The Scottish Budget Process and the Scotland Act 2012

David Bell

Stirling School of Management

University of Stirling

August 2012

The purpose of this paper is to review the Scottish Parliament budget process in the light of the additional powers granted to the Scottish Parliament under the Scotland Act 2012. These additional powers include a range of revenue raising and borrowing capabilities. Specifically, the Scotland Act gives the Scottish Parliament powers over:

- the "Scottish rate" of income tax,
- a Scottish land tax,
- a Scottish landfill tax

It also gives the Scottish Parliament powers to levy new taxes.

It follows that the budget process of the Scottish Parliament will no longer be focused primarily on expenditure.

The Scotland Act also confers borrowing powers on the Scottish Government. Scottish Ministers will be able to borrow:

- Up to £200 million in any *one year* in case of temporary shortfalls between revenues and expenditure and to deal with any deviation between forecast and actual outturn receipts. *Across years,* to smooth any differences between outturn receipts from devolved taxes and their forecast, up to a total of £500 million total current debt.
- Up to 10% of the Scottish capital budget in *any year*. The stock of such borrowing cannot exceed £2.2 billion.

Together the measures allow for borrowing of up to £2.7 billion. The Scotland Act allows for the statutory borrowing limits and the annual borrowing limits to be increased administratively. They cannot be decreased. The limits will be reviewed regularly by the Joint Exchequer Committee (JEC) ahead of UK Spending Reviews.

These changes have important implications for the budget process in the Scottish Parliament. This paper first considers the "Written Agreement", which governs how the Scottish Government and the Scottish Parliament interact during the budget process. It therefore most closely describes the current model of the budget process. The paper outlines the additional work that is likely to fall on the Scottish Parliament in the light of the Scotland Act and shows how this inevitably means a redrafting of the written agreement and possibly a redistribution of work between committees of the Scottish Parliament.

The paper then considers two further issues. It shows how to estimate the revenue that will be generated by the Scottish rate of income tax, highlighting how the block grant adjustment will be made. It finally discusses mechanisms that have been proposed for adjusting the block grant and how these distribute risk between the UK and Scottish governments.

Written Agreement between the Finance Committee and the Scottish Parliament regarding the Budget Process [1]

Following the review of the Budget Process carried out by the Finance Committee in Session 3[2], a new version of the written agreement was drafted for Session 4. It recognised three phases to the budget process:

1. Budget Strategy Phase
2. Draft Budget Scrutiny Phase
3. Budget Bill Phase

This paper is largely concerned with Phases 1 and 2, which are more direct concern to the Finance Committee. The written agreement makes a number of statements in respect of the timing and content of these phases. Consider first the Budget Strategy Phase.

> *"The Budget Strategy Phase will take place in the spring prior to the next UK Spending Review and is intended to allow the Parliament to scrutinise the progress which the SG is making in delivering its own targets through its spending priorities and to take a strategic overview of the public finances around the mid-point of the current Parliament."*

The Budget Strategy Phase replaces what was previously known as "Stage 1" of the budget process which had not been completed successfully since 2004. In its review of the budget process, the Finance Committee argued that Stage 1 had not been successful. Hence, the written agreement has been revised to take account of a process whereby strategic reviews of the Scottish budget precede UK Spending Reviews and only occur in Spending Review years. The Scottish Government has agreed that this strategic review might coincide with a self-evaluation of the Scottish Government's performance and its indicative spending priorities for the remainder of the Parliament.

> *"To assist with this process the SG has agreed to consider in consultation with the Finance Committee the options for provision to the Parliament of an assessment of its performance and its updated indicative spending priorities for the rest of the parliamentary session."*

Note that, although the Budget Strategy Phase may only occur once every three years, there will still be an increased workload for the Finance Committee, because such comprehensive

[1] Written agreement between the Finance Committee and the Scottish Government on the budget process in Session 4 of the Scottish Parliament. Accessed at: http://www.scottish.parliament.uk/S4_FinanceCommittee/General%20Documents/Written_Agreement_with_Scottish_Government_-_Revised_June_2012.pdf

[2] Scottish Parliament Finance Committee Report on the Review of the Budget Process Accessed at: http://archive.scottish.parliament.uk/s3/committees/finance/reports-09/fir09-05.htm

strategic scrutiny has not been undertaken since 2004. Pre-2004 exercises did not involve extensive input from Scottish Government including both retrospective and prospective spending information. In consequence, the Finance Committee will have to plan carefully how the Budget Strategy Phase can be accommodated within the timetable and whether sufficient research facilities are available for the Parliament to effectively scrutinise the information from the Scottish Government.

