What are the future options for devolved funding?

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Economic
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This presentation

- Current funding arrangements
- Incremental reforms
- More radical options

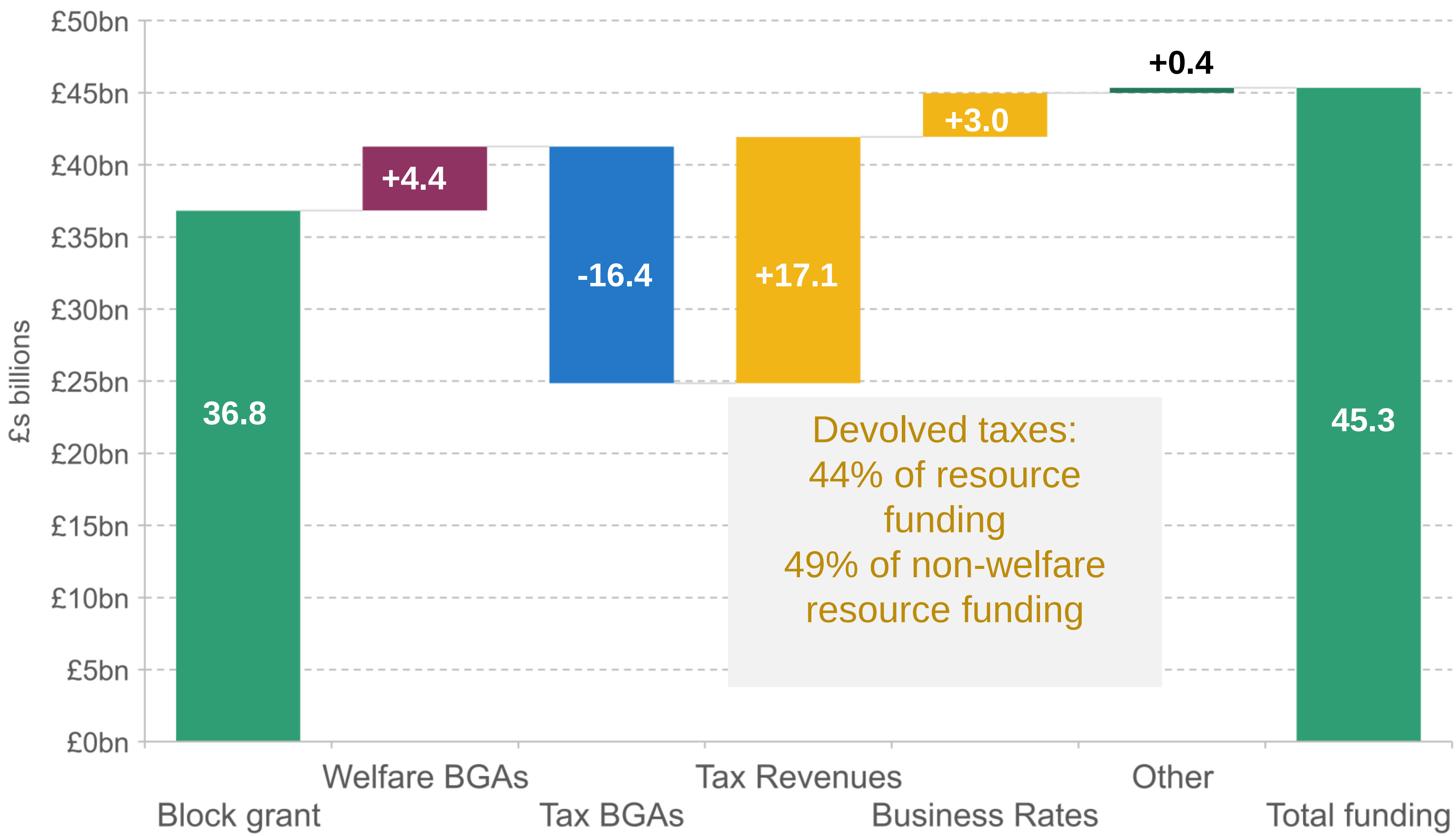
Current funding arrangements

Scottish Government funding

- UK government funding
  - Block grant funding, updated annually via Barnett Formula
  - Devolved social security funding
  - Other non ring-fenced funding
  - Ring-fenced funding for student loans, public sector pensions
- Devolved tax and other revenues
  - Income tax on non-savings, non-dividends income
  - Non domestic rates (and council tax)
  - LBTT and SLfT
  - Other small sources (e.g. Crown Estates)
- Borrowing and reserves
  - Capped at relatively low levels

Resource funding in 2023-24

Resource funding in 2023-24



Devolved tax policies

- Raising more income tax from top half of taxpayers
  - Raises about £1 billion compared to following rUK policy
  - But revenues forecast to be just £0.4 billion higher than BGA due to slow growth in tax base (employment & earnings) 2016-2021
  - Revenues channeled to new & enhanced social security benefits
- Council tax more progressive but substantially lower than E&W
  - Higher rates on Bands E-H raise approx £0.15 billion
  - But lower average bills, partly due to freeze from 2007 to 2017
- Business rates has more & costlier reliefs than England overall
  - But no special relief for retail, leisure & hospitality this year
- LBTT and SLfT policies have little impact on overall funding

