WELFARE REFORM COMMITTEE

THE FUTURE DELIVERYOF SOCIAL SECURITY IN SCOTLAND

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There has rightly been much focus on discussing the opportunities that devolved welfare powers provide to improve the delivery of welfare in Scotland. This note considers the way that issues of financing and fiscal governance are likely to influence the way that new powers are used (or at least the options for using the new powers).

Many of the issues discussed in this paper are expected to be clarified in Scotland's new Fiscal Framework. The Fiscal Framework is currently being negotiated by the two governments. There is no formal timetable for its publication, but it is expected to be available sometime after the UK Government's Spending Review and the Scottish Government's Draft Budget.

The key points that this note makes are:

- The block grant to the Scottish Government will be increased to reflect the transfer of welfare powers. In future years, the size of this transfer will be indexed in some way to spending on the 'devolved' benefits by the UK Government in rUK.
- The precise way in which this indexation is made is yet to be determined, but will influence the level of resource that is transferred to the Scottish Government to reflect the new powers.
- Over the period to 2020/1, the spending forecasts of the UK Government suggest that the level of resources transferred to the Scottish Government to reflect the new welfare powers will decline in real terms.
- The power to vary elements of UC, and to top-up other benefits, does not involve the transfer of spending to the Scottish Parliament per se. If the Scottish Government decides to vary one of these rates, then the costs of that policy variation (and any corresponding administrative cost) incurred by the UK Government would have to be reimbursed by the Scottish Government. Calculating the fiscal costs of such policy variation could be contentious.
- It is as yet unclear how resource will be transferred to the Scottish Government to reflect its new responsibilities for employability programmes. Different funding options would have different implications for the budgetary risks and rewards the Scottish budget is exposed to.
- Devolution of the Work Programme will provide the Scottish Government opportunity to re-think the provision of employability support, but the complicating factor is that sanctions and conditionality will remain reserved.

- Consideration must be given to the design of institutions and protocols for managing fiscal aspects of welfare devolution. Issues here include welfare expenditure forecasting, calculating the costs of policy variation, and agreed rules around how no detriment principles will be applied.

The devolved welfare benefits: funding implications

For the welfare benefits that are being transferred to Scotland, the Scottish Government's block grant will need to be increased, in the year that the powers are transferred, to reflect the value of spending by the UK Government on these benefits in Scotland. In 2013/14, spending on the 'devolved' benefits in Scotland amounted to £2.5bn.

In future years, this block grant adjustment (BGA) will have to be indexed in some way to reflect the UK Exchequer saving from having transferred the responsibility to Scotland. This indexation serves two purposes. First, to ensure that the BGA reflects, at least notionally, the value of expenditure 'foregone' (saved) by the UK Exchequer (thus the BGA can be thought of as representing the value of welfare expenditure that the UK government would have incurred if the benefits had not been devolved). Second, to ensure that the Scottish budget is protected from demographic or fiscal changes that affect welfare spending in the UK as a whole.

Over the course of this parliament, the UK Government is expecting to achieve reductions in spending on the majority of the benefits to be devolved. Spending forecasts contained in the July Budget imply a fall in spending on the benefits to be devolved from £2.5bn to £2.2bn by the end of the parliament (Table 1). A large part of this forecast 'saving' is driven by the transfer from DLA to PIP for claimants of working age, whose claims will be reassessed against stricter criteria. A significant fall in expenditure on Winter Fuel Payments is also forecast, due largely to the increase in State Pension age (which will have reached 66 for both males and females by 2020).

Table 1: Forecast change (Summer Budget 2015) in GB benefit spending and caseload, 2015/16 - 2020/21

	Caseload (000s)	Caseload (%)	Real terms exp.(£m)	Real terms exp. (%)	Real terms exp. per capita
All devolved benefits	***-1225***	***-6%***	***-£2,359***	***-9%***	***-12%***
Attendance Allowance	63	4%	£37	1%	-3%
DLA/ PIP	-344	-10%	-£1,867	-12%	-15%
Carer's Allowance	126	11%	£275	11%	7%
Severe Disablement Allowance	-88	-80%	-£383	-80%	-81%
Industrial Injuries	-22	-7%	-£121	-13%	-16%

Disablement Benefit					
Winter Fuel Payment	-960	-8%	-£294	-14%	-17%

Of course the full magnitude of these expected savings may not materialise. Compared to the forecasts in its 2010 Budget, the Coalition Government's spending on DLA/PIP was 11% (£1.4bn) higher in 2014/15 than had been expected. This higher than forecast expenditure was due to a combination of economic factors, forecast errors, and administrative problems in moving to the new assessment system.

The case has been made that, in designing a different system of disability benefits, Scotland could achieve savings of its own by having, for example, a less aggressive or repetitive form of assessment, or a delivery model that builds on existing integration between health and social care provision. **This notwithstanding, the clear implication is that, when welfare powers are transferred to the Scottish Parliament, the grant is likely to be less rather than more than £2.5bn, and the direction of policy at UK level is likely to be towards further spending retrenchment. The Scottish budget is thus likely to face a declining BGA rather than an increasing BGA to fund devolved welfare, at least in the initial years.**

The precise way in which Scotland's block grant adjustment for welfare powers will be indexed to rUK expenditure will be determined as part of the emerging Fiscal Framework. **Different indexation methods could yield quite different grant adjustments for Scotland.** For example, the BGA could be indexed to total spending on 'devolved' benefits in rUK; or to per capita spending on devolved benefits in rUK. The former approach would disadvantage Scotland if its population were to grow more rapidly than that of rUK; but even if the block grant was indexed to per capita spending in rUK, the Scottish budget would still bear the risk of a more rapidly ageing population, or less rapid decline in the incidence of disability. (As shown in Figure 1 in the Annex, relative per capita spending on the benefits to be devolved to Scotland has declined since 1999, due largely to a lower incidence of disability).

