GUIDE TO THE SCOTTISH BUDGET – SUBJECT PROFILE

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This briefing is intended to assist new Members and others in understanding the principles and processes underpinning the Scottish Budget. The briefing explains some of the basic elements of public finance and describes the process of parliamentary scrutiny. It also summarises the historical developments that led to the current process and provides a one-page summary of a "standard year" of budget scrutiny.

This briefing updates SPICe briefing 03/24.

The Scottish Parliament

CONTENTS

THE ANNUAL BUDGET PROCESS

Other elements		
Spring: UK Budget End Year Flexibility announced before or after summer Recess	Mar/Apr: Publication of Annual Evaluation Report ⇩ Finance Committee oversees consultation process with subject committees ⇩ April/May: Subject committees examine relevant chapter. Send reports to Finance Committee ⇩ June: Finance Committee Reports to Parliament. Parliament debates this Report ⇩	**Stage One** (March -June) **IN SPENDING REVIEW YEARS** The Annual Evaluation Report (AER) is published comprising a high level overview of the Executive's spending plans and priorities. The relevant subject committees will be responsible for commenting on the relationship between expenditure plans and policy priorities in their spending area (this may also involve consultation with outside bodies and interested individuals). These responses will be co-ordinated by the Finance Committee, which will report to the Parliament. The Report will be debated by the Parliament before summer Recess. In the light of the Parliament's input (and comment from other interested bodies), the Executive will prepare firmer plans. N.B. Under a revised written agreement, Stage One will only take place in Spending Review (SR) years. However, there will be no AER for SR 07 due to the Scottish election of May 2007.
UK Spending Review November: Autumn revisions December: UK Pre-Budget Report	September: Executive publishes draft Budget and Spending Plans ⇩ Subject committees examine and send reports to Finance Committee ⇩ Finance Committee considers the draft budget and may propose alternative ⇩ December: Finance Committee Report; Mid Dec.: Parliament debates Report	**Stage Two** (September – December) Firmer spending plans are published in September/October. Again, each subject committee may report to the Finance Committee on relevant parts of the package, and, where Stage One has taken place, to identify whether the Parliament's Stage One recommendations have been acted upon by the Executive. At this stage the Finance Committee has the option of putting forward an alternative budget with the proviso that this must keep within the overall spending limit set by the Executive's draft budget. In any event, the Finance Committee will produce a report by December which will then be debated by the Parliament before Christmas Recess.
February: Spring revisions	⇩ January: Executive produces proposals (having considered Parliament's recommendations) ⇩ Parliament debates Budget Bill ⇩ Executive amendments and Parliamentary vote	**Stage Three** (January – February) The formal parliamentary process of enacting the Budget Bill. Only a member of the Executive may move amendments. Parliament has a vote to accept or reject it. If accepted, it will authorise expenditure for the following financial year.

INTRODUCTION

The Scottish Budget funds the expenditure of the Scottish Executive and its associated departments and agencies, health boards, local authorities, non-departmental public bodies, nationalised industries, the Scottish Parliament and Audit Scotland.

It funds both current, and the majority of capital, expenditure for these organisations. Current expenditure includes most direct expenditure on public sector pay and providing services that are continuing programmes financed each year, e.g. health or education. It does not include the purchase of tangible, physical assets. Capital expenditure is money spent on physical assets, for example, new construction, land, extensions and alterations to existing buildings and the purchase of fixed assets like plant and machinery.

ORIGINS OF THE BUDGET PROCESS

FINANCIAL ISSUES ADVISORY GROUP (FIAG)

The budget process for post-devolution Scotland was developed in the late 1990s and was influenced by the prevailing attitude that the new Parliament should be as open and accessible as possible. These values informed the work of the Consultative Steering Group (CSG), established by the then Secretary of State, Donald Dewar MP, under the chairmanship of Henry McLeish MP, in order to develop the principles by which the Parliament and Executive would operate. As part of this, a smaller group on finance issues was established to inform the CSG. This was known as the Financial Issues Advisory Group (FIAG) and consisted of public finance experts and senior civil servants. FIAG's report was published in 1998 and recommended a three stage process of budget scrutiny and authorisation that marked a departure from the Westminster model (Scottish Office 1998).

