



**FINANCE AND CONSTITUTION COMMITTEE**

**AGENDA**

**22nd Meeting, 2017 (Session 5)**

**Wednesday 27 September 2017**

The Committee will meet at 9.30 am in the David Livingstone Room (CR6).

1. **Outlook for the UK Public Finances:** The Committee will take evidence from—

Paul Johnson, Director, Institute of Fiscal Studies.

2. **The Impact of Brexit on the Scottish Budget:** The Committee will take evidence from—

Professor David Bell, Fellow, Royal Society of Edinburgh;

Professor David Heald, Professor of Public Sector Accounting, University of Glasgow.

3. **Work programme (in private):** The Committee will consider an update to its work programme.

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Room T3.60  
The Scottish Parliament  
Edinburgh  
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The papers for this meeting are as follows—

**Item 2:**

Note by the Clerk

FCC/S5/17/22/1

**Item 4:**

PRIVATE PAPER

FCC/S5/17/22/2 (P)

**Finance and Constitution Committee**

**22<sup>nd</sup> Meeting, 2017 (Session 5), Wednesday 27 September 2017**

**The Impact of Brexit on the Scottish Budget**

**Introduction**

1. The purpose of this paper is to set out the background and evidence received on the impact of Brexit on the Scottish Budget in advance of the evidence session with Professor David Bell, Fellow, The Royal Society of Edinburgh and Professor David Heald, Professor of Public Sector Accounting, University of Glasgow.

**Background**

2. At its meeting on 28 June, the Committee considered its approach to the Draft Budget 2018-19 and agreed to focus on the short-term impact of Brexit on the public finances and any measures the Scottish Government could adopt to mitigate the impact of Brexit.

3. The Committee issued a call for views on 30 June with a deadline for responses of 18 August. The Committee received 13 responses. Written responses from Professor David Bell, The Royal Society of Edinburgh and Professor David Heald are attached at [Annexe A](#).

4. A summary of all the responses produced by SPICe is attached at [Annexe B](#).

**Next steps**

5. The Committee will continue to take evidence on the impact of Brexit on the Scottish Budget at its meeting on 4 October.

**Committee Clerks**

**20 September 2017**



**Annexe A  
Professor David Bell**

## **RSE Finance and Constitution Brexit Inquiry**

### **Introduction**

1. The Royal Society of Edinburgh welcomes the opportunity to submit a response to the Scottish Parliament's Finance and Constitution Committee inquiry into the potential differentiating effect in Scotland from Brexit.
2. The RSE has continued to be involved in activity regarding Brexit since well before the referendum. In advance to the referendum the RSE ran a series of events that addressed the main issues in the debate. After the decision to leave the EU in 2016, the RSE brought together an EU Strategy Group; the group is chaired by Sir John Elvidge and oversees the work of 4 Subgroups covering: Constitutional Law and Government; Economics and Public Finance; Research and Innovation; and Migration and Rights. The RSE intends that these groups will work to inform and engage in the debate around the withdrawal from the EU as negotiations develop. The RSE recently published 'Brexit: Challenges and Opportunities', this included 4 advice papers which came from the work of each subgroup. The subgroups will continue to work to inform the debate as more information is made available through the negotiation period.
3. In preparing this response the RSE has drawn from the work of the Economy and Public Finance subgroup as well as drawing on expertise from the Society's Fellowship and members from the Young Academy of Scotland. The Advice Paper has been approved by the General Secretary of the RSE, Professor Alan Alexander.

### **Are there any indications of a differential economic impact in Scotland separately from rUK?**

4. Currently there are many uncertainties around the various features of the final Brexit settlement. This makes it difficult to identify the different potential effects on the Scottish economy. However, the Scottish economy's reliance on particular sectors and skills suggests that there could be a differential economic impact from Brexit on Scotland, as compared to the rest of the UK.
5. Given these uncertainties we strongly urge that the Scottish Government to use scenario planning to help predict the effects of Brexit rather than relying on point forecasts. Scotland's Economic Strategy outlines the key growth sectors of the Scottish Economy including: Food and Drink, Creative Industries, Sustainable Tourism, Energy, Financial Services and Life Sciences. These are likely to be

affected in different ways by Brexit. Scenario planning might help Government, and others, to better understand the risks and challenges that the various sectors may face.

6. Scottish cities contribute heavily to the output of the Scottish economy. The economic importance of city regions has recently been recognised through the City Region Deals. Scottish cities have a critical role to play in determining the current and future size, scope and competitiveness of the Scottish economy<sup>1</sup>. Recent research has predicted that all UK cities will be negatively affected as a result of Brexit, due to higher trade costs and changes in the supply of key skills. Economic output in cities, measured through GVA, is predicted to be 1.2% lower on average in a 'soft' Brexit scenario and 2.3% lower on average under a 'hard' Brexit. All Scottish cities are likely to feel an economic impact from Brexit<sup>2</sup>.
7. In Scotland, it is forecast that Aberdeen, Dundee, Edinburgh and Glasgow will experience the most negative effects on Gross Value Added (GVA). Aberdeen's GVA is forecast to fall more than any other city in the UK, potentially experiencing an output loss of 4%. Edinburgh's GVA is forecast to fall by 3%, while the forecast falls in Dundee and Glasgow are less pronounced at around 1.5-2.5%<sup>3</sup>. The larger falls forecast for Aberdeen and Edinburgh stem from the reliance on knowledge-intensive services, particularly in oil and gas and the financial sector. The Scottish Government and the City Partnerships might wish to consider how these potential negative effects on output might best be ameliorated.
8. The Scottish Government has maintained clear population growth targets. Over the last decade the Scottish population has grown by 5% and now sits at a record 5.4 million. Growth in population is primarily due to migration rather than natural increase. Net migration to Scotland between 2015 and 2016 was 31,700. In these latest National Records Figures migration from the rest of the UK and from overseas are distinguished, but there is no distinction between migration from the EU and other international destinations<sup>4</sup>. Brexit has caused uncertainty over future levels of migration to the UK and Scotland, with an expectation that net migration levels will be reduced. The latest data shows that migration from the EU to the UK has fallen since the decision to leave the EU in 2016. This is largely due to a decline in migration from Eastern Europe and an increase in EU nationals choosing to leave the UK. Net migration to the UK in 2016 was estimated to be 248,000, 84,000 lower than in 2015. Around 117,000 EU citizens left the UK while the number migrating to the UK fell by

