



Northern Ireland  
Fiscal Council

Bringing transparency to NI's public finances

#NIFCAnnualConference

# The building blocks for fiscal sustainability



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Llywodraeth Cymru  
Welsh Government

# Welsh Government's fiscal framework agreement

# Elements of fiscal framework agreement

- Needs-based factor in Barnett
- Capital and resource borrowing
- Cash reserve
- Devolution of stamp duty land tax and landfill tax
- Partial devolution of income tax

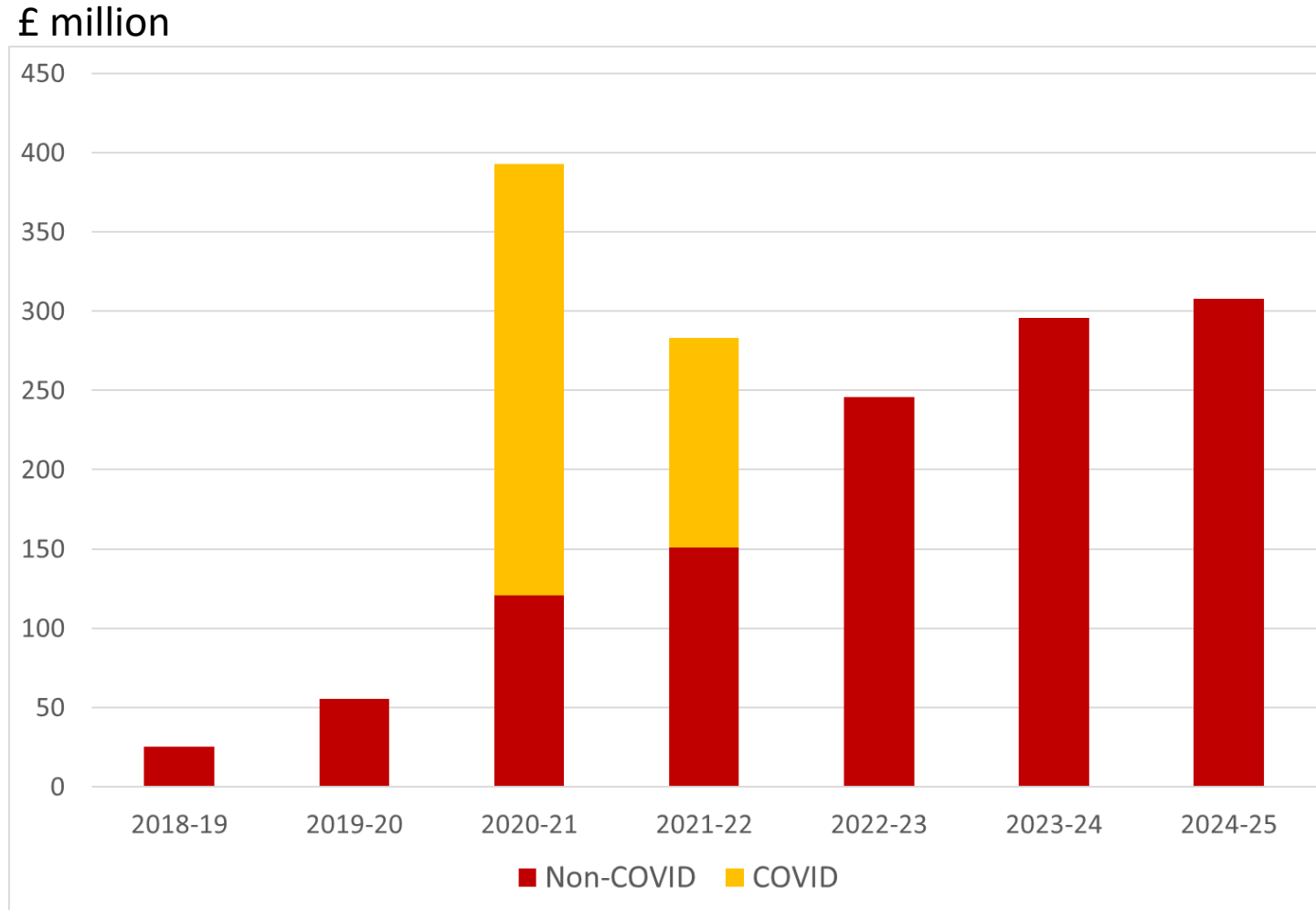
# Timeline

- Holtham Commission established 2008
- Holtham Commission Final Report July 2010
- Silk Commission 1<sup>st</sup> Report November 2012
- UK Government response to Silk Commission November 2013
- Silk Commission Final Report March 2014
- St David's Day agreement February 2015
- Fiscal Framework Agreement December 2016
- Land Transaction Tax and Landfill Disposals Tax April 2018
- Needs-based Factor from 2018-19
- Welsh Rates of Income Tax April 2019

