

Timing of the Draft Scottish Budget 2017/18

Introduction

The Draft Scottish Budget is presented to parliament in September, allowing adequate time for parliamentary scrutiny before the start of the financial year.

The Cabinet Secretary for Finance and the Constitution wrote to the Convener on 23 June 2016 requesting that the Committee consider agreeing that the Draft Budget 2017-18 be published after the UK Government's Autumn Statement, i.e. in late November or early December. He suggests that moving "the publication date beyond the Autumn Statement would be the most effective way of managing the risks and volatility presented by the relationship between the Autumn Statement, related OBR forecasts and the Scottish Budget."

This note assesses the arguments put forward by the Cabinet Secretary for delaying the presentation of the Draft Budget 2017/18¹. Issues around the timing of the Draft Budget in future years will be considered as part of the tri-partite Budget Review Process working group which the Committee has agreed to establish. The Budget Review Process working group is expected to report prior to the 2017 summer recess.

The existing and proposed timetable

The Cabinet Secretary proposes publishing Draft Budget 2017-18 after the Autumn Statement. This would have a significant impact on the timetable for budget scrutiny but is not without precedent. The Draft Budget 2016-17 was not published until 16 December 2015 following the publication of the UK Spending Review on 25 November 2015. Table 1 below provides a comparison of the timetable for Draft Budget 2014-15 which was published in September 2013 with the timetable for last year.

Table 1: comparison of Budget timetable, 2014/15 and 2016/17

	Draft Budget 14-15	Draft Budget 2016-17
Draft Budget Published	11 September 2013	16 December 2015
Subject Committees Report to Finance Committee	15 November	15 January
Finance Committee Consideration of Draft Report	27 November and 4 December	27 January
Finance Committee Report Published	9 December	29 January
Chamber Debate on Draft	19 December	Same time as the Stage 1

¹ The letter is dated June 23, i.e. before the UK's vote to leave the EU. Although the referendum outcome may increase uncertainty surrounding forecasts of tax receipts and government spending, it does not change any of the fundamental timing issues outlined in the Cabinet Secretary's letter.

Budget Report		debate
Budget Bill Published	16 January	28 January
Stage 1	22 January	3 February
Stage 2	29 January	10 February
Stage 3	5 February	24 February

The main impact of Draft Budget 2016/17 being published just before Christmas recess is on the amount of time both the Finance Committee and subject committees have to take evidence. Most subject committees could only have one oral evidence session post-publication in the w/b 4 January and then agree a report the following week so as to be able to report to the Finance Committee by 15 January.

A number of the subject committees raised concerns in relation to the truncated timetable for the scrutiny of Draft Budget 2016-17. For example, the Economy, Energy and Tourism Committee stated that it “a source of frustration to the Committee that the timeframe precluded us from fully examining the effect of the Draft Budget in relation to economy, energy and tourism.” The Rural Affairs, Climate Change and Environment Committee stated that the timetable “greatly squeezed the time available to committees in the Scottish Parliament to scrutinise relevant aspects of the draft budget and report any views to the Finance Committee.”

The arguments for delaying the Draft Budget

The letter from the Cabinet Secretary asserts that the implementation of the Scotland Act 2016 powers introduces greater risk and uncertainty to the Scottish Budget. He argues that the publication of the Draft Budget should be delayed until after the UK Government’s Autumn Statement in order to take advantage of the latest revenue forecasts and outturn data (access to the latest outturn data is important to the extent that it informs subsequent forecasts).

The Cabinet Secretary’s letter states:

“Two particularly important factors are the role of forecasts of Scottish and rest of UK tax receipts and demand-led social security spending, and the relationship between the Chancellor’s Autumn Statement and the calculation of the annual Block Grant Adjustment (BGA).”

There are a number of separate issues here which need to be unpacked relating to the timing of calculation of the block grant, the block grant adjustments, the forecasts of Scottish revenues, the availability of outturn data, and reconciliation to forecasts. The Cabinet Secretary’s letter also discusses the implication of policy change for the timing of the Draft Budget. The rest of this note reviews each of these points.