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<sup>1</sup> Fraser of Allander (2015), 'Scotland's Economic Powerhouses'. Accessed 11/08/17. URL: [https://www.scottishcities.org.uk/site/assets/files/1221/foa\\_-\\_scotland\\_27s\\_economic\\_powerhouses\\_-\\_28-10-15\\_1.pdf](https://www.scottishcities.org.uk/site/assets/files/1221/foa_-_scotland_27s_economic_powerhouses_-_28-10-15_1.pdf)

<sup>2</sup> Centre for Economic Performance (2017), 'Brexit, trade and the economic impact on UK cities'. Accessed 11/08/17. URL: <http://www.centreforcities.org/wp-content/uploads/2017/07/17-07-26-Brexit-trade-and-the-economic-impacts-on-UK-cities.pdf>

<sup>3</sup> Centre for Economic Performance (2017), 'Brexit, trade and the economic impact on UK cities'. Accessed 11/08/17. URL: <http://www.centreforcities.org/wp-content/uploads/2017/07/17-07-26-Brexit-trade-and-the-economic-impacts-on-UK-cities.pdf>

<sup>4</sup> National Records of Scotland (2017), 'Scotland's Population', 162 Edn. Accessed 11/08/17 URL: <https://www.nrscotland.gov.uk/files//statistics/rgar/16/16rgar.pdf>

43,000<sup>5</sup>. If the UK government's aim is to reduce net migration to the "tens of thousands" post-Brexit, net migration to Scotland is likely to fall below 10,000.

9. Immigrants tend to be of working age. This is true for Scotland with 80% of EU nationals falling into this category<sup>6</sup>. The increase in the size of the working age population has slowed the ageing of the population in both Scotland and the UK. If there is a substantial decline in EU net migration post Brexit, the pace of population ageing will accelerate. The Registrar General for Scotland's current central population projections predict that the number of pensioners will rise by 28% over the next 25 years, while the working age population will rise by only 1%<sup>7</sup>. Population ageing is predicted to progress more quickly in Scotland than in the UK as a whole, partly because migrants have disproportionately chosen to settle in England rather than Scotland.

### **What additional spending pressures are there on the public finances as a consequence of Brexit?**

10. Brexit may also affect Scotland's public finances. A continued fall in net migration will place pressure on Scotland's tax revenues, primarily through falls in income tax and VAT receipts. The size of these falls is difficult to predict, given that there are no reliable data on the taxes paid by migrants to Scotland. Nonetheless, the Scottish Government or the Scottish Fiscal Commission might wish to commission some research on the revenue implications of reduced migration. The effects on welfare spending are likely to be small since the welfare powers being transferred to Scotland are mostly associated with disability and relatively few migrants are likely to claim such benefits, given that their overwhelming motive in moving to Scotland is to find employment. These effects will likely increase over time as the gap between Scotland's *actual* population and *that which would have emerged under continued free movement* grows.
11. Immigration data suggest that most immigrants who arrive in Scotland are relatively young. Young migrants help to support public services and businesses through employment. However, data from forecast income tax revenues indicate that age is the one of the major determinants of tax take, with the bulk of income tax coming from the middle aged<sup>8</sup>. As young migrants are more likely to work in entry level jobs that usually are not in the top two tax rates, they do not, currently, make a significant difference to income tax revenues. Therefore a reduction in immigration is unlikely to have a major fiscal impact in the short term. However, in the longer term a reduction

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<sup>5</sup> Office for National Statistics (2017), 'Migration Statistics Quarterly Report: May 2017'. Accessed 11/1108/17. URL:

<https://www.ons.gov.uk/peoplepopulationandcommunity/populationandmigration/internationalmigration/bulletins/migrationstatisticsquarterlyreport/may2017>

<sup>6</sup> SPICe (2016), 'EU Nationals Living in Scotland'. Accessed 11/08/17. URL: [http://www.parliament.scot/ResearchBriefingsAndFactsheets/S5/SB\\_16-86\\_EU\\_nationals\\_living\\_in\\_Scotland.pdf](http://www.parliament.scot/ResearchBriefingsAndFactsheets/S5/SB_16-86_EU_nationals_living_in_Scotland.pdf)

<sup>7</sup> National Records of Scotland (2017), 'Scotland's Population', 162 Edn. Accessed 11/08/17, URL: <https://www.nrscotland.gov.uk/files//statistics/rgar/16/16rgar.pdf>

<sup>8</sup> Scottish Government, (2016), 'Scottish Budget - Draft Budget 2017-18 Devolved Taxes Methodology Report'. Accessed 17/08/17, URL: <http://www.gov.scot/Publications/2016/12/6669/5>

in migrant workers who may become higher-rate tax payers could have a greater impact. If Brexit does tighten the Scottish budget, this may place pressure on the Scottish Government to be more proactive in their use of the devolved income tax powers. Raising tax revenues will require the Scottish Government to target the top two income tax rates which would predominately affect a particular demographic.

12. If the UK economy does weaken as a result of Brexit, the UK Government may find itself under strong political pressure to adopt an expansionary fiscal policy to maintain output and employment. This could lead to an increase in funding to Scotland if the increased spending falls in areas such as health and education, which will result in Barnett consequential for the Scottish budget. This may offset reductions in tax revenues caused by the negative fiscal effects of reduced migration on the working age population, but the longer term consequences of a post-Brexit fiscal expansion may be higher taxes and/or reduced spending in the future.

**What should the Scottish Government's priorities be in formulating Draft Budget 2018-19 in response to the initial economic impact of Brexit?**

13. In the very short term there will be no major budgetary challenges from Brexit. Therefore it is unlikely that the Scottish Government will need to change its main priorities in formulating a Draft Budget for 2018-19. However, increased inflation, currently at 2.9%, resulting from sterling's devaluation following the 2016 referendum will put general pressure on governments' costs. The resultant falls in real wages are also likely to result in increased wage demands among public sector employees. Some of these may be difficult to resist, especially where staff shortages emerge due to public sector wages no longer being competitive with the private sector. These pressures will be heightened if public sector employers are no longer able to attract workers from other parts of the EU.
14. It is uncertain how much the UK will have to pay the EU in the proposed 'divorce bill'. Current estimates put the potential bill at around £36bn. Payments to the EU as a consequence of Brexit will be paid from the overall UK budget which includes the budgets of the devolved administrations. Some payments to the EU have been incorporated in current fiscal plans since the UK expected to be a net contributor to the current EU budget which ends in 2020. If, however, additional payments form part of the final divorce bill, then there are likely to be consequences for the Scottish budget since cuts will likely be made in Barnett-related components of UK public spending.

