

Finance and Public Administration Committee

Framework for the Resource Spending Review

Submission from from David Heald¹

The Scottish Government's Resource Spending Review 2022

Introduction

1. The decision of the Scottish Government (2021b) to conduct a Resource Spending Review (RSR 2022) covering the period 2022-23 to 2026-27 is most welcome. Since the end of the last Scottish Spending Review period in 2014-15, circumstances have meant that public spending has been planned annually, but that is not an efficient approach.
2. It is vital that RSR 2022, when published in May 2022, is a planning document and not a bidding document. All budgetary documents are political, but this should be proportionate. Whatever the future constitutional arrangements might be, public spending in the 2020s is going to be heavily constrained by the economic context. The framework document never misses an opportunity to complain about financial constraints, as if these were wholly attributable to present funding arrangements. This tone diverts attention from constraints which might plausibly be relaxed. A feature shared with Treasury documents is the use of language such as 'investing' and 'investment' in reference to public consumption. The persuasive intention is obvious, but this does not advance serious analysis: investment is not necessarily good, and consumption legitimately represents the bulk of public spending.
3. Establishing spending priorities for the full session of the Scottish Parliament is clearly desirable. However, this means that 2025-26 and 2026-27 are particularly uncertain, because these fiscal years are beyond both the period of the 2021 UK Spending Review (Treasury, 2021b) and the next UK general election, after which another UK Spending Review can be expected. Nothing can be done about this timing mismatch which, alongside the recovery from COVID-19, adds to uncertainties later in the period. Although outside the scope of this memorandum, the Scottish Government's Medium-Term Financial Strategy (Scottish Government, 2021c) is clearly relevant.

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4. This memorandum focuses on preparations for RSR 2022. However, this is one part of the broader financial picture, other crucial parts being the Capital Spending Review (Scottish Government, 2021c) and tax policy decisions. After the Smith Commission (2014), the Scottish Parliament exchanged funding certainty for some tax policy discretion. The relative performance of the Scottish economy, and hence Scottish tax revenues, now influences the total available resources to the extent of tax proceeds being higher or lower than the Block Grant Adjustment (BGA). My own view (Heald, 2016) was that the 2016 Fiscal Framework, incorporating both the per-capita method and revenue-productivity multipliers, was a better deal for Scotland than might have been expected. However, Bell et al. (2021) show that, notwithstanding the higher tax effort in relation to Scottish Income Tax, the BGA now exceeds tax revenues. These developments emphasise the importance of relative-to-UK Scottish economic performance to the Scottish Government's budgetary position.

Responses to the Committee's Questions

Question 1: How clearly does the framework set out the Scottish Government's priorities for the resource spending review?

5. The framework document (Scottish Government, 2021b) states three priorities:
 - To support progress towards meeting our child poverty targets
 - To address climate change
 - To secure a stronger, fairer, greener economy

Few would argue with these aspirational objectives, but they do not constitute priorities for the specific tasks of RSR 2022. The priorities should be repairing the economic and social damage attributable to COVID-19, paying close attention to improving the performance of public services and sustaining the post-COVID-19 economic recovery on which Scottish Government funding now partly depends. While making such plans, attention should certainly be paid to the aspirational objectives, the accomplishment of which also depends on UK and Scottish policies outside the scope of RSR 2022 decisions.

Question 2: What should be the overarching priorities in the resource spending review and how adequately are these currently covered in the framework?

6. As emphasised in the answer to Question 1, the overarching priorities stated in the framework document are mismatched to the tasks of RSR 2022. In brief, these should be:

- Supporting economic and social recovery from the direct and indirect effects of COVID-19
 - Improving the efficiency of Scottish public services
 - Improving relationships with Scottish local authorities
 - Ensuring that forward financial plans are fiscally sustainable in light of the COVID-19 legacy and the demographic challenges vividly illustrated in the three scenarios presented for each of the major spending areas
7. Such are the uncertainties in relation to Barnett formula consequentials, BGAs and devolved tax revenues, that it would be advisable in the later years of RSR 2022 to establish a substantial Contingency Reserve. This would create flexibility in responding to developing events without having to reduce previously announced budget allocations. The political difficulties of running such a Contingency Reserve are recognised (eg initially announced budget allocations are lower) but the benefits would materialise later in the Parliamentary session.
8. Structuring the Scottish Budget in terms of functional activities has the advantage of corresponding to ministerial responsibilities. However, there are two points which should be remembered. First, there is a trend for health and social care spending to dominate public budgets, increasing the downward pressure on other budgets. Second, the most effective way to improve the health of Scotland's population is not always to spend on programmes labelled as 'health' rather than on other programmes (eg housing and environment). Getting the balance of expenditures right is a challenge for all governments, especially in the context of demographic ageing and sudden shocks like COVID-19.

