The funding of the Scottish Parliament's new social security responsibilities: how they will work and what are the risks? 21 key questions (and answers)

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Abstract

Eleven social security payments associated with spending of around £3.5bn per annum are being devolved to the Scottish Parliament. Financial responsibility will largely be transferred in 2020, although the full roll-out of Scottish specific payments will take longer. This paper reviews the financial and budgetary implications of this transfer of fiscal responsibility. It considers how the Scottish block grant is being adjusted to reflect the transfer of responsibility, the risks associated with forecasting spending on 'demand-led' social security payments and how forecast error can be addressed; and issues around the concept of 'policy spillovers'.

Keywords: social security; devolution; fiscal framework; budget risks

Introduction

Eleven social security payments are being devolved to the Scottish Parliament following the recommendations of the Smith Commission. The total value of spending on these payments in 2020/21 is anticipated to be around £3.5bn (equivalent to around 12% of the government's current spending on public services).

The Scottish Government's block grant from Westminster will be increased to reflect this transfer of fiscal responsibility. The Scottish Government will have complete autonomy to determine the structure and value of these payments in Scotland or any new benefits or services which might replace them.

Nonetheless, the Scottish budget will be exposed to additional risks as a result of the transfer of fiscal responsibility. Spending on the payments devolved could exceed the additional resources transferred to the Scottish budget if the Scottish Government sets a policy that is in some way more generous in Scotland than prevails in England and Wales, or if the eligible population for a particular payment grows relatively more rapidly in Scotland.

Furthermore, since spending on these payments is 'demand-led', spending allocations in Scottish budgets will be made on the basis of forecasts made by the Scottish Fiscal Commission.

[1] I am grateful to Camilla Kidner and Anne Peat at the Scottish Parliament and Claire Murdoch at the Scottish Fiscal Commission for comments on an earlier version of this paper, and to the Scottish Parliament's Social Security Committee for inviting me to speak to them about the issues covered.

This exposes the budget to the risk of forecast error if spending turns out to be higher than had been forecast.

Financial responsibility for all but two of the eleven payments will be transferred to the Scottish budget in full in April 2020. The Scottish budget will therefore be exposed to fiscal risks associated with the social security powers from next year.

However, under a series of agency agreements agreed by the UK and Scottish Governments, the DWP will continue to deliver devolved benefits in Scotland on the Scottish Government's behalf over the next few years. A new Scottish Social Security Agency has been established, but the new Scottish social security payments will be rolled out to claimants in Scotland gradually over the period to 2024/25.

This paper outlines how the funding arrangements for the new social security payments will work. It covers issues including: how the Scottish block grant is adjusted to reflect the new powers; the risks that the Scottish budget is protected from and those that it is exposed to; how and when spending forecasts are made; what happens when forecasts are 'wrong'; and issues around 'policy spillovers', which have come to the fore in recent political debates. The article addresses these issues through a series of commonly asked questions and answers[2].

1. Which payments are being transferred to Holyrood?

The Smith Commission recommended that powers over eleven social security payments be transferred to Holyrood (Table 1). These comprise:

- Six payments associated with carers, disabled people or those who are ill: Attendance Allowance, Carer's Allowance, Disability Living Allowance, Personal Independence Payment, Industrial Injuries Disablement Allowance, and Severe Disablement Allowance.
- Four payments comprising the Regulated Social Care Fund: Cold Weather Payment, Funeral Payment, Sure Start Maternity Grant, and Winter Fuel Payment.
- Discretionary Housing Payments.

Ultimately the Scottish Parliament will have complete autonomy to determine the structure and value of these payments in Scotland or any new benefits or services which might replace them[3].

[2] The paper builds on the author's presentation to the Scottish Parliament's Social Security Committee (Dec. 2019). I am grateful to Committee members for posing some of the questions that are addressed in this paper.
[3] Healthy Start Vouchers are also being devolved to the Scottish Parliament, and are being replaced by a new payment called Best Start Foods. There is no funding transfer associated with this, as the Scottish Government paid the UK Department for Health and Social Care to administer Health Start vouchers in Scotland on its behalf (expenditure on Best Start Foods is forecast at around £4.5 million).