Second, the written agreement has been amended in relation to the Draft Budget Scrutiny phase. The Scottish Government has undertaken to make the draft budget available on or before September 20th each year. In years where there is a Spending Review, the Draft Budget and the Spending Review document will be published jointly. The Finance Committee may set out an alternative set of spending proposals, so long as the total spend does not exceed that proposed by Scottish Ministers. These measures do not involve radical departure from past practice, but do help clarify timing issues.

The written agreement acknowledges that the additional financial powers available through the Scotland Act may lead to further revision of the document. This will undoubtedly be the case, because the introduction of significant revenue raising capability substantially increases the demands on Parliamentary oversight. In the next section, these additional powers and their effect on Committee workload are discussed.

Committee structure and duties

What are the new powers associated with the Scotland Act? They include:

- the setting of the Scottish income tax rate including the forecasting of future tax revenues
- the setting of rates and allowances on those other taxes over which the Scottish Parliament has powers
- the adjustment to the block grant
- the use and long-term sustainability of borrowing powers by the Scottish Government

Administration of these powers clearly poses a considerable challenge to the Parliament and particularly to its Committees. For the first time, the Scottish Parliament will have to consider fiscal risk – the possibility that revenue falls short of spending and that borrowing may be necessary if spending plans are to be realised. Or that spending plans have to be cut if borrowing is not politically acceptable, or if Scotland has reached its borrowing limit.

These issues will be of considerable concern to the people of Scotland, through their effects on tax bills and on public services. There is clearly a need for Parliament to extend its scrutiny of the Scottish Government's budgetary proposals, including its tax proposals. This inevitably means increased workload, particularly for the Committees.

One possibility is for the Finance Committee, as presently configured, to take on this additional work. This would mean that in Spending Review years, the Finance Committee would have to undertake detailed scrutiny of all major spending plans in the light of evidence from the Scottish Government on outcomes. Then between September 20 and the time of the introduction of the Budget Bill (which is to be no later than January 20, according to the written agreement), the Finance Committee will have to carry out its usual duties in respect of spending proposals. Thus, it will have to set out guidelines to Subject Committees, take evidence, receive reports from Subject Committees, draft and agree a budget report and finally sponsor a full parliamentary debate on the budget. However, from 2014 onwards, it will additionally have to consider those tax rates and allowances which it will have under its control. For the Scottish rate of income tax, in particular, this is a complex procedure, involving consideration of issues such as the accuracy of the forecast tax revenue made by the OBR. Then there is the issue of borrowing. The Finance Committee may wish to offer its view on the current and proposed debt, issuance of bonds etc. In addition, though perhaps only in Spending Review years, it may wish to discuss the mechanism by which the block grant is to be adjusted by the Treasury in the light of Scotland's revenue raising capabilities.

The introduction of a more systematic Budget Strategy Phase will require additional Finance Committee time. Given that currently the Finance Committee is the obvious committee to deal with the additional tax powers, further demands will be made on its time, requiring significant additional work between September and December.

There are possible ways round this: the Scottish Government could set tax rates, such as the Scottish income tax rate, over a longer period than one year - say three years to correspond with Spending Review periods. The danger is that setting rates for such a long period would allow revenue forecast errors to be compounded, perhaps requiring higher levels of borrowing. Alternatively Parliament could adopt a fiscal rule whereby the income tax rate responded automatically to forecast surpluses or deficits in the Scottish budget. Some Parliaments have used such a rule to ensure that the executive does not implicitly raise the tax rates of future generations through over-generous current spending plans.

If neither of these outcomes is acceptable, comprehensive engagement with these additional responsibilities will leave the Finance Committee with little time to address any other issues outside the budget cycle. Indeed, it is not clear that it would be possible to address all of the budgetary issues adequately within existing time constraints.

