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23 June 2016

Dear Michael

Congratulations on your appointment as Convenor of the Finance Committee. I wish you well, and look forward to working with you and the members of the Committee on a range of issues of mutual interest. I want my relationship with the Committee to be helpful and open, with positive response to constructive challenge.

I am conscious that the work of the Committee will adjust in response to newly-devolved powers under the Scotland Act 2016, and I wish to support the Committee in this process. If the Committee would find it helpful to receive informal briefings from officials on the Scotland Act powers and on the associated fiscal framework agreement, I would be very glad to arrange that.

As recognised in the Finance Committee's Legacy Paper, a significant and immediate issue for both the Committee and me is the process and timetable for presenting and scrutinising the Government's spending plans for 2017-18 and beyond. As you know, that process will take place in the context of continuing challenges in the global, UK and Scottish economy and in the public finances. We must also be aware of the risks presented by the £3.5 billion of further cuts yet to be identified by the UK Government and we will continue to press for clarity on that, including in this year's Autumn Statement.

Next year will also be the first year in which some of the more significant new Scotland Act 2016 powers will become available, including the additional flexibility to vary income tax rates and bands.

Arrangements for bringing forward the Government's spending plans are governed by the conventions set out in the Written Agreement between the Finance Committee and the Government. The Written Agreement was adjusted to reflect the new powers under the Scotland Act 2012 and I wish to suggest that consideration is given to what further adjustments are needed in light of the 2016 Act powers.

In my view, it would be helpful to consider these in two ways – issues for the long-term future of the budget process and issues for this year in its own right.

The implementation of the Scotland Act 2016 powers introduces new fiscal cycles into the budget process. 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).

For the longer term, I agree with the relevant recommendation in the Legacy Paper and suggest that we not only establish a working group involving representatives from the Scottish Parliament and Scottish Government but potentially invite contributions more widely from civic Scotland to consider what process model would best reflect the extra requirements flowing from the new fiscal powers. If the Committee is supportive of such an approach, I suggest we ask our respective officials to work together over the Summer to develop some options for such a group, for our joint consideration in the Autumn.

In respect of the process for developing and scrutinising the Draft Budget 2017-18, I think we will have a shared objective of agreeing, if at all possible, the direction of any changes to this year's budget process before Parliament rises at the end of this month.

I have considered the issues very carefully and it has been helpful that there has been an opportunity for our respective officials to discuss them this week. The introduction of the new powers will add additional complexity and some uncertainty to the budget process, including potential volatility in the aggregate level of funding available.

As well as the requirement to forecast newly devolved tax revenues and, in due course, social security expenditure for Scotland to incorporate in the Budget, there will also be a requirement to forecast adjustments to the block grant for each of the devolved tax and spending powers - which will be based on growth in corresponding tax revenue and expenditure in the rest of the UK. Therefore, the new powers devolved through the Scotland Act 2016 will place a significantly greater emphasis on the timing and quality of economic forecasts – both in Scotland and in the UK. While the timing of Scottish forecasts can be chosen to suit the date of the Draft Budget publication, the calculation of the BGA also requires the Office for Budget Responsibility's (OBR) forecasts of corresponding rUK tax receipts and other economic determinants. Those forecasts are fixed to be published alongside the March UK Budget and again at the Chancellor's Autumn Statement, normally in late November/early December.

Publishing the Draft Budget 2017-18 at any point before the Autumn Statement would use Scottish forecasts of tax receipts (and, in due course, social security spending) produced shortly before publication but would have to rely on OBR forecasts of rUK tax receipts from the March 2016 UK Budget to calculate the BGAs. This introduces the risk that over the period March 2016 to December 2016 there could be material movements in forecast tax receipts at UK level, leading to risks in the forecasting of the BGAs, which would then need to be addressed after production of the draft Budget with consequent changes in spending power prior to the introduction of the Budget Bill. These risks were acknowledged in the advice the previous Finance Committee provided to the Devolution Committee in March 2016.

While forecasting issues will interact with the calculation of the BGA, so too would any significant policy change at the Autumn Statement in a tax that is devolved to Scotland, such that UK receipts from the tax in question change in the year ahead. We have had recent

experience of such changes taking place, for example in the announcement in Autumn Statement 2015 of the introduction of a levy on top of standard stamp duty land tax rates in respect of additional homes.

