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Scottish Budget 2019/20

Issues, choices and implications



December 2018





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The economic context



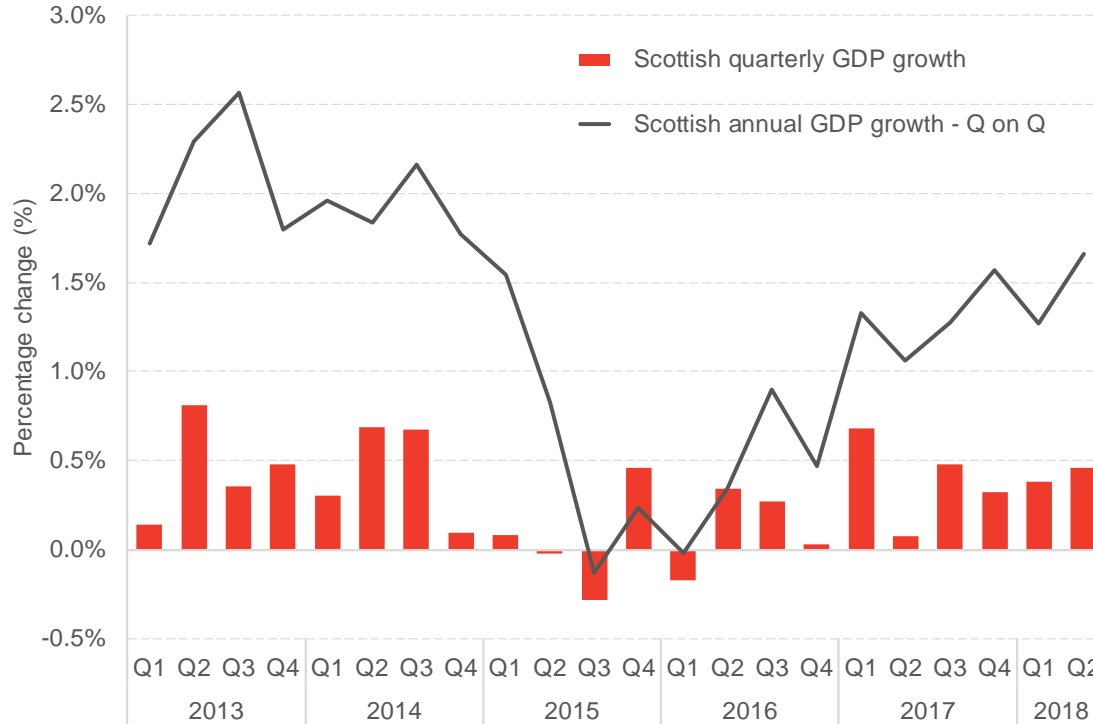
Summary

- › Economic outlook continues to remain highly uncertain

 - › Scottish economy has had a better 2018 (so far) than in any year since 2014.....next week's GDP data for Q3 will show whether or not that this trend has continued
 - Unemployment is at its lowest ever rate

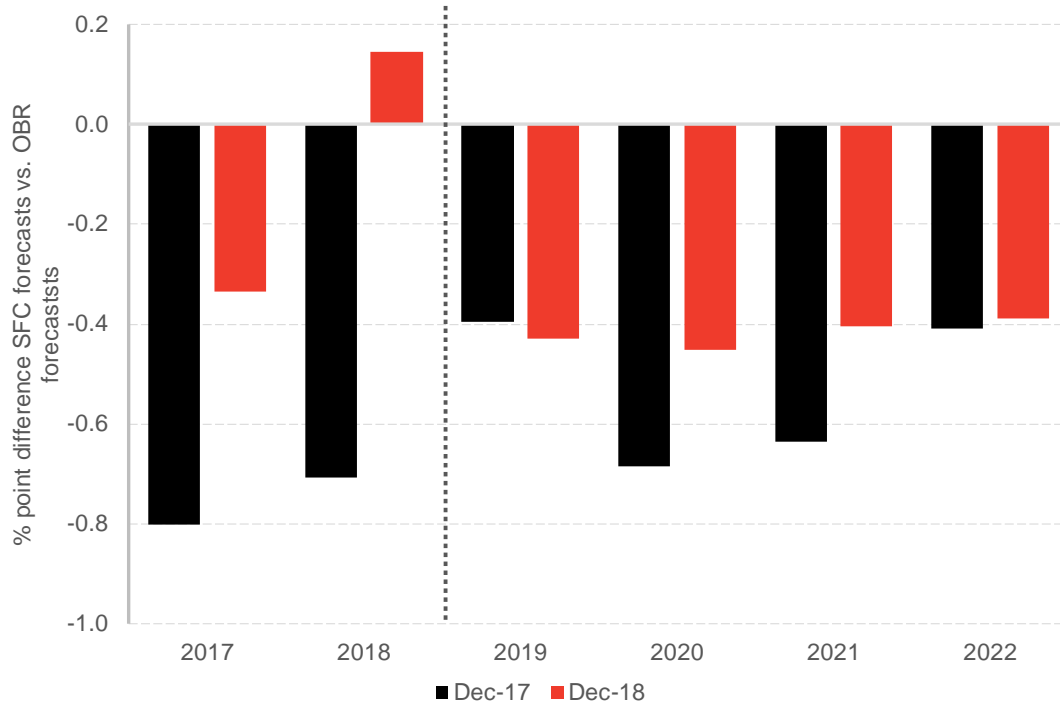
 - › Of course, the greatest uncertainty continues to be Brexit
 - Risk that disorderly exit from EU could not only weaken growth next year, but push it into reverse
-

A strengthening picture.....



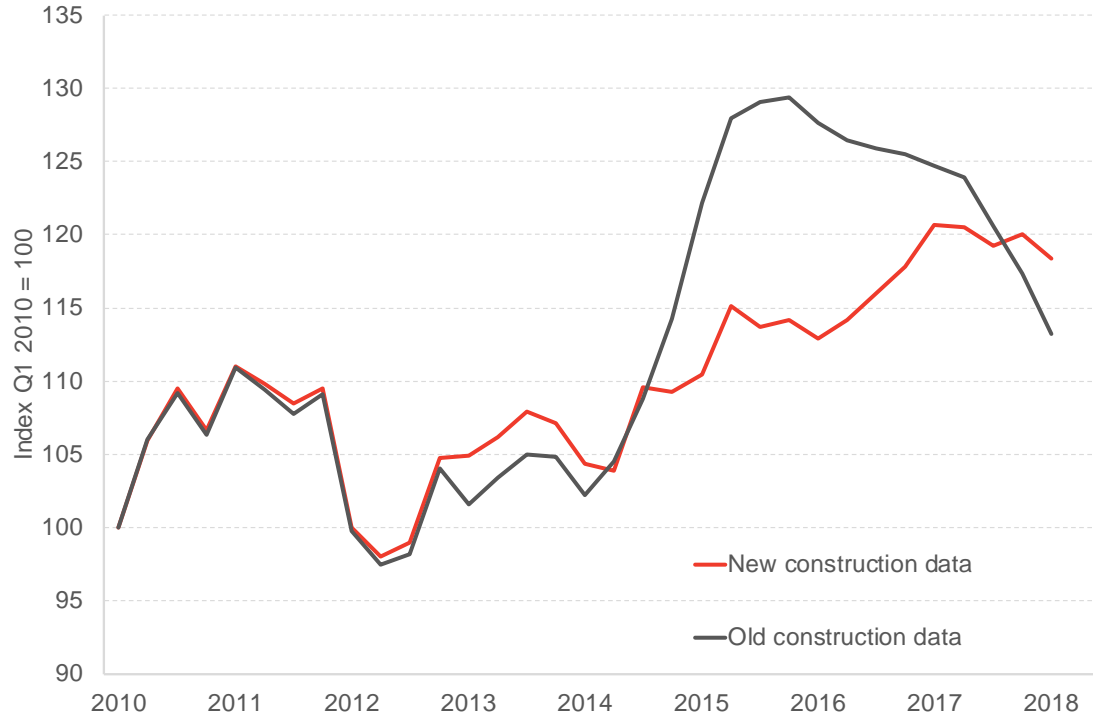
- › Growth has picked up and outpaced the UK as a whole in first six months of 2018...
- › ...but still below long term trend