Another argument is that the Scotland Act 2012 should prompt a re-examination of the Committee structure of the Parliament. One approach might be to introduce subcommittees of the Finance Committee. These subcommittees would deal with revenue and spending respectively. The revenue sub-committee would focus on:

- the size of the Scottish budget *including*
    - the adjustment to the block grant
    - the Scottish income tax rate
    - the setting of allowances and rates for other taxes

- the use of borrowing powers by the Scottish Government
- the sustainability of the Scottish budget *including*
  - long-term fiscal projections
  - design and maintenance of the Scottish tax base
  - the administration of Scottish taxes

The spending subcommittee would focus on the scrutiny of the budget and co-ordination with subject committees. Its task to combine the analysis of the budget *after* its overall size is determined. It could liaise with the Audit Committee to combine the ex ante and ex post aspects of budgetary scrutiny. This would more closely link decisions on spending with outcomes of audit and therefore give Parliament a more holistic perspective on the value for money of its various spending programmes. This would help realise the Financial Issues Advisory Group's (FIAG) original aspirations for the budget process.

Under the current written agreement with the Finance Committee, it is clear that the Scottish Government is willing to go some way towards joint scrutiny of spending proposals and past outcomes. This would be restricted to Spending Review years. The Finance Committee might wish to explore further what this joint scrutiny is likely to comprise before deciding whether a more comprehensive approach to scrutiny, using a different committee, is desirable.

The proposal to set up subcommittees of existing Scottish Parliament committees is allowable under rule 12.5 of the Standing Orders.

One might wish to link the two subcommittees through some level of joint membership.

This proposal would leave the number of committees unchanged. But there will inevitably be a significant increase in workload across the whole committee structure as a result of the new fiscal powers, irrespective of how the committees are organised. There is a need to examine how this additional work can be timetabled. The abilities of the committees to undertake such work is constrained by the number of MSPs and by the size and structure of these committees.

A further alternative option may be to set up a "Scottish Taxes and Borrowing Committee" whose duties would correspond to those of the "revenue" subcommittee of the Finance Committee as defined above. This would mean a full committee being directly involved with an the scrutiny of taxation and borrowing powers, but would inevitably mean more demands on MSP' s time.

Note also that these additional powers will put additional pressure on Parliamentary administrative services including the clerks and the Financial Scrutiny Unit.

There is a separate proposal which might spread the task of analysing and scrutinising budgets more evenly over the year. Many other parliaments, including the UK, separate taxation legislation from that dealing with spending (appropriations). In the UK, the Budget

Bill does not need to be passed before the start of the relevant fiscal year. Contingency arrangements are available to ensure that revenues are collected prior to the Bill's passage. The Appropriations Act is the device used by the UK Parliament to authorise expenditures. It has no direct link to the Budget Act. Spending and revenue are connected through the Spending Review process, but that has no legislative force. The Scottish Parliament could also choose to separate the legislative processes underpinning expenditure and revenue-raising. Thus, for example, it could focus on taxation and borrowing during the spring rather than compressing its expenditure and revenue functions during the autumn.

This might be achieved as follows: the Scottish Government introduces its draft budget in September, including its proposals for taxation. Following some preliminary consideration by the Finance Committee, a Parliamentary resolution is introduced in November setting the Scottish rate of income tax for the following fiscal year. This would allow sufficient time to inform HMRC to make the necessary changes to tax codes. The Budget Bill itself could follow the same schedule as in previous years, with the Parliament passing it in January or February prior to the beginning of the fiscal year. The Finance Committee might then return to the issue of taxation and borrowing in the spring, though the effects of such deliberations might not be implemented until the following fiscal year.

Note that the Parliament may also have to take powers to introduce tax changes at short notice. These might be needed at short notice to close tax loopholes or to react to an adverse fiscal situation. The Committee may have to consider how such measures might be dealt with.

These considerations suggest that the Scottish Parliament and its committees will have a substantially increased workload from 2014 onwards. This in conclusion applies whatever constitutional arrangements are in place. It will also require access to a wider range of skills than have previously been available to it. These will include skills associated with the understanding and management of various tax bases. In the following two sections, two of these issues are exemplified. The first considers factors likely to influence the revenue from the Scottish rate of income tax. The second considers various proposals for the adjustment to the Scottish block grant following the introduction of tax-raising powers.

Setting the Scottish Rate of Income Tax

This section considers how the Scottish rate of income tax may be set. Starting in 2016-17, the Scottish Parliament will have to set a Scottish rate of income tax, which will be the rate payable by Scottish income taxpayers. The revenues from the Scottish rate will help fund the Scottish Government's budget. Clearly there is an issue around defining what is meant by a Scottish "taxpayer". Whether the Scotland Act 2012 provides sufficient clarity on this issue remains to be seen.

