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Report On Draft Budget 2017-18



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Finance and Constitution Committee

1. The remit of the Finance and Constitution Committee is to consider and report on-
 - a. any report or other document laid before the Parliament by members of the Scottish Government containing proposals for, or budgets of, public revenue or expenditure or proposals for the making of a Scottish rate resolution, taking into account any report or recommendations concerning such documents made to them by any other committee with power to consider such documents or any part of them;
 - b. any report made by a committee setting out proposals concerning public revenue or expenditure;
 - c. Budget Bills; and
 - d. any other matter relating to or affecting the revenue or expenditure of the Scottish Administration or other monies payable into or expenditure payable out of the Scottish Consolidated Fund.
 - e. Constitutional matters falling within the responsibility of the Cabinet Secretary for Finance and Constitution.
2. The Committee may also consider and, where it sees fit, report to the Parliament on the timetable for the Stages of Budget Bills and on the handling of financial business.
3. In these Rules, “public expenditure” means expenditure of the Scottish Administration, other expenditure payable out of the Scottish Consolidated Fund and any other expenditure met out of taxes, charges and other public revenue.



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Note: The membership of the Committee changed during the period covered by this report, as follows:

Dean Lockhart replaced Alex Johnstone on 3 November 2016, Liam Kerr replaced Dean Lockhart on 18 January 2017

Introduction

1. Draft Budget 2017-18ⁱ (“the draft budget”) was published by the Scottish Government on 15 December 2016. This report sets out the views of the Finance and Constitution Committee (“the Committee”) on the draft budget and is informed by the helpful submissions we received from other parliamentary committees. Links to the other committees' reports can be found in Annexe A.

STRATEGIC CONTEXT FOR THE DRAFT BUDGET 2017-18

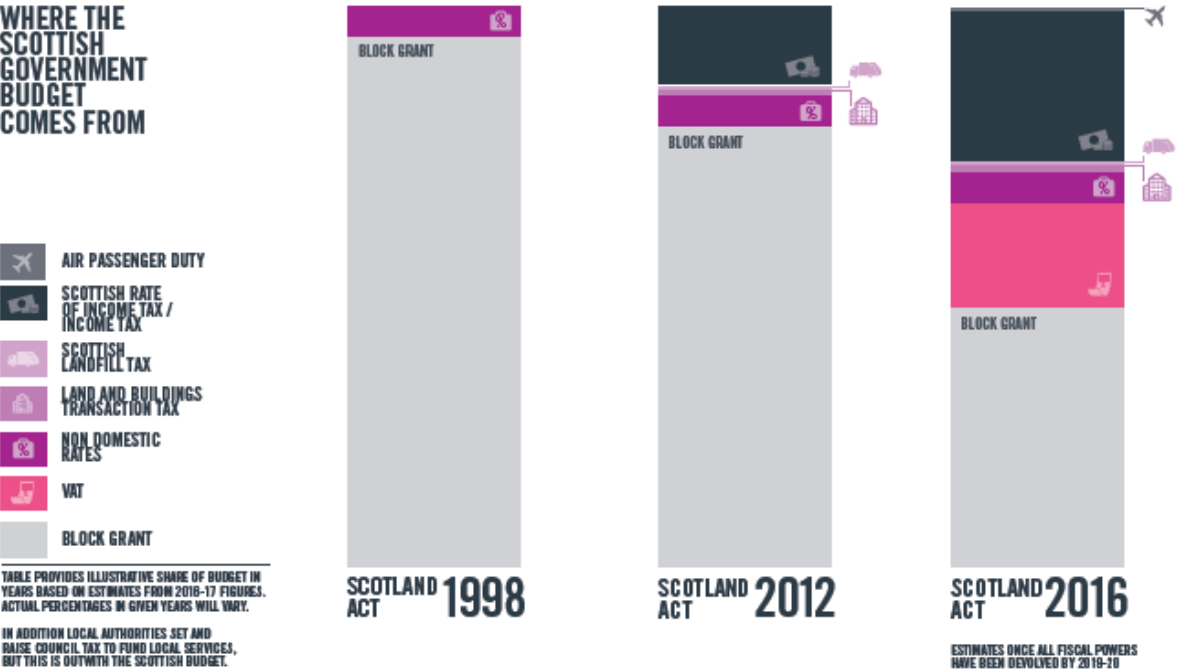
2. The strategic context for the draft budget is very different from previous years. This is the first draft budget to be published since the devolution of substantial further financial powers by the Scotland Act 2016 and the agreement of the Fiscal Framework by the UK Government and the Scottish Government.ⁱⁱ
3. From 2017-18 the Scottish Parliament will have the power to set all non-savings non-dividend (NSND) income tax rates and the thresholds of bands, with the exception of the personal allowance. Air Passenger Duty will be devolved in April 2018 and the Aggregates Levy will also be devolved in future years. The first 10 pence of the standard rate of Value Added Tax (VAT) and the first 2.5 pence of the reduced rate will also be assigned to the Scottish Government in April 2019.
4. Graph 1 below from the draft budget highlights the extent to which the funding system has changed.

ⁱ <http://www.gov.scot/Publications/2016/12/6610/downloads>

ⁱⁱ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/503481/fiscal_framework_agreement_25_feb_16_2.pdf

Graph 1

How our funding system is changing



- The new income tax powers in addition to the tax powers previously devolved means that approximately 40% of the money which the Scottish Government spends now comes from taxation raised in Scotland. This is a fundamental shift from a budget which historically was almost wholly funded by a block grant from Westminster. The Scottish Government's borrowing powers have also been increased to an overall limit of £3bn for capital spending and £1.75bn for resource borrowing and cash management.
- It is important to note at this point that having additional tax powers does not mean that the Scottish Government will therefore have more money to spend. This is because each time a tax is devolved there is a reduction in the size of the block grant to reflect the revenues foregone to HM Treasury. This initial baseline reduction then requires to be updated annually through an indexation mechanism. Otherwise, the size of the baseline reduction, in real terms, would erode over time.
- The budget is, therefore, now calculatedⁱⁱⁱ as follows—

Barnett-determined block grant	–	Block grant adjustment for each devolved tax	+	Tax revenues from each devolved tax
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- The calculations will initially be based on forecasts. The forecasts which inform the adjustments to the block grant will be carried out by the Office for Budget Responsibility (OBR) and will be subject to reconciliation once outturn data is

ⁱⁱⁱ The calculation is set out in Table 1.01 of the 2017-18 Draft Budget document.

available. The forecasts for the devolved taxes will be prepared by the Scottish Government for 2017-18 and by the Scottish Fiscal Commission (SFC) for 2018-19 onwards. The forecasts for income tax will be subject to reconciliation with outturn data. How this works in practice is determined by the Fiscal Framework as discussed in more detail below.

9. The new funding arrangements provide both opportunity and risk for the Scottish Parliament and the Scottish Government. In particular, the size of the Scottish budget is now much more dependent on the performance of the Scottish economy relative to the performance of the UK economy. So, there is now an opportunity for the Scottish Government to increase the size of its budget through growing the economy. At the same time there is a risk to the size of its budget if economic growth is weak. Essentially, for the Scottish budget to benefit there needs to be a higher per capita increase in devolved tax revenues than the per capita performance of receipts from the equivalent taxes in rUK.
10. It is also the case that a decline in Scottish tax revenues per capita does not necessarily mean a decline in the size of the budget. If rUK revenues per capita also decline to the same extent then the adjustment to the block grant will also decline and therefore offset any fall in tax revenues. As such, if Scottish revenues per capita grow at the same rate as those in rUK, the Scottish budget is no better/worse off than it would have been prior to the devolution of the relevant taxes.
11. At the same time it is important to note that the extent of these opportunities and risks are limited by both the extent to which the block grant is still determined by Westminster and many macro-economic levers remain at a UK level.

- 12. The Committee is very aware that the increased dependence of the budget on relative economic performance combined with the complexity of the Fiscal Framework means that there is now a much greater degree of volatility and uncertainty in the budget process. This uncertainty is exacerbated by the potential impact of Brexit on economic growth and the public finances.**
- 13. The Committee emphasises therefore, that it is essential that there is complete transparency in how the Fiscal Framework operates and one of the main purposes of this report is to provide some clarity on this process.**
- 14. The Committee recommends that information in relation to the operation of the Fiscal Framework should be provided as soon as it is available in order to provide greater opportunity for parliamentary and wider public scrutiny.**

- 15. The Committee also recognises that the operation of the Fiscal Framework is a shared responsibility between the Scottish Government and the UK Government. The Committee is, therefore, disappointed that the Chief Secretary to the Treasury declined to give evidence in relation to the operation of the Fiscal Framework. The Committee believes it is vital that we have the opportunity to hear from an HM Treasury Minister on the operation of the Fiscal Framework as part of the annual budget process. The Committee will continue to pursue this matter with HM Treasury.**

Fiscal Framework

16. The operation of the Fiscal Framework in calculating the size of the Scottish budget is complex. The Fraser of Allander Institute (FAI) describes it as “exceptionally complex and opaque” and “without precedent internationally.”^{iv}
17. The Auditor General for Scotland (AGS) emphasised in written evidence to the Committee that it “will be critical for the Scottish Government to report clearly and objectively on how all parts of the Fiscal Framework operate in practice, and on the overall picture.”^v
18. The key elements which are considered in more detail below are—
- Calculation of the adjustments to the block grant for each devolved tax;
 - Forecasting of the tax revenues from each devolved tax;
 - Reconciliation process.

Block Grant Adjustment (BGA)

19. The Scottish Government’s block grant will continue to be determined by the Barnett formula. But this has to be adjusted to reflect the transfer of tax powers from the UK Government to the Scottish Government. For each of the devolved taxes the BGA consists of two elements: an initial baseline adjustment and an indexation mechanism.

Baseline adjustment

20. The baseline adjustment is intended to be equal to the UK Government’s receipts from the relevant tax generated in Scotland in the year immediately prior to the devolution of the tax.

^{iv} http://strathprints.strath.ac.uk/57763/8/Fraser_of_Allander_Institute_Scotlands_Budget_2016.pdf page 90

^v http://www.parliament.scot/S5_Finance/Complete_PUBLIC_Finance_Cttee_Papers.pdf page 4

21. Table 1 sets out the initial baseline adjustments as follows—

Table 1

Tax	Initial Adjustment (£m)	Baseline
Income Tax	11,525	
LBTT	468	
SLfT	149	

22. The baseline adjustment for income tax is based on an OBR forecast for 2016-17 and will be reconciled against outturn data once this is available. The baseline adjustment for LBTT and SLfT are based on estimates of outturn receipts for the equivalent UK taxes collected in Scotland in 2014-15.

Indexation mechanisms

23. The purpose of the indexation mechanism is to provide a measure of the rate at which comparable revenues have grown in rUK between any two years. In calculating the BGA for each of the devolved taxes for 2017/18 the indexation mechanism is a measure of the growth rate of comparable revenues in rUK between 2016/17 and 2017/18.
24. During the negotiations on the Fiscal Framework there was disagreement between the two governments regarding the model for the indexation mechanism. The UK Government prefers the *comparable model* while the Scottish Government prefers the *Indexed Per Capita* (IPC) model.
25. The Committee's Adviser on the Fiscal Framework ("the Committee's Adviser") explains that the principal difference between the two models is "the way that they treat differences in relative population growth between Scotland and rUK."^{vi} The implication of the comparable model is that the Scottish budget is exposed to the risk that its population grows relatively slower than the rUK population, whereas the IPC model protects it from this risk.
26. The two governments have agreed that during a transition period until 2021/22 it will be necessary to concurrently calculate the block grant adjustment using both methods.
27. The IPC model, in broad terms, calculates adjustments to the block grant as follows—

Percentage change in the equivalent UK Government tax receipts per head	X	Scottish population growth
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^{vi} http://www.scottish.parliament.uk/S5_Finance/Essentials_of_the_Fiscal_Framework_David_Eiser.pdf

28. Figures for the comparable model will also be published. The comparable model calculates, in broad terms, adjustments to the block grant as follows—

Changes in UK Government revenues from tax devolved to the Scottish Parliament	X	Scotland's population share	X	Comparability factor
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29. The comparability factors – which are a measure of the tax raised per capita in Scotland relative to the tax raised per capita from the equivalent tax in rUK - for each of the devolved taxes in Draft Budget 2017/18, are set out in Table 2 below.

Table 2

Tax	Scotland's Share (%)
Income Tax	87.7
SDLT	51.5
Landfill Tax	108.3

30. The comparability factors will be revised to reflect outturn figures in the year immediately prior to devolution.
31. These calculations will be made separately for each tax each year and then applied to the block grant. If there is a difference between the calculations using the two methods there will be a “reconciling adjustment” to the comparable method to “ensure the mechanism delivers the IPC outcome.”^{vii}
32. The calculation of the BGA is carried out by HM Treasury and is based on the OBR forecasts of rUK tax receipts which will subsequently be reconciled with the outturn figures once these are available. The draft budget provides the total figure for the BGA for each of the devolved taxes using both the IPC Method and the Comparable Method. However, it doesn't provide any details of how these figures were calculated. The technical annex to the Fiscal Framework states that “the results from the two models will be presented in the annual reports to each Parliament.”^{viii}
33. The previous Finance Committee consistently raised concerns about the lack of transparency in relation to the adjustments to the block grant arising from the devolution of further financial powers. In its report on Draft Budget 2016-17 it stated that “full transparency is an essential element in securing public confidence in the process.”^{ix} It recommended that a detailed explanation is provided for the BGA and that this must include the workings used to arrive at the overall figures. The Committee's Adviser also suggests that the calculations should be set out in the public domain.

^{vii} https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/508102/Fiscal_Framework_k_-_Text_-_Annex_to_the_fiscal_framework_-_15th_March_2017....pdf paragraph C.32

^{viii} https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/508102/Fiscal_Framework_-_Text_-_Annex_to_the_fiscal_framework_-_15th_March_2017....pdf paragraph C.33

^{ix} http://www.parliament.scot/S4_FinanceCommittee/Reports/FIS042016R02Rev.pdf page 25

- 34. The Committee agrees with our predecessor that full transparency is an essential element in securing public confidence in the operation of the BGA. The Committee recommends that the Scottish Government explores with HM Treasury how best to provide the respective BGA calculations for the 2017-18 budget and that in future years the BGA calculations are published alongside the draft budget.**
- 35. The Committee also notes that it is HM Treasury which has responsibility for the operation of the Barnett formula and the BGA and it is, therefore, vital, as noted above that a HM Treasury Minister is available to appear before the Committee.**

Revenue Forecasting

36. The resources which are available to the Scottish Government in the draft budget depend on the block grant as adjusted to reflect tax devolution and the forecast revenues from the taxes devolved. The Fiscal Framework specifies that the SFC will have responsibility for preparing the forecasts for the devolved taxes from 2018-19 onwards. The forecasts for 2017-18 have been prepared by the Scottish Government and assessed as reasonable by the SFC.
37. The Scottish Government published a paper alongside the draft budget which sets out the methodology and assumptions relating to the devolved tax forecasts (“methodology note”).^x The SFC published its own report on its assessment of the reasonableness of the Scottish Government’s forecasts on the same day as the draft budget.^{xi}
38. The Committee welcomes the level of detail provided by both the Scottish Government and the SFC in relation to the forecasting of the devolved taxes. This provides a great deal of clarity and understanding of the preparation of the forecasts. However, as discussed below there are some minor areas which could be improved upon in line with the practice of the OBR. First, where forecasts have been revised, the ‘components of change’ should be set out and quantified clearly. Second, providing revised in-year forecasts.

- 39. The Committee recommends that in future years the SFC provides a breakdown of any changes to its forecasts including the reasons behind them and quantification of the amounts which result from each factor. For example, any proportion that is due to policy change and any proportion that is due to methodological change.**

^x <http://www.gov.scot/Publications/2016/12/6669>

^{xi} http://fiscal.scot/media/media_505786_en.pdf

- 40. The Committee also recommends that the SFC publishes in-year forecasts for each of the devolved taxes in its report on the draft budget in addition to future forecasts.**
- 41. The Committee also notes that the SFC has a statutory requirement to produce forecasts for the devolved taxes twice a year and further consideration will need to be given to how this works in practice including the level of parliamentary scrutiny and the impact of the revised forecasts on the public finances.**

Reconciliation

42. Both the forecasts which are used to inform the BGA for each of the devolved taxes and the forecast for the revenues from Scottish income tax will be reconciled with outturn figures once these are available. The technical annex^{xii} to the Fiscal Framework provides some details of how this process will work which varies between each tax.
43. The Cabinet Secretary provided further details of how the process will work in a letter to the Committee in August 2016. He explained that the BGA will be recalculated once outturn data is available and that “for the majority of the taxes this will be in the Summer following the end of the relevant financial year.”^{xiii} However, outturn data for income tax will not be available until around fifteen months after the end of the financial year.
44. The reconciliation process markedly illustrates the complexity of the Fiscal Framework. As the FAI points out “very quickly changes in budget lines will become inherently more complicated on a scale not yet witnessed” and finding “a way to make this accessible to promote scrutiny and accountability will be crucial.”^{xiv}

- 45. The Committee recommends that the Budget Process Review Group considers the scrutiny arrangements for the reconciliation process as part of its work and brings forward recommendations for amendments to the Written Agreement.**

Income Tax

46. Outturn data for income tax for 2017/18 will be available around July 2019. Once this data is available the BGA for income tax and the Scottish revenues will be

^{xii} http://www.parliament.scot/20160315_DFMletter_FFannex_comp.pdf

^{xiii} http://www.scottish.parliament.uk/S5_Finance/Cabinet_Secretary_to_Finance_Committee_-_Fiscal_Framework.pdf

^{xiv} http://strathprints.strath.ac.uk/57763/8/Fraser_of_Allander_Institute_Scotlands_Budget_2016.pdf page

recalculated. Any difference from the forecasts “will be incorporated into the equivalent funding for the following financial year, provided this information is available at least two months in advance of the Scottish Government’s Draft Budget.”^{xv}

47. If it is not available within this timescale then the Scottish Government “may determine whether the adjustment will apply in the following financial year or the second following financial year.”^{xvi} The technical annex also states that there will be no in-year updates to the Scottish income tax forecasts or the associated BGA.

48. The Committee recommends that the Budget Process Review Group considers the optimum timing for the publication of the recalculation of the Scottish income tax revenues and the BGA.

49. The Committee also recommends that it is essential that an analysis is provided of the outturn figures against forecast and an explanation provided for any differences. The Committee recommends that the SFC provides an analysis of the outturn figures against the forecast for Scottish income tax revenues as soon as practicable after the outturn figures become available.

Fully Devolved Taxes

50. The Scottish Government can use the receipts from the fully devolved taxes (LBTT and SLfT) as they are collected during the year to fund spending. This means that there is no need for a reconciliation between the revenue forecasts and outturn figures. However, there will need to be a reconciliation between the forecasts for the BGA and the outturn figures for the BGA for each of the devolved taxes. As noted above the Cabinet Secretary has informed the Committee that this will be in the Summer following the end of the relevant financial year.
51. Unlike income tax the BGA for the fully devolved taxes will be updated in-year to reflect the latest forecasts of corresponding tax receipts in rUK. The technical annex states that in-year adjustments to the BGA will occur at the Autumn Statement and this “will ensure that the Scottish Government is shielded from UK-wide in-year shocks.”^{xvii} However, if the BGA is due to an in-year policy change at a UK level then the Scottish Government can decide to adjust the block grant at the time of the Autumn Statement or at the time of the final reconciliation when outturn data is available.

