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BUDGET 2021/22: SUPPORTING THE COVID-19 RECOVERY – SCOTLAND'S TAXES AND FISCAL FRAMEWORK

ROYAL SOCIETY OF EDINBURGH RESPONSE

Introduction

1 The Royal Society of Edinburgh (RSE) welcomes the opportunity to respond to the Scottish Government consultation on Budget 2021/22: Supporting the Covid Recovery – Scotland's Taxes and Fiscal Framework.[1] The Society looks forward to engaging further with Scottish Government on the points raised in this paper as part of the Government's upcoming workshops and roundtables addressing the key issues impacting the Scottish Budget.

2 As Scotland addresses the significant challenges posed by COVID-19 and begins the recovery towards a 'new normal', the RSE, harnessing its multidisciplinary Fellowship and using its convening power, is well placed to provide evidence-based advice and support to both the Scottish and UK governments and parliaments. The RSE Post-Covid-19 Futures Commission, which brings together leading thinkers and practitioners from across academia, business, public service and the creative arts, will be leading a significant programme of work in this area. The aim of the Commission is to identify and address some of the immediate policy implications and challenges arising from the coronavirus outbreak, while also supporting thinking around the longer-term questions it raises.

3 In addition to the work being undertaken by the Commission, the RSE has also provided written submissions to the following consultations which are relevant to issues around taxation and the fiscal framework:

- Impact of COVID-19 on Public Finances and the Fiscal Framework (June 2020)[3]
- Devolved Taxes: A Policy Framework (June 2019)[4]
- A Scottish Approach to Taxation (October 2016)[5]

Key Points

4 Before going on to address the questions posed in the consultation document there are several key themes the RSE considers it important to highlight. While some of these focus on immediate actions that could prove relevant to the current crisis, others address the medium and long term. Taking action to address the challenges across both timescales must be a dual priority of government.

Priorities for Scotland at the UK Level

5 The questions posed in the consultation document predominantly focus on how Scottish Government can best utilise the powers it currently possesses and whether certain competences it does not have should be devolved. A vital priority for Scottish Government must be to identify the types of fiscal response undertaken at the UK level it considers will be of most value to the Scottish economy and advocate for these strongly. The most significant macro-economic levers continue to be controlled by the UK Government and so constructive engagement between governments on spending priorities is imperative.

1 https://www.gov.scot/publications/budget-2021-22-supporting-covid-19-recovery-scotlands-taxes-fiscal-framework/
2 https://www.rse.org.uk/inquiries/rse-post-covid-19-futures-commission/
3 https://www.rse.org.uk/wp-content/uploads/2020/06/AP20_06-1.pdf
4 https://www.rse.org.uk/wp-content/uploads/2019/06/AP19-08.pdf
5 https://www.rse.org.uk/wp-content/uploads/2016/10/AP16_21.pdf

6 The RSE similarly encourages Scottish Government to engage with the Department of Work and Pensions at the UK level on measures to ensure that those who are being asked to self-isolate are empowered and incentivised to do so. Before any action to address the economy can bear fruit the health crisis must be sufficiently under control. Achieving this will be made all the more difficult if financial imperatives force those who should be in quarantine out into the workplace.

Intergovernmental Relations

7 For constructive engagement between the Scottish and UK governments – whether on spending priorities or any other issue – to take place, a functioning system of intergovernmental relations (IGR) is required. Concern has been expressed by the RSE in numerous responses over several years[6] over the functioning of IGR in the UK, particularly in regard to the Joint Ministerial Committee (JMC). The current system is inadequate in supporting consistent and successful intergovernmental relations.

8 The RSE again reiterates its support for the establishment of an Independent Secretariat[7] as part of a refinement of the formality and structure of intergovernmental relations mechanisms in the UK. Principles of consultation, consensus and mutual respect are key to effective IGR and serve to encourage governments to work together to solve disputes and reach agreement.