Since decisions on the Scottish rate are made for the following fiscal year, tax revenue will have to be forecast in order to set at a rate appropriate to balance spending proposals, net of any changes in levels of debt. The forecasts will be made by the Office of Budget Responsibility (OBR). This means that Scottish tax revenues will be subject to forecast risk - the chance that the OBR gets it wrong – see Bell (2011)[3]

The Committee may wish to devote time to considering the reliability of these forecasts and how they are constructed. It might also wish to establish how sensitive revenues are to forecast errors.

The draft budget for 2015-16 will include proposals for the Scottish income tax rate and for those other taxes for which the Scottish government is responsible. This will be published in September 2014. This will be used as a test year to ensure that arrangements for the payment of the Scottish income tax function adequately. The government proposes that the Scottish rate will apply in reality from the 2016-17 tax year.

To implement the Scottish rate, the UK Treasury will reduce all income tax rates in Scotland by 10p. So the 20p rate will become 10p; the 40p rate will be 30p and the 45p rate will be 35p. The Treasury will also cut Scotland's block grant by an amount equivalent to the revenue lost by these rate reductions. The question that will then apply is whether to set the Scottish rate at 10p and so exactly offset the reduction in funding from the Treasury. This should mean that spending plans need not change. But the Parliament could set the Scottish rate below 10p, meaning that income tax rates in Scotland would be lower than those in RUK. Conversely it could set a higher rate, meaning Scottish tax payers would face higher income tax bills than those in RUK.

Obviously one key issue is how accurately the reduction in Scotland's block grant equates to the money raised by setting the Scottish rate at 10p. If the Scottish Government succeeds in its objectives of maximising sustainable economic growth, then the revenues generated by a 10p Scottish rate could exceed the loss in the block grant. Conversely, poorer economic performance in Scotland would lead to reduced revenues, which might force the Scottish government into cutting back its spending plans. The Scotland Act 2012 will make Scotland more responsible for the setting of its own fiscal policy and, for the first time, growth performance will have a direct impact on the amount of revenue reaching the Scottish government. If revenues are insufficient, the government could opt to borrow. There will then be a further set of issues for the Parliament to consider such as the cost of the debt, the arrangements for repayment etc.

Because of its importance in the public finances, income tax is probably the most researched form of taxation. Until recently, the received wisdom was that income tax rates had little impact on the willingness of males to supply labour, but higher tax rates deterred married women from seeking work. Recent evidence has argued that high tax rates can be counter-productive for high income individuals, particularly those who have opportunities for tax

---

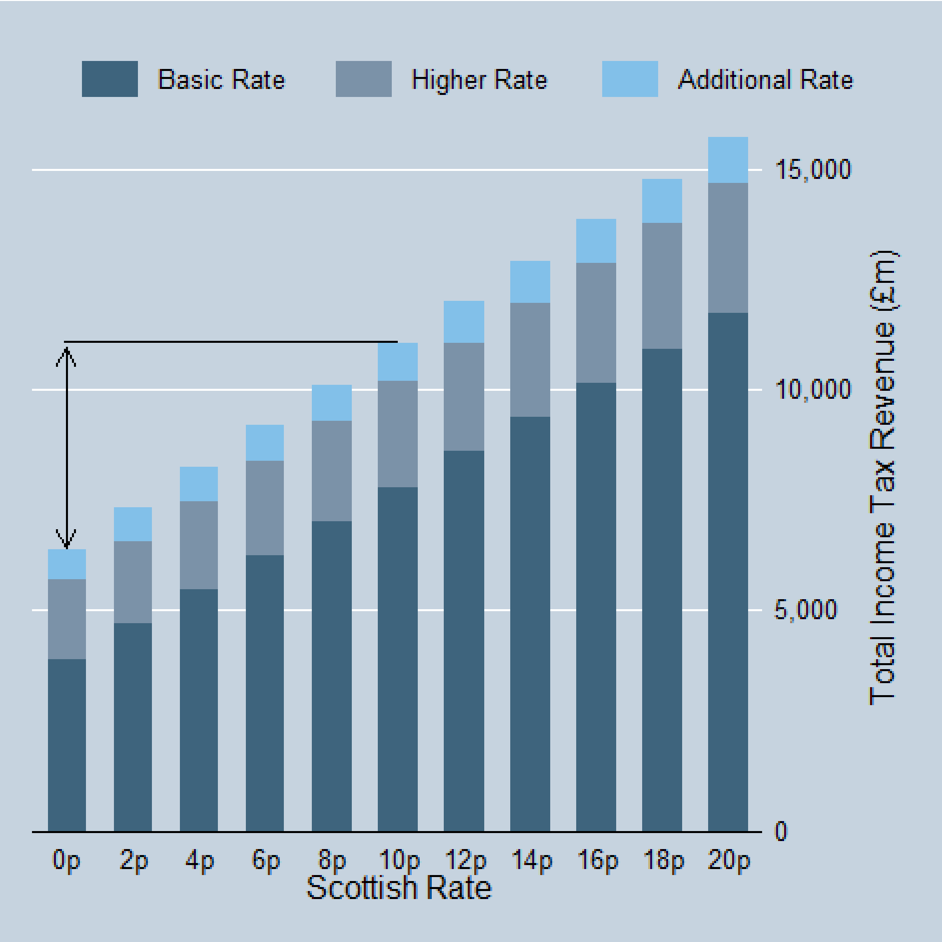
[3] The Scotland Bill Proposals for Forecasting and Reconciling Income Tax Receipts. Available at - http://s3.amazonaws.com/zanran_storage/www.scottish-parliament.tv/ContentPages/2472494430.pdf