^{xv} https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/508102/Fiscal_Framework_k_-_Text_-_Annex_to_the_fiscal_framework_-_15th_March_201....pdf

^{xvi} https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/508102/Fiscal_Framework_k_-_Text_-_Annex_to_the_fiscal_framework_-_15th_March_201....pdf

^{xvii} https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/508102/Fiscal_Framework_k_-_Text_-_Annex_to_the_fiscal_framework_-_15th_March_201....pdf paragraph C.56

52. The Committee recommends that the Budget Process Review Group considers the optimum timing for the publication of the recalculation of the devolved taxes revenues and the BGA.
53. The Committee also recommends that it is essential that an analysis is provided of the outturn figures against forecast and an explanation provided for any differences.
54. While there is no reconciliation between the Scottish revenue forecasts and the outturn figures the Committee nevertheless recommends that the SFC provides an analysis of the outturn figures annually.

Outlook for the Scottish Economy

55. The draft budget states that the “newly-devolved powers place a greater emphasis on Scotland’s relative economic performance in determining the resources available to fund devolved public spending.”^{xviii} This means, as Professor Roy points out, “the growth performance of the Scottish economy becomes fundamental to the overall outlook for the Scottish budget.”^{xix}
56. The Scottish Government has provided economic growth forecasts in its methodology note.^{xx} These can be compared with other Scottish Growth forecasts and the OBR’s UK growth forecast as illustrated in Table 3 below.

Table 3

	2016	2017	2018	2019
Fraser of Allander	1.0	1.1	1.3	1.6
Ernst & Young	0.7	0.4	1.2	1.4
PWC	1.8	0.9		
		<i>2017/18</i>	<i>2018/19</i>	<i>2019/20</i>
Scottish Government		1.3	1.6	1.7
OBR UK Growth Forecast	2.1	1.4	1.7	2.1

57. The Scottish Government notes that recent GDP growth has been below trend and that historically Scottish GDP has grown by around 2% per year. The Scottish Government’s forecasts show that growth is expected to be below this

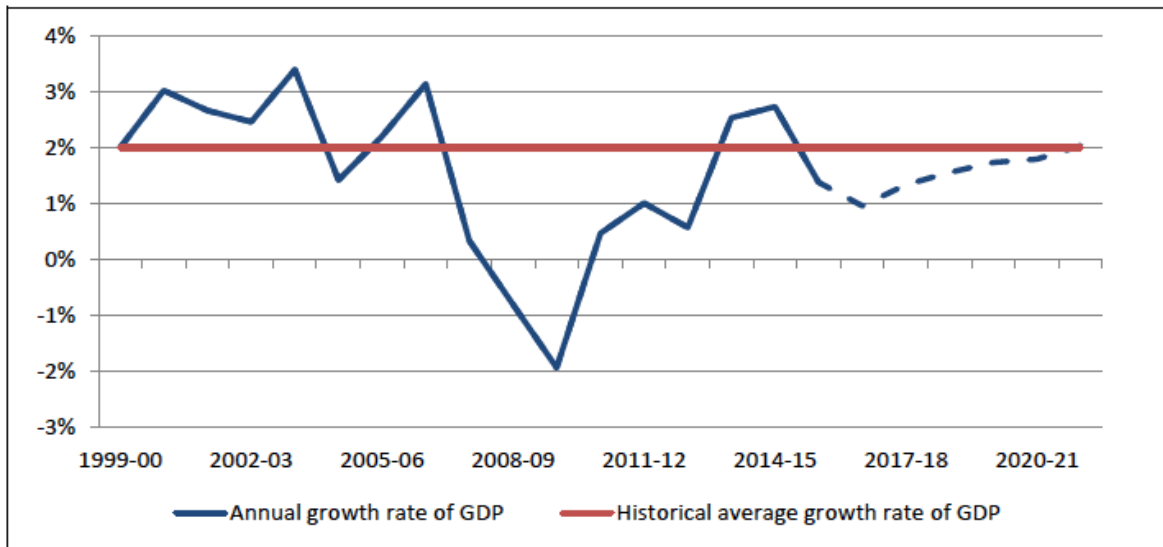
^{xviii} <http://www.gov.scot/Resource/0051/00511808.pdf> page 5

^{xix} Finance and Constitution Committee, 21 September 2016, OR Col. 10

^{xx} <http://www.gov.scot/Publications/2016/12/6669> page 18

trend over the next two years “as the impact of Brexit depresses economic activity” and then return to 2% by 2021-22.^{xxi} This is illustrated in Graph 2 below which is reproduced from the Scottish Government’s methodology note.

Graph 2



58. The Cabinet Secretary was asked by the Committee to provide some insight into how the increased dependence of the public finances on economic performance has changed the way that the Scottish Government has approached this year’s budget process, the draft budget and plans for future years. He responded—

” “Ministers have had to consider their portfolio decisions and how to stimulate the economy and how to support it, our population and public services. We have to ensure that we arrive at the right decisions to deliver sustainable economic growth.”^{xxii}

59. The Committee asks the Scottish Government what consideration it has given to restructuring its approach to managing its budget given the new powers in the Scotland Act 2016.
60. Overall, the Committee welcomes the level of information provided in the Scottish Government’s methodology note on the short term and the longer term outlook for the Scottish economy. However, the Committee recommends that the Budget Process Review Group should consider the options for increasing accessibility and transparency, for example by providing more detail on the economic and fiscal outlook in the draft budget document.

^{xxixxi} <http://www.gov.scot/Publications/2016/12/6669> page 18

^{xxii} [Finance and Constitution Committee, 11 January 2017](#), OR Col. 25

Productivity Growth

61. One of the Scottish Government's targets within the National Performance Framework (NPF) is to "rank in the top quartile for productivity against our key trading partners in the OECD by 2017."^{xxiii} The Scotland Performs website states—

“In 2014 Scotland was ranked 19th (out of 35 countries) for productivity levels amongst OECD countries, placing Scotland at the top of the third quartile. In 2013, Scotland was also ranked 19th, meaning that there has been no change in the latest year.

“Since the baseline position of 2006, Scotland's productivity rank has worsened. Between 2006 and 2010 it fluctuated between 16th and 18th, but has remained at 19th since 2011. The performance since 2010 is largely due to reduced purchasing power in Scotland and the UK as a whole relative to other OECD members.”^{xxiv}

62. The EY Scottish ITEM Club were asked by the Committee how close the Scottish Government was to meeting this target. They responded that these are challenging targets and that “we have had in Scotland, as in the rest of the UK, a long period in which aggregate productivity has not grown by much at all.”^{xxv}
63. The Economy, Jobs and Fair Work (EJFW) Committee also questioned the Chief Executive of Scottish Enterprise about the productivity target. She responded that meeting it would require a 200% hike in “innovation levels”. Scottish Enterprise is working with companies on productivity through the Scottish Manufacturing Advisory Service and has launched “productivity plans” for food and drink, tourism.
64. The Scottish Government states in its methodology note that the “OBR's forecast of productivity is used to project productivity in Scotland.”^{xxvi} This assumes that productivity growth will return to its long term average of 2% per year by 2021-22 although the OBR acknowledges significant uncertainty around this assumption.
65. This assumption matters due to the linkage between productivity growth and average earnings growth which in turn drives income tax revenue growth. However, the OBR notes in its most recent forecast evaluation report that productivity growth has fallen well short of its forecasts. The OBR explains that this lower than forecast productivity growth explains why average earnings growth has consistently been lower than it had forecast. This lower than forecast wage growth has consistently resulted in large downward revisions to the OBR's forecasts for income tax revenue growth.

^{xxiii} <http://www.gov.scot/About/Performance/scotPerforms/purposetargets>

^{xxiv} <http://www.gov.scot/About/Performance/scotPerforms/purposetargets/productivity>

^{xxv} Finance and Constitution Committee, 7 December 2016, OR Col. 42

^{xxvi} <http://www.gov.scot/Publications/2016/12/6669> page 16

66. In considering growth forecasts, as with all economic forecasts, the Committee remains mindful that they are not an exact science and will inevitably be subject to change. The Chairman of the OBR, for example, stated—

“It is occasionally tempting to treat economic forecasting as a spot-the-ball competition, but it is not like that—or, if it is, it is a spot-the-ball competition in which you have to be prepared for the judges to change their minds repeatedly about where the ball is, often many years after the closing date of the competition. Therefore, it is necessary to have a sense of wariness.”^{xxvii}

67. The Committee’s Adviser asked whether in this context it is wise for the Scottish Government to follow the OBR’s forecasts for wage and productivity growth. He suggests that arguably it does, given the way that the Fiscal Framework works. This means that if there are large forecast errors at a UK level then there is likely to be a similar error in the Scottish forecasts. As such, the impact of the reconciliation of the outturn figures with the forecasts for Scottish tax revenues is likely to be offset by the equivalent reconciliation which will apply to the BGA.
68. At the same time he points out that in relation to the Scottish Government’s income tax revenue forecast below, there is some risk from assuming Scotland will match the UK given recent trends in relative wage growth and wider economic performance. For example, if wages grow less quickly in Scotland than in rUK then the size of the BGA reduction could be greater than the Scottish income tax revenues.
69. Given the linkage between productivity levels and future tax revenues one of the major challenges for the Scottish Government will be to ensure that productivity growth performs at least as well as rUK. The FAI points out that if Scotland is to grow its revenues through faster growth then tackling relatively weak productivity will be key.^{xxviii} On this basis IPPR Scotland suggests that “a focus on productivity has to be a key thing for the Scottish Government in the current session of the Parliament and beyond.”^{xxix} The Scottish Council for Development and Industry (SCDI) recommends that the Scottish Government establishes a Scottish Productivity Commission.
70. The Chairman of the OBR explained to the Committee that “the defining puzzle of the present economic recovery has been that productivity” has grown “much less quickly than has historically been the case.”^{xxx} While this was not unique to the UK he suggested that it was probably more pronounced.

^{xxvii} [Finance and Constitution Committee, 11 January 2017](#), OR Col. 5

^{xxviii} [https://pure.strath.ac.uk/portal/files/55756062/Fraser_of_Allander_Institute_Scotlands_Budget_2016.p](https://pure.strath.ac.uk/portal/files/55756062/Fraser_of_Allander_Institute_Scotlands_Budget_2016.pdf)

^{xxix} [Finance and Constitution Committee, 16 November 2016](#), OR Col. 4

^{xxx} [Finance and Constitution Committee, 11 January 2017](#), OR Col. 2

71. He was also asked by the Committee what action the Scottish Government could take to address the productivity puzzle. He responded that it may be partly a global phenomenon and—

“That should be borne in mind when thinking about what potential domestic policy could do. If the global trend is for less investment opportunity or if the particular type of technological progress that we have seen is not as conducive to investment and GDP growth as it might have been, there may be bigger-picture stories that might not be particularly amenable to domestic policy.”^{xxxix}

72. The Cabinet Secretary was asked what additional measures he has introduced in his draft budget to support productivity growth. He began his response by pointing out that the economy was still a shared issue and many economic levers are still controlled by the UK Government.

73. This is a point which Professor Heald also emphasised. He warns that it is important not to oversell what the Scottish Government can do with the new powers “to improve the growth of the economy, when that will be affected much more by UK policy, monetary policy and Brexit.”^{xxxix} His view is that “most of the levers remain with the UK Treasury and with the Bank of England and monetary policy.”^{xxxix}

74. The Cabinet Secretary explained that within the powers of the Scottish Government “we are taking action across a range of portfolios.”^{xxxix} Some of the examples he provided include business rates, non-domestic LBTT, Scottish Government support for City Deals, the Scottish Growth Scheme and Government interventions in specific industries such as steel, aluminium and shipbuilding. Mr MacKay also highlighted elements of the enterprise agenda which focus on increasing export opportunities as well as support for the Scottish tourism industry. The policy response to economic growth within the draft budget is discussed in more detail below.

75. The Cabinet Secretary for Economy, Jobs and Fair Work explained to the EJFW Committee that—

“We have seen an increase of around 4.4% in productivity since 2007. By contrast, UK productivity has flat-lined in that period, although the UK still has higher productivity rates than Scotland does. Most of our competitors in the European Union have higher productivity rates than we do. We want to see productivity rates increase.”^{xxxv}

^{xxxix} [Finance and Constitution Committee, 11 January 2017](#), OR Col. 20

^{xxxix} [Finance Committee, 2 November 2016](#), OR Col. 9

^{xxxix} [Finance Committee, 2 November 2016](#), OR Col. 8

^{xxxix} [Finance and Constitution Committee, 11 January 2017](#), OR Col. 25

^{xxxv} [Economy, Jobs and Fair Work Committee, 20 December 2016](#), OR Col. 7

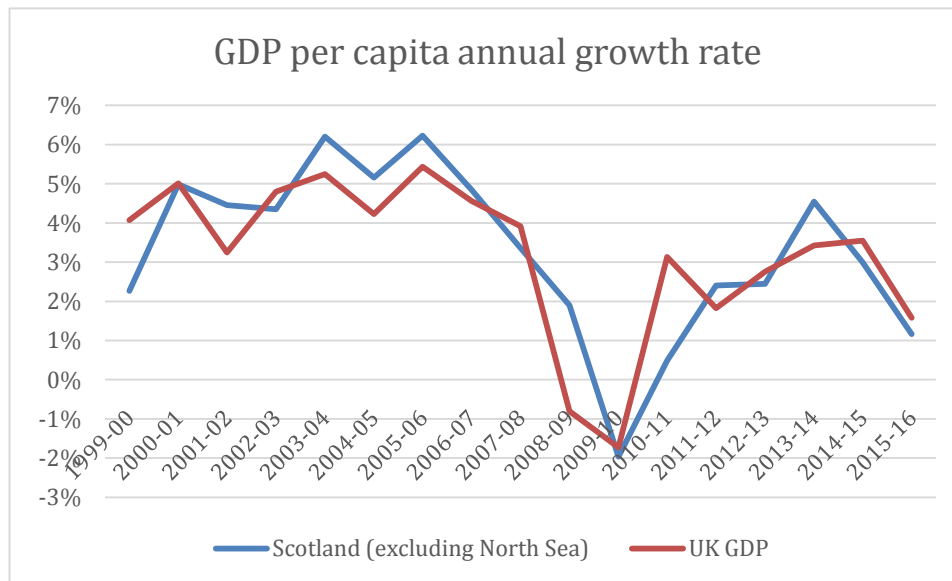
76. He told the EJFW Committee that one of the ways of achieving higher productivity growth was to promote trade.

77. The Committee asks the Scottish Government what analysis it has undertaken of its options for addressing the “productivity puzzle” in Scotland in light of the powers available to it and what opportunities the new financial powers provide to improve productivity growth given that the recent trends are also global and many of the macro-economic levers remain at a UK level.

Relative Economic Performance

78. The Committee’s adviser points out that whether Scotland has seen faster or slower GDP growth than the UK as a whole depends on:
- The extent to which output from the North Sea is included in calculations
 - The time period considered
 - Whether we consider total GDP, or GDP per capita
79. Prior to the financial crisis in 2008 Scotland experienced somewhat higher GDP growth than the UK as a whole if a geographical share of North Sea activity was included. Since then however, slowing North Sea activity has acted to widen divergence between Scottish and UK growth rates, if it is included. Excluding North Sea activity then, for the period as a whole Scotland has experienced marginally slower annual growth than the UK.
80. Given the structure of the Fiscal Framework (which emphasises the importance of relative per capita growth in income tax and property transactions tax revenues), the most directly relevant indicator of relative performance is arguably GDP per capita growth excluding North Sea activity. On this measure, Scotland marginally outperformed the UK before the recession, but has somewhat underperformed subsequently.
81. In general GDP per capita growth rates have been highly correlated historically as illustrated in Graph 3 below.

Graph 3



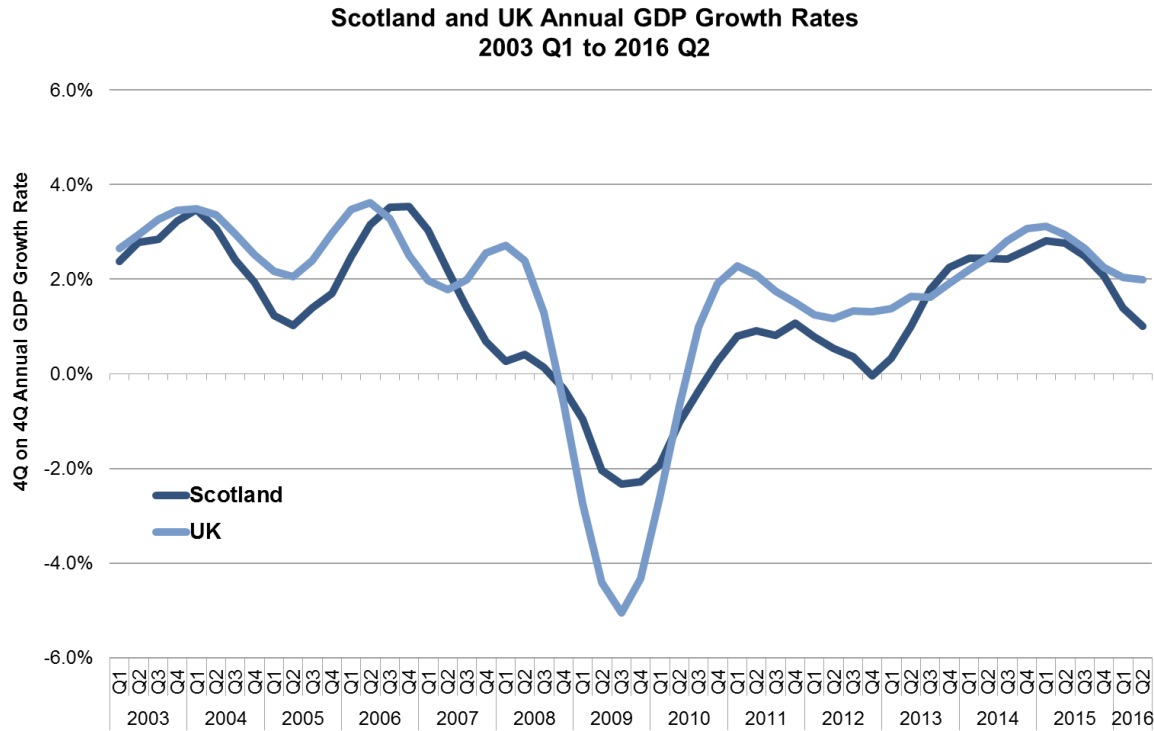
82. More recently, economic growth in Scotland has lagged behind that in the UK as a whole over the past year as demonstrated in the *Scotland Performs* scorecard published by the Scottish Government alongside the draft budget. The *Scotland Performs* website states—



“When rounded to one decimal place, at 2016Q1 annual GDP growth in Scotland was 0.6 percentage points lower than in the UK. At 2016Q2, annual GDP growth in Scotland was 1.0 percentage points lower than in the UK. Between 2016Q1 and 2016Q2, the gap between annual Scottish and UK GDP growth increased by 0.3 percentage points in favour of the UK (when rounded to one decimal place).”

