Written response to additional questions from the Social Justice and Social Security Committee – 17 March 2022

David Phillips, Institute of Fiscal Studies

1. **How is it possible to plan for 6 years ahead given the current levels of economic and price volatility?**

First, I would agree that it is difficult to project forward both funding and spending pressures over the period to 2026-27. Inflation has rapidly increased and its future path is particularly uncertain now given that will depend on both geopolitical factors and their impact on energy and food prices in particular, and it is unclear the extent to which it will affect long-term inflation expectations and hence future price-setting and wage bargaining. But there are many other uncertainties at the moment too. This includes:

- The medium-to-longer term effects of the COVID-19 pandemic on demand and costs for a range of public services, not just healthcare.
- The difficulties in forecasting the costs of rolling out new social security benefits with new approaches to implementing eligibility assessments by an organisation that aims for a different culture.
- And, of course, uncertainty about how the UK government – whose decisions still are the main factor determining the Scottish Government's funding envelope – will respond to various developments and update its own plans.

Bearing this in mind, I still think there is value in multi-year planning. Policy decisions typically don't just affect spending or revenues in the year ahead – they affect them for years to come. Policies that are affordable in the broader budget context in the short term may be much more difficult to fund in the longer term if their costs grow over time (like a policy on how to index social security benefits such as the 'triple lock' used for pensions), or if other spending pressures are growing. Spending Reviews and the MTFS are the vehicles to assess these sorts of issues and make policy accordingly given the best evidence currently available – knowing that the future is uncertain, and perhaps more so now than in future.

I think that uncertainty means its vital not to think of the projections or spending plans in the MTFS or Spending Review as fixed – they will have to be adapted over time. And one response to uncertainty is to keep more funding in reserve as a contingency that can be allocated down the line to particular pressure points or there is greater certainty about the fiscal situation. That is an approach the UK government took in its Spending Review.

The last point I would make is that the plans for 2025-26 and 2026-27 will be necessarily even more tentative than those for the period to 2024-25, as they are beyond the area covered by the UK government's spending review and funding allocations.

2. **What would you expect to see in the Spending Review to meet the child poverty targets?**

I will focus my answer to this question not on the type of policies I would expect to see but the type of analysis I would expect to see in documents published or updated alongside the Spending Review (such as a Child Poverty strategy).

First, I would say for policies in the tax and social security sphere which "microsimulation models" provide a pretty good basis for modelling the effects of policy on child poverty, I would expect such modelling to be included. It may also be possible to use evidence of the effects of policies (e.g. on childcare or welfare-to-work schemes) on employment or earnings to incorporate changes in household's pre-tax and-benefit incomes into such modelling – although here I'd say the uncertainties are greater, and evidence from different schemes is very mixed, suggesting the precise implementation of policy is likely to matter a lot. Colleagues have told me, for example, that expansions of childcare provision tend to have more modest effects on parental employment than one might expect and bigger longer-term impacts may come from effects on child development, which depend very much on quality and setting and are harder to predict.

That brings me to the policies that are expected to contribute to reductions in child poverty and improvements in social mobility, but which can't be mapped directly to changes in income. For these I wouldn't expect to see quantitative modelling of the impacts on child poverty. But I would expect to see the mechanisms set out clearly and a review of the evidence on how related policies have affected child poverty and broader outcomes either in the UK or other similar countries. I don't think you'd want to include much of this in the Spending Review document itself but it should inform Spending Review decisions and should be published in a separate strategy document.

3. **How can the Scottish Government monitor and evaluate the effects on public spending, including savings to other budgets, from policies to reduce child poverty?**

This is a very difficult thing to do. As I mentioned in oral evidence, the main challenge is defining the counterfactual – what would have happened in the absence of the policy. It is much easier to do this if there is a group of people that is not affected by the policy change but which is otherwise similar to the group that is affected, as their behaviour and outcomes can provide that counterfactual. We call this the "control group".

Sometimes that is possible – especially if a programme is being trialled before being rolled out. Trials can be very useful when you're uncertain about the impact of a policy but unless you're willing to wait years and years they typically only look at short-term outcomes.

Sometimes the roll out of a policy provides natural "control" groups. Perhaps its being rolled out in some places before others. Perhaps its affecting some cohorts of children before others as it is rolled out by age? That might provide a way to evaluate early impacts for the Scottish child payment for example.

But in many cases I don't think it will be possible to fully credibly identify the effects of policies on broader outcomes and hence savings to other budgets. In that case reviewing existing evidence from elsewhere (e.g. where a similar policy was trialled before being rolled out) and a simpler before-after or qualitative appraisal of the impact of policy (which is less robust than the treatment/control type analysis) may be the best that can be done.

4. **Does having a hybrid reserved and devolved social security system make financial sense? And can we ever protect the social security budget from risks effectively while we're so intrinsically tied to UK government policy decisions?**

I think its important to distinguish between two questions here and not to elide them.

a. What are the pros and cons of having some benefits reserved and some devolved?
b. What are the pros and cons of different ways of funding Scottish social security spending, and indeed, the Scottish Government more generally.

