

Fiscal Framework Technical Note

May 2019

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1 Introduction

The UK and Scottish Governments agreed a new funding model for Scotland following the passage of the Scotland Act 2016. This agreement, Scotland's Fiscal Framework, sets out the rules by which the new powers are implemented and managed.

This note explains how the Fiscal Framework operates in practice. It covers:

- the evolution of the fiscal powers of the Scottish Parliament and how they operate under the Fiscal Framework;
- the timelines for reconciliations and how they affect the Scottish Budget;
- the limits of the borrowing powers and Scotland Reserve;
- the Fiscal Framework Review.

This note will be updated at every Fiscal Framework Outturn Report to reflect any further implementation work undertaken throughout the year.

2 Operation of the Fiscal Framework

2.1 The Block Grant and Barnett Formula

Prior to the Scotland Act 2012 and the Scotland Act 2016, the Scottish Government's main source of funding was a Block Grant from the UK Government.

The growth of the annual Block Grant was (and still is) determined by the operation of the Barnett Formula. A comprehensive explanation of the methodology for calculating the Block Grant can be found in the UK Government's Statement of Funding Policy. However, a short summary is given below.

Under Barnett, each financial year's Block Grant is initially equal to that of the previous year. For any changes in comparable UK Government department spending (i.e., in areas which are devolved to Scotland), a population share of this increased or decreased funding is reflected in changes to the Block Grant. Barnett therefore does not determine the total allocation for each devolved administration afresh each time it is applied, rather it applies UK Government funding increases or reductions to the previous Block Grant.

The basic calculation for changes to the Block Grant is reflected in the formula below:

Figure 2.1 - The Barnett Formula



For example, suppose that £10 million extra Home Office funding for the next financial year were announced. The current Statement of Funding Policy states that the 'comparability percentage' of the Home Office's functions that are devolved to Scotland is 91.7%. The appropriate population share in this case is Scotland as a proportion of England and Wales (9.31%), given UK Government spending in this area primarily covers England and Wales only. Following those three steps, the calculation for the Barnett share is as follows:

$$£10,000,000 \times 0.917 \times 0.0931 = £853,737$$

A £10 million increase in Home Office spending would therefore result in £853,737 being added to the Scottish Government's Block Grant. Equally, if there were a £10 million decrease in spending, this amount would be deducted from the block grant. These amounts are referred to as 'Barnett consequentials'. It is the sum total of these Barnett consequentials that ultimately determine whether the initial size of the Block Grant is bigger or smaller than the previous year.

2.2 Evolution of the Scottish Parliament's fiscal powers

The Scotland Act 2012 and the Scotland Act 2016 devolved a number of significant new fiscal powers to Scotland. This required major changes to the process of calculating Scotland's annual Block Grant, described in a new Fiscal Framework. The new powers are set out below.

Land and Buildings Transaction Tax (LBTT) and Scottish Landfill Tax (SLfT) were fully devolved from the financial year 2015-16 under the Scotland Act 2012.

The Scottish Rate of Income Tax was devolved under the Scotland Act 2012, with the Scotland Act 2016 extending income tax powers significantly from 2017-18. The Scottish Parliament now has the power to set tax band thresholds (excluding the personal allowance) as well as the tax rates for all non-savings, non-dividend income of Scottish taxpayers.

The Scottish Government's capital borrowing powers were granted in the Scotland Act 2012 and the limits were increased in the Scotland Act 2016. Its resource borrowing powers were granted in the Scotland Act 1998, and increased in both the Scotland Acts 2012 and 2016.

The Scottish Government now has a statutory, aggregate capital borrowing cap of £3 billion, of which £450 million can be borrowed in a single year. For resource borrowing, the aggregate cap is £1.75 billion, with an annual limit of £500 million for in-year cash management, £300 million for forecast error and £600 million in total. The annual resource borrowing limit for forecast error is increased to £600 million in cases of a Scotland-specific economic shock.

The Scotland Reserve replaced a previous power under the Scotland Act 2012 to operate a limited cash reserve and the Budget Exchange Mechanism operated by HM Treasury (HMT). The Reserve is capped in aggregate at £700 million. Annual drawdowns from the Reserve are limited to £250 million for resource and £100 million for capital.

The Fiscal Framework and associated technical annex¹ set the rules by which these new powers are implemented and managed.

Further tax and social security powers in the Scotland Act 2016 are being implemented over the coming years.

Three Scotland Act 2016 tax revenues are yet to be implemented: assigned VAT, Air Passenger Duty and Aggregates Levy:

Discussions on the next steps on Scottish VAT assignment are ongoing with UK Government, with the Scottish Government proposing postponing the assignment of Scottish VAT and committing to review the position at the time of the Fiscal Framework review.

The Scotland Act 2016 devolved powers over Air Passenger Duty, enabling the Scottish Government to make arrangements for the design and collection of its replacement, Air Departure Tax (ADT). The tax has yet to be implemented due to legal issues surrounding the exemption for the Highlands and Islands. On 23 April

¹ <https://www.gov.scot/publications/agreement-between-scottish-government-united-kingdom-government-scottish-governments-fiscal/pages/1/>

2019, the UK Government and Scottish Government have agreed that introduction of Air Departure Tax (ADT) will be deferred beyond April 2020 to ensure it is not devolved in a defective state.

There have been ongoing legal issues in relation to the UK Aggregates Levy, which have now been resolved. There will be a review of the UK tax, and the Scottish and UK Governments will discuss the implications of this for the timing of devolution.

Eleven social security benefits are transferring to the Scottish Parliament under the Scotland Act 2016. Funding for three benefits is transferred into the Block Grant with no Block Grant Adjustment (BGA) and no subsequent reconciliation required, initially via 'Machinery of Government' (MoG) transfers instead (for a more detail see section 3.4).

Table 2.1 – Social Security Benefits transferring to Scotland

Benefit	Funding Mechanism	Commencement date
Discretionary Housing Payments ²	MoG	1 April 2017
Carer's Allowance	BGA	3 September 2018
Sure Start Maternity Grant	MoG	10 December 2018
Funeral Expenses Assistance	MoG	Summer 2019
Attendance Allowance	BGA	April 2020
Cold Weather Payments	TBC	April 2020
Disability Living Allowance	BGA	April 2020
Industrial Injuries Benefits	BGA	April 2020
Personal Independence Payment	BGA	April 2020
Severe Disablement Allowance	BGA	April 2020
Winter Fuel Payments	TBC	April 2020

² Responsibility for Discretionary Housing Payments was passed to the Scottish Government from April 2017, and these are administered through Local Authorities.

Why was a new Fiscal Framework needed?