SFC revisions – compared to OBR



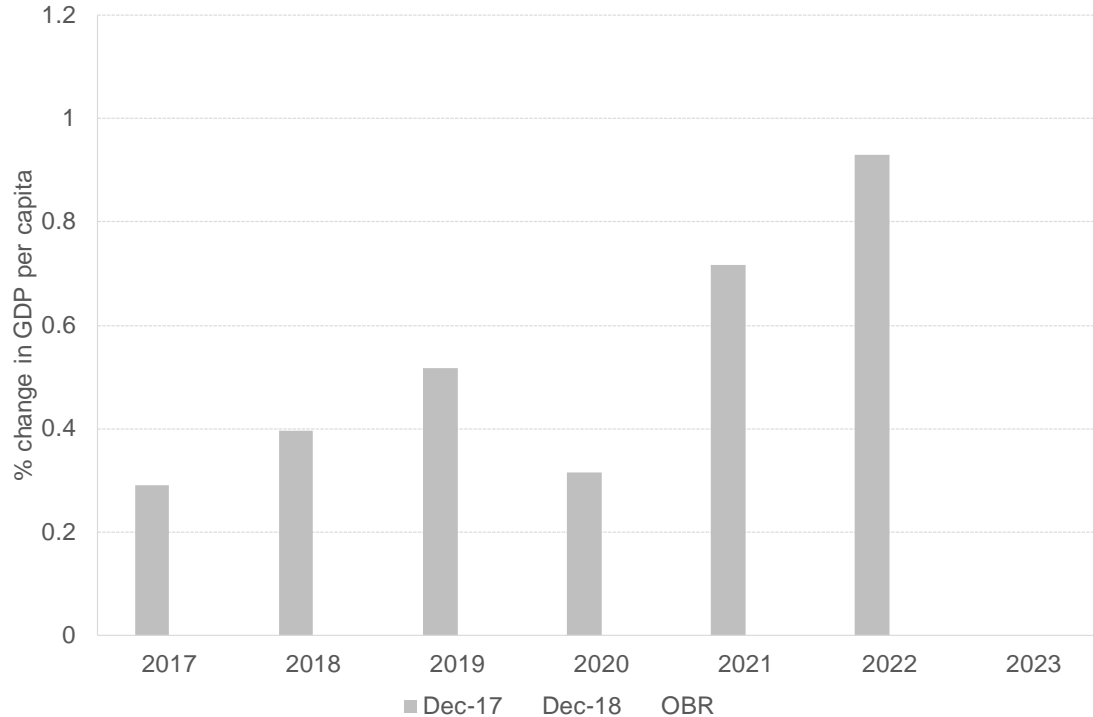
- › As a result, SFC have been forced to revise up their forecasts for 2017 and 2018.....
- ›much closer to OBR (and our own forecasts!)

Revisions to construction.....



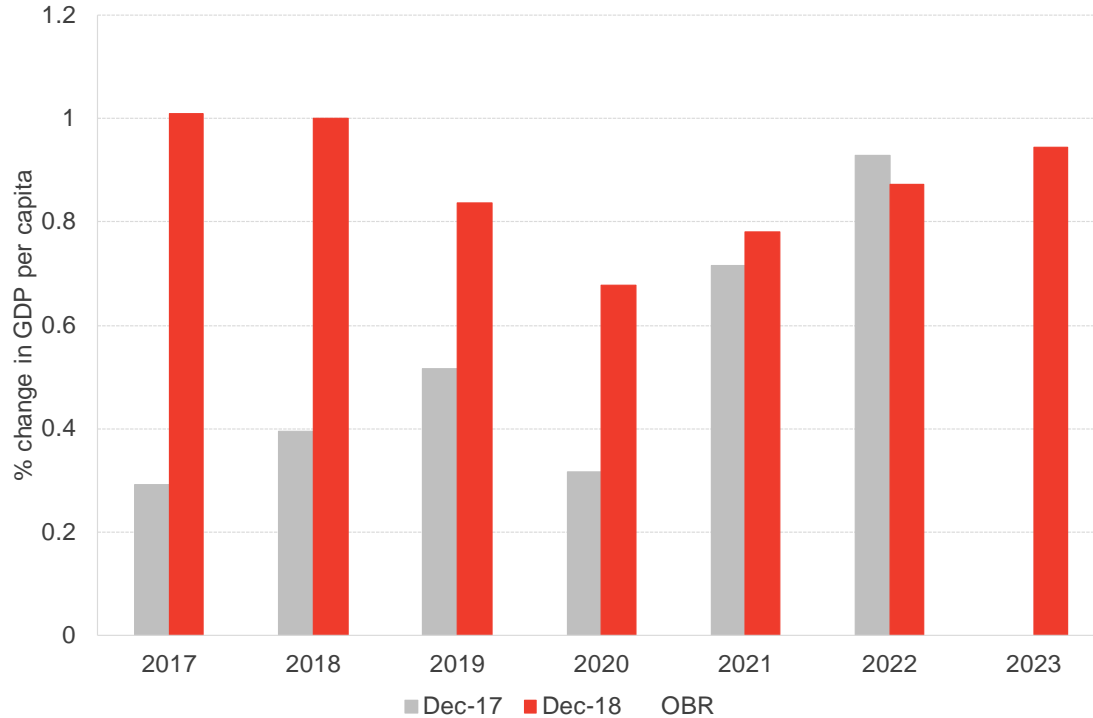
- › To be fair, one key reason why outturn data has turned out much higher than SFC forecast.....
- › ...was not because SFC forecast 'wrong'.....
- ›but because data was revised

A moderately better outlook....



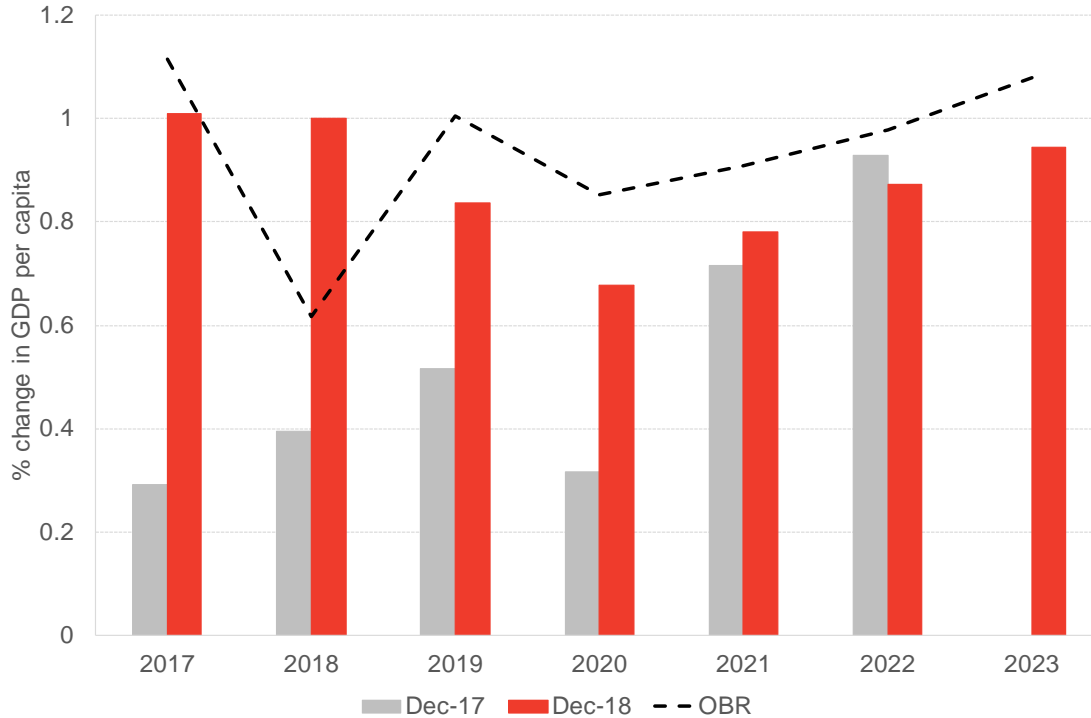
- › SFC have taken that better performance into consideration.....
- ›last year, surprised many with a forecast that suggested growth would be at its weakest rate in 60 years

A moderately better outlook....



