Published 25 January 2019
SP Paper 457
2nd Report, 2019 (Session 5)

The Scottish Parliament
Pàrlamaid na h-Alba

## Finance and Constitution Committee
## Comataidh Ionmhais is Bun-reachd

# Report on Scottish Government Budget 2019-20

**Published in Scotland by the Scottish Parliamentary Corporate Body.**

All documents are available on the Scottish Parliament website at:
http://www.parliament.scot/abouttheparliament/91279.aspx

For information on the Scottish Parliament contact Public Information on:
Telephone: 0131 348 5000
Textphone: 0800 092 7100
Email: sp.info@parliament.scot

# Contents

# Finance and Constitution Committee

To consider and report on the following (and any additional matter added under Rule 6.1.5A)—
(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 Government Business and Constitutional Relations.

http://www.parliament.scot/parliamentarybusiness/CurrentCommittees/Finance-Constitution-Committee.aspx

finance.constitution@parliament.scot

0131 348 5215

# Committee Membership

**Convener**
**Bruce Crawford**
Scottish National Party

**Deputy Convener**
**Adam Tomkins**
Scottish Conservative and Unionist Party

**Tom Arthur**
Scottish National Party

**Neil Bibby**
Scottish Labour

**Alexander Burnett**
Scottish Conservative and Unionist Party

**Willie Coffey**
Scottish National Party

**Angela Constance**
Scottish National Party

**Murdo Fraser**
Scottish Conservative and Unionist Party

**Emma Harper**
Scottish National Party

**Patrick Harvie**
Scottish Green Party

**James Kelly**
Scottish Labour

# INTRODUCTION

1. The Scottish Government published its Budget[1] for 2019-20 on 12 December 2018. This report sets out the views of the Finance and Constitution Committee ("the Committee") on the Budget.

2. This is the first year of the Parliament's new budget scrutiny process following the recommendations of the Budget Process Review Group[2] (BPRG) and the Parliament's agreement of a revised Written Agreement between the Committee and the Scottish Government.[3] The Committee issued guidance to the subject committees in April 2018 setting out the basis of the new budget process.[4]

3. An integral element of the new process is that the subject committees now undertake a full year approach to Budget scrutiny which should be more effective in influencing the Scottish Government's spending decisions and help committees develop a cumulative understanding of spending decisions within their respective portfolios and the impact of these decisions on outcomes.

4. A key feature of this new approach is the publication of pre-budget reports at least 6 weeks prior to the publication of the Budget. Chapter 4 of the Budget document sets out how this pre-budget scrutiny by the Parliament's committees has influenced the formulation of the Scottish Budget. Each committee also received a more detailed response from their respective Ministers to pre-budget reports. These reports were also subject to debate in the Chamber on 24 January 2019.

5. The Committee's own pre-budget report was published on 7 November and we received a response from the Cabinet Secretary for Finance, Economy and Fair Work ("the Cabinet Secretary") on 14 December 2018.[5] The Committee also received a joint response to our pre-budget report from the Office for Budget Responsibility (OBR) and the Scottish Fiscal Commission (SFC)[6] as well as responses from the Chief Secretary to the Treasury[7] and HMRC.[8] This work has helped to inform our scrutiny of the Budget 2019-20.

[1] https://www2.gov.scot/Publications/2018/12/9450
[2] http://www.parliament.scot/S5_Finance/Reports/BPRG_-_Final_Report_30.06.17.pdf
[3] http://www.parliament.scot/S5_Finance/General%20Documents/20180517WA_with_SG.pdf
[4] http://www.parliament.scot/S5_Finance/General%20Documents/Budget_guidance_final.pdf
[5] https://www.parliament.scot/parliamentarybusiness/CurrentCommittees/109564.aspx
[6] http://www.parliament.scot/S5_Finance/Reports/Letter_from_Dame_Susan_Rice_and_Robert_Chote_to_the_Finance_and_Constitu...(1).pdf
[7] http://www.parliament.scot/S5_Finance/General%20Documents/Scan.pdf
[8] http://www.parliament.scot/S5_Finance/General%20Documents/BC_5_Dec.pdf

# STRATEGIC CONTEXT FOR BUDGET 2019-20

6. The Scottish Budget is becoming increasingly complex and dependent on a number of moving parts which are interwoven. This is a consequence of two main factors. First, the substantial devolution of further tax, borrowing and social security powers since 2012. Second, the operation of the Fiscal Framework which links the performance of the Scottish economy and the level of devolved tax receipts with the performance of the UK economy and the level of the equivalent tax receipts in the rest of the UK.

7. Essentially this means that the Scottish Government now has more opportunity to both grow the Scottish economy and to generate increased tax revenues. But any benefit which accrues to the public finances in Scotland from economic growth and increased tax revenues is dependent to some extent on the equivalent performance of the UK economy and equivalent tax receipts in the rest of the UK. A significant number of tax and economic powers are also reserved to Westminster which limits the opportunities for the Scottish Government to grow the Scottish economy relative to the UK economy. Furthermore, Brexit introduces a great deal of economic uncertainty which was not anticipated when further tax devolution and the Fiscal Framework were introduced.

8. As well as creating opportunities for the Scottish Government the new budget powers and the Fiscal Framework also create potentially substantial risks in managing the public finances. In a written submission to the Committee, Audit Scotland summarise these risks as follows:

   - **Economic performance risk** – the extent to which Scotland's relative economic growth affects the budget available to pursue policy objectives
   - **Policy risk** – the extent to which policy choices in Scotland and at the UK level affect the Scottish budget
   - **Forecasting risk** – the extent to which differences between forecasts used to set budgets and actual outturns affect future years' budgets.
   - **Budget management risk** – the extent to which the Scottish Government can manage fiscal risks, ensuring that public spending programmes provide value for money, while remaining within authorised budgets and the limits in the Fiscal Framework.

9. The Institute for Fiscal Studies (IFS) explained to the Committee that it is important to break the different moving parts down in order to understand what is driving overall risks to the Scottish budget, including whether any underperformance and overperformance is a consequence of changes to the block grant adjustment at a UK level or a consequence of changes to tax revenues in Scotland. CIPFA's view

is that there is a need to drill down "to get a better understanding of risk and therefore what is driving the changes and where the budget volatility is likely to come from."[9] They suggest that the Committee may wish to examine some of the sensitivities in the modelling used for the relevant economic and fiscal forecasts which should "show the impact on the budget and from that, you can determine whether the budget is more sensitive to one factor or another."[10]

10. The SFC state that forecasts "cannot perfectly predict the future" and that their "forecasts aim to present a balanced pathway through a broad range of possible outcomes." [11] They have looked at nearly 30 years of UK revenue forecasts and found an average absolute forecast error of 3.3% across all one-year-ahead forecasts. They point out that while, highly illustrative, "applying the average UK revenue forecast error to Scotland suggests it is not unreasonable to expect an average one-year ahead error in our tax forecasts of around £530 million."[12] They also highlight that of "the 53 UK tax forecasts we looked at, there was an error of more than 5.0 per cent, or £810 million in a Scottish context, on 11 occasions."[13]

11. Audit Scotland explained to the Committee that we should "expect to see a similar error level from the OBR estimates through time" and "it is whether those error levels amplify or offset each other that will give rise to issues or opportunities."[14] The Committee notes that while there is a tendency to focus on the downside risks, forecast error can also result in additional revenue. The IFS told us that they "might expect there to be some improvement in the Fiscal Commission's forecasting capabilities, but forecasts are fundamentally an educated guess, so there will be a degree of error."[15] The IFS also pointed out that "the Scottish Government bears the relative risk of its revenues moving less or more quickly than those of the rest of the UK" but the Fiscal Framework also insures "the Scottish Government against broader macroeconomic shocks."[16]

12. The Cabinet Secretary was asked whether he was concerned about the level of forecast error set out by the SFC. He responded that the Scottish Government wants the reserves to be as "accurate as possible" and of course, "a finance secretary watches that closely."[17]

13. **The Committee notes the SFC's view that it is not unreasonable to expect an average one-year ahead error in their tax forecasts of around £30 million.**

---

[9] Finance and Constitution Committee, 19 December 2018, Official Report. Col. 4
[10] Ibid.
[11] http://www.fiscalcommission.scot/media/1435/scotlands-economic-and-fiscal-forecasts-december-2018-full-report.pdf paragraph 1.5
[12] http://www.fiscalcommission.scot/media/1435/scotlands-economic-and-fiscal-forecasts-december-2018-full-report.pdf box 1.1
[13] Ibid.
[14] https://www.parliament.scot/parliamentarybusiness/report.aspx?r=11861&mode=pdf Col.7
[15] https://www.parliament.scot/parliamentarybusiness/report.aspx?r=11861&mode=pdf Col. 8
[16] https://www.parliament.scot/parliamentarybusiness/report.aspx?r=11861&mode=pdf Col. 8
[17] Finance and Constitution Committee, 16 January 2018, Official Report. Col. 2

**While this may not be unreasonable in forecasting terms it presents a substantial risk to the Scottish Government's budget which may or may not be offset by similar forecast error by the OBR. These risks are discussed in more detail below. The Committee recognises that there is an increasing need for effective parliamentary scrutiny and wider understanding and awareness of these opportunities and risks. This report is intended to support that process.**

## Economic Outlook

14. The SFC's December 2018 forecasts report states that since "our first forecast published in December 2017 we have presented a subdued outlook for the Scottish economy" and "subdued growth remains the case" although "our forecasts are more positive than they were in May 2018." This is because –

- Recent revisions to economic data mean that GDP growth over the last two years is now stronger than the SFC's May forecasts;
- Significantly higher public expenditure in Scotland than forecast in May "primarily driven by higher UK Government expenditure, feeding through to Scotland via the Block Grant"; and
- Earnings data for 2018 "a little stronger" than the SFC's May forecast.

15. The SFC's GDP Growth forecasts are shown in Table 1 below

**Table 1: SFC GDP Growth Forecasts (%)**

| | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|---|
| **December 2017** | 0.7 | 0.7 | 0.9 | 0.6 | 0.9 | 1.1 | |
| **May 2018** | 0.8 | 0.7 | 0.8 | 0.9 | 0.9 | 0.9 | 0.9 |
| **December 2018** | 1.4 | 1.4 | 1.2 | 1.0 | 1.0 | 1.1 | 1.2 |

16. The SFC state that average "annual GDP growth since 2010 has been around 1.0 per cent" and that "it is likely that this relatively low level of growth will persist over the next five years." While the SFC expect growth to average around 1% over the next five years they forecast higher growth in 2018 and 2019 following a "strong performance in the production industry and exports in 2017 and 2018." They do not expect this to be sustained.

17. Compared to December 2017, the SFC has revised up its forecasts for Scottish GDP growth. Our Adviser points out that these upward revisions have been brought about by revisions to previously published outturn GDP growth which mean that growth has been slightly stronger in the past two years than had previously been expected. The SFC forecast higher GDP growth for Scotland than the OBR forecasts for the UK in 2018. The SFC then forecast slower growth for Scotland than the OBR's forecasts for UK GDP growth for the rest of the forecast period. The OBR's GDP growth forecasts are shown in Table 2 below.

**Table 2: OBR UK GDP Growth Forecasts (%)**

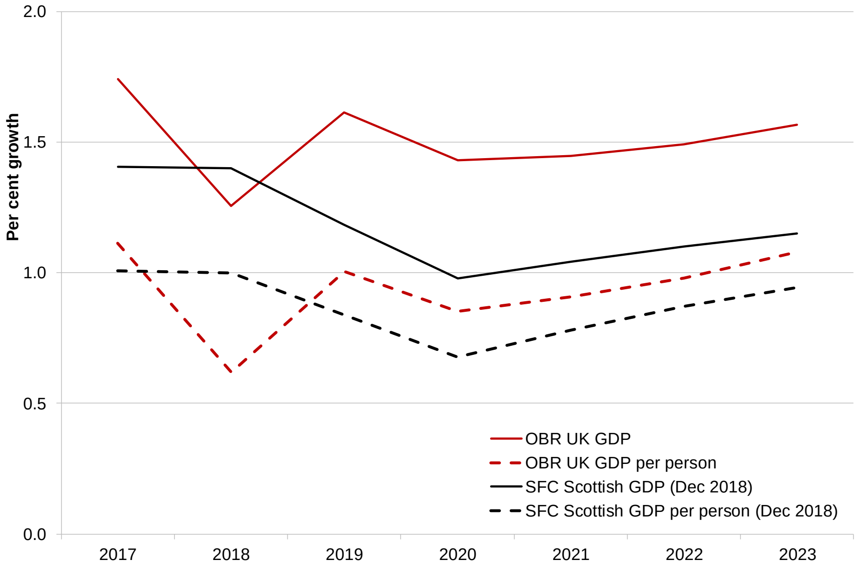
| | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|---|
| **November 2017** | 1.5 | 1.4 | 1.3 | 1.3 | 1.5 | 1.6 | |
| **March 2018** | 1.7 | 1.5 | 1.3 | 1.3 | 1.4 | 1.5 | |
| **October 2018** | 1.7 | 1.3 | 1.6 | 1.4 | 1.4 | 1.5 | 1.6 |

18. The OBR's Economic and Fiscal Outlook (EFO) published in October 2018 states that the "big picture in this forecast is of a relatively stable but unspectacular trajectory for economic growth – close to 1½ per cent in every year."[18] The OBR summarise their expectations for GDP growth over the next five years as follows -

> "We attribute the unexpectedly weak start this year to temporary factors, but they are still sufficient to lower real GDP growth for 2018 as a whole to 1.3 per cent from 1.5 per cent in March. We then expect it to pick up to 1.6 per cent next year, up from 1.3 per cent in March thanks to the Budget giveaway. Growth thereafter is only fractionally higher than in March, picking up from 1.4 per cent in 2020 and 2021 to 1.6 per cent by 2023 as underlying productivity growth improves."[19]

19. The SFC state that Scottish GDP growth "is expected to be significantly lower than in the UK…primarily because of slower population growth in Scotland."[20] The SFC also state that Scottish GDP growth per person "is expected to converge with the UK, but will remain lower because of slower productivity growth in Scotland." This is shown in Chart 1 below.

**Chart 1: Comparing OBR and SFC growth forecasts**




*Source: Scottish Fiscal Commission Economic and Fiscal Forecasts December 2018, Figure 2.22*

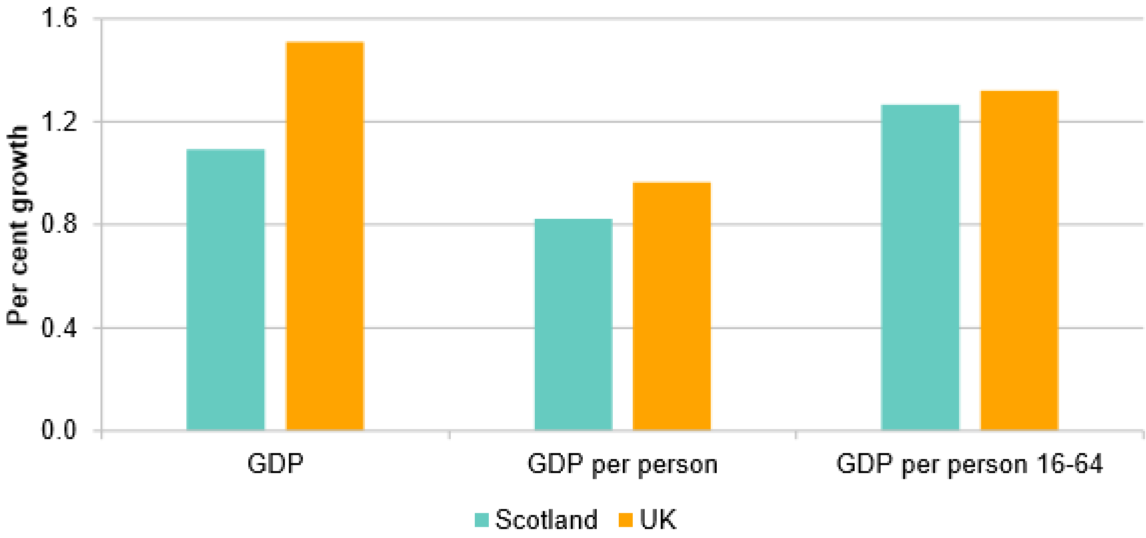
---

[18] https://cdn.obr.uk/EFO October-2018.pdf paragraph 1.11
[19] https://cdn.obr.uk/EFO October-2018.pdf paragraph 1.21
[20] http://www.fiscalcommission.scot/media/1435/scotlands-economic-and-fiscal-forecasts-december-2018-full-report.pdf paragraph 2.147

20. The SFC told us that productivity in Scotland "in the past few years has been marginally worse than in the rest of the UK" but they don't know why "because we do not really know what the drivers are for productivity being so weak over the past 10 years across all countries."[21]

21. The SFC also highlight that when "looking at growth in GDP per person for those aged 16 to 64, our forecasts for Scotland are even closer to the OBR's forecasts for the UK on average." This is shown in Chart 2 below.