Following the devolution of new fiscal powers, the Smith Commission³, whose conclusions formed the basis of the Fiscal Framework, envisaged a fundamental change in how the Scottish Government would be funded.⁴ They foresaw a substantial proportion of the Government's Budget coming directly from tax revenues raised in Scotland. The Commission made two key recommendations:

"The Block Grant from the UK Government to Scotland will continue to be determined via the operation of the Barnett Formula." (p.25)

"The revised funding framework should result in the evolved Scottish Budget benefiting in full from policy decisions by the Scottish Government that increase revenues or reduce expenditure, and the devolved Scottish Budget bearing the full costs of policy decisions that reduce revenues or increase expenditure." (p.25)

The objective of a new Fiscal Framework was to evolve the funding arrangement by transferring greater fiscal powers and policy responsibilities to Scotland while, to a significant extent, retaining the stability of Block Grant funding.

The Smith Commission laid down one key principle to guide the development of the new Framework - 'no detriment'. In the context of fiscal devolution, 'no detriment' means:

"...initial devolution and assignment of tax receipts should be accompanied by a reduction in the Block Grant equivalent to the revenue foregone by the UK Government, and that future growth in the reduction to the Block Grant should be indexed appropriately." (p.25)

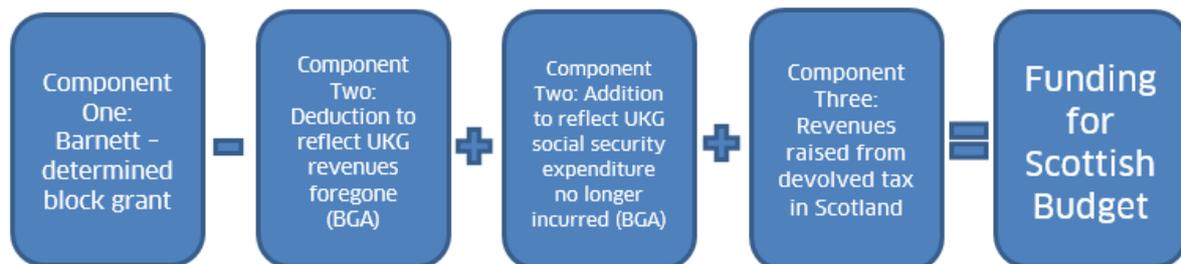
³ After the 2014 Scottish independence referendum, the Smith Commission made recommendations for the further devolution of powers to the Scottish Parliament.

⁴ http://webarchive.nationalarchives.gov.uk/20151202171029/http://www.smith-commission.scot/wp-content/uploads/2014/11/The_Smith_Commission_Report-1.pdf

How the Fiscal Framework works

Guided by Smith Commission principles, a new Fiscal Framework was agreed between the UK and Scottish Governments in February 2016. The Framework lays down three main components for calculating the Scottish Government's Budget.

Figure 2.2 – Calculation of Available Funding for the Scottish Budget



Component One – Barnett-determined Block Grant

Barnett continues to determine the initial size of the Block Grant before adjustments are made to take account of tax and social security devolution.

Component Two – Adjustment to the Block Grant

The Block Grant is adjusted to reflect the impact of the transfer of greater fiscal powers to the Scottish Budget. There are deductions for revenues foregone by the UK Government in devolving revenues to Scotland and additions for social security benefits.

Component Three – Devolved Revenues

These are the devolved tax revenues now retained by the Scottish Government⁵.

Other powers in the Fiscal Framework can also affect the Scottish Government's overall Budget totals. The Government can choose to borrow for capital expenditure, or carry forward underspends from previous years in the Scotland Reserve.

Overall, the net impact of forecast revenues from individual taxes and Block Grant Adjustments can move the Scottish Government's Budget in a positive or negative direction. If the Scottish Government raises more in devolved taxes than it loses in the corresponding Block Grant Adjustment, the net position is positive. If the Scottish Government's Budget is reduced via Block Grant Adjustments more than it raises in the corresponding devolved taxes, the net position is negative.

In the case of social security benefits, the situation is reversed – if BGA forecasts for these benefits exceed spending forecasts, this results in a positive net position; there is a negative net budget position if spending forecasts exceed the BGA. In cases where spending exceeds the BGA, the gap would need to be funded from the existing Scottish budget envelope.

⁵ Non-Domestic Rates also form part of the funding arrangements, together with other revenue raising powers (including fees, charges and sales of goods, services and assets), grants from the European institutions and borrowing.

How are the Block Grant Adjustments Calculated?

A 'baseline value' is required to establish the starting point for the Block Grant Adjustments. The baseline value reflects what was raised by the UK Government in Scotland in the year prior to the devolution of the tax.⁶ For example, for Scotland Act 2016 Scottish Income Tax, 2016-17 was the year prior to devolution of the tax. For LBTT and SLfT, 2014-15 was the year prior to their devolution.

To account for the revenue loss to the UK Government after the initial transfer of power, the baseline BGA is updated annually using an indexation mechanism reflecting the growth in the corresponding UK tax revenue.

The Governments agreed to apply two indexation mechanisms to track the growth in UK Government tax receipts – the Comparable Model (CM)⁷ and the Indexed Per Capita (IPC) method. The current Fiscal Framework states that the indexation mechanism will be based on the Comparable Model (CM), but then reconciled to the Indexed Per Capita (IPC) method. In practice, it is therefore the IPC method which determines the Block Grant Adjustment until the Fiscal Framework is reviewed.

Using IPC means that if corresponding UK Government tax revenues per head grow at the same rate as Scotland's, the Scottish Budget will be no better or worse off than before devolution.

Using IPC aims to achieve the Smith Commission's principle of no detriment - if Scotland's economic performance and tax policy matches the rest of the UK, the Scottish Budget will be the same as under the previous arrangements.

Both the revenue being added to the Scottish Government's Budget and the figures being deducted through the Block Grant Adjustment are based on forecasts at the time the Budget is set. Since 2018-19, the Scottish Government uses the Scottish Fiscal Commission's⁸ forecasts for revenues and social security spending. For the Block Grant Adjustments, HM Treasury uses the forecasts of the Office for Budget Responsibility (OBR).⁹

As revenue and Block Grant Adjustments are based on forecasts, these figures need to be 'reconciled' once outturn data for tax revenues and spending on devolved social security benefits is available. This is considered in detail in the next chapter. The box on the following page illustrates how BGAs are calculated using 2017-18 LBTT as an example.

⁶ Equivalent procedures will apply to social security Block Grant additions. The only exception is Cold Weather Payments, where the baseline will be an average of payments in Scotland since 2008-09.

⁷ The Comparable Model is calculated based on Scotland's population share of the cash change in corresponding UKG receipts and multiplied by a comparability factor.