**Given that increased inflation is likely to disproportionately impact on the poorest, what measures should the Scottish Government take in its Budget to address this?**

15. Following the decision to leave the EU and the consequent devaluation of sterling, inflation is currently at a four-year high. Its future path is uncertain. However, research by the Resolution Foundation indicates that inflation is now leading to reduced living standards. The research indicates that those on lower incomes are

more likely to be affected by current increases in inflation because their typical consumption “basket” has been more affected by price increases<sup>9</sup>.

16. The Scottish Government does not set the minimum wage. However, it has promoted the “Scottish Living Wage” in both the public and private sector. Efforts by the Scottish Government to promote improved wages for poorly paid workers helps mitigate the effects of inflation on living standards. On the other hand, its successful promotion within the public sector is likely to lead to increased costs and pressure on budgets unless compensating productivity increases can be achieved.
17. The devaluation of sterling has contributed to rising inflation, but it has also helped stimulate exports which have provided a modest boost to the UK economy in the short term. In Scotland, Sterling’s devaluation has been particularly beneficial to certain industries such as tourism and food production. Increased tax revenue from higher levels of output in these sectors will help offset some of the negative effects of Brexit described above.

### **What issues require to be considered from the loss of EU funding mechanisms arising from Brexit?**

18. European Structural Funds and EU Research Funding have been beneficial to Scotland, supporting the development of key infrastructure, research and innovation. In Scotland there are some differences in the support provided by the Structural Funds with the Highlands and Islands receiving the highest level of funding per capita. Post-Brexit the UK government may choose to maintain the levels of, and current distribution mechanisms, for these funds, thus allaying concerns from both the private and public sectors about the removal of such funding. Changes to the form and distribution of the funds are likely to be acceptable in the nations of the UK only if the UK Government is willing to negotiate in good faith with the devolved administrations.
19. The development of City Deal funding through the UK and Scottish Governments has opened a new stream of funding for city regions across the UK. Currently 3 city regions in Scotland have had their city deal packages approved by Government. The deals were planned before Brexit and have the clear objective of developing infrastructure projects as well as promoting private investment in the regions. Post-Brexit, the City Deal system might be used as an alternative channel to direct infrastructure and social funds across the UK, though this would likely have negative consequences for rural communities that are likely to be bypassed if the funding is largely directed towards cities.
20. There is uncertainty over the future of current funding that Scottish Universities receive from the EU; arguably this funding has been of particular benefit to Scotland through its support for research and innovation within the universities. Scotland has disproportionately benefited from research funding from the EU and EU students in comparison to the UK. If the UK withdraws from freedom of movement then it is likely

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<sup>9</sup> Clarke, Stephen (2017) ‘Inflation Afflictions’. The Resolution Foundation, London. Accessed 11/08/17. URL: <http://www.resolutionfoundation.org/media/blog/inflation-afflictions/>

that Scottish institutions will lose access to this funding stream. This withdrawal of EU research funding will provide challenges for both the UK and Scottish Governments, neither of whom will wish to see a decline in research and development activity. Both are likely to come under pressure from the higher education sector to find new avenues to support Scotland's research infrastructure. If additional funding is made available it will be important to monitor how far it manages to replicate existing international research networks and enables researchers to work at arms-length from both the UK and Scottish governments.

### **Additional Information**

This Advice Paper has been signed off by the General Secretary of the RSE.

Any enquiries about this response should be addressed to Paul Stuart, Policy Advice Officer (pstuart@rse.org.uk).

All responses are published on the RSE website ([www.rse.org.uk](http://www.rse.org.uk)).

**Memorandum by Professor David Heald<sup>1</sup> to the Finance and Constitution Committee**  
**THE IMPACT OF BREXIT ON THE SCOTTISH BUDGET**

**Introduction**

1. The opportunity is welcomed to submit written evidence to the Finance and Constitution Committee Inquiry into the impact of Brexit on the Scottish Budget.
2. Before addressing the five specific questions posed in the Finance and Constitution Committee's (2017) call for evidence, I summarise key points of context:
  - a) I have a long track record of emphasising the importance of devolved taxation, as in Heald (1976) where I proposed what later became known as the 'tartan tax' power of the *Scotland Act 1998* and later forewarned that the power might atrophy through non-use (Heald and Geaghan, 1997). The Smith Commission (2014) marked the point at which my relatively static position on tax powers was transformed from advocacy of careful extension of devolved taxation powers to nervousness about what had become conventional wisdom and legislated practice.
  - b) The Kilbrandon Commission (1973) distinguished between an expenditure-based system of devolution finance and a revenue-based system. The *Scotland Act 2016* marks a shift towards a revenue-based system that was not foreseen at the time of the *Scotland Act 1998*, when the Barnett formula system transferred from a within-UK government mechanism into an intergovernmental relationship (Heald and McLeod, 2002). Regrettably, the necessary fiscal architecture for devolution finance has never been put in place, too much continuing to depend on Treasury goodwill and on constraining political circumstances.<sup>2</sup>
  - c) Before Brexit became a serious possibility, the UK was experiencing the longest – but not the deepest – period of fiscal squeeze in the last century (Himaz and Hood, 2016). At least part of the criticism faced by the Scottish Government on the performance of education and health in Scotland ultimately derives from the

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<sup>1</sup> Professor of Public Sector Accounting at the Adam Smith Business School, University of Glasgow; member of the Financial Issues Advisory Group (1998); specialist adviser on public expenditure and government accounting to the Treasury Committee (1989-2010); and member of the Financial Reporting Advisory Board to HM Treasury (2004-09). Sole responsibility for the contents of this memorandum rests with the author.

<sup>2</sup> My view is that, with a few exceptions such as the Olympics and the Carter Review of prisons in England, the Treasury has largely played it straight by its own published rules, as articulated in successive Funding Policy documents. A Scottish MP being a Treasury-based Cabinet Minister from 1997 to 2015 was probably a factor in restraining Treasury action, notwithstanding a widespread view in Westminster and Whitehall that the Barnett formula over-privileges Scotland.

expenditure standstill enforced by the 2010-15 Coalition Government and by its Conservative successors, after a long period of strong public expenditure growth. There is growing evidence across the UK that the long period of fiscal squeeze is hurting public services, particularly when combined with demographic ageing, population growth and higher expectations.