The Barnett-determined block grant

The Barnett Formula determines the change in the Scottish block grant from one year to the next. It allocates the Scottish Government a population share of changes to comparable spending in England (or England and Wales).

Given that the Draft Scottish Budget is presented in September, subsequent announcements made by the UK Government at the Autumn Statement can impact on the Scottish Budget. Table 2 shows the impact of the last five Autumn Statements on the Scottish Budget.

Given the timing of the Autumn Statement there is currently little scrutiny of the impact of these Barnett consequentials on the Draft Budget. The Scottish Government can choose to allocate any additional funding either during the legislative process for the Budget Bill or as part of in-year revisions to the budget. As such, these allocations do not form part of the scrutiny of the draft budget.

However it should be noted that the fact that the Autumn Statement may have implications for the Scottish Government's spending consequentials has not hitherto been identified as a rationale for delaying the publication of the Draft Budget. To put the figures below in some context, a spending consequential of £145m, as resulted from Autumn Statement 2015, is equivalent to around half a percentage point of the Scottish Government's overall block grant.

Table 2: Revisions to the block grant at the Autumn Statement

Autumn Statement	Impact on following year's Scottish Budget (£m)
2011 (29 November 2011)	+112.8
2012 (5 December 2012)	+174.4
2013 (5 December 2013)	+119.6
2014 (3 December 2014)	+231.1
2015 (25 November 2015)	+145.2

Notes: The "impact on following year's Scottish Budget" is the combined DEL Resource and DEL Capital changes.

The block grant adjustment and revenue forecasts

As already noted, the Scottish budget depends from now on not only on the block grant, but also on the block grant adjustments, and the revenues from devolved taxes in Scotland. The forecasts for revenues raised from devolved taxes in Scotland could be, legitimately, quite different from the forecast of the BGAs for the same taxes. The interaction between the timing of the calculation of the BGAs and the timing of devolved Scottish revenues could have budgetary implications for the Scottish Government.

The arrangements for the timing of estimates of the BGA and revenue forecasts are different for income tax relative to LBTT and LfT, so are dealt with in turn.

The block grant adjustment and revenue forecasts – income tax

For income tax, the BGA in 2017/18 depends on two things:

- The revenues raised from NSND income tax in Scotland in 2016/17 (the so-called 'year 0' initial deduction); and
- The application of the 'indexation mechanism' to the initial deduction. The indexation mechanism is a measure of the rate at which rUK NSND income tax revenues grow between 2016/17 (year 0), and 2017/18 (the year when income tax revenues are devolved). The purpose of the indexation mechanism is to estimate how much Scottish income tax revenues would have grown by between 2016/17 and 2017/18, had they grown at the same rate as in rUK.

Before considering the implications of publishing the Draft Scottish Budget prior to the Autumn Statement, it is useful to consider how the process for calculating the BGA and forecasting Scottish revenues would work if the Draft Scottish Budget were published after the Autumn Statement.

- If the Draft Scottish budget were published after the Autumn Statement, the BGA for income tax in 2017/18 would be known, as its calculation is dependent on the OBR's forecasts for the growth in rUK income tax between 2016/17 and 2017/18. Once the BGA has been established at the Autumn Statement, it remains 'fixed' until final outturn data is available (FFA C.51).
- The Scottish Government/ Scottish Fiscal Commission would make a forecast for Scottish revenues in 2017/18 in sufficient time to inform the Draft Budget. The Scottish Government/ Scottish Fiscal Commission would then make a second forecast in sufficient time to inform the Bill for the Budget Act (This is set out in Section 5 of the Scottish Fiscal Commission Act). This forecast would determine the level of resource that HMRC would make available to the Scottish Government throughout the year.
- Once outturn data was available (some 15 months after the end of the financial year, i.e. in 2019/20), both the BGA and Scottish income tax revenues would be reconciled to outturn, with any changes being incorporated into the grant the following financial year.