**Chart 2: Growth in GDP and GDP per person, Scotland and OBR UK forecasts, average growth rates from 2019 to 2023 (per cent)**

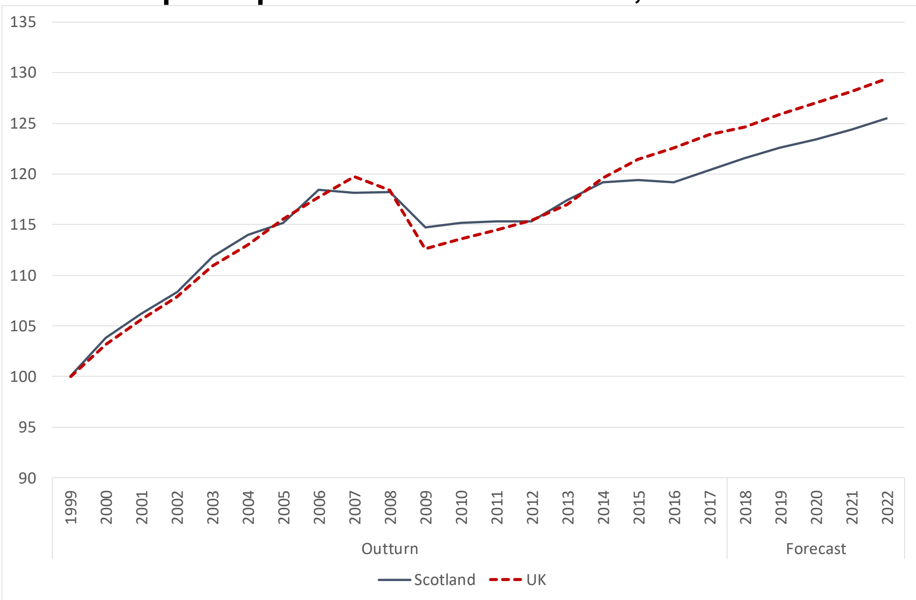



*Source: Scottish Fiscal Commission Economic and Fiscal Forecasts December 2018, Figure 2.14*

22. The Committee's Adviser points out that from a long-term perspective, the separation of Scotland's GDP per capita performance from the UK's, increasingly looks to have been a largely temporary phenomenon in 2015 and 2016. As shown in Chart 3 Scotland's GDP per capita is forecast to grow more slowly than the UK's, but only by around 0.2 percentage points per annum.

[21] http://www.parliament.scot/parliamentarybusiness/report.aspx□r□11876□mode□pdf Col.15

**Chart 3: GDP per capita outturn and forecast, Scotland and UK (1999=100)**




*Source: Outturn from Scottish Government Quarterly National Accounts; forecasts from SFC (December 2018) and OBR (October 2018)*

23. However, as the Committee noted in our pre-budget report, the SFC have pointed out that the population aged 16 to 64 in Scotland is expected to start to shrink from 2018 onwards in contrast to a growing 16 to 64 population in the UK and that this "places a particular drag on growth in GDP in Scotland."[22] But as we highlighted in our pre-budget report, the Fiscal Framework operates on the basis of general population growth in the UK relative to Scotland rather than working age growth.

24. The Committee's view is that this is potentially significant for the size of the Scottish Government's Budget. In our pre-budget report we asked whether the Scottish Government has sufficient policy levers to address this risk and whether the Fiscal Framework sufficiently recognises demographic divergence?

25. The Scottish Government responded that –

> "It is increasingly clear that the UK Government's immigration policy does not address our economic, demographic and social needs. Devolved powers on immigration would be an essential lever in addressing these challenges given that all of our population increase will come from migration over the next 25 years."[23]

26. The SFC told us that "there is a need to worry about the negative effects of migration not just because of the demographic effects…but because of the link

---

[22] http://www.fiscalcommission.scot/media/1300/scotlands-economic-and-fiscal-forecasts-may-2018-full-report.pdf paragraph 20

[23] https://www.parliament.scot/S5_Finance/Reports/Letter_from_Cabinet_Secretary_for_Finance_Economy_and_Fair_Work_response_to_FCC_pre-Budget_scrutiny_report.pdf

between migration and productivity" as there is "no doubt that migration has a very positive effect on productivity."[24]

27. The Committee also recommended that both of these fundamental questions are fully considered as part of the review of the Fiscal Framework. The Scottish Government responded that they are determined to ensure that the review "considers all the factors that may have a major impact on Scotland's finances in the long and near-terms" and that "Parliament and its committees will be among the range of stakeholders who will be consulted by officials in the run-up to the review."

28. The Chief Secretary to the Treasury (CST) responded that the Fiscal Framework ensures that the Scottish Budget "is shielded from the effects on its tax revenues of any UK-wide economic slowdown, from slower relative population growth and from forecast risk, including through increased borrowing powers and the use of the Scotland Reserve."[25]

29. In our pre-budget report the Committee considered the SFC's May forecasts for GDP growth which were broadly the same as the December 2017 forecasts and were less than 1% per annum for each year of the forecast period. The Committee noted that the GDP growth forecast differential between Scotland and the rest of the UK is around 0.4 to 0.5% for each of the next four years. The Committee asked whether the Scottish Government and/or the UK Government has carried out any risk analysis of the potential impact of differential economic growth rates between Scotland and the rest of the UK.

30. The Scottish Government responded that Chapter 6 of *Scotland's Fiscal Outlook* "sets out risks and uncertainties around its budget over the next five years" and that this includes an "assessment of the impact of differential growth in tax receipts per head on Scotland's spending power." The response also states that –

> "Producing a different range of funding scenarios, which reflect differential growth in the key drivers of income tax receipts such as earnings, provides a very useful basis for the Scottish Government's approach to financial planning, allowing a variety of outcomes to be modelled and to look at how we can manage the risks associated with the volatility of the public finances and the potential funding envelope."

31. The CST responded that –

> "the UK Government continues to analyse and manage the risks on Scottish Government receipts of relative population growth and any UK-wide economic effects as part of its management of wider UK macroeconomic risks. However, it is for the Scottish Government to analyse and manage the risks of different

---

[24] http://www.parliament.scot/parliamentarybusiness/report.aspx?r=11876&mode=pdf Col.21
[25] http://www.parliament.scot/S5_Finance/General%20Documents/Scan.pdf

economic growth rates between Scotland and the rest of the UK, given the significant levers it has to influence growth in Scotland."[26]

32. The CST added that, in particular, "the Scottish Government will have to give serious consideration as to whether to pass on the UK Government's tax cuts announced at Budget, in view of the potential knock-on effects on the wider Scottish economy."[27]

33. The Committee asked the Cabinet Secretary how the Scottish Government's capital investment can increase tax receipts. He responded that there "are a range of commitments to stimulate the economy in relation to manufacturing and a competitive rates regime to support business growth." He added that housing "is a good example of the short, medium and long-term multiplier effect of infrastructure investment."[28] He agreed to write to the Committee with details of the multiplier effect and the economic benefits that come from housing specifically.

34. The Cabinet Secretary was also asked by the Committee about how he will be judged on the success of his economic stimulus in terms of growth, wages and employment figures. He responded that "the total budget of £42.5 billion is an economic stimulus" which includes "more than £5 billion of capital investment, which will stimulate the economy." He also stated that the 2019/20 budget proposes "an expansion of early years and childcare provision, more work on energy efficiency and innovation, the creation of the national manufacturing institute, support for agriculture and work on digital, enterprise and skills."[29]

35. **The Committee welcomes the more positive outlook for the Scottish economy but notes that per capita GDP growth remains lower than the UK because of slower productivity growth in Scotland. Given that productivity growth is a key driver of increased income tax revenues (other drivers include population growth and taxation policy) this gap while small could be a risk to the public finances and will require close monitoring by both the Scottish Government and the SFC. In particular, the impact of a shrinking age 16 to 64 population in Scotland in contrast to a growing age 16 to 64 population in the rest of the UK on both productivity growth and income tax revenues requires to be closely monitored.**

36. **We reiterate our recommendation in our pre-budget report that the review of the Fiscal Framework should fully consider the impact of immigration policy following the UK's departure from the EU.**

---

[26] http://www.parliament.scot/S5Finance/General%20Documents/Scan.pdf
[27] http://www.parliament.scot/S5Finance/General%20Documents/Scan.pdf
[28] Finance and Constitution Committee, 19 December 2018, Official Report. Col. 12
[29] Finance and Constitution Committee, 19 December 2018, Official Report. Col. 15

# BREXIT

37. Since November 2016 the OBR's forecasts have reflected provisional broad-brush adjustments to incorporate the possible impact of Brexit. These are "notably that trade intensity, net inward migration, business investment and productivity growth would be weaker than would otherwise have been the case."[30] The OBR's most recent EFO states that "the referendum vote to leave the EU appears to have weakened the economy" while "uncertainty regarding the Brexit negotiations appears to have dampened business investment (by more than earlier data suggested)."[31] The OBR also took account of the "significant fall in the exchange rate that accompanied the referendum and its outcome."[32]

38. The EFO points out that the "average quarterly growth rate has slowed from 0.6 per cent between 2013 and 2015 to 0.4 per cent since the beginning of 2016, taking the UK from near the top of the G7 growth league table to near the bottom."[33] The OBR told us that "we had a forecast prior to the referendum, assuming that there would be a vote to remain in the EU, that the economy would grow by roughly 4.5 per cent between the time of the referendum and now. In the first forecast that we produced after the referendum, we reduced the figure to about 3 per cent. The latest outturn data suggests that growth has been about 3.2 per cent."[34]

39. The OBR's forecasts "assume an orderly end to the negotiations between the UK and the EU and so a smooth transition from the pre- to post-Brexit worlds."[35] The EFO states that a disorderly Brexit "could have severe short-term implications for the economy, the exchange rate, asset prices and the public finances. The scale would be very hard to predict, given the lack of precedent."[36] The OBR told us that "a disruptive outcome would be a lot worse than an outcome that is not disruptive."[37] This could mean that UK asset prices "fall sharply which, together with heightened uncertainty, would cause households and businesses to rein in their spending. A fall in the pound would also raise domestic prices, squeezing households' real incomes and spending."[38]

40. The SFC "continue to use the same broad-brush assumptions as the OBR"[39] which as noted above assume an orderly Brexit. The SFC's GDP growth forecast "broadly assumes a relatively smooth and orderly Brexit process" while also recognising that

---

30 https://obr.uk/docs/dlm□uploads/BrexitDiscussionWeb□ersion.pdf paragraph 5.3
31 https://cdn.obr.uk/EFO□October-2018.pdf paragraph 1.16
32 Ibid.
33 https://cdn.obr.uk/EFO□October-2018.pdf paragraph 1.16
34 http://www.parliament.scot/parliamentarybusiness/report.aspx□r□11876□mode□pdf Col.38
35 https://obr.uk/docs/dlm□uploads/BrexitDiscussionWeb□ersion.pdf paragraph 5.15
36 https://cdn.obr.uk/EFO□October-2018.pdf paragraph 1.12
37 http://www.parliament.scot/parliamentarybusiness/report.aspx□r□11876□mode□pdf Col.36
38 Ibid.
39 http://www.fiscalcommission.scot/media/1435/scotlands-economic-and-fiscal-forecasts-december-2018-full-report.pdf paragraph 27

the "potential effect of Brexit on Scotland remains highly uncertain."[40] The SFC also consider a no-deal Brexit to be a "downside risk" to their forecasts.

41. Incorporating the OBR's broad-based assumptions, the SFC identifies the following impact of Brexit on its forecasts –

- **Migration** – "we use the ONS 50 per cent EU migration variant, with projected lower EU migration than in the principal projection. This is slightly different to the principal population projection used by the OBR for the UK."
- **Productivity** – "we are forecasting slow growth in productivity, in part because of UK-EU exit."
- **Trade** – "using OBR assumptions we forecast slower growth in Scottish international trade from the end of the transition period, currently scheduled to last until 31 December 2020."

42. The OBR state that "if the UK moves to a stricter immigration regime following Brexit, the static effect on our forecast would be a smaller population and labour force which would lower potential output."[41] The OBR told us that "over a medium to longish horizon, lower net inward migration is a net negative for the public finances, primarily because inward migrants are more likely to be of working age than the population as a whole."[42]

43. The SFC were asked by the Committee whether they have examined the possible effects of a no-deal Brexit. They responded that while they have not looked at what the effects would be, they would expect the negative effects from a disorderly Brexit outlined above "to be bigger and there to be additional negative effects" and there "could be some quite big negative short-run adjustment effects at around the time of Brexit."[43]

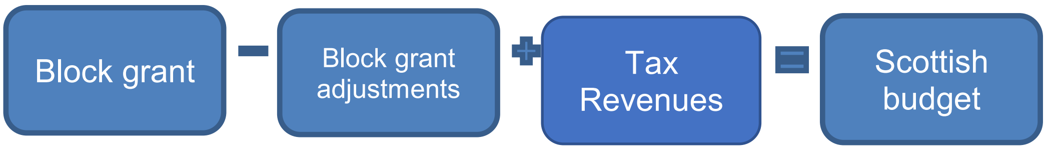
44. **The Committee notes that the OBR state that the referendum vote to leave the EU appears to have weakened the economy and predict that a no-deal Brexit could have a severe short-term impact on the public finances and would be a lot worse than an orderly Brexit. The Committee is strongly of the view that a no-deal Brexit would be damaging to the Scottish economy and public finances and therefore is clearly not in the national interest.**

---

[40] http://www.fiscalcommission.scot/media/1435/scotlands-economic-and-fiscal-forecasts-december-2018-full-report.pdf paragraph 9
[41] https://cdn.obr.uk/EFO-October-2018.pdf paragraph 3.23
[42] http://www.parliament.scot/parliamentarybusiness/report.aspx?r=11876&mode=pdf Col. 39
[43] http://www.parliament.scot/parliamentarybusiness/report.aspx?r=11876&mode=pdf Col.20

# OPERATION OF THE FISCAL FRAMEWORK

45. The operation of the Fiscal Framework in calculating the si□e of the Scottish Budget is complex. Each time a tax is transferred there is a reduction in the sie 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 size of the Scottish Budget is, therefore, calculated as follows –




46. The process is further complicated by the need to base the initial calculations on revenue forecasts which are then reconciled with actual outturn receipts. HM Treasury is responsible for calculating the adjustments to the block grant which are initially based on relevant OBR forecasts for tax receipts in the rest of the UK (rUK). The SFC has a statutory responsibility for forecasting revenues for the devolved taxes.

## Block Grant

47. Since December 2017 HM Treasury has published an annual publication designed to increase the transparency of the block grant calculation process.[44] The document provides a table setting out the Scottish Government's block grant between 2016-17 and 2019-20. Table 3 shows the block grant as calculated following the UK Budget in October 2018 while Table 4 shows the block grant as calculated following the UK Budget in November 2017.

**Table 3: Total Scottish Government Block Grant (October 2018)**

| £m | 2016-17 | 2017-18 | 2018-19 | 2019-20 |
|---|---|---|---|---|
| **Block Grant** | 29,342 | 30,347.3 | 30,906.2 | 32,138.9 |
| **Block Grant Adjustment** | -5,500 | -12,539.4 | -12,272.8 | -11,903.5 |
| **Total** | 23,842 | 17,807.9 | 18,633.5 | 20,235.4 |

[44] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment□data/file/767101/Block□Grant□Transparency□2018□PDF□1.pdf

**Table 4: Total Scottish Government Block Grant (November 2017)**

| £m | 2016-17 | 2017-18 | 2018-19 | 2019-20 |
|---|---|---|---|---|
| **Block Grant** | 29,342 | 30,380 | 30,742 | 31,141 |
| **Block Grant Adjustment** | -5,500 | -12,539 | -12,472 | -12,793 |
| **Total** | 23,842 | 17,841 | 18,270 | 18,348 |

## Block Grant Adjustments (BGAs)

48. The BGAs consist of two elements: an initial baseline adjustment and an indexation mechanism. The initial baseline adjustments are set out in Table 5.