- d) Fourteen months after the EU Referendum and five months after the activation of the UK withdrawal procedure, there is uncertainty about (i) the UK's future relationship with the EU27; and (ii) the effects on the UK and regional economies of possible relationships with the EU27. Conflicting forecasts of prosperity or doom often seem to align with the individual or organisation's view of the desirability of Brexit, or the best form of Brexit.
  - e) The contrast between economic and political realities is striking: I have argued that the EU Divorce Bill is of limited fiscal importance but that it is politically toxic due to rhetoric about the 'huge amounts of money sent to Brussels' (Heald, 2017). A UK-EU dispute about something of minimal importance relative to future trading relationships has the potential to stall the Brexit negotiations.
  - f) Two dimensions of economic performance have to be monitored. If the Rest of the UK (rUK) performs well (badly), then higher (lower) levels of public expenditure in England would be affordable, with benefit (damage) to the Scottish Budget.<sup>3</sup> If Scotland performs better (worse) than rUK in terms of per capita revenues from devolved taxes, then the Block Grant Adjustment (ie deduction) will be lower (higher).<sup>4</sup>
3. The combined effect of the above is great uncertainty, for the UK as a whole and for the budgetary positions of the devolved administrations. The EU Referendum and the 2017 UK General Election demonstrated complex social divisions which exhibit territorial dimensions.

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<sup>3</sup> The higher economic performance making possible higher levels of public expenditure requires that this translates into more taxation revenue: tax-poor recoveries have affected many countries since 2008.

<sup>4</sup> See Bell, Eiser and Phillips (2016) on the detailed mechanics of the Block Grant Adjustment under the Fiscal Framework.

## **Responses to the Committee's Specific Questions**

4. My answers vary in length in accordance with the extent of my experience and/or expertise in relation to the five specific questions set out in the Finance and Constitution Committee's (2017) call for written evidence.

### ***Q1: Are there any indications of a differential impact of Brexit in Scotland separately from rUK?***

I defer on this question to research organisations which run economic models, such as the Fraser of Allander Institute and the National Institute for Economic and Social Research. Scotland has a diversified economy which is aligned with that of the UK as a whole. Paradoxically, divergent and unbalanced regions that were Leave voting, such as in the North and Midlands of England, may be more vulnerable to differentially adverse impacts. As on other Brexit issues there is uncertainty: Brexit has not yet happened and its form is uncertain; exchange rate depreciation has occurred; and anticipatory behaviour by firms and households is proceeding, to a large extent below the radar. One particular uncertainty is whether damage to London arising from the loss of EU financial passporting rights will have a positive or negative knock-on effect to the Scottish financial sector. My expectation is that it will be difficult to disentangle Brexit effects from other effects, particularly in real time.

### ***Q2: What additional spending pressures are there on the public finances as a consequence of Brexit?***

I will interpret this question broadly, to include potential revenue shortfalls as well as additional spending pressures.

The interaction of different factors means that attribution of spending pressures to Brexit will be technically difficult and politically controversial. Leaving aside those issues covered under Question 5 below, the following pressures can be expected:

- a) Public sector costs will increase due to the effects of sterling depreciation working through the economy.
- b) A remarkable feature of UK fiscal squeeze post-2010 has been the real reductions in public sector wages and salaries, which have in turn protected service levels. Mounting

evidence of recruitment and retention problems and of employee discontent might indicate that this policy of wage repression will be difficult to sustain.

- c) Pressures from expectations of improved services and adverse demographic trends will not abate.

Whatever the contribution of Brexit to these pressures, their consequences will be interpreted through the lens of Brexit.

A paramount consideration for the Finance and Constitution Committee should be the monitoring of the implementation of the Scottish Parliament's extended fiscal powers. The precedents are discouraging, such as the failure to revalue the council tax base, which remains linked to property tax values in 1991.

The most important taxation power controlled by the Scottish Government is setting the bands and rates for personal income tax. While it is imperative that these powers do not atrophy as did the 1998 tartan tax power, such is the novelty of within-UK income tax variation that these powers require to be used cautiously on the basis of reliable statistical information. For the first time, taxpayers' declarations of residence are income tax-relevant and the revenues attributed to Scotland directly affect spending capacity. The following numbers (HMRC, 2017) are striking:

- Of 2,601,000 Scottish income taxpayers in 2014-15 paying £1.68 billion, the 4.38% with incomes greater than £50,000 accounted for 38.39% of that total
- The 0.77% of Scottish income taxpayers with incomes over £100,000 paid 18.82% of total income tax revenue
- The 10,000 Scottish income tax payers with incomes over £200,000<sup>5</sup> paid an average of £168,000, representing 14.07% of total revenues
- 68.74% of Scottish income taxpayers (incomes not higher than £20,000) pay 23.62% of the total, while 90.54% (incomes not higher than £30,000) pay 48.67%

These figures evidence not only the extent of income inequality within Scotland but also the vulnerability of the Scottish income tax base to decisions taken by a relatively small number of taxpayers.

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<sup>5</sup> With numbers of taxpayers in this income range being so small, the practice of rounding to the nearest thousand introduces error into this calculation of the mean.

To maintain public consent, a tax system must be seen to be administered efficiently and even-handedly. Much damage to that consent in the UK has been done by the perception that corporations and an ill-defined category of ‘rich’ individuals do not pay the amounts that Parliament intended. Devolved income tax in a hitherto highly centralised fiscal state may create new avoidance and evasion possibilities. On the other hand, it may stimulate better enforcement<sup>6</sup> and heightened Parliamentary interest<sup>7</sup> in the taxation side of the public budget. The administration of Scottish income tax and the attribution of VAT to Scotland are far more important to the Scottish Parliament and Scottish Government than they are to HM Revenue & Customs (HMRC), for which these constitute a small part of its overall responsibilities.

Audit Scotland’s monitoring of Scottish tax revenues, whether these are administered by HMRC or by Revenue Scotland, will be of profound importance. Sample size in surveys, so that there are robust data for policy-making in Scotland, and the timeliness of data reporting by tax administrations have enhanced importance in the context of tax devolution.

Many of those who favoured greater tax powers for the Scottish Parliament envisaged these being used to support more generous public services than funded by Westminster grants. However, there is a counter possibility: for each tax within the Scottish Parliament’s portfolio of taxes, there will be those who advance plausible or specious arguments about the economic benefits of tax reduction.<sup>8</sup> This is almost never done on a revenue-neutral basis. If Brexit leads to economic difficulties at the UK level, or has differentially adverse effects on Scotland, such advocacy would intensify.

***Q3: What should the Scottish Government’s priorities be in formulating Draft Budget 2018-19 in response to the likely economic impact of Brexit?***

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<sup>6</sup> Unease about the extent of tax avoidance is reinforced by media reports about the non-declaration of income from private rented property: ‘Newham council in east London, the first to introduce a compulsory borough-wide licensing scheme for landlords in 2013, shared their names and property addresses with HM Revenue & Customs. Newham, which has 27,000 registered landlords, said it understands that 13,000 had not registered for self-assessment, which is generally required if a property owner receives £2,500 a year or more in rent. HMRC would not confirm the figure. The council estimated that unpaid tax by landlords is costing the public purse nearly £200m in London – and far more nationally’ (Guardian Online, 2017).