Table 1: Social security payments being transferred under the Scotland Act 2016

	Forecast expenditure in Scotland, 2020/21 £m	Date of transfer of financial responsibility to the Scottish budget	Funding mechanism
Payments associated with carers, disabled people or those who are ill			
Attendance Allowance	£530	April 2020	BGA
Carer's Allowance	£344	Sep 2018	BGA
Disability Living Allowance	£628	April 2020	BGA
Industrial Injuries Benefit	£82	April 2020	BGA
Personal Independence Payment	£1,607	April 2020	BGA
Severe Disablement Allowance	£8	April 2020	BGA
Payments comprising the Regulated Social Care Fund			
Cold Weather Payments	£16	April 2021 (tbc)	tbc
Winter Fuel Payment	£168	April 2021 (tbc)	tbc
Best Start Grant	£16	Dec 2018	MoG (Barnett)
Funeral Support Payment	£7	Summer 2019	MoG (Barnett)
Other			
Discretionary Housing Payments	£66	April 2017	MoG (Barnett)
Total	**£3,406**		

Notes: Forecast expenditure figures are from the Scottish Fiscal Commission's May 2019 Economic and Fiscal Forecasts. Figure for Carer's Allowance includes the Carer's Allowance Supplement. Information on commencement dates and funding mechanisms is from Scottish Government's 'Fiscal Framework Technical Note', May 2019[4]

[4] https://www.gov.scot/binaries/content/documents/govscot/publications/publication/2019/05/scotlands-fiscal-outlook-scottish-governments-medium-term-financial-strategy-2019/documents/fiscal-framework-technical-note/fiscal-framework-technical-note/govscot%3Adocument/fiscal-framework-technical-note.pdf

2. What has happened so far?

First consider the six payments associated with carer's, disabled people and those who are ill.

A new Scottish Social Security Agency, Social Security Scotland (SSS) was established in September 2018 as an Executive Agency of the Scottish Government. Once it is fully up and running, SSS will deliver the new Scottish payments, replacing the DWP's current role in this regard[5].

It is anticipated that SSS will start accepting new claims for the first new replacement Scottish benefits from 2020. However, the transfer of existing claimants from legacy UK benefits administered by DWP to the equivalent new Scottish benefit will take place gradually over the period to 2024/25.

In the meantime, the Scottish budget took on financial responsibility for Carer's Allowance in Scotland in 2018 and the Carer's Allowance Supplement started to be paid summer 2018.

Financial responsibility for the remaining five disability/illness payments will transfer to the Scottish budget in full from budget 2020/21[6].

What this means in practice is that the Scottish budget takes on the risk that expenditure on these payments in Scotland is higher than the resources that are transferred to the Scottish budget, or that expenditure is higher than forecast. These risks are discussed subsequently.

In terms of the payments associated with the Regulated Social Fund:

- The Sure Start Maternity Grant was replaced by the Best Start Grant in December 2018. New payments introduced for nursery and school age children were rolled out during 2019[7].
- Funeral Expense Payment is now called Funeral Support Payment in Scotland and started to be paid to Scottish recipients in September 2019.
- Financial responsibility for the Winter Fuel Payment and Cold Weather Payment will not be transferred until April 2021.

Responsibility for Discretionary Housing Payments was devolved to the Scottish Government in April 2017, making it the first social security scheme to be devolved to Scotland following the Scotland Act 2016. DHPs are delivered through local authorities, and have to-date largely been used to mitigate the effects of the 'bedroom tax'.

[5] However, an exception to this is Severe Disablement Allowance, which will remain administered by DWP under a permanent agency agreement.
[6] Initially however the majority of Scottish claimants will continue to receive their payment under UK policy from the DWP; Scottish claimants will be transferred onto the replacement Scottish payments – paid by SSS – on a gradual basis to 2024/25.
[7] There are in fact three separate elements of the Best Start Grant: Pregnancy and Baby Payment, Early Learning Payment, and School Age Payment. Each payment is a one-off payment for eligible low-income families. The Pregnancy and Baby element started to be paid in 2018, with the other two elements starting to be paid in 2019.

3. How will the Scottish budget change to reflect this transfer of spending responsibility?

The Scottish budget will be increased to reflect the transfer of new responsibilities.