To what extent would this process be subject to greater uncertainty or volatility if the Draft Scottish Budget were published before the Autumn Statement?

The Cabinet Secretary alludes to two separate timing risks associated with publishing the Draft Scottish Budget in September.

- The first is that, by publishing in September, the Draft Scottish Budget would need to rely on forecasts of the BGA and forecasts of Scottish revenues that may be revised when the Autumn Statement is published, thus requiring revisions to the Draft Budget.

- The second relates to longer-term reconciliation issues. By publishing in September, the forecasts of the BGA and Scottish revenues may be subject to more error than if they were published three months later, implying larger subsequent revision once outturn data becomes available.

We consider each of these timing issues in turn.

Timing issue 1: changes between September and December and implications for 2017/18

The exact methodology for calculating the initial deduction has still to be agreed between the two governments (the Committee wrote to the Cabinet Secretary on 29 June 2016 requesting the figures and workings for the calculation of the initial deduction to the block grant for each tax). In principle there is nothing to stop the two governments agreeing what the initial deduction for income tax should be in advance of the Draft Scottish Budget, based on the latest outturn data available².

The indexation, i.e. the forecast of the growth in rUK per capita revenues between 2016/17 and 2017/18, combined with the forecast growth in Scottish population, is set at the Autumn Statement; this is made clear in the Annex to the Fiscal Framework. (C.46) Thus although the initial deduction can be agreed prior to a Draft Scottish Budget published in September, a Draft Budget published in September would have to rely on an estimate of the indexation, which may turn out to be revised at the Autumn Statement. Consequently, the estimate of Scotland's income tax BGA in 2017/18 made at the Draft Budget may need to be revised.

How significant are such revisions likely to be? It is important to remember that the indexation is based on the forecast change in rUK revenues per capita between 2016/17 and 2017/18. It is not unusual for the Autumn Statement to revise up (down) the March forecasts for income tax in that financial year; but when it does so, it also tends to revise up (down) the forecast for the following financial year as well. The revision to the change thus tends to be small.

Table 3 below shows the scale of revisions to UK income tax revenues between the March Budget and Autumn Statement for each of the last three Autumn Statements. For example, it shows that the 2015 Autumn Statement resulted in the estimate of income tax in 2015/16 (the in-year forecast) being revised up by £1.6bn, and the forecast for the following financial year being revised up by £2.1bn.

For example, between the Budget 2015 and Autumn Statement 2015, the forecast increase in UK income tax revenues between 2015/16 and 2017/18 was only revised up by £0.5bn. In per capita terms, the revision implied an increase in the growth rate of per capita income tax receipts of 0.2 percentage points. To put this in context, this

² The Cabinet Secretary's letter implies that any estimate of Scottish revenues and the BGA made before the Autumn Statement will need to rely on the forecasts and outturn data published in the March Budget. However, the Fiscal Framework emphasises the need for the UK Government, HMRC and OBR to share with the Scottish Government relevant information and data throughout the year to support and inform the preparation of the Draft Scottish Budget (FFA C.80).

revision to the growth rate of UK revenues would have implied an increase of around £30m in Scotland's BGA between an estimate made in March and the actual calculation made in the Autumn Statement.

Table 3: Change in UK income tax forecast At Autumn Statement, relative to March Budget

	In-year forecast		Forecast for following financial year	
	£bn	As % total UK income tax forecast	£bn	As % total UK income tax forecast
Dec-13	0.8	0.5%	1.8	1.1%
Dec-14	-3.6	-2.2%	-6.1	-3.6%
Nov-15	1.6	0.9%	2.1	1.1%

So although the Autumn Statement might result in changes to rUK income tax revenue forecasts, it is unlikely to result in significant changes to the indexation mechanism, assuming that forecasts for 2016/17 and 2017/18 are revised in similar directions.