<sup>7</sup> In the 2010-15 UK Parliament, the Public Accounts Committee took an unprecedented interest in taxation.

<sup>8</sup> For example, in relation to business rates, council tax, land and buildings transaction tax, and air passenger duty. The motivation in Northern Ireland for securing a measure of corporation tax devolution was to lower the tax rate to the level prevailing in the Republic of Ireland.

This question cannot be answered directly because there is so much uncertainty about the economic impact of Brexit, particularly in relation to a fiscal year that precedes exit from the EU.

The composition of Budget expenditure is essentially a political question, outside the scope of this memorandum. I make the following observations on the narrower question of process:

- (a) 2018-19 financial year is pre-Brexit, so relevant effects will come from expectations about Brexit, including decisions by firms on relocating productive activities and household decisions on migration.
- (b) The spending envelope will be determined by UK Government decisions (for example, in the November 2017 Budget) and how those translate through the Barnett formula into changes in the Scottish block.
- (c) 2018-19 will be a difficult financial year on the spending side, given the lengthy period of fiscal restraint and accumulating pressures for more spending on costly services such as health and education.
- (d) The major risks will be on the revenue side, as the *Scotland Act 2016* reforms come into implementation, with ramification for later years should actual tax revenues fall below expectation.

***Q4: Given that increased inflation is likely to disproportionately impact on the poorest, what measures should the Scottish Government take in its Budget to address this?***

On grounds of fiscal principle and practicalities, I continue to adhere to the public finance tradition of emphasising that redistribution is primarily the responsibility of the highest tier of government which has a wider range of policy instruments and is less vulnerable to avoidance behaviour. Moreover, as a non-expert on social security expenditure, I have voiced concerns about (a) a widely-held assumption that Scotland can be ‘more generous’ than the UK Government, without specifying the source of financing,<sup>9</sup> and (b) the reputational risks to the Scottish Government arising from the implementation of devolved benefits.<sup>10</sup>

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<sup>9</sup> The risks and complexity are evident from the Financial Memorandum to the *Social Security (Scotland) Bill* currently before the Scottish Parliament (2017).

<sup>10</sup> These risks will be amplified by the likely lack of public understanding about the division of responsibility between the UK and Scottish Governments.

If there is a view in the Scottish Parliament that the poorest are being disproportionately affected by Brexit-induced higher inflation, then the case for remedial measures should be pressed upon the UK Government by the Scottish Parliament and Government and by Scottish Members of the House of Commons.

***Q5: What issues require to be considered from the loss of EU funding mechanisms arising from Brexit?***

There has been discussion about bringing expenditure hitherto funded by the EU within the Barnett formula, but a crucial distinction must be made:

- (a) The normal practice when the expenditure responsibilities of the Scottish Parliament have been extended has been to transfer existing expenditure in Scotland into the block, not a pro-rata share of UK expenditure.
- (b) If brought within the Barnett formula, that expenditure will have to be financed out of the block whose future path will be shaped by the non-statutory Fiscal Framework.

The additional fiscal risks to the Scottish Budget arise from unpredictability about the future institutional and policy setting in relation to, for example, agricultural support and from the greater volatility of such spending relative to those functions currently within the Barnett-controlled block.

Scotland, Wales and Northern Ireland have been more dependent on the EU subsidy regime than has England, making them more vulnerable to its termination. Assuming Brexit does not affect the subsidy regime in the EU27, then the critical issues are (a) how agriculture is covered in the trading arrangements that the UK negotiates with non-EU countries; (b) the common UK framework that the UK Government seems likely to insist upon; and (c) the UK Government's willingness to maintain existing levels of subsidy in England, as reductions would generate negative formula consequences for the devolved administrations.<sup>11</sup>

The important political point is that agricultural subsidy would in the Scottish Budget be in direct competition with other public services: the relative priorities of spending on sheep or nurses would attract media and political attention.

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<sup>11</sup> If savings on agricultural support in England were to be transferred to health expenditure in England, then the net effect on Scotland would be zero.

## Concluding Comments

5. Given the high level of uncertainty about the UK's future relationships with the EU and about the economic and fiscal impact of whatever those are, the continuing engagement of the Committees of the Scottish Parliament with these developments is welcome. The polarisation of opinion and widespread misinformation about Brexit will interact with what would in any case have been a difficult transition period in the financing of the Scottish Parliament. The Barnett-formula system for financing devolution has evolved since 1998, its durability surprising those commentators who have regularly predicted its demise. If the Brexit process were to go badly, it would be unsurprising if the widespread hostility to Barnett at Westminster (on grounds that it is too favourable to Scotland) were to become more vigorous.
6. After Scotland's Fiscal Framework was finalised in February 2016 (HM Government and Scottish Government, 2016), I cautioned that difficult issues of fiscal architecture and regulation had been kicked into the long grass, then thought to be in 2021 (Heald, 2016). The climate in which such UK-Scotland negotiations take place will be influenced by Brexit, in a way that was not envisaged in February 2016 when the UK Government wished to secure a resolution before the Brexit referendum which it confidently expected to result in Remain.

*Glasgow, 22 August 2017*

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**SPICe SUMMARY OF RESPONSES TO THE CALL FOR EVIDENCE**

In its report on the Draft Budget 2017-18,<sup>1</sup> the Finance and Constitution Committee (“the Committee”) noted that the Scottish Government is likely to face additional spending pressures from inflationary pressures arising from Brexit. Placing this in the context of the new financial powers arising from the Scotland Act 2016, and the increased dependence of the Scottish budget on the performance of the Scottish economy through the Fiscal Framework, the Committee sought views on the short-term impact of Brexit on public finances. It issued a call for evidence<sup>2</sup> which closed on 18 August 2017 with the following questions:

- Are there any indications of a differential economic impact in Scotland separately from rUK?
- What additional spending pressures are there on the public finances as a consequence of Brexit?
- What should the Scottish Government’s priorities be in formulating Draft Budget 2018-19 in response to the initial economic impact of Brexit?
- Given that increased inflation is likely to disproportionately impact on the poorest, what measures should the Scottish Government take in its Budget to address this?
- What issues require to be considered from the loss of EU funding mechanisms arising from Brexit?

This paper summarises the written responses<sup>3</sup> to this inquiry and considers each question in turn.