The way in which the Scottish budget will be increased differs slightly across different payments (Table 1). For the six payments associated with illness and disability – which account for the vast majority of social security expenditure – there will a series of 'block grant adjustments', or additions to the Scottish block grant.

Funding for DHPs in Scotland is determined by so-called Machinery of Government (MoG) transfers. Funding was agreed between the two governments for the period 2017/18 – 2019/20, and in future years the funding will be determined by the Barnett Formula.

Similarly, funding for the Best Start Grant and Funeral Expense payment have been based to date on planned spending on the equivalent payments in England and Wales and Scotland's historic share of those payments. Increases in future years will be determined by the Barnett Formula.

For two payments, the Winter Fuel Allowance and Cold Weather Payments, the funding approach has not been formally determined yet.

This paper will largely focus on the methodology behind and implications of the block grant adjustments, as these are the mechanism through which the majority of funding associated with the new powers if being transferred to the Scottish budget.

4. What are the block grant adjustments?

Each of the six social security payments associated with carers, illness and disability that are being transferred to Holyrood will be associated with a block grant adjustment (BGA).

The BGAs are additions to the Scottish budget to reflect the transfer of spending responsibility from the UK Government to the Scottish Government. There will be a BGA for each payment in all future iterations of the Scottish budget.

One way to think of these BGAs is that they reflect the spending that UKG has saved as a result of no longer delivering the benefit in Scotland.

In effect, the BGA is saying: *If Carer's Allowance (for example) had not been devolved, how much would the UKG have spent on Carer's Allowance in Scotland?*

This estimated amount is transferred to the Scottish budget. It is not a ring-fenced amount. If the Scottish Government spends more on a payment in Scotland than has been transferred through the BGA (for example, if it establishes a policy that is in some way more generous than

that provided in England and Wales), it would have to find additional resources from elsewhere in its budget (via tax rises or spending decreases elsewhere).

On the other hand, if the Scottish Government spends less on a payment than it receives in BGA, it can use the additional resources to spend on other areas of devolved public spending, or cut taxes.

5. How are the block grant adjustments calculated?

There are two components to calculating a BGA:

- An initial addition. This is the amount that the UK Government spent on a payment (e.g. Carer's Allowance) in Scotland in the year prior to that payment being devolved.
- An indexation measure: a measure of the growth in spending on 'comparable' social security payments per capita in England and Wales.

This is shown schematically in Figure 1, for the hypothetical example of Carer's Allowance.

Effectively what the BGA calculation is saying is:

Let's assume that, if Carer's Allowance had not been devolved, the UK Government's spending on it in Scotland would have grown at same per capita rate as in England and Wales (E&W).

This amount is transferred to the Scottish budget, and if the Scottish Government spends more on it (as has been the case in 2019/20 following the payment of a Carer's Allowance Supplement in Scotland), then the Scottish budget bears the additional cost.

Figure One: Calculating the BGA: example of the UKG Carer's Allowance

6. Can you show a worked example?

Imagine we are trying to calculate the BGA for Carer's Allowance in 2019/20.

- The first step is to find out the initial deduction, i.e. spending on Carer's Allowance by the UK Government in 2017/18. This was £249m. We then need to express this in per capita terms, so we divide it by the Scottish population in 2017/18 of 5.425m to get spending per capita of £46.

- The second step is to work out the growth rate of spending on the Carer's Allowance in England and Wales between 2017/18 and 2018/19. It turns out that spending per capita in England and Wales grew from £44 to £47, a growth rate of 7%.
- The third step is to apply that growth rate in spending per capita of 7% to Scotland's spending per capita in 2017/18. If Scotland's spending per capita on the Carer's Allowance grew by 7% between 2017/18 and 2018/19, it would increase from £46 to £49.
- Finally, we multiply that figure of £49 by Scotland's population *in 2018/19* of 5.438 million, giving a BGA for the Carer's Allowance of £267 million.

Figure Two: Calculating the BGA for the UKG Carer's Allowance in 2019/20

	2017/18	2018/19
A: Spending in E&W on Carer's Allowance	£2,581m	£2,771m
B: Population of E&W	58,744,600	59,115,800
C: Spending per capita in E&W (A/B)	£44	£47
D: Growth of spending per capita in E&W		7%
E: Spending in Scotland in year prior to devolution	£249m	
F: Scottish population	5,424,800	5,438,100
G: Scotland spending per capita (E/F)	£46	
H: Hypothetical Scottish per capita spending		£49
I: Block Grant Adjustment (F*H)		£267m

7. What are the implications of the BGAs for the Scottish budget?

One of the features of the BGAs is that the Scottish budget is protected against factors that push up spending per capita on the payments across the UK as a whole.