Of course, the budget available to the Scottish Government is not just about the BGA, but it is about how the forecast for the BGA interrelates with the forecast for Scottish revenues. The resource available to the Scottish Government in 2017/18 is a function of the block grant (set at the Autumn Statement) and the forecast of HMRC collected income tax revenues in Scotland (FFA C.41) which the UK Government makes available to the Scottish Government to draw down throughout the year. For 2017/18, this forecast will be made by the Scottish Government and scrutinised by the SFC (in subsequent years the forecasts will be made by the SFC). As noted above, the Scottish Fiscal Commission Act sets out that the SFC will make two forecasts available: one in time to inform the Draft Scottish Budget, and the other to inform the Bill for the Budget Act).

Currently, neither the OBR nor Scottish Government/ SFC has access to tools, models and data that allow them to estimate Scottish income tax revenues with much greater accuracy than assuming that Scottish revenues are a particular share of UK revenues. Given this observation, revisions to the UK forecasts at the Autumn Statement – which would influence the calculation of the indexation mechanism – will also tend to imply equivalent revisions to Scottish forecasts.

What this means in practical terms is the following:

- If the Draft Scottish Budget is published in September, it will rely on an estimate of the indexation to the block grant, and an estimate of the growth in Scottish revenues between 2016/17 and 2017/18 (the estimate of Scottish revenues in 2016/17 and the 'initial deduction', which are by definition equal, can be agreed by the two governments in advance of the Draft Budget).

- If the estimate of the indexation is revised at the Autumn Statement, this is also likely to imply a revision to the growth in Scottish income tax forecasts.
- Thus although the Scottish Government/ Scottish Fiscal Commission may want to revise its September forecasts for Scottish revenues in 2017/18 in light of the Autumn Statement forecasts, the revision to the Scottish revenue forecasts will be offset by the revision to the estimate of the indexation.
- From the point of view of the total resource available to the Scottish Government, the revisions have cancelled each other out.

The Cabinet Secretary argues that publishing the Draft Scottish Budget 2017/18 at any point before the Autumn Statement ‘would have to rely on OBR forecasts of rUK tax receipts from the March 2016 Budget to calculate the BGAs’. This point is indeed made in Para C47 of the Fiscal Framework Annex, which states: ‘Where the Scottish Government’s Draft Budget occurs before the UK Autumn Statement, the UK Government will additionally provide a provisional estimate of the adjustments for budgeting purposes based on the previous UK Budget forecasts, which will be revised at the Autumn Statement.’

In summary, if the Draft Scottish Budget is published in September, then it is possible that there will be some changes to the indexation mechanism used to calculate the BGA for income tax between 2016/17 and 2017/18 when the Autumn Statement is published. However, even if revisions to rUK income tax in the Autumn Statement are relatively large, the effect on the indexation mechanism is likely to be relatively minor. This is because, if revisions are made to rUK income tax receipts in 2016/17, similar revisions are also likely to be made to the forecast for 2017/18. The change in the growth rate between the two years is thus likely to be relatively less significant, and it is the growth rate that is important for the BGA indexation.

Furthermore, even if the estimate of the BGA indexation does change between the Draft Scottish Budget in September and the Autumn Statement, changes to the indexation are likely to imply changes to the forecast for Scottish income tax growth between 2016/17 and 2017/18. From the point of view of the Scottish budget, revisions to the indexation mechanism and revisions to the Scottish forecasts can be expected to cancel each other out. The Scottish Government/ Scottish Fiscal Commission will be able to revise their September forecasts prior to the publication of the Budget Bill, and this forecast will determine the resources that the UK Government makes available to the Scottish Government to draw down throughout the year.