**Table 5: Initial Baseline Adjustments**

| (£m) | Initial Baseline Deduction |
|---|---|
| **NSND Income Tax** | 10,718.9 |
| **LBTT** | 468 |
| **SLfT** | 149 |

49. The initial baseline adjustments are equal to the UK Government's tax receipts generated in Scotland in the year immediately prior to the devolution of the powers. The deductions for Land and Buildings Transaction Tax (LBTT) and Scottish Landfill Tax (SLfT) are based on outturn figures for 2014-15.

50. The baseline adjustment for Non-Savings Non-Dividend (NSND) income tax is based on revenues raised in Scotland in 2016-17. Initially the baseline adjustment was based on forecasts as outturn figures were unavailable. The outturn figures for 2016-17 were published by HMRC in July 2018.

51. The Committee's pre-budget report highlighted a risk to the Scottish Budget from forecast error following HMRC's publication of the outturn data for 2016-17. This meant that the baseline adjustment for NSND income tax was revised down from the forecast £11,214m to the actual £10,718m. The outturn figures do not have a direct impact on the public finances as 2016/17 is the baseline year for both the BGA and Scottish income tax receipts. This means that the baseline for both the BGA and Scottish income tax receipts will now be revised downwards to £10.7 billion which means the net impact on future Budgets is zero.

52. The Committee noted that the impact on the budget will depend on the relative growth of income tax receipts per capita in Scotland and the rest of the UK from this baseline figure. If the relative growth is the same then there will be no impact. There is only an impact where there is divergence in the rate of growth. As the Committee

noted in our pre-budget report, while there may be no direct impact on the size of the public finances there may nevertheless be an indirect impact arising from the fewer number of higher and additional rate taxpayers in Scotland than previously thought.

53. This risk is exacerbated by the gap between the income tax forecasts which inform the Budget, the publication of outturn figures and subsequent reconciliation. This means that the forecasts for income tax, which in part decide the size of the Scottish Budget 2019-20, will not be reconciled with the actual tax receipts until outturn figures are published in July 2021. Any difference between forecast and outturn is then addressed in the Scottish Budget 2022-23.

54. **The Committee reiterates the need for this process to be closely monitored and the risks to be effectively and transparently managed.**

## Indexation Mechanisms

55. 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 adjustment to the block grant for each of the devolved taxes for 2019/20 the indexation mechanism is a measure of the forecast growth rate of comparable revenues per capita in rUK between 2018/19 and 2019/20.

56. 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. 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 models.

57. 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 |

58. 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 |

59. 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

models there will be a "reconciling adjustment" to the comparable model to "ensure the mechanism delivers the IPC outcome."[45]

60. HM Treasury has published the calculations for the adjustments to the block grant using both models in a spreadsheet alongside its block grant transparency document in December 2018.[46] The most recent calculations for 2019-20 using both models are reproduced in Tables 6 and 7 below.

**Table 6: Block Grant Adjustment Calculations (IPC Model) 2019-20.**

| | **Relative Scottish Population Growth** | **% change in UKG Receipts** | **Block Grant Adustment (m)** |
|---|---|---|---|
| **Income Tax** | 99.8% | 100.3% | 11,501.1 |
| **LBTT** | 99.7% | 104.1% | 566.5 |
| **SLfT** | 99.7% | 88% | 91.1 |

**Table 7: Block Grant Adjustment Calculations (Comparable Model) 2019- 20**

| | **Comparability** | **Population** | **Change in UKG receipts (£m)** | **Block Grant Adjustment (£m)** |
|---|---|---|---|---|
| **Income Tax** | 79.8% | 8.9% | 479.1 | 11,582.3 |
| **LBTT** | 48.9% | 9.4% | 481.2 | 573.6 |
| **SLfT** | 164.1% | 9.4% | -80.7 | 92.8 |

61. This shows that the Scottish Government's 2019-20 budget would be worse off by £90m if the comparable model were used to calculate the block grant rather than the IPC model.

62. For comparative purposes the figures for the IPC model for the block grant adjustment calculations for the 2018-19 Budget are shown in Table 8 below.

[45] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/508102/Fiscal_Framework_-_Text_-_Annex_to_the_fiscal_framework_-_15th_March_201....pdf paragraph C.32
[46] https://www.gov.uk/government/publications/block-grant-transparency-december-2018

**Table 8: Block Grant Adjustment Calculations (IPC Model) 2018-19**

| | Relative Scottish Population Growth | % change in UKG Receipts | Block Grant Adustment (m) |
|---|---|---|---|
| **Income Tax** | 99.7% | 102.2% | 11,749 |
| **LBTT** | 99.7% | 101.8% | 600.1 |
| **SLfT** | 99.7% | 91.2% | 94.4 |

63. These figures show that the block grant adjustment has declined by £284.8m between 2018-19 and 2019-20. However, HM Treasury does not provide any accompanying narrative explaining this change which could be a consequence of a number of interrelated factors. These factors include UK tax policy changes, changes to the baseline for income tax, the performance of the UK economy and the performance of UK tax receipts. Without this information there is a lack of transparency regarding the operation of the block grant adjustment.

64. **The Committee highlighted this issue in our report on Draft Budget 2018-19. The Committee recommended that the OBR should have responsibility for publishing an independent analysis of the year on year changes to the adjustments to the block grant as part of its devolved taxes forecast. The Committee will take this forward with HM Treasury with a view to improving the transparency of the annual adjustments to the block grant. This is vital in ensuring confidence in the operation of the Fiscal Framework.**

## Revenue Forecasting

65. As noted above, the Scottish Budget is dependent on the block grant minus the adjustments to reflect tax devolution plus the forecast revenues from the devolved taxes. The SFC have a statutory responsibility to provide the latter. Table 9 provides details of those forecasts for 2019-20 alongside the forecasts for the adjustments to the block grant and the net impact on Budget 2019-20.

**Table 9: Net Resource Budget Adjustment (2019-20)**

| | Forecast Tax Receipts (£m) | Forecast Block Grant Adjustment (£m) | Net Resource Budget Adjustment (£m) |
|---|---|---|---|
| **NSND Income Tax** | 11,684 | 11,501.1 | +182.9 |
| **LBTT** | 643 | 566.5 | +76.5 |
| **SLfT** | 104 | 91.1 | +12.9 |
| **Total** | 12,431 | 12,158.7 | 272.3 |

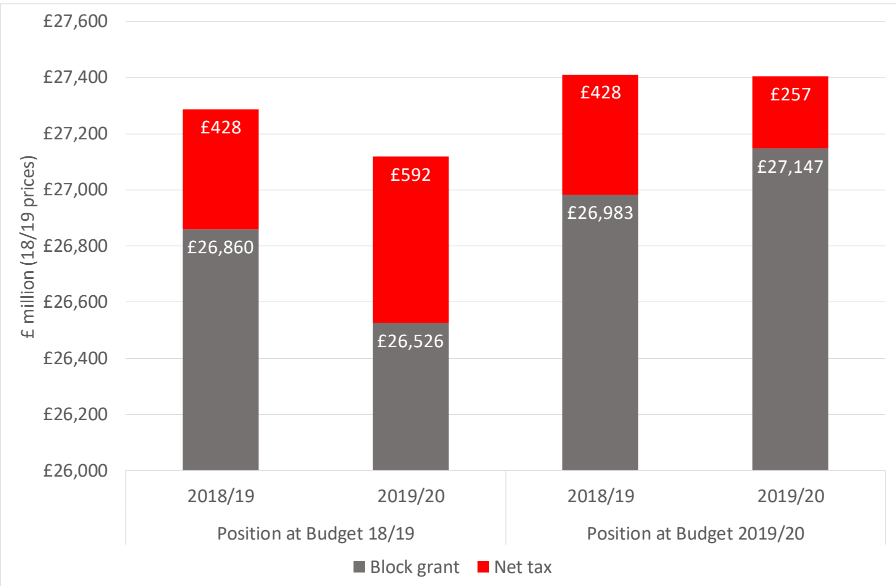
66. This means that devolved revenues are forecast to raise £272.3m more than the adjustments to the block grant for revenues foregone to HM Treasury. This compares to a net resource budget adjustment of £428m for 2018-19 as shown in Table 10 below.

**Table 10: Net Resource Budget Adjustment (2018-19)**

| | Forecast Tax Receipts (£m) | Forecast Block Grant Adjustment (£m) | Net Resource Budget Adjustment (£m) |
|---|---|---|---|
| **NSND Income Tax** | 12,177 | 11, 749 | +428 |
| **LBTT** | 588 | 600 | -12 |
| **SLfT** | 106 | 94 | +12 |
| **Total** | 12,871 | 12,443 | 428 |

67. Chart 4 below shows how this adjustment impacts on the size of the Scottish Government's resource budget.

**Chart 4: Changes in the Fiscal Resource budget (real terms, 2018-19**




Source: Committee's Fiscal Framework Adviser. *To convert 2019/20 prices into 2018/19 terms, a deflator of 1.0141 has been used for Budget 2018/19 (consistent with the published deflator at that time), and a deflator of 1.0179 has been used for Budget 19/20 (consistent with the deflators used in the 2018/19 Budget).*

68. The first two columns of Chart 4 show the outlook for the resource budget at the time the Budget 2018/19 was set (including the income tax changes proposed at Stage 2 of the Budget Bill process). In 2018/19, the block grant was projected at £26,860m, and the 'net tax' difference between Scottish revenues and the BGAs was forecast at £428m. This 'net tax' difference was entirely accounted for by Scottish income tax, which was forecast to raise £428m more than the

corresponding BGA (the 'net tax' positions for LBTT and Landfill Tax offset each other, at -£12m and +£12m respectively).

69. When the 2018/19 budget was set, the Scottish Government therefore planned, on the basis of the relevant forecasts from the OBR and the SFC, on having £428m more in tax receipts than the adjustment to the block grant. Latest forecasts imply that for 2018-19 the Scottish Government will only have £12m more in tax receipts than the adjustment to the block grant. This means that according to the revised forecasts, the 2018/19 budget would be £416m worse off than when that budget was introduced in December 2017. While these revised forecasts for 2018-19 do not have a direct impact on the public finances they do emphasise the potential risk if these forecasts are closer to the actual outturn receipts which will be published in July 2020. This is discussed in more detail in relation to income tax below.

70. The second two columns of Chart 4 show that the 'net tax' position for 2019/20 has deteriorated compared to what had been forecast in December 2017. The 2019/20 budget now has a forecast net tax position of £257m in real terms compared to a forecast net tax position of £592m in December 2017.

71. The Committee discussed with witnesses whether there is a risk that the current approach to the budget might be potentially storing up significant problems for the next Parliament. The IFS responded that the "idea behind the framework is to give the Scottish Government a chance to adapt to changes in the forecast." This is because there is a three-year gap between the publication of the income tax forecasts which inform the annual Budget and the publication of the Budget which needs to address the reconciliation of those forecasts with the outturn figures.

72. The income tax forecasts which inform Budget 2019-20 were published in December 2018 by the SFC and October 2018 by the OBR. The outturn income tax receipts for 2019/20 will be published in July 2021. The Scottish Government is then required to address the difference between the forecast and the actual receipts in its Budget 2022-23 which is likely to be published in December 2021.

73. The IFS told the Committee that "given the existing fiscal forecasts, the Scottish Government needs to constantly look ahead and consider what it is going to do two years down the line to adjust to the forecast changes."[47] Audit Scotland told us that "there needs to be an awareness that the volatility is built into the system and that, in the decisions that Government and Parliament make, a longer term and more strategic approach is needed to take account of that."[48] This should include "consideration of the extent of the volatility over time and how to design tax and indeed spending policies that can respond to the volatilities."[49]

[47] https://www.parliament.scot/parliamentarybusiness/report.aspx?r=11842&mode=pdf Col. 5
[48] https://www.parliament.scot/parliamentarybusiness/report.aspx?r=11842&mode=pdf Col. 6
[49] Ibid.

74. The Committee asked the SFC whether they agreed with the analysis that there is a big risk to Scotland's Budget if Scottish income tax revenues are overestimated and UK income tax revenues are underestimated and whether there is a likely risk of that happening over the next two to three budgets. The SFC responded that the current position on reconciliations "shows that those adverse circumstances seem to be likely, but they can of course change; it is just a forecast of a forecast difference."[50]

75. **The Committee noted in our report on Draft Budget 2018-19 that while we welcomed the introduction of HM Treasury's Block Grant Transparency document "there is no accompanying narrative explaining the year on year changes to the adjustments to the block grant." This means that it is very difficult to understand the extent to which the changes are due to –**

- **Tax outturn data;**
- **UK policy changes which will apply in Scotland (e.g. the Personal Allowance increase);**
- **UK Government tax policy changes that will not automatically apply in Scotland (e.g. the increase in the Higher Rate threshold);**
- **Changes in the outlook for the underlying determinants of equivalent UK tax revenues.**

76. **The Committee recommends that the Block Grant Transparency document includes an explanation of the year on year changes to the adjustments to the block grant caused by each of these factors. The Committee will also request that the document is published alongside the UK Budget document and provides BGA calculations for each year of the five-year forecast period.**

77. **The Committee will take forward these recommendations in discussion with HM Treasury with a view to improving the transparency of the annual adjustments to the block grant. The Committee views this as being vital in ensuring confidence in the operation of the Fiscal Framework.**

78. **The Committee also recommends that any changes to the methodology for calculating the adjustments to the block grant are published and communicated to us at the earliest opportunity. This has not been the case to date, for example, in relation to the changes as a consequence of the partial devolution of income tax to Wales. As we have stated many times it is essential that, if the public is to have confidence in the operation of the new financial arrangements for devolution, there must be transparency in how these arrangements operate.**

79. **The Committee welcomed the appearance by the CST before us in September 2018 to discuss the operation of the Fiscal Framework and considers that it would be very helpful for a HM Treasury Minister to provide oral evidence to**

[50] http://www.parliament.scot/parliamentarybusiness/report.aspx?r=11876&mode=pdf Col.18

**us on these complex issues on an annual basis. In particular, this would help to provide a better understanding of how the Fiscal Framework operates and its impact on the Scottish Budget.**

# SCOTTISH INCOME TAX

80. The Scottish Government's proposals for income tax rates and bands for 2019-20 are show in Table 11 below.

**Table 11 : Proposed Scottish tax rates and bands, 2019-20**

| Bands | Band name | Rate (%) |
|---|---|---|
| Over £12,500* - £14,549 | Starter | 19 |
| Over £14,549 - £24,944 | Basic | 20 |
| Over £24,944 - £43,430 | Intermediate | 21 |
| Over £43,430 - £150,000** | Higher | 41 |
| Above £150,000** | Top | 46 |

*Assumes individuals are in receipt of the standard UK personal allowance (£12,500 in 2019-20)
**Those earning more than £100,000 will see their personal allowance reduced by £1 for every £2 earned over £100,000

81. These proposals incorporate:

- An increase to the personal allowance to £12,500 which is determined by the UK Government;
- A 5% increase in the threshold for the basic rate and a 4% increase in the threshold for the intermediate rate;
- No change in the higher rate threshold or top rate threshold, which remain at £43,430 and £150,000 respectively.

82. The Scottish Government states that their income tax proposals "are set using four key tests – protecting the lowest paid taxpayers; improving productivity; raising additional revenue; and supporting public investment in the Scottish economy."[51] They also state that they "will not follow the UK Government in providing a tax cut to higher earners" and that in Scotland "this applies to around the top 15 per cent of taxpayers."[52] The Budget document points out that the income tax proposals for 2019-20 "continue to ensure that 55 per cent of Scottish tax payers pay less tax than they would if they lived elsewhere in the UK" and that on current incomes, 99% "will pay less income tax than they do this year."[53]

83. The Financial Scrutiny Unit (FSU) have published a blog on what the Budget means for Scottish taxpayers.[54] They point out that while all those earning up to £124,375 will pay less tax in 2019-20 than they did in 2018-19, much of this gain is due to the

[51] https://www2.gov.scot/Resource/0054/00543975.pdf page 6
[52] Ibid.
[53] Ibid.
[54] https://spice-spotlight.scot/2018/12/13/what-does-the-scottish-budget-mean-for-taxpayers/

increase in the personal allowance in the UK Budget. Income tax at various levels of earning under the Scottish Government proposals are show in Table 12 below.