Funding outlook

- Medium-term Financial Strategy (MTFS) projected funding would be £1 billion lower than needed to maintain services next year, growing to nearly £2 billion by 2027-28
  - Lots of uncertainty – demand, inflation/costs, and UK govt decisions on tax and spending
  - Projected gap in 2027-28 equivalent to 3.5p on income tax rates
- SFC Fiscal Sustainability Report shows big long-term challenges
  - Rising health and social care costs
  - ‘Barnett Squeeze’: because funding per person is currently higher in Scotland, the same cash-terms increase as in England is a smaller *percentage* increase
  - Again lots of uncertainty – due to same factors as above
- **Can existing taxes or funding reform help Scottish Government meet these long-term pressures and/or have other benefits?**

Incremental reforms

Existing devolved taxes

- Scope to go further with existing income tax powers
  - Government considering a new rate between higher & additional rates – if so, likely only raise a relatively modest sum
  - Increases in tax rates on middle income taxpayers needed to raise more significant sums
- Case to devolve savings and dividends income
  - Wouldn’t in itself boost funding
  - But could apply Scottish rates to all income sources
- Property taxes are overdue fundamental reform
  - Council tax revaluation and reform
  - Business rates ➔ Land value tax
  - Abolish (or at least reduce) LBTT

New or newly devolved taxes

- Scottish Government has broad powers to grant local authorities with revenue-raising powers
  - e.g. tourism accommodation levies, parking levies, planning gain supplements, etc.
  - Even local sales or payroll taxes
- Devolution of apprenticeship levy makes sense but small beer
- Devolution of many other taxes has larger admin, compliance and efficiency costs and only worthwhile if major reforms likely
  - Corporation tax
  - VAT
  - Excise Duties
  - CGT
  - VED

Reform of the Barnett Formula

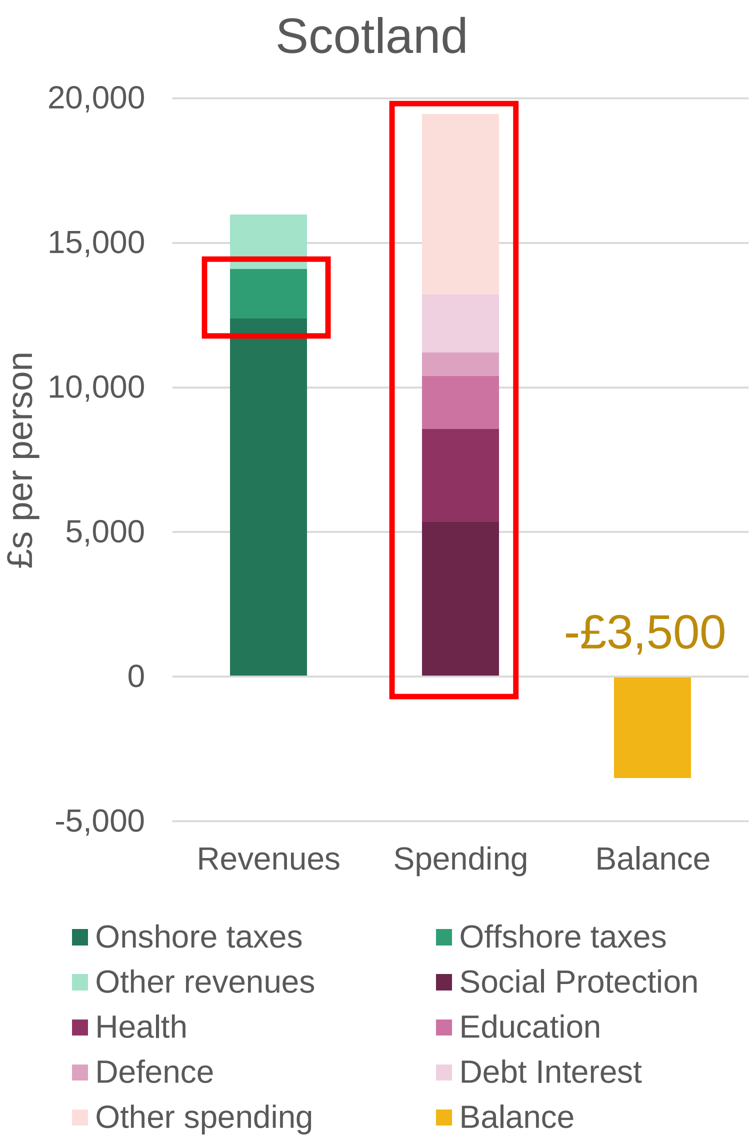
- Wales and now NI are pushing for reform of the Barnett Formula
    - Wales has uplift to reflect higher needs
    - NI will want similar – or new needs-based formula
- Barnett squeeze means Scotland will do less well from formula over time than has historically been the case
- BUT, all reasonable estimates are that Scotland currently receives significantly more funding than it would under a needs-based formula
    - It is not higher taxes or more efficient government that pays for free HE tuition, free personal care, higher public sector pay, etc.
- Scotland unlikely to get a Wales-style deal and therefore should probably lobby to keep the Barnett Formula for the time being