Timing issue 2: reconciliation to outturn

What about the longer-term reconciliation issue? Once outturn data becomes available, both the BGA and the forecast for Scottish revenues will be reconciled to outturn. The Cabinet Secretary is correct to state that ‘the closer to the start of the tax year an income tax forecast is made, the smaller the likely difference between forecast and eventual outturn’, and this statement is as true for the BGAs as for Scottish revenues. The Cabinet Secretary’s letter implies that any estimate of

Scottish revenues and the BGA made before the Autumn Statement will need to rely on the forecasts and outturn data published in the March Budget. However, the Fiscal Framework emphasises the need for the UK Government, HMRC and OBR to share with the Scottish Government relevant information and data throughout the year to support and inform the preparation of the Draft Scottish Budget (FFA C.80). Thus the question is not about whether March 2016 forecasts will be reliable forecasts of outturn data, but instead, how much more reliable an Autumn Statement forecast will be relative to one made 2-3 months earlier. It seems unlikely that an assessment of the underlying economic determinants of income tax revenues would change radically between September and December.

Furthermore, to the extent that differences between forecasts and outturn for rUK revenues and Scottish revenues are likely to mirror each other, it might normally be expected that if Scottish income tax outturn is lower than forecast, rUK income tax outturn would also be lower than forecast. Thus reconciliations to Scottish revenues and reconciliations to BGA outturn would hopefully offset to a large extent.

Block Grant Adjustment and revenue forecasts – LBTT and LfT

A one-off BGA for LBTT and LfT of £600m was made in the Scottish Budget 2016/17.

In future years, and without prejudice to the one-off BGA in 2016/17, the initial deduction for these taxes will be based on Scottish revenues in 2014/15 (FFA C.8). Thus unlike income tax, the initial deduction is already known.

For LBTT and LfT, the BGA in 2017/18 will be calculated by indexing the initial deductions according to the indexation methodology, i.e. on the growth rate of comparable tax revenues in rUK. However the timing process for calculating the indexation mechanism is quite different for LBTT and LfT relative to income tax.

Specifically, the BGA for LBTT and LfT will be *updated during the year* to reflect the latest forecasts of corresponding tax receipts in rUK (FFA C.56). The reason for this is that the Scottish Government collects the receipts from these taxes throughout the year (in contrast to income tax, where the tax receipts are collected by HMRC, and what is made available to the Scottish Government is the *forecast* for Scottish income tax revenues for the year ahead). The BGA for LBTT and LfT therefore adjusts throughout the year in order to protect the Scottish budget from UK-wide variations in those tax receipts.

Despite the regular updating throughout the year of both the BGAs and the Scottish forecasts, in preparing the Draft Scottish Budget, the Scottish Government will clearly want to make a forecast of the BGAs for LBTT and LfT in 2017/18, and a forecast of its actual revenues from those taxes in 2017/18.

The timing of the Draft Scottish Budget does not have any material implications for the forecasting of Scottish revenues of LBTT and LfT. As the Cabinet Secretary recognises in his letter, monthly outturn data for these taxes is published throughout the year, and thus ‘the timing of Scottish forecasts can be chosen to suit the date of

the Draft Budget publication'. By publishing the Draft Budget in September rather than after the Autumn Statement, the Scottish Government will have access to a few months of additional 2016 outturn data on which to base its forecasts of 2017/18 revenues, but this seems unlikely to result in radical revisions to forecast.

What about the BGAs? As with income tax, it may be the case that the OBR will revise its estimates of rUK revenues from the comparable taxes in 2016/17 and 2017/18. These revisions may imply a change to the BGAs between September and the Autumn Statement. But as with income tax, what is important is the extent of the revision to the growth rate of the comparable taxes between 2016/17 and 2017/18, and this is likely to be small, even if revision to actual receipts in each year is large.

By publishing the Draft Scottish Budget after the Autumn Statement, the Scottish Government would have access to a few months additional outturn data for Scottish revenues from LBTT and LfT, and this may improve the accuracy of its forecasts for those taxes in 2017/18 at the margin.

By publishing the Draft Scottish Budget after the Autumn Statement, the Scottish Government may have a clearer idea about what the BGAs for LBTT and LfT will be in 2017/18 than if it published the Draft Budget in September, but again this difference will be marginal.