According to FIAG, the problems with budget scrutiny at Westminster were four-fold:

- the limited time available for discussion of budget proposals on the floor of the House
- the motions available do not allow the House of Commons to influence the budget proposals
- the range of documents in which financial information is presented and the way in which such documents are considered by Parliament is less than satisfactory
- many MPs lack the time and the technical expertise required to understand the budget documents

The report went on to argue that:

> Therefore, the Westminster system has not succeeded in promoting a constructive discussion of budgetary and expenditure priorities or a sensible dialogue between Executive and Parliament on these issues. As a result, the UK Parliament has no meaningful input and the approval of expenditure is made ex post facto. So, although the present system ensures that financial information is presented, it does not encourage the House and its Committees to make the best use of that information. (Scottish Office 1998, p28)

The Group produced 82 recommendations across five broad areas, the first two of which are most relevant to the budget process in Scotland:

- **Terminology** – the need to use plain English, and standard accountancy terms where possible to aid a wider understanding of and therefore participation in the budgetary process.
- **Budgetary procedures** – a budget process less dominated by the Executive, involving greater scrutiny by the Parliament than is the case at Westminster.
- **Accounting Arrangements** – including the adoption of "resource accounting and budgeting" as opposed to cash accounting, meaning that accounts measure resources when they are used as opposed to when they are paid for. Additionally the accounts should be presented in an accessible manner, should be wide ranging and should cover financial as well as performance information.
- **Accountability** – including providing clear lines of accountability through a system of "accountable officers" and explicit rights of access to a range of financial information for the Auditor General for Scotland,
- **Audit Arrangements** - including a need for a streamlining of audit functions.

Despite the move to three-yearly planning at the UK level, FIAG argued that there was still a strong need for statutory annual budget procedures and recommended that the Scottish Parliament introduce an annual procedure to scrutinise and approve the Executive's spending proposals. FIAG was determined that, as a matter of good practice, the Budget should be approved prior to the commencement of each financial year.

LEGISLATIVE BASIS

Basic financial provisions for the Parliament were set by the Scotland Act 1998 (c 46). This required the establishment of the Scottish Consolidated Fund into which payments were to be made by the Secretary of State for Scotland (mainly the assigned budget or block, which are discussed below), the proceeds of varying the tax rate, and other receipts. The Act also provides for the Secretary of State to lend Scottish Ministers up to £0.5 billion for meeting a temporary shortfall on the Fund. While taxation in general is reserved (except for the varying power), the Act allows for the Parliament to legislate on local taxation and charges for public services.

The arrangements were further developed by the Public Finance and Accountability (Scotland) Act 2000 (asp 1), which was the first primary legislation (barring an emergency Act) to be passed by the new Parliament.

In 1999, Jack McConnell, then Minister for Finance and Local Government, stated that the aims of the legislation were:

- to create a world class system of financial management for the Scottish Parliament
- to enable the Scottish Parliament to make informed, transparent decisions on expenditure and hold to account those who spend public money
- to meet the requirements of the Scotland Act for Scottish legislation on financial issues

HOW IS THE SCOTTISH BUDGET PROCESS CONSTRUCTED?

"The Budget" (also referred to as Total Managed Expenditure, or TME) is essentially the budget that the Scottish Parliament is required to approve each year with the passing of the Budget Act. The vast majority of the budget is funded by a grant authorised by Westminster. This used to be known as the "Scottish Block" but is now commonly called the "assigned budget". The budget is also composed of locally financed expenditure (non-domestic rates) and the variable rate of income tax should the Scottish Parliament opt to utilise its power in this regard. Scotland's share of European Structural Funding is also allocated through the assigned budget from Westminster.

Expenditure is paid from the Scottish Consolidated Fund which is, in effect, a "bank account" into which payments are made and from which all expenditure incurred by the Scottish Executive, Scottish Parliament and associated bodies is taken. Most of the receipts are paid into the Fund by the Secretary of State for Scotland, being the monies authorised by the Westminster Parliament to fund the Scottish assigned budget. Payments into the account also include receipts from charges and other income.