For example, to the extent that many of the payments being transferred are more likely to be claimed by older aged groups, then an ageing population will imply higher spending per capita. Scotland's population of older age groups is projected to increase, implying higher expenditure in Scotland. But the population of older groups in England and Wales is also projected to increase, which will lead to an increase in the size of the BGAs.

On the other hand, the Scottish budget is exposed to the risk of faster growth in spending per capita on the payments being transferred relative to spending per capita on the equivalent payments in England and Wales.

This outcome could arise if the payments were more generous in Scotland than in England and Wales, either in terms of eligibility criteria or payment amounts.

But it could also arise if the population of eligible claimants grows more quickly in Scotland than in England and Wales.

Think again about the demographic issue described above. The share of older aged groups is expected to grow in Scotland and England and Wales. But it is expected to grow relatively more rapidly in Scotland. So whilst the effects of an ageing population in Scotland on social security spending might be offset to an extent by increases in the BGAs, they are unlikely to be fully offset.

It's possible therefore that future spending on social security in Scotland might be higher than the resources transferred through the BGAs, not because of any policy change, but because of differential demographic trends.

Whether this outcome would be 'fair' and whether or not it was an intended feature of the funding mechanism could be debated.

8. Is it fair that the level of resources provided to the Scottish Government are dependent on the UK Government's policy choices?

The resources made available to the Scottish Government via the BGAs are a function of UK Government policy choices on the equivalent payments in the rest of the UK. If the UK Government increased the Carer's Allowance rate, or widened the eligibility criteria for PIP, this would increase spending in England and Wales and hence the BGA.

On the other hand, if the UK Government started means testing the Winter Fuel Payment, reduced the rate associated with a payment or made eligibility criteria stricter in some way, this would reduce spending in England and Wales and hence the BGA (although as noted above it has not yet been formally decided whether the block grant in respect of the Winter Fuel Payment will be made via a BGA or some other method).

Some people question whether it is fair that the resources available to the Scottish Government for a devolved function should be determined by UK Government policy. In practice it is very difficult to see how an alternative arrangement could operate (short of full fiscal autonomy and cessation of the grant transfer entirely).

If the resources transferred to the Scottish budget are de-linked entirely from UK Government spending on equivalent benefits, then the only real alternative would be for the UK Government to transfer sufficient resources to Scotland for the Scottish Government to be able to fund its own stated policy. However, this arrangement would clearly incentivise the Scottish Government to set the most generous policy imaginable and would require that policy to be funded by taxpayers throughout the UK (in the form of higher taxes or reduced spending elsewhere).

9. Why don't we just use the Barnett Formula?

The majority of the Scottish Government's block grant from the UK Government is determined by the Barnett Formula. This allocates the Scottish budget a population share of changes in UK Government spending on 'comparable' services in England.

In principle, the annual change to the Scottish budget in respect of the social security payments could be made by the Barnett formula (the initial transfer would always reflect what the UK Government had spent in Scotland prior to a payment being devolved). From a Scottish perspective there is at least one good reason why you would not want that to happen.

Spending per capita on most of the payments being devolved is noticeably higher in Scotland compared to England and Wales. Under the Barnett Formula, Scotland would be allocated a population share of changes in English spending. This would amount to a smaller cash uplift than if the Scottish budget was increased in proportion to the increase in England.

This can be illustrated with a simple example. Imagine for simplicity that the population of England and Scotland is the same (completely unrealistic but makes no difference to this illustration). Imagine that spending on a particular payment is £100 per capita in England and £120 in Scotland. Then imagine that spending in England increases by £10 per capita, which is 10 per cent.

- Under the Barnett Formula, Scotland's block grant would increase by £10 per capita, an increase of only 8.3%.
- In contrast, under the BGA approach, Scotland's block grant would increase by 10%, which is an increase of £12 per capita.