**Table 12: Differences between Scottish and r□K income tax**

| | Scottish Government proposals £ per year | Difference compared with 2018-19 £ per year | Difference compared with rUK £ per year |
|---|---|---|---|
| 15,000 | 480 | -130 | -20 |
| 20,000 | 1,479 | -130 | -20 |
| 25,000 | 2,480 | -140 | -20 |
| 30,000 | 3,530 | -140 | 30 |
| 35,000 | 4,580 | -140 | 80 |
| 40,000 | 5,630 | -140 | 130 |
| 45,000 | 6,994 | -140 | 494 |
| 50,000 | 9,044 | -140 | 1,544 |
| 60,000 | 13,144 | -140 | 1,644 |
| 70,000 | 17,244 | -140 | 1,744 |
| 80,000 | 21,344 | -140 | 1,844 |
| 90,000 | 25,444 | -140 | 1,944 |
| 100,000 | 29,544 | -140 | 2,044 |

84. The FSU also state that the Scottish Government's income tax proposals mean that the gap between the higher rate thresholds in Scotland and rUK will widen. The higher rate threshold in rUK will increase to £50,000 from April 2019, which is £6,570 higher than the proposed threshold for Scotland. In addition, Scottish taxpayers earning above the higher rate threshold will be paying 41% tax compared to 40% in rUK and will pay 46% on earnings above £150,000, compared to 45% in rUK. The rUK bands and rates are show in Table 13 below.

**Table 13: rUK tax bands and rates , 2019-20**

| Bands | Band name | Rate (%) |
|---|---|---|
| Over £12,500* - £50,000 | Basic | 20 |
| Over £50,000 - £150,000** | Higher | 40 |
| Above £150,000** | Additional | 45 |

*Assumes individuals are in receipt of the standard UK personal allowance (£12,500 in 2019-20)
**Those earning more than £100,000 will see their personal allowance reduced by £1 for every £2 earned over £100,000

85. The FSU also point out that National Insurance Contributions (NICs) are linked to UK tax thresholds and the NIC rate drops from 12% to 2% at the UK higher rate threshold. This means that Scottish taxpayers who earn between the Scottish higher rate threshold (£43,430) and the rUK higher rate threshold (£50,000) will pay 41% income tax and 12% NICs on their earnings between these two amounts – a combined rate of 53%. For example, for someone earning £46,000 they would pay this 53% rate on only £2,570 of their income. The Chartered Institute of Taxation (CIT) told us that this "is a significant kink in the effective marginal rate for those earners" which they believe will affect around 120,000 taxpayers.

86. The Scottish Government states that If it "were to change its income tax policy to match all UK Government rates and bands, it would come at a cost to the Scottish budget of around £500 million."[55] Both the IFS and Audit Scotland suggested that the Committee might want to ask the Scottish Government for more details of how that £500m has been calculated.

87. However, income tax receipts for 2019-20 are only forecast to be £183m higher than the adjustment to the block grant. The Committee's Adviser points out that this "implies that the underlying drivers of Scottish income tax revenues are forecast to grow more slowly than in the UK."

88. The Cabinet Secretary was asked by the Committee whether anyone earning less than £124,375 paying less tax in 2019-20 than they did in 2018-19 is a fair taxation policy. The Cabinet Secretary responded that the "income tax policies that we have made are fair because they meet the tests of raising the necessary income, protecting the economy – it is important to have that balance and give that stability – and protecting lower income earners." He added that we "have designed the system to be more progressive and we are not passing on the tax cuts for higher-rate taxpayers that the UK Government has made by raising the threshold in the rest of the UK."[56]

89. The Cabinet Secretary was also asked where the £500m in additional revenue from not matching UK tax policy had been allocated in the Budget. He responded that "we don't generally extrapolate income tax alone and say where that element of revenue is allocated in the budget" and that income tax revenues are "not hypothecated in the way that has been suggested." He added that there would have been a reduction of £500m in the budget if the Scottish Government had followed the UK's income tax policy.

90. **The Scottish Government state that it would cost £500m if the budget where to match UK Income tax policy. Therefore, in order to provide clarity, the Committee asks the Scottish Government to provide a breakdown of the £500m cost of matching all UK Government rates and bands.**

## Income Tax Revenue Forecasts

91. As can be seen in Table 14 below the SFC's income tax forecasts for 2019-20 have been revised down by £963m since February 2018.

[55] https://www2.gov.scot/Resource/0054/00543975.pdf page 6
[56] Finance and Constitution Committee, 19 December 2018, Official Report. Col. 6

**Table 14 SFC Scottish Income Tax Forecasts**

| £million | 2019-20 | 2020-21 | 2021-22 | 2022-23 |
|---|---|---|---|---|
| **February** | 12,647 | 13,152 | 13,733 | 14,372 |
| **May** | 12,345 | 12,805 | 13,335 | 13,936 |
| **December** | 11, 684 | 12,285 | 12,746 | 13,242 |
| **Change** | -963 | -867 | -987 | -1,130 |

92. The Committee's Adviser has provided a summary analysis of what has driven these changes based on the SFC forecast reports published in December 2017 and May 2018. This is shown in Table 15 below.

**Table 15: Explaining revisions in income tax forecasts Feb 2018 to Dec 2018**

| | 2016-17 | 2017-18 | 2018-19 | 2019-20 | 2020-21 | 2021-22 | 2022-23 |
|---|---|---|---|---|---|---|---|
| **Feb-18** | 11214 | 11584 | 12177 | 12647 | 13152 | 13733 | 14372 |
| **Outturn data** | -548 | -556 | -570 | -586 | -608 | -634 | -663 |
| **Economic forecast** | 36 | -43 | -156 | -183 | -250 | -332 | -437 |
| **UK Policy** | 0 | 1 | -15 | -275 | -85 | -98 | -120 |
| **Policy recostings** | 0 | -4 | -21 | -5 | -23 | -20 | -28 |
| **Other** | 16 | 25 | 37 | 19 | 27 | 21 | 37 |
| **2019-20 Policy** | 0 | 0 | 0 | 68 | 71 | 75 | 80 |
| **Total change** | -496 | -576 | -726 | -963 | -867 | -987 | -1,130 |
| **Dec-18** | 10,719 | 11,008 | 11,452 | 11,684 | 12,285 | 12,746 | 13,242 |

*Source: Committee Adviser*

93. This shows that £586m of the downward revision for 2019/20 is accounted for by the lower than expected income tax outturn data for 2016/17 that was published by HMRC in July 2018. £275m is accounted for by various UK Government policy measures (of this, £199m is accounted for by the increase to the Personal Allowance, but changes to various allowances and reliefs at UK level also reduce the revenue forecasts).

94. Our Adviser points out that both of these elements should in theory be associated with a broadly similar corresponding change to the BGA. The lower than expected income tax outturn data in 2016/17 results in a downward revision to the baseline adjustment for the BGA. The Personal Allowance increase clearly reduces revenues in rUK and thus reduces the size of the BGA.

95. The downward revision to the economic outlook (the reduction in forecast of Scottish wage growth that was announced in the SFC's May 2018 forecast) only accounts for £183m of the £963m downward revision to total income tax revenue forecast in 2019/20.

96. Table 16 below shows the changes to the BGA forecasts for income tax compared to the Scottish income tax revenue forecasts. Whilst the income tax forecast for

2019/20 has been revised down by almost £1bn in the last year, the BGA forecast has only been revised down by £550m. As a result, the 'net tax' forecast for 2019/20 has fallen from £591m at the time of Budget 2018/19 to £183m.

**Table 16: Changes to forecasts of Scottish income tax and BGAs (m)**

| | | 2017/18 | 2018/19 | 2019/20 | 2020□21 | 2021□22 | 2022□23 |
|---|---|---|---|---|---|---|---|
| Revenues | *Budget 2018/19* | *11,584* | *12,177* | *12,647* | *13,152* | *13,733* | *14,372* |
| | **Budget 2019□20** | **11,008** | **11,452** | **11,684** | **12,285** | **12,746** | **13,242** |
| BGA | *Budget 2018/19* | *11,523* | *11,749* | *12,056* | *12,477* | *12,936* | *n/a* |
| | **Budget 2019□20** | **11,046** | **11,49□** | **11,501** | **12,089** | **12,478** | **12,954** |
| Net tax | *Budget 2018/19* | *61* | *428* | *591* | *675* | *797* | *n/a* |
| | **Budget 2019□20** | **-38** | **-43** | **183** | **196** | **268** | **288** |

97. So, why has the BGA forecast been revised down by just £550m compared to last year? Our Adviser points out that the answer is that the OBR has revised up its forecasts for the performance of the key determinants of UK income tax revenues (the employment rate and average earnings) since last year. These revisions increase UK forecasts of income tax and hence BGA forecasts and are discussed below.

98. However, no breakdown is provided of the determinants of the changes to the BGA. So, whilst some things have happened in the past year to significantly reduce the BGA (the 16/17 outturn data, UK income tax policy changes to the Personal Allowance and the Higher Rate threshold), some of this downward pressure on the BGA has been partially offset by upward revision to forecast growth of underlying income tax determinants. But as discussed above, we don't know with any certainty how these various different factors play off against each other. **The Committee's view is that it is essential in terms of wider understanding of how the Fiscal Framework operates that this information is published.**

99. The SFC told the Committee that "UK tax forecasts have been pushed up this year: unexpectedly strong performance of tax receipts in 2018 has led the OBR to increase its forecasts for UK income tax and other taxes."[57] The OBR explained that as "the numbers were evolving last year, we were struck that most of the major tax streams…were kicking in considerably more money than was anticipated through this period so there seemed to be something more general going on."[58] In relation to income tax the OBR told us that "there were positive surprises in 2018-19 in the strength of those receipts that we would not expect to push through into future years and which we did not push through into future years in the forecast."[59]

57 http://www.parliament.scot/parliamentarybusiness/report.aspx□r□11876□mode□pdf paragraph 25
58 http://www.parliament.scot/parliamentarybusiness/report.aspx□r□11876□mode□pdf Col.32
59 http://www.parliament.scot/parliamentarybusiness/report.aspx□r□11876□mode□pdf Col. 33

100. The SFC told us that while they do not have as detailed information about Scottish tax receipts as the OBR has about UK tax receipts, “there is no evidence that Scottish income tax receipts have gone up as UK-wide tax receipts have gone up.”[60] The SFC also told us that there is some early evidence “that UK income tax receipts have gone up particularly at the higher end of the income distribution.”[61] Given that there are proportionately fewer higher-rate taxpayers in Scotland, the SFC currently “think that Scottish tax receipts have probably not been subject to the same rate of increase in 2018 as UK tax receipts.”[62] The OBR told us that “the issue of whether some of the growth in the relative strength of income tax receipts in the rest of the UK might have been down to the fact that there was more rapid growth at the top…is certainly a plausible path.”[63]

## The Determinants of Income Tax Revenue Forecasts

101. The principal determinants that underpin both the OBR and SFC income tax forecasts are earnings growth and employment growth. These are both discussed below. Table 17 below shows the SFC’s and the OBR’s latest forecasts for earnings growth compared with the forecasts which informed Budget 2018-19.

**Table 17: Changes to forecasts for earnings growth**

| | 2017-18 | 2018-19 | 2019-20 | 2020-21 | 2021-22 | 2022-23 |
|---|---|---|---|---|---|---|
| **SFC – Scotland** | | | | | | |
| Dec-17 | 2.0 | 2.2 | 2.4 | 2.6 | 2.8 | 3.1 |
| Dec-18 | 1.5 | 2.0 | 2.3 | 2.5 | 2.8 | 3.0 |
| *Change* | *-0.5* | *-0.2* | *-0.1* | *-0.1* | *-0.1* | *-0.1* |
| **OBR – UK** | | | | | | |
| Nov-17 | 2.3 | 2.2 | 2.4 | 2.7 | 3.1 | 3.1 |
| Oct-18 | 2.7 | 2.3 | 2.6 | 2.9 | 3.0 | 3.2 |
| *Change* | *0.5* | *0.2* | *0.1* | *0.2* | *-0.1* | *0.1* |
| **Difference between SFC and OBR forecasts (latest)** | | | | | | |
| | **-1.2** | **-0.4** | **-0.3** | **-0.3** | **-0.2** | **-0.2** |

**Source: Committee Adviser.** *Note that SFC forecasts are for calendar years; here the forecast for each calendar year is shown alongside the most closely overlapping financial year (e.g. the forecast for 2017 is shown as 2017/18).*

102. The SFC’s forecasts for average earnings growth have been slightly revised down in each year of the forecast period while the OBR’s forecasts have generally been revised up by a similar order of magnitude. This means that OBR now forecasts that UK earnings growth will be faster than the SFC forecasts for Scotland over the forecast period.

[60] http://www.parliament.scot/parliamentarybusiness/report.aspx?r=11876&mode=pdf Col.28
[61] Ibid.
[62] Ibid.
[63] http://www.parliament.scot/parliamentarybusiness/report.aspx?r=11876&mode=pdf Col.44

103. Table 18 shows the SFC's and the OBR's latest forecasts for the employment rate compared with the forecasts which informed Budget 2018-19.

**Table 18: Changes to forecasts for the 16+ employment rate**

| | 2017-18 | 2018-19 | 2019-20 | 2020-21 | 2021-22 | 2022-23 |
|---|---|---|---|---|---|---|
| **SFC – Scotland** | | | | | | |
| Dec-17 | 58.8 | 58.7 | 58.5 | 58.4 | 58.4 | 58.3 |
| Dec-18 | 58.7 | 58.4 | 58.3 | 58.3 | 58.2 | 58.1 |
| *Change* | *-0.2* | *-0.4* | *-0.2* | *-0.2* | *-0.2* | *-0.2* |
| **OBR – UK** | | | | | | |
| Nov-17 | 60.8 | 60.9 | 60.8 | 60.6 | 60.5 | 60.3 |
| Oct-18 | 60.8 | 61.2 | 61.3 | 61.3 | 61.2 | 61.0 |
| *Change* | *0.0* | *0.3* | *0.5* | *0.7* | *0.7* | *0.7* |
| **Difference between SFC and OBR forecasts (latest)** | | | | | | |
| | **-2.2** | **-2.8** | **-3.0** | **-3.0** | **-3.0** | **-2.9** |

**Source: Committee Adviser**

104. The SFC has revised down its forecasts for the employment rate in Scotland slightly, whilst the OBR has revised up its forecasts for the employment rate in the UK. The OBR anticipates that the UK employment rate will increase slightly in 2018/19 and 2019/20, whilst the SFC anticipates that the Scottish employment rate will decline slightly over the same period.

105. The Committee asked the SFC why they forecast slower earnings and employment growth in Scotland than the OBR is forecasting for the UK. The SFC responded that over "the past few years, productivity performance has been somewhat worse in Scotland than in the rest of the UK, which is probably an underlying driver."[64]

## Outturn Data

106. The OBR and SFC in a joint response to the Committee's pre-budget report stated "there are several sources of income tax data, with different coverage for Scotland and the UK and with availability at different times." While the SFC "has access to Scottish data of comparable quality and timeliness to that available to the OBR…there are richer and more timely data available for the UK as a whole than there are for Scotland." The data includes –

• The UK monthly cash receipts outturn: Timely estimates of UK PAYE and SA cash receipts. The data are publicly available, but for the whole of the UK only, with no breakdown for Scotland or, at the UK level, between receipts from NSND income versus other income sources;

[64] http://www.parliament.scot/parliamentarybusiness/report.aspx?r=11876&mode=pdf Col.15

- Real Time Information (RTI): Timely estimates of PAYE liabilities for Scotland and the UK, produced by HMRC but not yet publicly available on a high frequency basis;

- Outturn data: High-level final estimates of Scottish tax liabilities. Publicly available, but only around 15 months after the end of the tax year;

- Survey of Personal Incomes and its public use tape: a detailed sample of HMRC taxpayer records, available around 18 to 24 months following the end of the tax year. The OBR's UK and Scottish forecasts are based on the full survey of personal incomes individual-level taxpayer records. The SFC uses the anonymised public use tape (PUT), which is of near comparable □uality and timeliness.

