Summary

The Financial Memorandum addresses:

- The way in which the Scottish block grant will be adjusted (increased) to reflect the spending foregone by the UK Government as a result of transferring the benefits to Scotland, as well as an assessment of the risks to the Scottish budget that this creates;
- The likely costs associated with setting up and then administering the Scottish social security system;
- Indicative costs of two specific policy proposals – the decision to increase the annual value of Carers Allowance to the same value as Jobseekers Allowance and replacing the Sure Start Maternity Grant with an enhanced Best Start Grant (approx. £34m and £17m per year respectively).

On the whole, the estimate of costs contained in the Financial Memorandum (both in terms of the policy costs and the costs associated with setting up and running the Social Security system) are presented very much as indicative, provisional estimates of costs, that will be refined and amended as further detail about delivery becomes available.

This is perhaps inevitable given the stage we are at in terms of the design of the Social Security Agency. But it does raise questions about the role of parliament in scrutinising more specific elements of proposals, as these become available.

Following the transfer of social security expenditure to the Scottish budget, the Scottish budget will bear the risk that spending per capita on any benefit increases more rapidly in Scotland than in rUK. This could arise if demand rises relatively more rapidly in Scotland (perhaps because of more rapid population ageing), if rates or eligibility criteria for a given benefit are set more generously in Scotland, or if uptake rates are higher in Scotland (perhaps as a result of improved awareness of eligibility) for a given policy.

The devolution of the social security powers, together with the process for adjusting the Scottish block grant and the difficulties inherent in forecasting social security expenditure, also poses a significant in-year cash management risk for the Scottish budget. This re-emphasises the importance of establishing a contingency fund in the Scotland Reserve.

The estimated costs of setting up and running the Scottish social security system substantially exceed the funding that the UK Government has agreed to transfer to the Scottish budget to contribute to these set-up and running costs. Any excess funding must be found from the Scottish budget.

The block grant adjustments

The block grant to the Scottish Government will be adjusted to reflect the transfer of responsibility of new social security powers.
The adjustments to the block grant for social security powers will work according to similar principles as the adjustments to the block grant for new tax powers. But whereas the block grant adjustments for tax are designed to represent the ‘revenues foregone’ by the UK Government, the block grant adjustments for social security are designed to represent the ‘spending foregone’ by the UK Government as a result of transferring the powers to the Scottish Parliament.

In practical terms, the block grant adjustments (BGA) will work as follows:

- There will be a separate block grant adjustment for each social security power
- The BGA will consist of two elements, an initial addition and an indexation mechanism.
- The initial addition will be the amount spent by the UK Government on the social security benefit in question in Scotland in the year prior to its devolution
- Over the period until 2021/22, the BGA will be indexed according to the ‘Indexed Per Capita’ (IPC) mechanism. This means that the BGA will increase in line with spending per capita on the social security benefit in question in rUK.

For example, imagine that Attendance Allowance is devolved in 2019/20. The initial addition would be the amount spent by the UK Government on the Attendance Allowance in Scotland in 2018/19, which according to Table 2a of the Financial Memorandum the UK Government forecasts at £504m. If spending per capita on the Attendance Allowance in rUK increased by 5% between 2018/19 and 2019/20, then the BGA for Attendance Allowance in 2019/20 would be £529m (assuming no change in Scottish population). Actual spending on the Attendance Allowance in Scotland might be higher or lower than £529m.

The implication of this arrangement is that the Scottish budget bears the risk that spending per capita on any benefit increases more rapidly in Scotland than in rUK. This could arise if demand rises relatively more rapidly in Scotland (perhaps because of more rapid population ageing, as noted in paras 25 and 47 of the FM), or if rates or eligibility criteria for a given benefit are set more generously. Higher uptake rates, perhaps as a result of improved awareness of eligibility, could also result in higher costs relative to rUK.

After 2021/22, the BGA indexation mechanism to apply will be negotiated by the Scottish and UK Governments.

**Forecasting, reconciliation and budget implications**

The Scottish Fiscal Commission (SFC) will be responsible for making the official forecasts for spending on the devolved social security benefits for budget purposes.

The BGAs for the social security benefits will be based on forecasts made by the UK Government (DWP). Once outturn expenditure on the devolved benefits is known (in September following the end of the financial year), the forecast BGA will be ‘reconciled’ with the outturn BGA.
This process creates a cash management risk for the Scottish budget, explained in paras 35-43 of the FM. The risk is accentuated by the fact that in recent years the UK Government has tended to overestimate the savings it will make from various welfare reforms; as a result, expenditure has been greater than forecast. A practical example of the implications of this for the Scottish budget is as follows:

- Imagine that the Personal Independence Payment (PIP) has been devolved, and that on the basis of rUK expenditure forecasts, a BGA of £1.5bn is transferred to the Scottish block grant. The SFC forecasts Scottish spending at £1.5bn, so the budget is in balance.
- However, imagine that higher than anticipated demand results in expenditure in rUK on PIP being 7% higher than forecast, and for the same reasons, expenditure is also 7% higher than forecast in Scotland.
- This means that, despite having a BGA of £1.5bn, the Scottish Government spends £1.6bn on PIP. The £100m difference between actual spending and the BGA must come from borrowing, savings elsewhere, or use of the Scotland Reserve.
- Subsequently, once it emerges that rUK spending was higher than forecast, the BGA will be reconciled upwards by £100m, leaving the Scottish budget no worse off in aggregate. But this does not detract from the significant cash management implication of the forecast error.