The more principled argument for using the BGA approach it is that the BGA is more likely to represent a realistic reflection of the spending that the UK Government has foregone as a result of transferring the social security payments to Scotland.

In other words, if the payments had not been devolved, would spending on those payments in Scotland by the UK Government be more likely to have increased at the same per capita percentage rate as in England and Wales, or the same per capita cash amount as in England and Wales? This is the sort of question that the two governments are likely to debate when the fiscal framework is reviewed in 2021/22[8].

[8] See Eiser and Roy (2019) The fiscal framework: 2021 review. Fraser of Allander Economic Commentary https://pure.strath.ac.uk/ws/portalfiles/portal/88616522/FEC_43_2_2019_EiserD_RoyG.pdf

10. Where does forecasting come into things?

Of course, when Scottish budgets are set, we won't know what will be spent on the 'equivalent' social security payments in England and Wales for the forthcoming financial year. Therefore, we won't know for sure what the BGAs will be.

So there'll need to be a forecast of each BGA at the time of a Scottish budget. These BGA forecasts will be calculated on the basis of forecasts of spending on the relevant social security payments in England and Wales. These forecasts are made by the OBR.

At the same time, Scottish budgets will rely on forecasts of Scottish spending on the social security payments. These forecasts will be made by the Scottish Fiscal Commission (SFC).

11. How much error will be associated with the forecasts?

Actual spending by the UK Government on the equivalent benefits in England and Wales will almost certainly differ from the forecast. As a result, the outturn BGA will differ from forecast.

Evidence suggests that the error associated with the year-ahead forecasts of spending on the payments being devolved is typically around 3.5% at UK level[9]. Given that the value of the payments being determined by BGAs is around £3.2bn in 2020/21, this suggests an error in value terms of around £110 million.

However, there will also be error associated with the forecasts of Scottish spending. What really matters for the Scottish budget is not the level of forecast error on Scottish spending or the BGA in isolation, but how correlated those errors are.

Think of a specific example to illustrate. Imagine that forecast expenditure on the PIP in Scotland is £1.6bn, and the forecast of the BGA is also £1.6bn.

Now imagine that actual spending in Scotland turns out to be higher than forecast, say £1.7bn. In this case, the Scottish Government has had to pay out £100m more on PIP than it had expected.

If spending on PIP in England and Wales is also higher than forecast, by a similar proportion, then the outturn BGA will also end up being £100m higher than was anticipated in the budget. So in this case, forecast error on Scottish spending is offset by forecast error on the BGA; ultimately the Scottish budget is no worse off than what was forecast.

Of course if the forecast errors are completely uncorrelated, this could create significant budget risks. If Scottish spending and the BGA are forecast at £1.6bn, but Scottish spending turns out to be higher at £1.7bn whilst the BGA turns out to be lower at £1.5bn, then the Scottish Government effectively has a £200m gap in its budget relative to its plans.

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[9] Evidence from Cabinet Secretary for Social Security and Older People to Scottish Parliament Social Security Committee, 10 October 2019 http://www.parliament.scot/parliamentarybusiness/report.aspx?r=12322&mode=pdf

In terms of forecast error therefore, the key issue is not the size of the forecast error on Scottish spending, but the correlation between the forecast error on Scottish spending and the forecast error on equivalent spending in England and Wales.

12. When do the effects of forecast error impact on the budget?

Whilst forecast error on Scottish spending can be offset (or accentuated) by forecast error on spending in England and Wales, there are timing differences in the way that these errors would play out[10].

Figure 2 illustrates these timing issues for a hypothetical scenario. Imagine that the budget for 2020/21 has been published (typically this would happen in December, although this year is different). The budget includes a forecast for Scottish spending on a particular payment, say Carer's Allowance, of £300m in 2020/21. The forecast of the BGA is £290m.

Note that in this hypothetical case, Scottish spending is forecast to be £10m higher than the BGA. This might be because of policy variation in Scotland, or it could be because of differential growth in the eligible population, or it could simply be due to differences in forecast methodology. Regardless of the explanation, the Scottish Government cannot borrow to fund this difference; the gap has to be found from elsewhere in the budget. The UK Government would transfer £290m to the Scottish budget.

Throughout the 2020/21 year, SSS would make payments to Scottish claimants. In this hypothetical example, these payments total £310m, i.e. £10m more than was forecast.