avoidance. Increases in income tax rates may have significant effects on the extent to which high earners indulge in socially inefficient practices to reduce their tax burden.

This matters because of the very unequal distribution of income tax liabilities in Scotland, as in the UK. In 2010-11, the bottom 50% of income earners in the UK provided 23.8% of total income tax revenue. This only just exceeded the 23.5% provided by just the top 5% of earners. Top earners provide a massively disproportionate share of total income tax revenues. While one might argue that this is a socially just distribution of the tax burden, the responsiveness of this group to changing tax rates is an issue that the Scottish Parliament cannot ignore. In 2010-11, 5 per cent of Scottish tax payers comprised around 130,000 individuals, and 23.5% of Scottish income tax revenue was worth around £2.4bn – around £0.5bn more than the revenue from council tax, and £150m less than the revenue from corporation tax. This suggests that, under present economic arrangements, a significant proportion of Scotland's tax revenue will depend on a small number of taxpayers. This will be true for the foreseeable future. The Finance Committee might wish to take evidence on the robustness of this tax base.

In the short-run, small variations in tax rates are unlikely to have much effect on the willingness to work and the effects of tax rate changes can be modelled with reasonable accuracy. This is done by using a household survey and calculating the tax liabilities of the members of each household, given their incomes, ages and family situations. The University of Stirling model uses survey responses from more than 4000 Scottish households. For each household, the model calculates liabilities for income tax and national insurance as well as tax credits and a variety of benefits.

Figure1: Revenue Generated by Different Rates of Scottish Income Tax (£m)



So how much revenue would different values of the Scottish rate generate? Estimates using the model for the year 2010-11 are shown in Figure 1 above. These show total income tax revenue in Scotland for different values of the Scottish rate of income tax and indicates how this revenue is divided between the basic rate, the higher rate and what is termed the additional rate, which was 50p in 2010-11, and was payable only on incomes above £150,000. As the Scottish rate increases in steps of 2p from left to right in the figure, the same increases are applied to the higher rate and the additional rate, in line with the rule set out in the Scotland Act.

When the Scottish rate is zero, the basic rate of income tax in Scotland will be 10p, the Treasury having subtracted 10p from the current basic rate of 20p. As the Scottish rate increases, as shown in the figure, revenues to the Scottish Government will also rise. When the Scottish rate is set at 10p, there should be sufficient revenue to offset the reduction by the Treasury to Scotland's block grant. If it increases the Scottish rate beyond 10p, the government will have more cash to spend on its priorities, but runs the risk of increasing tax evasion and reducing labour market participation.

The difference between the zero and 10p Scottish rates (shown by the arrow) is around £4.7bn. This would be the value of the reduction on the Scottish Government's budget if it chose to set the Scottish rate at zero. This would be only part of the overall effect however.

The Scotland Act also confers responsibility for stamp duty and landfill tax to the Scottish Government, though in revenue terms they are much smaller than income tax. Estimates of the revenue from these sources will also affect the reduction in Scotland's block grant.