The budget is composed of a number of different categories of public expenditure:

- **Departmental Expenditure Limit (DEL)**: Broadly speaking, this is the bulk of the Scottish budget, which operates in much the same way as the old Scottish Block. DELs are spending plans that are set for three years in the first instance. DELs are divided into current and capital budgets and account for approximately 86% of the total Scottish budget in 2007-08. Changes to Scotland's allocated DEL budgets are determined through the Barnett Formula.

- **Annually Managed Expenditure (AME)**: This is spending included in the budget but not falling within DEL. Expenditure in AME is generally less predictable, more demand led and so less controllable than expenditure in DEL. It therefore needs to be "annually managed" rather than determined on a longer-term basis. The main AME items in the Scottish budget are student loans, housing support grant and NHS and teachers' pensions. AME accounts for approximately 14% of TME in 2007-08. The Barnett Formula does not apply to spending in AME.

(These components are not unique to the Scottish Budget. All other UK Government departments' spending plans are also composed of DEL and, where appropriate, AME).

- **Non-Domestic Rates Income (NDRI)**: This forms part of the Scottish Executive's support to local authorities. NDRI is more commonly referred to as business rates. All commercial properties pay rates based on rateable values of properties multiplied by a rate poundage. Prior to 1989 local authorities had responsibility for setting business rates in their own area; however, business rates are now set nationally. Local authorities collect the tax but the Executive determines how the income from the "national pool" of non-domestic rates is distributed amongst local authorities.

Although the Scottish Parliament technically has the freedom to establish its own budgeting and accounting procedures, a number of practical constraints have led to a particular model being adopted (Heald and McLeod 2002). The vast majority of funding is voted by Westminster and the Scottish Executive must be able to account for it in terms acceptable to the UK Treasury. In practice this means that Scotland, in common with Whitehall departments, has moved from traditional, cash-based accounting to a resource basis - known as Resource Accounting and Budgeting (see below).

In addition, the system must be "externally credible", which implies compliance with generally accepted standards of accounting practice.

THE SCOTTISH PARLIAMENT'S ROLE IN ALLOCATING EXPENDITURE

Apart from the power to vary the basic level of taxation, the Scottish Parliament's budgetary role is restricted to authorising expenditure, rather than generating income and raising taxes. This is one important difference between the process and its counterpart at Westminster. Budget scrutiny largely concentrates on allocations within the overall total, rather than the adequacy of that total – however, increasing income tax could yield additional funds if that was considered necessary.

The process is intended to allow the Parliament's subject committees the opportunity to comment on the Executive's spending plans at several points during the year prior to the annual budget being agreed. The expectation is that the subject committees should have an active role in scrutinising and making recommendations on spending priorities.

The process is divided into distinct stages and is guided by an agreement between the Finance Committee and the Executive originally agreed in 2000 (Finance Committee 2000), but updated in 2005 (Finance Committee 2005). The original agreement set an annual three-stage process, with the update in 2005 agreeing to a three-stage process in Spending Review years, with no Stage One of the process in non-Spending Review years. This change was to reflect the importance of the biennial Spending Review cycle in setting spending plans. The stages span the course of the year prior to the financial year being discussed, i.e. in 2006-07, the budget proposals for 2007-08 were analysed.

STAGE ONE
Will only take place in Spending Review year (unless there is a Scottish Parliamentary election)

Aim – The first stage allows the Parliament to consider the spending priorities across the current three-year spending review period; and assess progress made against key performance targets for each portfolio set in the previous Spending Review. This will involve consultation with the public and recommendations to the Executive.
Timescale – The Executive undertakes to submit to the Parliament by 31 March or the first day thereafter on which Parliament sits a "provisional expenditure plan"; an initial assessment of progress against the key performance targets for each portfolio set in the previous Spending Review; and its views on the priorities for the coming Spending Review period. This is currently known as the Annual Evaluation Report (AER). The Parliament responds to the Executive before the summer recess.
Activity – The Parliament's subject committees make comments on the budget in relation to the areas for which they have scrutiny responsibility (e.g. the health spending plans are scrutinised by the Health Committee). These responses are submitted to the Finance Committee which makes recommendations to the Executive in its Stage One report. There is a plenary debate on the report and the Executive is later required to respond in detail to the report.

