existing' expenditure on the benefit being devolved?**

*(Para 95(3) of the Smith agreement principles for a fiscal framework (Annex A) states that, "initial devolution of these powers should be accompanied by an increase in the block grant equivalent to the existing level of Scottish expenditure by the UK Government on the benefit being devolved".)*

**How much notice will the Scottish Government have of the amount it will receive each year via the block grant?**

This will be important every year, but particularly in advance of devolution as it will be difficult for the Scottish Government to design a system of benefits if it doesn't know how much money will be available. Any significant UK social security cuts and reforms are likely to have an impact on Barnett consequentials, the size of the block grant and the resources available to the Scottish Government to plan devolved social security policy. .

**Will the Scottish Government be given advanced warning of any planned cuts to the social security budget at UK level that would affect the block grant in subsequent years?**

**If the UK Government decides to devolve powers over a benefit to local authorities in England and Wales or abolish it altogether what would that mean for ongoing funding arrangements in Scotland?**

**How much advance notice of UK changes in spending on devolved areas must there be to avoid disruption to service provision in Scotland?**

### **No Detriment Policy**

**What are the difference between behavioural effects and 'indirect and second round effects'? How would you tell the difference? (para 47 and 48) For example, would a generous Scottish top-up to tax credits which the UK government potentially believed might reduce the incentive to work and increase the UK benefit bill constitute a direct effect, behavioural effect or an indirect effect?**

**Are both governments confident that there is a clear, shared understanding of the term 'behavioural effects'? Could some example of 'behavioural effects' be provided?**

**What constitutes the exceptional circumstances in which behavioural change will be taken into account when establishing detriment/no detriment?**

**What tracking will be put in place at an early stage so that analysis of impact is possible? What resource will be put into analytical services to enable these effects to be monitored and analysed (and by whom?) (See Lord's Freud's letter on the difficulty of analysing financial impact [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/336726/lord-freud-letter-ssac-cumulative-impacts.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/336726/lord-freud-letter-ssac-cumulative-impacts.pdf) )**

**Given that “any transfer or decision relating to spill over effect must be jointly agreed by both governments. Without a joint agreement, no transfer or decision will be made” (para 53), is there a risk that disputes as to the meaning of 'behavioural effects' and the extent and value of detrimental effect will stall the policy making process in Scotland?**

**Though there are mechanisms for 'raising a dispute' if governments can't agree, there is no external arbiter and it still falls to the two governments to reach agreement. In the event that agreement can't be reached “there would be no specific outcome from the dispute and so no fiscal transfer between governments.” (para 103)**

**What arrangements can be put in place to ensure that both government's identify and resolve potential spill-over impact at an early stage to minimise disruption in policy making and/or service delivery?**

**Miscellaneous**

**Why does para 118 not include Healthy Start amongst the benefits being devolved?**

**Para 120 states that employment programmes are 'covered separately in the fiscal framework'. There is however, very little detail elsewhere in the document. Are we to understand that a separate document is to be published giving further information with respect to the fiscal framework as it relates to employment programmes?**

**PROF JD GALLAGHER AND PROF IS MCLEAN, NUFFIELD COLLEGE  
OXFORD**

**Scotland Bill Fiscal Framework: what happens after the agreement?**

Now that the Scotland Bill fiscal framework has been agreed between the UK and Scottish governments, the very strong likelihood is that the Scotland Bill will reach the statute book later this year, and that the tax and welfare partners recommended in the report of the Smith commission will be available to the Scottish parliament elected in 2016. The most important consequence is that new tax and welfare decisions will have to be taken by the Scottish government and Parliament.

*Taxing questions*

Up until now, the Scottish government has been able to take its receipts for granted: it simply draws down grant from the UK Treasury as and when it is needed. Any cash flow issues from the two main devolved taxes (council tax and nondomestic rates) have been managed within the local government system, though in the current financial year some taste of revenue uncertainty has been offered by land and buildings transaction tax. This is a major new responsibility for an administration which retains most of the characteristics of a "spending department" of government, and Scottish ministers need to plan to develop their capacity to deal with this. In addition, it is important that there is effective, wholly independent, scrutiny of ministers' plans and forecasts. We understand that proposals for a wholly independent fiscal commission are likely to be forthcoming (as initially proposed by the parliament's finance committee) and are strongly of the view that this is desirable. It is no criticism of any particular political party to say that, in this area especially, ministers need independent scrutiny to help them resist the temptation to over optimism.