The Scottish Government might choose to set a Scottish rate above 10p, depending on its priorities and the state of its finances. Figure 1 shows the Scottish rate rising up to 20p. With the first 10p payable to the UK government, this would imply a basic rate of 30p, a higher rate of 50p and an additional rate of 55p. At these rates, Scottish income tax revenue is likely to fall below the model's predictions, because some workers will leave the Scottish labour market and tax avoidance/evasion activity will increase.

One of the features emerging from the model results is that the design of the Scottish Rate means that the Scottish Parliament has no control over the progression of income tax in Scotland. This means that the shares of Scottish income tax revenue from the basic rate, the higher rate, and the additional rate hardly change as the Scottish tax rate increases. The design thus reflects the UK government view that control over tax progression should not be ceded to Scotland, but instead should be retained by central government. The Scottish Parliament can raise the overall level of income tax, but it cannot focus particularly on, say, high income earners. This would only be possible if it were able to control income tax allowances and vary tax rates independently of each other.

This exercise illustrates the type of consideration that will be essential to understand the likely revenues generated by the Scottish rate of income tax. Clearly these are not simple issues and will take some time to debate either in Committee or in Parliament.

The block grant adjustment

Another new issue for Parliament to consider is the adjustment to the block grant that will be made as a result of the Scotland Act. Once Scotland controls a proportion of its tax revenues, it will be able to meet some of its public expenditure needs from its own resources. It will therefore require less funding from the UK government. A key question will be the size of the reduction in the Barnett-determined grant from Westminster. This is known as the block grant offset.

There are a number of possible methodologies for the offset. All of them increase the fiscal risk to the Parliament, since they involve a change from the status quo, where all fiscal risk is borne by the UK Government. Increased fiscal risk is an inevitable consequence of moving towards greater fiscal autonomy.

The Holtham Commission in Wales helpfully classified how such block grant offsets might be designed and how, in consequence, the allocation of risk would change. There will be three main sources of risk associated with tax revenues accruing to the Scottish Government. These are:

- **Macro fiscal risk or cyclical risk.** Tax receipts are subject to volatility due to changing economic circumstances. Some forms of tax are more volatile than others: for example council tax revenue does not vary significantly with the economic cycle, while stamp duty, which is heavily dependent on the number of house sales and the price of houses, is much more volatile.

- **Differential tax base growth.** The tax base in Scotland might grow more slowly, or more rapidly, than that in RUK. As a result, the resources available to the Scottish government might change relative to those that would have been available from a continuation of the block grant system. Clearly, if it wanted to finance higher levels of public expenditure, it would be in the interest of the Scottish Government to adopt policies which would increase the Scottish tax base.

- **Policy risk.** Either the Scottish or UK governments take decisions which affect Scotland's tax revenues. This might, for example, occur if, in relation to income tax, the UK government were to take decisions affecting allowances and tax rates that consequently affected Scotland's income tax revenue.

Holtham then describes four methods of arriving at the block grant offset which take account of these various forms of risk. These are:

- **Own base deduction (OBD).** The deduction from the block grant is indexed to the growth in the devolved tax base. This simply means that the block grant offset is set equal to whatever revenue Scotland is able to collect from its new sources of taxation. This would leave its total revenue unaffected by the introduction of these tax powers: it would bear no additional risk and would have no incentive to increase its tax base. This would effectively mean a continuation of the status quo.

- **Indexed deduction (ID).** An offset is calculated for an initial year. Subsequently it is indexed to some external point of reference, such as the growth in comparable UK tax receipts. With this method, and focusing solely on the income tax adjustment, one would expect that the reduction in the block grant in the first year would equate to the expected revenue from the application of a 10p Scottish rate of income tax. Assuming that actual revenue equalled expected revenue, the resources available to Scotland would be the same as under the block grant system. In subsequent years, the offset of the block grant might be tied to the growth in RUK income tax revenues. Thus if UK income tax revenues rose by 4%, the offset would also grow by 4%. And suppose that income tax revenues in Scotland grew by 5%. The Scottish government would have more resources than it might have expected under the block grant system because, it has increased its income tax revenue at a rate faster than in RUK.