Macro-economic Issues

9 The gravity of the current macro-economic situation should not be understated, with the Organisation for Economic Co-operation and Development (OECD) projecting the UK to be the most badly damaged of any major economy in the world.[8] Unlike the European Union, which is moving ahead with proposals for a stimulus package, the UK is still focussed on measures to provide life support to the economy.

10 What is required, from both the Scottish and UK governments, is a dual focus. While managing the immediate COVID-19 crisis remains paramount, adequate planning for and successful implementation of measures to stimulate the economy are also vital. Significant portions of the UK economy remain closed and immediate action must prioritise measures to mitigate high unemployment, particularly among young people and the long-term unemployed.

11 A Scotland-only stimulus would carry significant risks. Due to Scotland's status as a relatively small economy, highly integrated within the UK, such measures are likely to 'leak' to the rest of the UK and abroad, with the resulting benefits being felt elsewhere. As a result, a UK-wide stimulus package, grounded in cooperative dialogue between governments and taking proper account of Scotland's economic needs, would be optimal.

12 To fulfil its pledge to "build back better" the UK Government must provide sufficient funding for capital projects in Scotland, and across the UK. Should this allocation of funds not be forthcoming, or should Scottish Government wish to access additional funding to address differential issues, then borrowing should continue to be accessed through the current arrangement whereby Scotland borrows from the Treasury. The RSE notes, however, that any decision by Scottish Government to take on additional debt, beyond that of the level of the UK, would put even greater fiscal pressure on Scotland in first stabilising, then eventually repaying, this debt. This reality only serves to underline the importance of the UK Government providing sufficient allocation of funds for capital projects.

6 See:
UK Internal Market (August 2020) https://www.rse.org.uk/wp-content/uploads/2020/08/UK-Internal-Market-White-Paper.pdf
Scotland and the UK Internal Market (February 2020) https://www.rse.org.uk/wp-content/uploads/2020/03/AP20_03.pdf
UK Intergovernmental Relations (November 2018) https://www.rse.org.uk/wp-content/uploads/2020/03/AP20_03.pdf
Common UK Frameworks (August 2018) https://www.rse.org.uk/wp-content/uploads/2018/10/AP18-15.pdf

7 For further information on the proposed Independent Secretariat see: UK Internal Market (August 2020) https://www.rse.org.uk/wp-content/uploads/2020/08/UK-Internal-Market-White-Paper.pdf

8 http://www.oecd.org/economic-outlook/june-2020/

13 The RSE stresses the importance of action to allocate significant resources for capital spending to support restructuring and transition work across a number of areas, including infrastructure, research and development, third sector funding, arts and culture, and education. Smaller-scale and 'shovel ready' projects, and maintenance spending, should be prioritised in the short term. Spending is required immediately with delays potentially proving extremely damaging. While certain areas of the economy, for example the construction industry, remain open and functioning, this may cease to be the case should funding not be forthcoming. Capital spending can be undertaken in a manner that simultaneously creates or maintains jobs and improves living standards and wellbeing, but will involve trade-offs that must be understood and accepted.

14 While the RSE emphasises the importance of long-term fiscal sustainability, of greater immediate danger to the wellbeing of the people of Scotland and the UK would be prematurely taking measures to balance the books through cutting public services or raising taxes. As a result of many factors, including poor productivity and challenging demographics, the UK already had a significant problem with fiscal sustainability pre-COVID-19, which has been significantly worsened by the crisis. These circumstances will require difficult future choices, including tax increases and public expenditure constraint, but mistimed fiscal consolidation would be damaging.

Comprehensive Spending Review

15 The system of Comprehensive Spending Reviews – setting multi-year budgets for most government spending on public services - introduced over two decades ago, provided a stable planning background for government departments, devolved administrations, local authorities and other public bodies. It provided the opportunity for longer term planning and better value for money. There has, however, been no long-term Comprehensive Spending Review in the UK since 2015. The lack of review can be partly attributed to the disruption and uncertainty of Brexit and, more recently, major short-term spending decisions that had to be taken by the government in response to the crisis.