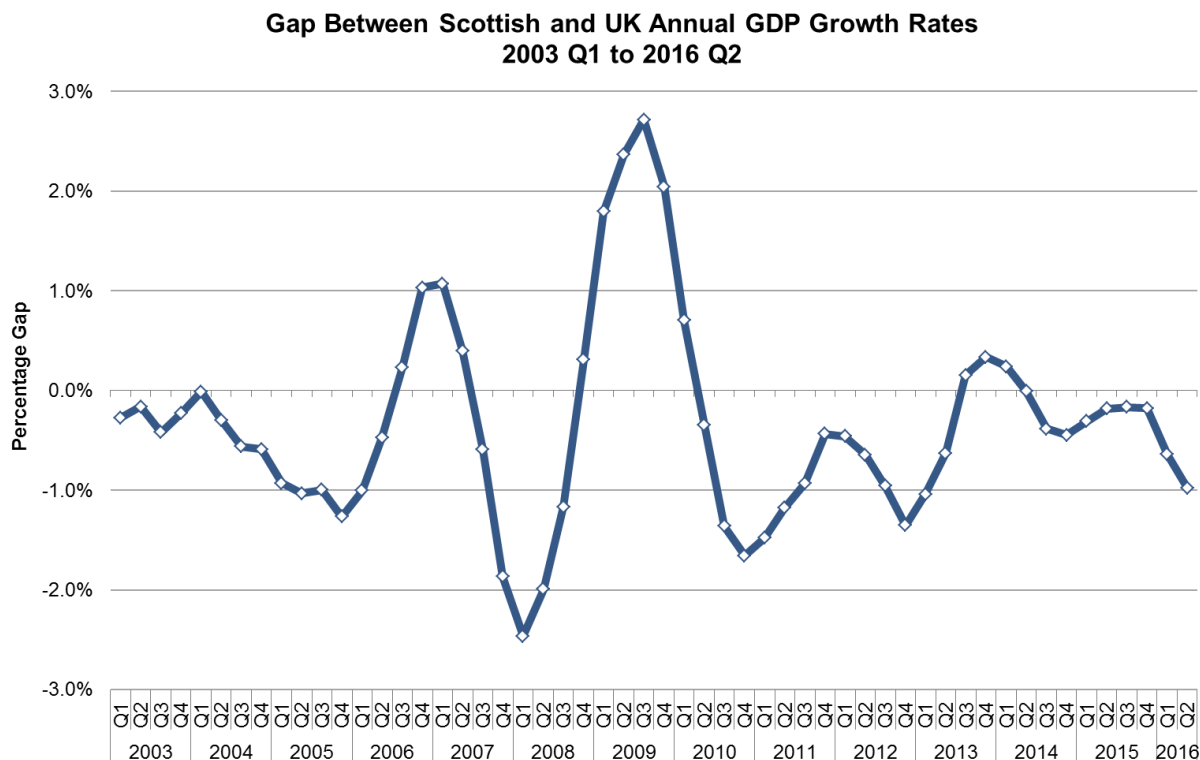
83. Graph 4 below which is reproduced from the *Scotland Performs* website provides details of the annual GDP growth rates for Scotland and the UK between 2003 and 2016.

Graph 4



84. Graph 5 below which is also reproduced from the *Scotland Performs* website illustrates the gap between Scottish and UK annual GDP growth rates between 2003 and 2016.

Graph 5



85. The FAI's view is that the Scottish economy remains fragile and that the "balance of evidence suggests that Scotland will do well to match UK economic performance at least in the short-term."^{xxxvi} The FAI also raises concerns about a possible sustained structural slowdown in the North Sea economy. It argues that the lack of any fiscal support mechanism to mitigate the impact of such asymmetric structural decline is a "key weakness embedded within the new Fiscal Framework."^{xxxvii} Consequently the Scottish Government's budget is more exposed to risks which it only has limited power to mitigate. Brexit has the potential to significantly exacerbate this risk as discussed below.

86. The Committee asks the Scottish Government whether it shares the concerns of the Fraser of Allander Institute regarding a possible sustained structural slowdown in the North Sea economy and, in the event that these concerns prove to be correct, what the likely consequences are for the Scottish budget given the way the in which Fiscal Framework operates.

^{xxxvi} http://strathprints.strath.ac.uk/57763/8/Fraser_of_Allander_Institute_Scotlands_Budget_2016.pdf

^{xxxvii} http://strathprints.strath.ac.uk/57763/8/Fraser_of_Allander_Institute_Scotlands_Budget_2016.pdf

87. The Committee notes that GDP per capita growth rates have been highly correlated historically which on the upside means that the Scottish budget is less likely to be reduced due to higher growth in per capita tax revenues in rUK than in Scotland. However, on the downside it means that the Scottish budget is less likely to increase due to higher growth in per capita tax revenues in Scotland than in rUK. The Committee asks the Scottish Government for its view on what this means for Scotland's public finances in the medium to long-term.

Brexit

88. The Scottish Government recognises in its methodology note that the outcome of the EU referendum "inevitably increases the economic uncertainty faced in Scotland and in turn the future path of tax revenues."^{xxxviii} It anticipates that the impact in the short-term is likely to be as follows—

- ” “The depreciation of sterling pushes up inflation, which in turn depresses real wages and, coupled with an increase in economic uncertainty, depresses consumption;
- ” Increased economic uncertainty delays or suppresses business investment;
- ” Lower economic growth in the rest of the UK, Scotland's largest trading partner, reduces intra-UK trade;
- ” This is partly offset by the depreciation in sterling providing a boost to Scotland's international exports.”^{xxxix}

89. The EJFW Committee heard evidence from Scottish Enterprise on the impact of Brexit. The Chief Executive explained that—

- ” “There is a lot of uncertainty, which is the enemy of confidence. A lack of confidence is the enemy of investment, and that is why we are seeing hesitancy and slowing down, even for companies that might have some cash in the bank.”^{xl}

90. A key question for the Committee given the importance of relative economic performance as discussed above is whether there will be a different impact from Brexit in Scotland than in rUK. Professor Muscatelli states in his written evidence that at this stage there is no evidence that the economic shock in Scotland from Brexit will “at least in the short term, be significantly different from in the UK as a

^{xxxviii} <http://www.gov.scot/Publications/2016/12/6669> page 2

^{xxxix} <http://www.gov.scot/Publications/2016/12/6669> page 14

^{xl} [Economy, Jobs and Fair Work Committee, Official Report, 6 December 2016](#), Col 38.

whole.” The FAI’s view is that it is not clear at this stage if there will be any differential impact.^{xli}

91. IPPR Scotland identifies two likely inter-related short-term impacts on the UK economy arising from the Brexit vote: a ‘growth shock’ and an ‘inflation shock’. The main impact of the inflation shock is a likely reduction in living standards, particularly for the poorest. The primary impact of the ‘growth shock’ is on the size of the public finances. IPPR Scotland refers to a recent report by the IFS which suggests that the average forecast reduction in UK economic growth “will likely lead to a £25.3bn black hole in the public finances, per year by 2019-20.” They point out that “whether the UK Government decide to fill this black hole with additional borrowing, tax rises, or further cuts to day to day spending will have implications for the Scottish Parliament’s budget.”^{xlii}

Inflation

92. The FAI states that the Scottish Government is “likely to face additional spending pressures from rising inflation.” This is due to both the declining real terms value of budgets and the increased costs of commitments to maintain spending in real terms. For example, the Scottish Government plans to increase health spending by £500m more than inflation by the end of the current parliament. Professor Bell notes that CPI inflation is forecast to rise to 2.5% in 2017.^{xliii} He also identifies a number of potential impacts on the public finances including likely demands for increased public sector pay.
93. The FAI states that “after years of pay freezes and below inflation increases, the pressure for more generous awards is likely to increase.”^{xliiv} Professor Heald suggests that part of the reason for relatively high employment rates in the UK following the financial crisis in 2008 was the freeze on public sector pay. He points out that there “is a trade-off in the public sector between the number of jobs and pay rises” and now “is not a time for big increases in public sector pay.”^{xliv} However, Professor Bell points out that there may possibly be an issue of “public sector pay getting so low that there are problems of recruitment, morale and retention.”^{xlvi}
94. Professor Muscatelli notes that the Bank of England now expects inflation to reach 2.7% next year while the National Institute for Economic and Social Research forecasts that it could reach 3.8%. He points out in his written evidence that all “else being equal such an increase in inflation will reduce the real spending power

^{xli} http://strathprints.strath.ac.uk/57763/8/Fraser_of_Allander_Institute_Scotlands_Budget_2016.pdf page 20

^{xlii} http://www.parliament.scot/S5_Finance/20161111CompletePUBLICPapers.pdf

^{xliii} http://www.scottish.parliament.uk/S5_Finance/Complete_28_for_2nd_-_public.pdf

^{xliv} http://strathprints.strath.ac.uk/57763/8/Fraser_of_Allander_Institute_Scotlands_Budget_2016.pdf page 52

^{xlv} Finance and Constitution Committee, 2 November 2016, OR Col. 24

^{xlvi} Finance and Constitution Committee, 2 November 2016, OR Col. 25

of the Scottish Government next year, and therefore increase the fiscal pressures faced.”^{xlvii}

95. Professor Bell’s view is that workers’ real purchasing power is likely to decline in 2017. This means that recent UK economic growth rates will be difficult to sustain given that it has been largely driven by increased consumer spending. Professor Muscatelli also points out that given “the importance of the public sector in Scotland and the fact that incomes in this sector will be constrained by tight fiscal policy, one might expect consumer spending to be particularly constrained in Scotland.”^{xlviii}
96. Professor Bell’s “main concern about inflation is that it will hit poorer segments of society harder.”^{xlix} This is partly due to increased energy costs which are determined by world dollar prices and partly due to the cost of food, much of which is imported into the UK.
97. The Cabinet Secretary was asked whether the Scottish Government has done any sensitivity analysis of the potential impact of increased inflation on the draft budget especially in areas where the Scottish Government has a commitment to maintain spending in real terms. In response, he stated that the Government had assumed a 1.5 percent rate of inflation but confirmed that—

” “clearly, if there is a change to inflation levels over the course of the financial year—which is anticipated—that will present further challenges for the public sector.”^l

98. The Committee asks to what extent the Scottish Government has taken steps within the draft budget to address the potential disproportionate impact of inflationary pressures arising from Brexit on households on lower incomes and on public services.

European Structural and Investment Funds

99. The Culture, Tourism, Europe and External Relations (CTEER) Committee notes that all European and Structural Investment funding committed before the UK leaves the EU will be guaranteed by the UK Government with the funding guarantee passed on by the Scottish Government. The CTEER Committee notes that £383 million has been committed under the current programmes, leaving over £400 million of EU funding still to be committed in the programme, or risk being lost.

^{xlvii} http://www.parliament.scot/S5_Finance/20161111CompletePUBLICPapers.pdf

^{xlviii} [Finance and Constitution Committee, 2 November 2016](#), OR Col. 24

^{xlix} [Finance and Constitution Committee, 2 November 2016](#), OR Col. 10

^l [Finance and Constitution Committee, 16 January 2017](#), OR Col. 32

100. Progress in committing funding is an issue of concern for the CTEER Committee and it intends to write to the Cabinet Secretary for Economy, Jobs and Fair Work requesting details on progress in committing funds due to the challenge of meeting match-funding requirements as well as the risk that funds are not committed.
101. An issue of concern for the Equalities and Human Rights (EHR) Committee is the support provided through EU structural funds to the third and voluntary sector across Scotland, which will cease on leaving the EU. Brexit is expected to place additional pressures on third sector and voluntary organisations involved in assisting those with protected characteristics, or from marginalised groups.
102. The EHR Committee has, therefore, called on the Scottish Government to take an early lead in opening dialogue between the Scottish third sector and voluntary organisations, the UK Government and EU authorities on assessing the potential impact of the loss of such EU funding support to Scottish society, and negotiating on how such funding gaps are going to be addressed so as to ensure no disruption in the funding base for such groups.

Strategic Financial Planning and Budget Scrutiny

103. The Committee recognises that the new powers in the Scotland Act 2012 and 2016 and the Fiscal Framework fundamentally change the budget process. Consequently, the Committee and the Cabinet Secretary have established a tri-partite working group to review the budget process.^{li} The Budget Process Review Group (BPRG) includes Scottish Parliament and Scottish Government officials and a number of external experts including the AGS. The BPRG aims to publish interim findings for public consultation by the end of February and a final report with recommendations for a revised budget process before Summer recess.
104. A number of issues have arisen during this year's draft budget process which the BPRG is invited to consider.

Timing

105. Given the way the Fiscal Framework operates and fact that the draft budget is still substantially dependent on a block grant from the UK Government the timetable for the Scottish Parliament's budget process is inherently linked to the main fiscal events at Westminster. The UK Chancellor announced at the Autumn Statement that the UK budget will now be announced in the Autumn rather than March. This has potentially significant implications for the timing of the publication of the draft budget. This is because the size of the draft budget is partly dependent both on the size of the block grant and on the level of the adjustments to the block grant.
106. HM Treasury has not specified when in the Autumn the UK budget will be announced but previously the Autumn Statement has tended to be towards the

^{li} <http://www.scottish.parliament.uk/parliamentarybusiness/CurrentCommittees/100930.aspx>

end of November. If the UK budget were to be published annually at this time then it is difficult to see how the current timetable for scrutiny of the draft budget as set out in the Written Agreement could be maintained.

107. But publishing the draft budget after the UK budget/Autumn Statement substantially limits the amount of time available for scrutiny of the Scottish Government's revenue and spending proposals. This is evident from this year's draft budget process. A number of subject committee raised concerns about the time available.
108. The Social Security Committee's view is that this "is clearly not a sufficient timescale in the interests of thorough committee scrutiny" while the Rural Economy and Connectivity Committee stated that the timescale is "unrealistic" and severely undermined its ability to "conduct scrutiny of sufficient depth and quality."
109. The EJFW Committee noted that late publication of the draft budget severely restricted the time available for scrutiny this year. They "expect nothing less than clearly defined arrangements better suited to effective parliamentary scrutiny to be in place in time for the next budget." At the same time they intend to "pursue more meaningful scrutiny by looking more closely at the spending plans of Scottish Enterprise and Highlands and Islands Enterprise as they become clearer during the year."
110. However, given the timing of the publication of the draft budget a number of committees carried out pre-budget scrutiny. For example, the Justice Sub-Committee on policing carried out pre-budget scrutiny on police financial planning for 2017-18. The Local Government and Communities (LGC) Committee focused its pre-budget scrutiny on the housing supply budget and the Health and Sport Committee (H&S) Committee examined the budget setting processes of the newly established health and social care partnerships (HSCPs).
111. The Environment, Climate Change and Land Reform (ECCLR) Committee intends to review the scrutiny of climate change issues by subject committees in relation to the draft budget. In particular, whether the delay in publication of the draft budget allowed committees sufficient time to properly scrutinise climate change issues. A copy of the report will be sent to the BPRG.

112. The Committee recognises that the Budget Process Review Group faces a real challenge in designing a new budget process which meets the need for the publication of reliable and accurate budgetary information while also allowing sufficient time for parliamentary and wider public examination of the Scottish Government's proposals and an opportunity to make alternative tax and spending proposals.

113. The Committee notes that while pre-budget scrutiny can be carried out in areas such as the performance of public bodies in delivering outcomes this should not be viewed as an alternative to the scrutiny of the draft budget.

114. The Committee intends to write to HM Treasury highlighting the potential challenges to the budget scrutiny timetable by changes to the timing of the UK budget announcement and asking what consultation took place with the devolved governments. The Committee will also ask HM Treasury to clarify when in the Autumn the UK budget is likely to be published.

115. The Committee recommends that the Budget Review Group considers the impact of the change on the Scottish budget process.

Multi-year budgeting

116. The UK Government carried out a Comprehensive Spending Review (CSR) covering the period of the current UK Parliament in 2015. This means that indicative figures for the block grant are available for each financial year until 2019-20. However, the Scottish Government has not published its own CSR but instead published one-year budgets for 2016-17 and 2017-18. The one-year budget for 2016-17 was due to the Scottish Parliament elections. In respect of 2017-18 the Cabinet Secretary explained to the Committee that due to the “degree of uncertainty and volatility that exists right now, it would be unwise to publish a three-year spending review.”

117. The FAI points out that a “single year budget is difficult to reconcile with medium term plans and priorities for government” and suggests “it will be essential to return to multi-year budgeting as early as possible.”^{lii} This also allows for greater certainty for public bodies, allowing them to plan more effectively.

118. The Social Security Committee “strongly recommends that the Scottish Government in future years provides information based on a longer term cycle which covers the whole of this parliamentary session.” The Cabinet Secretary explained to the LGC Committee—



“Would I prefer to set out a three-year spending review? Of course I would. Would that be welcomed by local government, the third sector and business? Of course it would. However, I would rather have an accurate, credible budget than one that was ill informed or subject to so many variables that it would change drastically and would not provide the certainty that people sought.”^{liii}

^{lii} <https://www.sbs.strath.ac.uk/economics/fraser/20160913/ScotlandsBudget-2016.pdf> page 88

^{liii} [Local Government and Communities Committee, OR, 21 December 2016](#), c38

119. The LGC Committee recommended that next year an indicative budget for 2019-20 is presented alongside Draft Budget 2018-19. The CTEER Committee noted that a one-year budget presents publically funded bodies, particularly those involved in the creative arts, with a distinct set of challenges. They stress the importance of reverting to a three-year budget cycle when this is possible in order to provide cultural organisations more security in planning their activities.

120. The Committee notes that the timing issues which apply to the accuracy and scrutiny of one-year budgets are likely to be even more acute in relation to multi-year budgets. For example, it is likely that the publication of a multi-year budget in December would present further difficulties for the subject committees in carrying out effective scrutiny.

121. The Committee therefore recommends that the Budget Process Review Group considers the options for broadening financial scrutiny beyond solely the period between a draft budget being published and the Budget Bill being passed.

Medium-Term Financial Strategy

122. In addition to the CSR, the AGS and Audit Scotland also suggest the need for an over-arching medium-term financial strategy (MTFS). While the CSR provides very detailed proposals for each spending area, a MTFS would provide a broader overall analysis of the outlook for the economy and public finances over a five to seven year period.

123. The AGS and Audit Scotland suggest a number of issues which could be considered for inclusion in a MTFS—

- The Scottish Government's expectations and broad plans;
- An analysis of the economic context and the impact of anticipated economic performance;
- The possible consequences for the block grant, adjustments to the block grant and devolved tax revenues;
- The impact on borrowing levels and the Scotland Reserve;
- Indicative spending levels and a sense of what the priorities and broad levels of spending are.

124. The FAI also emphasises the need for “an overall strategy outlining the role that fiscal policy will play in achieving the government’s core economic and social objectives.”^{liv} This should provide clear links with the draft budget.

125. The Committee notes the increased levels of tax and borrowing powers and the increased dependence of the budget on relative economic performance. It recommends that the Budget Process Review Group explores the options for a more strategic approach to financial planning. This should include the role of the SFC in supporting such an approach.

Transparency and Accountability

126. The AGS also emphasised within the context of the new powers the need for transparency and accountability. She stated in written evidence to the Committee that “comprehensive, transparent, reliable and timely reporting of Scotland’s public finances is needed to support Parliamentary scrutiny.”^{lv} For example, the assumptions underlying changes in revenues and spending from one year to another should be clear.

