Financial Scrutiny Unit Briefing
Draft Budget 2017-18

This briefing summarises the tax and spending plans contained within the Scottish Government’s Draft Budget 2017-18.

More detailed presentation of the budget figures can be found in the Draft Budget 2017-18 spreadsheets. The Draft Budget 2017-18 level 1 and 2 spreadsheet covers higher level figures. Level 3 is the most detailed breakdown contained in the Government’s spending plans and can be found in the Draft Budget 2017-18 level 3 spreadsheet. The FSU has also published the most detailed available level 4 figures.

A high level overview of the budget can be found in the Draft Budget 2017-18 infographic and an overview of the taxation plans in the Income Tax and Devolved taxes infographic.
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EXECUTIVE SUMMARY

2017-18 marks a significant shift for the Scottish budget as it moves from being a largely spending budget to a tax and spending budget. With this change, economic performance becomes a much more significant issue in determining the size of the spending envelope. This change comes at a time of significant economic uncertainty arising from the Brexit vote and the downturn in the oil and gas sector.

Scotland’s budget is growing in 2017-18, with Total Managed Expenditure (TME) increasing by 1.0% in real terms to £38,048m. The discretionary spending power of the Scottish budget, the Departmental Expenditure Limit (DEL), increases in size. DEL Resource, which covers day-to-day expenditure increases by 0.7% in real terms to £27,597m. DEL Capital increases by 8.7% in real terms to £3,896m. DEL Capital is also supplemented by the borrowing powers of Scotland Act 2016 which allows borrowing of £450m in 2017-18.

In terms of spending, Health and Sport is the largest budget portfolio, comprising just under 42% of DEL. The next largest is Communities, Social Security and Equalities, which includes Local Government and comprises just under 27% of DEL.

In terms of taxation, income tax rates will be set at the same level as the rest of the UK, but the threshold at which the higher rate of tax is paid in Scotland will be lower (£43,430) than in the rest of UK (£45,000). This will mean Scottish taxpayers earning £45,000 will pay £314 more per annum in income tax compared to taxpayers in the rest of the UK in 2017-18. The Scottish Government forecast that this policy difference with the rest of the UK will contribute to the Scottish budget being £79m higher than it would have been had the UK policy been replicated.

The Scottish Government has forecast income tax and devolved taxes for 2017-18, a task that will be done in the future by the Scottish Fiscal Commission (SFC). Scottish forecasts for income tax are higher than the Office for Budget Responsibility (OBR), but the OBR’s forecasts for Land and Buildings Transaction Tax (LBTT) are higher than the Scottish Government’s. The SFC has adjudged the Scottish Government’s forecasts as “reasonable”.

To reflect the retention of income tax and devolved taxes in the Scottish budget, the block grant will be adjusted according to an initial baseline adjustment (based on tax receipts in the year prior to devolution) and an indexation mechanism.

The Scottish Government plans to supplement its DEL Capital plans with Non-profit distributing (NPD) financing of infrastructure projects. These will be worth £416m in 2017-18, almost half the value of the previous year.

A wide range of interpretations of the local government budget have been presented since the publication of the Draft Budget, which can produce a confusing and complicated picture. The “Total Local Government” line is shown as falling by either 1.6% in real terms (when compared to Draft Budget 2016-17) or falling by 3.2% in real terms (when compared to Budget 2016-17).

In terms of “General Revenue Grant + Non-Domestic Rates Income”, which makes up the core revenue settlement for local authority services, this is shown as falling by either 4.5% (when compared to Draft Budget 2016-17) or 5.8% (when compared to Budget 2016-17). When “other sources of support” are added to the Local Government allocations, there is either a small real terms increase (+0.4%) when comparing with the 2016-17 Draft Budget, or a small real terms decrease (-1.1%) when comparing with the latest Budget for 2016-17.

Draft Budget 2017-18 confirms an end to the Council tax freeze, with increases capped at 3%.
CONTEXT

Draft Budget 2017-18 was published on 15 December 2016 and presents the Scottish Government’s draft spending and tax plans for 2017-18. Publication of the Draft Budget commences a parliamentary budget scrutiny process which will be truncated due to the Scottish budget being published later than the September date contained in the Written Agreement between the Scottish Government and the Finance Committee.

2017-18 will represent a significant change to the Scottish Budget process with approximately 40% of the Scottish discretionary spending power coming from taxation raised in Scotland. Non-savings non-dividend Income tax will be largely under the control of the Scottish Parliament (the personal allowance will remain reserved) in addition to the already devolved taxes (Council Tax, Non-Domestic Rates, Land and Buildings Transaction tax (LBTT) and Scottish Landfill Tax (SLfT)). With a larger proportion of the Scottish budget now dependent on tax receipts, economic performance, and specifically the relative economic performance of Scotland compared with the rest of the UK, will have a greater direct impact on the size of the Scottish budget than it has in the past.

Draft Budget 2017-18 is published against a backdrop of economic uncertainty arising from the Brexit vote of June 2016 and the downgrading of economic prospects by a number of independent forecasters. It comes at a time of challenge for the North Sea oil and gas sector. In its Economic Commentary published two days before the Draft Budget, the Fraser of Allander Institute (2016) stated “on balance, we continue to forecast a weak outlook with growth below trend to 2019.” The Scottish Government forecast growth of 1.3% in 2017-18 (Scottish Government 2016b), and generally have higher Scottish forecasts for growth than other economic forecasters. Scottish Government forecasts are for financial years, while other forecasts are for calendar years.

Table 1: Comparative Scottish Growth Forecasts

<table>
<thead>
<tr>
<th></th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fraser of Allander</td>
<td>1.0</td>
<td>1.1</td>
<td>1.3</td>
<td>1.6</td>
</tr>
<tr>
<td>Ernst &amp; Young</td>
<td>0.7</td>
<td>0.4</td>
<td>1.2</td>
<td>1.4</td>
</tr>
<tr>
<td>PWC</td>
<td>1.8</td>
<td>0.9</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table 1.01 in the introduction to the Draft Budget document presents the Scottish Departmental Expenditure Limit (DEL), which is the discretionary spending power of the Scottish Government. Scottish Government DEL is determined by three main elements: a block grant from HM Treasury, forecasts of receipts generated by taxes devolved to Scotland by Scotland Acts 2012 and 2016, and planned use of devolved borrowing powers. Table 1.01 presents the Scottish DEL allocations through to financial year 2019-20 in cash terms. This table shows that Total DEL grows in 2017-18 (+2.6% on 2016-17), but is expected to grow more slowly in 2018-19 (+0.9%) and 2019-20 (+1.3%). Although the block grant allocations are known through to 2019-20, this budget only allocates these monies for one financial year, 2017-18.