16 This makes financial planning for all public bodies, including Scottish Government, markedly more difficult. This, in turn, has serious consequences for planning and budgeting across the large sections of the Scottish economy that rely on the public sector for business. In particular, the absence of a Comprehensive Spending Review means that the Treasury Statement of Funding Policy, which sets out the way in which Scottish Government (and the Welsh Government and Northern Ireland Executive) are funded, has not been revised. As this statement is normally updated at each spending review, there has been no revision to account for the significant changes to Scottish Government's tax powers since 2015.[9] In addition, the uncertainties over funding allocations have added to the difficulties in intergovernmental relations between the Scottish and UK governments.

17 Given indications that a Comprehensive Spending Review may again be delayed in favour of a one-year Spending Round, the RSE sees no reason why the UK Government could not then provide the devolved administrations with indicative multi-year Capital Departmental Expenditure Limits and Financial Transactions Capital, in order to facilitate their planning. In terms of overall UK public expenditure, these numbers would be relatively small.

Question 1 How should the Scottish Government use its devolved and local tax powers to support the COVID-19 recovery as part of Budget 2021-22?

18 Of the tax powers available to Scottish Government, Non-Domestic Rates (business rates) and Council Tax are the most obvious tools at its disposal. Sectors of the economy the government considers to be particularly vulnerable or requiring of additional protection could, for example, be granted Non-Domestic Rates reductions or holidays to assist them through the crisis.

9 The one-year 2019 Spending Round saw the publication of an Addendum to the 2015 Statement of Funding Policy: https://www.gov.uk/government/publications/spending-round-2019-document/spending-round-2019#statement-of-funding-policy-addendum.

19 If Scottish Government did decide to use business rates in this way, serious consideration would be needed over which sectors are most in need of support. While some jobs or industries may prove to have both easy entrance and exit to the market, others, if lost, could potentially never return seeing entire sectors disappear. This would be particularly damaging in areas such as culture or tourism which are integral to the way Scotland promotes itself to the world.

20 Conversely, if Scottish Government wished to raise additional revenue in order to prioritise spending in other areas, it could look at sectors which are growing as a result of the crisis and the changes in public behaviour resulting, for example online retailers or warehouses, and decide whether they could be asked to contribute more in Non-Domestic Rates. If Scottish Government wished to provide additional revenue for local authorities, leeway could be given for changes to Council Tax rates or bands.

21 While changes to both Non-Domestic Rates and Council Tax would constitute local tax measures, and so fall within devolved competence, it should be noted that any economic benefit derived would not be seen immediately. Furthermore, any measures which resulted in reduced revenues would require action elsewhere to make up any shortfall.

Question 2 Are there any further tax powers that should be devolved to the Scottish Parliament to facilitate our ability to support the economic recovery?

22 The fiscal powers available to Scottish Government are fairly narrow in scope and given the need to address the crisis quickly, there is little chance that any additional powers devolved to the Scottish Parliament, irrespective of what they were, would prove relevant to the current situation. Indeed, two tax raising powers – Air Passenger Duty and Aggregates Levy – recommended by the Calman Commission in 2009 and conferred to Scotland through the Scotland Act 2016 are yet to be used. The partial VAT assignment, also in the Scotland Act 2016, was put on hold before the COVID crisis.

23 Instead, the focus must be on best utilising the current powers available and engaging with the UK Government to use its macro-economic levers to best address the issues facing Scotland's economy. As part of this, a restructuring of the economy should be a priority. This sort of major restructuring will require significant capital. In some ways, the crisis presents an opportunity to address the problems and inequalities within the current system. As far as possible, the economic recovery should focus on achieving sustainable regeneration of the economy while also addressing strategic priorities which aim to reduce inequalities and create a more resilient economy. Exploring the ways in which this can be achieved is a significant focus of RSE's Post-Covid-19 Futures Commission.[10]

Question 3 Are there any new tax proposals you would like to see implemented by the Scottish Government?