127. The FAI recognises that the Scottish Government has “made substantial improvements in the level and quality of budgetary and financial information that is provided and is publicly accessible” but “there remains significant scope to improve the availability and transparency of publicly available budget data.” Also, given the complexity of the Fiscal Framework, “the urgent need for transparency and accessibility to budgetary data will increase.”^{lvii}

128. The FAI also highlights a number of areas where the transparency of the draft budget document could be improved as follows:

- Figures in different sections are not comparable because of what they do (and do not include);
- Comparisons of spend over time rarely exist in a comparable manner;
- The document is produced in a pdf format with no corresponding publication of data in excel;
- The budget should not be seen simply as a set of spending allocations, but as the end point in a process of strategic planning.^{lvii}

^{liv} http://strathprints.strath.ac.uk/57763/8/Fraser_of_Allander_Institute_Scotlands_Budget_2016.pdf page 92

^{lv} http://www.parliament.scot/S5_Finance/Complete_PUBLIC_Finance_Cttee_Papers.pdf

^{lvii} http://strathprints.strath.ac.uk/57763/8/Fraser_of_Allander_Institute_Scotlands_Budget_2016.pdf page 90

^{lvii} <https://www.sbs.strath.ac.uk/economics/fraser/20160913/ScotlandsBudget-2016.pdf> page 90

129. The Education and Skills Committee noted that the value of the overall settlement to individual local authorities and whether this represents a net gain or loss is complex and recommends that “the Scottish Government provides full clarity on this issue during the final passage of the Draft Budget and in the months ahead.”
130. The ECCLR Committee welcomed the publication of details of funding for climate change mitigation measures alongside the level for figures which in their view was a considerable improvement of the experience of previous years.
131. The EHR Committee welcomes the new section on ‘intersectionality’ (a term used to refer to combinations of protected characteristics. e.g. young disabled women) which has been added to the Equality Budget Statement (EBS). It notes that this explains the complexity for policymakers, funders and service providers when making decisions. It also acknowledges the difficulties in gathering evidence of impact on intersections of protected characteristics. Otherwise the EBS remains much as it did previously. The EHR Committee intends to examine the EBS more closely as part its scrutiny of Draft Budget 2018/19.

132. The Committee recognises that this is a transitional year for both how budgetary information is presented by the Scottish Government and how it is scrutinised by the Scottish Parliament. The significant complexity of the Fiscal Framework combined with the extent of the new powers and the uncertainty of Brexit means that significant work is required in developing a new budget process and wider financial scrutiny.

133. The Committee also believes that consideration needs to be given to improving the transparency of the budget document as highlighted by the Fraser of Allander Institute.

134. The Committee looks forward to receiving the interim report from the Budget Process Review Group at the end of February.

135. At the same time the Committee has agreed to continue with the approach to budget scrutiny of its predecessor. The previous Committee adopted the Chartered Institute of Public Finance’s (CIPFA’s) four principles of financial scrutiny—
- Affordability – the wider picture of revenue and expenditure and whether they are appropriately balanced;
 - Prioritisation – a coherent and justifiable division between sectors and programmes;
 - Value for Money – the extent to which public bodies are spending their allocations well and achieving outcomes; and

- Budget Processes – integration between public service planning and performance and financial management.

136. The Committee has agreed to continue with this approach and, in particular, to continue to develop a more outcomes-based approach to financial scrutiny. This is a view shared by the FAI which states in its recent report on Scotland's budget—

“Budget planning and allocations should not just be forward-looking, but should consider questions such as how well has money been spent previously, and what has it achieved.”^{lviii}

137. Guidance was issued to the subject committees on 30 June 2016.^{lix} The Committee recommended that subject committees continue to focus on prioritisation and value for money throughout the current parliament. This should include the extent to which public bodies are adopting a priority-based budgeting approach and whether they are spending their allocations well and achieving outcomes.

AFFORDABILITY

138. This aspect of financial scrutiny relates to the need for a balanced budget which means expenditure should be no greater than the revenue source. As discussed above, the revenue source of the Scottish Government's budget has substantially changed. Prior to the Scotland Act 2012 over 90% of Scotland's budget was funded by a block grant from Westminster. Now that the Scottish Parliament has responsibility for setting the rates and bands for NSND income tax, it will raise around 40% of the money which it spends.

139. Table 4 below sets out the estimated receipts from these taxes for 2017-18.

Table 4

Tax	Forecast Revenue (2017-18) £m
NSND Income Tax	11,829
Land and Buildings Transaction Tax (LBTT)	507
Scottish Landfill Tax (SLfT)	149
Non-Domestic Rates Income (NDRI)	2,605.8
Council Tax	2,234
Total	17,324.8

^{lviii} http://strathprints.strath.ac.uk/57763/8/Fraser_of_Allander_Institute_Scotlands_Budget_2016.pdf

^{lix} http://www.parliament.scot/S5_Finance/General%20Documents/Convener_to_Convener_guidance_2016.30.06.pdf

Scottish Income Tax

140. The budget for 2017/18 is the first in which the Scottish Parliament has the power to vary rates of income tax by band, introduce new bands and vary the threshold between bands. Some aspects of NSND income tax remain reserved such as setting the level of the personal allowance and changing existing, or introducing new, reliefs and exemptions.
141. The net impact of the devolution of income tax on the draft budget is dependent on the interaction of the adjustment to the block grant and the forecast for Scottish income tax revenues. If the Scottish Government's income tax forecast is larger than the forecast for the adjustment to the block grant, then the Scottish budget will be higher than it would have been had the tax not been devolved (and vice versa).

Rates and Bands

142. The Scottish Government's proposals for the rates and bands of Scottish income tax are set out in Table 5 below.

Table 5

Scottish Income Tax Rates	Scottish Bands
Scottish Basic Rate 20%	Over £11,500 - £43,430
Scottish Higher Rate 40%	Over £43,430 - £150,000
Scottish Additional Rate 45%	Over £150,000 and above

143. The Scottish Government explains in the draft budget that it is committed to protecting low-income tax payers and is therefore proposing to freeze the basic rate of income tax at 20%. It also proposes to freeze the higher rate at 40% and the additional rate at 45%. However, it proposes a different threshold for the higher rate of tax than rUK.
144. The threshold for the higher rate in rUK will increase from £43,001 in 2016-17 to £45,000 in 2017-18 and the UK Government has a policy commitment to increasing this to £50,000 by the end of the current UK Parliament. The Scottish Government proposes to increase the higher rate threshold in Scotland by inflation from £43,001 to £43,430.
145. The UK Government is also committed to raising the personal allowance which is the amount of income you don't pay tax on to £12,500 by the end of the current UK Parliament. The personal allowance will rise by £500 to £11,500 from 2017-18. The Scottish Government is also committed to raising the personal allowance to £12,750 by the end of the current Scottish Parliament. Although the personal allowance is not devolved it can nevertheless achieve this policy aim by setting a zero rate on top of the UK allowance.

146. The Scottish Government states in the draft budget that the proposed—

“increase in the higher rate of income tax threshold, when combined with the increase in the personal allowance, means that lower and middle income taxpayers will be protected at a time of rising inflation, while priority is given to the protection of public services over a substantial tax cut for the top 10 per cent of taxpayers.”^{lx}

147. The Cabinet Secretary explained the Scottish Government’s tax proposals as being rooted in the principles of certainty, convenience, efficiency and ability to pay. Specifically, with regard to income tax, the Cabinet Secretary stated—

“Our key decisions include our proposals to freeze income tax rates and to increase the higher rate threshold in line with inflation, which we believe – as with all our taxation positions – is a responsible, balanced and progressive approach.”^{lxi}

148. The Committee questioned why the Scottish Government’s position that the higher rate threshold, and not the additional rate threshold, will be increased by a maximum of in line with inflation in each of the remaining financial years of the current parliamentary session. The Cabinet Secretary responded that—

“The figure is to be in line with inflation. That feels like the right thing to do in a balanced way”^{lxii}.

149. He then expanded that—

“One of the reasons why is that a change to the threshold for the higher rate generates more income than a change to the threshold for the additional rate, because of the number of people who are paying that”^{lxiii}.

150. The Cabinet Secretary also acknowledged that freezing the higher rate threshold would generate more revenue than the Scottish Government’s proposal to increase it by the rate of inflation.

151. The difficulty in determining behavioural responses to taxations changes was also cited by the Cabinet Secretary as underpinning some of the policy choices made by the Scottish Government. For example, in response to questioning on the rationale for not increasing the additional rate the Cabinet Secretary stated that—

“The key issue is whether raising the additional rate would generate more income and bring us the benefit of an increased tax take. Albeit that the income would come from the richest in our society, the point of the approach would be to raise income, and the analysis was that there was a

^{lx} <http://www.gov.scot/Resource/0051/00511808.pdf> page 14

^{lxi} [Finance and Constitution Committee, 11 January 2017](#), OR Col. 24

^{lxii} [Finance and Constitution Committee, 11 January 2017](#), OR, Col.35.

^{lxiii} [Finance and Constitution Committee, 11 January 2017](#), OR, Col.35.

risk, in that a movement of as much as 5 per cent among Scottish taxpayers, through whatever mechanism, would mean that we no longer raised the income, so the policy would be counterproductive.”^{lxiv}

152. More generally, the Cabinet Secretary stressed that the Scottish Government’s position on income tax remained under review and would be informed by further evidence on behavioural responses to tax changes. For instance, the Cabinet Secretary observed—

” “Decisions on tax, including income tax, will be taken year to year. In our manifesto, we made it clear that the position on the additional rate will remain under review, and it will. We will bear in mind all the evidence that we receive on scenarios and the certainty of tax collection, and the best analysis on tax behaviours and minimising tax avoidance, and we will ensure that we have assurances about residency and that we do not have taxpayers moving elsewhere to avoid any increase in the Scottish rate of income tax”^{lxv}.

153. The Committee recognises that there are challenges in understanding the behavioural effects of tax changes and intends to address this issue further as part of our ongoing inquiry on a Scottish response to taxation.

154. The Committee recognises that there is a wide range of views on income tax, including rates and bands, in the Scottish Parliament and beyond. The Members of the Committee were likewise unable to come to a consensus on these matters. Given the limited time available for this year's scrutiny of the draft budget, the Committee has only had a limited opportunity to take evidence on the Scottish Government's income tax proposals. The Committee notes that the Scottish Government has not consulted on its income tax policies and, therefore, asks on what basis the proposals have been put forward. The Committee also intends to consult on the income tax rates and bands which are agreed for 2017/18 prior to the publication of the Draft Budget 2018/19.

Income Tax Revenue Forecast Methodology

155. The SFC summarises the NSND income tax methodology in the following terms—

” “The preferred methodology of the Scottish Government involves constructing detailed forecasts of taxpayers by age group and by income source (income from employment and pensions, principally) and by sector

^{lxiv} [Finance and Constitution Committee, 11 January 2017](#), OR, Col.37.

^{lxv} [Finance and Constitution Committee, 11 January 2017](#), Col.38.

(private and public). In effect, a distribution of NSND income is forecast for each age group and then combined to arrive at the aggregate NSND distribution of income”^{lxvi}.

156. In order to produce a forecast, the Scottish Government is required to consider wider macro-economic trends. The Scottish Government essentially relies upon the OBR forecast for the UK economy in order to take account of these wider trends. The Scottish Government summarises the rationale for this approach as being that—

” “Because the UK is Scotland’s largest trading partner, and Scotland is part of the UK monetary system, the UK has an important role in determining the path of the UK economy. The Office for Budget Responsibility’s (OBR) forecast for the UK economy published alongside the Autumn Statement 2016 is used to fix the path of the UK economy in SGGEM^{lxvii}. This achieves a degree of coherence between the Scottish Government’s forecasts of Scotland’s economic performance and the OBR’s forecasts of the UK. Key UK-wide variables, such as interest rates and inflation, are also fixed within SGGEM to the OBR’s forecasts. This means that many of the OBR’s assumptions around the impact of the EU Referendum outcome are implicitly included in the Scottish Government’s forecasts”^{lxviii}.

157. The Chairman of the OBR commented on the use of the OBR forecast by the Scottish Government that—

” “The Scottish Government’s approach to forecasting is, in essence, to take our forecasts for the UK as a whole for average earnings and then to use its own modelling techniques to try to discern whether there are any differences that are important for Scotland. That seems a sensible approach”^{lxix}.

158. The SFC suggested that—

” “future work could usefully pursue further economic modelling of the Scottish labour market. That would help provide earnings and employment projections for possible use in the modelling of the economy as a whole and as input for income tax projections”^{lxx}.

^{lxvi} [Scottish Fiscal Commission \(2016\) Commission Report on Draft Budget 2017-18](#) p.21.

^{lxvii} SGGEM – the Scottish Government’s macro-econometric forecasting model.

^{lxviii} [Scottish Government \(2016\) Devolved Taxes Forecast Methodology](#), p.12.

^{lxix} [Finance and Constitution Committee, 11 January 2017](#), Col.5.

^{lxx} [Scottish Fiscal Commission \(2016\) ‘Commission Report on Draft Budget 2017-18’](#), p.39-40.

Income Tax Revenue Forecasts

159. The Scottish Government's forecasts for income tax receipts and the forecasts for the BGA using the IPC method and the net impact are set out in Table 6 below.

Table 6

	2017-18 (£m)	2018-19 (£m)	2019-20 (£m)	2020-21 (£m)	2021-22 (£m)
Forecast Receipts	11,829	12,290	12,912	13,647	14,559
BGA (IPC)	11,750	12,159	12,672	13,233	13,898
Net Impact	79	131	240	414	661

160. This shows that Scottish income tax revenues are forecast to be higher than the BGA in each year of the forecast period. This implies that Scottish income tax revenues per capita are forecast to grow more quickly in Scotland relative to rUK. The Committee's Fiscal Framework adviser has provided details of the implied relative per capita growth rates and these are shown in Table 7.

Table 7

	2017-18	2018-19	2019-20	2020-21	2021-22
Implied per capita growth rate of rUK income tax revenues (BGA)	1.5%	3.0%	3.8%	3.9%	4.5%
Implied per capita growth rate of Scottish revenues (Scottish Government forecast)	2.2%	3.4%	4.6%	5.2%	6.2%

161. However, the Committee's Adviser points out that the OBR is mandated to reflect actual UK Government policy rather than stated policy intentions. This means that the OBR forecasts which inform the BGA do not include the UK Government's commitment to increase the higher rate threshold to £50,000 by the end of the current UK Parliament. The OBR assumes that the UK higher rate threshold will be £45,000 in 2017/18 and will then increase in line with inflation thereafter. The OBR forecasts also do not include the UK Government's commitment to raise the personal allowance by the end of the UK Parliament.

162. If the UK Government implements its commitments on the higher rate and the personal allowance then the BGA may be lower than the forecasts which will benefit the Scottish budget. At the same time this means that it is difficult to compare the OBR forecasts for the BGA with the Scottish Government forecasts for income tax revenue. Consequently, it is not clear to what extent the higher Scottish Government forecasts reflect the impact of its policy to implement a lower threshold for the higher rate or faster underlying growth in Scottish income tax revenues per capita. It may also be influenced by the fact that the OBR's

forecasts assume a slower future rise in the Personal Allowance than the UK Government is likely to implement in practice.

163. The Committee's Adviser suggests that the main limitation in the way in which the forecasts are presented is that there is no attempt to provide an estimate of the revenues raised from the Scottish Government's policy on the higher rate. The FAI estimates that the revenue gain to the Scottish Government from raising the threshold by inflation rather than to £45,000 will be £130m in 2017-18. It also estimates that the "net impact of the UK Government and SNP Manifesto commitments would be to boost the Scottish budget by around £370m annually by 2020-21."

164. The draft budget states that the £79m in additional revenue for 2017/18 arising from income tax—

” “reflects the policy choice of increasing the higher rate of income tax threshold in line with inflation, which means that more revenue is raised in Scotland than would have been under the UK Government's tax policy of increasing the higher rate threshold faster than inflation.”^{lxxi}

165. The Scottish Government's key determinants of its income tax forecasts are derived from the OBR's forecasts for UK wages and salaries growth. The Scottish Government is, therefore, effectively assuming that Scottish wage and productivity growth matches that in the UK as a whole. However, as noted above the latest figures for Scottish and UK annual GDP growth rates on the *Scotland Performs* website show that in the second quarter of 2016 annual GDP growth in Scotland was 1% lower than in the UK.

166. The Committee's Adviser also points out that—

” “the latest wage data indicates that wages grew less quickly between 2015 and 2016 in Scotland than in the UK as a whole. This differential wage growth was particularly marked among higher wage earners, who account for a disproportionate amount of tax revenue. Moreover, the latest GDP data also suggests the Scottish economy may be lagging the UK as a whole slightly.”^{lxxii}

167. On this basis, he suggests that there may be a case for arguing that there are greater downside risks to the Scottish forecasts than there are to the UK forecasts. In this context, assuming that Scotland will match the UK in relation to key economic determinants exposes the Scottish budget to the risk that its revenues will be revised down to a greater extent than the BGA.

^{lxxi} <http://www.gov.scot/Resource/0051/00511808.pdf> page 15

^{lxxii} http://www.parliament.scot/S5_Finance/General%20Documents/2017.01.06_Fiscal_Framework_Adviser_Paper.pdf page 7

- 168. The Committee asks the Scottish Government to provide an estimate of the gain to the Scottish Government by raising the higher rate threshold by inflation rather than to £45,000 in 2017-18 and by inflation rather than to £50,000 by 2019-20.**
- 169. The Committee recognises that any increase in the higher rate threshold will reduce the amount of income tax collected, but that if the threshold is higher in rUK than it is in Scotland this may reduce the Block Grant Adjustment and therefore provide an overall gain to the Scottish budget via the block grant.**
- 170. The Committee therefore asks the Scottish Government to provide an estimate of—**
- **The income tax revenues that would be foregone by the Scottish Government in 2017-18, and by 2019-20, as a result of the proposed inflation-based threshold increase;**
 - **The gain to the Scottish Government via the BGA mechanism in 2017-18, and by 2019-20, on the assumption that the tax policies of both governments are implemented;**
 - **The total gain to the Scottish Government via tax revenues plus the BGA mechanism, if the threshold remains unchanged in 2017-18 and up to 2019-20.**
- 171. The Committee notes that Scottish income tax revenues are forecast to grow more quickly than rUK income tax revenues in each year of the forecast period despite lower forecasts for GDP growth and asks the Scottish Government for its view on the level of risk to the Scottish budget.**

Incorporations

- 172. Prior to a final forecast being made, the Scottish Government makes ‘off model adjustments’ to the NSND income tax forecast to take account of other influences on tax receipts. For 2017-18, this includes the recent trend of a rise in incorporations, whereby individuals set up as companies in order to pay corporation tax rather than income tax, and thereby reduce their tax bill. The Scottish Government estimates that this will account for a reduction in Scottish NSND income tax receipts of around £200m in 2021-22. The Scottish Government states that—**



“The OBR expects UK incorporations to rise by 5% per annum over the forecast period, much faster than the 0.4% increase in total employment. It forecasts that this could cut total UK income tax receipts by £3.1 billion in

2021-22, compared with a situation where incorporations increased in line with employment. The rising trend in incorporations therefore implies that relatively more taxpayers are expected to pay tax on dividends and profits rather than employment income which would depress NSND liabilities”^{lxxiii}.

173. In evidence to the Committee, Robert Chote observed in relation to incorporations—

” “We have taken account of the trend in the UK forecast, so that will feed into the Scottish forecast. There is an offset in the UK corporation tax forecast. Clearly, there is a loss to the Exchequer overall; we assume that there is such a degree of incorporation because people know that they will be paying less in corporation tax than they would have been paying income tax. As you say, part of the loss of income tax receipts is offset by corporation tax receipts. We do not know to what degree that matters to Scotland, which is seeing the hit on the income tax side – although presumably the impact on the corporation tax side would in some way feed through into the block grant adjustment, from which we steer very clear, as those are deep waters. We have not looked at the Scotland-specific implications, but our Scottish income tax forecasts reflect the judgements that we have made on incorporations in the UK forecast”^{lxxiv}.