⁸ <http://www.fiscalcommission.scot/>

⁹ <https://obr.uk/topics/scotland-wales-and-northern-ireland/scottish-tax-forecasts/>

Example - BGA calculation for *Land and Buildings Transaction Tax* in 2017-18

For 2017-18, the deduction from the Scottish Government's Block Grant was set in November 2016 based on the OBR forecast of growth in UK Government Stamp Duty Land Tax receipts at the UK Autumn Statement 2016. This was calculated in three steps:

Step One - Baseline Value - The Fiscal Framework agreed that the baseline value would be 2014-15 Stamp Duty Land Tax receipts in Scotland - in other words, what was being raised in Scotland the year before LBTT began operating in Scotland. The OBR's forecast for 2014-15 tax receipts in Scotland at the Autumn Statement 2016 was £468 million.¹⁰

Step Two - Revenue Growth - This baseline value is then indexed annually using growth in equivalent UK Government tax receipts. UK Government Stamp Duty Land Tax receipts grew by 4.2% between 2014-15 and 2015-16, 4.0% between 2015-16 and 2016-17, and were forecast to grow by 8.6% between 2016-17 and 2017-18.

Step Three - Relative Population Growth - Finally, the BGA also factors in the relative difference in population growth between Scotland and the rest of the UK. A figure of 99.7% was used for each of the years from 2015-16 to 2017-18.¹¹

Taking into account the baseline value, growth in UK Government Stamp Duty Land Tax receipts, and relative difference in population growth, the Block Grant Adjustment for LBTT was £486 million in 2015-16, £504 million in 2016-17, and £545 million in 2017-18, as set out in the table on the following page.

¹⁰ The baseline for Stamp Duty Land Tax was reduced by £20 million to account for the forestalling estimated to have occurred before the tax devolved to Scottish Parliament.

¹¹ To calculate population growth, the two Governments agreed to use the growth rate between the two most recent financial years of population outturn data. This growth rate is then applied to all future years.

Table 2.2 – LBTT BGA Calculation*

	2014-15 (Year 0)	2015-16 (Year 1)	2016-17 (Year 2)	2017-18 (Year 3)
Step 1 - Initial baseline value				
Scottish receipts (£m)	468			
Step 2 - Indexation				
rUK receipts (£m)	10,251	10,682	11,113	12,069
% growth in UKG receipts		4.2%	4.0%	8.6%
Step 3 - Adjustment for relative difference in population growth				
rUK population (thousand)	59,249	59,737	60,229	60,725
Scottish population (thousand)	5,348	5,373	5,399	5,424
Relative Scottish/rUK population growth		99.7%	99.7%	99.7%
BGA		486	504	545

*Figures may not sum due to rounding.

Expressed otherwise, the calculation for each year is as follows:

2015-16 BGA						
£468 million	x	1.042	x	0.997	=	£486 million
2016-17 BGA						
£486 million	x	1.040	x	0.997	=	£504 million
2017-18 BGA						
£504 million	x	1.086	x	0.997	=	£545 million

£545 million was therefore deducted from the Scottish Government's 2017-18 Budget to reflect the UK Government's revenue loss from devolving LBTT to Scotland.

Changes in the Geographical Coverage of the Block Grant Adjustment Indexation

Block Grant Adjustments are indexed to 'UK Government' expenditure rather than 'Rest of UK' expenditure. This means that social security BGAs are indexed to growth in benefit expenditure in England and Wales only, as social security is fully devolved to Northern Ireland.

Since Scotland's Fiscal Framework was agreed in February 2016, there has also been significant fiscal devolution to Wales. Land Transaction Tax and Landfill Disposal Tax were devolved in 2018-19, and Welsh Rates of Income Tax in 2019-20.¹²

As these receipts are no longer retained by the UK Government, the Block Grant Adjustment indexation mechanism has to be updated to remove Welsh receipts. This is in line with paragraph C.16 of the Fiscal Framework:

"For revenues, "corresponding UK government receipts" are the revenues from the equivalent taxes or other revenue-raising powers collected by the UK government in the rest of the UK. The scope of the UK government receipts will be updated with any devolution of tax powers to other parts of the UK."

Since 2018-19, this means that the LBTT and SLfT BGAs have been indexed to growth in England and Northern Ireland tax receipts and population.

For income tax, the BGA will still be indexed using growth in receipts and population data for England, Wales and Northern Ireland in 2019-20. This is necessary because there will be no 2018-19 outturn figure for England and Northern Ireland (ENI) income tax receipts only. Without this figure, it is not possible to measure the growth between 2018-19 and 2019-20 ENI income tax receipts, which would be needed to operate a 2019-20 BGA based on ENI only.

From 2020-21 and onwards, the income tax BGA will be indexed using growth in receipts from England and Northern Ireland only.

¹² Since April 2019, the UK Government has reduced the three rates of Income Tax paid by Welsh taxpayers: basic rate from 20% to 10%; higher rate from 40% to 30%; additional rate from 45% to 35%. The National Assembly then decides the Welsh rates of Income Tax which will be added to the reduced UK rates.

3 Reconciliations

At the time of each budget both revenues and BGAs are forecast. These forecasts are reconciled to the outturn data when that becomes available so that the funding available to the Scottish Government ultimately corresponds to actual revenues and BGAs based on outturn data. This chapter describes the timelines for reconciliations, how they work in practice, and what the impact of reconciliations will be on the Scottish Government's Budget. It covers income tax, the fully devolved taxes (Land and Buildings Transaction Tax and Scottish Landfill Tax), fines, and social security.

Because outturn data is available on different timescales for each of these areas, different processes determine how they are reconciled. For fully devolved taxes, social security benefits and fines, outturn data is available three to six months after the end of the financial year. This is also the case for the corresponding UK revenues, or expenditure in the case of benefits.

For income tax, outturn data is available around sixteen months after the end of the financial year. There is a greater lag for income tax largely because self-assessment income taxpayers have around 10 months after the end of the financial year to pay any income tax due to HMRC.

Once outturn data is available, a reconciliation needs to be made in the subsequent Budget to account for the difference between forecast and outturn data Block Grant Adjustments – and in the case of income tax for differences between forecast and outturn tax revenues.¹³

3.1 Scottish Income Tax

A basic principle of income tax devolution under the current Fiscal Framework is that once forecast revenue is assigned and the corresponding BGA is made, there are no changes in the Scottish Government's funding until outturn data is available. These figures are 'locked in' to the Budget.

In practice, the amount of revenue that the Scottish Fiscal Commission forecasts¹⁴ as part of each Budget process is added to the Scottish Government's available funding. This amount is not revisited until outturn data is available for Scottish Government income tax receipts. Likewise, for the Block Grant Adjustments, the initial deduction for income tax is based on the OBR's forecast of growth of UK Government receipts until outturn data is available for UK Government income tax receipts.