Where you land on both questions will reflect your views on the big constitutional question about Scotland's position in the UK – but also the pros and cons.

On question (a), broadly speaking, the potential drawbacks of such an approach include:

- Less flexibility over the design and generosity of reserved benefits – although not no flexibility given powers to top up reserved benefits.
- Weaker financial incentives for the Scottish Government to take actions that could help reduce reserved benefit spending – e.g. by improving employment and earnings opportunities, increasing housing affordability, etc.
- Potential mismatches where benefits interact – e.g. if eligibility for a Scottish benefit is used to passport people on to a UK benefit or vice versa – and complexity for Scottish residents dealing with two benefits agencies.
- Potential missed opportunities to integrate reserved social security spend with public services, although disability benefits were chosen for devolution as it was felt this was where the biggest opportunities for a more integrated approach were.

The potential benefits of such an approach are:

- Less exposure of the Scottish Government's to the more cyclically volatile means-tested benefits like Universal Credit and JSA.
- Less exposure of the Scottish Government's budget to the main age-related benefits, which may be useful given the more pronounced ageing of the Scottish population.
- Reduced administration costs given the potential economies of scale in implementing many benefits across the whole of the UK.
- No need to be worried about how the contributory elements of the system, including the State Pension, work for people who move between different parts of the UK.

- From a UK-wide perspective, less distortion to people's behaviour and economic activity across places solely due to differences in policy across places.

Whether or not social security remains partially or was fully devolved isn't the key issue for the link between UK government social security spending and Scottish Government funding. That's really about how the Scottish Government is funded and the fiscal framework associated with it.

As I mentioned in the oral evidence session, I think it would make sense to provide enhanced reserve and borrowing powers to better address forecast error, volatility and policy changes elsewhere in the UK. I don't think powers should be unlimited – there is a fairness issue at stake if Scotland effectively benefits from a much larger than population share of UK wide borrowing by the UK government and is then allowed to borrow unlimited amounts on top of that. But they should be more generous than now.

But under the current way the Scottish Government is funded the amount provided to the Scottish Government to pay for social security benefits has to be linked in some way to changes in what is spent on social security in the rest of the UK. That's true whether social security is partially or fully devolved.

To see this, consider what happens if the UK government decides to increase the generosity of a UK social security benefit. That either means: higher borrowing, which all people in the UK including Scots contribute to; higher taxes, again which in most cases Scots would also contribute to; or lower spending on other areas, again meaning less money flowing to Scotland. If you didn't link the funding for Scottish social security benefits to UK government spending, Scotland would be helping pay for the costs of this policy without getting its share of the revenues. I'm sure everyone would agree that would be unfair. The flip-side of course, is that if the UK government cuts spending on UK social security benefits the amount it provides to the Scottish Government for social security benefits is reduced too. Otherwise Scotland would still have as much money coming in via the social security element of the block grant as before, and would also be benefitting from lower debt servicing costs, lower taxes or higher spending elsewhere. That would be unfair too.

And its important to note in both cases, devolution gives the Scottish Government the flexibility to shift funding between social security and other budgets, and vary some types of tax – so its not just the social security block grant funding that can be spent on social security. So if social security spending is changed elsewhere in the UK, the Scottish Government doesn't have to change social security spending in Scotland – it could change other spending or taxes instead.

Its important to note that this isn't the only funding model available for the Scottish Government. You could break the link between the Scottish Government's budget and decisions by the UK government if Scotland were to move to a model of "full fiscal autonomy", or of course if Scotland were independent.

Both would mean that the Scottish Government would initially receive all Scottish tax revenues and be responsible for all Scottish Government spending – which under “full fiscal autonomy” would mean a contribution to things like defence, foreign affairs and the existing debt stock almost certainly done at a UK-wide level, and under independence, taking on those responsibilities itself.

This would mean if taxes or spending in the rest of the UK were changed it wouldn’t directly affect the Scottish Government’s budget for social security or anything. But rather than taxes and social security being devolved on the basis of “no detriment” at the point of devolution, under these fiscal systems the Scottish Government would become responsible for the gap between Scottish tax revenues and public spending in and for Scotland. That gap is presently very large – much larger per person than for the UK as a whole. Presently the UK government is responsible for that gap and its just subsumed within the wider UK budget deficit. “Full Fiscal Autonomy” or independence would make the Scottish Government responsible for its large budget deficit, necessitating tax rises or spending cuts. I discuss this in a recent article for the Economics Observatory (https://www.economicsobservatory.com/what-might-the-public-finances-of-an-independent-scotland-look-like).

There are approaches in between the current model, and the “Full Fiscal Autonomy” model which would still provide for some redistribution across the UK while removing the link between decisions on social security benefits in the rest of the UK and the Scottish Government’s budget. But they would involve fundamental reform of the rest of the UK – separating the UK government and “English” (or English regional) budgets and tax system. Such a ‘federal’ UK is favoured by some and would be an option but obviously requires reforms to the fiscal and constitutional architecture of the whole of the UK, not just Scotland.