STAGE TWO

Aim – This stage allows subject committees the opportunity to scrutinise the Executive's **Draft Budget** which presents firm spending plans for the following financial year. The second stage allows the Parliament to assess whether the Executive has taken on board the comments made at Stage One and to assess the allocation of any additional monies assigned by Westminster since the publications of the AER (for example, from the UK Budget or UK Spending Review). It also provides the Finance Committee with the opportunity to propose an alternative budget. The Executive must indicate at this point if it intends to use the tax varying power in the following financial year.
Timescale – Scottish Ministers normally present their proposals by 20 September (or the first sitting day thereafter). The Finance Committee produces a report, again to be debated by the Parliament before the end of December. However, this timescale will be affected by the delay in the 2007 UK Spending Review until the "autumn" (it is usually published in July), which will delay the Stage Two process for Scotland (as the Executive will not know the size of the Scottish settlement until the UK government publishes its Spending Review plans).
Activity – The Finance Committee again co-ordinates the responses from the subject committees. The Parliament debates a motion tabled by the Finance Committee. Committees or individual members may also table motions at this stage.

STAGE THREE

Aim – This stage provides Parliamentary authority for spending in Scotland for the following financial year.[1]
Timescale – Because of the extensive pre-legislative scrutiny, the time allocated to the passage of the Bill is truncated. The Executive must introduce the **Budget Bill** by 20 January each year (or the first day thereafter on which the Parliament sits). Stage 3 of the Bill must begin between 20 and 30 days from introduction. If the Budget Act is not in place by the end of the financial year, the Public Finance and Accountability (Scotland) Act 2000 allows for expenditure to continue for previously approved purposes up to the same rate as the previous year.
Activity –Only a member of the Executive is allowed to bring forward amendments to the Bill at this stage. The Parliament finally passes the Budget Bill, approving expenditure for the following financial year.

The documents published at each of the three stages serve different purposes and are presented in different ways. The Stage One and Two documents, the AER and the Draft Budget, are presented on a portfolio basis (i.e. in terms of Ministerial responsibility). However, the Budget Documents accompanying the Budget Bill will now re-present these figures on a Directorate General (or Vote) basis. This is for reasons of "stability" (i.e. Directorate Generals are less likely to alter than ministerial portfolios) and also because each budget heading is allocated an accountable officer within the Scottish Executive who is accountable to the Parliament for the use of the resources under their control (Public Finance and Accountability (Scotland) Act, asp 1 2000, s15).

The documents record expenditure at different "levels" to ensure that scrutiny of the budget can be relatively detailed. "Level One" is expenditure recorded at portfolio level (e.g. Education and

[1] While this is the third stage of the budget process, the passage of the Budget Bill itself, in common with other Scottish Parliament legislation, also has three stages.

Lifelong Learning, Justice or Health and Wellbeing). "Level Two" is expenditure recorded at sub-portfolio level (e.g. Student Awards Agency for Scotland (within Education and Lifelong Learning), Scottish Prison Service (within Justice) or Health Improvement (within Health and Wellbeing)). Finally, "Level Three" records expenditure in greater detail (e.g. Grants and Bursaries, Capital Spending, or Her Majesty's Inspectorate of Education).

TAX VARYING POWER

Sections 73 to 80 of the Scotland Act 1998 allow the Scottish Parliament to raise or lower the basic rate of income tax by up to three pence (in multiples of half pence). Any variation would apply to the taxable income of Scottish taxpayers. A resolution to exercise the tax-varying power can only be moved by a member of the Executive. The UK Treasury is required to propose amendments to these powers where changes to the UK taxation structure (e.g. in the width of the various taxation bands) would significantly alter the Parliament's ability to raise or forgo taxation revenue.