The tax and spending choices to be made by the Scottish government in the next Parliament are, properly, a matter of political argument: setting a balance between the right level of taxation and the provision of public services is a key responsibility for government, and this will now, in our view rightly, rest on ministers in St Andrews House, and not solely in Whitehall. The electorate will make their judgements on their proposals and actions accordingly. This is as it should be.

*The fiscal framework:*

It is clear that the negotiations to agree a fiscal framework have proved very difficult, and as a result the agreement is subject to review in five or six years' time. We are pleased that both governments have now agreed that 'The agreed fiscal framework set out in this document is consistent with the principles in the Smith Agreement' (Agreement paragraph 6). While it is arguably unfortunate that a permanent agreement could not be reached, this does provide an opportunity for analysis of what happens in practice, rather than argument about

what might happen, to inform the next set of negotiations, which are, we understand, to be preceded by an independent review.

The critical thing to prepare for such a review properly is the provision of data, published regularly and addressing the relevant questions. One of us (IM) was involved in a review of Treasury data which produced substantial improvements in the geographical material in the Treasury's annual publication *Public Expenditure Statistical Analysis*, and we have both made extensive use of the Scottish Government *Government Expenditure and Revenues in Scotland* material. Both publications meet the standards for National Statistics. To analyse the fiscal framework issues properly, however, more specific data is needed not merely on expenditure at the country level, but on the comparative levels of expenditure on devolved services, and how these are financed, ideally in each part of the United Kingdom.

It would therefore be helpful if either or both governments published data about how the fiscal framework operates in practice, on an annual basis. The data should include the following:

- Comparative expenditure per capita on devolved services for Scotland and the rest of the UK: at a minimum this should include the total comparable expenditure used in the calculation of the Barnett formula, and how it compares to expenditure in Scotland.
- Data on how this expenditure is financed: including in particular
  - the grant which is allocated under the Barnett formula, as it would be have been calculated excluding the effect of devolved taxes (what has been described as the "levels" method, explained [here](#))
  - the amounts which are calculated under the Treasury's proposed formula which will be put into practice under the agreement
  - the difference between the two
  - the additional amount which flows to Scotland as a result of applying the Scottish government's favoured formula of per capita indexation
  - and the amount which is yielded by the devolved taxes
- These data should be prepared in a way which enables them to be properly validated as National Statistics.

These data will provide transparency to the public in Scotland and elsewhere in the UK and will offer a firm factual basis for review on the dates agreed between the governments. The exercise would be comparable to the annual exercise conducted by *Government Expenditure in Scotland* of calculating how much North Sea revenue would accrue to Scotland under different assumptions about how it might be split between the two governments.

