Part 1: The economic context
Backdrop was always going to be economy

Scottish growth slipped to just 0.1% in Q2……..

......in 5 of the last 6 quarters, Scottish growth has been less than 0.1%.

Scotland's current annual growth rate is just 1/3 that of the UK as a whole

Source: Scottish Government GDP Series, Oct 2017
Strong headline labour market......

Scottish labour market continues to hold up well......

....despite fall in employment in recent months......near record levels (since LFS was first conducted in 1992)

But there remain questions about the nature of much of the work being created

Source: ONS LFS, Dec 2017
Scottish productivity had been catching up with UK….

…but productivity has been weak since 2008 (and catch-up with UK largely driven by pace of job creation at UK level)

Productivity – in terms of output per hour – falling for 7 consecutive quarters

Source: Scottish Government Productivity series, Nov 2017
The SFC’s economy forecasts

Both OBR and BofE had revised down forecasts for UK – Brexit uncertainty and weak productivity outlook

Growth below trend: <2%

Our latest forecasts are also for below trend growth

SFC predicting much weaker growth…..less than 1% to 2021

Source: SFC, OBR, BofE, FAI Dec 2017
To put this in context.....

If this forecast from the SFC turns out to be true.....

.....longest run of below 1% growth in 60 years

Source: Scottish Government GDP Series, Oct 2017
Why are the SFC pessimistic?

Reason 1:
SFC more pessimistic than OBR on current output gap

Despite weak growth for over 2 years, they believe that Scotland is ‘operating above capacity’

Limits potential for ‘bounce-back’ in growth

Big judgement call – believe slowdown all ‘structural’

Source: Scottish Fiscal Commission
Why are the SFC pessimistic?

Reason 2:

Scotland’s working age population projected to decline over next few years…but rise in UK SFC use 16-64 projections – (we use ‘working age’ which is more optimistic)

SFC also use ‘50 percent EU migration variant’ – OBR use principal projection (again which is more optimistic)

Source: ONS population projections
Why are the SFC pessimistic?

Reason 3:

Like OBR, SFC believe slowdown in productivity over last few years will continue.....

....even then, more pessimistic than OBR for UK

With little growth in participation or hours worked, growth potential of Scotland much slower

Source: SFC, December 2017
By the end of the forecast horizon, the two key drivers of the gap between Scotland and the UK are –

1. Weaker productivity forecasts

2. Weaker population forecasts

Source: SFC, December 2017
Key driver of difference = population

Combined, this leads to much weaker forecast for Scottish growth than UK....

Source: SFC, December 2017
Key driver of difference = population

...gap slightly smaller when viewed in per capita terms

But still weak outlook

SFC forecast real household incomes to be below 2007 levels even by 2022....

...marking at least 15 years of a squeeze on households

Source: SFC, December 2017
Implications for Scottish budget

- Under the fiscal framework, Scotland’s relative performance to the UK is crucial for Scottish budget.

- ...but SG insisted on comparisons being made on performance per capita.

- Budget confirms why this was so important, as weaker population growth rates don’t feed through to growth in per capita income tax.

- At the same time, SFC believe that weaker productivity growth will be offset by slightly better participation rate and earnings propped up by tighter labour market.
The economic impact of tax rises

Needs to be put in context:

1) 0.11% of Scottish GDP
2) Tax rise offset by spending rise
3) Not all behavioural changes lead to change in economic activity
4) Other policy measures can – in theory – help offset (but take time and not guaranteed)

But perception important

Source: FAI calculations
Policy measures (largely flowing from Barclay Review) cost £96m in 18/19 – offsetting 60% of income tax cut

These include Business Growth Accelerator and some new reliefs

Continuation – in 18/19 – of transitional relief for businesses in Aberdeen (costing £15m)

Policy to uprate bills by CPI rather than RPI brought forward from 2020 to 2018, following UKG announcement of same (arguably revenue neutral as associated with Barnett consequentials)

Some Barclay Review recommendations (raising revenue) not yet implemented
Policies to support growth - capital

Substantial additional capital spending – combination of rise in CDEL & FT’s

Targeted at housing & economy - 30% cash terms increase in housing capital spending

Plan to use borrowing in full….by 18/19 government will have used up nearly 50% of borrowing cap

Source: Scottish Government, Dec 2017
Policies to support growth - spending

- EJFW up £260m in real terms...........95% in the form of capital and FT’s (£115m capital & £130m FT’s)

- £340m capitalisation over 2019-2021 of National Investment Bank. £70m in 2018-19 on ‘Building Scotland Fund’

- Small real terms increase in colleges vs. further small real terms cut in higher education

- £2.4bn on enterprise and skill support system..... “A key priority for the Strategic Board will be development in 2018 of a plan”..... “to help to inform the decision-making process for budget allocations in future years”. How radical are government prepared to be?
Scottish Fiscal Commission very downbeat about outlook for Scottish economy

Driven by weak assessment for productivity and working age population – and belief that recent slowdown is structural rather than cyclical