174. The Committee notes that the impact of the forecast increase in incorporations on the Scottish budget depends on the relative impact on rUK income tax revenues and Scottish income tax revenues. As such, if incorporations grow at the same level in Scotland and rUK we would expect that the loss in Scottish tax revenues would be offset by the reduction in the size of the adjustment to the block grant. However, a reduction in the size of the Scottish tax base would have an impact on the amount of revenue which the Scottish Parliament could raise through changes to the rates and thresholds for Scottish income tax. There is also a possibility that differential tax rates may lead to a behavioural response which could impact on the level of incorporations.

175. The Committee intends to examine this issue further as part of our ongoing inquiry on a Scottish approach to taxation.

^{lxxiii} [Scottish Government \(2016\) Devolved Taxes Forecast Methodology](#), p.34.

^{lxxiv} [Finance and Constitution Committee, 11 January 2017](#), OR Col. 18.

Implementation of Income Tax

176. NSND Income tax is now a shared policy between the Scottish and UK Government. In addition, responsibility for the collection and administration of devolved income tax is the responsibility of Her Majesty's Revenue and Customs (HMRC). The cost to the Scottish Government of HMRC implementing devolved income tax is currently between £25 and £30 million which compares to the original estimate of between £40 and £45 million.
177. The identification of Scottish taxpayers is critical to the process of implementing income tax devolution. During the process of seeking to identify Scottish taxpayers, it transpired that HMRC had not identified 420,000 taxpayers as being Scottish taxpayers. In evidence to the Committee, HMRC stated in relation to this issue that—

” “The people concerned had addresses on our database that should have enabled us to identify them as Scottish taxpayers. It is very regrettable that an error in the scan parameters meant that they were not initially picked up. We have been completely transparent with the Scottish Government and with you about that problem. It is reassuring that, because of the communications work that we had done to raise awareness, we were quickly alerted to the fact that people who would have expected to receive a letter had not received, so the communications campaign acted as a back-up to help us to get this right”^{lxxv}.

178. The devolution of income tax powers is taking place at the same time as HMRC is currently undertaking an office closure programme across the UK. In Scotland, this involves the rationalisation of HMRC's estate in Scotland to two sites in Edinburgh and Glasgow with a 'transitional' site being kept in East Kilbride over the nine years of the planned office closure programme. HMRC sought to outline the rationale for this programme of office closures in the following terms—

” “The purpose of the transformation programme is to move to 13 large regional centres around the country and a small number of specialist sites. There will be some transitional sites as well, because we recognise that we have to take time to make the transition, not only to ensure that we retain the skills that we need as we make the change but to help people with the impact of it. That is the strategic challenge”^{lxxvi}.

179. The Committee also sought questions for the Cabinet Secretary, on issues relating to revenue regarding the draft budget, from members of the public via Twitter (#askthecabsec). John Davidson from Glasgow submitted a question on the HMRC office closure programme and whether this would impact on the ability of HMRC to collect tax revenues in Scotland. The Cabinet Secretary responded—

^{lxxv} [Finance and Constitution Committee, 14 December](#), OR, Col.14.

^{lxxvi} [Finance and Constitution Committee, 14 December](#), OR, Col. 8-9.

“That is clearly a decision for the UK Government, although I note that there is a great deal of opposition to the reductions. However, I should say, on the specific question, that I have been reassured by HMRC that there will be satisfactory implementation and operation of the Scottish rate of income tax, because it is set out in a memorandum of understanding and supported by the development of a service-level agreement. Notwithstanding the dispute and disagreement that exists over the deployment of staff, and the great deal of opposition to which I have already referred, I have been informed that the move should not impact on HMRC’s collection of our taxes in Scotland”^{lxxvii}.

180. The Committee will keep the matter of the closure of HMRC offices under review.

Land and Buildings Transaction Tax

181. The Scottish Government proposes to maintain the rates and bands for LBTT at their current levels which are set out in Table 8 below.

Table 8

Residential Transactions			Non-Residential Transactions			Non-Residential Leases		
Band	Rate		Band	Rate		Band	Rate	
Up to Nil £145,000			Up to Nil £150,000			Up to Nil £150,000		
£145,001 to £250,000	2%		£150,001 to £350,000	3%		Over £150,000	1%	
£250,000 to £325,000	5%		Over £350,000	4.5%				
£325,001 to £750,000	10%							
Over £750,000	12%							

182. The Scottish Government also proposes maintaining the Additional Dwelling Supplement (ADS) at 3% of the total price for all relevant transactions above £40,000.

183. The Committee carried out an inquiry on the first year’s operation of LBTT and published its report in December 2016. The key findings are as follows—

- The Committee considers that the transition to LBTT went well and that its first year has been operationally successful.

^{lxxvii} [Finance and Constitution Committee, 16 January 2017](#), OR Col.40.

- The Committee considers that it is too early to draw any definitive conclusions on the impact of the rates and bands from the available outturn data but recommends that the Scottish Fiscal Commission should continue to monitor the data on an ongoing basis.
- A key challenge faced by the Committee has been the lack of consistency in the presentation of data relating to LBTT. This has made it difficult to compare forecast and outturn data and to fully assess the impact of LBTT on the property market in Scotland.
- The Committee has also faced challenges in identifying causality in respect of changes to the housing market, i.e. how to assess the impact of LBTT rates and bands in comparison to the impact of extraneous factors such as the general economic situation.
- The Committee recommends that the Scottish Government's review of the first year of LBTT includes an analysis of the behavioural response to LBTT, particularly in relation to homes costing between £325k and £750k. This should include an assessment of the likelihood of an on-going response and an analysis of the impact of extraneous factors.
- The Committee invites the Scottish Government to provide information in relation to the impact that LBTT has had on the first time buyer market, including whether it has contributed to increased house prices.^{lxxviii}

184. As with income tax the net impact of the devolution of Stamp Duty on the draft budget is dependent on the interaction of the adjustment to the block grant and the forecast for LBTT revenues. If the Scottish Government's LBTT forecast is larger than the forecast for the adjustment to the block grant, then the Scottish budget will be higher than it would have been had the tax not been devolved (and vice versa).

185. The Scottish Government's forecasts for LBTT receipts and the forecasts for the BGA using the IPC method and the net impact are set out in Table 9 below.

Table 9

	2017-18 (£m)	2018-19 (£m)	2019-20 (£m)	2020-21 (£m)	2021-22 (£m)
Forecast Receipts	507	543	571	597	624
BGA (IPC)	545	585	634	689	741
Net Impact	-38	-42	-63	-92	-117

186. This shows that LBTT revenues are forecast to be lower than the BGA in each year of the forecast period. This implies that LBTT revenues per capita are forecast to grow more slowly in Scotland relative to rUK. The reason for this is

^{lxxviii} http://www.scottish.parliament.uk/S4_FinanceCommittee/Reports/FCCS052016R02.pdf

that the OBR is forecasting faster growth in both house prices and transactions for residential property in rUK than the Scottish Government is for Scotland.

187. Given that the Committee considers that it is too early to draw any definitive conclusions on the impact of the rates and bands from the available outturn data. The Committee has also previously recommended that the SFC should continue to monitor the data on an on-going basis.

188. The Committee notes that the Scottish Government states in its response to our predecessor committee's report on Draft Budget 2016/17 that it "intends to review the operation of LBTT after the first full year of operation and will update Parliament on the outcome of that review in the 2017-18 Draft Budget." The Committee asks the Scottish Government whether it has conducted this review and when the update will be provided.

Residential Transactions

189. The draft budget states that the Scottish Government's "policy priority for residential LBTT remains to help first-time buyers enter the property market and to assist people as they progress through the property market."^{lxxix} The Scottish Government also states that the policy intentions of LBTT and the ADS are related. Both are structured to benefit most those buying at the lower end of the housing market which typically includes first time buyers.

190. The Scottish Government states in its methodology note that the data at this stage does not indicate any significant over/underperformance of different segments of the market following the introduction of LBTT.

Residential Revenue Forecasts

191. The Scottish Government's forecasts for residential LBTT which have been assessed as being reasonable by the SFC are set out in Table 10 below alongside the forecasts in Draft Budget 2016-17.

Table 10

	2016-17 (£m)	2017-18 (£m)	2018-19 (£m)	2019-20 (£m)	2020-21 (£m)	2021-22 (£m)
Draft Budget 2016-17	282	347	406	469	533	
Draft Budget 2017-18		211	235	251	265	280
Change		-136	-171	-218	-268	

^{lxxix} <http://www.gov.scot/Resource/0051/00511808.pdf> page 16

192. The Scottish Government methodology note on the devolved taxes forecasts states that the downward revision to these forecasts “is due to weaker forecasts for both prices and transactions”^{lxxx} as a consequence of weaker outturn data for 2015-16 and 2016-17 as well as changes to the forecast methodology.
193. The SFC was asked by the Committee to provide a report on outturn figures for LBTT for 2015-16. The report states that lower than expected revenues for residential LBTT were “largely due to reduced transactions in the £325k-£750k price band.” While the SFC partly attributes this to forestalling, its analysis “also suggests that the volume of transactions in this section of the housing market remain subdued throughout the entire fiscal year, excluding March 2016.”^{lxxxi}
194. The Committee recommended in its report on the first year of LBTT that the Scottish Government should publish a response to the findings of the SFC’s outturn report alongside the draft budget. The Committee also recommended that this should include an assessment of the SFC’s conclusion that the housing market in the £325k to £750k band remained subdued throughout the entire fiscal year, excluding March 2016.^{lxxxii}
195. The SFC also provided an analysis of the available outturns figures for 2016-17 in its report on Draft Budget 2017/18. Extrapolating the revenues received between April and October, if they were to continue at this rate, the outturn figure for 2016-17 is expected to be £207.6m which is £74.4m less than the forecast.
196. This does not necessarily mean that there will be a £74.4m shortfall in the budget for 2016-17. As discussed above, this is because the impact on the budget is driven by the performance of the devolved taxes relative to the performance of the equivalent taxes in rUK. So, the impact on the budget will also depend on the outturn figures for SDLT in rUK.
197. The SFC explains that the main reason for the difference in the outturn figures from the 2016-17 forecast is that “the underlying economic determinants have been mis-forecast.”^{lxxxiii} Specifically, both median and mean house prices have not grown as expected across the whole of the market, but since the £325k-£750k price band accounts for over 60% of revenues this is where the difference appears most clearly. As such, “the bulk of the extrapolated difference from forecast comes from overpredicting the revenues expected to be generated from the £325k-£750k price band.”^{lxxxiv} Although “this does not imply that there has been a deterioration in this segment of the market relative to others.”^{lxxxv}

^{lxxx} <http://www.gov.scot/Resource/0051/00511834.pdf>, page 41

^{lxxxj} http://fiscal.scot/media/media_485479_en.pdf paragraph 2.1

^{lxxxii} [Finance and Constitution Committee Report on the First Year’s Operation of the Land and Buildings Transaction Tax](#) paragraph 23

^{lxxxiii} http://fiscal.scot/media/media_505786_en.pdf paragraph 5.20

^{lxxxiv} http://fiscal.scot/media/media_505786_en.pdf paragraph 5.23

^{lxxxv} http://fiscal.scot/media/media_505786_en.pdf paragraph 5.26

198. The Committee's Adviser points out that while the forecasting methodology is reasonable and well explained there is insufficient information on the components of change which have influenced the forecast revisions. He suggests that it would be useful if the revisions to the forecasts could be broken down. For example, what proportion is due to outturn data and what proportion is due to methodological change. The Committee notes that the OBR provides a breakdown of revisions to its forecasts.

199. The Committee notes that the response to the findings of the SFC's outturn report on the first year of LBTT has not been published by the Scottish Government alongside the draft budget. The Committee recommends that this should be provided alongside the response to this report. As previously requested this should include an assessment of the SFC's conclusion that the housing market in the £325k to £750k band remained subdued throughout 2015-16, excluding March 2016.^{lxxxvi}

200. The Committee asks the SFC to clarify whether the available outturn data for 2016-17 shows that the housing market in the £325k to £750k band remains subdued as explained in its outturn report for 2015-16.

201. The Committee asks the Scottish Government to provide a breakdown of the changes to its LBTT forecasts including the reasons behind them and quantification of the amounts which result from each factor.

Behavioural Responses

202. One of the key issues which the previous Finance Committee considered was the extent to which behavioural factors in response to the introduction of LBTT are temporary or longer term. The temporary response is known as forestalling whereby homeowners shifted the timing of property transactions when the tax was introduced. A longer term response could include homeowners deciding to upgrade existing homes rather than moving home.

203. The SFC's report on Draft Budget 2016-17 stated that "there may be longer-term behavioural responses to the new tax which the current forecasting approach does not allow for." Previously, the SFC had recommended in its report on Draft Budget 2015-16 that behavioural factors should be included in the forecasting methodology as soon as practicable. In its report on Draft Budget 2016-17 the SFC stated "we are increasingly concerned about the residential LBTT forecasts which still assume no behavioural responses."^{lxxxvii}

^{lxxxvi} http://www.scottish.parliament.uk/S4_FinanceCommittee/Reports/FCCS052016R02.pdf paragraph

23
^{lxxxvii} http://www.fiscal.scot/media/media_461136_en.pdf page 37

204. The previous Committee recommended in its report on Draft Budget 2016-17 that the Scottish Government needs to carry out an analysis of the initial behavioural response to LBTT once a full year of outturn data is available. In particular, there is a need to address whether there is a longer-term behavioural response to the new tax at the higher end of the market. As noted above the Committee reiterated this recommendation in its report on the first year of operation of LBTT.
205. The SFC report on Draft Budget 2017-18 does not refer to its previous concerns regarding the impact of behavioural responses on the residential LBTT forecasts in its report on Draft Budget 2017-18. However, the report does state that—

“Although the main LBTT forecast does not include any behavioural response to taxes – forecasting divergence or convergence of mean and median house prices serves to reallocate anticipated transactions to different parts of the market in much the same way as might be expected with varying behavioural responses to the tax or other differential effects on the housing market.”^{lxxxviii}

206. The Committee asks the SFC whether it intends to include behavioural factors in its forecasting methodology for residential LBTT.

Additional Dwelling Supplement (ADS) Revenue Forecasts

207. The Scottish Government’s forecasts for ADS residential LBTT which have been assessed as being reasonable by the SFC are set out in Table 11 below alongside the forecasts in Draft Budget 2016-17.

Table 11

	2016-17 (£m)	2017-18 (£m)	2018-19 (£m)	2019-20 (£m)	2020-21 (£m)	2021-22 (£m)
Draft Budget 2016-17	36	51	56	62	66	
Draft Budget 2017-18		72	75	78	80	82
Change		+21	+19	+16	+14	

208. The Scottish Government methodology note explains that the upward revision to these forecasts is due to larger number of transactions in this segment of the market than was expected at the time of Draft Budget 2016-17. This more than offsets the downward revisions to the residential LBTT forecasts which also reduce forecast ADS revenues.

^{lxxxviii} http://fiscal.scot/media/media_505786_en.pdf page 46

209. The Committee requested a report from the SFC on the first six months of ADS outturn data and this was provided in November 2016. The key findings of the SFC's preliminary analysis are—

- A lack of data makes it difficult to gauge the size of the tax base to which the ADS applies;
- Initial outturn data suggest the typical price for ADS properties is lower than for other residential LBTT transactions;
- The volume of transactions appears to be higher than inferred from buy-to-let mortgage data;
- It is not possible to definitively assess the extent to which there is an ongoing behavioural response to the new tax.^{lxxxix}

210. The SFC states in its report on the draft budget that the significant upward revision in the forecasts for ADS is due to the preliminary outturn data which suggests that “the initial estimate of the tax base was too low.”^{xc} At the same time, the rate of growth of ADS revenues is less than previously forecast as a result of the downward revisions to the economic determinants for residential LBTT which also drives the ADS forecasts.

211. The Committee notes that, as with the residential LBTT forecasts, there is insufficient information on the components of change which have influenced the forecast revisions. Again, it would be useful to receive a breakdown of the revisions to the forecasts including the reasons behind them and quantification of the amounts which result from each factor.

Non-Residential Revenue Forecasts

212. The Scottish Government's forecasts for non-residential LBTT which have been assessed as being reasonable by the SFC are set out in Table 12 below alongside the forecasts in Draft Budget 2016-17.

^{lxxxix} http://fiscal.scot/media/media_501191_en.pdf page 2

^{xc} http://fiscal.scot/media/media_505786_en.pdf paragraph 3.26

Table 12

	2016-17 (£m)	2017-18 (£m)	2018-19 (£m)	2019-20 (£m)	2020-21 (£m)	2021-22 (£m)
Draft Budget 2016-17	220	230	240	250	260	
Draft Budget 2017-18		224	233	242	252	262
Change		-6	-7	-8	-8	

213. The Scottish Government's methodology note states that the forecasting approach to non-residential LBTT remains largely the same as in Draft Budget 2016-17. This relies on using OBR forecasts of the UK commercial property market. The small downward revision to the forecast is explained by the Scottish Government "as a result of a downward revision to the OBR forecast for price growth being largely offset by an upward revision to their forecast for transactions growth."^{xc1}
214. The previous Finance Committee recommended in its report on Draft Budget 2016-17 that the Scottish Government develops a Scottish model for non-residential LBTT rather than relying on the UK data. The SFC states in its report on Draft Budget 2017-18 that it "shall explore the possibility of utilising more Scotland-specific microeconomic data in forecasting non-residential LBTT." However, it points out that this "may be complicated by taxpayer confidentiality issues and the thinness and volatility inherent in the commercial property market in Scotland."^{xc2}

Scottish Landfill Tax (SLfT)

215. SLfT is described by the Scottish Government as being an environmental tax which is designed to help reduce the amount of material which ends up in landfill sites in Scotland. A small proportion of the tax revenues is used to fund environmental restoration projects in the vicinity of landfill sites which qualify for funding under the Scottish Landfill Communities Fund (SLCF).
216. The Scottish Government proposes to increase the Standard rate of SLfT from £84.40 per tonne to £86.10 per tonne in line with RPI inflation. It is also proposed to increase the lower rate in line with RPI inflation from £2.65 per tonne to £2.70 per tonne. As with the rates in previous years these are the same as the planned UK landfill tax rates for 2017-18. This approach is intended to address the possibility of waste tourism.
217. The credit rate for the SCLF will remain at a maximum of 5.6% of an operator's tax liability compared to the UK credit rate which is 4.2%.

^{xc1} <http://www.gov.scot/Publications/2016/12/6669> page 42-43

^{xc2} http://fiscal.scot/media/media_505786_en.pdf page 17

Revenue Forecasts

218. The Scottish Government's forecasts for SLfT, which have been assessed as being reasonable by the SFC, are set out in Table 13 below alongside the forecasts in Draft Budget 2016-17.

Table 13

	2016-17 (£m)	2017-18 (£m)	2018-19 (£m)	2019-20 (£m)	2020-21 (£m)	2021-22 (£m)
Draft Budget 2016-17	133	123	114	104	94	
Draft Budget 2017-18		149	118	109	112	106
Change		+26	+4	+5	+18	

219. The forecast methodology differs significantly from Draft Budget 2016-17 where the forecast was driven explicitly by the Scottish Government's headline waste policy targets. The SFC had previously raised concerns that a target does not automatically imply a forecast. The new modelling approach assumes no underlying trends.