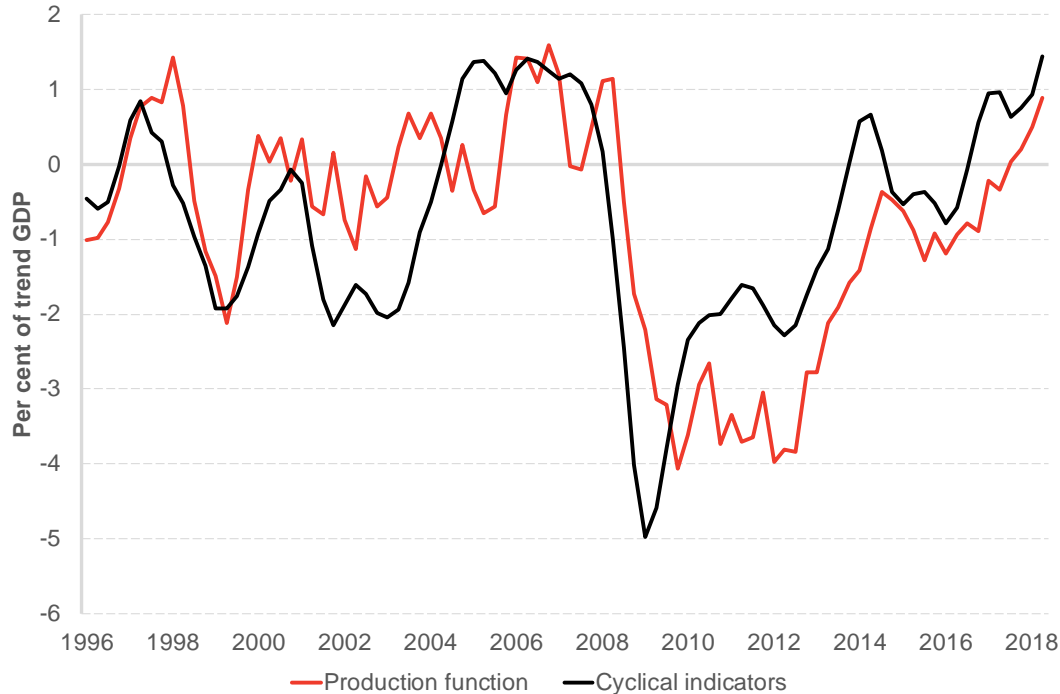
› Significant uplift in their forecast.....

A moderately better outlook....



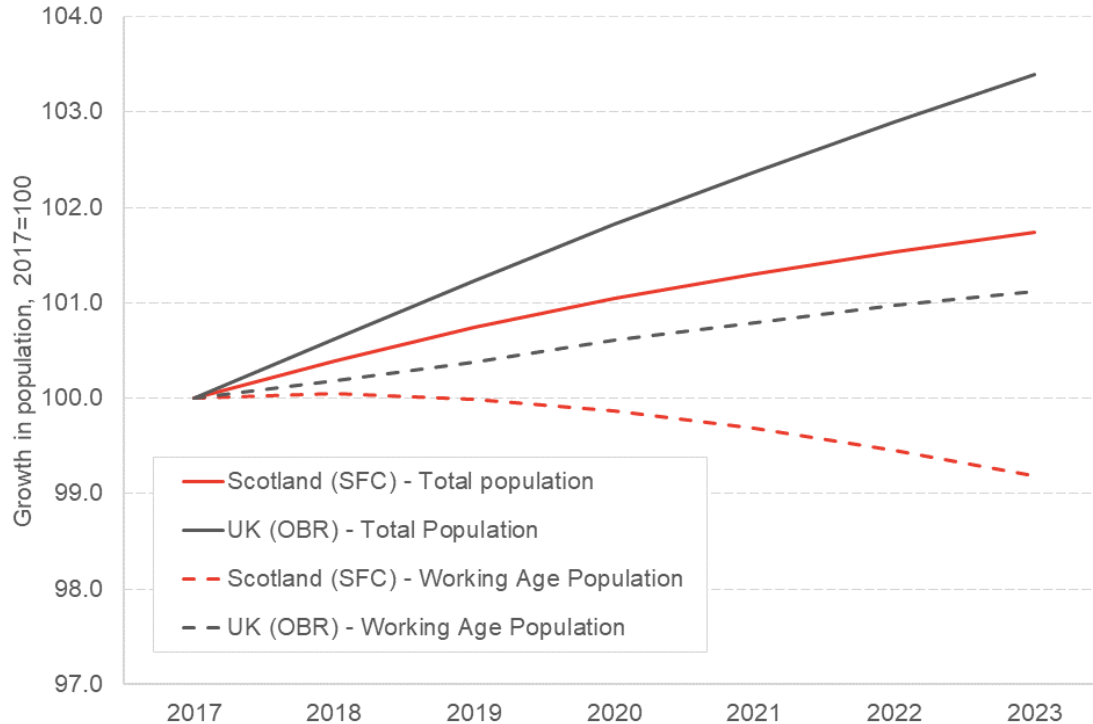
- › But still weaker than UK forecast by OBR
- › Both are still cautious by historical standards – we’re slightly more optimistic

Drivers of outlook (1)



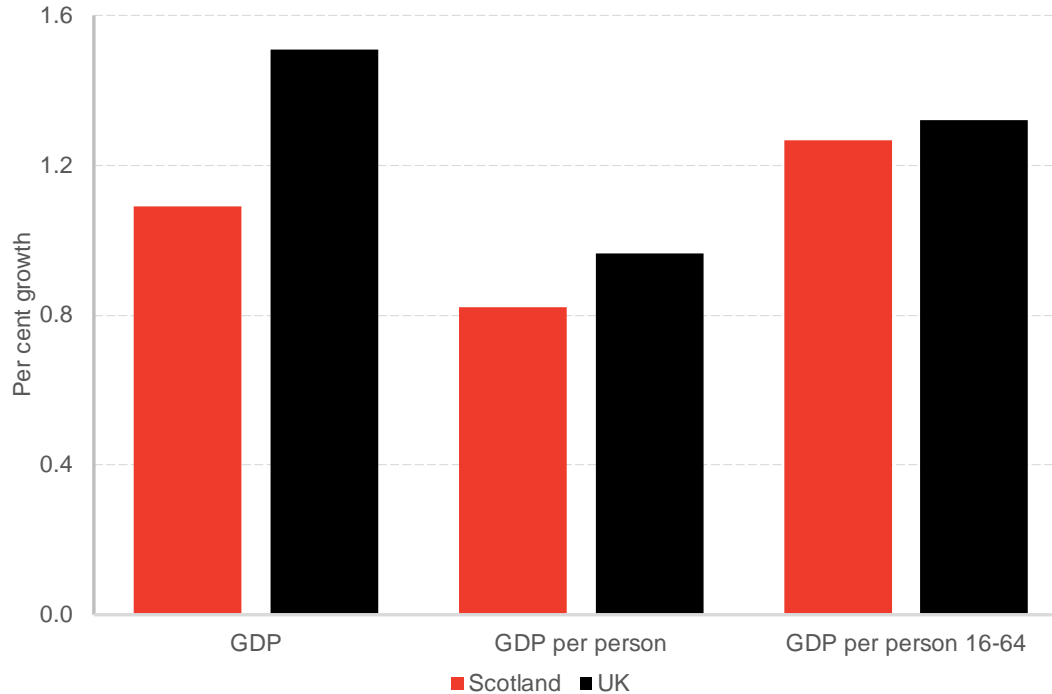
- › SFC continue to forecast Scotland above trend....
- ›we take a slightly different view
- › In our view, key driver of 'catch-up' over last year has been narrowing of capacity gap with the UK

Drivers of outlook (2)



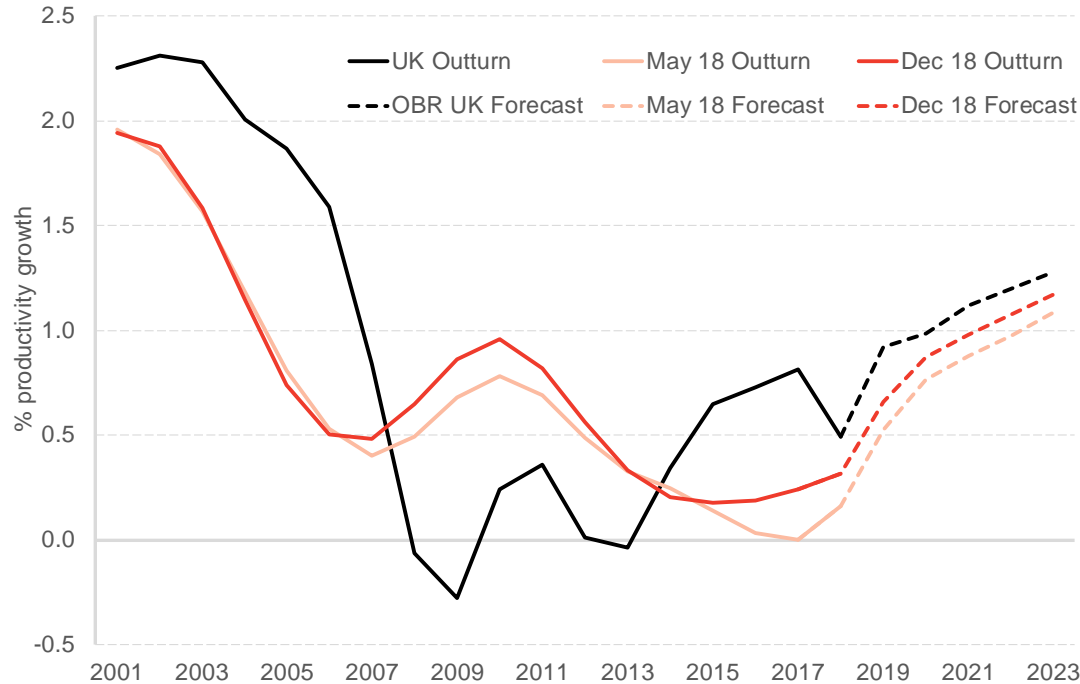
➤ Key driver of difference between SFC and OBR forecasts is weaker population projection

Drivers of outlook (2 contd.)