13 responses were received from:

- A. [Scottish Retail Consortium Brexit Tariff Roadmap submission of 5 July 2017 \(1208KB pdf\)](#)
- B. [Chartered Institute of Taxation submission of 1 August 2017 \(258KB pdf\)](#)
- C. [Professor Paul Hare submission of 6 August 2017 \(158KB pdf\)](#)
- D. [Scottish Disability Equality Forum submission of 8 August 2017 \(46KB pdf\)](#)
- E. [North Ayrshire Council submission of 14 August 2017 \(198KB pdf\)](#)
- F. [Scottish Fire and Rescue Service submission of 15 August 2017 \(77KB pdf\)](#)
- G. [The Chartered Institute of Public Finance and Accountancy submission of 18 August 2017 \(207KB pdf\)](#)

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<sup>1</sup> [http://www.parliament.scot/S5\\_Finance/Reports/FCCS052017R01.pdf](http://www.parliament.scot/S5_Finance/Reports/FCCS052017R01.pdf)

<sup>2</sup> <http://www.parliament.scot/parliamentarybusiness/CurrentCommittees/103089.aspx>

<sup>3</sup> <http://www.parliament.scot/parliamentarybusiness/CurrentCommittees/105823.aspx>

- H. [Women in Scotland's Economy Research Centre submission of 18 August 2017 \(109KB pdf\)](#)
- I. [NFU Scotland submission of 18 August 2017 \(180KB pdf\)](#)
- J. [Professor David Heald of 23 August 2017 \(171KB pdf\)](#)
- K. [The Royal Society of Edinburgh submission of 24 August 2017 \(198KB pdf\)](#)
- L. [COSLA submission of 25 August 2017 \(86KB pdf\)](#)
- M. [Highlands and Islands Enterprise submission of 25 August 2017 \(70KB pdf\)](#)

**1. Are there any indications of a differential economic impact in Scotland separately from rUK?**

**Potential impact of Brexit on the UK**

Respondents discussed two types of economic impact Brexit may have:

- Factors that affect the UK as a whole such as lower GDP growth, reduced inward investment and increased administrative burdens for cross-border businesses;
- Factors that may lead to a differential impact in Scotland compared to the rest of the UK such as the level of EU funding that currently goes to Scotland compared to the rest of the UK.

In relation to the UK as a whole, Professor Hare for instance argued that:

“The Brexit process, and associated uncertainty, could cut the likely growth of UK GDP – possibly just temporarily if some investment is merely delayed, possibly for a longer period if important investment is diverted elsewhere. It would very likely reduce government revenues from taxation of all sorts.”

WiSE also noted that Brexit “is likely to have a negative impact on foreign direct investment both in terms of attracting new FDI but also on existing FDI who may decide to relocate part or all of their existing UK operations in the EU if Britain is no longer part of the single market.”

CIOT anticipate that import and export declarations and procedures, as well as VAT border procedures in both the UK and the EU could lead to increased compliance costs and burdens for exporters in Scotland (though this is not specific to the UK). In its submission BRC presented a map of:

- The current tariff applying to the various goods which depend on both the nature of the existing EU (and hence UK) relationship with the exporting country and of the product;
- What the tariff would be if there were no agreement in place and the UK had a “WTO relationship with that country for that type of product.”

Though illustrative as the exact nature of a “WTO relationship” is a matter of political negotiation, this map does demonstrate that for many products the tariff

may increase substantially, for instance BRC report that wine from Chile currently has a tariff of 1.3%. Under “WTO rules” it estimates the tariff would rise to 4.0% CIOT noted in addition that when EU directives, such as the Interest and Royalties Directive, the Parent-Subsidiary Directive and the Merger Directive, cease to apply in the UK post-Brexit, companies may see an increase in their effective tax rate as a result of double taxation on dividends for instance.

### **Potential impact of Brexit in Scotland**

A number of respondents commented on the impact of Brexit on Scotland specifically. Citing a Fraser of Allander (FAI) report,<sup>4</sup> WiSE highlighted for example:

“[most] of the economic forecasts would suggest that growth in Scotland over the next couple of years is likely to be lower than it otherwise would have been as a result of Brexit.”

CIPFA noted, based on a Scottish Government study,<sup>5</sup> that Brexit could lead to:

- A fall in Scottish GDP of up to £11.2 billion by 2030
- A fall in Scottish tax revenues by £1.7 to £3.7 billion annually

It said this would be as a result not only of decreased trade with the EU, but also as a spill-over effect of slower UK economic growth feeding through to Scottish sector and firms.

NAC cautioned that “the difference in a region’s ability to adapt to Brexit-related changes is likely to widen regional economic gaps in the long run” and pointed out that North Ayrshire Council had “taken significantly longer to recover from the 2008 financial crash than other areas in Scotland”.

Drawing on research by the Centre for Economic Performance,<sup>6</sup> the RSE stated that all UK cities will be negatively affected as a result of Brexit, with Aberdeen, Dundee, Edinburgh and Glasgow the hardest hit in Scotland. In particular: “Aberdeen’s GVA is forecast to fall more than any other city in the UK, potentially experiencing an output loss of 4%. Edinburgh’s GVA is forecast to fall by 3%, while the forecast falls in Dundee and Glasgow are less pronounced at around 1.5-2.5%.”

RSE, CIPFA and COSLA all commented on the role EU nationals play in the Scottish economy, in relation both to the labour market (and potentially tax revenue) and demographics.

According to COSLA:

“Scotland is differentially [more] (sic) dependent on migration than rUK.”

It stated “many local authorities rely heavily on EU migrant workers”. COSLA stated that leaving the EU single market would have “significant implications for the workforce and the local economy” namely in social work, care and teaching as

<sup>4</sup> <https://www.sbs.strath.ac.uk/economics/fraser/20161006/Long-term-Economic-Implications-of-Brexit.pdf>

<sup>5</sup> <http://www.gov.scot/Resource/0050/00504615.pdf>

<sup>6</sup> <http://www.centreforcities.org/wp-content/uploads/2017/07/17-07-26-Brexit-trade-and-the-economic-impacts-on-UK-cities.pdf>

well as lower and unskilled sectors such as agriculture, fishing, hospitality, and the food industry. COSLA gave the example of Angus where “the number of migrants can reach 3-4,000 over the season.”

CIPFA also stated:

“Access to EU labour is important to Scotland across a range of sectors and industries both public and private sector. The House of Lords European Union Committee report concluded that the Scottish economy has particularly pressing needs, including its reliance on access to EU labour. This is particularly acute in sectors such as health and social care, agriculture, food and drink and hospitality”

Citing the same House of Lords Committee European Union report,<sup>7</sup> CIPFA also highlighted that EU immigration has contributed to 50% of the net population growth in Scotland since 2000. COSLA also stated:

“NRS [National Records of Scotland] projected that the impact of Brexit could see a reduction in population growth from 7% to 3% in Scotland by 2030, compared to a drop of 15% to 11% for the whole of the UK.” The RSE added: “the latest data shows that migration from the EU to the UK has fallen since the decision to leave the EU in 2016.”