The Scottish budget is protected – at least in short-term – from some of these effects under the fiscal framework……but growth vital to long-term sustainability of public finances

Tax and pay measures – “apart from the change to public sector pay policy, the Commission’s judgement is that these policies are not of a large enough magnitude to have a significant aggregate impact on the Scottish economy…. “
Part 2: The tax view
The Scottish Budget – the tax view

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

18 December 2017
Overview: Scottish Budget

Scottish income tax
- Rates and bands 2018/19
- Take home pay
- Interaction with UK taxes
- Administering SIT

Devolved taxes
- LBTT, SLfT and ADT
- Non domestic (business) rates

Tax thoughts for the future
Scottish rates and bands for NSND income

<table>
<thead>
<tr>
<th>Band of NSND income</th>
<th>Name of rate/band</th>
<th>Income tax rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Over £11,850* – £13,850</td>
<td>Starter rate</td>
<td>19%</td>
</tr>
<tr>
<td>Over £13,850 – £24,000</td>
<td>Basic rate</td>
<td>20%</td>
</tr>
<tr>
<td>Over £24,000 – £44,273</td>
<td>Intermediate rate</td>
<td>21%</td>
</tr>
<tr>
<td>Over £44,273 – £150,000**</td>
<td>Higher rate</td>
<td>41%</td>
</tr>
<tr>
<td>Above £150,000**</td>
<td>Top rate</td>
<td>46%</td>
</tr>
</tbody>
</table>
## SIT take home pay in 2018/19

<table>
<thead>
<tr>
<th></th>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>£15,000</td>
<td>£610</td>
<td>£90 more in your pocket in 2018</td>
<td>Scots £20 better off</td>
</tr>
<tr>
<td>£24,000</td>
<td>£2,410</td>
<td>£90 more in your pocket in 2018</td>
<td>Scots £20 better off</td>
</tr>
<tr>
<td>£26,000</td>
<td>£2,830</td>
<td>£70 more in your pocket in 2018 – due to UK personal allowance increase</td>
<td>Scots no better or worse off</td>
</tr>
<tr>
<td>£30,000</td>
<td>£3,670</td>
<td>£30 more in your pocket in 2018</td>
<td>Scots £40 worse off</td>
</tr>
<tr>
<td>£33,000</td>
<td>£4,300</td>
<td>No difference</td>
<td>Scots £70 worse off</td>
</tr>
<tr>
<td>£60,000</td>
<td>£13,115</td>
<td>£15 less in your pocket in 2018</td>
<td>Scots £755 worse off</td>
</tr>
<tr>
<td>£90,000</td>
<td>£25,415</td>
<td>£315 less in your pocket in 2018</td>
<td>Scots £1,055 worse off</td>
</tr>
</tbody>
</table>
Income tax rates and bands 2018/19

UK Personal allowance - £11,850
  • Applies to the whole of the UK; can’t be changed in Scotland

rUK: and also for ‘Scottish’ taxpayers – these bands are relevant for establishing the rates of tax chargeable on savings and dividend income
  • £11,850 - £46,350 - basic rate
  • £46,350 – £150,000 – higher rate
  • Over £150,000 - additional rate
SIT: interaction with UK tax

- Rates and bands set by Holyrood
- Reliefs and allowances set by Westminster
  - Personal allowance
- What is the basic rate?
  - Gift aid
  - Pension contributions
  - Marriage allowance
- National insurance contributions
Administering SIT in 2018/19

- HMRC
  - Identification of ‘S’ taxpayers
  - Responsible for collection
- Employers - PAYE
- Software houses
- Self employed
- Taxpayer reaction
Devolved taxes

**LBTT**
- Rates remain unchanged
- A first time buyer relief - £175,000

**SLfT**
Increase in rates – in line with the UK

**ADT**
- No progress in its implementation date
- Delay due to state aid issues
No domestic (business) rates

- Most of the Barclay review recommendations adopted
- Inflationary uplift: capped at CPI (3.0%) instead of RPI (3.9%)
- Three yearly revaluations
- Small business bonus scheme
- Implementation plan published

- Removal of some charities reliefs
Tax thoughts for the future

- The direction of Scottish tax policy
- Making Tax Digital
- Simplification…….
- Employment status and the gig economy – the tax issues remain and at some stage will need to be addressed
- Brexit
- How does a government grow the tax take?
Part 3: The fiscal context
## The resource budget (£m)

<table>
<thead>
<tr>
<th></th>
<th>2017/18</th>
<th>2018/19</th>
<th>2018/19</th>
<th>change</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>cash</td>
<td>real</td>
<td>%</td>
<td>£</td>
</tr>
<tr>
<td>Block grant</td>
<td>26,679</td>
<td>26,860</td>
<td>26,469</td>
<td>-0.8%</td>
</tr>
</tbody>
</table>