The tables in the budget document for individual portfolios present three sets of figures:

- 2016-17 Draft Budget (as published in December 2015)
- 2016-17 Budget (which are 2016-17 Draft Budget figures updated by the 2016-17 Autumn Budget Revision (published in September 2016)
- 2017-18 Draft Budget figures.

This briefing compares the 2017-18 Draft Budget figures with the 2016-17 Budget figures, as these represent the most recent Budget plans for 2016-17 and more accurately reflect what will be spent in the current financial year. For the local government budget, both options are presented. The local government budget is discussed in detail later in this briefing.

Scotland Act 2016 allows the Scottish Government to borrow up to 15% of its overall DEL Capital borrowing limit of £3bn, which is equivalent to £450m per annum. The Draft Budget indicates that the Scottish Government intends to use the full borrowing limit in 2017-18 of £450m. Table 1.01 still includes a borrowing figure of £306m in the DEL figure of 2015-16 even though no borrowing was used in that financial year, and it also includes a borrowing figure of £316m in 2016-17, although there has been no borrowing as yet in 2016-17.

Many of the numbers in this briefing are adjusted for inflation (presented in “real terms” or 2016-17 prices) and the deflator used is the HM Treasury GDP deflator, as used in the Draft Budget, which is 1.45% in 2017-18.

**BUDGET ALLOCATIONS**

Total Managed Expenditure (TME) comprises DEL and Annually Managed Expenditure (AME). TME in 2017-18 is £38,048.2m. Figure 1 shows how this is allocated between DEL and AME. DEL is the element of the budget over which the Scottish Government has discretion and is divided into Capital and Resource. AME is expenditure which is difficult to predict precisely, but where there is a commitment to spend or pay a charge, for example, pensions. Pensions in AME are fully funded by HM Treasury, so do not impact on the Scottish Government’s spending power. Non-Domestic Rates (covered below) are also classed as an AME item in the budget and form part of Local Government spending.

**Figure 1: Allocation of TME, 2017-18, cash terms**
Figure 2 shows the real terms changes in DEL Resource and DEL Capital between 2016-17 and 2017-18. DEL Capital numbers include the £450m in proposed borrowing in 2017-18.

Figure 3: DELs by portfolio, 2017-18

- **Communities, Social Security and Equalities**: £8,477m
  - Cash: ▲ 1.2%
  - Real: ▼ 0.3%

- **Rural Economy and Connectivity**: £2,867m
  - Cash: ▲ 6.7%
  - Real: ▲ 5.2%

- **Education and Skills**: £2,846m
  - Cash: ▲ 2.6%
  - Real: ▲ 1.1%

- **Health and Sport**: £13,126m
  - Cash: ▲ 2.1%
  - Real: ▲ 0.6%

- **Justice**: £2,580m
  - Cash: ▲ 2.6%
  - Real: ▲ 1.2%

- **Economy, Jobs and Fair Work**: £385m
  - Cash: ▲ 5.1%
  - Real: ▲ 3.6%

- **Culture, Tourism and External Affairs**: £325m
  - Cash: ▲ 8.4%
  - Real: ▲ 6.9%

- **Scottish Parliament and Audit Scotland**: £103m
  - Cash: ▲ 0.9%
  - Real: ▼ 0.6%

- **Crown Office and Procurator Fiscal Service**: £111m
  - Cash: ▼ 2.1%
  - Real: ▼ 3.5%

- **Finance and the Constitution**: £175m
  - Cash: ▲ 68.8%
  - Real: ▼ 1.7%

- **Administration**: £193m
  - Cash: ▲ 0.3%
  - Real: ▲ 66.3%

- **Environment, Climate Change and Land Reform**: £307m
  - Cash: ▲ 66.8%
  - Real: ▲ 64.4%

*Figures may not sum due to rounding.*
Figure 3 shows the DEL Portfolio budgets and their cash and real terms change in 2017-18. Key points to note are as follows:

- Health and Sport is the largest portfolio, comprising 41.7% of total DEL in 2017-18. This is a decrease on Health and Sport’s share of the 2016-17 Budget, which is 42.1%.

- The next largest portfolio is Communities, Social Security and Equalities which comprises 26.9% of total DEL in 2017-18.

- Environment, Climate Change and Land Reform receive a large percentage increase, largely due to an increase in the Scottish Water capital grant relative to the current financial year. Excluding Scottish Water the ECCLR portfolio increased by 1% compared to a 3% increase in the overall DEL.

- There is a similarly large increase in the Finance and Constitution percentage change due in large part to a “Scotland Act 2016 non-tax Implementation” budget line being included in the plans for the first time.

RESOURCE AND CAPITAL EXPENDITURE

Figure 4 shows the split between DEL Resource and DEL Capital by portfolio in 2017-18. This shows that the Rural Economy and Connectivity; Environment, Climate Change and Land Reform and Economy, Jobs and Fair Work portfolios have the largest element of Capital spending as a share of spending.

Figure 4: Resource and capital split

TAXATION POLICY AND REVENUES

INCOME TAX

Draft Budget 2017-18 sets out the Scottish Government’s proposed rates and bands for income tax. These are presented in table 2 below. The rates will be set at the same level as in the rest of the UK. However, the Scottish Government proposes that the Scottish higher rate threshold should increase by inflation to £43,430 in 2017-18 compared to a larger increase in the higher
rate threshold in the UK which will rise to £45,000 in 2017-18. This means that individuals earning £45,000 will pay £314 more per annum in Scotland compared with the rest of the UK. The Scottish budget will receive an additional £79m in 2017-18 from not replicating the UK Government’s higher rate policy.