CIPFA observed that:

“The [House of Lords European Union Committee] report (...) noted Scotland’s demographic needs in relation to EU migration to enable its population (and in particular, that of working age) to grow.”

A number of respondents commented that a reduction in EU migration post-Brexit could also have implications for the tax base. CIPFA explained there could be a:

- A potential decrease in real wages; CIPFA highlighted Scotland had seen the weakest growth in earnings across the UK in 2016, with Aberdeen Council particularly hard-hit.
- A potential decrease in taxpayers through the emigration of EU taxpayers in Scotland.

A reduction in the tax base would affect tax revenue, and the RSE explained that:

“Brexit may also affect Scotland’s public finances. A continued fall in net migration will place pressure on Scotland’s tax revenues, primarily through falls in income tax and VAT receipts. The size of these falls is difficult to predict, given that there are no reliable data on the taxes paid by migrants to Scotland. Nonetheless, the Scottish Government or the Scottish Fiscal Commission might wish to commission some research on the revenue implications of reduced migration.”

The RSE noted however that as migrants are mostly young and thus tend to be in a low tax band, the short-term fiscal impact of a reduction in migration was likely to be small. Professor Hare also stated that the major taxes (VAT, income tax, national insurance, corporation tax, excise duties, etc.) are “unlikely to be

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<sup>7</sup> <https://publications.parliament.uk/pa/ld201719/ldselect/lducom/9/9.pdf>

changed markedly or at all”, the only potential impact of Brexit on tax take being on net customs tariff revenue. However, the RSE cautioned that:

“... in the longer term a reduction in migrant workers who may become higher-rate tax payers could have a greater impact. If Brexit does tighten the Scottish budget, this may place pressure on the Scottish Government to be more proactive in their use of the devolved income tax powers.”

## **2. What additional spending pressures are there on the public finances as a consequence of Brexit?**

CIPFA contextualised the potential impact of Brexit on the Scottish budget amid pre-existing pressures on the Scottish budget including demographic changes and the UK Government’s objective of a balanced budget in the medium term. On the latter point, Professor Hare noted that “the UK Government (...) needs to update its views on how rapidly it considers that the budget deficit should be falling (or possibly not falling) for a while longer.” Professor Heald added that he did not expect the pressures from “expectations of improved services” to abate, putting further pressure on public spending.

CIPFA identified the following potential impacts of Brexit on the Scottish budget:

- The UK’s financial settlement with the EU
- The potential replacement of EU funding streams;
- Core competences of the Scottish Government;
- The impact of the final deal on the future relationship with the EU.

COSLA explained however that beyond the “financial transfer elements” such as domestic replacement for EU funds, EU Procurement and State Aid rules frame “in a significant amount how and how much discretion Councils have in their own budgets.” It highlighted “the biggest potential change can come from the State Aid rules” given that EU Procurement rules have been transposed to domestic Scottish legislation through the Procurement Reform (Scotland) Act 2014<sup>8</sup> and the Scottish Procurement Regulations 2016.<sup>9</sup>

### **UK Financial settlement with the EU**

CIPFA pointed out the Scottish Government had the “potential” to contribute to the financial settlement although this depends:

“whether there will be any requirement for devolved administrations to recognise a share of this liability”.

It added:

“If it is determined that there is a requirement to share the liability across the UK devolved governments, the question will become how this might be allocated.”

<sup>8</sup> <http://www.legislation.gov.uk/asp/2014/12/contents>

<sup>9</sup> <http://www.legislation.gov.uk/ssi/2016/145/contents/made>

## Inflation

The RSE and Professor Heald both commented on the pressure put on public sector costs as a result of inflation, itself currently a result of the depreciation of the pound.

SFRS warned that it would require additional funding from the Scottish Government if inflation continued at its current rate because of increased operating costs such as energy and fuel. It also noted that if there was a rise in wage pressures as a result of falling real wages, it had no provision in its current budget for more than a 1% pay award. Professor Heald added that given the real reductions in public sector wages and salaries post-2010:

“Mounting evidence of recruitment and retention problems and of employee discontent might indicate that this policy of wage repression will be difficult to sustain.”

### **3. What should the Scottish Government’s priorities be in formulating Draft Budget 2018-19 in response to the initial economic impact of Brexit?**

All respondents who answered this question commented on the difficulty of planning ahead given the uncertainty around the future relationship between the UK and the EU and the potential impact on EU labour for instance.

The RSE however explained that in the short-run, it was *unlikely* that the Scottish Government would have to change its formulation of the Draft Budget 2018-19.

Moving forwards it suggested:

“Given these uncertainties we strongly urge that the Scottish Government to use scenario planning to help predict the effects of Brexit rather than relying on point forecasts. Scotland’s Economic Strategy outlines the key growth sectors of the Scottish Economy including: Food and Drink, Creative Industries, Sustainable Tourism, Energy, Financial Services and Life Sciences. These are likely to be affected in different ways by Brexit. Scenario planning might help Government, and others, to better understand the risks and challenges that the various sectors may face.”

NAC recommended the “Scottish Government should use its influence to press UK Government for adequately resourced and targeted replacement funding mechanisms post Brexit. In the interim, this is a key time to invest in Scotland’s Regional Growth, City and, Island Deals to support the development of innovative, smart, productive and inclusive regional economies.” It called for support to local government to be maintained despite potential pressures on the Scottish budget arising from Brexit. It stated there should be a “focus on growth and jobs in weaker local economies with a commitment to addressing the barriers identified that prevent people to participate in economic growth” and pointed to a number of steps the Scottish and UK Governments could take to support inclusive regional economic growth including:

- Investing in Scotland’s regional infrastructure through City, Island and Regional Growth Deals

- Establishing funding mechanisms to compensate for the loss of EU funding, and providing additional resources to match the scale of post Brexit challenges
- Align a wider range of public spending with the priority of local and regional economic development

Though the call for evidence was centred on the short-term impact of Brexit on the Scottish budget, a number of respondents such as NAC and CIPFA stressed that measures needed to be taken now to address not just the short-term, but also the long-term impact of Brexit. COSLA highlighted that Brexit needs to be built into long-term and local budget plans and “should not therefore be an excuse for continuing with short term politically expedient budget planning.” WiSE for instance called for the Scottish Government to increase investment in the care sector, as “[a] number of international studies have suggested that expansion of the care sector generates more jobs than most of the other sectors of the economy.”

