Alignment of Budgetary Processes of UK and Scottish Parliaments

David Phillips

Thank you for your letter requesting further information on the alignment of budget processes. This is not a core area of my expertise on the fiscal framework but I will endeavour to answer your questions to the best of my ability. I would also suggest you contact Professor Heald for his views too, as I believe he has thought about this area somewhat more.

Your question relates to a concern that the Scottish government and UK government operate to different timetables when it comes to setting Budgets and determining tax rates, and that this might give rise to the potential for "gaming" by the UK government. In particular you ask whether better alignment could be achieved through the fiscal framework negotiations, or changes to the Scottish Parliament's budget process.

Let's begin with the fiscal framework negotiations. First, is the issue of whether one might reasonably expect the UK government to agree in such negotiations to bring forward its own decision making to remove (or reduce) the asymmetry. Clearly this would be a decision for the UK government to take and in doing so it would weigh up multiple considerations. There may be benefits from bringing forward decisions on tax rates and structures – including reduced costs and greater certainty for taxpayers and the tax authorities. But there would also be costs. One is a loss of policy flexibility – to respond to economic, political or other factors which may make a change in tax policy desirable. Another relates to the fact that policies announced far in advance can lead to significant behavioural effects as people bring forward or delay their activities to reduce their tax liabilities. Announcing a policy change with immediate (or near immediate) effect reduces the scope for such time-shifting and the associated economic and revenue distortions. These reasons suggest that it may be unlikely for the UK government to agree to new constraints on when it can make tax policy.

Second is whether changes to reporting requirements can be negotiated – which I think relates mainly to income tax. In doing this I would note that that the agreement for income tax is between the SG and HMRC (not HMT). It states that the SG is to provide the "proposed Scottish rate for the coming tax year" by November 30, but that the final rate "resolution" need not be passed until April 5, just before the start of the tax year.[1] So it seems that there is at least scope for income tax policy changes to be made up to the last minute – although this would require the reissuing of tax codes, which may incur a cost. What is less clear is whether the Scottish government will have the power to change the Scottish rates or bands of income

[1] www.scottish.parliament.uk/S4_PublicAuditCommittee/final_mou_sa.pdf.

part-way through the tax year. The UK government does: the last time this happened for income tax was in 2008 when the personal allowance was increased part-way through the year (and the effect backdated to the start of the tax year). This may be something the committee would like to investigate.

The other main issue you highlight is the Scottish Government's budget process, which seems to be the main factor for the issues with Land and Buildings Transactions Tax (where there are not the same reporting requirements to HMRC as for income tax). The equivalent UK tax is one where the UK government often makes decisions with immediate (or near-immediate) effect precisely because it is a tax where it is felt distortions from pre-announced policies (the re-timing of sales and transactions) can be particularly large and disruptive. There may therefore be merit in adjusting budget processes to allow for changes to be made later and/or with immediate effect for this tax, in particular.

I hope these comments are helpful. I would also like to take the opportunity to send you a separate written note on issues relating to the block grant adjustments and their relation to transfers across the UK and the no-detriment principles. This will hopefully help elucidate my comments that while one can clearly see which approach is likely to be most beneficial to Scotland, it is less clear which system is 'fair' given that there are different conceptions of what 'fairness' means in devolved finance. I hope this additional note, which I attach, will also be of use.

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NB. The opinions stated in this letter are those of the author only. The Institute for Fiscal Studies has no corporate opinions.