What happens to the BGA? It is revised at two points:

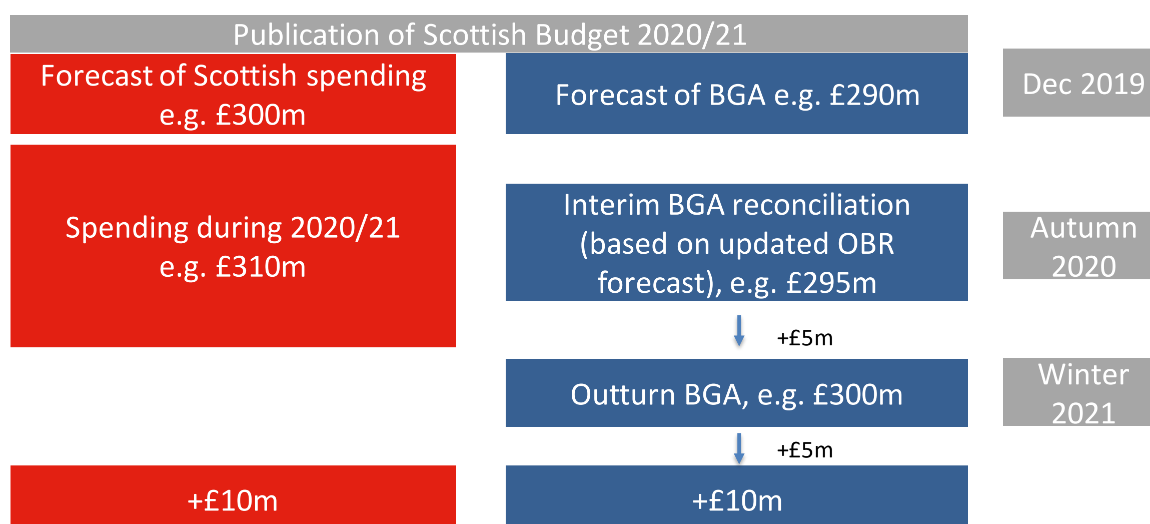
- First, an **interim BGA reconciliation** is made halfway through the financial year (coinciding with the UK's autumn budget for 21/22), based on updated forecasts for spending in England and Wales in 2020/21. In this hypothetical example, the forecast for spending in England and Wales has been revised up, resulting in an upwards revision to the BGA. This results in an additional transfer of resources from the UK Government to the Scottish Government, to make up the difference between the first estimate of the BGA and the revised estimate.
- Second, the **final outturn BGA** is calculated based on outturn data on spending in England and Wales. This will be available in autumn/winter of 2021, 7-8 months after the end of the financial year. In this example, outturn spending is slightly higher than the revised forecast. Again, there would be an additional transfer of resources from the UK Government to the Scottish Government to make up the difference between the interim BGA estimate and the final outturn BGA.

[10] In this sense the process is different from the process for income tax, where there is a one-off 'reconciliation' that simultaneously addresses the combined effects of forecast error for Scottish revenues and forecast error for the BGA.

In this hypothetical case, both Scottish spending and the BGA have ended up £10m higher than originally forecast, cancelling out the effect of forecast error on the two components individually.

But there is a timing issue in the sense that whilst the (higher than forecast) Scottish spending occurs within the financial year, some of the BGA reconciliation occurs in the subsequent fiscal year.

Figure 3: Timing of BGA reconciliation



13. How can the Scottish Government manage forecast error?

The preceding example shows a hypothetical case whereby forecasting error on Scottish spending is cancelled out by forecast error on the BGA. So there is no forecast error as such, although timing issues relating to differences between when expenditure is incurred and when BGAs are updated may create some in-year cash management challenges – discussed subsequently.

Of course, it's possible that forecast errors do not cancel out. And it's quite possible that Scottish spending could end up £100m or more higher than forecast, and/or the BGA could end up £100m or more lower than forecast.

The Scottish Government has two main tools to address forecast error (in addition to adjusting its spending on other areas):

- It can use resources built up in the 'Scotland Reserve'. The Scotland Reserve is effectively a rainy day fund. The government can add resources to it from underspends or from years when tax revenues have been higher than forecast.
- It can use its borrowing powers.