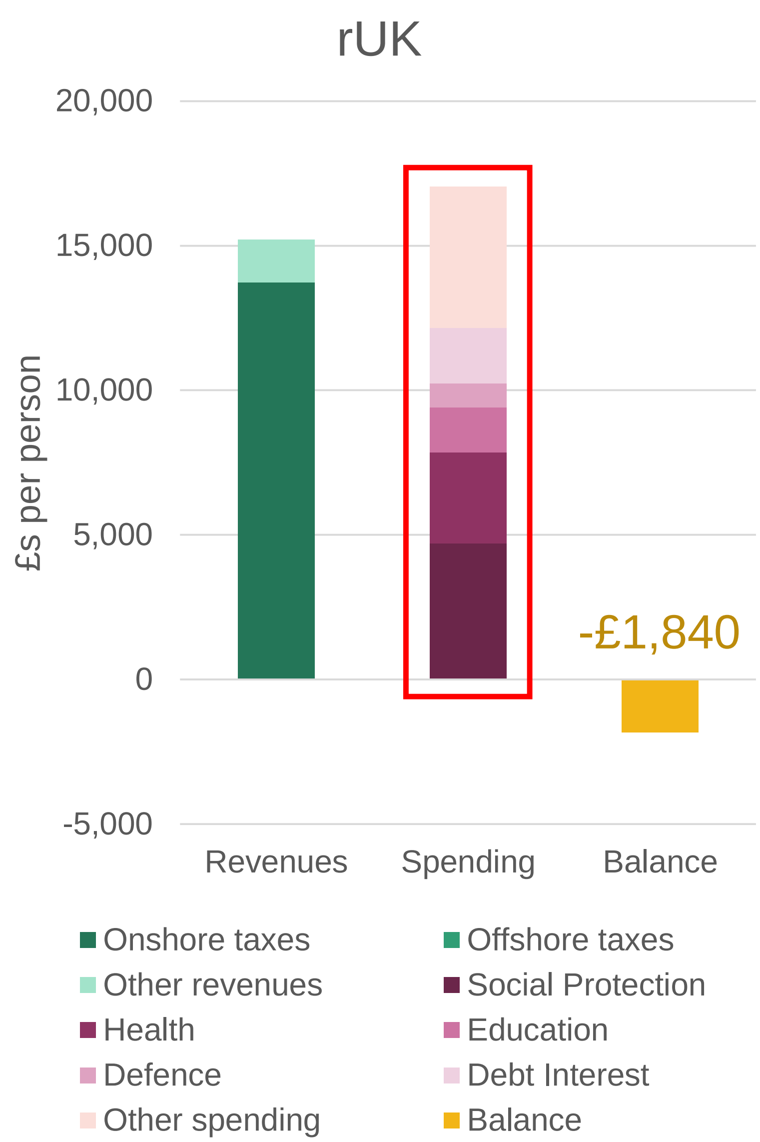
Additional borrowing powers

- Recent renegotiation of Scottish Fiscal Framework will modestly boost borrowing powers
  - £600m versus £300m to address tax and welfare ‘forecast errors’
  - Unlimited reserve drawdown
  - Borrowing limits unfrozen and indexed to inflation
- But resource borrowing still only available in limited circumstances and capital limit still pretty low
- Understandable UK government is reluctant to grant much more expansive borrowing powers
  - No equivalent “English” borrowing
  - Scotland benefits from a much higher-than-population share of UK government borrowing under current arrangements

More radical reform

Scotland's underlying finances





Implications within the UK

- Scotland’s fiscal position means that Full Fiscal Autonomy is not currently appealing
  - Scottish Government’s expenditure and contribution to UK-wide spending on defence, ODA and debt interest would far exceed current Scottish revenues
- Scotland’s fiscal position also means substantial further fiscal devolution may not be feasible
  - No guarantee that substantial additional revenues would be devolved under the ‘no detriment’ principle
  - At some point, if Scottish Govt has more tax and spend levers, I think its likely that it would be expected to take responsibility for Scotland’s weaker fiscal position

A federal UK?

- Further significant fiscal devolution to Scotland may require reforms to England’s fiscal regime
  - e.g. England-only budget, taxes and borrowing
  - e.g. Single settlements for English city-regions or counties
- Growing interest in this idea – except in central government
- Would taxpayers of S.E England baulk if redistribution to Scotland, Wales, NI and the North of England was much more explicit and there was more competition for economic activity via taxes and subsidies as you see in e.g. USA?

Summary

What are the ways forward?

- Further incremental reforms feasible and probably desirable
  - Savings and dividends income tax devolution
  - Reformed, more efficient, property tax system
  - Potentially more local tax options
  - Modest additional borrowing flexibilities
- More radical change requires a step-change in economic performance and views in rUK
  - Scotland currently benefits from large fiscal transfers from rUK
  - Is there an appetite for English budget and/or regional devolution?
- Whatever happens, coming decades will involve painful tax and spending decisions

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