107. HMRC publishes monthly data on all UK tax receipts, covering receipts up to and including the preceding month. This includes both PAYE and SA receipts for the whole of the UK. The OBR uses this data to adjust its forecasts. However, there is no breakdown for Scotland.

108. HMRC state in their response to the Committee's pre-budget report that they "provide the monthly, in-year, figure of total Scottish income tax PAYE liabilities to the Scottish Government" and that since "the vast majority of income tax receipts are paid via PAYE (only circa 16-17% is paid via Self-Assessment), such PAYE liabilities provide the best possible source of information from which to estimate Scottish tax receipts in-year." HMRC intend to publish this information in summer 2019.

109. **The Committee notes that the revised forecasts for income tax illustrate the extent of the potential risk to the Scottish Government's Budget. This risk is determined by two main factors. First, there is the actual strength of income tax growth in Scotland relative to the rest of the UK. Second, there is the extent to which the OBR and the SFC can accurately forecast this relative growth.**

110. **While the extent of this risk will not become clearer until the audited outturn figures are available[65] the Committee notes that there is some indication about the direction of travel from the revised forecasts and the in-year data which has been published for 2018-19 at a UK level. In particular, UK tax receipts have been unexpectedly strong in 2018 while the SFC's view is that "Scottish tax receipts have probably not been subject to the same rate of increase." The SFC suggest that there is some evidence that this is due to the disproportionate level of higher taxpayers in the rest of the UK relative to Scotland.**

[65] These are normally published around 15 months after the financial year has ended.

111. **At the same time the SFC have revised down their income tax forecasts since the December 2017 forecasts which informed Budget 2018-19. While the OBR have also revised down their forecasts for the rest of the UK since November 2017 the net position for income tax is a worsening of £461m for 2018-19.**

112. **The Committee recognises that these remain forecasts and therefore do not have a direct impact on the Budget. However, the in-year outturn data for income tax receipts at a UK level in 2018-19 does suggest that there is an increased risk which requires to be effectively managed by the Scottish Government.**

113. **The Committee, therefore, asks the Cabinet Secretary whether he has any concerns about the impact on Budget 2018-19 arising from the monthly, in-year figure of total Scottish income tax PAYE liabilities provided by HMRC, given the unexpectedly strong performance of income tax receipts in 2018 in the rest of the UK. The Committee reiterates our view that monthly in-year data should be published for Scottish income tax as soon as practicable to do so.**

114. **The Committee notes that the SFC's income tax forecasts for 2019-20 have been revised down by £183m since December 2017 as a result of minor downward revisions to forecast rates of earnings growth and employment rate growth. But as noted above it is not clear how much the BGA forecast has changed as a consequence of the OBR's upward revisions to its forecast rates of earnings growth and employment rate growth. The Committee will take forward the future provision of this information with HM Treasury.**

115. **The Committee also notes that despite slower earnings and employment rate growth in Scotland compared to the rest of the UK, Scottish income tax revenues are forecast to grow more than the adjustments to the block grant. The Committee invites the OBR and the SFC to provide their views on this seemingly contradictory position.**

## Income Tax Policy Costing

116. The SFC has a statutory requirement to estimate the revenue effects of Scottish Government tax policy change and has provided a policy costing of the Scottish Government's proposals to freeze the higher rate threshold at £43,430. This is because the SFC's baseline assumption is that the higher rate threshold would have increased with inflation and therefore the freeze raises additional revenue for the Scottish Government. The SFC forecasts of this additional revenue are shown in Table 19.

**Table 19: Income tax 2019-20 policy costing**

| £ million | 2019-20 | 2020-21 | 2021-22 | 2022-23 | 2023-24 |
|---|---|---|---|---|---|
| **Static costing** | 75 | 78 | 83 | 87 | 93 |
| **Behavioural change** | -6 | -7 | -7 | -8 | -8 |
| **Post-behavioural costing** | 68 | 71 | 75 | 80 | 84 |

**Source: SFC**. *Figures may not sum because of rounding*

.

## Number of Scottish Income Taxpayers

117. Tables 20 and 21 below show the SFC's December 2018 forecast for the number of additional and higher rate taxpayers in Scotland compared with previous forecasts.

**Table 20: Forecast Number of Additional Rate Taxpayers**

| | 2016-17 | 2017-18 | 2018-19 | 2019-20 | 2020-21 | 2021-22 | 2022-23 |
|---|---|---|---|---|---|---|---|
| **February 2018** | 16,700 | 17,800 | 18,900 | 20,300 | 21,800 | 23,500 | 25,300 |
| **May 2018** | 15,500 | 16,200 | 17,100 | 18,000 | 19,200 | 20,800 | 22,800 |
| **December 2018** | 13,300 | 14,000 | 14,900 | 15,800 | 17,000 | 18,400 | 20,100 |

**Table 21: Forecast Number of Higher Rate Taxpayers**

| | 2016-17 | 2017-18 | 2018-19 | 2019-20 | 2020-21 | 2021-22 | 2022-23 |
|---|---|---|---|---|---|---|---|
| **February 2018** | 309,700 | 332,900 | 349,900 | 355,700 | 366,200 | 380,900 | 392,900 |
| **May 2018** | 308,500 | 324,600 | 338,400 | 340,300 | 350,400 | 362,200 | 374,300 |
| **December 2018** | 294,000 | 310,400 | 308,400 | 351,200 | 362,000 | 373,100 | 385,100 |

118. The Committee examined the number of Scottish income tax payers as part of its pre-budget scrutiny. The Committee noted that HMRC's outturn figures for the number of additional rate and higher rate Scottish income tax payers were lower than the previous forecasts which were based on SPI data. Previous HMRC forecasts for income tax receipts assumed there to be 18,000 additional rate taxpayers and 337,000 higher rate taxpayers. The outturn data showed that there were in fact 13,300 additional rate and 294,000 higher rate taxpayers in 2016-17. This is shown in Table 22 below.

**Table 22: Number of Income Taxpayers, 2016-17**

| | Higher Rate | Additional Rate |
|---|---|---|
| **HMRC Forecast** | 337,000 | 18,000 |
| **HMRC Outturn Figure** | 294,000 | 13,300 |

119. The SFC were asked by the Committee how the change in the number of additional and higher rate tax payers in Scotland would impact on future forecasts. They responded that "we will be rebasing the forecasts and the number of taxpayers using the outturn data for 2016-17, which should give us a far better and more accurate forecast."

120. The SFC state that “over time, the total number of Scottish taxpayers is set to increase, primarily because of demographic changes. We estimate there will be an increase in the number of top, or additional, rate, taxpayers of around 34 per cent. This is mainly a result of fiscal drag. As earnings grow while the additional rate threshold is fixed at £150,000, the share of taxpayers expected to fall into this band increases rapidly over the forecast horizon.”[66]

121. The SFC told the Committee that “we have a tight labour market and the population is not projected to grow very much, so the growth in the number of taxpayers is a relatively small factor. The big driver is the increase in earnings and the fact that the top-rate threshold is frozen.”[67] The IFS explained that if “quite a number of people’s earnings are just below the threshold, even small earnings growth will push quite a few people over it.” They suggested that further information about the number of taxpayers that are just below the £150,000 threshold would be useful. The SFC pointed out that “we have a fairly good idea of the distribution of income among taxpayers in Scotland through the survey of personal income, and we can use that to fairly reliably project the shape of that distribution…quite a lot of people are sitting just below some of those thresholds.”[68]

122. The Committee asked the SFC why, given that the number of additional tax payers is rising significantly over the forecast, income tax revenues are rising relatively modestly. The SFC explained that this is because someone who moves from just below to just above the additional rate threshold pays relatively little additional tax.

123. The Committee also heard concerns from our witnesses about the two million adults in Scotland who do not pay income tax. The Scottish Human Rights Commission (SHRC) stated that this is a “huge and concerning number” while the Equality Budget Advisory Group (EBAG) told us that there are “significant challenges of having a low-wage or no-wage economy in Scotland.”[69] The SHRC suggested that if we are to address this issue of two million people who are not paying income tax “we need to look at our budget policy decisions.”[70]

124. CIPFA pointed out that the “issue is the nature of the jobs that you are bringing or that you are encouraging others to bring to the marketplace and ways of attracting higher-wage jobs…instead of there being just a focus on getting people into work.” The IFS pointed out that in 2004 the personal allowance was about £5,000, so “most of people’s earnings, even in low paid jobs, were being taxed” but

[66] http://www.fiscalcommission.scot/media/1196/scotlands-economic-fiscal-forecasts-publication.pdf paragraph A.8
[67] http://www.parliament.scot/parliamentarybusiness/report.aspx□r□11876□mode□pdf Col.5
[68] http://www.parliament.scot/parliamentarybusiness/report.aspx□r□11876□mode□pdf Col.8
[69] https://www.parliament.scot/parliamentarybusiness/report.aspx□r□11861□mode□pdf Col. 17
[70] www.parliament.scot/parliamentarybusiness/report.aspx□r□11861□mode□pdf Col.18

now that "the personal allowance is £12,500, a lot of lowish-paid people, which includes many migrant workers, are not paying as much tax."[71]

125. We also heard concerns about the gender balance of the income tax base. EBAG told us that "there are 300,000 fewer women taxpayers" and that "higher rate taxpayers comprise 91,000 women and 275,000 men."[72] EBAG's view is that "there continue to be all sorts of structural problems in the labour market and earnings that affect who is paying tax and at what level."[73]

126. The Cabinet Secretary was asked by the Committee what the Scottish Government is doing to attract new additional rate taxpayers into the Scottish economy. He responded that the Scottish Government "want to attract as many people as possible to come here to live, work and invest." To achieve that, he highlighted that the Scottish Government want a "more welcoming migration policy" and to grow "the sectors of the economy that ensure there are high-value jobs" through its economic strategy. He also emphasised the quality of the education system and quality of life as being attractive to all taxpayers. He added that he is mindful that the Scottish Government's tax policy should "not deter people from coming to live, work and invest in Scotland."

127. **The Committee invites the SFC to provide a breakdown of the forecast increase in tax revenues from the increased number of additional and higher rate taxpayers over the forecast period.**

128. **The Committee asks the Scottish Government to respond to the concerns of the SHRC and EBAG at paragraph 123 above. The Committee also asks the Scottish Government to provide details of how its priorities in Budget 2019/20 address the gender imbalance in the structure of higher rate taxpayers.**

## Behavioural responses

129. The SFC suggest that the growing gap between the higher rate threshold in Scotland and the rest of the UK has two distinct effects on taxpayers. First, in relation to the combined 53% rate of income tax and N.I.C. for those earning between £43,430 and £50,000, the SFC "expect that this higher marginal tax rate will start to affect taxpayer behaviour, for example decisions on how many hours to work."[74] They estimate that "that this effect will lead to a reduction in income tax in Scotland of £7 million in 2019-20."

---

[71] https://www.parliament.scot/parliamentarybusiness/report.aspx?r=11861&mode=pdf Col.23
[72] Ibid.
[73] https://www.parliament.scot/parliamentarybusiness/report.aspx?r=11861&mode=pdf Col.17-18
[74] http://www.fiscalcommission.scot/media/1435/scotlands-economic-and-fiscal-forecasts-december-2018-full-report.pdf paragraph 59

130. Second, given the growing difference in income tax liabilities for higher earners in Scotland and the UK, the SFC "expect this to start to have an effect on tax residency decisions."[75] This behaviour "includes both changes in migration and, for those individuals who already split their lives between Scotland and the rest of the UK, decisions about how to report their primary residence to HMRC."[76] The SFC expect "the latter category to account for most of the behaviour change in response to higher income tax in Scotland by higher and additional rate taxpayers" and that this "will lead to a reduction of income tax in Scotland of £6 million in 2019-20." [77] The SFC told us that "it is not necessary for very many people to decide to move from Scotland to the rest of the UK or to not move from rest of the UK to Scotland to have quite a big impact on revenues."[78]

131. As noted above the SFC also forecast a reduction of revenue of £6m in 2019-20 as a consequence of the forecast behavioural response to the Scottish Government's proposals to freeze the higher rate threshold at £43,430. The SFC's central estimate of the total effects of the behavioural response to income tax changes including those in previous budgets is a loss of revenues of £74m as shown in Table 23 below.

**Table 23: Effects of Behavioural Response**

| **Description of behaviour** | **High variant** | **Central estimate** | **Low variant** |
|---|---|---|---|
| 2017-18 Policy costing | -12 | -8 | -4 |
| 2018-19 Policy costing | -75 | -50 | -25 |
| 2019-20 Policy costing | -9 | -6 | -3 |
| Behavioural Response: UK Personal Allowance | 5 | 3 | 2 |
| Behavioural Response: UK £50k National Insurance | -11 | -7 | -4 |
| Behavioural Response: rUK/Scotland tax migration | -9 | -6 | -3 |
| Total change to liabilities | -111 | -74 | -37 |

Source: Scottish Fiscal Commission

132. The SFC told us that although it is important to consider behavioural effects "their magnitude is small." For example, the forecast £13m behavioural response to UK income tax policy changes in 2019-20 "is about 0.1 per cent of the £11.7 billion that is forecast for income tax revenue."[79]

133. In our report on Draft Budget 2018-19 the Committee asked what evidence it examined of behavioural responses to relatively small changes to marginal tax rates including a 1p change and how this informed its forecast. The SFC responded that it

[75] http://www.fiscalcommission.scot/media/1435/scotlands-economic-and-fiscal-forecasts-december-2018-full-report.pdf paragraph 61
[76] Ibid.
[77] Ibid.
[78] http://www.parliament.scot/parliamentarybusiness/report.aspx?r=11876&mode=pdf Col. 6
[79] http://www.parliament.scot/parliamentarybusiness/report.aspx?r=11876&mode=pdf Col.3

"uses evidence from HMRC, the OBR and the academic literature, based on analysis of historic tax changes, to model the impact of behavioural change. However, this provides a range of the scale of behavioural responses, and is not specific to Scotland."[80] The response also states that based "on this evidence and the judgement of the Commission, we use a broad-brush approach to model the impact of behavioural change. We cannot know with precision what the behavioural response will be to any particular policy change."[81]

134. The SFC subsequently published a report explaining how it forecast behavioural responses to income tax policies in March 2018[82]. It stated that there is strong international evidence that taxpayers do respond to changes in tax policy and that this impacts on tax revenues. The report outlined that behavioural change covered a wide range of responses of taxpayers to a change in taxes which may include:

- greater use of tax planning
- avoidance, artificially reducing one's tax liability, often through complex and convoluted but legal schemes
- evasion, which illegally reduces tax liabilities - for example, failing to declare income to HMRC
- economic responses, such as individuals choosing to seek a job or increase their hours worked
- migration, both into and out of Scotland.

135. The IFS explained that "we can think about behavioural responses as short term and long term." Short term responses include paying more of your earnings into pensions or reducing the number of hours you work while longer-term responses include migration. The IFS told us that we "need to acknowledge that people can avoid tax or reduce their tax liabilities without leaving Scotland."[83]

136. The CIT point out that there are fairly simple behavioural responses which taxpayers might undertake "such as paying additional pension contributions." For example, a taxpayer may be able to raise their pension contributions by enough to ensure that they do not pay any higher-rate tax. The CIT explain that "if you make pension contributions under the relief at source system, it effectively increases your basic-rate band and your intermediate-rate band by the gross amount of the pension contribution."[84]

137. The SHRC told us that "it is important when we are considering negative behavioural change that we also consider social attitude surveys on the issue, which are generally much more positive about people's impressions of increased tax,

---

[80] https://www.parliament.scot/S5_Finance/General%20Documents/Correspondence_-_Budget_18-19_-_180213_-_Response_to_Finance_Committee_R....pdf
[81] Ibid.
[82] http://www.fiscalcommission.scot/media/1223/how-we-forecast-behavioural-responses-to-income-tax-policy-march-2018.pdf
[83] http://www.parliament.scot/parliamentarybusiness/report.aspx?r=11861&mode=pdf Col.30
[84] http://www.parliament.scot/parliamentarybusiness/report.aspx?r=11861&mode=pdf Col.25

paying tax and the value of paying tax." The EBAG explained that the most recent Scottish social attitudes survey found that "47 per cent of the population think we should pay more and spend more and 46 per cent think that taxation should stay the same, with only 7 per cent saying that taxation should be cut."