14. Will these budget management tools be sufficient?

The government can save a maximum of £750m in the Scotland Reserve for resource spending, and draw down a maximum of £250m per annum. Additionally, it can borrow up to £300m per annum to manage forecast error (within an overall cap of £1.75bn).

In the context of the social security powers, these budget management tools might appear reasonably generous. However, these limits have to cover forecast errors across social security spending and all devolved tax revenues combined.

At the moment it is difficult to know whether these limits will be sufficient in 'normal' years. Whether they are will depend on the extent to which forecast errors on social security spending are correlated with errors on social security BGAs; whether the errors across different social security payments will be correlated or not; and whether errors associated with devolved tax revenues are correlated with errors associated with social security payments.

However, the fact that the forecast error associated with income tax alone in 2018/19 could be as high as £600m suggests that, in some years, the budget management tools may not be sufficient to address forecast error.

15. Why are the forecasts made by the SFC? Doesn't this weaken democratic accountability?

It is sometimes argued that if the budget is determined by the forecasts of a body that is not directly accountable to the electorate, this may weaken accountability and lead to a lack of transparency in how the budget is determined. An argument is made that if the government is responsible for forecasting, then if its forecasts are consistently poor the electorate can reflect dissatisfaction at the ballot box, whereas an independent forecaster can only be held accountable indirectly via scrutiny by parliamentary committee.

The main argument for having forecasts of demand-led spending (and tax revenues) made by an independent forecaster is that an independent forecaster should be less prone to systematic optimism bias than a government might be. Indeed it is for this reason that the majority of developed country governments have now established independent fiscal organisations.

This does not mean that an independent forecaster will never be wrong, but that in the long run they should be less systematically wrong than a government would be. Forecasts that are systematically over-optimistic would be more likely to result in the government needing to use its borrowing powers, and ultimately in its borrowing limits being reached.

On the accountability side, the SFC is accountable to parliament for its forecasts, both in terms of justifying ex ante the decisions it has made, and ex post explaining the reasons behind any

error. It is not obvious that there would be greater transparency around those factors if the forecasts were made by the government itself.

16. What are the government's 'in-year cash management' borrowing powers for?

As well as borrowing for forecast error, the government can borrow up to £500m annually for 'in-year cash management'.

This borrowing enables the government to manage cash flow when spending is volatile throughout the year. For example, some payments might be disproportionately claimed in some times of year over others. Alternatively, there might be lags (as we illustrated above) between spending being incurred in Scotland and the BGA 'catching up' with that spending at a later date.

At the current time we have little idea as to how often these borrowing powers might be used, or whether they will be sufficient.

Note however that, whilst the government can borrow up to £500m annually for in-year cash management, and £300m annually for forecast error, the annual cap on all types of resource borrowing is £600m. So if the government borrows £500m one year for cash management, it would only be able to borrow £100m to address forecast error.

17. What are 'policy spillovers' and when might they apply in the social security context?

The Smith Commission identified the concept of 'policy spillovers' as follows:

'*where either government makes a policy decision that affects the tax receipts or expenditure of the other, the decision-making government will either reimburse the other if there is an additional cost, or receive a transfer from the other if there is a saving*'.

The UK and Scottish Governments have subsequently agreed that they will generally only consider providing financial recompense in the case of 'direct' spillover effects. Direct spillovers are those where the financial implication comes about mechanistically as a result of a policy change by one or other of the governments. Indirect spillover effects – which come about as a result of behavioural responses to a policy change – will generally not be subject to consideration of financial recompense (unless the financial effect is particularly large and can be proven reliably).

A hypothetical example of a direct policy spillover in the social security sphere could be if the Scottish Government broadened the eligibility criteria for one of the new Scottish disability benefits in such a way that this led to an increase in the number of people in Scotland who

qualify automatically for the disabled child addition in Universal Credit – which is paid by the UK Government[11].

It remains unclear how many instances of direct policy spillover effects might arise as the Scottish Government implements new social security payments in Scotland.

18. If the Scottish Government encourages people to take-up reserved benefits in Scotland, would this constitute a policy spillover?

The Scottish Government has expressed an ambition to encourage take-up of reserved benefits in Scotland, with a particular emphasis on Pension Credit. Pension Credit is provided to low-income households of state pension age. Encouraging take-up of Pension Credit may be an effective part of a strategy to reduce poverty rates among pensioners.