Table 2: Scottish income tax rates and bands

<table>
<thead>
<tr>
<th>Scottish Income Tax Rates</th>
<th>Scottish Bands</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scottish Basic rate 20%</td>
<td>Over £11,500* - £43,430</td>
</tr>
<tr>
<td>Scottish Higher rate 40%</td>
<td>Over £43,430 - £150,000</td>
</tr>
<tr>
<td>Scottish Additional rate 45%</td>
<td>Over £150,000 and above**</td>
</tr>
</tbody>
</table>

* Assumes individuals are in receipt of the Standard UK Personal Allowance
** Those earning more that £100,000 will see their Personal Allowance reduced by £1 for every £2 earned over £100,000.

For the first time, the Scottish Government has produced forecasts for Scottish income tax. Figure 5 shows the Scottish Government’s forecast compared with those of the Office for Budget Responsibility (OBR). It shows the Scottish Government’s forecasts to be higher than the OBR, which will in part reflect the Scottish Government’s decision not to replicate the UK Government’s increase in the higher rate threshold in 2017-18. The OBR forecasts do not take account of the UK Government’s planned further increases in the personal allowance and higher rate threshold beyond 2017-18, assuming only inflationary increases after 2017-18. The Scottish Government forecasts take account of the announced plans for the full forecast period (as set out in Scottish Government 2016g).

Figure 5: Scottish Government and OBR Income tax forecasts, £m

The Scottish Fiscal Commission (SFC) carried out an independent assessment of the Scottish Government’s forecasts and published its Report on Draft Budget 2017-18 the same day as the Draft Budget was published (Scottish Fiscal Commission 2016). The SFC assessed the forecast tax receipts and economic determinants for forecast non-domestic rate income as “reasonable”.

From 1 April 2017, the SFC will become an independent statutory body and will take responsibility for preparing and publishing forecasts from financial year 2018-19 for income tax,
fully devolved taxes and onshore GDP. It will also be responsible for producing forecasts for demand-driven welfare spending when that is devolved.

DEVOLVED TAXES

LBTT and SLfT have been devolved to the Scottish Parliament since 2015. The Draft Budget proposes no changes to the rates and bands of LBTT, which have remained the same since they were devolved.

Table 3: LBTT bands and rates

<table>
<thead>
<tr>
<th>Residential transactions</th>
<th>Non-domestic transactions</th>
<th>Non-residential leases</th>
</tr>
</thead>
<tbody>
<tr>
<td>Band</td>
<td>Rate</td>
<td>Band</td>
</tr>
<tr>
<td>Up to £145,000</td>
<td>Nil</td>
<td>Up to £150,000</td>
</tr>
<tr>
<td>£145,001 to £250,000</td>
<td>2%</td>
<td>£150,001 to £350,000</td>
</tr>
<tr>
<td>£250,001 to £325,000</td>
<td>5%</td>
<td>Over £350,000</td>
</tr>
<tr>
<td>£325,001 to £750,000</td>
<td>10%</td>
<td></td>
</tr>
<tr>
<td>Over £750,000</td>
<td>12%</td>
<td></td>
</tr>
</tbody>
</table>

The Additional Dwelling supplement (ADS) is three percentage points of the total price of the property for all relevant transactions above £40,000 and will be charged in addition to the rates set out in table 3 above. The Scottish Government estimate that the ADS will generate £72m in 2017-18.

Table 4 shows the proposed SLfT rates that will apply from 1 April 2017 and compares them with the previous year.

Table 4: SLfT rates

<table>
<thead>
<tr>
<th></th>
<th>2016-17</th>
<th>2017-18</th>
<th>% increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>Standard rate</td>
<td>£84.40</td>
<td>£86.10</td>
<td>2.0%</td>
</tr>
<tr>
<td>Lower rate</td>
<td>£2.65</td>
<td>£2.70</td>
<td>1.9%</td>
</tr>
</tbody>
</table>

These rates are the same as the planned UK Landfill Tax rates for 2017-18. The Draft Budget states this “helps to address concerns over potential ‘waste tourism’ should one part of the UK have a lower tax charge than another.”

The Scottish Government has also produced five-year forecasts for the devolved taxes. Figure 6 shows the Scottish Government’s forecast for LBTT and figure 7 shows the SLfT revenues compared to the OBR’s forecast. The Scottish Government’s forecasts for residential LBTT receipts are consistently lower than the OBR’s forecasts. However, the Scottish Government’s forecasts for non-residential LBTT receipts are consistently higher than the OBR forecasts.
Changes to the Scottish Government’s block grant will still be determined by the Barnett formula, which reflects changes to UK spending in areas that are devolved to the Scottish Parliament. The Block Grant will then be adjusted to reflect the retention of some tax revenues in Scotland. (In future years, it will also be adjusted to reflect the devolution of welfare powers.)

The Fiscal Framework agreement between the Scottish and UK government stated that adjustments will involve two elements:

- an initial block grant baseline adjustment; and
- an indexation mechanism.
The initial block grant adjustment is equal to the UK Government’s tax receipts generated in Scotland in the year immediately prior to devolution. An indexation mechanism is then applied to each initial baseline adjustment. For 2017-18, the planned adjustments are as shown in Table 5. The Scottish Government’s forecasts for the relevant taxes are also shown in the table.

### Table 5: Block grant adjustments and Scottish Government forecasts, 2017-18, £m

<table>
<thead>
<tr>
<th></th>
<th>Block grant adjustment (BGA)</th>
<th>Scottish Government (SG) forecast</th>
<th>Difference between SG forecast and BGA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income Tax (NSND)</td>
<td>11,750</td>
<td>11,829</td>
<td>79</td>
</tr>
<tr>
<td>LBTT</td>
<td>545</td>
<td>507</td>
<td>-38</td>
</tr>
<tr>
<td>SLfT</td>
<td>119</td>
<td>149</td>
<td>30</td>
</tr>
<tr>
<td>Total</td>
<td>12,414</td>
<td>12,485</td>
<td>71</td>
</tr>
</tbody>
</table>

The differences between the BGA and the Scottish Government forecasts will reflect:

- the indexation methodology for the BGA (see below)
- Differences between Scottish Government forecasts of Scottish revenues and OBR forecasts of revenues for the equivalent taxes in rUK
- the policy choices of the Scottish Government (for example, the Scottish Government’s decision not to increase the higher rate income tax threshold in line with the UK Government results in an anticipated increase in income tax revenues relative to the BGA, which is based on no assumed change in policy).