138. The SHRC also pointed out that although "we might be paying marginally more tax in Scotland than people pay elsewhere in the UK, it is important to look at different costs of living in other parts of the UK compared with here."[85] However, the SFC pointed out that those factors have not changed and that the "only thing that has changed is the tax change, so that is what we look at when we factor in the behavioural effects."[86]

139. The Cabinet Secretary stated in his Ministerial Statement on the Budget that he "will ask our council of economic advisors to expand its analysis of the potential impact of behavioural effects on future revenues."[87]

140. **The Committee notes that the SFC's central estimate of a behavioural response to income tax policy changes in Scotland and income tax policy changes in Scotland relative to income tax policy changes in the rest of the UK is £74m from a total forecast of around £11.7 billion. The Fiscal Framework review should consider the options available to the Scottish Government to address behavioural responses to tax changes.**

## Tax-Motivated Incorporations

141. In our report on Draft Budget 2018-19 the Committee noted that the SFC stated that throughout the UK "there has been a steady rise in the proportion of people working for themselves, rather than as an employee."[88] Those who work for themselves may choose to be self-employed or have the option to incorporate and manage their business as directors of a limited company. This means that three people doing very similar work "can face differing tax treatment depending on their employment classification."[89]

142. Table 24 below shows the SFC forecast for the loss of NSND income tax revenues due to tax motivated incorporations compared to its December 2017 forecast published alongside Draft Budget 2018-19.

---

[85] https://www.parliament.scot/parliamentarybusiness/report.aspx?r=11861&mode=pdf Col. 24
[86] http://www.parliament.scot/parliamentarybusiness/report.aspx?r=11876&mode=pdf Col. 7
[87] https://www.parliament.scot/parliamentarybusiness/report.aspx?r=11842&mode=pdf Col.40
[88] http://www.fiscalcommission.scot/media/1196/scotlands-economic-fiscal-forecasts-publication.pdf paragraph 3.14
[89] Ibid.

**Table 24: Tax Motivated Incorporations (£m)**

| | 2017-18 | 2018-19 | 2019-20 | 2020-21 | 2021-22 |
|---|---|---|---|---|---|
| **Budget 2018-19** | -178 | -239 | -297 | -354 | -440 |
| **Budget 2019-20** | -39 | -100 | -157 | -221 | -315 |
| **Difference** | 139 | 139 | 140 | 123 | 125 |

143. The SFC note that the UK Government's reform to off-payroll working will reduce the reduce the scope for certain taxpayers in the private sector to 'incorporate' and move the majority of their liabilities away from NSND income tax. The SFC states that, while there is a high level of uncertainty about the impact of this policy change, "as it reduces the number of tax-motivated incorporations this leads to an increase in our NSND income tax forecast."[90]

144. The CIT explained to the Committee in oral evidence that a person can incorporate only if they are self-employed and the off-payroll measures being introduced will "limit the ability of certain types of self-employed people to incorporate and, in effect, change their income tax from being Scottish to being UK-based."[91]

145. In our report on Draft Budget 2018-19 the Committee asked the SFC to explain whether it believed that the number of incorporations in Scotland is likely to increase relative to the rest of the UK as a consequence of income tax policy changes. The SFC responded that higher "tax rates in Scotland may provide a slightly greater incentive to incorporate, but we believe this is captured in our overall approach to behavioural modelling."[92]

146. **The Committee notes that the SFC has substantially revised down its forecast for tax-motivated incorporations which increases its total income tax forecast. This raises the question of whether the OBR has also revised down its forecast for tax-motivated incorporations to the same extent which would result in zero impact on the net income tax position in the Budget. The Committee will invite the OBR to provide this information**.

## Reconciliation

147. 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. This creates a potentially substantial risk for the Scottish Government if the outturn figures deviate from the forecasts. In

[90] http://www.fiscalcommission.scot/media/1435/scotlands-economic-and-fiscal-forecasts-december-2018-full-report.pdf paragraph 3.29
[91] Finance and Constitution Committee, 19 December 2018, Official Report Col. 24.
[92] https://www.parliament.scot/S5_Finance/General%20Documents/Correspondence_-_Budget_18-19_-_180213_-_Response_to_Finance_Committee_R....pdf

particular, there is a risk to the public finances if the OBR forecasts which inform the BGA are below the outturn figures for income tax receipts in the rest of the UK and the SFC forecasts are above the outturn figures for income tax receipts in Scotland. This would mean that the size of the BGA would increase while the level of receipts would decrease. At the same time, if the OBR forecasts prove to be overly optimistic and the SFC forecasts prove to be overly pessimistic then this would benefit the sie of the Scottish Government's budget. This is because income tax receipts in Scotland would be higher while the adjustment to the block grant would be lower.

148. As noted in the Committee's pre-budget report a further risk for the Scottish Government in managing the size of the Scottish Budget is the lag between budget allocation based on forecast income tax receipts and the reconciliation process based on outturn figures. HMRC's audited outturn figures for income tax are not normally available until 15 months after the financial year. The SFC state that the "largest reconciliations in the next couple of years are expected to relate to income tax."

149. The first reconciliation for income tax will occur after the outturn data for 2017-18 become available in July 2019. Table 25 below shows the potential risk to the public finances if the updated forecasts are more accurate than the initial forecasts which informed the size of Budget 2017/18 and 2018/19.

### Table 25: Income Tax Reconciliations

| £ million | Liabilities | BGA | Difference | Forecast reconciliation |
|---|---|---|---|---|
| **2017-18 budget** | | | | |
| Forecasts used in budget | 11,857 | 11,750 | 107 | |
| Latest forecasts | 11,008 | 11,046 | -38 | -145 |
| **2018-19 budget** | | | | |
| Forecast used in budget | 12,177 | 11,749 | 428 | |
| Latest forecast of outturn | 11,452 | 11,495 | -43 | -472 |

Source: SFC

150. This shows that based on the latest forecasts for 2017-18, the reconciliation will result in an adjustment of minus £145 million to the Scottish Budget 2020-21 and based on the latest forecasts for 2018-19, the reconciliation will result in an adjustment of minus £472 million to the Scottish Budget 2021-22."[93]

151. As noted above, while these revised forecasts have no immediate impact on the size of Budget 2017/18 and Budget 2018/19 they do nonetheless emphasise the

[93] http://www.fiscalcommission.scot/media/1435/scotlands-economic-and-fiscal-forecasts-december-2018-full-report.pdf paragraph 45

extent of the potential risk. The Committee considers that this raises two fundamental questions in relation to the operation of the Fiscal Framework. First, as we discussed in our pre-budget report, whether there is scope to have a provisional reconciliation process in advance of the final reconciliation between the forecasts and outturn figures. Second, whether the borrowing powers to deal with forecast error are sufficient.

152. In our pre-budget report the Committee stated that careful consideration should be given to the possibility of a provisional reconciliation process but that should be dependent on detailed consideration of:

- the robustness of RTI data in comparison with outturn figures; and
- the extent of forecast error and the impact on the size of the Scottish Budget.

153. The Cabinet Secretary was asked by the Committee whether he would need to find £472m for Budget 2021-22 as a consequence of the reconciliation process. He responded that the “forecast numbers will inevitably change” and that the SFC’s recent forecast report “upgraded the outlook for economic growth.” He told the Committee that the Scottish Government “has produced balanced budgets and will continue to do so.” He added that “there should be room for further discussion with the UK Government about borrowing limits and caps.”

154. **The Fiscal Framework provides the Scottish Government with an annual limit of £300m resource borrowing powers to deal with forecast error in relation to devolved and assigned taxes and demand-led welfare expenditure. The Committee notes that, given the latest forecasts for income tax would result in a reconciliation of minus £472m to the Budget 2018-19, this highlights the issue of whether this annual limit is appropriate.**

155. **The Committee notes that the first reconciliation of outturn figures for income tax with forecasts will occur following the publication of the outturn figures for 2017-18 by HMRC in July 2019. Given the significance of this data for the Scottish Budget the Committee recommends that a separate Scottish income tax outturn document is published by HMRC. The Committee considers that, as a minimum, this document should contain—**

**• The Scottish NSND final outturn figure for 2017-18 (with 2016-17 restated);**
**• The rUK NSND final outturn figure for 2017-18 (with 2016-17 restated);**
**• The number of Scottish taxpayers by marginal tax rate for 2017-18 (with 2016-17 restated).**

156. **The Committee also recommends that the calculations which inform the reconciliation process are published by HM Treasury as soon as is practicable after HMRC publish the outturn data. The Committee believes that the**

**publication of this reconciliation document is essential in allowing effective parliamentary scrutiny and transparency and to ensure confidence in the operation of the Fiscal Framework.**

157. **The Committee intends to examine the impact of the reconciliation process on Budget 2017-18 after Summer recess. The Committee will take forward with HM Treasury the development of this information which will be necessary to ensure the effective scrutiny of the reconciliation process.**

# LAND AND BUILDINGS TRANSACTION TAX (LBTT)

158. The Scottish Government proposes to maintain the rates and bands for residential transactions at their current levels and proposes reducing the lower rate of non-residential LBTT from 3% to 1%. The Scottish Government also proposes increasing the upper rate from 4.5 to 5% and to reduce the starting threshold of the upper rate from £350,000 to £250,000. This is shown in Table 26 below.

**Table 26: LBTT Rates and Bands**

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

159. The Scottish Government also propose increasing the Additional Dwelling Supplement (ADS) from 3% to 4% of the total price for all relevant transactions above £40,000.

## Residential Transactions

160. Budget 2019/20 states that the Scottish Government's "policy priority for residential LBTT remains to help first-time buyers, and to assist people as they progress through the property market. Since its introduction, this policy has ensured that over 80 per cent of taxpayers benefit from LBTT by paying either no tax or less tax than in England."[94]

[94] https://www2.gov.scot/Publications/2018/12/9450 page 29

161. The SFC's forecasts for residential LBTT (excluding ADS) are set out in Table 25 below.

**Table 27: Residential LBTT forecasts (excluding ADS) (£m)**

| | 2017-18 | 2018-19 | 2019-20 | 2020-21 | 2021-22 | 2022-23 | 2023-24 |
|---|---|---|---|---|---|---|---|
| **Budget 2018-19** | 271 | 305 | 336 | 366 | 395 | 426 | |
| **Budget 2019-20** | 258 (outturn) | 267 | 296 | 324 | 349 | 373 | 398 |
| **Change** | -23 | -38 | -40 | -42 | -46 | -53 | |

## Additional Dwelling Supplement

162. The Scottish Government states that the proposed ADS increase "forms an important element of the Scottish Government's drive to protect opportunities for first-time buyers in Scotland, reinforcing the progressive approach in place for LBTT rates and bands."[95] The Committee has reported separately on this policy change as part of its scrutiny of the relevant subordinate legislation.

163. The SFC's forecasts for ADS revenues compared to its December 2017 forecasts at the time of Draft Budget 2018-19 are set out in Table 28 below.

**Table 28: ADS Revenue Forecasts (£m)**

| | 2017-18 | 2018-19 | 2019-20 | 2020-21 | 2021-22 | 2022-23 | 2023-24 |
|---|---|---|---|---|---|---|---|
| **Budget 2018-19** | 93 | 93 | 98 | 102 | 106 | 110 | |
| **Budget 2019-20** | 95 (outturn) | 94 | 122 | 123 | 127 | 130 | 134 |
| **Change** | 2 | 1 | 24 | 21 | 21 | 20 | |

164. The SFC forecast that increasing the rate of ADS from 3% to 4% will affect all 23,000 additional dwelling transactions in 2019-20 and increase ADS revenue by £27 million in 2019-20. In the absence of any behavioural response, the SFC forecast that the tax change would raise an estimated £35.3 million in net revenue.

## Non-Residential Transactions

165. Budget 2019-20 states that the proposed changes to the rates and bands for non-residential transactions mean that they "are the most competitive in the UK for all non-residential transactions."[96]

[95] https://www2.gov.scot/Publications/2018/12/9450 page 29-30
[96] https://www2.gov.scot/Publications/2018/12/9450 page 30

166. The SFC's forecasts for non-residential LBTT revenues compared to its December 2017 forecasts at the time of Draft Budget 2018-19 are set out in Table 27.

**Table 27: Non-Residential Revenue Forecasts (£m)**

| | 2017-18 | 2018-19 | 2019-20 | 2020-21 | 2021-22 | 2022-23 | 2023-24 |
|---|---|---|---|---|---|---|---|
| **Budget 2018-19** | 193 | 190 | 194 | 200 | 206 | 212 | |
| **Budget 2019-20** | 204 (outturn) | 208 | 226 | 233 | 240 | 247 | 255 |
| **Change** | 11 | 18 | 32 | 33 | 34 | 35 | |

## Block Grant Adjustment

167. The total forecast revenues for Budget 2019-20 compared to Budget 2018-19 are shown in Table 28 below

**Table 28: Total LBTT Revenue Forecasts (£m)**

| | 20117-8 | 2018-19 | 2019-20 | 2020-21 | 2021-22 | 2022-23 |
|---|---|---|---|---|---|---|
| **Budget 2018-19** | 557 | 588 | 628 | 668 | 707 | |
| **Budget 2019-20** | 557 (outturn) | 569 | 643 | 680 | 716 | 751 |
| **Change** | | -19 | 15 | 12 | 9 | |

168. The total forecast BGAs for LBTT for Budget 2019-20 compared to Budget 2018-19 are shown in Table 29 below.

**Table 29: Total BGA Forecasts (£m)**

| | 2017-18 | 2018-19 | 2019-20 | 2020-21 | 2021-22 | 2022-23 |
|---|---|---|---|---|---|---|
| **Budget 2018-19** | 591 | 600 | 622 | 650 | 682 | |
| **Budget 2019-20** | 584 | 546 | 567 | 596 | 632 | 667 |
| **Change** | -7 | -54 | -55 | -54 | -50 | |

169. The 'net tax' position for the 2019-20 Budget is calculated by subtracting the forecasts for the BGA from the forecasts for revenues and this is shown in Table 30.

**Table 30: Net LBTT (£m)**

| | 2017-18 | 2018-19 | 2019-20 | 2020-21 | 2021-22 | 2022-23 |
|---|---|---|---|---|---|---|
| **Budget 2018-19** | -34 | -12 | 6 | 18 | 25 | |
| **Budget 2019-20** | -27 | 23 | 76 | 84 | 84 | 84 |
| **Change** | 7 | 35 | 70 | 76 | 59 | |

170. This shows that based on the latest forecasts for 2019-20 there will be a net benefit to the Scottish Budget of £76m in 2019-20. The Committee's Adviser points out that there are now several tax policy differences between Scotland and rUK as well as different assumptions being made about price and transactions growth by

the SFC and OBR. However, it is very unclear to what extent the net tax position is determined by policy differences versus forecast differences in underlying determinants.

171. Table 31 below shows the OBR forecasts for residential price growth and transactions growth alongside the SFC's equivalent forecasts for Scotland. The OBR tends to forecast more rapid growth for the UK than the SFC forecasts for Scotland.

**Table 31: Assumptions for residential property price and transactions growth**

| | | 2017-18 | 2018-19 | 2019-20 | 2020-21 | 2021-22 | 2022-23 |
|---|---|---|---|---|---|---|---|
| **Price growth** | **OBR** | 4.5% | 3.1% | 3.2% | 3.1% | 3.3% | 3.6% |
| | **SFC** | 5.1% | 2.1 % | 1.9% | 2.1% | 2.1% | 2.1% |
| **Transactions growth** | **OBR** | | -1.7% | 2.0% | 2.8% | 2.8% | 2.8% |
| | **SFC** | | 3.7% | -0.7% | -1.7% | 1.1% | 1.0% |

172. The OBR's assumptions for non-residential transactions and price growth is shown in Table 32. However, our Adviser points out that the SFC has not published its equivalent assumptions for Scotland, so it remains unclear if the non-residential side is a source of the gap between revenues and the BGA.