One way to address these concerns in the short term, and without prejudice to whatever changes a working group might recommend in future, would be to hold over finalising and publishing the Draft Budget 2017-18 until after the UK Autumn Statement.

Also relevant is the issue of tax behaviours as a result of Scottish tax announcements in the Draft Budget and the potential implications for the public finances. A balance needs to be struck between providing certainty for taxpayers over future tax liabilities, and protecting future revenues which may under some circumstances be eroded by tax avoiding behaviours.

Finally, I have been reflecting on the timing and role of forecasts and outturn data in setting the Draft Budget. In relation to income tax, HMRC publish a disaggregation of tax receipts by country in late September/early October, which estimates the amount of income tax receipts collected in Scotland in the previous tax year (on a cash basis rather than an accruals basis). This data would inform forecasts of Scottish income tax receipts. HMRC publish provisional outturn income tax data earlier in the summer (typically May) but that publication does not include disaggregated data for Scotland. Forecasts for such a significant source of SG funding should use the latest information available.

Scottish Government income tax modelling also depends on an assessment of the economic determinants (i.e. GDP, labour market movements, etc). These determinants are updated regularly as new data becomes available. 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. The Finance Committee highlighted these issues when writing to the Devolution Committee in March 2016 about the changes proposed in the then Scotland Bill.

Final outturn data for fully devolved taxes (Land and Building Transactions Tax and Scottish Landfill Tax) is available in the September 6 months after the financial year end to which it relates. Outturn data for the 2015-16 financial year will therefore be available in September 2016, although monthly outturn data is published throughout the year.

In addition, social security outturn data is published by DWP in late September and will be key to estimating both Scottish forecasts of expenditure on social security provision and the associated BGA. The DWP does not publish monthly or provisional outturn data for Scotland ahead of September.

These seem to me among the key issues to be taken into account in determining the budget process and timetable. They must, of course, be seen alongside the importance of enabling effective parliamentary scrutiny of the Government's plans.

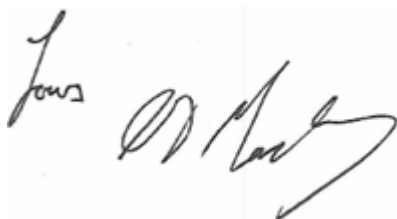
I consider that the balance of these issues points towards a revised process in this transitional year where we would publish the Draft Budget 2017-18 later in the year. Moving publication beyond the Autumn Statement would be the most effective way of managing the risks and volatility presented by the relationship between the Autumn Statement, related OBR forecasts and the Scottish Budget. It would also minimise the potential need for significant revisions between Draft Budget and Budget Bill but would reduce the time available for scrutiny. It would be my preference to do this and to work with the Committee to consider what additional information the Government could provide beforehand to support or reprofile scrutiny in a helpful way. For example in relation to the on-going work on the

implementation of the Scotland Act 2016 and the revised fiscal framework or the delivery of the national outcomes and continuing scrutiny of the Government's programme of public service reform. I would also be open to considering the implications for other aspects of the budget timetable, including the Autumn Budget Revision.

I recognise that there may be a range of views on the budget timetable and am very open to discussing them. An earlier Draft Budget would provide longer time for parliamentary scrutiny as currently designed, but increase the level of volatility that would need to be managed during the process including the potential need for parliament to resource further scrutiny of any revisions between Draft Budget and Budget Bill.

I am also taking into account that this year's process represents the first occasion on which we have had to build some of these considerations into our collective work. It is imperative that we take steps to minimise risk and uncertainty, both in the development of the Government's tax and spending plans but also in the process of parliamentary scrutiny and business planning on the part of delivery partners and other stakeholders. We must be mindful of the potential impact that frequent revisions to budget forecasts and allocations could have on the overall credibility of the budget process. It is key that the Scottish people have confidence in our collective ability to use the newly devolved powers efficiently and effectively. I see this task as a joint venture between the Scottish Government and the Committee and, subject to the Committee's views, the establishment of the proposed working group would offer an opportunity to consider these issues in more depth for future years.

I look forward to hearing from you on this or any other matters of interest to the Committee. And as I have said, I look forward to a strong and effective working relationship with you and your colleagues.



DEREK MACKAY