Sections 77 and 78 of the Scotland Act 1998 provide that an estimate of the revenue to be raised through any increase in the basic rate will be paid by the Inland Revenue to the Scottish Consolidated Fund. Were the basic rate to be reduced in Scotland, the Scottish Consolidated Fund would be required to pay an amount equal to the estimated shortfall into the UK Consolidated Fund. When the tax-varying power is used, the Scottish Departmental Expenditure Limit (DEL) will be adjusted to take account of any change in the amount available to spend. At the same time, where its use produces a cost to UK Government departments, the DEL will be adjusted downwards to compensate. If, for example, the basic rate of tax is increased by one penny the DEL will be adjusted to take account of running costs for the DSS and the Inland Revenue. The latest UK Budget (Treasury 2007) estimates that a one penny increase in the basic rate of income tax would be worth £300m in 2007-08, and £370m in 2008-09 (including the proposed changes to income tax announced by the Chancellor).[2]

UK FACTORS INFLUENCING SCOTTISH BUDGET

In addition to the allocation of the assigned budget from Westminster, a number of factors influence the total amount of money coming to the Scottish Consolidated Fund.

SPENDING REVIEWS

The UK Spending Reviews (SRs) mark the most important release of additional funding to UK departments and the Scottish Budget. Prior to 1997, Scottish Office budgets were drawn up in annual negotiation with the Treasury (although forward planning was done on a loose three-year basis, known as the Public Expenditure Survey (PES)). In 1998, the Labour Government replaced this model with the Spending Review process described as a "three year plan reviewed every two years". The intention has been to fix firm three-year plans for the bulk of the budget (the part known as the Departmental Expenditure Limit), and only annually plan for those parts of the budget that cannot be planned for over a longer time-frame (Annually Managed Expenditure). The first Spending Review was announced in 1998 and was described as a

[2] These changes involved removing the starting rate and cutting the basic rate of income tax from 22 pence to 20 pence in April 2008.

comprehensive review of departmental aims and objectives alongside an analysis of each spending programme. It set new baselines for expenditure and three subsequent SRs in 2000, 2002 and 2004 have updated these baselines. The SR planned for 2006 was delayed until summer 2007 and is now expected to be published in "autumn" 2007 and will set budgets for 2008-2011. The last SR in 2004 set plans up to and including 2007-08.

Because Spending Reviews thus far have occurred during a period of expansion of public spending, each Review has had the effect of releasing additional resources to Scotland, mainly via the Barnett Formula. UK Spending Reviews have historically been announced in the summer, in between Stages One and Two of the Scottish budget process. Although, as mentioned above, with the latest 2007 SR being delayed until "autumn", it is likely that this year will see a delay to the publication of Scotland's SR and Draft Budget plans.

UK BUDGETS

In addition, the UK Budget can also increase (or, in theory, decrease) available resources, outwith the SR process. Increased new spending announced by the Chancellor in his Budget statement in March or April and in his Pre-Budget statement in December will reach Scotland as a consequential of the Barnett Formula (see below).

Both these events, while bringing more money to Scotland via the Barnett Formula, mean that the total budget estimated in the Draft Budget can be substantially different in one year compared with the next, and can differ from the Stage One figures.

END YEAR FLEXIBILITY (EYF)

In line with UK Government accounting rules, departments are not permitted to overspend in a financial year. This means that the Scottish Parliament cannot authorise expenditure in excess of the total assigned budget and other sources of income. Indeed, the Treasury's Statement of Funding Policy, which lays out the arrangements for funding the devolved administrations, states:

> Breaches in DELs which materialise at the end of the year would be viewed by the United Kingdom Government as serious mismanagement on the part of the devolved administration and the presumption would be that the following year's DEL and grant to the devolved administration would be reduced by an amount equivalent to the breach. The same rule applies to Departments of the United Kingdom Government. (Treasury 2004, p27)

However, the rules relating to underspend were relaxed in the late 1990s. Under previous UK fiscal regimes, any departmental underspend would automatically transfer back to the centre. However, departments (including those in or under the control of the devolved administrations) are now allowed much greater flexibility to carry forward unspent monies from one year to the following. This is partly a reflection of the move to three-year planning in the Departmental Expenditure Limits (AME expenditure is not eligible to be carried forward because it is allocated on an annual basis).