HMRC is responsible for the collection of Scottish income tax. Outturn data for Scottish income tax and UK Government non-savings, non-dividends receipts are available around 16 months after the end of the financial year. Given this long lag of availability of outturn data, income tax revenue and Block Grant Adjustments are fixed for three years from the time the Budget is set. This means that for

¹³ Revenue for the fully devolved taxes collected in-year by Revenue Scotland is already taken account of within the year. The corresponding Block Grant Adjustment is reconciled when the relevant UK outturn data for the year is available.

¹⁴ For 2017-18, the Scottish Government was the official forecaster of Scottish income tax receipts. The independent SFC found our forecasts to be reasonable.

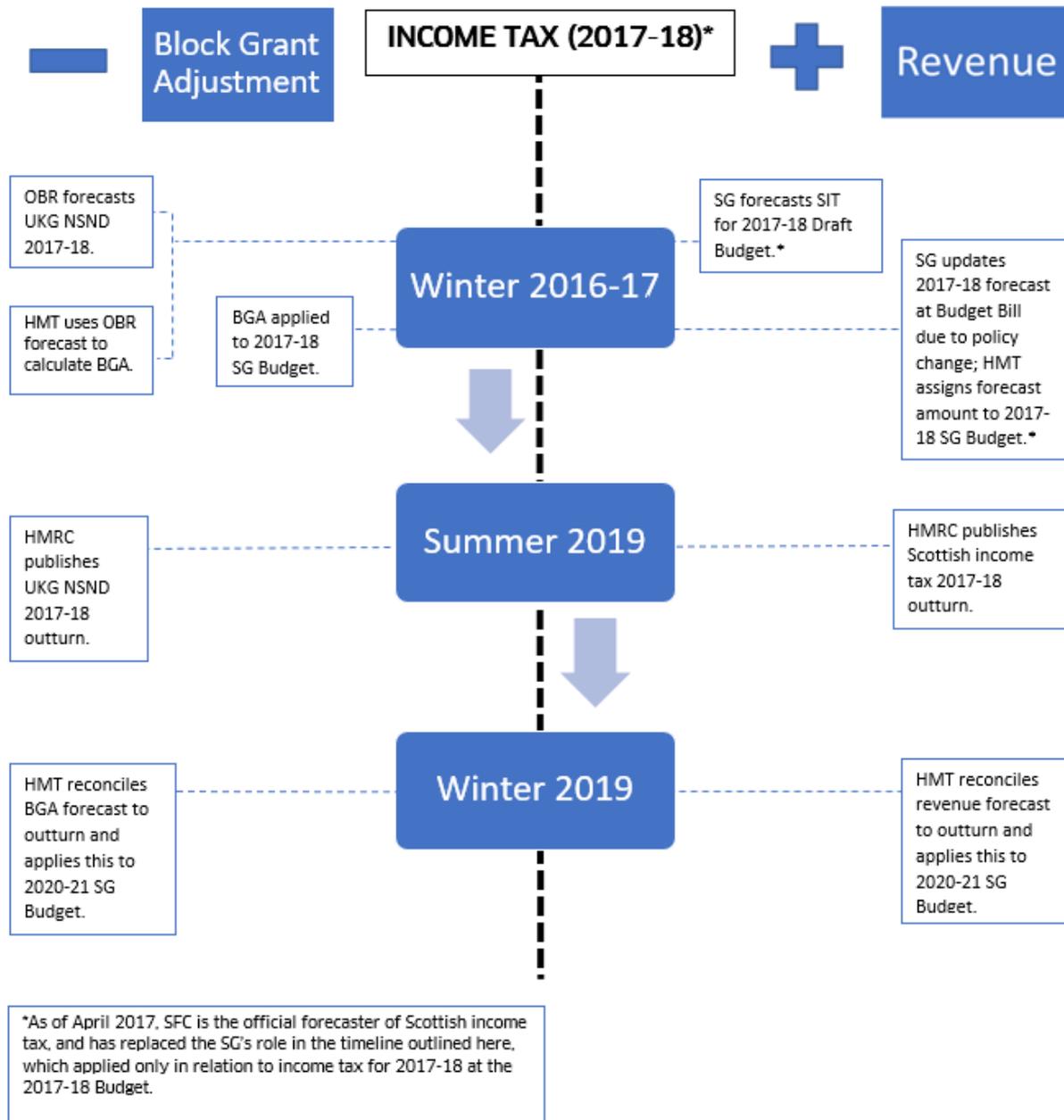
2017-18, income tax revenues were forecast as part of the Budget Bill process in February 2017 and the BGA was forecast at Autumn Statement in November 2016. Outturn figures will not be available until July 2019. The outturn figures for revenues and the BGA will then be compared with forecast and reconciliations calculated, which will be applied in the 2020-21 financial year.

Reconciliation process for income tax

1. To determine funding for the Scottish Budget, SFC's forecasts are used for tax revenues and OBR's forecasts are used to inform the BGA, set by HMT.
 2. The forecast BGA for income tax is deducted from the Scottish Government's Block Grant.
 3. Forecast tax revenues are added to the Scottish Government's Block Grant. Effectively, the Block Grant includes the expected income tax revenue which is transferred by HMT. Revenues and BGA are fixed until outturn data is available.
 4. Reconciliations are made to reflect differences between outturn and forecast figures for revenue and the BGA. When revenues increase more (or decline less) than the BGA compared to the initial forecasts, the Scottish Government has more resources available than anticipated.
 5. It is this net effect of the revenue and BGA reconciliations which determines whether the Scottish Government's Budget is higher or lower than originally forecast and thereby the impact on the Budget at which the reconciliation takes place.
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A timeline outlining the income tax reconciliation process for the 2017-18 Budget - which will become relevant for the 2020-21 Budget - is shown on the following page.

Figure 3.1 - Timeline for Income Tax Reconciliation



3.2 Fully Devolved Taxes

This section focuses on the operation of the ‘fully devolved taxes’: Land and Buildings Transaction Tax, Scottish Landfill Tax, Air Departure Tax, and Aggregates Levy. These are the taxes over which the Scottish Government has full policy control and are collected by Revenue Scotland.