- › So whilst the SFC are forecasting much weaker growth than (already weak) UK.....
- ›the gap narrows significantly when adjusting for population

Drivers of outlook (3)



- › The key driver of weak growth in the economy is the weak outlook for productivity
- › With SFC forecasting slightly weaker productivity growth than UK

- › Fiscal Commission – like most forecasters – have taken the view that a broad-based agreement will be secured with the EU and that there will be a smooth transition

Table 7: Bank of England projections - what could they mean for Scotland? (compared to the financial crisis)

- › But how likely?

	GDP	Unemployment	House prices
<i>2008-09 Financial Crisis</i>	-4%	+131,000	-16%
Disorderly	-8%	+100,000	-30%
Disruptive	-3%	+52,000	-14%
Economic partnership	-0.75% to +1.75%	+/- 2,000	N/A

Source: Bank of England, Fraser of Allander Institute

Scotland's budget: the tax aspects

Charlotte Barbour, MA CA CTA(Fellow)
Director of Taxation, ICAS

14 December 2018



A reminder.... ‘Scottish taxes’ with different types of devolved taxes

Fully devolved

- Land and Buildings Transaction Tax
- Scottish Landfill Tax
- Air Departure Tax – on hold

i.e. small transactional based taxes – locus in Scotland

Partially devolved – income tax

- Scottish Income tax – but still a UK tax
- Scottish taxpayer

Assigned – VAT

- A proportion of ‘Scottish’ VAT receipts

2019/20 Scottish rates and bands on non savings, non dividend (NSND) income

Band 2019	Band 2018	Band Name	Rate 2018/19 and 2019/20
£12,500-£14,549	£11,850 to £13,850	Starter Rate	19%
£14,549-£24,944	£13,851 to £24,000	Basic Rate	20%
£24,944-£43,430	£24,001 to £43,430	Intermediate Rate	21%
£43,430-£150,000	£43,431 to £150,000	Higher Rate	41%
Over £150,000	over £150,000	Top Rate	46%

Challenges and constraints.....

The personal allowance

- set at Westminster but applies across the UK
- £12,500 for 2019/20
- can't be changed by the Scottish Govt
- has a huge impact on the revenues that can be collected

Higher rate threshold

- Within Scottish Govt powers to change... but
- Tendency to compare with rUK
- Very political...

SIT thresholds and operational considerations 2019/20

HMRC and SG – systems should work

Complications continue to arise with:

- Pension payments and relief at source
- Gift Aid
- Marriage Allowance

but practical solutions that will continue

Main issue - the interaction between IT and NIC for income
of £43,430 - £50,000

Income tax and NIC – upper thresholds

Divergence in income tax higher rate thresholds and NIC thresholds

	2017/18	2018/19	2019/20
Rest of UK	£45,000	£46,350	£50,000
Scotland	£43,000	£43,430	43,430
NIC	£45,000	£46,350	£50,000

Tax differentials

...lend themselves to tax planning

SIT - interacts with rUK taxes

SIT levied on NSND income

- A sole trader or partner pays income tax on their profits to the Scottish Government
- A company based in Scotland will pay corporation tax to the UK; and the owner pays income tax on dividends to the UK

Identification of Scottish taxpayers

High rates of tax...

...drive behavioural change

Emigrate!

Or not come to Scotland?

Taxpayers might change behaviours, such as

- Make higher pension contributions
- Take unpaid leave
- Work less

Relatively minor, but cumulatively?

LBTT changes....

- Changes are proposed to LBTT as follows from 25 January 2019:
- the rate of Additional Dwelling Supplement will change from 3% to 4%
- non-resident LBTT changes to thresholds and rates, such that an anticipated 2/3rds of all non-resident transactions will result pay less

Also

- An intention to introduce two reliefs from LBTT for property investment funds.
- No suggestion to mirror the recent UK proposal to consider a SDLT charge on non-residents.

LBTT – ongoing change....

- Applicable in Scotland since 1 April 2015
- But quite a few changes since then
 - A new charge to tax – additional dwelling supplement, from 1 April 2016
 - A new relief – first-time buyer relief, which came into effect on 30 June 2018.
 - Removal of anomalies – for example around group relief
 - Seeding relief now expected
- Changing rates.....

There's a need for a more sensible process

2019/20 – other devolved taxes

Scottish Landfill Tax

- Indexed up in line with inflation

Air Departure Tax

- In the hangar, and staying there!

Aggregates Levy

- for the future
- VAT assignment

Further thoughts.....

- Brexit – but the possibility of a different budget in Scotland may be difficult (due to process)
- New taxes.....
 - Visitor tax
 - Charges on plastics, disposable cups etc
 - Parking space levy
 - Land value tax
 - Social care levy
- Taxes on land.....
 - Council tax
 - NDR
 - LBTT

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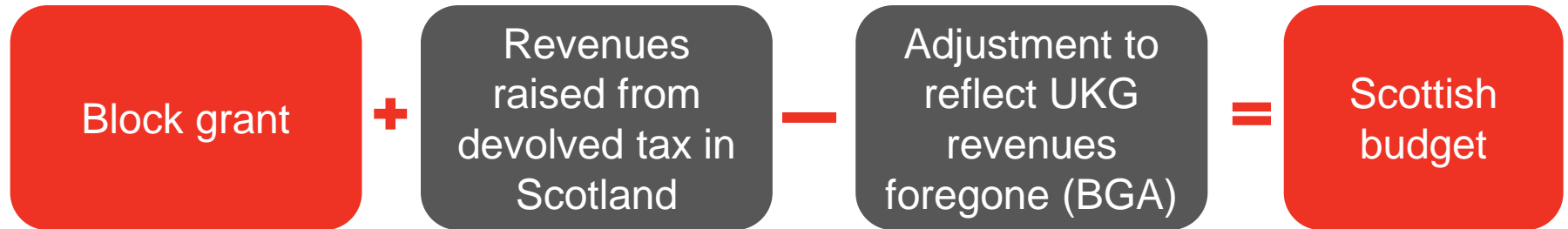
Budget overview



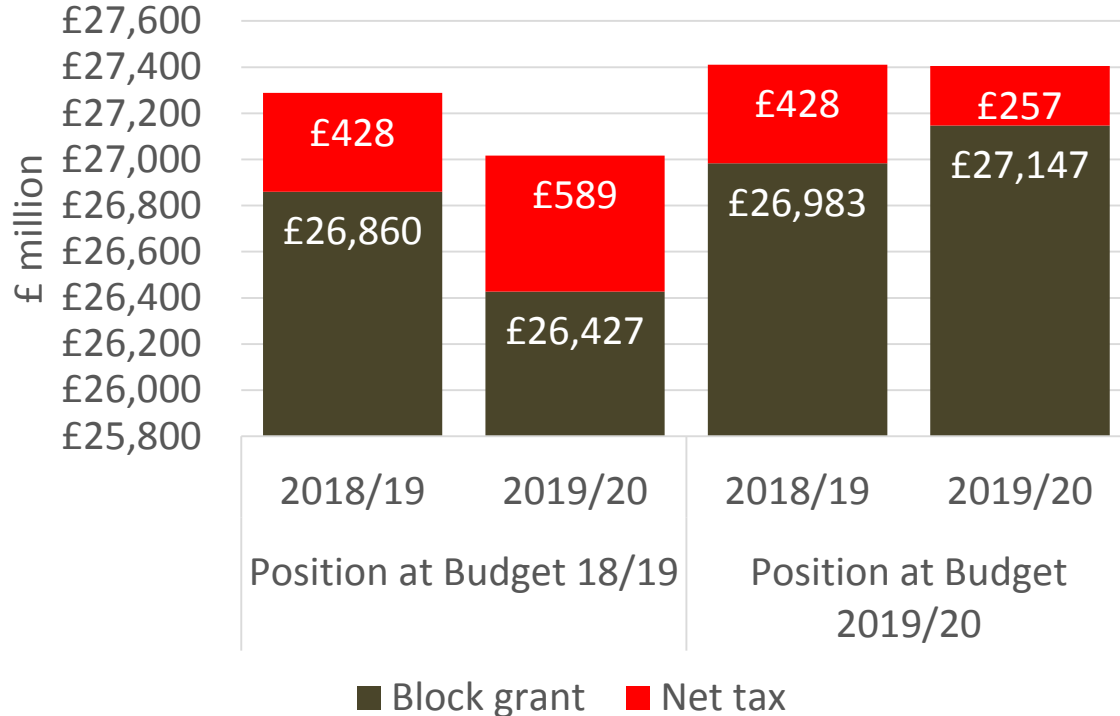
Is the budget up or down on last year?