The Scottish Government states that the £79m difference between its forecast and the block grant adjustment for income tax reflects its policy decision with regard to the higher rate threshold. In its manifesto, the SNP stated that its income tax policy decisions would generate £1.2bn over the parliamentary term. This was based on Scottish Government analysis which showed the policy decisions generating £120m in 2017-18. (Scottish National Party 2016 and Scottish Government 2016g].

Under the terms of the Fiscal Framework agreement, the block grant adjustment will be indexed using the Comparable Model (CM) and the results will then be adjusted to “achieve the outcome delivered by Indexed Per Capita (IPC)”. Each year, block grant adjustments will be produced based on both these mechanisms. Table 6 sets out the block grant adjustments that would be implied by the two methodologies. As shown in the table, use of the IPC methodology results in a smaller block grant adjustment than would be the case under the CM methodology. The gap increases over time so that, by 2021-22, the block grant adjustment is expected to be £229m lower than would be the case if the CM methodology had been adopted. Further information on the block grant adjustment can be found in Berthier (2016).

### Table 6: Block grant adjustments using alternative methodologies, £m

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>IPC</td>
<td>12,414</td>
<td>12,849</td>
<td>13,403</td>
<td>14,014</td>
<td>14,729</td>
</tr>
<tr>
<td>CM</td>
<td>12,460</td>
<td>12,938</td>
<td>13,536</td>
<td>14,194</td>
<td>14,958</td>
</tr>
<tr>
<td>Difference</td>
<td>-46</td>
<td>-89</td>
<td>-133</td>
<td>-180</td>
<td>-229</td>
</tr>
</tbody>
</table>

The forecasts for both Scottish tax revenues and the BGA are produced based on the latest available information at the time of the Draft Budget. Once outturn data is available for the Scottish tax revenues, a reconciliation will be carried out as per the timetable set out in the Fiscal Framework. For Scottish income tax, outturn data is likely to be available 15 months after the end of the financial year and for LBTT and SLfT this is likely to be available six months after the end of the financial year (Scottish Government 2016a).
CAPITAL AND INFRASTRUCTURE

The 2017-18 DEL capital budget from HM Treasury is £3,087m, a 5.3% increase in real terms compared with 2016-17. The Scottish Government’s borrowing powers have increased in 2017-18 and the Scottish Government is now able to borrow up to £450m per year, up to a cumulative limit of £3bn. In addition, the Scottish Government has £289m allocated for financial transactions in 2017-18. The Scottish Government also plans to carry forward £55m to the 2017-18 capital budget using the budget exchange mechanism. The Scottish Government also expects to receive £15m during the year from HM Treasury in relation to the Glasgow City Deal. In total, this gives a capital budget of £3,896m.

NON-PROFIT DISTRIBUTING (NPD) PROGRAMME

In 2017-18, the Scottish Government plans to progress a range of projects using NPD financing. Planned investment through NPD financing in 2017-18 is £416m. This is almost half the level of NPD capital investment in 2016-17. The planned NPD investment for 2017-18 includes projects such as the Aberdeen Western Peripheral Route, the NHS Lothian Royal Hospital for Sick Children and the NHS Dumfries and Galloway Royal Infirmary as well as a range of schools and community health projects. NPD investment is a form of revenue funding which means that the Scottish Government does not pay the upfront construction costs, but is committed to making annual repayments to the contractor, typically over the course of 25-30 years. However, the budgeting treatment of NPD projects has been affected by changes to accounting guidance.

ESA 10

New European accounting guidance (European System of Accounts 2010 – ESA10) came into effect in September 2014. These rules have implications for the accounting treatment of public-private partnership projects (PPPs), including NPD. The new guidance means that some projects that were formerly classified as private sector will now be classified as public sector. This affects any projects reaching financial close since September 2014.

Projects that are deemed to be public sector projects require upfront budget cover to be provided from the capital DEL budget over the construction period of the asset. This compares with the budget treatment for private sector projects, where the costs are treated as revenue costs and are spread over the period (usually 25-30 years) over which the asset is used and maintained. The change in treatment means that affected NPD projects impact on the capital DEL budget.

The Scottish Government has been able to adjust the design of smaller NPD hub projects so that they can continue to be treated as private sector assets and financed through the revenue budget as before. However, a number of larger “stand-alone” NPD projects have not been able to meet the requirements for private sector classification and the capital costs for these projects must now be included in the capital DEL budget in line with the profile of planned capital spending by the contractor. The UK Office for National Statistics (ONS) has determined that the following projects that had formerly been treated as private sector projects must now be reclassified as public sector projects. These include a number of projects currently under construction:

- Aberdeen Western Peripheral Route (AWPR) project (£745m total capital value)
- Dumfries & Galloway Royal Infirmary (£275.5m)
- Royal Hospital for Sick Children/Department for Clinical Neurosciences (£230.1m)
• Balfour Hospital, Orkney (£67.5m).

The projects affected are continuing to the same timetable, but amounts have been included in the capital DEL budgets to allow for the capital costs incurred in 2017-18:

• £92m in the health capital DEL budget for the three health projects listed above
• £142m in the motorways and trunk roads capital DEL budget for the AWPR.

The Draft Budget notes that the Balfour Hospital in Orkney will no longer be procured using NPD financing.

REVENUE FINANCING AND THE 5% CAP

Annual repayments resulting from revenue financed projects, such as NPD projects, come from the Scottish Government’s revenue budget. The Scottish Government has committed to spending no more than 5% of its total DEL budget on repayments resulting from revenue financing (which includes NPD, previous PPP contracts, regulatory asset base (RAB) rail investment) and any repayments resulting from borrowing. Based on current plans, the Scottish Government will spend just over 4% of its total DEL budget on such payments in 2017-18, rising to a peak of just under 4.5% in 2020-21. On the basis of the 2017-18 total DEL\(^1\), this would suggest current repayment commitments of around £1.2bn.