In Scotland, current Scottish Executive policy permits each department within the Executive to retain 25% of its current (or resource) budget underspend and 100% of any specified capital budget underspend, via the End Year Flexibility (EYF) process. The remaining 75% is returned to be centrally allocated by the Executive. Departments can then make a case for additional in-year resources from that amount. There is no formal bidding process, just a series of discussions between the Finance Ministers and other Ministers. In theory, a department could receive more than 100% of its EYF total. EYF levels (ie, amounts of EYF allocated to portfolios) since devolution are presented in the table below. Until the money is spent the funds are held by the Treasury. At 31 March 2006 the amount held on behalf of the Scottish Executive was £1.454bn (Treasury 2006).

Table 1: End Year Flexibility allocations since 1999

Year	£m
1999-00	435
2000-01	718
2001-02	643
2002-03	693
2003-04	441
2004-05	690
2005-06	273
2006-07	25

According to the Scottish Executive, EYF occurs for the following reasons:

- finance put aside against future, planned spending commitments
- additional in-year income
- fluctuations in demand within demand-led budgets
- a contingency reserve
- underspend from slippage in the implementation of some projects (mainly capital)
- budgets controlled by other, arms-length bodies that count against the assigned budget for the purposes of reconciling EYF with HM Treasury (Scottish Executive 2002).

Heald and McLeod (2002) suggest some additional reasons for the high levels of underspend:

- the availability of EYF means that departments no longer feel pressured to indulge in unnecessary year-end spending
- the recent large year-on-year increases in DELs have led to departmental difficulties in spending the additional money
- where capital programmes had been run down, it has taken a considerable period of time for departments to re-equip themselves to manage such programmes
- the diversion of effort into Private Finance Initiative (PFI) schemes may also have contributed to underspending on capital
- the increasing amount of top slicing of resources for particular purposes, has built more fragmentation into programmes. In their view, this is likely to lead to cumulative underspend as the ability to move resources quickly is impeded

CENTRAL UNALLOCATED PROVISION (CUP)

The basic purpose of introducing EYF was to prevent the inefficient use of unspent monies at the end of the financial year. Following on from this, on 24 June 2004, then Finance Minister, Andy Kerr, announced a new approach to managing unspent money. He created a new facility known as the “Central Unallocated Provision” (CUP) to hold the portfolios’ unspent monies. Under the CUP system, portfolios retain the entitlement to draw down any of their resources held in the CUP when they are needed, but in the meantime the provision is available to Ministers to borrow money in the CUP to meet alternative spending priorities.

BUDGET REVISIONS

Each Budget (Scotland) Act authorises planned expenditure for the following financial year. However, in reality, spending commitments will inevitably shift within that year and more, or less, money will be required for different spending areas than originally envisaged. Therefore, the Executive is able to request parliamentary authority to make in-year changes. These are known as “budget revisions”, and usually occur in the autumn and spring (although there is also the opportunity for a summer revision where required). These are changes that apply to the current financial year and are outwith the three-stage process outlined above (which always scrutinises plans for the next financial year).

Budget revisions usually seek parliamentary approval to:

- transfer monies between departments of the Scottish Executive
- allocate transfers of monies between Whitehall and the Scottish Executive

The Finance Committee has responsibility for scrutinising the proposals, in the relevant Scottish Statutory Instrument, and making a recommendation to the Parliament as to whether or not they should be agreed.

RESOURCE ACCOUNTING AND BUDGETING (RAB)

This is a fundamental change to the way in which the UK Government accounts for and controls public expenditure. Until financial year 2001-02, the UK Government accounted for expenditure solely on the basis of cash spent and cash received in any one year, known as cash accounting (or appropriation accounts).