220. The SFC states that Standard Rate waste levels have not decreased as anticipated in previous forecasts. Based on the outturn data for the first quarter of 2016-17 the SFC estimates tax revenues of £150m for 2016-17 compared to the Scottish Government's initial forecast of £133m.

221. The Committee notes that, as with the LBTT forecasts, there is insufficient information on the components of change which have influenced the forecast revisions. Again, it would be useful to receive a breakdown of the revisions to the forecasts including the reasons behind them and quantification of the amounts which result from each factor.

Non-Domestic Rates Income (NDRI)

222. The Financial Scrutiny Unit (FSU) advises that NDRI is projected to fall from £2,768.5m in 2016-17 to £2,605.8m in 2017-18. This amounts to a fall of £162.7m in cash terms or £200m in real terms. The main changes are—

- Matching the English Poundage by dropping the rate by 3.7%;
- Raising the threshold for the small business bonus scheme (SBBS);
- Raising the threshold for the large business supplement.

223. Estimated costs for these changes have not been provided in the draft budget. However, the Scottish Government provided SPICe with estimated costs for 2017-18 as follows—
- reducing the poundage from 48.4p to 46.6p is £108m;
 - expanding the SBBS is £40m;
 - raising the large business supplement threshold is £7m.
224. The Draft Budget states that the Scottish Government remains committed to competitive business rates and that this will support inclusive economic growth. The Scottish Government intends to expand the SBBS by “significantly raising the eligibility threshold.”^{xciii} The higher threshold for the large business supplement means that less than 10 percent of properties will be affected.
225. The Committee received conflicting evidence on the proposal to raise the threshold for the SBBS. The Federation of Small Businesses (FSB) Scotland was “delighted” with the proposal while the STUC was “disappointed.” FSB Scotland’s view is that there is “no doubt that the SBBS has been a key support mechanism to tens of thousands of smaller businesses during recent turbulent economic times.” The STUC’s view is that continuing “to provide general tax cuts to very small businesses is an appalling waste of scarce public resources.”^{xciv}
226. The FSB highlighted evidence from a recent survey of around 1,000 of its members which suggests that, if the SBBS was removed, “a fifth of small firms report they would close the business, while almost a fifth would cancel investment.” The STUC’s view is that it “is risible to suggest that this policy does anything but undermine the Scottish Government’s ‘national drive to improve productivity’” and there has not been any discernible boost to employment.
227. As noted above, when asked by the Committee what additional measures he had introduced to support economic growth the Cabinet Secretary highlighted the changes he has made to business rates. He describes this as a “competitive regime” and a “supportive package.”^{xcv} The estimated total cost for the expanded SBBS is £224m in 2017-18.

228. The Committee recommends that in future the estimated costs and revenues of any policy changes to business rates and the total cost of the SBBS and total revenues from the large business supplement are included in the Draft Budget.

^{xciii} <http://www.gov.scot/Publications/2016/12/6669> page 89

^{xciv} http://www.parliament.scot/S5_Finance/Meeting%20Papers/PUBLIC_PAPERS_-_21_DEC.pdf

^{xcv} [Finance and Constitution Committee, 11 January 2017](#), OR Col. 25.

BORROWING

229. The Written Agreement between the Committee and the Scottish Government states that the Scottish Government—

“will provide details of any planned borrowing under the Scotland Act powers as part of the Draft Budget publication. Details should include the amounts to be borrowed, and a commentary explaining the use of the powers.”^{xcvi}

Capital Borrowing

230. Table 14 below sets out the annual limit of the Scottish Government’s capital borrowing powers.

Table 14

	2015-16	2016-17	2017-18	2018-19	2019-20
Capital Borrowing Limit (£m)	306	316	450	450	450

231. The Fiscal Framework increased the capital borrowing powers within the Scotland Act 2012 from an overall limit of £2.2 billion to £3 billion and an annualised limit of just over £300m to £450m. The draft budget states that the Scottish Government intends to utilise its capital borrowing powers in 2017/18 up to the maximum of £450m.

European System of National and Regional Accounts (ESA 10)

232. The Committee wrote to the Cabinet Secretary on 21 December 2016 in relation to the impact of ESA 10^{xcvii} on the Capital DEL (CDEL) Budget and the Scottish Government’s capital borrowing powers. The Cabinet Secretary responded on 5 January 2017.^{xcviii}

233. In relation to the capital borrowing powers for 2015-16 the Cabinet Secretary has advised that £283m of the capital borrowing limit was used to comply with ESA10. However, because the NPD contracts do not require payments to begin until the projects are delivered no borrowing was needed. The £283m will count towards the Scotland Act 2012 overall borrowing limit of £2.2 billion and will be nominally repaid over the lifetime of the projects.

^{xcvi} http://www.parliament.scot/S4_FinanceCommittee/General%20Documents/Written_Agreement_-_Revised_April_2015.pdf

^{xcvii} The European System of Accounts 2010 (ESA10) is new European accounting guidance which came into effect in September 2014. The new guidance means that some projects that were formerly classified as private sector will now be classified as public sector.

^{xcviii} http://www.scottish.parliament.uk/S5_Finance/General%20Documents/Cab_Sec_FC_to_FinConvenor_-_05Jan17.pdf

234. The expected budgetary impact on the CDEL Budget in 2016-17 is £398m. The Committee asked the Cabinet Secretary to what extent had the ESA10 reclassification process reduced the Scottish Government's capital spending, either by imposing a commitment on the DEL Capital budget or by constraining the use of borrowing powers.
235. The Cabinet Secretary responded that it had imposed an opportunity cost because budgetary cover had had to be allocated to the affected projects. He further explained that "had the rules not been changed and the budget cover not then been required for these projects, the cover would have been available to support the overall capital programme."^{xcix}
236. The Cabinet Secretary has advised that this means that the Scottish Government will need to give up the amount from the CDEL Budget to reflect the capital costs incurred even though no payments are required until construction is complete. The intention is to borrow up to the full amounts available in order to support the overall capital programme.
237. The Cabinet Secretary was then asked by the Committee on 16 January 2017 whether he accepted that the impact of ESA 10 in the three financial years between 2015-16 and 2017-18 is a loss of spending power of nearly £1 billion. He responded "no" and stated that—
- ” “The capital programme is delivered in such a way that it does not have an impact on those projects that we are already committed to. Part of this is an accountancy exercise. Some of the drawdown that is required for capital and for the revenue finance projects comes from revenue so it has not impacted on any projects that we are already committed to and which are in line to be delivered through our capital programme.”^c
238. The Cabinet Secretary was also asked whether he was “having to borrow to the max to cover up for the fact that £1 billion has had to be allocated in the budget as a result of the Government not keeping abreast of the new accounting rules?” He responded that—
- ” “That is not the case. I have outlined a very ambitious programme for capital investment for Scotland, which covers the kind of proposals that members of the Parliament have been asking for, whether they relate to investment in transport, digital infrastructure, housing or energy efficiency. We are ensuring that there continues to be a very ambitious programme of capital investment.”^{ci}

^{xcix} http://www.scottish.parliament.uk/S5_Finance/General%20Documents/Cab_Sec_FC_to_FinConvenor_-_05Jan17.pdf

^c [Finance and Constitution Committee, 16 January 2017](#) Col. 5

^{ci} [Finance and Constitution Committee, 16 January 2017](#) Col. 7

239. The Committee notes the total drawdown of £915m capital borrowing powers for the years 2015/16, 2016/17 and 2017/18 as a result of projects being brought ‘on balance sheet’ as a consequence of the ESA 10 ruling. The Committee notes the impact of this drawdown on other capital projects and asks the Scottish Government to provide a full and comprehensive analysis of the use of borrowing powers.

Resource borrowing and cash management

240. The Fiscal Framework also increases the Scottish Government’s resource borrowing powers. It now has the ability to borrow up to £600m each year within a statutory overall limit of £1.75 billion. This resource borrowing can be used for the following purposes—

- Up to £500m annually for in-year cash management;
- Up to £300m annually for forecast errors relating to either the tax revenue forecasts or BGA forecasts;
- Up to £600m annually for any observed or forecast Scotland-specific economic shock.^{cii}

Scotland Reserve

241. The Fiscal Framework also allows the Scottish Government to make payments up to a total of £700m into a cash reserve - the Scotland Reserve – which will be separated between resource and capital. Payments into the resource reserve may be made from the resource budget including tax receipts. Funds in the resource reserve may be used to fund resource or capital spending. Payments may be made into the capital reserve from the capital budget and capital reserve funds may only be used to fund capital spending. Payments can be used for resource spending up to £250m a year and up to £100m a year for capital spending.

242. Under the terms of the previous cash reserve which was introduced by the Scotland Act 2012, any outstanding resource borrowing had first call on surplus outturn receipts against forecast. Similarly any shortfall in receipts had to be met from within any available funds within the cash reserve before resource borrowing could be used.

243. The Committee previously wrote to the Cabinet Secretary asking whether these arrangements still applied to the Scotland Reserve. He responded that—

^{cii} The Fiscal Framework defines such a shock as periods when (on a rolling 4 quarter basis) Scotland’s GDP grows (or is forecast to grow) by less than 1% and is also more than 1% less than UK GDP growth.

” “Operational arrangements for the Scotland Reserve are still being discussed with HMT. However, it would be prudent financial management to repay borrowing as soon as reasonably possible from surplus receipts and to exhaust funds in the Scotland Reserve before deciding to borrow, to reduce and avoid the additional cost of borrowing.”^{ciii}

244. The Cabinet Secretary announced provisional outturn figures of £572m for the first year of LBTT in June 2016 which is £74m above the revenue forecast. He indicated that this £74m would be placed in the Scotland Reserve.

245. The Committee notes that the Draft Budget states that detailed “arrangements for reporting and repaying borrowing and the operation of the Scotland Reserve are being agreed with the UK Government.”^{civ} It is also the case that once these arrangements have been agreed with the UK Government, scrutiny arrangements will also have to be agreed with the Committee.

246. The Committee recommends that the Budget Process Review Group considers the scrutiny arrangements for the operation of the Scotland Reserve as part of its work and makes recommendations for amendments to the Written Agreement.

Long-Term Investment Commitments

247. The Scottish Government has stated that it will limit future commitments arising from revenue funded methods of capital borrowing to a maximum of 5% of its expected future total annual DEL budget. Annex A of the Draft Budget provides an update which shows that the Scottish Government plans to 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. This compares to last year’s Draft Budget which showed annual revenue costs peaking at just over 4.2% in 2020-21.

248. The previous Finance Committee recommended in its reports on Draft Budget 2015-16^{cv} and Draft Budget 2016-17^{cvi} that the Scottish Government should provide the underlying data behind Figure 1 in Annex A of the Draft Budget document. The Scottish Government responded that there is some “commercial sensitivity regarding elements of the underlying data behind Figure 1 in the Draft Budget”. As such the data behind figure 1 has still not been provided in the form suggested by the Committee.

^{ciii} http://www.scottish.parliament.uk/S5_Finance/Cabinet_Secretary_to_Finance_Committee_-_Fiscal_Framework.pdf

^{civ} <http://www.gov.scot/Resource/0051/00511808.pdf> page 22

^{cv} <http://www.parliament.scot/parliamentarybusiness/CurrentCommittees/85404.aspx>

^{cvi} <http://www.parliament.scot/parliamentarybusiness/CurrentCommittees/96135.aspx>

249. The previous Committee also recommended in its last two Draft Budget reports that the SFC should have a role in monitoring the Scottish Government's long-term investment commitments. However, the Scottish Government's view at that time was that this would fall outside the remit of the SFC but that it was considering a broader role for the SFC in assessing the borrowing regime that might be applied after the implementation of the Scotland Act 2016.

250. The Committee notes that the SFC remit now includes a duty to “set out the Commission’s assessment of the reasonableness of Scottish Ministers’ projections as to their borrowing requirements.” The Committee recommends that this includes analysis of the Scottish Government’s long-term investment commitments which currently amount to over £1 billion annually.

251. Recognising that there will be commercial sensitivities in relation to individual deals, the Committee reiterates its view that the Scottish Government explores the practicability of publishing the underlying data behind Figure 1 in Annex A of the Draft Budget. The Committee therefore asks if this can be done in a way which protects commercial sensitivities, given the aggregate nature of the figures requested.

PRIORITISATION

252. Prioritisation is defined as a coherent and justifiable division between sectors and programmes. The Committee recognises the need to scrutinise whether the Scottish Government's spending decisions reflect the priorities and commitments it has set out in, for example, the programme for government.^{cvii}

253. Audit Scotland has defined a priority-based budgeting approach as one which focuses “on the delivery of priority outcomes and allocates money to those services or areas which make the greatest contribution to delivering those outcomes.”^{cviii} However, few public bodies have “undertaken a structured approach to budget setting in this way” although the NPF can be viewed as a “first step in adopting a priority-based approach to budgeting.”^{cix}

254. The FAI points out that the Scottish Government has made a number of expensive spending commitments including maintaining real terms spending on policing, doubling the provision of free childcare, and increasing health spending by £500m more than inflation by the end of this parliament. The FAI suggests that delivering

^{cvii} <http://www.gov.scot/programme2016>

^{cviii} http://www.audit-scotland.gov.uk/docs/central/2011/nr_110825_scotlands_public_finances.pdf

^{cix} http://www.audit-scotland.gov.uk/docs/central/2011/nr_110825_scotlands_public_finances.pdf

these commitments “will require difficult decisions and a serious re-prioritisation of existing spending.”^{CX}

255. One of the key issues raised by the FAI in its report on Scotland’s budget is the lack of consideration of opportunity costs. In other words, what is the impact of spending cuts in non-protected areas? For example, the FAI points out that while the health budget has increased in real terms since 2009-10, other areas of spending such as enterprise, energy and tourism, and further and higher education have fallen.
256. The FAI questions whether “we have a clear sense of the likely medium and longer-term strategies and impacts of these decisions? Most often, the answer is probably not.”^{CXI} Consequently, there “needs to be a greater recognition of the opportunity costs of spending decisions, particularly over the medium to longer term.”^{CXII} The FAI also states that “it is vital that political parties from all sides set out their clear priorities – including how they will fund new commitments and manage the increasing demands on public services.”^{CXIII}
257. The Committee recommended in its guidance to subject committees^{CXIV} that they focus on prioritisation including—
- The extent to which public bodies have moved towards a priority-based budgeting approach;
 - Whether spending priorities support outcomes;
 - Whether current performance informs the choices about where to allocate resource;
 - The extent to which the NPF influences the budget-setting process of public bodies.

Longer-Term Financial Planning

258. A number of subject committees considered the extent to which public bodies within their respective remits are carrying out longer-term financial planning. For example, the Justice Committee refers to an Audit Scotland report from 2011 in which it recommended that public bodies develop long-term financial strategies. The Justice Committee focused its budget scrutiny this year on the Crown Office and Procurator Fiscal Service (COPFS). The AGS told the Justice Committee that

^{CX} http://strathprints.strath.ac.uk/57763/8/Fraser_of_Allander_Institute_Scotlands_Budget_2016.pdf page

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^{CXI} http://strathprints.strath.ac.uk/57763/8/Fraser_of_Allander_Institute_Scotlands_Budget_2016.pdf page

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^{CXII} http://strathprints.strath.ac.uk/57763/8/Fraser_of_Allander_Institute_Scotlands_Budget_2016.pdf page

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^{CXIII} http://strathprints.strath.ac.uk/57763/8/Fraser_of_Allander_Institute_Scotlands_Budget_2016.pdf page

3

^{CXIV} http://www.parliament.scot/S5_Finance/General%20Documents/Convener_to_Convener_guidance_2016.30.06.pdf

a long-term financial strategy is a key element for the COPFS being able to identify its priorities and plan for future work. The Justice Committee noted its disappointment in the delay in the COPFS producing a long-term financial strategy and “considers that the strategy should be completed as a matter of urgency.”

259. The Accounts Commission told the LGC Committee—

“we strongly think that councils should take a long-term view in their financial planning, and we identify where that is happening and where it is not happening. We accept that it is more difficult to do when they have to deal with one-year settlements, as they have for the past couple of years.”^{CXV}

260. The LGC Committee agrees with this view that all local authorities should implement medium to long term financial planning to optimise service delivery.

Fuel Poverty

261. The EJFW Committee highlighted that the Housing (Scotland) Act 2001’s target of eradicating fuel poverty “so far as reasonably practicable” by November 2016 had not been met. Figures from the Scottish House Condition Survey: 2015,^{CXVI} showed 748,000 households (30.7%) as being fuel poor in 2015 with 203,000 (8.3%) living in extreme fuel poverty.

262. The draft budget proposes a 10.5% increase in the overall fuel poverty budget line in cash terms, or an 8.8% increase in real terms with the overall budget line increasing to £114m. This increase comprises a 6.1% increase in the Home Energy Efficiency Programmes (HEEPS) element of the fuel poverty budget along with 25% increase in the loans element of the budget to assist registered social landlords in meeting the Energy Efficiency Standard for Social Housing.

263. When invited by the Committee to outline the expected impact of the funding package on fuel poverty figures, the Cabinet Secretary undertook to “engage with the portfolio secretary” before getting back to the Committee.

264. The Committee invites the Scottish Government to provide an update on the expected impact of this additional funding on fuel poverty. The Committee supports the view of the EJFW Committee that “a robust and up-to-date cost analysis” of the impact of levels of spending on fuel poverty should be undertaken.

265. In response to suggestions from the Committee that year-on-year allocation of funding on energy efficiency was not the most efficient use of resources, the Cabinet Secretary accepted “that long-term funding and a long-term direction of

^{CXV} [Local Government and Communities Committee, OR, 14 December 2016](#), Col. 3

^{CXVI} <http://www.gov.scot/Resource/0051/00511081.pdf>

travel would be helpful.” Describing the Government’s commitment to investing £500m over the course of the parliamentary session as “a step in the right direction,” he undertook to “engage further on how we can ensure that there is some longer-term stability so that we can enable effective planning of the programmes” to ensure that “we can pull together welfare, housing and energy efficiency and try to set out the issues in an even more meaningful way.”^{cxvii}

266. The Committee welcomes the Government’s commitment to considering ways of providing “longer-term stability” to “enable effective planning” of the fuel poverty programme.

Social Security

267. The Draft Budget contains an allocation for ‘Scotland Act 2016 non-tax Implementation’ of £80m for 2017-18 within the Finance and Constitution portfolio. The Social Security Committee highlighted this budget allocation and sought greater clarification on how the budget of £80m was calculated and whether such an allocation would be sufficient for implementation of the 2016 non-tax powers. The Social Security Committee also sought clarification on what proportion of the £80 million budget would be allocated to implementation of the social security powers devolved by the Scotland Act 2016.

268. The Committee asked the Scottish Government how the budget of £80m had been calculated. Scottish Government officials responded that the budget allocation—

” “reflects the transfer into our budget. If the cost of the implementation of powers is more or less than that, we will need to accommodate that within the wider programme. However, you should bear in mind that most of what we are talking about is to do with the set-up and implementation of powers over a period of time. There will be further transfers under the Fiscal Framework in future years, and the task for cabinet secretaries is to design their programmes around the funding that is available through the transfers that have been made”^{cxviii}.