FINANCIAL TRANSACTIONS

The Draft Budget includes £289m in 2017-18 for “financial transactions”. This relates to Barnett consequentials resulting from a range of UK Government housing-related equity/loan finance schemes. Over the period 2012-13 to 2019-20, on the basis of current plans, financial transactions allocations will total £1.8bn. The Scottish Government has to use these funds to support equity/loan schemes beyond the public sector, but has some discretion in the exact parameters of those schemes and the areas in which they will be offered. This means that the Scottish Government is not obliged to restrict these schemes to housing-related measures and is able to provide a different mix of equity/loan finance.

In 2017-18, a total of £255m has been allocated to housing-related schemes, including Help to Buy (Scotland). The Scottish Government is also providing equity/loan finance support in areas other than housing. Individual tables in the budget document show the following profile for financial transactions.

\(^1\) excluding Financial Transactions.
Table 7: Financial transactions, £m

<table>
<thead>
<tr>
<th>Portfolio area</th>
<th>2016-17</th>
<th>2017-18</th>
</tr>
</thead>
<tbody>
<tr>
<td>Health and sport</td>
<td>3.2</td>
<td>0.0</td>
</tr>
<tr>
<td>Finance and constitution</td>
<td>3.3</td>
<td>0.0</td>
</tr>
<tr>
<td>Education &amp; skills</td>
<td>12.5</td>
<td>14.0</td>
</tr>
<tr>
<td>Economy, jobs and fair work</td>
<td>35.5</td>
<td>13.8</td>
</tr>
<tr>
<td>Communities, social security and equalities</td>
<td>255.5</td>
<td>259.5</td>
</tr>
<tr>
<td>Rural economy and connectivity</td>
<td>12.0</td>
<td>10.0</td>
</tr>
<tr>
<td>Culture, tourism and external affairs</td>
<td>5.0</td>
<td>5.0</td>
</tr>
<tr>
<td><strong>Total of above</strong></td>
<td><strong>327.0</strong></td>
<td><strong>302.3</strong></td>
</tr>
</tbody>
</table>

Note: the total of amounts shown for individual portfolios differs from the total shown in Table 1.01 of the Draft Budget (£329m in 2016-17 and £289m in 2017-18). The Scottish Government has indicated that this reflects a carry-forward of allocations for financial transactions from earlier years.

The Scottish Government will be required to make repayments to HM Treasury in respect of these financial transactions. The repayments will be spread over 30 years, reflecting the fact that the majority of FT allocations relate to long term lending to support house purchases and the construction sector. The repayment schedule is based on the anticipated profile of Scottish Government receipts. The first repayment to HM Treasury is scheduled for 2019-20.

**REAL TERMS INCREASES AND DECREASES**

Figure 8 presents the largest real terms level 2 budget line increases and decreases in 2017-18 on the previous financial year. Only increases and decreases above £5m have been included.
**LOCAL GOVERNMENT**

**INTERPRETING THE LOCAL GOVERNMENT BUDGET**

Since the publication of the Draft Budget, a wide range of interpretations of the local government budget have been presented. There are four main factors which affect the presentation of the local government numbers for 2017-18:

1. Whether the Draft Budget 2016-17 or Budget 2016-17 number is used as the base year.

2. Which number is used for the Scottish Government’s direct grants to local government – either the “Total Local Government” line or the sum of “General Resource Grant + Non-Domestic Rates Income”.

Note: as stated in the Context section, this briefing compares the 2017-18 Draft Budget figures with the 2016-17 Budget figures, as these represent the most recent Budget plans for 2016-17 and more accurately reflect what will be spent in the current financial year. For local government, given changes likely to occur after the Draft Budget is published, it is also useful to compare to the Draft Budget numbers. Comparing to the Draft Budget numbers also shows local government with the largest real terms level 2 reduction (£166m). These issues are discussed in detail in the local government section of the briefing below.

---

### Figure 8: Largest real terms changes, 2016-17 to 2017-18, £m

<table>
<thead>
<tr>
<th>Category</th>
<th>Change (£m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Motorways and Trunk Roads</td>
<td>-£400</td>
</tr>
<tr>
<td>Scottish Water</td>
<td>-£300</td>
</tr>
<tr>
<td>Social Security</td>
<td>-£200</td>
</tr>
<tr>
<td>Health</td>
<td>-£100</td>
</tr>
<tr>
<td>Higher Education Student Support</td>
<td>£0</td>
</tr>
<tr>
<td>Finance &amp; Constitution</td>
<td>£100</td>
</tr>
<tr>
<td>Children and Families</td>
<td>£200</td>
</tr>
<tr>
<td>Scottish Public Pensions Agency</td>
<td>£300</td>
</tr>
<tr>
<td>Parliamentary Business and Government...</td>
<td>£400</td>
</tr>
<tr>
<td>Employability and Training**</td>
<td>£500</td>
</tr>
<tr>
<td>Other Transport Policy, Projects and...</td>
<td>£600</td>
</tr>
<tr>
<td>Scottish Fire and Rescue Service</td>
<td>£700</td>
</tr>
<tr>
<td>Digital Connectivity</td>
<td>£800</td>
</tr>
<tr>
<td>Rail Services</td>
<td>£900</td>
</tr>
<tr>
<td>Housing</td>
<td>£1000</td>
</tr>
<tr>
<td>Police Central Government</td>
<td>£1100</td>
</tr>
<tr>
<td>Culture, Tourism and Major Events</td>
<td>£1200</td>
</tr>
<tr>
<td>National Records of Scotland</td>
<td>£1300</td>
</tr>
<tr>
<td>Scottish Police Authority (SPA)</td>
<td>£1400</td>
</tr>
<tr>
<td>Community Justice Services</td>
<td>£1500</td>
</tr>
<tr>
<td>Marine</td>
<td>£1600</td>
</tr>
<tr>
<td>Revenue Scotland</td>
<td>£1700</td>
</tr>
<tr>
<td>Police and Fire Pensions</td>
<td>£1800</td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>£1900</td>
</tr>
<tr>
<td>Highland and Islands Enterprise</td>
<td>£2000</td>
</tr>
<tr>
<td>Skills &amp; Training**</td>
<td>£2100</td>
</tr>
<tr>
<td>Concessionary Fares and Bus Services</td>
<td>£2200</td>
</tr>
<tr>
<td>Ferry Services</td>
<td>£2300</td>
</tr>
<tr>
<td>Scottish Funding Council</td>
<td>£2400</td>
</tr>
<tr>
<td>Enterprise and Energy</td>
<td>£2500</td>
</tr>
<tr>
<td>Local Government</td>
<td>£2600</td>
</tr>
</tbody>
</table>