› Remember first that the resource budget is a function of:

- The block grant from Westminster
- The difference between:
 - Revenues raised in Scotland from taxes that have been transferred; and
 - The block grant adjustments that are used to estimate the revenues foregone by the UKG



Resource budget flat on like-for-like basis



- › Block grant 19/20 much higher than projected this time last year...
- › ...But outlook for income tax somewhat worsened

But resource spending increasing

- › Although like-for-like resource budget is flat, resource spending is increasing by 1.8%
- › Difference of £500m is accounted for by:
 - Additional funding of £290m to deliver new social security powers
 - Various ‘anticipated’ transfers not yet formally confirmed
 - Additional carry forward from Scotland Reserve

	Cash increase in budget	Real terms change
Resource <i>budget</i> increase	£484m	0%
Resource <i>spending</i> increase	£989m	1.8%

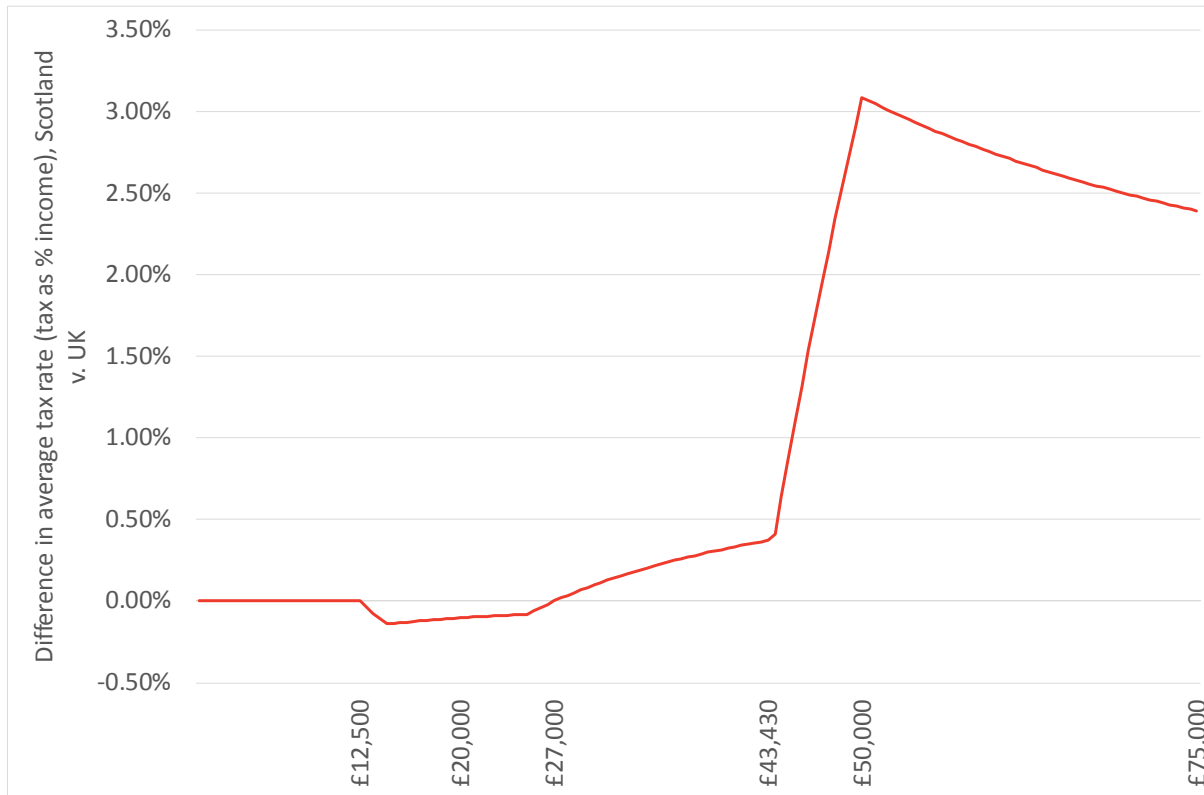


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Tax policy choices and implications

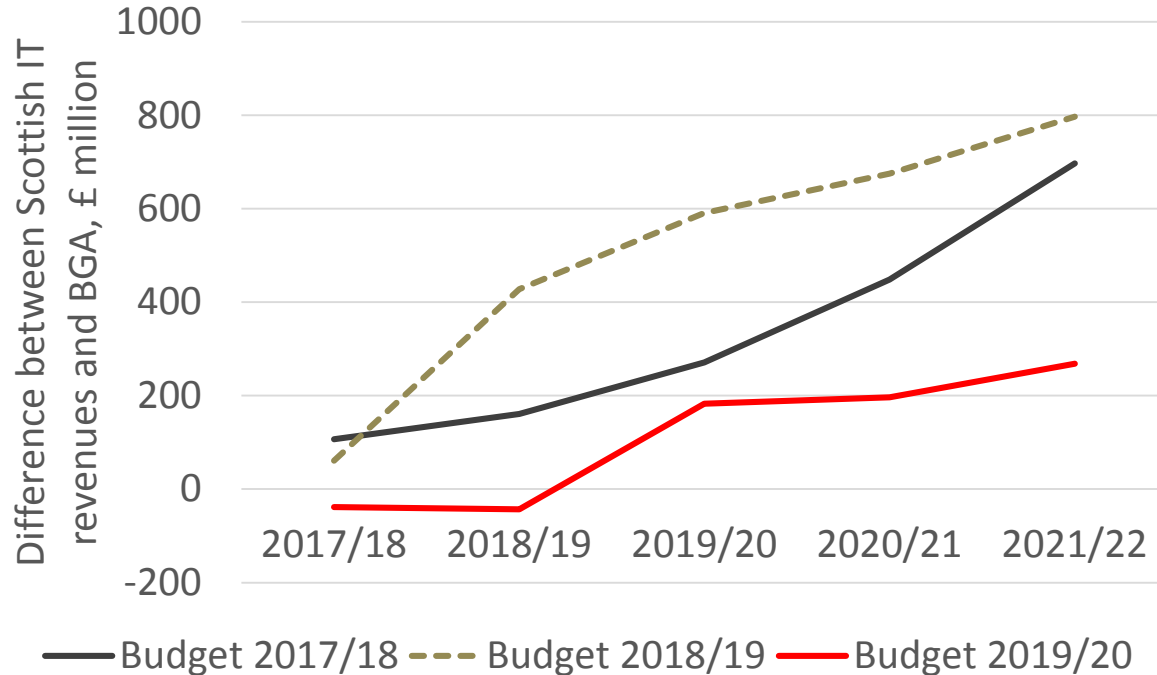


Income tax: the £500m policy divergence



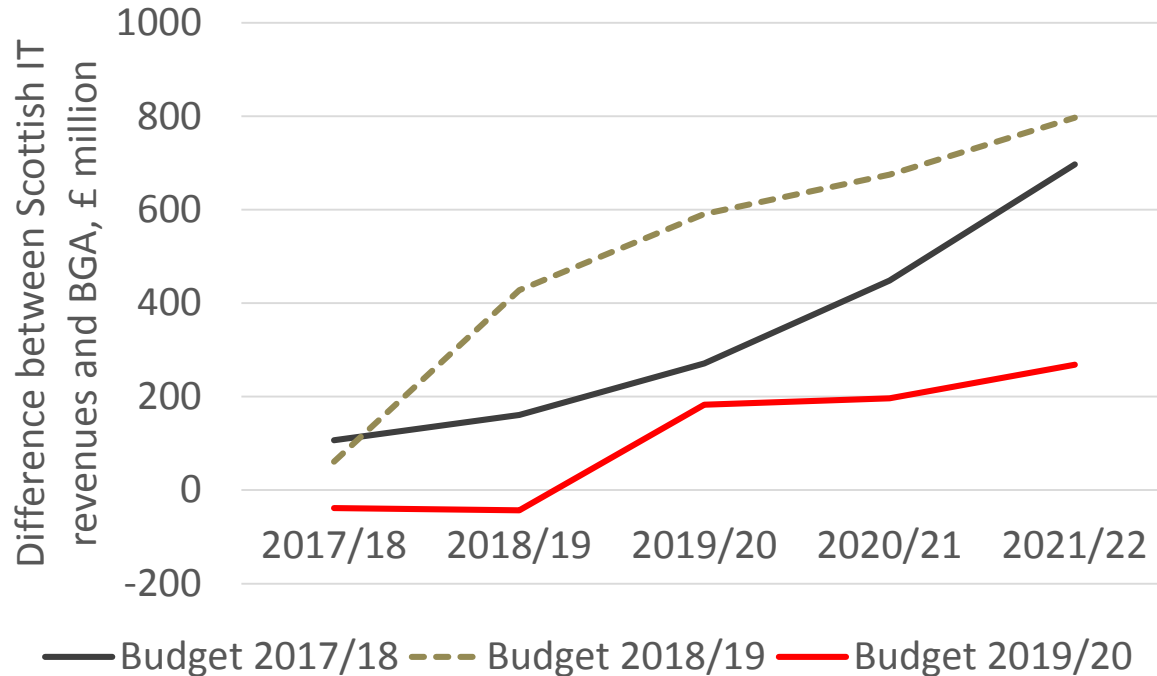
- Further divergence between Scottish and rUK income tax policy
- Scottish income tax revenues likely to be around £0.5bn higher relative to setting rUK policy
- But sig difference in average tax rates

But what is budget impact of IT?