- **Proportionate reduction (PD).** Again, the first year offset is fixed at the expected revenue from Scottish income tax. This will equate to some proportion of Scotland's total revenues. In subsequent years, the offset is adjusted by calculating what the block grant would have been and then applying the same proportion to this value to calculate the offset. Thus, for example, suppose that, under the present block grant scheme, the allocation to Scotland would be £30 billion. In the first year, the yield from the Scottish rate of income tax is expected to be £6 billion. The initial offset is therefore set at £6 billion. The offset percentage wold be 20%. In the following year the grant might be set at £32 billion, in which case the offset would be 20% of £32 billion which equals £6.4 billion. To be able to spend £32 billion, the Scottish government would have to increase revenue from income tax from £6 billion to £6.4 billion. Clearly the correlation between the spending plans of the UK government and the ability of the Scottish government to raise additional revenues is key to whether this would be possible.

- **Fixed real deduction (FRD).** This method operates by indexing the offset to inflation in some way. Clearly there would be a discussion around the appropriate method of indexation. Suppose again that the first year allocation block grant was £30 billion and the offset £6 billion. In the following year, inflation ran at 5%. And therefore the offset increased to £6.3 billion. Suppose the block grant increased in line with inflation to £31.5 billion. Then the net resources made available to Scotland from the UK government would be £25.2 billion. So long as the Scottish Government could increase income tax revenues faster than the rate of inflation, it would be able to increase the real resources available for public spending in Scotland relative to the block grant system.

How do the risks facing the Scottish government vary across these methods for calculating the offset?

- **Cyclical risk**. Suppose there is a recession which has a negative effect on income tax receipts. The OBD calculation makes good any shortfall in Scottish income tax receipts and therefore the Scottish government faces no additional risk. Under ID, a fall in UK income tax receipts would reduce the size of the offset; however, the recession might also have a negative effect on Scotland's income tax receipts. The net effect on the resources available to the Scottish Government would depend on the relative effect of the recession on income tax receipts in Scotland and RUK. With PD, a fixed proportional reduction will be applied to the block grant even though tax revenues in both Scotland and RUK are falling. Scotland will bear some of the risk due to the contraction of income tax receipts. Similarly, with FRD, Scottish tax receipts may fall and there is some risk of a real reduction in the resources available to the Scottish government, depending on the evolution of inflation.

- **UK policy risk.** Suppose that the UK government changes allowances on income tax, reducing its yield in both Scotland and RUK. Under OBD and ID, there is no risk to the Scottish Government, since under the former any shortfall in Scottish tax revenues are made good by Westminster, while under ID, indexation to the RUK income tax base means that the offset will be reduced if the RUK income tax base contracts. Under both PD and FRD, the offset is not directly linked to the RUK income tax base and therefore the offset will not be adjusted to take account of the reduced revenues from income tax. Both these methods therefore involve some additional risk for the Scottish Government. This risk would not arise if the Scottish government had full control over all elements of income tax.

- **Scottish policy risk.** Suppose that the Scottish Government embarks on a policy which harms the Scottish income tax base. Under OBD, it faces no risk from this action since the UK government would make good the shortfall caused by this policy. This suggests that OBD is unlikely to be acceptable to the UK government. Under both PD and FRD, actions taken by the Scottish government which reduce the tax base will not be made good by the UK government, since the method of calculating the offset is independent of variations in the Scottish tax base.

- **Differential tax base growth.** This might occur if the Scottish economy either grew more rapidly or more slowly than that of RUK. This could happen if the Scottish and UK economic cycles became misaligned. There is no strong evidence of this happening during the last two decades. Again, with OBD, the UK government would reduce the offset if there was a shortfall in Scottish tax revenues, but would increase its value should Scottish tax revenues grow more quickly than those in RUK. With ID, indexation of the offset to the tax base in Ireland UK would mean that Scotland would have a revenue shortfall if it experienced a more severe recession than that in RUK, while it would experience a revenue gain if the Scottish economy grew more quickly.

Which of the methods used for the block offset is clearly important: not only do they have different funding implications for Scottish public spending; they also distribute risk in different ways.

Conclusion

This paper has shown that the Scotland act 2012 will add considerably to the workload of the Scottish Parliament and its committees. It invites members to consider the implications of such changing workload and makes some suggestions about how they might be handled. It also exemplifies some of the new issues that may come before the finance committee. These are firstly concerned with the forecasting of revenues from setting the Scottish rate of income tax and secondly with the ways in which the block grant might be adjusted. These are both complex issues. Parliament may require additional resources to be devoted to these questions if it is to fulfil its scrutiny role adequately.