---

### Diagram:

- Motorways and Trunk Roads: -£400
- Scottish Water: -£300
- Social Security: -£200
- Health: -£100
- Higher Education Student Support: £0
- Finance & Constitution: £100
- Children and Families: £200
- Scottish Public Pensions Agency: £300
- Parliamentary Business and Government...: £400
- Employability and Training**: £500
- Other Transport Policy, Projects and...: £600
- Scottish Fire and Rescue Service: £700
- Digital Connectivity: £800
- Rail Services: £900
- Housing: £1000
- Police Central Government: £1100
- Culture, Tourism and Major Events: £1200
- National Records of Scotland: £1300
- Scottish Police Authority (SPA): £1400
- Community Justice Services: £1500
- Marine: £1600
- Revenue Scotland: £1700
- Police and Fire Pensions: £1800
- Miscellaneous: £1900
- Highland and Islands Enterprise: £2000
- Skills & Training**: £2100
- Concessionary Fares and Bus Services: £2200
- Ferry Services: £2300
- Scottish Funding Council: £2400
- Enterprise and Energy: £2500
- Local Government: £2600
3. Whether figures are presented in cash or real terms.

4. Whether “other sources of support”, which are not included in the Scottish Government’s grants to local authorities, or in the “Total Local Government” budget line, are added into the amount used to calculate the local government numbers.

Taken together, the variations in the different figures produced can present a confusing and complicated picture. This section of the briefing therefore outlines the basis for the different interpretations of the local government numbers.

**LOCAL GOVERNMENT BUDGET BREAKDOWN**

The total allocation to local government in the 2017-18 Draft Budget is **£10,131m**. This is mostly made up of General Revenue Grant (GRG) and Non-Domestic Rates Income (NDRI), with smaller amounts for General Capital Grant and Specific (or ring-fenced) revenue and capital grants.

The Scottish Government guarantees the combined GRG and distributable NDRI figure, approved by Parliament, to each local authority. If NDRI is lower than forecast, this is compensated for by an increase in GRG and vice versa. Therefore, to calculate Local Government’s revenue settlement, the combined GRG + NDRI figure is used.

Throughout this briefing, year on year comparisons are made by comparing the 2017-18 Draft Budget figures with the 2016-17 Budget figures, as these represent the most recent Budget plans for 2016-17 and more accurately reflect what will be spent in the current financial year. For the local government budget, the Scottish Government has stated that comparing 2016-17 Budget with 2017-18 Draft Budget is misleading, as there are a number of funds that will be added to the local government settlement from other portfolios, after the Draft Budget is published. However, the amounts are not yet clear. Therefore, the Government’s view is that the Draft Budget 2016-17 numbers should be compared to the Draft Budget 2017-18 numbers.

For clarity therefore, the full picture of both alternatives is presented below in tables 8 and 9. The tables show the change in the “Total Local Government” figure and the “GRG + NDRI” figure, comparing the 2017-18 Draft Budget to both the 2016-17 Budget and the 2016-17 Draft Budget, and in both cash and real, £ million and percentage, terms.
Table 8: Local Government budget – compared to 2016-17 Budget

<table>
<thead>
<tr>
<th>Local Government</th>
<th>2016-17 Budget</th>
<th>2017-18 (cash)</th>
<th>Cash change</th>
<th>Cash change %</th>
<th>2017-18 (real)</th>
<th>Real change</th>
<th>Real change %</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Revenue Grant</td>
<td>6,819.4</td>
<td>6,557.8</td>
<td>-261.6</td>
<td>-3.8%</td>
<td>6,463.9</td>
<td>-355.5</td>
<td>-5.2%</td>
</tr>
<tr>
<td>Non-Domestic Rates</td>
<td>2,768.5</td>
<td>2,605.8</td>
<td>-162.7</td>
<td>-5.9%</td>
<td>2,568.5</td>
<td>-200.0</td>
<td>-7.2%</td>
</tr>
<tr>
<td>Support for Capital</td>
<td>506.5</td>
<td>623.1</td>
<td>116.6</td>
<td>23.0%</td>
<td>614.2</td>
<td>107.7</td>
<td>21.3%</td>
</tr>
<tr>
<td>Specific Resource Grants</td>
<td>92.5</td>
<td>211.0</td>
<td>118.5</td>
<td>128.1%</td>
<td>208.0</td>
<td>115.5</td>
<td>124.8%</td>
</tr>
<tr>
<td>Specific Capital Grants</td>
<td>126.2</td>
<td>133.4</td>
<td>7.2</td>
<td>5.7%</td>
<td>131.5</td>
<td>5.3</td>
<td>4.2%</td>
</tr>
<tr>
<td>Total Level 2</td>
<td>10,313.1</td>
<td>10,131.1</td>
<td>-182.0</td>
<td>-1.8%</td>
<td>9,986.1</td>
<td>-327.0</td>
<td>-3.2%</td>
</tr>
</tbody>
</table>