Reconciliation process for fully devolved taxes

1. In advance of the forthcoming financial year, SFC’s forecasts are used for tax revenues and OBR’s forecasts are used to inform the BGA, set by HMT.
 2. The forecast BGA for each tax is deducted from the Scottish Government’s Block Grant for the forthcoming financial year.
 3. Revenue Scotland collects revenues over that financial year.
 4. Block Grant Adjustments are reconciled twice. The interim reconciliation is made at the UK Autumn Budget, on the basis of the most recent OBR forecasts. Once outturn data is available in the following financial year, a final reconciliation is applied to the Scottish Government’s Block Grant for the financial year thereafter (i.e. two years after the year to which the revenues relate).
 5. Whether the Scottish Budget is in a better position at outturn than as originally forecast depends on both: i) how outturn revenues compare with forecast, and ii) how the outturn BGA compares with forecast.
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Treatment of Revenues

For the fully devolved taxes, Revenue Scotland collects revenues and sends them to Scottish Government over the course of the year. The Scottish Government manages any variation between actual receipts collected in-year and what was forecast at the Budget as part of its overall annual Budget management process.

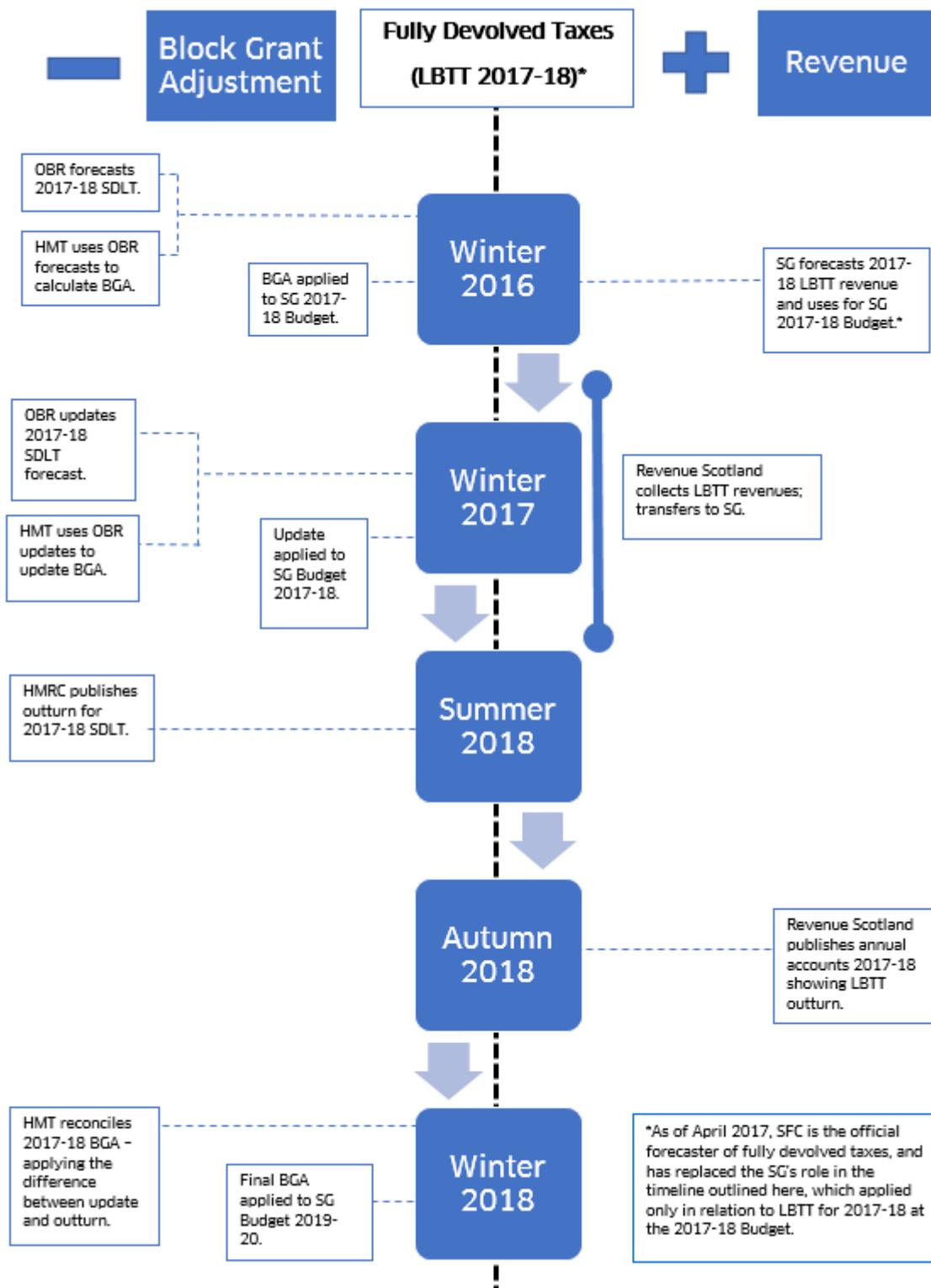
Reconciliation process for BGA

The Block Grant Adjustments for the fully devolved taxes are reconciled twice. An interim reconciliation is made during the same financial year to which the forecast applies at the UK Autumn Budget. This reflects the latest forecasts of corresponding UK Government tax receipts, and is managed as part of in-year budget management. The second reconciliation takes place in the following financial year once outturn data for corresponding UK Government tax revenues is available, and is applied to the Scottish Government’s Block Grant for the financial year two years after the year to which the revenues relate. Where the Block Grant Adjustment is higher than forecast, the Scottish Government’s Budget is reduced, and vice versa.

Changing the BGAs in this way means that the Scottish Government is shielded from Budget volatility as long as BGAs move in the same direction as tax revenues during the financial year.

A timeline outlining the fully devolved tax reconciliation process using 2017-18 as an example can be found below. This is for LBTT – the process for the other fully devolved taxes will be the same.

Figure 3.2 - Timeline for Devolved Tax Reconciliation



3.3 Fines, Forfeitures and Fixed Penalties

As with the fully devolved taxes and income tax, revenue from fines, forfeitures, and fixed penalties (FFFP) results in a corresponding downwards adjustment of Scotland's Block Grant indexed using the Indexed Per Capita method. This Block Grant Adjustment is only reconciled after outturn data is available.

Reconciliation process for fines

1. In advance of the forthcoming financial year, Scottish Government forecasts of fine revenue and OBR's forecasts are used to inform the BGA, set by HMT.
 2. The forecast BGA for each benefit is deducted from the Scottish Government's Block Grant for the forthcoming financial year.
 3. Fine revenue is collected over that financial year and sent to the Scottish Consolidated Fund.
 4. The Block Grant Adjustment is only changed once outturn data is available around three months after the end of the financial year. A final reconciliation is applied to the Scottish Government's Block Grant for the financial year thereafter (i.e. two years after the year to which the expenditure relates).
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Treatment of Revenues

At every Budget, the Scottish Government forecasts what revenues it will raise from FFFP in the next financial year using information from the Scottish Courts and Tribunal Service (SCTS).