269. The Cabinet Secretary outlined the approach via which the budget would be allocated across policy areas dealing with the implementation of new power as being one where—

” “Over the course of the year, when cabinet secretaries require amounts to deliver the implementation of new powers, they will approach me, so the allocation will be determined over the course of the year. That is why that money has not been allocated to individual portfolio budgets but has,

^{cxvii} [Finance and Constitution Committee, 16 January 2017](#), Col. 33

^{cxviii} [Finance and Constitution Committee, 16 January 2017](#), Col. 26.

instead, been retained by me to spend as required in relation to the proper implementation of the new powers”.

270. The Committee welcomes the greater clarity that has been provided by the Scottish Government with regard to how the budget for the implementation of non-tax Scotland Act 2016 powers was arrived at and the general approach with regard to allocating the budget. The Committee does, however, recommend that the Scottish Government provides indicative allocations for each of the new powers, including social security, that it intends to fund in 2017-18.

Local Government

271. The Committee notes that there have been a variety of sets of figures presented in relation to the local government settlement and with regard to expenditure on local services. These figures are contained in the SPICe briefing on the draft budget and the Committee notes the SPICe briefing and in particular pages 17 to 18 of that paper^{cxix}.

272. The LGC Committee notes, in its report, that “whilst the core grant to local authorities is being reduced in 2017-18, the Scottish Government has also provided data which asserts an overall increase to local authorities once all other sources of support are taken into account”. In evidence, to the Committee, the Cabinet Secretary accepted that the local government finance settlement for 2017-18 would reduce by £47.4 million compared to the 2016-17 settlement.

273. However, the Cabinet Secretary stated that when wider spend on local services, including funding for health and social care integration and from council tax reform is considered, there is an increase in expenditure on local services by local authorities of £240 million or 2.3 per cent. The Cabinet Secretary did accept that local authorities were facing budget pressures by commenting that—

” “Of course there are pressures. I am not dismissing the pressures within local government or any part of the public sector. It is fair to reflect that there are increased pressures, as demand for services has risen, and all parts of the public sector will have to continue to be efficient”^{cxx}.

274. The LGC Committee states in its report that it “believes that greater transparency is required, and that the Draft Budget for local government, and the allocations to local authorities are very difficult to follow”. The LGC Committee goes on to request—

^{cxix} [SPICe Briefing 16-103 Draft Budget 2017-18](#)

^{cxx} [Finance and Constitution Committee, 16 January 2017](#), Col. 16.

” “That the Scottish Government produce detailed proposals on making the local government draft budget more transparent in advance of next year’s budget process”.

275. Due to the different presentation and sets of numbers relating to the local government settlement some Members were concerned about the level of financial resource available to Local Government in the settlement.

276. The Committee agrees with the LGC Committee that greater transparency is required in relation to the local government draft budget.

Concessionary Travel Scheme

277. The REC Committee notes that the Level 4 figures on concessionary fares indicate a reduction in the budget for the concessionary travel scheme from £207.8m in 2016-17 to £198.3m in 2017-18 or £9.5m (4.6%). The REC Committee also received an assurance from Transport Scotland that the proposed budget provision would have no effect on entitlement for current participants in the scheme. The Finance and Constitution Committee questioned the Cabinet Secretary as to whether the budget reduction would result in a reduction in bus services or an increase in cost to fare-paying passengers. The Cabinet Secretary responded—

” “There is on-going support for the bus services operators grant and concessionary travel. We have said that we want a consultation on concessionary travel, but we want to ensure the sustainability of the scheme. We also have proposals on expanding the scheme to cover apprentices and those who are seeking work. We will have to go into dialogue for all that but the budget for 2017-18 of £198.3 million reflects the latest forecasts, in reimbursement terms, to be agreed with bus operators”^{cxxi}.

278. The Cabinet Secretary was also asked whether the eligibility criteria for the concessionary travel scheme would be amended. He responded that the Scottish Government “will take forward a consultation on concessionary travel.”^{cxxii}

279. The REC Committee notes the Scottish Government’s assurance that the proposed budget reduction for concessionary travel will have no impact on entitlement for current scheme participants. The REC Committee called on the Scottish Government to provide further clarity on whether this cut will have any consequential impact on bus services and ticket prices for the general public.

^{cxxi} [Finance and Constitution Committee, 16 January 2017](#), Col. 35.

^{cxxii} [Finance and Constitution Committee, 16 January 2017](#), Col. 35-36.

280. The Committee agrees with the position of the REC Committee.

VALUE FOR MONEY

281. Value for money is defined as the extent to which public bodies are spending their allocations well and achieving outcomes. Since 2007 the Scottish Government has adopted an outcomes-based approach to its objectives. A new emphasis was also placed on partnership working with public bodies which were now expected to work towards the shared objectives of government.
282. The whole of the public sector was invited to align their own objectives with the delivery of the Scottish Government's Purpose and National Outcomes as set out in the NPF. The Scottish Government's Purpose is to "focus government and public services on creating a more successful country, with opportunities for all of Scotland to flourish, through increasing sustainable economic growth."^{CXXIII} Sixteen national outcomes describe more fully what the Government wants to achieve over the next ten years. 55 national indicators allow progress to be tracked on the *Scotland Performs* website.
283. The previous Finance Committee emphasised in its report on Draft Budget 2016-17 that Scotland's public bodies "must be held to account for the value for money which they are providing and be able to demonstrate how the spending decisions which they are making have an impact on outcomes."^{CXXIV} It asked the Scottish Government what action it was taking to ensure that Scotland's public bodies are spending their allocations well and achieving outcomes. In particular, in what ways does it examine the contribution which they make towards the national outcomes.
284. The Scottish Government responded that it expects all public bodies to align their spending plans with the NPF and that the contribution of individual public bodies is "examined by their boards and by the Scottish Government through the sponsorship arrangements in place."^{CXXV} The Scottish Government also welcomed the work that the subject committees carried out in scrutinising the outcomes delivered by public bodies and agreed that public bodies must be held to account for the value for money which they are providing and the impact they are making on outcomes.^{CXXVI}

^{CXXIII} <http://www.gov.scot/Resource/0049/00497339.pdf>

^{CXXIV} http://www.scottish.parliament.uk/S4_FinanceCommittee/Reports/FIS042016R02Rev.pdf paragraph

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^{CXXV} http://www.scottish.parliament.uk/S4_FinanceCommittee/General%20Documents/Response_to_Finance_Committee_draft_Budget.pdf

^{CXXVI} http://www.scottish.parliament.uk/S4_FinanceCommittee/General%20Documents/Response_to_Finance_Committee_draft_Budget.pdf

285. The FAI's view is that the draft budget "should not be seen simply as a set of spending allocations, but as the end point in a process of strategic planning" which should include, where possible, a "much greater emphasis on outcomes budgeting."^{cxvii} The AGS suggests that enhanced financial reporting could include "performance reporting, so that it is clearer what spending is aiming to achieve and how this contributes to the Government's overall purpose and specific outputs and outcomes."
286. The Committee recommended to the subject committees in its guidance on the scrutiny of Draft Budget 2017/18^{cxviii} that in addition to prioritisation they also focus on value for money including—
- The extent to which public bodies are spending their allocations well and achieving outcomes;
 - The extent to which an open and rigorous performance culture has been embedded within the public services;
 - The extent to which the public services are using performance data to ensure value for money;
 - The progress of public bodies in moving towards a more outcomes-based approach to public service management;
 - The contribution which public bodies are making towards the NPF.

Health and Social Care Partnerships

287. As noted above, the H&S Committee examined the budget setting processes of HSCPs. The Public Bodies (Joint Working) (Scotland) Act 2014 sets out the framework to implement health and social care integration. Thirty one HSCPs which became statutory bodies on 1 April 2016 manage over £8 billion of health and social care resource.
288. HSCPs are required to publish performance reports. They must report annually on how their activities have contributed towards meeting nine statutory national health and wellbeing outcomes. The Scottish Government has also published 23 core integration indicators to support delivery of these outcomes.
289. The nine outcomes were introduced by the Public Bodies Act referred to above and are intended to provide a framework for improving health and care services across Scotland.^{cxix} These outcomes are also intended to help to underpin the delivery of the national outcomes in the NPF.

^{cxvii} http://strathprints.strath.ac.uk/57763/8/Fraser_of_Allander_Institute_Scotlands_Budget_2016.pdf

^{cxviii} http://www.parliament.scot/S5_Finance/General%20Documents/Convener_to_Convener_guidance_2016.30.06.pdf

^{cxix} <http://www.gov.scot/Resource/0047/00470219.pdf>

290. The H&S Committee asked each HSCP how their respective budgets linked to the national outcomes. However, only one, Aberdeenshire made any attempt to link budgets to outcomes. Some stated that they were working towards linking budgets and outcomes but the majority did not provide any linkage.
291. Several HSCPs told the H&S Committee about the difficulties in linking budgets and outcomes. South Lanarkshire HSCP explained that allocating funding to outcomes “was particularly tricky, because a number of activities that we undertake might have a range of outcomes.”^{cxxx} Edinburgh HSCP bluntly stated that “It is impossible to [link budgets to outcomes] because the outcomes are interrelated.”^{cxxxi}
292. The H&S Committee welcomes and supports the requirement by the Scottish Government that HSCPs must link budgets to performance. It states that they “will be monitoring closely the extent to which [HSCP] annual reports provide this information which we consider vital to understanding the impact of outcomes on budgets.”^{cxxxii}

Crown Office and Procurator Fiscal Service

293. The Justice Committee also focused on linking spend with outputs as part of its scrutiny of the COPFS. It asked the Lord Advocate to present details of COPFS budgets since 2012 by areas of work. The Committee concluded that the presentation of budget information by areas of work provides a useful method of linking spend with output.

Enterprise Agencies

294. The EJFW Committee focused on the to the enterprise agencies’ spending on investment in terms of measuring success, value for money and plans for the coming years. It expressed concerns about “whether a 28% cut to Scottish Enterprise’s grant-in-aid budget (or 33.2% depending how figures are broken down) is prudent in the interests of promoting economic growth.”
295. In response to questioning from the EJFW Committee on these figures the Cabinet Secretary for Economy, Jobs and Fair Work responded—
- ” “It is, I understand, a complicated picture. Money is moving around, and a straightforward cut is not how I would represent it ...I think that you will still see a cut, however, to direct grant in aid to Scottish Enterprise.”^{cxxxiii}
296. The EJFW Committee noted the Cabinet Secretary’s explanation, including availability of sources of funding other than grant-in-aid plus various investments

^{cxxx} [Health and Sport Committee, 4 October 2016](#), OR Col. 23

^{cxxxi} [Health and Sport Committee, 4 October 2016](#), OR Col. 24

^{cxxxii} <http://www.scottish.parliament.uk/parliamentarybusiness/CurrentCommittees/102464.aspx#o>

paragraph 96

^{cxxxiii} [Economy, Jobs and Fair Work Committee, 20 December 2016](#), OR Col 5.

by the Scottish Government in areas relevant to enterprise but not being channelled through the agency, and also the increase for support for Scottish trade and investment.

297. The EJFW Committee also notes concerns about “whether Scottish Enterprise can continue to meet all the expectations placed upon them.” It invited the Committee to reflect on the question of whether the Scottish Enterprise can continue to meet all the expectations placed upon them.
298. The EJFW Committee refers to Audit Scotland’s recent report on ‘Supporting Scotland’s Economic Growth’ which identifies a 12% real terms reduction in the enterprise agencies budgets between 2008/09 and 2014/15. Despite this reduction, there has been “little change in relation to the Scottish Government’s expectations in relation to the priorities or the number of growth sectors they support.”^{cxv} Audit Scotland suggests that this “creates a risk that the enterprise bodies’ resources are being spread over too broad a range of activities and this might not be the most efficient use of their funding and expertise.”^{cxvi}

299. The Committee asks the Scottish Government to clarify how its approach to the funding of the Enterprise Agencies meets its overall purpose within the NPF of increasing economic growth and the delivery of its Economic Strategy.

Education and Skills

300. The E&S Committee wrote to four public bodies within its remit asking them to set out—
- how they measure their impact in terms of the NPF;
 - how the quality of their work is evaluated;
 - how their strategies and financial plans link to outcomes;
 - how they take forward work which reflect the Christie Commission’s four principles of reform;
 - how they are able to manage change; and
 - how their work supports the Scottish Government’s climate change targets.

^{cxv} http://www.audit-scotland.gov.uk/uploads/docs/report/2016/nr_160714_economic_growth.pdf
paragraph 66

^{cxvi} http://www.audit-scotland.gov.uk/uploads/docs/report/2016/nr_160714_economic_growth.pdf
paragraph 66

301. The E&S Committee also wrote to a number of stakeholders for each of the public bodies and sought the views of the users of the bodies' services. The four bodies considered were:

- Skills Development Scotland ("SDS");
- Scottish Funding Council ("SFC");
- Scottish Qualifications Authority ("SQA"); and
- Education Scotland.

302. The E&S Committee welcomed the focus on outcomes in the strategies and planning documents of all four public bodies. However while both SDS and the SFC provided data on outcomes, the SQA and Education Scotland did not. The E&S Committee has requested that the SQA and Education Scotland identify indicators appropriate for the outcomes they seek to contribute to and report on progress on those indicators.

303. The E&S Committee highlighted the importance of ensuring national programmes are designed with enough flexibility to adapt to local circumstance and that local partners understand how they can co-produce provision with national agencies.

304. The Committee also asked each of the four public bodies how they contribute to the Scottish Government's climate change goals. Each of the bodies has internal policies to reduce their carbon footprint. In addition, each has a role to support the broader societal change required to meet the Scottish Government's commitments to reduce Scotland's carbon footprint and promote sustainable growth.

305. In relation to the SFC, the EHR Committee recommended that the new Outcome Agreements with the universities should provide a platform for developing and implementing a more integrated programme of policy initiatives to ensure the proper mainstreaming of equalities across the entire university sector. Future budget expenditure delivered through the SFC should be aligned to support and deliver such a programme. This work should also be more clearly aligned with the National Performance Framework.

Environment

306. The ECCLR Committee focused on the contribution of three public bodies within its remit to the national objectives set out in the NPF and whether the success of meeting these objectives may have been affected by—

- a declining budget over a number of years;
- challenges faced in maintaining existing functions; and
- the need to respond to changing priorities.

307. The ECCLR Committee also issued a call for evidence seeking views on the contributions of the three public bodies to the Scottish Government's national objectives. The three public bodies considered were—

- Scottish National Heritage (SNH);
- Marine Scotland;
- Scottish Environment Protection Agency (SEPA)

308. In relation to SNH, the ECCLR Committee acknowledged the difficulties in continuing to meet its objectives while faced with a declining budget over a number of years. It was also in no doubt about the potential impact of both a reduced budget and the removal of EU funding on SNH and Scotland's landscapes, habitats and wildlife. However, it was also concerned about a lack of specific detail from SNH as to how these significant budgetary pressures would impact on its work.

309. Unlike SNH and SEPA, Marine Scotland has seen a 14.1% rise in its 2017-18 budget to £52.3m. The Cabinet Secretary for Environment, Climate Change and Land Reform explained to the ECCLR Committee that the increase was primarily to manage one-off pressures. The ECCLR has requested a detailed breakdown of these 'one off pressures,' their associated costs and what the increased budget will cover.

310. The ECCLR Committee was impressed with SEPA's approach to both managing and maximising its resources. It found that it was innovative in its interactions with stakeholders and that it continually pursued efficiency savings. It has asked the Scottish Government to provide further details on how SEPA's innovative approach to improve performance while managing a smaller budget has been shared with other public bodies.

BUDGET PROCESSES

311. This scrutiny test is concerned with examining the integration between public service planning and performance and financial management. The previous Committee focused on the Scottish Government's commitment to the transformation of the public services which is built on four pillars—

- Decisive shift towards prevention;
- Greater focus on 'place' to drive better partnership, collaboration and local delivery;
- Investing in people who deliver services;
- A more transparent public service culture which improves standards of performance.

A Decisive Shift to Prevention

312. The Written Agreement between the Scottish Government and the Finance Committee which was last revised in April 2015 states that—

“Both the Scottish Government and the Finance Committee recognise the need to move towards a greater emphasis on a preventative approach to public spending. The Finance Committee aims to ensure that the scrutiny of preventative spending is integral to the budget process and the Scottish Government agrees to include an overall assessment in the Draft Budget of the progress that is being made towards a more preventative approach.”^{cxxxvi}

313. The previous Finance Committee monitored the progress being made by the Scottish Government in making a decisive shift towards prevention throughout the previous Parliament. It wrote to the Cabinet Secretary on 23 March 2016 setting out its conclusions and recommendations. The main finding was disappointment at the relative lack of progress despite the commitment of the Scottish Government. It recommended the need for “strong leadership across all of the political parties and a consistent message and clear direction provided to Scotland’s public bodies that prevention is a priority.”^{cxxxvii}

314. The Committee wrote to the Cabinet Secretary on 30 June 2016^{cxxxviii} asking for a response to its predecessor’s letter dated 23 March. One of the main concerns of the previous committee was the need for the Scottish Government to provide a clear definition of preventative spending. The Cabinet Secretary’s response provided the following definition—

“Activity which maintains positive outcomes and breaks cycles of negative outcomes, helping to tackle persistent inequalities for people and communities. Over the long term, these activities will reshape services and demand and contribute to the long-term vitality of communities and the sustainability of the public services.”^{cxxxix}

315. The Committee’s guidance to the subject committees indicated agreement with the previous Finance Committee that there needs to be strong leadership across all of the political parties and a consistent message and clear direction provided to Scotland’s public bodies that prevention is a priority. The Committee recommended that, as part of their budget scrutiny, they may also want to

^{cxxxvi} http://www.parliament.scot/S4_FinanceCommittee/General%20Documents/Written_Agreement_-_Revised_April_2015.pdf

^{cxxxvii} http://www.parliament.scot/S4_FinanceCommittee/General%20Documents/Prevention_letter_23.03.2016.pdf

^{cxxxviii} http://www.parliament.scot/S5_Finance/General%20Documents/Ltr_to_Cab_Sec_on_Prevention_2016.06.30.pdf

^{cxxxix} http://www.parliament.scot/S5_Finance/General%20Documents/Cabinet_Secretary_to_Finance_Committee_-_Prevention.pdf

scrutinise the extent to which public bodies have adopted a more preventative approach including—

- Evidence of disinvestment;
- The impact of the Change Funds;
- Cultural change;
- Measurement and evaluation including interim targets and benchmarking;
- Joint-working and public sector collaboration;
- Engagement with the Third Sector;
- Innovation and the role of digital technology;
- The role of community planning.^{cxl}

316. The H&S Committee has identified preventative spending as an important theme in its work and has committed to scrutinising policy issues in relation to their preventative focus. This includes their work on the integration of health and social care which it carried out as part of its draft budget scrutiny as “ultimately shifting the balance of care is about moving resources towards preventative spending.”
317. The H&S Committee recognises that it is “too early to expect to see any discernible shift in expenditure from hospital to community care.” It therefore asked HSCPs how they planned to achieve this shift over the longer term and to provide specific examples of projects being designed to achieve this. Most HSCPs provided very broad descriptions while some provided more specific examples.
318. The Cabinet Secretary for Health and Sport told the H&S Committee that “there was an expectation changes would be made in the allocation of resources in next year’s budget.” The H&S Committee emphasised an expectation that “in the next financial year there should be evidence of changes made in the allocation of resources.”
319. More generally the H&S Committee also recognises that “there is a growing consensus the NHS needs to focus on the development of preventative models of care.” The H&S Committee aims to “determine what is being allocated to preventative policies, how it is being evaluated and its cost effectiveness assessed.” It asked the Scottish Government to provide detail on ways in which this could be reflected in the draft budget.