RAB moves away from a cash-based system to one that takes account of resources and assets. It is based on the resources consumed by each department and treats capital and current expenditure relative to economic significance. RAB is intended to provide a better measure of the cost of the activities of central government departments. Its impact will be greater on the presentation of budgets for departments with heavy capital expenditure (e.g. roads), as it includes a charge for depreciation, a measure of the consumption or wearing out of capital assets.

The UK Government’s view is that RAB provides the following benefits:

- new incentives for the management of assets and investment
- a long-term planning framework removing distortions and perverse incentives intrinsic in the old budgeting system, and building in new incentives to reward good management
- better information for managers on the costs of providing public services, on which to base decisions, and better information for Parliament and the public
- higher quality financial management throughout Government (Treasury 2003)

RAB became fully operational in 2003-04, making comparisons between years before and after that date difficult because the figures are presented on a different basis.

THE RESERVE (OR CONTINGENCY FUND)

The Reserve is a small budget maintained by the Scottish Executive in order to meet (from within the assigned budget) exceptional expenditure that could not have been foreseen at the time the budget was set. FIAG recommended the establishment of some kind of fund:

> There is a requirement to provide funding to meet sudden, unexpected needs. In most cases, this will require additional expenditure on areas where spending already takes place. For example, in the event of a natural disaster, it may be necessary to supplement grants to a local authority, For this reason, FIAG recommends that Parliament makes arrangements to set aside each year, a Reserve. This would consist of money that will be held back to deal with any crises that arise. (Scottish Office 1998)

Access to the Reserve is essentially a bidding process, with the relevant Minister applying for additional funding (with, where appropriate, Cabinet approval). Parliamentary authority would be sought as part of the usual process of in-year revisions (i.e. scrutinised by the Finance Committee).

In addition, a UK Reserve exists and access to this by the Secretary of State for Scotland on behalf of the Scottish Executive can be considered by Treasury Ministers in exceptional circumstances. Because DELs set three-year spending plans, the expectation of the UK Government is that all UK departments and the devolved administrations must spend within these plans and absorb unforeseen pressures. The presumption is that devolved administrations will contain pressures on their budget by re-allocating priorities, not through in-year access to the UK Reserve (the move toward End Year Flexibility is designed to encourage this process). The devolved administrations will be treated in the same manner as United Kingdom departments in decisions on access to the DEL Reserve (Treasury 2004, p25). Applications might be made where large amounts of unforeseen expenditure were incurred by the Scottish Executive (e.g. the Lockerbie Trial or the impact of Foot and Mouth Disease).

THE BARNETT FORMULA

The formula was introduced in 1978 and is designed to apply automatically to Scotland a proportionate share (based on population) of any increase or decrease in comparable UK spending programmes.[3] UK spending departments reach agreement with the Treasury through departmental negotiation and the Barnett Formula then ensures that Scotland and Wales receive increases in the same spending areas, on the basis of their population share.

As originally devised, the population proportions reflected population estimates from 1976 by which Scotland received 10/85^{ths} of any increase/decrease in comparable programmes. In 1992, these were "recalibrated" to reflect changes in population ratios based on data from the 1991 census. Following devolution, population shares are re-calculated annually on the basis of the latest mid-year population estimates for England, Scotland and Wales published by the

[3] In this sense, "UK" means either English or English and Welsh programmes.

Office of National Statistics (Treasury 2004 p.10). The population percentages currently applying[4] are:

Scotland as a proportion of England:	10.10%
Scotland as a proportion of England and Wales:	9.54%

The formula is applied only when there are *changes* to expenditure in England and, once allocated, Scottish Ministers are not obliged to spend this money in the same spending area as in England. The formula only applies to comparable devolved spending and has no relevance to UK Government expenditure in Scotland by other departments, e.g. the Ministry of Defence or the Department for Work and Pensions. Contrary to some popular misconception, the Barnett Formula is not and never has been a "needs-based formula" and has never attempted to allocate expenditure on the basis of comparative need. It is simply a transparent way of allocating changes on the basis of population share.