**Table 32: OBR assumptions for the non-residential property market**

| | 2017-18 | 2018-19 | 2019-20 | 2020-21 | 2021-22 | 2022-23 |
|---|---|---|---|---|---|---|
| **Commercial property prices growth** | -7.0 | 3.0 | -1.4 | -0.7 | 1.8 | 1.8 |
| **Commercial property transactions growth** | -0.8 | -4.1 | 1.0 | 1.5 | 1.6 | 1.6 |

*Source: OBR Economic and Fiscal Outlook October 2018 (Table 4.1)*

173. **The Committee asks the OBR and the SFC to clarify why there is a forecast net benefit of £76m to Budget 2019-20 from LBTT when the underlying drivers of LBTT revenues (prices and transactions) do not appear to be forecast to grow more quickly in Scotland than in rUK. The Committee also asks the SFC to publish its assumptions for non-residential transactions and price growth.**

# SCOTLAND RESERVE

174. The Scotland Reserve is held within the UK Government's Exchequer and is separated between resource and capital. Financial transactions form part of the capital reserve. Under the rules of the Fiscal Framework, the Scottish Government can build up funds in the Scotland Reserve which can be drawn down as required. The government is able to build up reserves of £700m in aggregate. Payments into the resource reserve can be made from the resource budget (including tax receipts), and drawn down at a rate of up to £250m per year to fund resource or capital spending[97]. Payments into the capital reserve can be made from the capital budget and can be drawn down at a rate of up to £100m per year for capital spending only.

[97] See paragraphs 71 to 78 of the Fiscal Framework

175. The Committee considered the Scotland Reserve as part of its consideration of the Autumn Budget Revision. The Scottish Government provided details of the balance of the Reserve as shown in Table 33 below.

**Table 33: Scotland Reserve Balance**

| | £m |
|---|---|
| **Forecast Reserve balance brought forward from 201□-18 □ SBR** | **430.3** |
| **Barnett conse□uentials for Brexit (March 2018 Spring Statement)** | **37.4** |
| **Additional carry forward from 201□-18 Provisional Outturn** | **96.7** |
| **Total funding available for deployment** | **564.4** |
| **Already deployed in 2018-19 budgets** | **-334.6** |
| **Deployed at Autumn Budget Revision** | **-32.1** |
| **Available for future deployment** | **197.7** |

176. Table 34 below shows the closing balance for the Scotland Reserve for 2017-18 as provided by the Scottish Government to the SFC.

**Table 34: Scotland Reserve Closing Balance 2018-19**

| £ million | Resource | Capital | Financial transactions | Total |
|---|---|---|---|---|
| **2017-18 opening balance** | 74 | | | 74.0 |
| **2017-18 additions to the reserve** | 366 | 86.5 | 11.4 | 463.9 |
| **2017-18 closing balance** | 440 | 86.5 | 11.4 | 537.9 |

177. This shows that the closing balance for the Scotland Reserve for 2017-18 is £537.9m compared to an opening balance of £74m. It is not clear how this closing balance relates to the figures provided to the Committee in the ABR where the balance appears to be £564.4m. It is also not clear how the closing balance for the Scotland Reserve is communicated to the Scottish Parliament.

178. The planned use of the Scotland Reserve for 2018-19 and 2019-20 is shown in Table 35 below.

**Table 35: Planned use of Scotland Reserve (£m)**

| | Resource | Capital | Financial Transactions |
|---|---|---|---|
| **2017-18** | | | |
| **Closing balance** | 440 | 86.5 | 11.4 |
| **2018-19** | | | |
| **Planned use** | -250 | -85 | - |
| **Payments in** | N/A | N/A | N/A |
| **2019-20** | | | |
| **Planned use** | -220 | -46 | -47 |
| **Payments in** | N/A | N/A | N/A |

*Source: Committee Adviser Briefing*

179. The SFC note that the planned drawdown from the resource reserve in 2018-19 has increased from £238 million in May to £250 million which is the maximum allowed within the fiscal framework. The planned drawdown from the capital reserve has increased from £68m in May to a planned £85 million drawdown. In 2019/20 the Scottish Government plans to drawdown £220m of resource from the Scotland Reserve to support resource spending, £46m to support capital spending and £47m of financial transactions.

180. Our Adviser points out that the Scottish Government "is thus planning to drawdown more from the Reserve than is currently in the Reserve, although there will of course be additions from underspends in 2018/19 and 2019/20 which will add to the Reserve's balance." The SFC note that the Scottish Government has not provided information on the level of any underspend and, therefore, "it is not possible to estimate payments into the reserve or the closing balance for 2018-19 at this point."[98]

181. Our Adviser also points out that there appear to be some differences between the figures for the Reserve in Table A.01 in the Budget 2019/20 document and the figures for the Reserve provided by the SFC. Specifically, the Budget document identifies a drawdown from the Reserve of £234m for 2018-19 while the SFC reports a drawdown of £335m for the same period.

182. The Committee notes that the SFC has a statutory responsibility to assess the reasonableness of Ministers' projections of borrowing. To do so the protocol between the SFC and the Scottish Government states that 17 days in advance of the Budget, Ministers will provide "capital and resource borrowing plans, use of the Scotland Reserve and estimates of stock of debt."[99]

183. The Cabinet Secretary told the Committee that he "will give an update on the Scotland Reserve at the next appropriate time" and that "the situation remains fluid." He stated that "I want to have adequate reserves to meet any requirement that arises, for example as a result of forecast error" and that "if there was a request from this committee or elsewhere to have a strategy of building up reserves to a particular figure, that would essentially be a budget decision." He added "but putting more money into the reserves would take money away from day to day spending. That would be a political choice."

184. The Cabinet Secretary was asked by the Committee whether he has any additional money available which has not yet been allocated in the 2019/20 Budget and which he excepts to allocate through amendments to the Budget Bill. He responded that "I have fully allocated the resources that are at my disposal." He

---

[98] http://www.fiscalcommission.scot/media/1435/scotlands-economic-and-fiscal-forecasts-december-2018-full-report.pdf paragraph 5.46
[99] http://www.fiscalcommission.scot/media/1231/march-2018-protocol-for-engagement-between-the-scottish-fiscal-commission-and-the-scottish-government.pdf

was also asked whether there might be an underspend from the 2018/19 Budget which will be available to allocate in the 2019/20 Budget. He responded that the underspend is "factored into the budget as published."

185. **The Committee recommends that the Parliament needs to give thoughtful consideration in relation to both this Budget and future Budgets about whether it may be prudent to begin building up the Scotland Reserve to deal with potential forecast error and where this money should come from. For example, whether building up the Scotland Reserve should be a priority in allocating any underspends.**

186. **The Committee notes the Cabinet Secretary's view that this is a political choice and needs to be considered by the Parliament as part of the budget process.**

187. **The Committee asks why the Scottish Government has planned to use all of the available funds in the Scotland Reserve when the latest tax forecasts are now £400m lower for 2018-19.**

188. **The Committee asks the Scottish Government to provide details of the level of underspend from the 2018-19 Budget which has been factored into the 2019-20 Budget.**

189. **The Committee invites the Scottish Government to explain the apparent difference between the figures for the Scotland Reserve in the Autumn Budget Revision and in the 2019-20 Budget.**

190. **The Committee is unclear to what extent the SFC can make an assessment of the reasonableness of the Government's borrowing projections without some indication of the level of provisional underspends for 2018-19. The Committee asks the SFC whether it has requested that information from the Scottish Government and if not to explain how it has assessed the reasonableness of Ministers' borrowing projections without it.**

# NON-DOMESTIC RATES INCOME (NDRI)

191. The 2019-20 Budget states that new policies to be introduced include -

- a below-inflation increase in the domestic rates poundage;
- an enhanced 100 per cent fibre broadband relief for a 10-year period to 31 March 2029; and
- a continuation of the transitional relief cap which means that 2019-20 bills will rise by no more than 12.5 per cent in real terms.

192. The Scottish Government states that these new and existing policies taken together amount to "the most generous package of reliefs available in the United Kingdom, forecast to be worth a record £750 million in 2019-20, up from £732 million in 2018-19."[100] The SFC states that, in practice, this means "an eligible property will pay no more than a 53 per cent increase on their 2016-17 NDR bill in 2019-20 (compound of three 12.5 per cent caps and the measures of inflation used to uprate the poundage)."[101]

193. The SFC's forecasts for NDRI revenues over the next five years are set out in Table 36 below—

**Table 36 – SFC NDRI Revenue Forecasts**

| £m | 2018-19 | 2019-20 | 2020-21 | 2021-22 | 2022-23 |
|---|---|---|---|---|---|
| **Budget 2018-19** | 2,812 | 2,867 | 2,939 | 3,117 | 3,331 |
| **Budget 2019-20** | 2,827 | 2,785 | 2,887 | 3,087 | 3,295 |
| **Change** | 15 | -82 | -52 | -130 | -36 |

194. The Cabinet Secretary was asked for his view on the Scottish Retail Consortium's concern that the large business rates supplement remains twice that which applies in England which "makes it more expensive to operate on our high streets and retail destinations and raises the hurdle for attracting commercial investment." He responded that this view does not take into account non-domestic rates in their totality and that "the overall approach has been welcomed by business representative organisations." He added that the 2019/20 budget "will make sure that the vast majority of businesses – including all the medium-sized businesses in Scotland – are paying less tax than they would if they were south of the border."

195. The Cabinet Secretary also told the Committee that he will reduce the large business supplement when "resources allow it." When pressed on when this might be he responded that "I am not proposing to do it in this budget because I do not think that resources allow me to."

196. The Cabinet Secretary was also asked about "eye-watering and punitive increases in business rates across the hospitality sector in Glasgow." He responded that "I proposed a cap of 12.5 per cent so that we could limit the increase that hospitality businesses would endure from year to year." He also stated that assessors should engage with the hospitality sector on the methodology that they use while acknowledging that the decisions about methodology are a matter for the assessors and not the government.

[100] https://www2.gov.scot/Resource/0054/00544654.pdf page 33
[101] http://www.fiscalcommission.scot/media/1435/scotlands-economic-and-fiscal-forecasts-december-2018-full-report.pdf paragraph 3.69

197. **The Committee concurs with the Cabinet Secretary's view that the assessors should engage with the hospitality sector on the methodology which they use.**

# EU Funding

198. Scotland receives monies from a range of EU funds with the Common Agricultural Policy (CAP) and the Structural Funds being the principal sources of monies. During the 2014-2020 EU budget period, Scotland will receive €4.6bn to implement CAP and €941m in Structural Fund support.[102] Smaller sums of EU funding received by Scotland include Common Fisheries Policy Funding (€108m), Competitive research, innovation and education exchange funding (including €533m of Horizon 2020 funding, €65m of Erasmus+ funding and €58m of Territorial Cooperation funding). The European Investment Bank Group also provides finance outwith the MFF 2014-20 in the form of loans. Since 2016, the EIB has signed loans worth €2.0 billion to projects in Scotland.[103]

199. The UK Government has agreed to match CAP payments until 2020 while the agreement between the EU and the UK Government at Stage One of the Brexit negotiations provides for the "continued participation"[104] in current EU funding streams to the end of the 2020 budgetary period. In a post-Brexit environment, the extent to which the UK would continue to participate in EU funding streams or what would replace such funding streams remains to be agreed.

200. In its report on Draft Budget 2018-19 the Committee reiterated its intention to undertake further work on funding of competences currently provided for by the EU and recommended that "the Scottish and UK Government should begin work on agreeing replacement funding streams for all current EU funding sources as a matter of urgency." In its response[105], the Scottish Government welcomed the Committee's intention to undertake further work on this issue and stated that "it is crucial that repatriated powers transferred to the Scottish Parliament are accompanied by a sustainable funding package." The response further stated that the Scottish Government

[102] Scottish Government website – EU funding. Accessible at—
http://www.gov.scot/Topics/International/Europe/Benefits-EU-Membership/Funding European Commission, 2017
[103] https://sp-bpr-en-prod-cdnep.azureedge.net/published/2018/9/28/European-Union-funding-in-Scotland/SB%2018-61.pdf
[104] European Commission, 2017, 'Joint Report from the Negotiators of the European Union and the UK Government on Progress During Phase 1 of Negotiations Under Article 50 of the United Kingdom's Orderly Withdrawal From The European Union', p.9. Accessible at—
https://ec.europa.eu/commission/sites/beta-political/files/joint_report.

[105] https://www.parliament.scot/S5_Finance/General%20Documents/Cab_Sec_to_Fin_Comm_-_report_on_Draft_Budget_2018-19_-_20_Feb_18.pdf

"remains particularly concerned that successor arrangements to replace these EU funding programmes have yet to be proposed in sufficient or meaningful detail by the UK Government. The devolved administrations must be fully engaged in decision-making on the establishment of future funding arrangements rather than being regarded as 'consultees'."

201. Following publication of its report on Draft Budget 2018-19 the Committee issued a call for evidence seeking views on the public finances issues raised for the devolution settlement by the Brexit process, including potential mechanisms for funding those competences returning from the EU to the Scottish budget. The Committee then held an informative roundtable discussion with economists, academics and representatives of sectoral interests and organisations with experience of bidding for competitive EU funding in June 2018. Issues relating to EU funding have also been touched upon during the Committee's consideration of other subjects including the UK Trade Bill and proposals for UK common frameworks.

202. In its pre-budget report the Committee recommended "that there needs to be much greater transparency and consultation with the devolved institutions in developing and agreeing the successor arrangements for EU funding post-Brexit." In its response, the Scottish Government stated that it fully agreed with this recommendation but remained "concerned that the UK Government has given very little detail regarding successor arrangements to EU funding after the 2014-20 budget round." The Scottish Government was "clear that all lost EU funding should be replaced in full."

## Current Arrangements

203. There are currently two models for the distribution of EU funding—

- Pre-allocated funds (including funding pre-allocated to member states and regional pre-allocated funding); and
- Competitive funds that can be bid for by governments, universities, businesses and other organisations.

204. Pre-allocated funds include CAP funding and structural funds which according to the IFS, "are largely aimed at disadvantaged geographical or economic areas," whilst competitive funds include Horizon 2020 and Erasmus+. National and sub-national governments currently have significant autonomy in managing pre-allocated funds and to date, the implementation of areas of EU funding has tended to differ between Scotland and the rest of the UK.

205. Professor David Bell has noted that EU funding allocated to Scotland is equivalent to 2.8% of the current Scottish Government budget or around 1.2% of overall (Scottish and UK government) public expenditure in Scotland. This does not take account of match funding from governments or their agencies which amounts to around 40% over and above the original EU funding. He points out that Scotland

receives 14.8% of EU funds compared to its 8.2% share of the UK population whilst noting anomalies such as the fact that Scottish agricultural land comprises 33% of such land in the UK whilst it receives only 22.5% of Agricultural Guarantee Funds.

## CAP Funding

206. Professor Bell also highlights the importance of CAP payments to Scottish farmers, noting that average farm income in 2016-17 was £26,400 whilst the average subsidy was £41,000. Were such subsidies not in place, therefore, farms would have made an annual average loss of £14,900 (although payments are "very unequally distributed").

207. Whilst highlighting the importance of CAP funding, the NFUS notes that "leaving the EU presents the first opportunity in over 40 years to overhaul and rebalance Scottish agricultural policy." The NFUS suggests that HM Treasury should fund a UK-wide framework but that devolved administrations should have "the policy tools and levers to ensure agricultural policy works for all four parts of the UK." The NFUS is clear that a "Defra-centric, one-size-fits-all" approach "would not be acceptable."

208. The Committee heard a number of views on potential replacement models for the CAP, including whether a Barnett approach would be appropriate. In the NFUS' view, any move towards a Barnett approach "would almost immediately cause some sort of collapse, particularly in our red meat sector," putting Scotland "in a very difficult competitive position within the UK agricultural market, let alone within Europe." However, Professor Bell suggested that "Scottish farmers should not be terrified about the Barnett formula." In his view, "in the first instance, Scotland would probably get 16.3 per cent of the funding and Barnett would then apply only to the changes."

209. In oral evidence, the IFS pointed out the likelihood that "agriculture could, in effect, be a joint competence because it is a devolved policy measure that interacts with UK trade policy and needs to conform to certain UK-level rules for our trade agreements." The NFUS echoed this point, noting that "we are looking at having a commonly agreed regulatory framework that would be applied across it (the UK). It would cover all sorts of standards to protect intra-UK trade, as well as to enable the negotiation of trade deals outwith the UK and so on."

## Structural Funds

210. Structural funds support economic development across all EU countries and are intended to promote sustainable and inclusive growth. In Scotland, the structural funds are composed of two similar sized funds: the European Regional Development Fund (ERDF) and the European Social Fund (ESF). Structural funds are distributed to Member States according to an EU-wide formula based on

economic performance (GDP per person) in regions within Member States. The UK Government has proposed a new fund – the UK Shared Prosperity Fund – to replace structural funds, using money returned from the EU. As yet, no formal consultation on the Shared Prosperity Fund has been published.