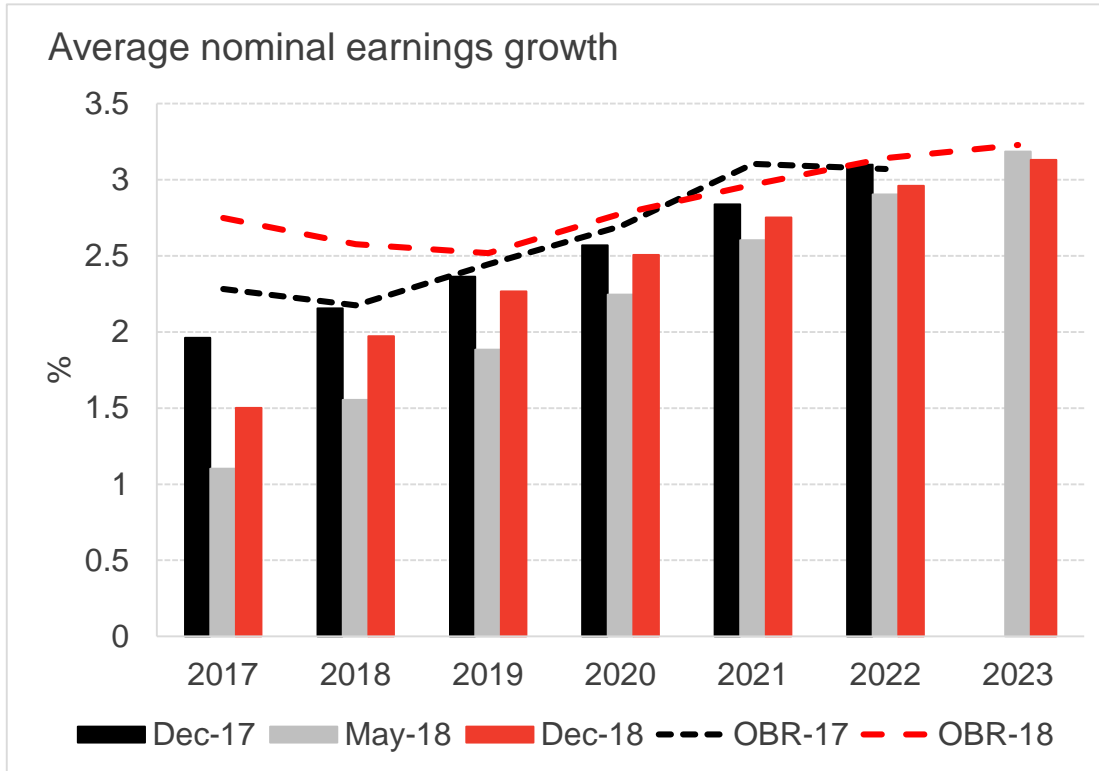
- › Budget 18/19 forecast healthy difference between Scottish revenues and BGA, boosting budget
- › Most recent forecasts mark significant deterioration, despite tax policy choices

But what is budget impact of IT?



- › Budget 18/19 forecast healthy difference between Scottish revenues and BGA, boosting budget
- › Most recent forecasts mark significant deterioration, despite tax policy choices

But what is budget impact of IT?



- › Forecasts for earnings growth in Scotland and UK were comparable this time last year
- › Subsequently the forecasts have moved apart significantly...
- › ...might they converge further?

-
- › Revenues from LBTT forecast to raise £76m more than BGA in 2019/20
 - › In part due to policy decisions:
 - Increase in Additional Dwelling Supplement from 3% to 4% forecast to raise £27m
 - Change to non-residential rates structure forecast to raise £13m
 - › However, some recent signs of market dampening particularly on residential side.
-

Non-Domestic Rates

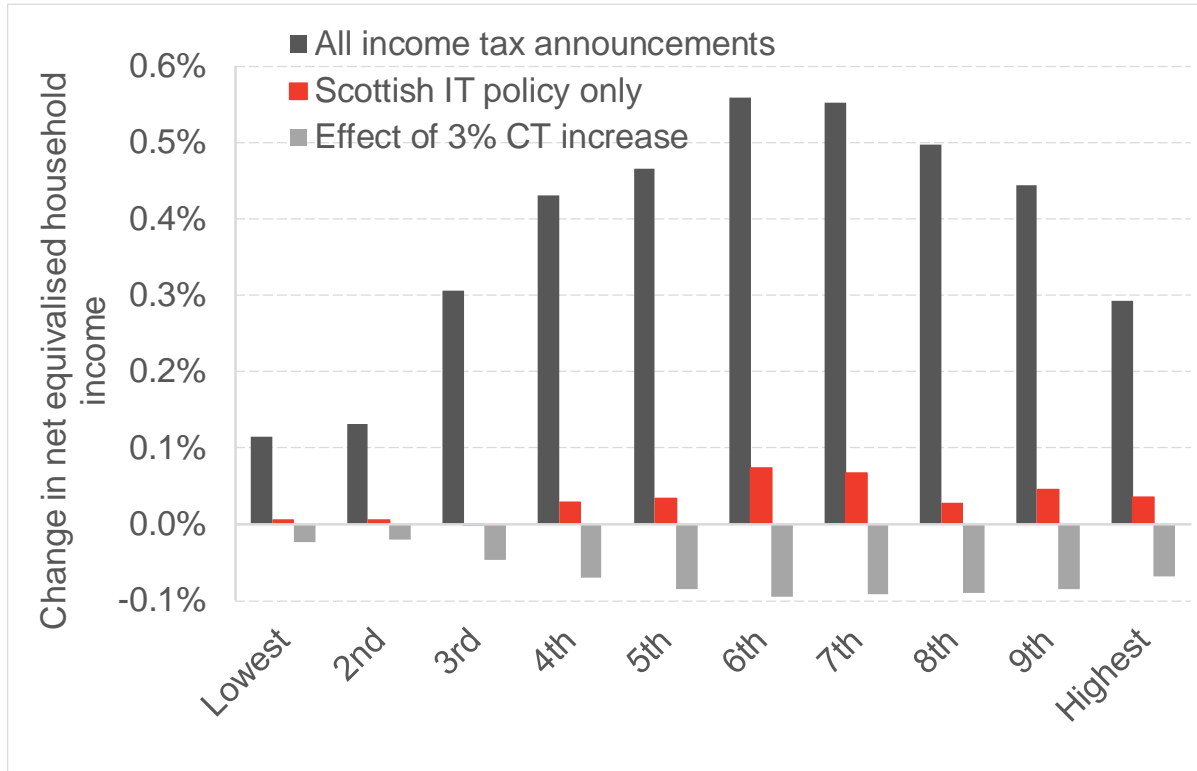
- › Increase in poundage capped just below inflation ‘ensuring over 90 per cent of properties in Scotland pay a lower poundage than they would in other parts of the United Kingdom’
- › Policy costs £35m. Saves a business occupying a property of average rateable value around £200

Average rateable value = £31,525

- | | |
|----------------------------|---------|
| • Bill in 2018-19 | £15,132 |
| • Bill in 2019-20 (before) | £15,636 |
| • Bill in 2019-20 (after) | £15,447 |

- › Council tax: locally determined increases capped at 3%, for third year running
 - › No mention of council tax reform
 - › Only a loose commitment to hold ‘national discussion events’ to consider views on a local tourist tax
 - › Unclear where this leaves prospects of reaching a budget deal with the Scottish Greens, who had made progress on local tax reform their key ask to support the budget
-

Distributional implications



- PA increase tends to benefit households in the top half of the distribution
- Similarly with increase to basic and intermediate thresholds
- A 3% council tax increase is slightly progressive in the lower half of the dist.