**SCOTTISH ASSOCIATION FOR MENTAL HEALTH (SAMH)**

1. SAMH thanks the Scottish Parliament Devolution (Further Powers) Committee for the opportunity to comment on the agreement between the Scottish Government and the United Kingdom Government on the Scottish Government's Fiscal Framework. We are pleased that an agreement has been reached, and that the powers agreed through the Scotland Bill can now be devolved according to the proposed timetable. A delay would have had a detrimental impact for individuals with disabilities, whether in terms of social security or employability support.
2. SAMH is a member of Disability Agenda Scotland and the Scottish Campaign on Welfare Reform. We refer the Committee to our previous collective statements regarding the transfer of powers, at no detriment to people with disabilities, and ask that a human rights-based approach is taken going forward.
3. In our submissions to the Smith Commission and the Scotland Bill, SAMH restricted our comments to employability and welfare support issues. Our comments on the fiscal framework agreement will therefore focus on these areas, given the impact they have on the individuals we support; however, we welcome news that the agreement achieved was at no detriment to Scotland. We look forward to learning how these new powers will be used to improve the lives of everyone in Scotland.
4. Paragraph 8 of the Agreement on the Fiscal Framework notes that welfare and employment programme spending will be calculated on a different basis than that of other further spending powers. Specifically, for the employment programmes, the Barnett formula will apply to changes in the entirety of UK government spending, including any elements funded by payment by results (PBR). SAMH highlights this as we do not yet know if a decision on the funding of the Scottish employment programmes will include this mechanism, and in what ratio between service fee and outcome; and query if this will have an impact on spending as a result. SAMH further notes that under DWP, Work Programme and Work Choice had different PBR structures; going forward, it is crucial that a fair payment by results system is in place to discourage the 'parking and creaming' that too often occurred in the Work Programme, through the relatively low service fee. SAMH proposes a 50:50 split between service and outcomes fees as a fairer settlement.
5. Paragraphs 15-17 of the Agreement sets out that welfare spending will be determined by the Barnett formula, with the comparability factor being set at 100%, with the uses of comparable mode and the IPC method for a transitional period. SAMH would welcome clarification that this will be of no detriment to people with disabilities in Scotland, given the higher percentage of the population in Scotland with disabilities than in the UK as a whole. While we note the annual reconciliation process in place until 2021 will top up any discrepancy in resource, we hope that the funding follows individuals with disabilities and will not be lost to the overall pot.



6. SAMH notes the communication between the Convener of the Committee and the UK Government's Minister of State for Employment, regarding the estimated reduction in funding for the contacted employment programmes; which was also explored with the Secretary of State for Scotland on 23 February 2016.
7. The contracted employment programmes will be devolved in April 2017; however, since the Smith Agreement and introduction of the Scotland Bill to the UK Parliament, there have been significant proposed changes to the scope of the contracted employment programmes, as announced in the Comprehensive Spending Review, but not yet made law by the UK Parliament – according to an FOI request<sup>9</sup>, DWP plans to publish a white paper in 2016. While it is true that the Smith Commission is devolving those powers to the Scottish Parliament and Scottish Ministers, this is a significantly reduced package of funding and scope of support than had been envisaged at the time of negotiation in 2014; and as this change has not been scrutinised or endorsed by the UK Parliament, it is potentially undemocratic to reduce this funding for the Scottish programmes in advance.
8. As a subcontracted provider of Work Choice, we also note that although the programmes will stop taking referrals from April 2017, many people receiving support from Work Choice (or indeed Work Programme) at that stage will have commenced support towards employment up to the handover between DWP and the Scottish Government; there could also be ongoing contracted support for individuals who require in-work support, and unsupported customers are also tracked by providers for six months after a job is secured in case support is required. We raise this to ensure that funding for such support should be calculated as part of the settlement going forward.
9. The Scottish Government's Fairer Scotland consultation on the devolved employability powers took place before the Comprehensive Spending Review announcement. As such, SAMH queries how open and respectful dialogue was between governments, with the planning for the forthcoming Scottish programmes likely to be undermined by the significant reduction in UK funding; and the plans proposed by the Scottish Government being unimplementable without significant restructuring of employability services within Scotland.
10. However, SAMH also notes that an estimated 90% of funding for employability is currently spent within Scotland<sup>10</sup>, and recommends that an audit of all spending should take place **alongside the Scottish Government's tendering process for future service delivery**, especially in terms of local authority spending; so that this overall funding available to

<sup>9</sup><https://www.whatdotheyknow.com/request/304617/response/753939/attach/html/2/FoI%204969%20reply.pdf.html>

<sup>10</sup> Cambridge Policy Consultants [http://www.employabilityinscotland.com/media/473005/sef - employability\\_research - cambridge\\_policy\\_consultants - final\\_report - november\\_2014.pdf](http://www.employabilityinscotland.com/media/473005/sef_-_employability_research_-_cambridge_policy_consultants_-_final_report_-_november_2014.pdf)

employment support can be deployed in the most effective way possible from April 2017. Better tracking of funding and outcomes should also be considered going forward.