211. The Committee heard a number of views on the merits of a "needs-based" approach to the replacement of structural funds and the potential impact on Scotland's budget settlement. The RSE considers it likely that the UK will wish to create a new UK wide programme to replace structural funds. Given "stark contrasts" across the UK, the RSE suggests that Scotland may not receive the same level of funding post-Brexit. The RSE is clear that any future arrangements must maintain the current devolution settlement.

212. Prof Gallagher noted that "historically Scotland has also done well out of the structural funds, e.g. in the Highlands and former industrial areas, but this is less true now, with Scotland as a whole one of the richer regions of the UK." He also notes that under the Scotland Act, economic development is not solely a devolved matter but exercisable by both governments.

213. In Professor Bell's view "the overall question is whether the UK Government should determine need with a global view across the UK economy" which would likely mean that "even more structural funds money would go to Wales and less would go to Scotland" given the differences in relative GDP.

214. CIPFA supports the view "that the UK Government should put in place funds for investment in the UK based on recognised measures of need that support identified and agreed objectives for the funding." However, it was clear that the devolved governments must be party to the agreement of the aims and objectives of the funds "through a strengthened and renewed role for the JMC." Once agreed such funds should be administered by the Scottish Government in line with the achievement of its own desired outcomes.

215. In oral evidence, the IFS highlighted the lack of clarity regarding "whether the shared prosperity fund will provide money from the UK Government to Scottish Government to set up authorities in Scotland or whether there will still be an element in which individual city regions, local authorities or groups of organisations in Scotland will bid direct to the UK Government." It further noted the impact that this might have on local government and its existing relationship with the Scottish Government, should such funding be centrally managed at a UK level.

## Other EU Funding

216. Prof McEwen and Dr Remond note that it is extremely difficult to get a comprehensive figure for EU spending on environment, energy and climate change in Scotland as it is incorporated into several funding streams. Such funding is often allocated on a competitive basis and if not maintained or replaced, could adversely

affect the Scottish Government's efforts to meet its climate change targets. Such funding generally requires national co-funding from public or private sources. Prof McEwen and Dr Remond also note that Scottish bids for such funds have been "particularly successful," attracting €296m from the Horizon 2020 programme for research and innovation. This represents 11% of the UK total and is euivalent to €55 per capita compared to €40 per capita across the UK.

217. In oral evidence, Professor Diamond explained that universities currently receive two types of block grant – one that can be used in any way they want, allowing "enormous leverage of other funds" and the other which must be audited to assess effectiveness in achieving designated goals (such as alleviating poverty in low-income countries). Professor Diamond expressed concern "that we could end up with all kinds of relatively small pots that must be used in particular ways" creating challenges in managing university budgets.

218. Professor Diamond pointed out that the Prime Minister had been clear that the UK Government wished to remain part of the European research funding stream. However, in the event that Scottish universities do not have access to European funds, he expressed the hope that there would be an increase in UK research funding.

219. Diane Milne of the East of Scotland European Consortium highlighted the importance of match funding, often a requirement for the release of LEADER funds to deliver projects (an EU funded rural grant programme designed to support rural development projects initiated at the local level in order to revitalise rural areas and create jobs), stating "We can be given all the money in the world, but if we do not have any match funding—if that is a requirement for delivering projects—we cannot deliver anything." She went on to state that the timing of any replacement funding was critical, whether direct from the UK Government or distributed through the Scottish Government. In her view "that work is not being developed quickly enough. We have only until 2020 to identify what our future will be like."

220. **The Committee intends to examine what will replace EU funding following Brexit as part our year-round budget scrutiny with a view to reporting in our pre-budget report in the Autumn.**

# VAT

221. The Scotland Act 2016 provided for the first 10 pence of the Standard Rate of Value Added Tax (VAT), and the first 2.5 pence of the Reduced Rate, to be assigned to the Scottish Government.

222. The Fiscal Framework set out that VAT assignment will be implemented in 2019-20. There will be a one-year transitional period during which VAT assignment will be

forecast and calculated, but with no impact on the Scottish Government's budget. From 2020-21 the Scottish Government's budget will in part be determined by forecast and final estimated VAT receipts in Scotland.

223. The assignment of VAT will be based on a methodology that will estimate expenditure in Scotland on goods and services that are liable for VAT. The draft model for calculating Scottish VAT receipts[106] was published on 22 November 2018 and is expected to be finalised by the Joint Exchequer Committee in spring 2019.

## Forecasts

224. On the 12 December 2018, the Scottish Fiscal Commission (SFC) published its first full VAT forecast in the Economic and Fiscal Forecasts publication[107], which accompanied the 2019-20 Scottish budget. The forecasts for VAT receipts assigned to Scotland are set out in the table below.

**Table 3: VAT receipts assigned to Scotland – outturn and forecast**

| **£ million** | 2016-17 Outturn | 2017-18 | 2018-19 | 2019-20 | 2020-21 | 2021-22 | 2022-23 | 2023-24 |
|---|---|---|---|---|---|---|---|---|
| | 5,033 | 5,383 | 5,631 | 5,801 | 5,966 | 6,122 | 6,279 | 6,434 |

*Source: Scottish Fiscal Commission, HM Treasury, HMRC and Scottish Government*

225. The forecasts are based on the concept of a VAT total theoretical liability which is the total value of VAT that could theoretically be collected from the tax base across various sectors. Household expenditure accounts for the majority (around 70%) of VAT revenue assigned to Scotland. The report outlines the variability in the assignment outturn model.

226. It states that a boost funded by the Scottish Government and HMRC to double the living costs and food survey sample which is used for assigning household expenditure liable to VAT, to 600-700 households *'is still a reasonably small sample'.*

227. In addition to sample size, the report states that actual Scottish consumption is a source of volatility as patterns may change from year to year. It states[108]—

> "Sample size is not the only source of volatility. Actual Scottish consumption patterns, including spending patterns and disposable income, may change from one year to the next. It will not be possible to determine how much volatility is because of actual consumption patterns and how much is because of sample

[106] https://www.gov.uk/government/publications/scottish-vat-assignment-summary-of-vat-assignment-model
[107] http://www.fiscalcommission.scot/media/1435/scotlands-economic-and-fiscal-forecasts-december-2018-full-report.pdf page 137
[108] http://www.fiscalcommission.scot/media/1435/scotlands-economic-and-fiscal-forecasts-december-2018-full-report.pdf page 146

size. This variability will affect both the baseline for our forecast and our forecast evaluation."

228. The Committee's Adviser raised questions regarding the level of accuracy of the assignment model and questioned the fact that the model calculates the Scottish share of central government expenditure using labour market data and not public spending data. In addition, he highlighted the lack of data in relation to VAT exempt businesses and the appropriateness of the approach used to calculate the Scottish share of VAT in the UK exempt sector[109].

## Volatility

229. During our pre- budget scrutiny, the Committee explored the methodology being used to forecast VAT assignment and how robust it was. The Committee was told that the Cabinet Secretary continued to have concerns that the assignment of VAT to Scotland will be based on a statistical model rather than actual outturn VAT receipt data.

230. The Committee concluded that basing VAT assignments for Scotland on estimated figures could introduce further volatility into Scotland's finances and recommended that both Governments should continue to review the methodology used for assigning VAT to Scotland during the implementation year to ensure its robustness and reduce the risk of introducing yet further volatility into the Scottish budget.

231. In its response to the pre-budget report,[110] the Scottish Government said that the survey data that underpins elements of the methodology is being boosted to improve the reliability and stability of the data and that it will continue to monitor the methodology during the VAT assignment transitional period.

232. **The Committee notes that basing VAT assignments for Scotland on estimated figures could potentially introduce further volatility into Scotland's public finances. The Committee asks the Scottish Government to keep the Committee updated on the development of the methodology used for assigning VAT to Scotland in advance of it being finalised by the Joint Exchequer Committee in spring 2019.**

# AIR DEPARTURE TAX

233. Air Departure Tax (ADT) was devolved by the Scotland Act 2016, and the Scottish Government introduced the Air Departure Tax (Scotland) Bill in December

[109] Insert when online
[110] https://www.scottish.parliament.uk/S5 Finance/Reports/Letter from Cabinet Secretary for Finance Economy and Fair Work response to FCC pre-Budget scrutiny report.pdf

2016 to make provision for ADT to be charged on the carriage of chargeable passengers on chargeable aircraft by air from airports in Scotland.

234. The Committee was lead committee on scrutiny of the Bill which received Royal Assent in July 2018[111] with the introduction of this tax planned for April 2018. An exemption from Air Passenger Duty (APD) for flights from the Highlands and Islands (H&I) has been in place since 2001 and transferring the exemption to the new ADT requires notification to and assessment by the European Commission under State Aid rules, in compliance with EU law.

235. The UK and the Scottish Government decided to delay the introduction of ADT because discussions about a possible tax exemption for flights from H&I airports had not been resolved.

236. The Committee has been kept updated on the expected introduction of ADT and took evidence on this issue from the Chief Secretary to the Treasury and the Cabinet Secretary as part of its pre-budget scrutiny. During this scrutiny, the Committee heard that the Treasury said they would only notify the European Commission formally for a Highlands and Islands exemption for ADT if the Scottish Government agreed to accept full liability for all risks, both historical and future, including the potential for knock-on effects on Highlands and Islands business. The Cabinet Secretary told us that these "conditions are clearly unacceptable and not something I can agree to."

237. In its pre-budget report published in November 2018[112], the Committee concluded that it was imperative that both Governments continue to work together more closely to develop options for devolving ADT and delivering an exemption for Highlands and Islands passengers at the earliest opportunity. The Committee also requested further information on the Highlands and Islands working group and to be kept updated on this issue.

238. The Scottish Government confirmed in its response to the pre-budget report[113] that it was continuing to work with the UK Government to seek a solution to this issue and that it would update the Committee on the outcomes of the working group's findings once completed. Budget 19-20[114] confirmed that the position remains the same—

> "The Scottish Government has been clear that a resolution to the Highlands and Islands exemption issue must be found before ADT can be introduced in Scotland, to ensure that devolved powers are not compromised. The Scottish Government continues to work closely with the UK Government, and with the new Highlands and Islands ADT Working Group, to seek a solution. The UK

[111] http://www.legislation.gov.uk/asp/2017/2/contents/enacted
[112] http://www.scottish.parliament.uk/S5-Finance/Reports/report.pdf
[113] https://www.scottish.parliament.uk/S5-Finance/Reports/Letter-from-Cabinet-Secretary-for-Finance-Economy-and-Fair-Work-response-to-FCC-pre-Budget-scrutiny-report.pdf
[114] https://www.gov.scot/publications/scottish-budget-2019-20/ page 35

Government will maintain the application of Air Passenger Duty in Scotland in the interim."

239. **The Committee notes the difficulties surrounding the introduction of ADT in Scotland and requests that the Scottish Government keeps the Committee updated on progress in seeking a solution with the UK Government.**

# SCOTTISH PARLIAMENT CORPORATE BODY (SPCB)

240. 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 (termed 'Officeholders') which fall within the definition of SPCB supported bodies.

241. The SPCB budget[115] was submitted to the Committee on 5 December 2018 and the Committee took oral evidence on it at its meeting on 12 December 2018[116].

242. The SPCB identified a total budget requirement, including capital charges and non-cash items, of £102.9m for 2019-20. Excluding capital charges and non-cash items, the SPCB 2019-20 budget submission for revenue and capital expenditure is £90.4m. This represents a £0.6m (0.7%) increase, in cash terms, on the 2018-19 budget and matches the indicative forecast for the 2019-20 SPCB budget provided to the Committee last year.

243. The Presiding Officer, in a letter to the Committee[117], attributed the net increase in the budget submission as being the result of inflation, offset by the one-off Officeholder relocation contingency in 2018-19 of £1.75m. If this one-off cost is excluded, the 2019-20 budget is £2.3m (2.7%) higher than the equivalent current year budget.

---

[115] https://www.scottish.parliament.uk/S5-Finance/Meeting%20Papers/12th-Dec.-18-Meeting-Pack-(Public).pdf
[116] http://www.parliament.scot/parliamentarybusiness/report.aspx?r=11848 Finance and Constitution Committee Official Report 12 December 2018
[117] Correspondence from the Presiding Officer, SPCB Budget Submission 2019-20, p.2: Available at: https://www.scottish.parliament.uk/S5-Finance/Meeting%20Papers/12th-Dec.-18-Meeting-Pack-(Public).pdf

## Scottish Parliament

244. Last year in its report on the Draft Budget 2018-19[118], the Committee noted that the powers of the Scottish Parliament will further increase following Brexit and recommended that the main priority for any additional posts should be to ensure that the Scottish Parliament can fulfil its scrutiny role in relation to constitutional change and Brexit.

245. The SPCB, in its response[119] to the report recognised the priority of fulfilling the Parliament's scrutiny role in relation to constitutional change and Brexit and said it would ensure that this area of work is kept under review when setting budgets for future years.

246. In the letter from the Presiding Officer on this year's SPCB budget submission, it states that:

> "Uncertainty remains around the Brexit process and the parliamentary impact. However, the steps which the SPCB took last year to ensure that we have the right level of skills and support available to Members provide a stable platform to cope with the emerging legislative and scrutiny demands."

247. During evidence, the Committee explored how confident the SPCB was that the right level of skills and support continued to be appropriate in relation to constitutional change and Brexit. Jackson Carlaw MSP told us that there was a 27 percent increase in the amount of committee time and a 9 percent increase in chamber time over the previous year and committee meetings are up by 22 percent. To cope with this increased workload, Sir Paul Grice said[120]—

> "Compared with the same point in the previous session, there has been a 19 per cent increase in the amount of committee time and a 5 per cent increase in the amount of chamber time and, in general, committee meetings are up by 17 per cent."

248. **The Committee notes the ongoing uncertainty in relation to Brexit and recommends that the SPCB continues to review the resources available to members.**

## Officeholders: Ombudsman and Commissioners

249. Schedule 3 of the SPCB's submission outlines the Officeholders budget—

> "The Officeholders' 2019-20 budget submissions total £9.9m. The officeholders' 2018-19 budget submission, totalling £11.6m, included a one-off contingency of £1.75m for the office co-locations taking place in 2018-19. Excluding this one-off

[118] https://www.scottish.parliament.uk/S5□Finance/Reports/Report□on□Draft□Budget□2018-19.pdf
[119] https://www.scottish.parliament.uk/S5□Finance/General%20Documents/20180406SPCB.pdf

[120] Finance and Constitution Committee Official Report 12 December 2018. Col 4

> cost in 2018-19, the Officeholders' proposed budget submissions for 2019-20 have increased by £103k (1.0%) and are within the previously advised indicative forecast."

250. During evidence, Jackson Carlaw MSP confirmed that two offices have now relocated with the third office expected to relocate in January 2019. He told the Committee[121]—

> "we can confirm that there will be rental savings in the order of £0.5 million over a 10-year period. As a result of co-location, we anticipate that further savings and efficiencies will be achieved in the future through the shared services agenda."

251. **The Committee requests that the SPCB provides an update in the next SPCB Budget on any potential efficiencies and savings realised through the shared services agenda.**

# CONCLUSION

252. **The Committee has previously emphasised the increasing volatility, uncertainty and upside and downside risks arising from the way which the Fiscal Framework works and in particular the reliance on forecasts for the annual budget. The evidence we have considered in relation to Budget 2019-20 reinforces this view. In particular, there has been substantial movement in the forecasts which inform a large part of the budget. While these forecasts are likely to move again there is also some evidence from in-year income tax receipts for 2018-19 of stronger UK growth relative to Scotland.**

253. **This reinforces the Committee's view of the need to closely monitor in-year income tax receipts rather than awaiting the outturn figures which are not published until 15 months after each financial year has ended. It also means that the Parliament as a whole needs to consider what its priorities are regarding how these risks should be addressed.**

254. **The Committee also notes that these risks are exacerbated by the continuing uncertainty around Brexit which both the SFC and OBR have highlighted as having a negative impact on business investment and economic growth. As stated above, the Committee is strongly of the view that a no-deal Brexit would be damaging to the Scottish economy and public finances and therefore is clearly not in the national interest.**

[121] Finance and Constitution Committee Official Report 12 December 2018. Col 3