**4. Given that increased inflation is likely to disproportionately impact on the poorest, what measures should the Scottish Government take in its Budget to address this?**

WiSE explained that inflation was likely to have a disproportionately negative impact on people on low wages and reliant on social security benefits such as pensioners. SDEF also expressed concern that the disabled community may be disproportionately affected as a result of Brexit. WiSE suggested the Scottish Government maintain public sector pay rises at the same level as inflation and use its social security powers to mitigate the impact of inflation on the most vulnerable. WiSE notes this additional spend will need to be funded, and at a time when tax revenue is likely to be declining, “the Scottish Government should seriously consider whether it is now time to use their tax raising power.”

Professor Heald wrote:

“If there is a view in the Scottish Parliament that the poorest are being disproportionately affected by Brexit-induced higher inflation, then the case for remedial measures should be pressed upon the UK Government by the Scottish Parliament and Government and by Scottish Members of the House of Commons.”

**5. What issues require to be considered from the loss of EU funding mechanisms arising from Brexit?**

Respondents discussed the following EU funding:

- Structural Funds: the European Regional Development Fund (ERDF) and the European Social Fund (ESF);
- the Common Agricultural Policy (CAP);
- EU competitive programmes.

## Current funding

HIE also explained it had been an important recipient of EU funding over the last three decades of both Structural Funds, CAP, and EU competitive programmes such as Horizon 2020 and INTERREG programmes. It noted that in the short-term, access to EU funding remained unchanged while the UK is still a member of the EU (even when expenditure takes place after that date). In the long-run, it noted that future collaboration with European partners was desirable, and that “this could be facilitated through a continued participation in EU funding programmes (EEA members such as Norway and Iceland, as well as Switzerland currently participate in this way).” It alternatively suggested that the UK and/or Scottish Governments could undertake to collaborate with EU partners outside of existing programmes. COSLA equally stated:

“we see benefit, and we have already obtained explicit support from the EU, in enabling Councils and other bodies to access some of the EU funds post Withdrawal in the same fashion that municipalities of non-EU Member States such as Norway, Iceland and certain Eastern and Mediterranean countries do at the moment.”

NAC estimated the EU contributes 15-25% of Scottish Councils’ spend on economic development. It explained that NAC had been awarded over £40m from 1997- 2013 EU Structural Funds programmes and £7m from the EU 2014-2020 Structural and Investment Funds (ESIF) through the following:

- £2.1m for North Ayrshire’s Youth Employment Initiative
- £2m for North Ayrshire’s Employability Pipeline
- £1.25m for Business Competitiveness (Ayrshire wide)
- £0.6m for Poverty & Social Inclusion activity in North Ayrshire
- £1.27m for Hunterston Energy Storage Project

In addition, NAC pointed out North Ayrshire Council had secured £3m from the Big Lottery Fund/European Social Funds Financial Inclusion programme for the Better Off North Ayrshire project. It noted work that was underway on Regional Partnerships to achieve inclusive growth and the UK Government’s Industrial Strategy, and that it was important any domestic replacement funding aligned with this work.

NFUS Highlighted that “CAP accounts for two-thirds of total net farm income in Scotland” and observed that from 2014 to 2020, Scotland is set to receive £3.5 billion under the CAP. It stated it had received “verbal assurances” from UK ministers that it would honour its Conservative Party 2017 manifesto and provide the “same cash total” in CAP funding up to 2022, and called for the Scottish Government in its budget to protect funds committed for agriculture “as had been guaranteed before the referendum.”

WiSE commented that EU Structural Funds play an important role in the promotion of gender mainstreaming, and that in the absence of EU leadership, “Scotland will need to ensure that adequate procedural and legal frameworks are in place to maintain commitments to Gender Equality. Here, assessments of the Great Repeal Bill and its impact on existing equality commitments should be considered in detail, to ensure that legislation and powers related to equalities are not

watered-down, or relocated.” It added that the Scottish Government may also in future be able put greater weight on equalities in the public procurement processes, which was currently governed by EU directives.

### **Replacement funding**

NAC observed that the loss of Structural Funds risked causing not only a financial vacuum but also a policy gap in terms of strategic planning, multiannual programming and multi-level governance. COSLA had a similar view and explained that EU funding was not just about financial support but:

“... on the priority setting, partnership-based governance arrangements and their funding certainty for Councils and other beneficiaries, that protect these investments from sudden and discretionary decisions from central government.”

A number of respondents called for EU funding to be replaced (COSLA, NAC, WiSE and NFUS). NAC for instance stated:

“If regional and national efforts to grow a strong, inclusive economy are to continue, replacement funding has to be found to replace the EU’s regional, competition and innovation programmes.”

Professor Hare however noted:

“... it is not yet clear how if at all they will be replaced by new funding from Westminster.”

Professor Hare commented for instance on the apparent lack of strategic thinking on the Scotland Rural Development Programme delivering Pillar 2 of the CAP, ERDF and ESF and recommended that the Scottish Government “review their policies towards agriculture, fisheries and rural development quite urgently as well as their policies regarding the Structural Funds” in order to:

- Update their views on how these significant areas of Scottish life should develop post-Brexit;
- Review possible funding and support models;
- Lobby the UK Government both about funding and about associated devolution issues.

COSLA also observed:

“Whilst there are assurances in place around the existing funds, there remains uncertainty about the future and to what extent alternative arrangements, post withdrawal, will provide in terms of replacement benefits. We are keen that the main governance elements of the EU funds (strategic focus, partnership based, medium term commitments and funding certainty beyond a single parliamentary term) are retained in their domestic replacement.”

The RSE, CIPFA and NFUS cautioned that Scotland receives a much higher population share of EU funding (14% between 2014 and 2020 according to CIPFA, 16% according to NFUS) to the UK than its population share (8.3% in 2015), and

that Scotland would lose out if UK Government replacements for EU funding were delivered through the population-adjusted Barnett formula. Professor Heald added:

“If brought within the Barnett formula, that expenditure will have to be financed out of the block whose future path will be shaped by the non-statutory Fiscal Framework.”

Professor Heald also pointed out that a replacement for EU funding would put streams like CAP:

“...in direct competition with other public services: the relative priorities of spending on sheep or nurses would attract media and political attention.”

CIPFA emphasised:

“Consideration and planning for the replacement or alternative funding needs to take place during this parliamentary period in order to be understood and in place prior to EU exit.”

The RSE cautioned that if domestic funding were to replace EU research funding for Scottish universities, “it will be important to monitor how far it manages to replicate existing international research networks and enables researchers to work at arms-length from both the UK and Scottish governments.”

Finally, COSLA suggested that the UK should consider seeking membership of the European Investment Bank as it is one of the main shareholders and loan beneficiaries.

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September 2017**