Para 34 of the FM notes that UK forecasts for the benefits being devolved have been affected by systematic downward bias of 6.9% per year since 2014/15. In the context of total spend on the devolved benefits in Scotland of around £3bn, a 7% error equates to £210 million.

Under the Fiscal Framework, the maximum that the Scottish Government can draw down from the Scotland Reserve in any year is £250m (for all purposes, including revenue shortfalls), whilst the maximum it can borrow for forecast error (again including revenue forecasts errors too) is £300m annually.

Table 1 of the FM provides DWP forecasts of social security spending in Scotland for 2017/18, whilst Table 2a provides estimates of expenditure on each benefit in Scotland from 2018/19 to 2021/22; these forecasts are based on DWP’s forecasts for the UK as a whole, and assume that Scotland’s share of the UK caseload remains unchanged.

**Policy**

The Scottish Government will bear the costs/benefits of any policy differentiation. For example, the costs of a higher benefit rate, or wider eligibility, for a particular benefit relative to rUK would have to be borne by the Scottish budget. Similarly policy change to a benefit in rUK would have budgetary implications for the Scottish budget via the block grant. The introduction of means testing for the Winter Fuel Payment in rUK, to take a hypothetical example, would result in a reduction to rUK spending and hence the Scottish Government’s BGA for the Winter Fuel Payment.
Scottish Ministers have committed to a number of policies they intend to deliver. Namely these include:

- Increasing the annual value of Carers Allowance to the same value as Jobseekers Allowance; and
- Replacing the Sure Start Maternity Grant with an enhanced Best Start Grant.

The Financial Memorandum sets out estimated costs of these policies in Table 3a (although the forecasts are couched as ‘an illustration of the likely value of these commitments with assumptions made on rates and eligibility, as these factors are not yet confirmed’. The increase to the Carer’s Allowance is forecast to cost around £34m per year whilst the Best Start Grant is forecast to cost £17m per year. There is no assessment of the degree of confidence in these estimates, nor in the risks and sensitivities that might make the costs higher or lower than those forecast.

These are the only policies that are indicatively costed in the Financial Memorandum to the Bill. Details of future policy will be contained in secondary legislation.

**Costs of setting up and running the system**

Substantial costs will be incurred in setting up the Scottish social security system as a whole (the **system** includes not only the new Social Security Agency, but also arrangements for the assessment process, forecasting arrangements, policy design, and so on).

The costs set out in the Financial Memorandum are fairly broad and indicative, given the stage at which the Scottish Government is in its planning.

The Financial Memorandum provides initial, indicative cost estimates associated with setting up the social security agency. These are shown below. The estimates include ‘an appropriate level of optimism bias’.

<table>
<thead>
<tr>
<th></th>
<th>Total costs for four year period to 2020-21, £m</th>
</tr>
</thead>
<tbody>
<tr>
<td>IT systems</td>
<td>190</td>
</tr>
<tr>
<td>Estates</td>
<td>14</td>
</tr>
<tr>
<td>Staffing</td>
<td>104</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>308</strong></td>
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</tbody>
</table>

The Financial Memorandum notes that these estimates ‘will change materially as further decisions are taken and the programme of work to specify and procure the infrastructure required for Scotland’s new social security system evolves’ (para 57).

The Financial Memorandum estimates the costs of running the social security system once it is fully operational at between £144m - £156m per annum. This represents around 5% of the value of benefits being devolved. However the figure does not include optimism bias or ‘contingency for expenditure on enabling systems’. 
Under the Fiscal Framework, the UK Government will transfer up to £66 million each year to the Scottish budget to cover ongoing administration costs (£22 million will be transferred in 2017/18). The UK Government will also make a one-off transfer of £200m to the Scottish budget to cover implementation costs associated with the new powers (of which £100m has been transferred so far). Note that these transfers are to cover all costs associated with the newly devolved powers, not just social security.

Any additional costs will need to be funded by the Scottish Government through its existing resources. The estimated costs of setting up the agency (£308m) clearly exceed the value of the transfer from the UK Government. Similarly the estimated running costs (around £150m) exceed the value of the £66 million to be transferred each year from the UK Government. These additional resources will need to be found from other areas of the Scottish budget.

The Scottish Fiscal Commission will incur costs in producing its official forecasts of spending on the devolved Social Security Benefits. In a separate submission to the Parliament’s call for evidence on the Financial Memorandum to the Bill, the SFC estimate the costs associated with the forecasting of social security expenditure to rise to £290,000 per annum by 2020/21.

The preferred option for the Social Security Agency incorporates various support and pre-claims being provided in existing public sector locations. These locations may include local authority premises. It is expected that local authorities would recharge the agency for such use of premises, but estimates of these costs have been built into the agency running costs discussed earlier.

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