24 The most significant tax over which Scottish Government has control is Scottish Income Tax. There are, however, substantial fiscal consequences and considerable uncertainty when altering rates. This is illustrated by the significant reduction Scotland will see to the Block Grant in 2021/22 as a result of revenues from income tax in Scotland being lower than forecast (and subsequent Scottish Government decisions to carry forward forecast errors). This will, in turn, require additional cuts to the 2021/22 Budget.

25 The Scottish Government could also look to develop new taxes, with the permission of the Treasury, provided these do not concern money that existing taxes already cover. If Scottish Government is seeking to find new revenue streams it could look to implement some form of carbon tax (separate from Air Departure Tax) or tourism tax. Again, the process of developing and implementing these measures would likely mean they would not be relevant to the current crisis, and in the case of a carbon tax would serve more as a 'sin tax' to change behaviour than to raise revenue.

10 https://www.rse.org.uk/inquiries/rse-post-covid-19-futures-commission/

Question 4 What particular fiscal challenges have been highlighted as a result of the Covid-19 emergency?

26 Clearly, the eventual need to repay UK government borrowing is a major challenge. The scale of UK state intervention to support the economy during the pandemic is unprecedented and will consequently lead to the highest level of public debt as a percentage of GDP in peacetime history. Recent figures show UK public debt to have risen to more than 100 per cent of GDP for the first time since the 1960s.

27 Immediate costs, combined with a decrease in tax receipts and other revenues (such as fees and charges) as a consequence of increased levels of unemployment, reduced consumption and business inactivity, will reduce the amount of money available from tax revenue for both the Scottish and UK governments. A need for increased spending on the health sector, significant rise in unemployment despite measures after the closure of the furlough scheme, and any action to redress the significant inequalities that have been highlighted over the course of the crisis, will add further fiscal strain.

28 The devolution settlement is also struggling to cope with the current UK Government approach of incremental fiscal policy announcements; as discussed above, no Comprehensive Spending Review has taken place since 2015. This makes financial planning for all public bodies, including Scottish Government, markedly more difficult, with uncertainties over funding allocations serving to add to the difficulties in intergovernmental relations between the Scottish and UK governments. The RSE reiterates that there appears no reason why the UK Government could not provide the devolved administrations with multi-year indicative capital limits to assist their planning, even if the planned Spending Review 2020 becomes a one-year Spending Round.

Question 5 What changes, if any, should be made to the scope of devolved fiscal powers under the Fiscal Framework?

29 The fiscal framework is due to be reviewed in 2021. This provides an opportunity to consider the performance of the framework to date and during a time of crisis. The review will provide the Scottish and UK governments with the opportunity to propose improvements and flexibilities to the framework that can help provide certainty around spending and budgets in a time of crisis.

30 In a previous submission to the Scottish Parliament Finance and Constitution Committee, the RSE recognised that there might have been a temptation to bring the 2021 review forward so that flexibilities on spending could be added. The Society argued, however, that undertaking a complex review during a crisis when there would be a lack of full and analysed evidence on how the framework had coped was ill advised. Given that we are still very much in the midst of the crisis, this remains the RSE position. The review should take place following the crisis when the full data is available, and lessons can be learned, whether this is in 2021 or beyond.

31 There is a strong argument for Scottish Government seeking additional time to address the overhang of the spending cuts required as a result of higher Block Grant Adjustments. Additional revenue borrowing could help to manage the shortfall against forecast revenue which would otherwise force spending cuts and cause further damage to the Scottish economy at a very inopportune time.

32 As part of any discourse around additional fiscal powers, a much more constructive and informed conversation is required on the rationale for borrowing, what the money would be spent on, what limits there should be to this borrowing, and the period of time over which it would be repaid.

Question 6 What fiscal rules should the Scottish Government follow?

33 As Scotland looks to deal with and eventually emerge from the crisis, it will be imperative that the tax base, tax rates and revenues are all closely monitored, transparent and open to scrutiny. The issue of future sub-national fiscal rules could be addressed during the review of the Fiscal Framework.

Additional Information

Any enquiries about the Advice Paper should be addressed to Craig Denham (cdenham@therse.org.uk).

Responses are published on the RSE website (https://www.rse.org.uk/)

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