11. In regards to other aspects of the Fiscal Framework, SAMH notes that the Paragraph 13 states that the initial baseline addition to the block grant for devolved welfare payments will be the UK government's spending on these areas in Scotland in the year immediately prior to the devolution of powers. In our earlier evidence, SAMH highlighted that the rollout of PIP within Scotland may lead to an ongoing reduction in access to disability support, as many individuals on the lower rate of care award for DLA may not qualify for this support. This will have an impact on social security spending throughout 2016-17. We raise this issue given the 'no detriment' principle, as well as highlighting the need to provide support to these individuals with disabilities in the short and longer term; and the impact on already devolved spending on health and social care services.
12. SAMH notes paragraph 89 of the Agreement, which states that any new benefits or discretionary payments introduced by the Scottish Government must provide additional income and not result in an automatic offsetting reduction by the UK government in their entitlement elsewhere in the UK benefits system. We would be concerned about how this could be interpreted for circumstances where an individual has been unfairly or inappropriately sanctioned, as is the case for many individuals with mental health problems<sup>11</sup>; and ask how the Scottish Government will proceed to ensure that their rights are protected.
13. Annex A of the Agreement notes the need to transfer a share of associated implementation and running costs in the policy area being devolved, sufficient to support the functions being transferred, at the point of transfer. SAMH welcomes this. We would appreciate further information about the proposed budget envisaged by the UK and Scottish governments for the administration of benefits and administration of the employment programmes and social security benefits, as to whether these sums are in agreement, as well as adequate to provide for the Scottish Government's preferred systems of support.
14. As well as our submission<sup>12</sup> to the Scottish Government's Fairer Scotland consultation on employment support, SAMH's manifesto<sup>13</sup> suggested a series of recommendations, which we hope will be adopted. We look forward to seeing the next Government's plans to create a fairer system in Scotland which we hope will address the structural discrimination against people with mental health problems, both in terms of accessing support and moving into work.

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<sup>11</sup> <https://www.gov.uk/government/statistics/jobseekers-allowance-and-employment-and-support-allowance-sanctions-decisions-made-to-march-2015>

<sup>12</sup> [https://www.samh.org.uk/media/457237/samh\\_response\\_to\\_fairer\\_scotland\\_consultation\\_october\\_2015.pdf](https://www.samh.org.uk/media/457237/samh_response_to_fairer_scotland_consultation_october_2015.pdf)

<sup>13</sup> [https://www.samh.org.uk/media/462301/samh\\_ask\\_once\\_get\\_help\\_fast\\_manifesto\\_for\\_the\\_2016\\_scottish\\_parliament\\_election.pdf](https://www.samh.org.uk/media/462301/samh_ask_once_get_help_fast_manifesto_for_the_2016_scottish_parliament_election.pdf)

# **EVIDENCE FROM THE SCOTTISH FEDERATION OF HOUSING ASSOCIATIONS**

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**SFHA SUBMISSION TO THE DEVOLUTON (FURTHER POWERS) COMMITTEE ON  
SCOTLAND'S FISCAL FRAMEWORK**

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**02 March 2016**

## **1. Purpose of Submission**

- 1.1. The SFHA welcomes the invitation from the Scottish Parliament's Devolution (Further Powers) Committee to submit our views on Scotland's fiscal framework published in February 2016 ahead of the committee's evidence session with Scottish and UK Government Ministers on Thursday 3 March. We are grateful to provide our views to the committee even within the tight time constraint of the publication of the fiscal framework and the committee's scheduled evidence session with Scottish and UK Government Ministers.
- 1.2. This submission follows our previous evidence to the Devolution (Further Powers) Committee across 2015 that outlined the SFHA's response to the Smith Commission, Draft Clauses and the Scotland Bill.
- 1.3. The SFHA is interested to ensure that the fiscal framework will enable the Scottish Parliament to make best use of the powers contained in the Scotland Bill in relation to the work of our members. As such, the following points are mostly directly related to housing, but intend to point the committee to useful routes of enquiry regarding the fiscal framework that will help the development of co-ordinated and coherent housing policy.