Question 3: Does the framework properly reflect the current economic and political context?

9. The present context is exceptionally uncertain. In common with other OECD economies, the UK Government made a huge fiscal response to the economic and social disruption caused by COVID-19. This produced a drastic fiscal deterioration in UK public finances at a time when the Office for Budget Responsibility (2020) was already signalling that UK public finances were unsustainable on present policies. The long-term paralysis of UK tax policy, together with increased political polarisation, render well-designed tax reform impossible. This leads to a situation in which tax measures, such as the Health and Social Care Levy, add to inefficiencies and inequities rather than resolving them (Heald, 2020).² At the UK level, it will prove difficult to eliminate the emergency expenditures and tax reliefs associated with the COVID-19 fiscal response. Moreover, there is great uncertainty about the future fiscal direction of the UK Government in terms of spending and tax levels.

² Examples of paralysis within the powers of the Scottish Parliament are council tax valuations still being based on 1991, and Business Rates, the viability of which has been undermined by technological change.

10. An important feature of the 1999 devolved fiscal settlement was the relatively clear distinction between functional expenditure which was devolved and that which was reserved. The aftermath of Brexit is blurring this distinction, with the UK Government wishing to spend on public services which are functionally devolved. There are two main dangers in this. First, it weakens lines of accountability, encouraging games of credit claiming and blame shifting. Second, it makes it more difficult for the Scottish Government to set priorities, especially if Scottish public bodies become heavily involved in bidding for UK-controlled resources in the way that has become dysfunctional in England.
11. The RSR 2022 provides an opportunity to review the pattern of devolved public spending after more than two decades of devolution. The ability of the Scottish Government to determine its own priorities within the block system is a valuable feature. The first decade of devolution was one of fiscal plenty, when new commitments could be readily accommodated, but the second and third decades are characterised by fiscal scarcity. While asserting the value of determining its own priorities, the Scottish Government has to be careful about commitments which have no comparator in England and therefore do not generate Barnett formula consequentials, and have to be accommodated at the expense of other programmes. The Northern Ireland Fiscal Council (2021) usefully analysed spending by the Northern Ireland Executive which is 'above parity' and 'below parity'. Expenditure items which are 'above parity' require particular attention in forward planning, as these impose opportunity costs on other devolved functions. 'Below parity' items are scarce. For Scotland, this is a particular consideration in relation to devolved social security benefits, for which the demand-led expenditure drivers are not necessarily well understood.

Question 4: How does the framework approach cross-cutting issues, long-term challenges such as demographic trends, and preventative approaches?

12. The scenario modelling in the framework document illuminates the scale of budgetary challenges, particularly by presentation of Upside and Downside variants on the Central Scenario. Given the uncertainties outlined above in relation to UK spending and tax policy, Table 1 on resource funding is a matter of intelligent guesswork. Figure 1 on population change by age group between 2000 and 2020 shows pronounced changes, with implications for demands on public services, and the possibility that these might accelerate. The worrying aspect of the scenario modelling in relation to adult social care expenditure and health spending is the prospect that the high-spend scenarios might materialise.
13. It has long been known, for example from the annual Public Expenditure: Statistical Analyses (Treasury, 2021a) that per-capita public spending is higher in the devolved nations than in England. Unsurprisingly therefore, Figure 2 shows that public sector employment is also higher. What is required is disaggregation,

for example distinguishing employment in activities which are not in the public sector in England (eg water and sewerage), or where there is more extensive contracting out in England, or where a larger proportion of the Scottish population uses public services (eg health and education).

Question 5: How well do the priorities in the framework link in with National Performance Framework outcomes?

14. The stated priorities for RSR 2022 are higher level than the 81 indicators of the National Performance Framework. As of 19 January 2022 (Scottish Government, 2022), most indicators are 'Maintaining' (59%), while some are 'Improving' (17%) and some 'Worsening' (12%). In the context of post-COVID-19 economic difficulties and the likely constraints on the total Scottish Budget, it is important that decisions are taken within RSR 2022 about what the Scottish Government's priorities are at the level of National Indicators. Prioritisation requires choices to be made between outcomes that are all valued, some of which the Scottish Government has more policy control over than others.

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Glasgow, 21 January 2022

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