The bulk of this revenue is collected throughout the year by the SCTS; some revenue is also collected by the Scottish Government and the Scottish Solicitors Disciplinary Tribunal. All revenue is sent to the Scottish Consolidated Fund (SCF). The Scottish Government has to deal with any variation between actual receipts and what was forecast as part of its annual budget management process.

The amount of FFFPs collected throughout the year is reported in the SCF's Accounts¹⁵ in Autumn each year.

Block Grant Adjustment

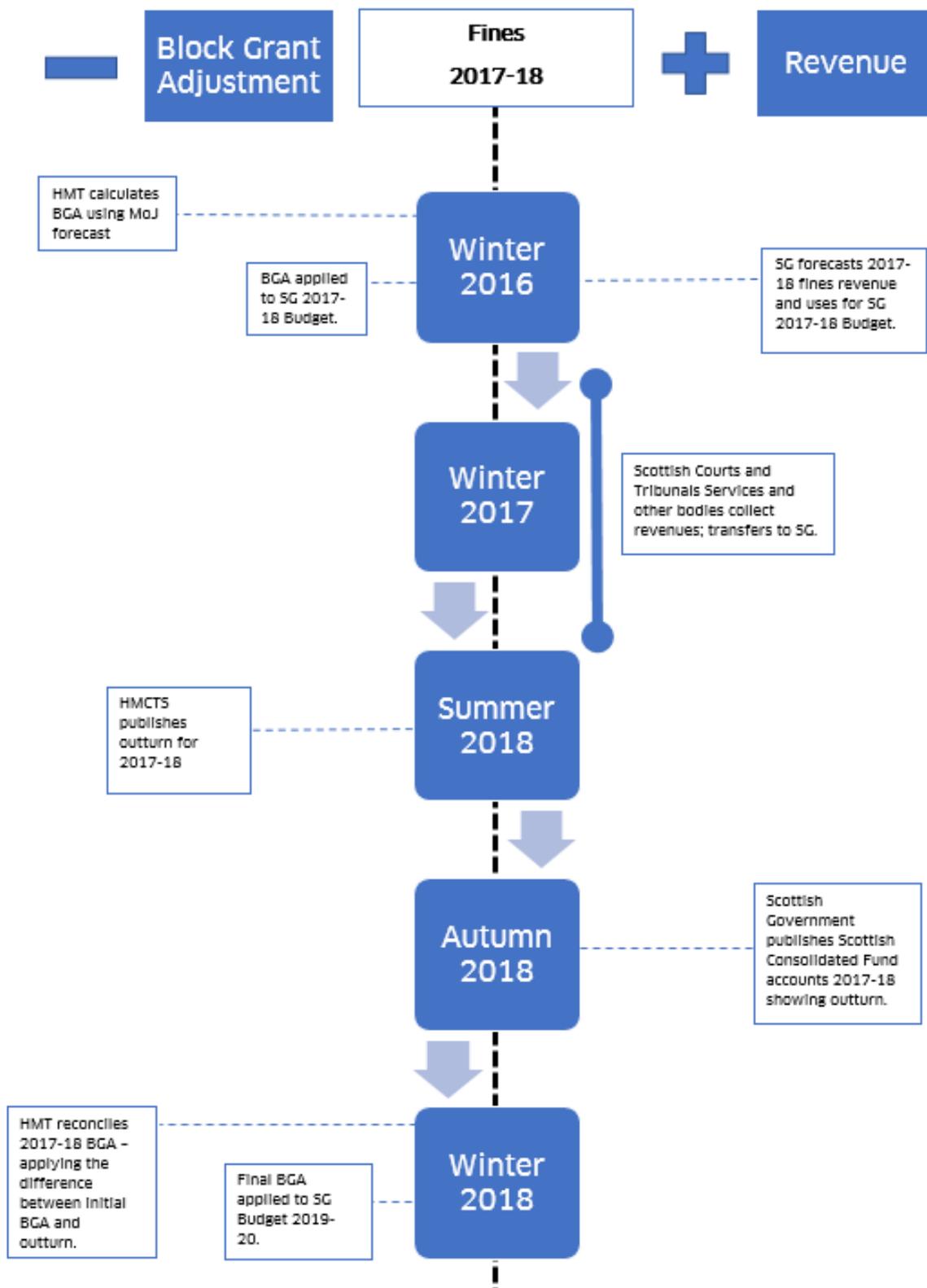
The Block Grant Adjustment for FFFPs is based on the growth in equivalent UKG revenues retained by the Ministry of Justice (MoJ). At Budget, the BGA is initially based on a MoJ forecast of this revenue for future years. Once a Block Grant Adjustment is agreed, it is not revisited until outturn data is available.

Outturn for this revenue retained by MoJ is reported in HM Courts and Tribunals Service's Trust Statement, which is usually published around three months after the end of the financial year. A final reconciliation is applied to the Scottish Government's Block Grant for the financial year two years after the year to which the revenues relate.

A timeline outlining the reconciliation process can be found on the next page using 2017-18 as an example.

¹⁵ <https://www.gov.scot/publications/scottish-consolidated-fund-accounts-year-ended-31-march-2018/pages/3/>

Figure 3.3 Timeline for Fines, Forfeitures and Fixed Penalties Reconciliation



3.4 Social Security

The process of calculating and applying social security BGAs is similar to the fully devolved taxes in regards to forecasting and indexing, and in the timeframes for reconciling forecasts with outturn data.

Reconciliation process for social security

1. In advance of the forthcoming financial year, SFC forecasts are used for benefit expenditure and OBR forecasts are used to inform the BGA, set by HMT.
 2. The forecast BGA for each benefit is added to the Scottish Government's Block Grant for the forthcoming financial year.
 3. Social Security Scotland, or DWP through an agency agreement, administers expenditure over that financial year.
 4. Block Grant Adjustments are reconciled twice. The interim reconciliation is made at the UK Autumn Budget, on the basis of the most recent OBR forecasts. Once outturn data is available in the following financial year, a final reconciliation is applied to the Scottish Government's Block Grant for the financial year thereafter (i.e. two years after the year to which the expenditure relates).
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Treatment of Expenditure

Benefit payments will be made throughout the financial year. The Scottish Government will manage any variation between actual benefit expenditure in-year and what was forecast at the Budget as part of the overall annual Budget management process.

The Scottish Government is therefore exposed to the in-year volatility associated with benefit expenditure much in the same way it is exposed to the in-year revenue volatility for the fully devolved taxes.