## **2. Who we are**

- 2.1. The SFHA exists to lead, represent and support housing associations and co-operatives throughout Scotland. There were 160 Registered Social Landlords (RSLs) across Scotland at the start of 2014. Their housing provision ranges across general and specialist need with around 280,000 homes, and over 5,000 places in supported accommodation. They currently add to new supply of housing, mainly for rent to people in need and at rents below market levels.
- 2.2. SFHA is the national voice of housing associations and co-operatives. Our role is to assist and support them to meet a diverse range of housing need, to provide high quality genuinely affordable housing and to develop sustainable communities. To this end, we wish to see Scotland develop a well-functioning housing system that is able to make a significant and effective contribution to tackling poverty, inequality and deprivation across Scotland.

- 2.3. Currently over 61% of all rental income of housing associations and co-operatives is sourced from Housing Benefit, making the changes brought about by the Scotland Bill, and underpinned by the fiscal framework, vital to the interests of our members.

### **3. SFHA views on Scotland's fiscal framework**

- 3.1. The following points indicate areas of the fiscal framework which appear to need clarification according to the SFHA. The below paragraphs are concise and the SFHA would be happy to expand upon any points if required.

#### **No Detriment due to Policy Spillover**

- 3.2. We would like to know whether the 'no detriment' principle enshrined in paragraphs 44 to 53 of the fiscal framework would future proof Scotland's social security measures and compensate the Scottish Government in the event that the UK Government initiated a policy decision that would have a negative impact upon the Scottish Government's expenditure.
- 3.3. To illustrate the point, it is important to get to the bottom of what would happen if the UK Government reduced spending on reserved benefits that directly caused the Scottish Government to increase their expenditure to compensate for the reduction. This could be illustrated by the real life example of the 'LHA Maxima' whereby the Chancellor announced a new policy in his Autumn Statement 2015 that directly impacts upon devolved policy around housing in Scotland. The UK Government proposes to use the Local Housing Allowance (LHA) as a cap on social rents which generates a variety of problems, for which please see the SFHA's research on the [LHA Maxima](#). Whilst we note that the concession of extra time for this policy to come into effect has been given for supported accommodation, in all other cases the provisions apply to new tenancies from 1 April 2016, merely weeks away. The UK Government has suggested that Discretionary Housing Payments (DHPs) could be used to mitigate any shortfalls between a vulnerable tenant's rent support and their charged rent. This could increase pressure for the Scottish Parliament to channel funds to compensate for this policy in order to safeguard both tenants' wellbeing and their ability to pay. Without such mitigation, tenants could fall into arrears which could prejudice the future economic viability of housing associations.

### **Dispute Resolution of Fiscal Framework**

- 3.4. The SFHA fully supports the development and definition of positive intergovernmental relations between the Scottish and UK Governments. Whilst we are not expecting any conflicts to arise between the two governments, it is vital to be clear about the escalation mechanism to resolve any potential disputes.
- 3.5. We are concerned that the mechanism for dispute resolution regarding the fiscal framework in paragraphs 98 to 104 appears to be incomplete. This is because paragraph 104, to ultimately resolve any disputes, would refer the dispute to the “Protocol on the Resolution and Avoidance of Disputes” attached to the Memorandum of Understanding (MoU) between the UK Government and the devolved administrations, however paragraph 104 states that the MoU is subject to review.
- 3.6. This means that the final step for dispute resolution (which can entail disputes over the calculation of the Block Grant Adjustment or consideration of spillover effects) is not currently confirmed in the fiscal framework. Presumably the existing MoU should be used until the MoU is revised. It is difficult to comment upon the adequacy of provisions in the existing MoU due to the time constraints around this submission.

### **Implementation of the Fiscal Framework**

- 3.7. The SFHA would like to know when the fiscal framework will come into effect, particularly concerning the no detriment to policy spillover paragraphs.

### **Key Contacts**

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