^{cxl}http://www.scottish.parliament.uk/S5_Finance/General%20Documents/Convener_to_Convener_guidance_2016.30.06.pdf

320. The LGC Committee “welcomes evidence that integration fund monies have addressed some of the cost pressures in social work services and supported delivery of the living wage.” However, a number of written submissions to the LGC Committee also emphasised that “preventative spending is becoming increasingly difficult. The LGC Committee acknowledges the impact that current financial pressures can have on the ability of local authorities to prioritise additional investment in preventative services.
321. The EJFW also examined preventative spending as part of its focus on fuel poverty. In particular, it emphasised the impact which addressing fuel poverty could have on spending in other areas. For example, energy efficiency can help to “reduce the amount of money spent on health conditions related to cold and damp housing and wider poverty issues.” On this basis the EJFW Committee is of the view that the “preventative spend agenda – reflecting the findings of the Christie Commission – ought to underpin every national policy, community action and individual intervention.”
322. The Committee asked the Cabinet Secretary about how the draft budget supported the shift to prevention. He responded that the Government has “proactively promoted policies that will make a difference in prevention, such as what we are doing around childcare, regeneration and our investment in housing,” adding “when we take our budget decisions, we take a holistic look at prevention.”

SCOTTISH PARLIAMENTARY CORPORATE BODY

323. The Committee is required to consider the budget proposal from the Scottish Parliamentary Corporate Body (SPCB). The SPCB has a prior call on the Consolidated Fund, meaning that its budget is allocated before the Scottish Government makes any other allocations. The SPCB budget provides for the costs of the Parliament and also the costs of the Ombudsman and Commissioners which fall within the definition of SPCB supported bodies.
324. The SPCB budget^{cxli} was submitted to the Committee on 30 November 2016 and the Committee took oral evidence on it at its meeting on 7 December 2016^{cxlii}.
325. The SPCB identified a total budget requirement, including capital charges and non-cash items, of £97.7m for 2017-18. This represents an increase in cash terms of £1m, or 2.1%, compared to the budget of £96.7m for 2016-17. Excluding capital charges and non-cash items the SPCB budget submission for revenue and capital expenditure is £85.2m, £0.8m (0.9%) higher than the approved 2016-17 budget and £1.4m (1.7%) higher than the indicative forecast for 2017-18 presented to the Committee last year.

^{cxli} http://www.parliament.scot/S5_Finance/20161205_FCCCompletePUBLICpapers.pdf
^{cxlii} [Finance and Constitution Committee, 7 December 2016, OR](#)

326. The Presiding Officer commented on the wider context for the SPCB budget proposal by observing that—

” “Over the course of the previous five-year parliamentary session, the Corporate Body delivered a 10% real terms reduction in the total SPCB budget from 2010-11 to 2015-16. This was achieved by a combination of pay freezes and pay restraint (for Members, Members’ support staff and SPS staff), and a change management programme, which has reviewed every aspect of the Parliament’s operations and which reduced staffing in the Parliamentary service by more than 10%”^{cxliii}.

327. With regard to the budget setting approach of the SPCB underpinning the budget proposal, the Presiding Officer commented—

” “Our budget bid for 2017-18 reflects the emerging demands arising as a result of the complex new powers which the Parliament will exercise in this session. Despite the challenges and uncertainties that these present, we have been able to restrict the overall uplift on our current year budget to 1%, principally by redeploying the contingency previously identified in our indicative forecast for 2017-18 to meet these demands. We have continued to maintain a tight control over recurring annual costs and one-off project costs to ensure that resources are available for these new cost pressures”^{cxliv}.

328. In terms of remuneration, MSP pay is directly linked to public sector pay rises in Scotland, via the Annual Survey of Hours and Earnings (ASHE), which has replaced the previous link to MP salaries. Accordingly, MSP pay will increase by 1.8% in 2017-18. Jackson Carlaw MSP, a member of the SPCB, commented on the impact of directly linking MSP pay to ASHE data in the following terms—

” “This is the first time that the budget submission has been the method by which MSP pay has been confirmed. As you know, we decoupled ourselves from Westminster, under which arrangement the MSP pay rate was 87.5 per cent of what Westminster MPs earned. In the current year, it is 81 per cent, which represents a reduction in the percentage. In the budget that we are looking at, there will be a 1.8 per cent rise for MSPs from April next year”^{cxlv}.

329. In terms of the pay of Parliamentary staff, 2017-18 is the second year of a two-year agreement negotiated with the trade unions. With regard to staff costs, there is a 6.9%, or £1.7m, increase in the 2017-18 budget proposal from the 2016-17 budget which reflects investment in two areas. Firstly, several new posts have been created to support demands arising from the new powers being devolved to the Scottish Parliament and to support the implementation of the new Register of

^{cxliii} [Presiding Officer’s letter, 30 November](#), p.1.

^{cxliv} [Presiding Officer’s letter, 30 November](#), p.1.

^{cxlv} [Finance and Constitution Committee, 7 December 2016, OR](#), Col.11.

Lobbyists^{cxlvi}. Secondly, investment in the IT capacity of the Parliament including the establishment of seven new IT / Digital posts in 2016-17 and a further twelve posts being under consideration subject to approval of a business case^{cxlvii}. The Presiding Officer commented on the purpose of this IT expenditure as representing—

” “a firm commitment to developing, delivering and maintaining the new technologies necessary to support the business in the digital age. The cost will be partially offset by a reduction in the use of IT contractors within projects. A number of these new posts have been filled in the current financial year, funded from contingency, and further posts remain subject to approval on the basis of a robust business case”^{cxlviii}.

330. With regard to contingency, the 2017-18 contingency budget is set at £1m as compared to a budget of £4m in 2016-17. Jackson Carlaw MSP commented on the 2017-18 budget for contingency that—

” “The SPCB is proposing to set aside a £1 million, regarded as prudent, for emergencies, anticipated potential costs that are not yet certain and emerging costs pressures. We consider that contingency to be tight in the current climate of uncertainty, and it is less of a contingency than has been applied previously. We have set that level to maintain the overall budget submission within the previous indicative forecast on a like-for-like basis”^{cxlix}.

331. In terms of income generated by the SPCB, the 2017-18 budget forecasts income of £255,000 as compared to income of £262,000 in 2016-17 representing a forecast decline in income of 2.5%, or £7,000, from 2016-17. In response to questioning from James Kelly on the reasons for this decline in income, Derek Croll, group head of finance and security, observed that—

” “The income is, in effect, the turnover from the shop, which is related to visitor numbers in the building, and we have seen a general trend over four or five years of visitor numbers reducing. With regard to the £262,000 figure for this year, our current year outturn forecast is that turnover will come down to the level that is in next year’s budget bid. The fact is that we are seeing a reduction in visitor numbers”.^{cl}

^{cxlvi} Schedule 3 to the Presiding Officer’s letter notes that 5.5 new posts have been created to meet demands arising from the devolution of new powers and 2 new posts to deal with the new Register of Lobbyists.

^{cxlvii} See Schedule 3 of the [Presiding Officer’s letter](#).

^{cxlviii} [Presiding Officer’s letter, 30 November](#), p.3.

^{cxlix} [Finance and Constitution Committee, 7 December 2016, OR](#), Col. 4.

^{cl} [Finance and Constitution Committee, 7 December 2016, OR](#), Cols. 7-8.

Ombudsman and Commissioners

332. As noted above, the SPCB budget also includes the costs of Ombudsman and Commissioners that fall within the definition of SPCB supported bodies. The budget for these officeholders is proposed to increase by £1.3m, or 15%, from £8.4m in 2016-17 to £9.6m in 2017-18. Schedule 3 to the Presiding Officer's letter to the Committee comments on the reason for this increase as follows—

” “This increase includes funding of £1,000K for the Scottish Public Services Ombudsman's new statutory functions in relation to the Scottish Welfare Fund and social work complaints.... If the £1m for new statutory functions is excluded, the underlying increase is £255k (3.0%) which is largely attributable to the officeholders implementing staff pay uplifts in line with the pay award for SPCB staff”^{cli}.

333. With regard to the rationale for the increase in the budget of the Scottish Public Services Ombudsman, as a result of new statutory responsibilities, the Chief Executive stated that—

” “The increase represents a direct transfer of responsibilities from the Government to the ombudsman and was negotiated on that basis. The Government would expect to make a commensurate saving on its own expenditure. The negotiation took place principally between the ombudsman and the Government and we were content on the basis that the transfer was agreed at that level”^{clii}.

334. In response to a question from the Convener regarding when there had last been a review of commissioners and ombudsman, the Chief Executive observed that—

” “We had a review a number of years ago, because a previous corporate body was very interested in a deeper rationalisation of the officeholders. I think it is fair to say that the reform that occurred fell somewhere between where the SPCB wanted to go and what was felt to be acceptable at the time.”^{cliii}

335. The Chief Executive went on to comment further on the issue of a review of SPCB-supported officeholders, stating—

” “If the Finance and Constitution Committee were interested in encouraging such an approach, I can say that it was certainly the case that the SPCB was very interested in exploring the issue, but it would require wider parliamentary agreement on whether anything further could be done. I am pretty confident that, if that were something that the Finance and Constitution Committee wished us to look at, the SPCB would be more

^{cli} [Presiding Officer's letter, 30 November](#), Schedule 3, p.5.

^{clii} [Finance and Constitution Committee, 7 December 2016, OR](#), Col. 8-9.

^{cliii} [Finance and Constitution Committee, 7 December 2016, OR](#), Col 6

than happy to take that on and perhaps come back to the committee with some further thoughts about^{cliv}.

336. The Committee welcomes the suggestion that the SPCB may wish to consider undertaking a review of SPCB-supported officeholders and therefore invites the SPCB to consider this issue further.

AUDIT SCOTLAND

337. Audit Scotland is required to prepare, for each financial year, proposals for its use of resources and expenditure. It is the responsibility of the Scottish Commission for Public Audit (SCPA) to examine these proposals and report on them to Parliament.
338. Audit Scotland submitted its budget proposal for 2017-18, and its associated fee strategy, on 7 December 2016^{clv}. The SCPA took evidence from Audit Scotland on 21 December 2016.
339. Audit Scotland's budget proposal for 2017-18 requests a total requirement of £6,582,000 for 2017-18. This represents an overall cash reduction of £51K (-0.8%) in cash terms on the approved 2016-17 budget. The expenditure of Audit Scotland is budgeted to reduce by 4.3%. This reduction is primarily driven by a range of efficiency savings measures including reduced fees and expenses being paid to external audit firms as a consequence of a recent procurement exercise dealing with the appointment of external firms over the next five years. In terms of capital expenditure, Audit Scotland's budget remains unchanged at £200K all of which is allocated to support expenditure on information technology and, in particular, the resilience and security of Audit Scotland's IT systems.
340. The vast majority of Audit Scotland's income comes from the fees charged to local government, the NHS, Scottish Water, central government and further education for audit work. In 2017-18, Audit Scotland estimates an income from fees of £17.193m which represents a 5.5% reduction in fee income in 2016-17. This reduction in fee income arises primarily from savings from the audit procurement exercise relating to external firms which has enabled Audit Scotland to reduce the fees it charges to audited bodies in 2017-18.
341. Audit Scotland highlights, in its budget proposal, that it will be undertaking new areas of work in 2017-18 as a result of legislative change. This includes the audit of 30 Integrated Joint Boards (IJBs) created under the Public Bodies (Joint Working) (Scotland) Act 2014; audit work in relation to Revenue Scotland as tax

^{cliv} [Finance and Constitution Committee, 7 December 2016, OR](#), Col. 6.

^{clv} <http://www.parliament.scot/ScottishCommissionforPublicAudit/SCPA-S5-16-2-2-2016.12.14-Audit-Scotland-Budget-Proposal-20172018.pdf>

new powers come into force; and, work in relation to the financial aspects of the Scotland Act 2016. Audit Scotland also emphasised that its budget proposal had been prepared in the context of a number of uncertainties which may impact on the workload of the organisation. These include the scale of work required as a consequence of the Scotland Act 2016 and the impact of the recent European referendum result. The SCPA looks forward to discussing these issues with Audit Scotland in due course.

342. The SCPA noted that whilst it welcomes the reduction in fees and expenses being paid to external firms it was concerned that this could result in poorer quality audit work being undertaken. Audit Scotland outlined measures it is taking to mitigate against any impact of this kind and also noted that a review of Audit Scotland's quality arrangements is currently underway and that the 2017-18 budget proposal included £100K to support an enhanced quality regime. Nevertheless, the Commission stated that this is an issue which it intends to take further evidence on.

343. Audit Scotland has recently undertaken a review of its funding and fee setting arrangements. This included a consultation with audited bodies and other stakeholders. The main change proposed as a result of the review, and contained in the fee strategy accompanying the budget proposal, is that all the funding of NHS performance audit work should be drawn from the Scottish Consolidated Fund (SCF). This would amount to a £495K reduction in NHS audit fees in 2017-18. At present, NHS performance audit work is funded 60% from the SCF and 40% from NHS Boards. All other areas of performance audit work, within the remit of the Auditor General, is funded via the SCF. The SCPA approved the fee strategy including the change to the charging of NHS performance audit work.

344. The SCPA recommended that Audit Scotland's budget proposal for 2017-18 be approved.

345. The Committee notes the report from the Scottish Commission for Public Audit.

CONCLUSION

346. The Committee recognises that this is an historic draft budget. This is the first time that any Scottish Parliament will set the rates and bands for income tax in Scotland. It is also the first budget that will operate within the context of the Fiscal Framework. This is complex and potentially introduces a much higher level of uncertainty and volatility to the budget process. This would have been challenging enough during a period of economic stability. But the added uncertainty arising from Brexit significantly increases the challenge faced by both the Scottish Parliament and the Scottish Government in agreeing the budget for 2017/18.

347. Given this level of complexity the Committee emphasises that it is critical that there is a sufficient level of transparency to ensure public confidence in the operation of the new financial powers and the Fiscal Framework. The Committee welcomes the detailed analysis which the SFC has carried out and believes it has a crucial role in supporting parliamentary scrutiny of the draft budget. The Committee also welcomes the work which think tanks, such as the FAI and IPPR Scotland, have done in examining Scotland's budget which is also crucial in supporting effective parliamentary scrutiny.

348. Overall, the Committee is very aware that there is a steep learning curve for all involved in the budget process and that it is vital that we seek to improve public understanding of how it works. To do so, it is essential that both the UK Government and the Scottish Government are willing to provide timely and detailed information on how the Scottish budget is now calculated. The Committee welcomes the work which the Budget Process Review Group is doing in addressing many of the issues which we consider in this report. The Committee agrees with the Cabinet Secretary that there is a need for a transformational approach to the review. The review group is invited to consider the findings of this report that are relevant to its remit.

Annexe A: Reports from other Committees and the Scottish Commission for Public Audit

- [Culture, Tourism, Europe and External Relations Committee](#)
- [Economy, Jobs and Fair Work Committee](#)
- [Education and Skills Committee](#)
- [Environment, Climate Change and Land Reform Committee](#)
- [Equalities and Human Rights Committee, 1st Report 2017 \(Session 5\): Disabilities and Universities](#)
- [Equalities and Human Rights Committee, 2nd Report 2017 \(Session 5\): Report on Draft Budget 2017-18](#)
- [Health and Sport Committee](#)
- [Justice Committee](#)
- [Local Government and Communities Committee](#)
- [Rural Economy and Connectivity Committee](#)
- [Scottish Commission for Public Audit](#)
- [Social Security Committee](#)



The Scottish Parliament
Pàrlamaid na h-Alba

SOCIAL SECURITY COMMITTEE

By email:

Bruce Crawford

Convener

Finance and Constitution Committee

The Scottish Parliament
Edinburgh
EH99 1SP

Direct Tel: 0131 348 5208

SocialSecurityCommittee@parliament.scot

22 December 2016

Dear Bruce

I am writing on behalf of the Social Security Committee with our response to the Finance and Constitution Committee regarding the Scottish Government's Draft Budget 2017-18.

The Committee took evidence from the Minister for Social Security on the elements of the Draft Budget relevant to the Committee's remit which included the newly devolved social security powers and existing powers, and also child poverty.

The Committee did not wish to make points on specific subject areas within the Draft Budget, but did wish to comment and express concerns on a more overarching basis.

In particular the Committee found it difficult to scrutinise the Scottish Government's long term plans for social security programmes by considering a Draft Budget for one year (2017-18) in isolation. The Committee strongly recommends that the Scottish Government in future years provides information based on a longer term cycle which covers the whole of this parliamentary session, whilst also recognising that it is more usual to scrutinise a draft budget that sits within a three year cycle. The Committee found it very difficult to assess this Draft Budget on the criteria that the Finance and Constitution Committee has suggested (such as prioritisation of monies) based on a one year budget (although the suggested approach from your Committee is helpful). The Committee therefore intends to assess the various components of the budget throughout its work as a whole, rather than restrict it to specific Draft Budget scrutiny (for example, scrutiny of the Financial Memoranda for the forthcoming legislation on social security and child poverty).

The Committee also noted that social security programme costs for 2017-18 are no longer included as a separate budget line, but are "planned to be funded from the centrally-held budget relating to Scotland Act 2016 non-tax implementation." This is part of the Finance and Constitution portfolio, and £80 million has been allocated to this central fund for implementing the new powers (which the Committee understands from the Minister includes the Crown Estate, and employability programmes as well as social security programmes).

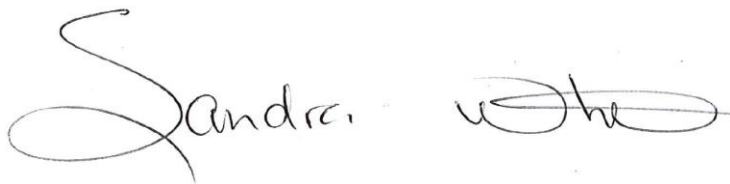
Although the Committee found it helpful to receive information in oral evidence from the Minister as to the main areas where the £80 million would be allocated, the Committee had concerns in relation to understanding how this figure was calculated, and so whether it would be sufficient. Whilst the Committee understands that the budget planning for a new social security system is extremely complex and is very aware of the many and varied demands and pressures on that budget, it was also concerned that there was not sufficient clarity in how the £80 million was described across the Draft Budget documents, including the Level 4 figures, and in particular on what proportion of the £80 million would be allocated to social security programmes.

The Committee wished to highlight that the Minister stated that she would clarify in writing as to what proportion of the £80 million would be allocated to social security programmes. The Committee also asks for ongoing cooperation from the Scottish Government to provide financial details for specific policy initiatives when these are available, even if only estimations are possible (examples of policy initiatives being the use of top up benefits, e.g. for Carer's Allowance and Child Benefit).

The Committee also wished to note our concern regarding the limited timescale between publications of the Draft Budget and reporting to your Committee, which has limited the extent of our scrutiny to one committee meeting on 22 December 2016, at which we considered oral evidence from the Minister for Social Security.

This is clearly not a sufficient timescale in the interests of thorough committee scrutiny. However the Committee notes that these timescales are unusual and not intended as a precedent, and intends to conduct more detailed scrutiny in further years as I have described above, particularly in relation to the budget for the new powers on social security.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Sandra White', with a stylized, cursive script.

**SANDRA WHITE MSP
CONVENER**