GRG+NDRI  

| GRG+NDRI | 9,587.9 | 9,163.6 | -424.3 | -4.4% | 9,032.5 | -555.4 | -5.8% |

Table 9: Local Government budget – compared to 2016-17 Draft Budget

<table>
<thead>
<tr>
<th>Local Government</th>
<th>2016-17 Draft Budget</th>
<th>2017-18 (cash)</th>
<th>Cash change</th>
<th>Cash change %</th>
<th>2017-18 (real)</th>
<th>Real change</th>
<th>Real change %</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Revenue Grant</td>
<td>6,685.9</td>
<td>6,557.8</td>
<td>-128.1</td>
<td>-1.9%</td>
<td>6,463.9</td>
<td>-222.0</td>
<td>-3.3%</td>
</tr>
<tr>
<td>Non-Domestic Rates</td>
<td>2,768.5</td>
<td>2,605.8</td>
<td>-162.7</td>
<td>-5.9%</td>
<td>2,568.5</td>
<td>-200.0</td>
<td>-7.2%</td>
</tr>
<tr>
<td>Support for Capital</td>
<td>480.6</td>
<td>623.1</td>
<td>142.5</td>
<td>29.7%</td>
<td>614.2</td>
<td>133.6</td>
<td>27.8%</td>
</tr>
<tr>
<td>Specific Resource Grants</td>
<td>91.0</td>
<td>211.0</td>
<td>120.0</td>
<td>131.9%</td>
<td>208.0</td>
<td>117.0</td>
<td>128.5%</td>
</tr>
<tr>
<td>Specific Capital Grants</td>
<td>126.3</td>
<td>133.4</td>
<td>7.1</td>
<td>5.6%</td>
<td>131.5</td>
<td>5.3</td>
<td>4.1%</td>
</tr>
<tr>
<td>Total Level 2</td>
<td>10,152.3</td>
<td>10,131.1</td>
<td>-21.2</td>
<td>-0.2%</td>
<td>9,986.1</td>
<td>-166.2</td>
<td>-1.6%</td>
</tr>
</tbody>
</table>

GRG+NDRI  

| GRG+NDRI | 9,454.4 | 9,163.6 | -290.8 | -3.1% | 9,032.5 | -421.9 | -4.5% |

So, using the numbers above, the Total Local Government line is shown as falling by either 1.6% in real terms (when compared to Draft Budget 2016-17) or falling by 3.2% in real terms (when compared to Budget 2016-17).

In terms of GRG+NDRI, which makes up the core revenue settlement for local authority services, this is shown as falling by either 4.5% (when compared to Draft Budget 2016-17) or 5.8% (when compared to Budget 2016-17).
OTHER SOURCES OF SUPPORT

As noted above, in this Draft Budget, for the first time, there is an additional line in the local government budget tables titled “Other sources of support”. “Other sources of support” includes funding for Health and Social Care Integration, and additional income expected from Council tax reform. But, the money for Health and Social Care Integration is already included in the Health budget totals, and therefore contributes to the real terms growth in the Health budget.

In presenting its interpretation of the local government figures, the Scottish Government has regularly included these “other sources of support”. Therefore, Table 10 below adds these numbers to both of the alternative “Total Local Government” numbers in the tables above.

Table 10: Total Local Government, added to “other sources of support”

<table>
<thead>
<tr>
<th>Local Government</th>
<th>2016-17 (cash)</th>
<th>2017-18 (cash)</th>
<th>Cash change</th>
<th>Cash change %</th>
<th>2017-18 (real)</th>
<th>Real change</th>
<th>Real change %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Other sources of support</td>
<td>250.0</td>
<td>468.0</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total LG + other sources of support, compared to 2016-17 Budget</td>
<td>10,563.1</td>
<td>10,599.1</td>
<td>36.0</td>
<td>0.3%</td>
<td>10,447.4</td>
<td>-115.7</td>
<td>-1.1%</td>
</tr>
</tbody>
</table>

| Total LG, + other sources of support, compared to 2016-17 Draft Budget | 10,402.3 | 10,599.1 | 196.8 | 1.9% | 10,447.4 | 45.1 | 0.4% |

Therefore, if choosing to add these “other sources of support” to the Scottish Government’s support to local government, the result is either a small real terms increase (+0.4%) when compared with the 2016-17 Draft Budget or a small real terms reduction (-1.1%) when compared with the 2016-17 Budget.

In the “Strategic Context” chapter of the Draft Budget, the Scottish Government cites a figure of £267 million, as the “potential increase in the total spending power to support local authority services from a combination of the Scottish Government grant and increased revenue from local taxation.” This figure is produced by adding £70 million (which assumes all councils increase council tax by 3%) to the cash increase of £196.8m in table 10 above. It is not clear why this £70m figure is included in the Strategic Context chapter of the Draft Budget but not within “other sources of support” in the local government chapter.

In addition, the Scottish Government has also cited figures of “up to £240.6 million in additional funding and revenue” for local government (Scottish Government 2016d).

This figure cannot be produced from the Draft Budget document. Instead it is produced by adding the £47.4m reduction in “total local government” from Local Government Finance Circular 1/2016 (for 2016-17) to Local Government Finance Circular 9/2016 (for 2017-18), and then adding the following additional income streams, totalling £288m:
• £111m for additional council tax income from changes to Bands E-H
• £107m for the additional integration fund
• £70m for raising council tax by 3%.

ALLOCATIONS TO LOCAL AUTHORITIES

Local Government Finance Circular No. 9/2016 (Scottish Government 2016e) was published alongside the Draft Budget, and contains provisional allocations to local authorities. The allocations in the Circular were revised on 16 December, following initial consultation with COSLA, and a second version of the Circular was published.

A public briefing paper for the Local Government and Communities Committee will be published early in the week of 19 December 2016, setting out SPICe analysis of the allocations. However, although published on the same day, Circular 9/2016 contains a different total for the total local government finance settlement, £10,252.9m, further complicating the picture of the local government budget. This is a difference of around £122 million compared to the numbers in the Draft Budget, due to a number of small funds included in the Circular but not the Draft Budget.

COUNCIL TAX

On 3 November 2016, the Parliament passed the Council Tax (Substitution of Proportion) (Scotland) Order, which increased the ratios of the upper bands (E-H) relative to Band D for 2017-18 onwards. Originally, the Government stated that these reforms “would generate £100 million of additional revenue to invest in schools.” (Scottish Government 2016c). It later confirmed that this would be distributed on the basis of free school meals. However, in the Draft Budget, the Government stated that the Attainment Scotland Fund of £120m was funded “from the resources available to the Scottish Government at a national level.” The Draft Budget also confirmed that the council tax freeze would end, but that council tax increases would be capped at 3%.