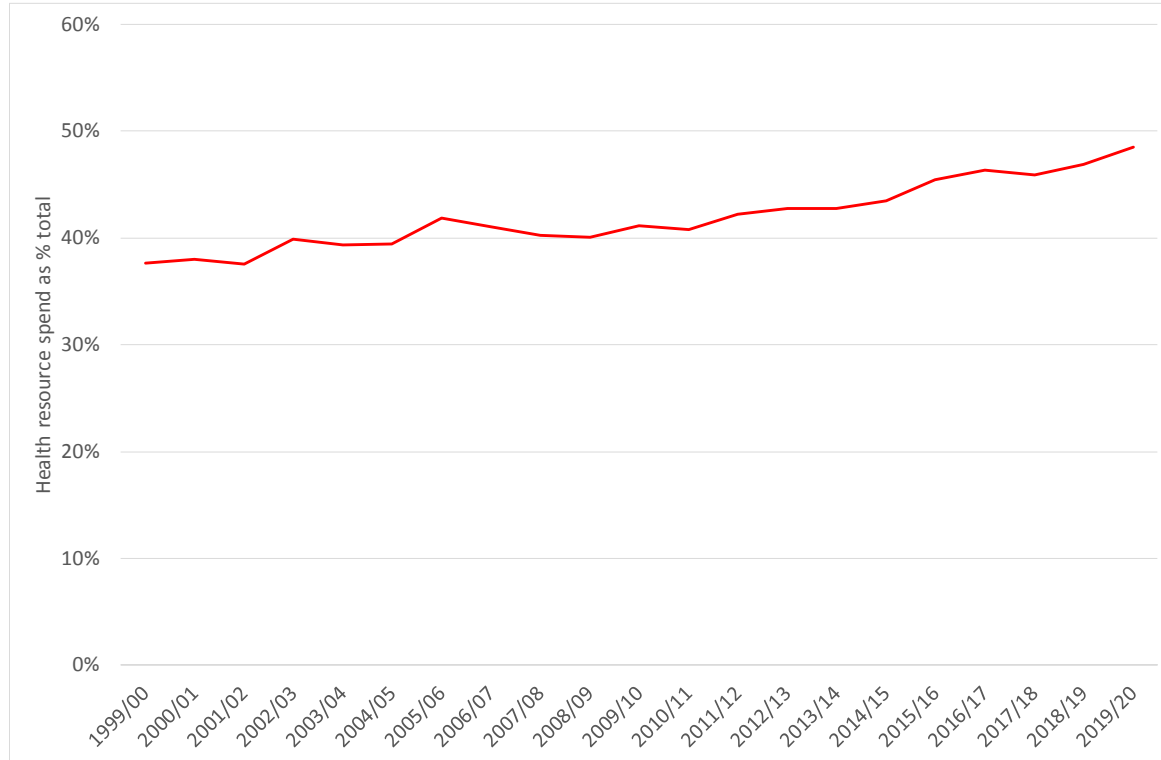


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Spending decisions and implications



Health spending



- › Health resource spend up £670m (3.4% real terms)
- › Sufficient to keep pace with SG's estimate of demand growth
- › Takes health to almost 50% of total resource spend

Local government

2018/19 prices	2018–19	2019–20	Real change
General Revenue Grant	6,734	6,248	-7.2%
Non-Domestic Rates	2,636	2,803	6.3%
<i>Core settlement</i>	<i>9,370</i>	<i>9,050</i>	<i>-3.4%</i>
Specific grants	274	475	73.6%
Total resource	9,643	9,525	-1.2%
General capital			15.5%
Specific capital	598	691	34.4%
<i>Total capital</i>	<i>278</i>	<i>374</i>	<i>21.5%</i>
Resource + capital	876	1,065	0.7%

- › Core settlement is down £300m (3.4%) in real terms on last year
- › With the addition of specific grants, fall of just 1.2%
- › Increase in specific grant due entirely to roll-out of early years and childcare provision
- › Inclusion of capital funding allows government to state that total settlement is increasing in real terms

Social security: new responsibilities

£m	Forecast spend	UKG funding	Difference
Carer's Allowance	283	290	7
Carer's Allowance Supplement	37	0	-37
Discretionary Housing Payments	63	20	-44
Best Start Grant	12	2	-10
Funeral Expense Assistance	6	6	-1
Scottish Welfare Fund	33	0	-33
SG Social Security portfolio - total benefit expenditure	435	317	-117
Healthy Start Vouchers / Best Start Foods	5	0	-5
Employability Services	19	14	-5
Total benefit expenditure	458	331	-127

- › New Social Security and Older People Portfolio in this year's budget, reflecting growing responsibilities
- › Funding transfers from UKG to reflect 'spending foregone' are generally less than forecast expenditure as a result of policy choices

Which services are feeling the strain?

	Real terms change, 16/17 – 19/20	Cash increase (£m) required to restore 16/17 funding in real terms
Higher Education	-5.5%	£58
HESS	-5.2%	£18
Scottish Prisons	-5.9%	£18
Legal Aid	-4.7%	£8
Fire and Rescue	-1.4%	£15
Env. Services (SEPA, SNH, Zero Waste)	-4.2%	£7
Historic Environment Scotland	-23.8%	£2
Concessionary fares and bus services	-2.6%	£15
LG Core settlement	-9%	£539

- › Savings have been realised across many portfolios...
- › ...including some areas of strategic priority
- › But the core LG settlement accounts for the lion's share of savings



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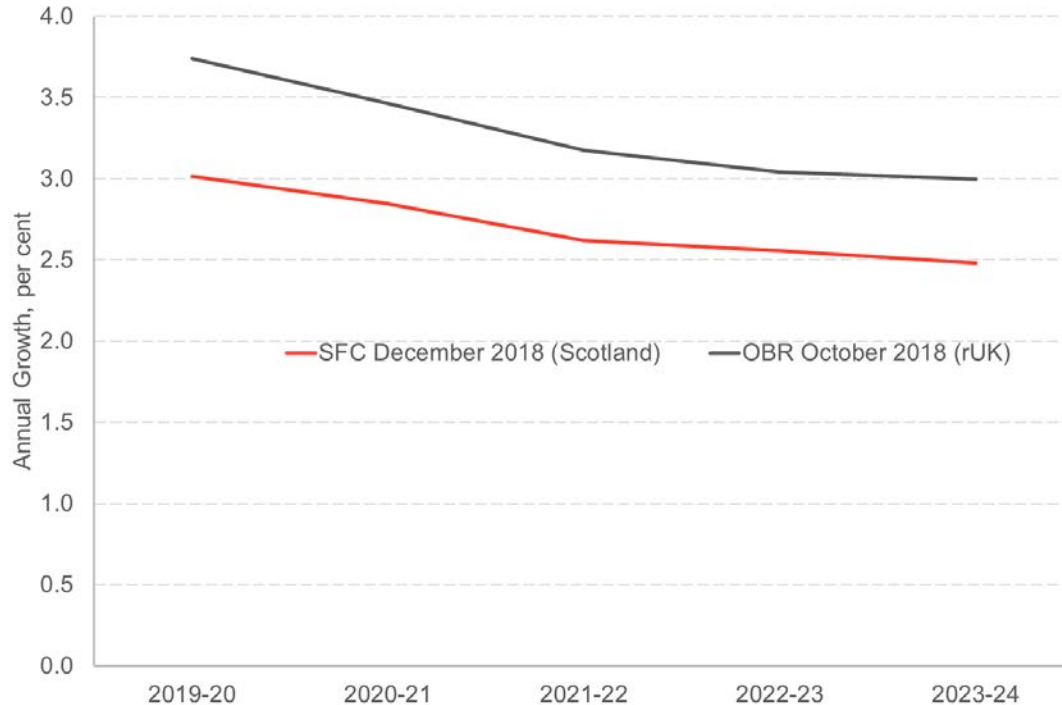
Wrapping up



Looking beyond 2019/20 – big risks

- › VAT to start to ‘count’ in 2020/21
 - › Social security – huge transfer of powers in 2020/21 and 2021/22
 - › Possible income tax reconciliations:
 - On current forecasts, there may be downward reconciliations for income tax of £145m (in 2020/21) and £471m (in 2021/22) in respect of financial years 2017/18 and 2018/19...
 - At the end of 17/18 the Scotland Reserve had a balance of £440m, but the government plans to use £250m of this to support spend in 2018/19 and £220m to support spend in 2019/20
-