Policy change

The letter from the Cabinet Secretary identifies two types of tax policy change which may influence the preferred timing of the Draft Scottish Budget.

The first of these is tax policy change by the UK Government at the Autumn Statement. Policy change by the UK Government on taxes that have been devolved to Scotland will influence Scotland's BGA (for example, if the UK Government decided to raise income tax or Stamp Duty, this would imply an increase to Scotland's BGA, relative to what may have been forecast in September). By publishing the Draft Scottish Budget after the Autumn Statement, this risk of changes to the Scottish budget via changes to the BGA as a result of UK Government policy change are eliminated.

The second of these is behavioural changes in response to Scottish tax announcements that influence Scottish revenues. It is undoubtedly the case that any tax policy change may have behavioural consequences. For example, the announcement that a devolved Scottish tax was going to be increased in April 2017 may result in some forestalling (bringing forward) of activity into the 2016/17 financial year, at the expense of revenues in 2017/18. However, it seems unlikely that delaying the Draft Scottish Budget from September to December would materially alter the scope for such forestalling to occur (other than perhaps in the case of LBTT). To reiterate, the issue here is not whether behavioural effects would occur or not for any given tax announcement, but whether the behavioural effect would be more significant if the Draft Budget were presented in September, compared to December.

Social security benefits

The letter from the Cabinet Secretary also discusses issues around the timing of outturn and forecast data for the social security benefits that are being devolved to Scotland. However, given that these benefits will not have been devolved by 2017/18, forecasting and outturn issues have no bearing on the timing of the Draft Budget 2017/18.

Conclusion

The Committee is invited to consider the above issues at the business planning event in the first instance. The Committee will also have the opportunity at the event to have an informal discussion with the Cabinet Secretary and may then wish to seek a formal response from him before finalising a view on the timetable for the scrutiny of Draft Budget 2017/18. In particular, the Committee may wish to seek further details on:

- The methodology for calculating the provisional baseline adjustment for income tax including who will prepare in-year forecast for 2016-17 and any risks related to the timing of that forecast relative to the timing of the publication of Draft Budget 2017/18;
- The interaction between changes to the block grant adjustment at the time of the Autumn Statement and revisions to the Scottish income tax receipts forecast at the time of the publication of the Budget Bill and the impact on the Scottish Government's budget;
- The interaction between changes in Scottish income tax receipt forecasts for 2016/17 and 2017/18 at the time of the Autumn Statement and the likelihood of a relatively minor impact on Block Grant Adjustment;
- The marginal impact of the timing of the publication of the draft budget on the forecasts for the devolved taxes;
- The progress in taking forward part 7 of the technical annex to the fiscal framework on data and information sharing arrangements which states that both Governments and the OBR and SFC will require access to information and data in order to "discharge their duties in respect of Parliamentary accountability, scrutiny, policy development and forecasting."³

**David Eiser and Jim Johnston,
August 2016**

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https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/508102/Fiscal_Framework_-_Text_-_Annex_to_the_fiscal_framework_-_15th_March_201....pdf

Annex – an alternative Budget timetable

Table 4 provides a further option based on the Draft Budget being published in October which was the case in relation to Draft Budget 2015-16.

The flexibility to move the publication date of the Finance Committee report from December to January meant that the subject committees essentially had the same amount of time for budget scrutiny as they did the previous year when the Draft Budget was published in September.

However, publishing the Draft Budget in October would not materially alter the issues involved in publishing the Budget prior to the Autumn Statement, in that estimates of the BGA for income tax would be based on an estimate which may be revised in the Autumn Statement itself.

Table 4

	Draft Budget 15-16
Draft Budget Published	9 October 2014
Subject Committees Report to Finance Committee	12 December
Finance Committee Consideration of Draft Report	7 January 2015
Finance Committee Report Published	12 January
Chamber Debate on Draft Budget Report	Same time as Stage 1 debate
Budget Bill Published	15 January
Stage 1	22 January
Stage 2	29 January
Stage 3	5 February