The indexation method chosen depends on the set of risks and rewards that it is felt the Scottish budget should be exposed to. It is important to note however that the indexation method for the devolved welfare benefits cannot be discussed in isolation from the question of how the block grant is indexed for devolved tax powers.

Varying housing elements of UC, and top-up payments

The power to vary elements of UC, and to top-up other benefits, does not involve the transfer of spending to the Scottish Parliament per se. Indeed, if the Scottish

Government chooses not to vary UC or any individual benefit rate, then there is no funding implication. If however the Scottish Government decided it wanted to increase the local housing allowance rates under UC, or a particular benefit, then the costs of that policy variation (and any corresponding administrative cost) incurred by the UK Government would have to be reimbursed by the Scottish Government.

A critical issue is how the costs of policy variation are estimated. The calculation of the cost of policy variation is likely to be contentious, especially given that changes to benefit rates may induce behavioural effects which alter benefit spend or tax take in other parts of the fiscal system. Under the 'no detriment' principles, the Scottish Government may have to compensate the UK Government for these second order or knock-on effects. How these no detriment calculations are made is yet to be resolved.

One implication of not devolving Housing Benefit entirely, but only the power to vary certain elements, is that the Scottish Government does not gain the fiscal rewards from investment in social housing that results in reduced spending on Housing Benefit (as a result of lower rents). Between 1999-2013, real terms per capita Housing Benefit expenditure increased by 45% in GB, compared to 17% in Scotland, due largely to lower growth in private and social rent in Scotland. The extent to which this differential growth in rents is due to policy intervention cannot be ascertained with any certainty.

Of course the powers to vary housing elements of UC and top-up other benefits amount to a partial devolution of working age benefits. At UK level, whilst the freeze in working age benefits, tax credits and Local Housing Allowance for four years is expected to save some £4bn by 2020, changes to eligibility, work allowances and taper rates account for almost £6bn of welfare savings. **A scenario whereby the Scottish Government were to increase UC benefit rates, whilst the UK Government were reducing work allowances or increasing taper rates, is likely to weaken work incentives for some claimants. This may create further tension between governments in relation to 'no detriment' principles.**

Employability Programmes
Devolution of the Work Programme will provide the Scottish Government opportunity to re-think the provision of employability support, including the funding model, the focus on particular target groups, delivery arrangements, flexibility of support, and programme objectives and targets. Similar decisions will also be possible in respect of Work Choice.

It is as yet unclear how resource will be transferred to the Scottish Government to reflect the spending forgone by the UK Government. The resource transfer could be made on the basis of spending per capita on equivalent programmes in rUK, or spending per target group claimant. Which of these options is deemed appropriate depends on whether one thinks the Scottish Government should face the costs of differential rates of unemployment/ disability in Scotland. Of course the Scottish Government would bear the costs of a relatively more generously funded programme (whether this generosity is in terms of the type of support available, or the focus across client groups).

Alternatively, the UK Government could reimburse the Scottish Government for the job outcomes that it achieves through its programmes, at the same rates that providers in rUK are (plus any administration fee). This approach is unlikely to be satisfactory, as it would imply that, should the Scottish Government elect to place more emphasis on supporting those furthest from the labour market, this policy choice may result in it receiving less than its 'fair' share of UK funding.

The greatly complicating factor in all of this is that the conditionality and sanctions regime will remain reserved at Westminster. Thus the DWP continues to determine who is referred to the Work Programme and the type of activity that should be undertaken. Work Programme providers cannot impose sanctions themselves, but report non-compliance to DWP who decide whether to impose a sanction. There is some scope for discretion in respect of referrals, reporting and sanctions at individual level. But it is unclear to what extent there could be broader flexibility in Scotland in terms of:

- Who is referred (e.g. could age limits on dependent children be varied?)
- The type of activity mandated
- The 'reasons' considered suitable for 'non-compliance'.

Fiscal governance

Previous sessions have given consideration to issues around the delivery infrastructure for devolved welfare programmes in Scotland. It is also necessary to consider wider administrative/ institutional architecture that will be required, both at UK and Scottish levels, to manage fiscal governance.

For example, there is the issue of how grant to the Scottish Government is determined/calculated, and the need for transparency around that.

There is also the issue of forecasting benefit expenditure in Scotland – to what extent should this be a role for an independent fiscal commission, and what level of cooperation in terms of data-sharing or model-sharing with HMRC/DWP might be necessary to inform this.

Where non-devolved benefits are 'topped-up', there is a question about how the costs of this are calculated. The direct or first order fiscal implications might be relatively uncontentious – effectively this is the number of people in receipt of benefit multiplied by the increase in rate. But indirect or second order implications – which will be very relevant if the 'no detriment' principles are fully implemented in practice – will be subject to greater uncertainty. Changes to benefit rates could theoretically induce behavioural responses, leading to higher or lower claimant rates for non-devolved benefits. Similarly, changes to devolved income tax rates in Scotland could effect eligibility for some reserved means-tested benefits in Scotland.

It is imperative that the forthcoming Fiscal Framework sets out proposals for both the type of secondary order effects that will be subject to 'no detriment' calculations, and how the process of arriving at policy costings will be arrived at. Will estimates be made by an existing institution such as the OBR, by some new UK-level independent body set up to advice on devolution finance, or by both UK and Scottish level institutions separately, prior to some form of negotiation. Similar questions exist with regard to the calculation of the administrative costs of policy variation. There is a clear need for transparent and agreed processes around how such costs are arrived at, and how any disputes are resolved.

Annex 1: Index of real terms per capita spending on selected benefits in Scotland relative to rGB, 1996/7 – 2014/15, rGB=1