Beyond 2019-20: VAT Assignment



- ▶ Leaving aside measurement issues (see our recent blog!), the first Scottish and rUK forecasts suggests this is a risk on the downside to the Scottish Budget in future, with rUK growth forecast to be higher than Scottish growth

Conclusions

- › Like-for-like budget basically flat in real terms
 - › But with health spending increasing by over 3% in real terms it is inevitable that the cuts must fall somewhere
 - › LG core settlement will again be subject to debate... and may form focal point for any future budget deal, perhaps alongside something more concrete on local tax reform
 - › Scottish budget is now £0.5bn higher than it would be if the government followed rUK income tax policy – but weaker economic outlook offsets almost half this potential benefit according to latest forecasts
 - › Like for like budget is projected to increase in 2020/21, but major fiscal challenges too in relation to social security and VAT... and of course the outlook is unusually uncertain
-

Scottish Budget 2019/20

Emma Congreve

Senior Economist

Joseph Rowntree Foundation

Poverty in Scotland

1 million in relative poverty in Scotland

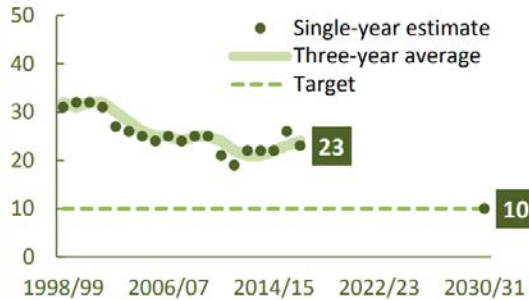
Including a quarter of all children



Relative poverty

Measures poverty relative to the rest of society.

It is the proportion of children living in households with equivalised incomes below 60% of the median (middle) UK income in the current year.



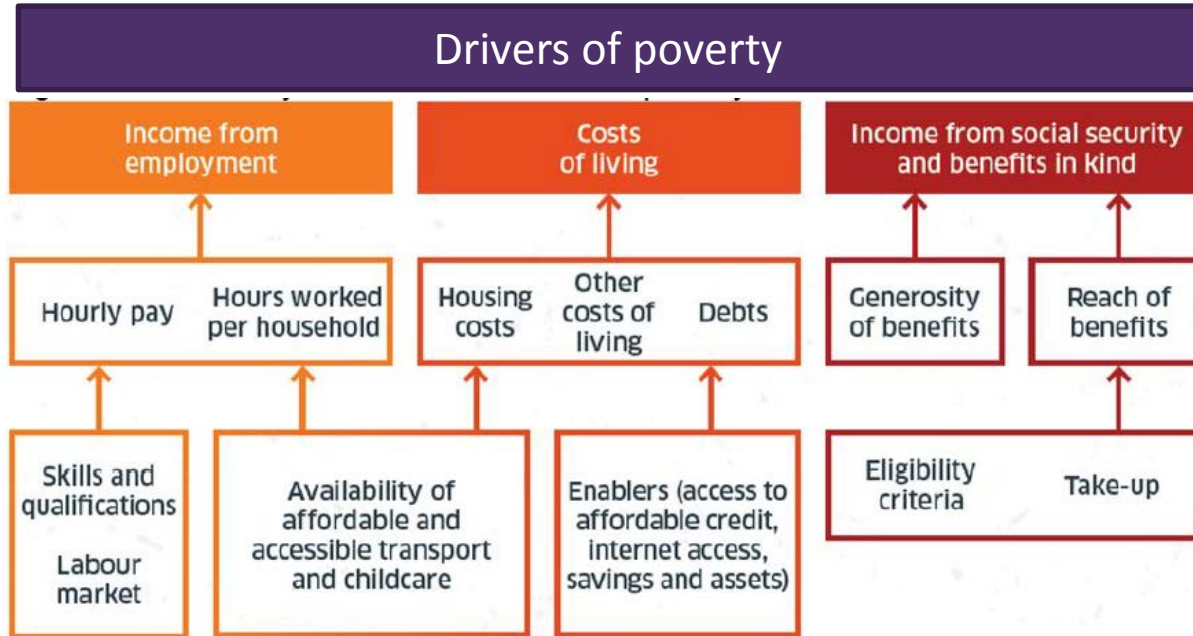
Absolute poverty

Measures changes in poverty relative to a point in time

It is the number of children living in households with equivalised incomes below 60% of the median UK income in a base year – currently 2010/11 - adjusted for inflation.

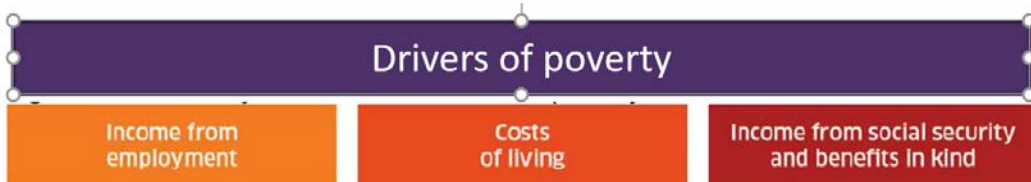


How to end poverty?



Spending to reduce harm of poverty does not itself tackle the underlying causes of poverty for people at this point in time.

Investment in tackling poverty in 2019/20 budget



Little 'new' spending – instead more of the same

E.G. Affordable housing
Intensive parental employment
Fair Start Scotland

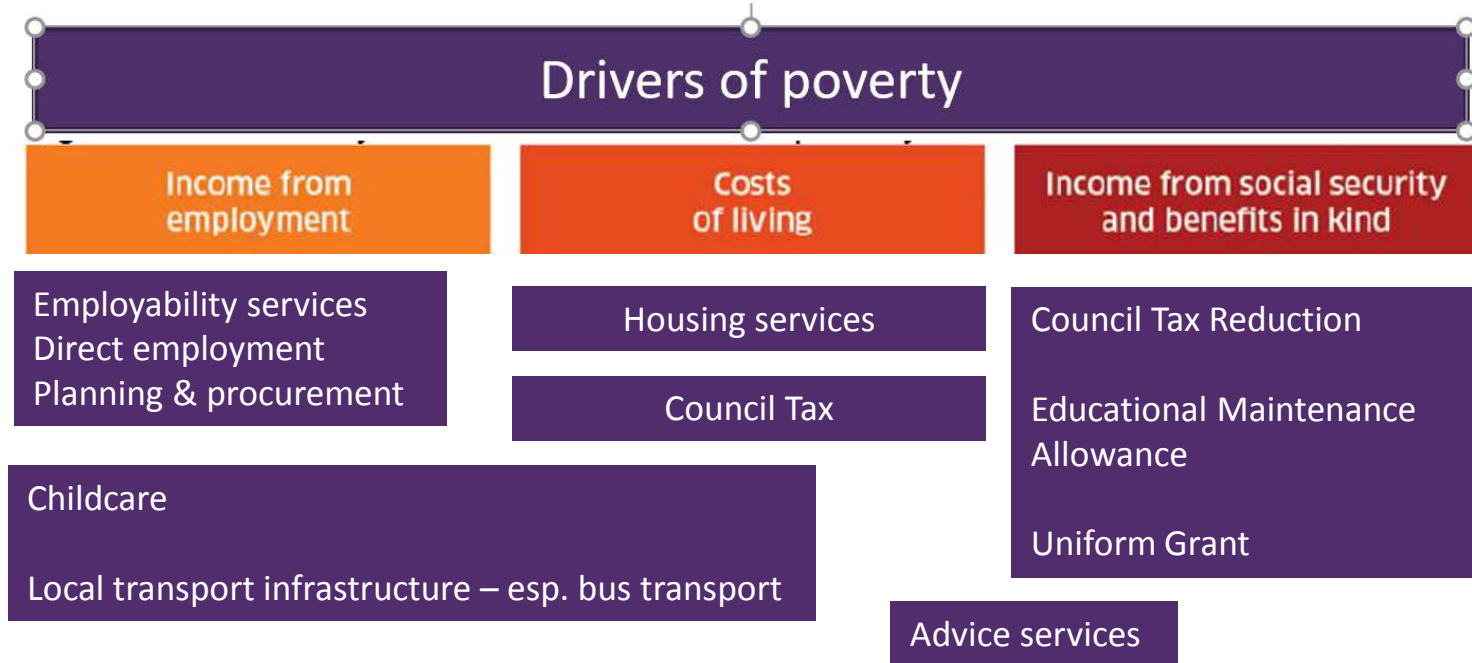
Additional: £2m to help tackle food insecurity

No announcement on Income Supplement

Bulk of new spending on areas where need is at least partly caused by poverty:

- Poverty related attainment gap
 - Health

Local Government is a key delivery partner



Thank you

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Scotland's Budget 2018 Economic Context



November 2018