The Formula applies to changes in the assigned budget within DEL, but not to Annually Managed Expenditure (AME) which is calculated on an annual basis according to actual requirement.[5]

AUDITING ARRANGEMENTS

The **Auditor General for Scotland** is responsible for scrutinising the accounts of departments of the Scottish Executive and most other public spending bodies (with the exception of local authorities and fire and police boards, which are the responsibility of the Accounts Commission for Scotland). He is an independent official, appointed by the Queen on the nomination of the Parliament and can only be removed by a two-thirds majority of the members of the Parliament.

Scottish Ministers, the Lord Advocate and any other accountable individual receiving money from the Scottish Consolidated Fund (e.g. the Registrar General), are required by the Public Finance and Accountability (Scotland) Act 2000, to prepare accounts for each financial year. The Auditor General must audit these accounts (either himself or through an appointed auditor) and send both the accounts and the auditor's report to Scottish Ministers who must lay the accounts before the Parliament.

He may also conduct Value-For-Money (VFM) examinations or "performance audits" into the economy, efficiency and effectiveness of public bodies in their use of resources.

The **Accounts Commission** for Scotland was set up in 1975 and is independent of both central and local government. The Commission is responsible for securing the audit of the 32 local authorities and 34 joint boards. It also seeks to promote "best value" and aims to assist audited bodies to achieve economic, efficient and effective use of their resources.

Audit Scotland provides services to the Auditor General and the Accounts Commission for Scotland. Its role is to ensure that the Scottish Executive and public sector bodies in Scotland are held to account for the proper, efficient and effective use of public money. It is composed of staff of the Accounts Commission, together with former staff of the Scottish office of the National

[4] Correspondence between the Treasury and the Scottish Executive, September 2006.
[5] Main AME items in the Scottish budget include Student Loans spending, housing support grant and NHS and teachers' pensions, motorways & trunk roads cost of capital charge, local authority self-financed expenditure and non-domestic rates

Audit Office. Audit Scotland receives funding as a discrete vote within the Budget (Scotland) Act each year, thereby maintaining its independence from the Scottish Executive.

POTENTIAL BUGETARY DEVELOPMENTS IN THIS PARLIAMENTARY TERM

This section presents some possible developments in the budget process during the course of this Parliament.

In the recent Scottish Parliamentary election three of the four main parties had manifesto commitments which were to varying degrees open to the possibility of the Scottish Parliament attaining additional powers. These commitments may lead to an increased level of debate on the fiscal powers of the Parliament during this term.

The SNP's manifesto favoured complete independence for Scotland; the Liberal Democrats favoured more powers for the Parliament and a form of "fiscal federalism to increase significantly the taxation powers of the Scottish Parliament"; and the Conservatives stated that although they were staunch defenders of the Union, they were open to having a "debate" on the powers of the Scottish Parliament. The Labour Party, who favoured retaining the status quo, claimed during the campaign that they did not rule out the gradual accretion of more powers to Edinburgh.

There is a wide literature on the possible financial models for Scotland ranging from those who defend the status quo (Ashcroft, Christie and Swales); those who propose a model of finance based on "equity and needs" (Mackay & Bell, McLean and McMillan); those proposing full "fiscal autonomy" (Hallwood and MacDonald); and those proposing a model of "fiscal federalism" (the Steel Commission). For more detailed information summarising the various points made in this debate, see Scottish Council for Development and Industry 2007.

Other potential budgetary developments for members to be aware of in this parliamentary term are as follows.

- There are potential implications for Scotland's budget process stemming from minority government. A minority government situation may increase the likelihood of moves to suggest amendments to the budget at Stage Two of the process.

- There may be increased demands for a review of Barnett and the existing UK funding arrangements from those who believe that the existing financial settlement is overly generous to Scotland and Northern Ireland, compared to other parts of the UK?

- The upcoming UK Spending Review is expected to usher in a tighter fiscal settlement for Scotland than has been the case in recent times. This will mean that budgetary choices and scrutiny will likely be tougher than in previous years, with less discretionary spend available to the government.

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