- **Block grant down £200m (0.8%) real terms**

### Revenues minus BGA:

<table>
<thead>
<tr>
<th></th>
<th>2017/18</th>
<th>2018/19</th>
<th>change</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>LBTT</strong></td>
<td>79</td>
<td>-12</td>
<td></td>
</tr>
<tr>
<td><strong>SLfT</strong></td>
<td>-38</td>
<td>12</td>
<td></td>
</tr>
<tr>
<td><strong>IT</strong></td>
<td>30</td>
<td>366</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>71</td>
<td>362</td>
<td></td>
</tr>
</tbody>
</table>

- But income tax revenues forecast to outperform BGA by £366m in 2018/19

| Total resource budget | 26,750 | 27,222 | 26,826 | 0.3%   | 76     |

- Result: resource budget up £76m (0.3%)
Scottish income tax forecast revised down throughout forecast period

But income tax BGA forecast also revised down

Result: Scottish budget better off than without tax devolution (and compared to last yr)

(But forecasts not always ‘right’!)
Why gap between Scotland’s IT revenues and BGA in 18/19?

The £366 gap between forecast Scottish income tax revenues and the income tax BGA in 2018/19 is largely explained by:

- Additional forecast revenues of around £140m from the decision to set Higher Rate Threshold at £44,273 rather than £46,350
- Additional forecast revenues of £164m from this year’s tax policy announcements
- Residual largely explained by effect of faster public sector wage growth on Scottish revenues

Implicitly, underlying tax base grows as fast in Scotland as in rUK
## Income tax policy

<table>
<thead>
<tr>
<th></th>
<th>Income</th>
<th>Marginal rate</th>
<th>No. of taxpayers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal Allowance</td>
<td>Up to £11,850</td>
<td>0%</td>
<td></td>
</tr>
<tr>
<td>Starter rate</td>
<td>£11,851 - £13,850</td>
<td>19%</td>
<td>250,000</td>
</tr>
<tr>
<td>Basic rate</td>
<td>£13,851 - £24,000</td>
<td>20%</td>
<td>1,031,000</td>
</tr>
<tr>
<td>Intermediate rate</td>
<td>£24,001 - £44,273</td>
<td>21%</td>
<td>893,000</td>
</tr>
<tr>
<td>Higher rate</td>
<td>£44,274 - £150,000</td>
<td>41%</td>
<td>332,000</td>
</tr>
<tr>
<td>Additional rate</td>
<td>&gt;£150,000</td>
<td>46%</td>
<td>18,900</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td><strong>2,500,000</strong></td>
</tr>
</tbody>
</table>
Relative to what taxpayers would pay in 18/19 had there been no policy action, those earning <£26k pay less/same

Max saving per taxpayer = £20 per year

3% change in Band D council tax = approx £35 per year
Forecasts for residential LBTT revised up due to faster than expected growth in prices and transactions in 17/18

Zero rate introduced for first time buyers from £145k -£175k

Reduces FTBs average tax bill by £290 (for those within band) and £600 (for those above band)

SFC estimate policy will result in an additional 150-200 FTB transactions per year…

…at a revenue cost of £5-£6m per year

Non-residential revenue forecast revised down slightly

Over remainder of forecast period, LBTT revenues now forecast to marginally outperform BGA
Revenues: summary

- The resource block grant falling 0.8% (about £200m) in 18/19
- Underlying income tax base forecast to grow at same per capita rate in Scotland as rUK
- As a result of income tax policy decisions taken this year and last, income tax revenues forecast to be higher than income tax BGA by £366m
- For both LBTT and LfT, revenues broadly forecast to match BGA
- Net result is Scottish resource budget up 0.3% (£76m)
- But remember, forecasts might not be ‘right’
Spending commitments

› Resource budget up about £75m (0.23%) in real terms but government announced spending increases of £250m (0.9%) – the result of ‘draft budget to draft budget’ comparisons

› Health resource budget up £400m (almost 2% real terms). But matching pay policy could cost £170m, and budget has to increase 1%/yr just to match demographic trends

› Resource allocation to police ahead of commitment, but not sufficient in itself to match pay policy

› Additional investments in childcare to support expansion, and in Pupil Equity Fund/Attainment Fund to close education attainment gap
Discretionary resource grant (GRG + NDRI) down 2% (£183m) real terms

Including specific grants, total resource settlement is ‘flat cash’ (1.4% real terms fall)

Within this total, at least £150m for delivering specific policy commitments

On back of real terms decline in resource funding of 8% since 2010 (compared to 5% for SG)

SPICe estimates cost to LG of implementing SG pay policy at £150m

Increasing council tax by 3% could raise around £77m

On capital, discretionary budget down £63m but extra £150m specific grants to support childcare
Conclusions

- Unprecedentedly weak economic outlook for next five years
- But growth in devolved revenues largely forecast to keep pace with ‘block grant adjustments’…
- …with income tax policy announcements in 17/18 and 18/19 helping to raise a further £300m revenue in 2018/19, offsetting fall in block grant
- Budget emphasis on growth, through significant expansion in capital expenditure and use of Financial Transactions, plus cuts to business rates
- On track to deliver major policy commitments on health, policing, education and childcare, but all settlements constrained especially in context of pay policy
The Scottish Budget 2018-19
18 December 2017