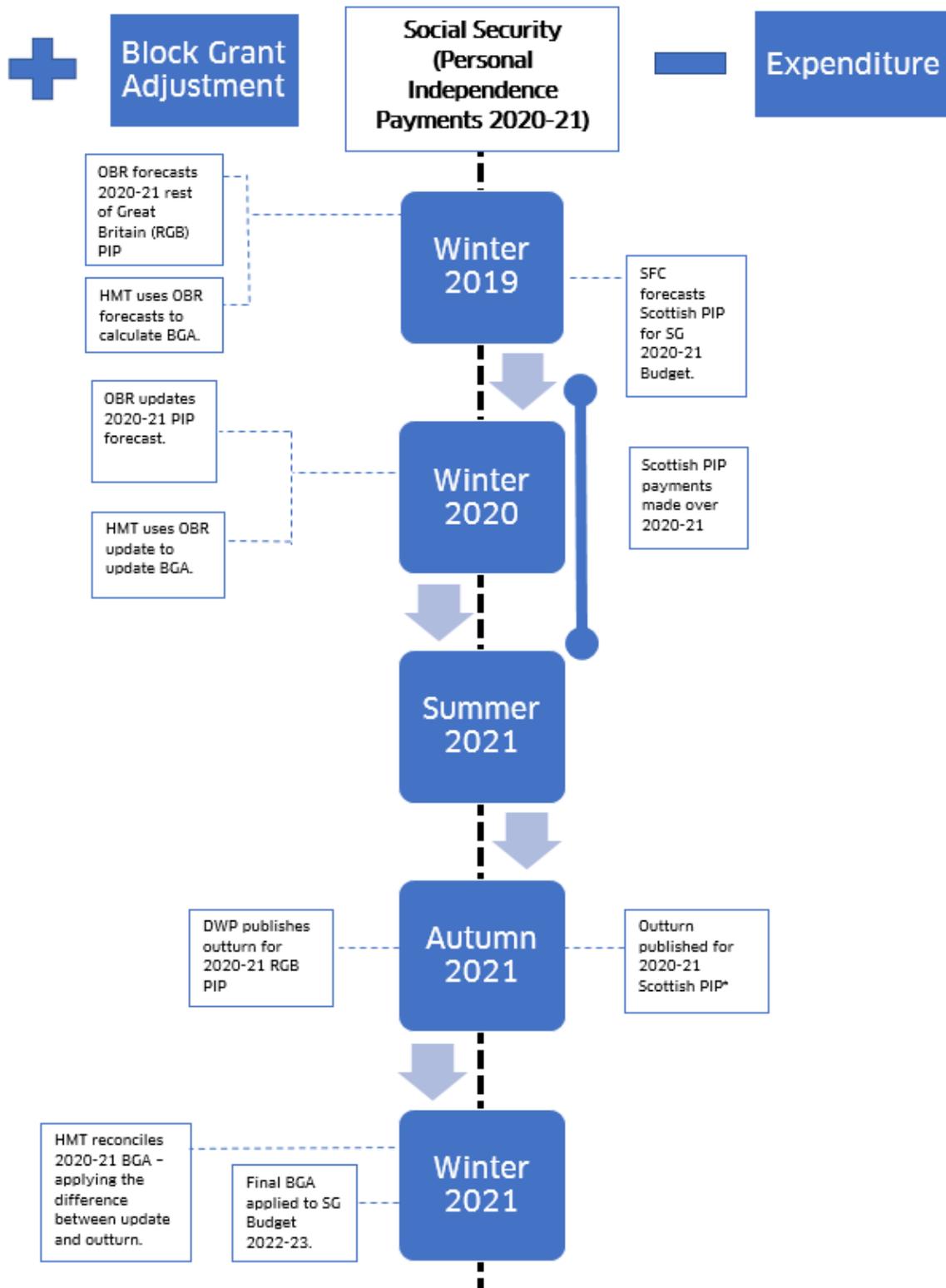
Reconciliation process for BGA

The Block Grant Adjustments for social security are reconciled twice. An interim reconciliation is made during the same financial year to which the forecast applies at the UK Autumn Budget. This reflects the latest forecasts of corresponding UK Government social security expenditure, and is managed as part of in-year budget management. The second reconciliation takes place in the following financial year once outturn data for corresponding UK Government benefit expenditure is available,¹⁶ when a final reconciliation is applied to the Scottish Government's Block Grant for the financial year two years after the year to which the revenues relate. Where the Block Grant Adjustment is higher than forecast, the Scottish Government's Budget is reduced, and vice versa.

A timeline outlining the social security reconciliation process can be found below using 2020-21 Personal Independence Payment (PIP) as an example.

¹⁶ The UK and Scottish Governments have agreed that the UK Government's benefit expenditure and caseload tables will be used to calculate outturn BGAs: <https://www.gov.uk/government/publications/benefit-expenditure-and-caseload-tables-2018>

Figure 3.4 Timeline for Social Security Reconciliation



Part-Year Block Grant Adjustment

In cases where a devolved benefit is not commenced at the beginning of the financial year, the forecast BGA will be based on historic UKG expenditure during the part of the year the benefit is devolved. The baseline year will be, as in other BGAs, the year prior to devolution, and subsequent years will likewise be indexed on the basis of whole financial years.

As an example, executive competence for Carer's Allowance transferred to Scotland in September 2018. As the benefit was transferred partway through the financial year, the BGA was apportioned on a pro rata basis based on DWP's historic expenditure in the part of the year the Scottish Government assumed responsibility for the benefit.

As set out in table 3.4, Carer's Allowance expenditure from September 2017 to March 2018 accounted for around 59% of DWP's expenditure in 2017-18 therefore the BGA for 2018-19 is 59% of the total year BGA. This proportion will also be used to make the reconciliation after 2018-19 outturn data becomes available in Autumn 2019.

Table 3.4 Carer's Allowance 2018-19 BGA Calculation

DWP's expenditure on Carer's Allowance in Scotland (April 2017 - March 2018)	£249m
DWP's expenditure on Carer's Allowance in Scotland (Sept 2017 - March 2018)	£146m
% of expenditure (Sept 2017 - March 2018)	59%
Block Grant Adjustment (April 2018 - March 2019)	£267m
Block Grant Adjustment (Sept 2018 - March 2019)	£157m

Machinery of Government Transfer for DEL Benefits

Some devolved social security benefits will not have associated BGAs. They are instead initially funded by direct transfers directly from the Department for Work and Pensions. These are known as 'Machinery of Government' transfers. These transfers will be made until the end of the UK Government Spending Review period. After that, funding for these benefits becomes part of the core resource block grant and is subject to the Barnett formula.

This is because the funding of these benefits is classified at UK level as part of DWP's resource ('Departmental Expenditure Limit' or DEL) budget rather than funded centrally through Annually Managed Expenditure (AME). Unlike AME, DEL expenditure is not normally subject to the forecast/reconciliation cycle of AME expenditure.