The Scottish Parliament's Social Security Committee has heard evidence that a policy by the Scottish Government to increase take-up of reserved benefits may, by increasing the spending of the UK government, create a policy spillover, and that the UK Government may seek financial recompense for the increase in expenditure that results.

My personal view is that this is a red herring. A policy to increase the take-up of a reserved benefit in Scotland could not be construed as creating a policy spillover because, by definition, there has been no policy change.

Instead, the Scottish Government is simply proposing to encourage Scots to claim what they are eligible for under the policy as designed by the UK Government. In this respect, the Scottish Government could argue that it is doing the UK Government's job for it.

19. Will the arrangements be reviewed?

Yes. The governments have committed to review the fiscal framework periodically, with the first review set for 2022. The review is likely to consider, among other things, the appropriateness of the methods used for calculating BGAs, the adequacy of budget management tools, and arrangements for identifying and resolving policy spillover issues.

[11] I am grateful to Camilla Kidner at the Scottish Parliament Information Centre for this example.

20. What about the costs of administering the social security payments in Scotland?

In the Financial Memorandum to the Social Security (Scotland) Bill, the Scottish Government estimated that the costs of setting up the new Social Security Scotland Agency would total £308m by 2020/21[12].

The Financial Memorandum estimates the costs of *running* the social security system once it is fully operational at between £144m - £156m per annum. This represents around 5% of the value of benefits being devolved.

Under the Fiscal Framework, the UK Government will transfer up to £66 million each year to the Scottish budget to cover ongoing administration costs. The UK Government will also make a one-off transfer of £200m to the Scottish budget to cover implementation costs associated with the new powers.

Note that these transfers are to cover all costs associated with the newly devolved powers, not just social security. Additional costs are associated with the Scottish Fiscal Commission and Revenue Scotland for example.

Any administration costs over and above those provided through the fiscal framework will need to be funded by the Scottish Government through its existing resources. The estimated costs of setting up the agency (£308m) clearly exceed the value of the transfer from the UK Government. Similarly the estimated running costs (around £150m) exceed the value of the £66 million to be transferred each year from the UK Government.

The Scottish Government has not yet updated its estimates of the set-up or running costs of SSS, of which a recent Audit Scotland report was critical[13]. It is anticipated that the government will publish a revised business case for the social security programme at the time of the next Scottish budget.

21. How would you summarise the main risks that the Scottish budget faces?

The transfer of responsibility for Social Security payments to Holyrood creates broadly two types of financial risk for the Scottish budget to manage:

- First is the risk that spending on social security in Scotland significantly exceeds the additional resources (BGA) transferred to the budget.
- Second is the risk of forecast error: specifically, that the difference between spending and BGA turns out to be larger than forecast.

[12] Scottish Parliament (2019) https://www.parliament.scot/parliamentarybusiness/Bills/105267.aspx
[13] Audit Scotland (2019) Social security: implementing the devolved powers. https://www.audit-scotland.gov.uk/report/social-security-implementing-the-devolved-powers

The first risk is the more significant in the long-run. If spending is higher than the BGA purely because the Scottish Government has chosen to implement a more generous policy in Scotland, then this might not be viewed as too problematic – after all, policy choices have to be paid for.

If on the other hand the BGAs decline as a result of a stricter policy being applied in England and Wales, some will perceive this as being unfair – although it is difficult to conceive of a funding approach that is completely removed from the implications of UK Government policy and spending.

And if spending in Scotland grows relatively more rapidly simply because the eligible population has grown more rapidly (e.g. as a result of demographic trends), this might fuel a view that the fiscal framework is not fit for purpose.

It is too early to say what might happen in the next few years in this respect. In recent years, spending per capita in Scotland on many of the payments being transferred has tended to grow *less* rapidly than in England and Wales (as Scottish spending declines from a higher base), but this trend could be offset by divergent demographic trends in future.

In terms of the second risk, we currently can only guess at the likely size of forecast error and the crucial question of whether forecast errors on Scottish spending are correlated with forecast errors on the BGAs. But it does seem safe to assume that, as Scottish policy diverges from that in England and Wales, forecast errors are likely to become less strongly correlated.

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