NON-DOMESTIC RATES

As shown in the tables above, non-domestic rates income is forecast to fall by £200m in real terms in 2017-18 (-7.2%). A number of changes are proposed to the system of non-domestic rates in the Draft Budget, including:

• Matching the English Poundage by dropping the rate by 3.7%.
• Raising the threshold for the small business bonus scheme, which the Government states will lift “100,000 properties out of rates altogether.”
• Raising the threshold for the large business supplement, although the supplement itself will continue at the current rate.

At present, the Scottish Government makes forecasts for Non-Domestic Rates Income, and the Scottish Fiscal Commission assesses the “reasonableness of the economic determinants underpinning” those forecasts. From April 2017 onwards, the Scottish Fiscal Commission will become responsible for the production of forecasts of receipts for Non-Domestic Rates.
NATIONAL PERFORMANCE FRAMEWORK

Since 2007, the Scottish Government has been operating an outcomes based National Performance Framework (NPF). The Scotland Performs website aims to measure and report on progress of government in Scotland, with indicators providing “a broad measure of national and societal wellbeing, incorporating a range of economic, social and environmental indicators and targets which are updated as soon as the data are available”. The indicators were refreshed in March 2016 with the addition of five new indicators.

To support scrutiny of the 2017-18 Draft Budget the government has provided its Scotland Performs Update. This document includes a Performance Scorecard which maps the NPF to most of the Scottish Parliament’s subject committees and provides an update on relevant indicators. The report also includes narratives for each of the 16 National Outcomes, showing examples of contributions made by various agencies towards these outcomes. For example, the Government highlights the contribution the £76.3m (in 2015/16) Modern Apprenticeship programme makes to providing better employment opportunities, reducing staff turnover and increasing chances of sustaining employment for the individuals involved.

EQUALITY BUDGET STATEMENT

For eight years the Scottish Government has published an Equality Budget Statement (EBS) as part of its Draft Budget process. The aim of the EBS is to assess the impact on equality of the various spending decisions made in the Draft Budget. The document informs us that many aspects of the EBS are “acknowledged by stakeholders as world-leading” (2016f), including the publication of the EBS on the same day as the Draft Budget and the involvement of an expert advisory group in assessments.

This year’s EBS includes an assessment of budget impact on protected characteristics, i.e. age, disability, gender, race, religion/belief, and sexual orientation. In addition there is also an assessment of potential impacts on low-income households. It includes a “thematic chapter” on inclusive growth, with case studies focussing on the Attainment Scotland Fund, as well as early learning and childcare provision. These policies are considered “some of the most equality enhancing aspects on inclusive growth announcements made in the draft budget”.

As highlighted in last year’s SPICe briefing, the vast majority of budget measures identified in the EBS are seen as making positive contributions to tackling inequality. Nevertheless, the Statement does express concern about reductions in certain budgets, for example in a couple of budget lines within the health portfolio: “Unless mitigated, these reductions may have negative implications for equality groups. However, in some cases, funding reductions are addressed by changes to other budget lines” (p.23). Furthermore, within the Environment, Climate Change and Land Reform and Rural Economy and Connectivity portfolios some decreases in spend are highlighted, but these “generally have little or no equality impact” (p.53).

WELFARE REFORM

Within the ‘Social Security’ section of the Communities, Social Security and Equalities budget line, the Scottish Government sets out spending plans aimed at mitigating “the negative impacts of welfare changes and cuts” arising from UK-wide welfare reforms. Total funding for these measures amounts to £95.9 million in 2017-18, including:

- £38.0 million for the Scottish Welfare Fund (SWF). The SWF provides a safety net in an emergency or a disaster when there is an immediate threat to health and safety. It is also
a source of help for people on low incomes to access household goods to set up home or remain in their community.

- £47.0 million for discretionary housing payments, which, according to the Scottish Government, allows local authorities to “fully mitigate the effects of the bedroom tax”.

- £10.9 million for other Discretionary Payment Costs “to help those who are affected by other UK Government welfare reforms such as the Local Housing Allowance (LHA) rate and the Benefit Cap”.

These changes are allocated in the Budget Revisions.

The Draft Budget document reminds us that, following the Scotland Act 2016, the Scottish Government will assume devolved responsibility for Discretionary Housing Payments in 2017-18. The Government also expects further spend during 2017-18 on developing its social security programme, funded from a “centrally-held budget relating to Scotland Act 2016 non-tax implementation”.

PUBLIC SECTOR PAY

The Scottish Government published a public sector pay policy for 2017-18 alongside the draft budget. This pay policy directly affects the pay of Scottish Government staff, and the staff of around 40 public bodies, which together account for around 8% of the Scottish public sector (around 32,000 staff). Large parts of the public sector, such as local government and the NHS are not directly covered by the Scottish Government’s pay policy and determine pay separately.

The main features of the pay policy are:

- a 1% cap on the cost of the increase in basic pay for staff earning above £22,000

- a minimum basic pay increase of £400 for those earning less than £22,000, before progression payments (to be awarded on a pro-rata basis for part-time staff); the costs of this are not included in the 1% cap

- a continued commitment to paying a Scottish living wage (currently at £8.45 per hour)

- a continued suspension of non-consolidated performance related pay (bonuses)

- discretion for individual employers to reach agreements relating to pay progression, whereby employees progress through set pay bands on an annual basis, regardless of the basic pay settlement

- a continued commitment to no compulsory redundancies, to be negotiated by individual employers in exchange for agreements on workforce flexibilities and efficiencies where appropriate
SOURCES


Fraser of Allander. (2016) *Economic commentary volume 40, number 3*. Available at: https://www.sbs.strath.ac.uk/economics/fraser/20161213/Fraser_Economic_Commentary-Vol_40_No_3.pdf


Scottish National Party (2016) *Re-elect: 2016 manifesto*. Available at: https://drive.google.com/file/d/0B8Tu6kHw0HUMdXZyb0RHNHzRSzQ/view [Accessed 16 December 2016]
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SB 16-88 The Fiscal Framework

SB 16-95 Autumn Statement 2016: impact on Scotland

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