The following benefits are currently funded through this process: Discretionary Housing Payments, Best Start Grant, and Funeral Expense Assistance (from summer 2019).

4 Scotland Reserve

The Scotland Act 2016 replaced a previous power under the Scotland Act 2012 (to operate a limited cash reserve) and the HMT rules on the Budget Exchange Mechanism with a new Scotland Reserve. This allows the Scottish Government to build up funds when devolved revenues are higher than forecast, smooth all types of spending (including carrying-forward underspends), assist the management of tax volatility and determine the timing of expenditure. The Scotland Reserve applied from 2017-18 onwards and is split between resource and capital.

The Reserve is capped at £700 million, or only 2.1 per cent of the total Scottish Budget in 2019-20. Annual drawdowns from the Reserve are limited to £250 million for resource and £100 million for capital.

Updates on the balance of the Scotland Reserve are published at the following times of the year:

- Autumn Budget Revision (October)
- Spring Budget Revision (February)
- Provisional Outturn Statement (June)
- Fiscal Framework Outturn Report (September)

The Scottish Government also reports at each Budget what funding it intends to draw down from the Reserve to underpin the forthcoming year's spending plans.

5 Borrowing

The Scotland Act 1998 gave the Scottish Government power to borrow for resource and the Scotland Act 2012 gave the Scottish Government power to borrow for capital. Both powers are subject to statutory aggregate caps and annual limits, and were increased as part of Scotland Act 2016 and the Fiscal Framework.

Resource borrowing can only be funded from the National Loans Fund (NLF), whereas capital borrowing can be funded from the NLF, commercial loans or the issue of bonds. The Scottish Fiscal Commission is required to assess the reasonableness of Scottish Ministers borrowing projections and does so at each fiscal event.

5.1 Capital Borrowing

Capital borrowing allows the Scottish Government to fund capital projects, for example to invest in schools, roads and hospitals.

Table 5.1 – Capital Borrowing

Statutory Limit	£3,000 million
Annual Limit	£450 million
Repayment Period	Normally 10 years, but where the lives of the assets being purchased through the loan justify longer or shorter terms, these can be agreed.
Source	NLF ¹⁷ , Commercial Loan, Bonds

The Scottish Government usually announces its capital borrowing plans for the forthcoming financial year at the Scottish Budget. Decisions on borrowing are taken in-year dependent on factors prevailing at the time such as an ongoing assessment of programme requirements and value for money assessment of the options available, including interest rates and the impact on the resource budget.

Sometimes this means that there is a difference between planned borrowing and actual borrowing amounts. For example, the Scottish Government announced at its 2018-19 Budget in December 2017 that it would borrow £450 million for capital. The actual drawdown took place in March 2019 and was only £250 million. The Scottish Government borrowed less than was planned, mainly due to a number of significant additional Barnett consequentials confirmed in-year.

¹⁷ The Scottish Government capital borrowing loan facility agreement can be found here: <https://www.gov.scot/binaries/content/documents/govscot/publications/factsheet/2019/03/national-loans-fund-terms-of-borrowing/documents/capital-borrowing-loan-facility-agreement/capital-borrowing-loan-facility-agreement/govscot%3Adocument>. The latest borrowing rates for the National Loans Fund can be found at the following link: <https://www.dmo.gov.uk/data/pdfdatareport?reportCode=D7A.6>

5.2 Resource Borrowing

The Scottish Government has the power to borrow for resource spending for the following reasons:

In-year cash management to fund a temporary shortfall in cash flow or working capital, without affecting the overall budget balance. So far this power has been never been used.

Forecast error in relation to devolved and assigned taxes and devolved social security expenditure arising from forecasts of Scottish receipts/expenditure and corresponding UK forecasts for the Block Grant Adjustments.

Any observed or forecast shortfall in devolved or assigned tax receipts or devolved social security expenditure incurred where there is, or is forecast to be, a Scotland-specific economic shock. This is defined as annual GDP growth of below one per cent and GDP growth in Scotland one percentage point below GDP growth in the UK. A forecast economic shock would depend on the Scottish Fiscal Commission forecast of Scottish GDP compared to the OBR's forecast of UK GDP and is assessed on a rolling 4-quarter basis.

Table 5.2 – Resource Borrowing

Statutory Limit	£1,750 million
Annual Limit	£600 million of which: <ul style="list-style-type: none"> • £500 million for in-year cash management (maximum annual allocation of £600 million can be used for this purpose in Scotland-specific economic shock) • £300 million for forecast error (maximum annual allocation of £600 million can be used for this purpose in Scotland-specific economic shock)
Repayment Period	3 to 5 years
Source	NLF

The Scottish Government could invoke its resource borrowing powers for a net Budget shortfall to the extent that the outturn net Budget position falls below the forecast for tax revenue and/or social security spending. The resource borrowing power is deliberately restricted to very specific circumstances and does not detract from the fundamental requirement for a balanced Scottish Budget each financial year. In all circumstances, the maximum resource borrowing limit is £600 million a year.

6 Fiscal Framework Review

The Smith Commission's report recommended that, once agreed, the Fiscal Framework should be reviewed periodically to ensure arrangements "continue to be seen as fair, transparent, and effective."¹⁸

The Fiscal Framework agreed that a review of the current Framework will take place after a Parliament's worth of experience. It does not specify an exact date for when the Review will be carried out.

Both Governments agreed that the Smith Commission principles should inform the Review. In particular, the method for adjusting the Block Grant must be agreed, and no default method will be assumed.

Aside from this specific issue, the exact scope and remit of the Review will need to be agreed by both the UK and Scottish Governments. The technical annex to the Framework states that the exact scope of the Review is to be determined by the Joint Exchequer Committee at least 3 months before it starts.

Input should be sought from the OBR, the Scottish Fiscal Commission, stakeholders and academics but not be limited to these parties. Parliamentary Committees in the Scottish and UK Parliaments are actively encouraged to give evidence to the Review.

Independent Report

To inform the Review, the two Governments agreed that an Independent Report on the operation of the current Framework should be concluded by the end of 2021. The report will make recommendations to both Governments.

The remit for the report and the membership of the group producing the report will be jointly agreed by the Scottish and UK Governments through the Joint Exchequer Committee.

Future Reviews

The technical annex of the Fiscal Framework agreed that subsequent reviews should take place on a 5 yearly basis but not more than once in any UK or Scottish electoral cycle. The timing of these reviews will be agreed between the Scottish and UK Governments at the Joint Exchequer Committee.

¹⁸ https://webarchive.nationalarchives.gov.uk/20151202171029/http://www.smith-commission.scot/wp-content/uploads/2014/11/The_Smith_Commission_Report-1.pdf