# Impact of needs factor on WG funding



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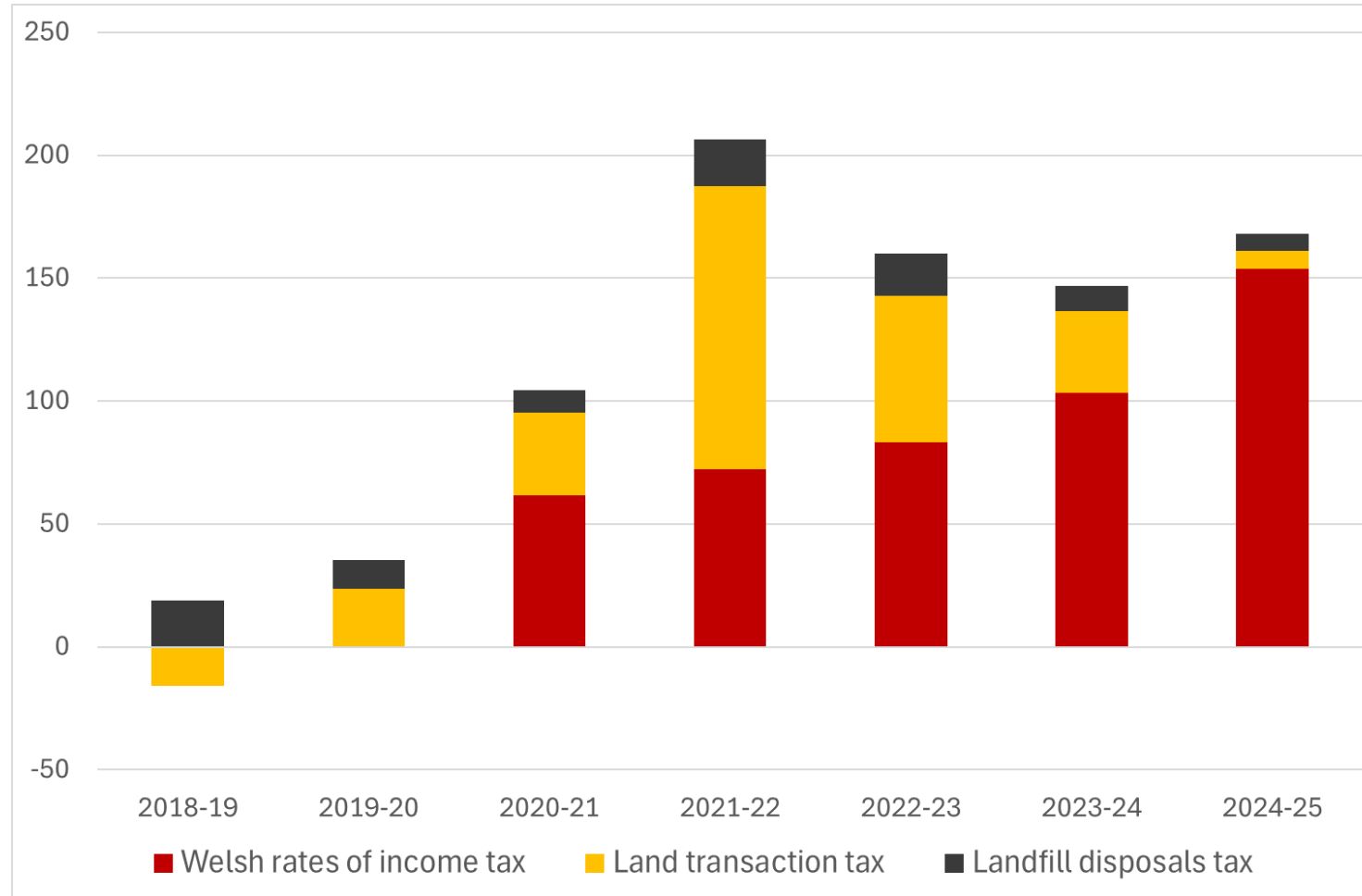
Source: Block Grant Transparency and WG calculations

# Impact of devolved taxes on WG Budget



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£ million



Source: HMRC, OBR, WG calculations

# How the fiscal framework shapes the public finances

*A perspective on the Scottish experience so far*

João Sousa

Fraser of Allander Institute

NIFC Annual Conference

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# The road to fiscal devolution

- › The Scottish Parliament has since its inception had competencies far and wide in terms of spending
  - Health, education, housing, environment, transport and justice are all fully or nearly fully devolved, and funded using the Barnett formula
  - To a large extent building on the already large powers in the Scottish Office due to formally separate institutions
- › But on the revenue side, initial devolution was limited to council tax framework (rate-setting is locally determined) and the non-domestic rates system
- › Further devolution came later:
  - Calman Commission (2009) and Scotland Act 2012: stamp duty and landfill tax, mostly
  - Smith Commission (2014) and Scotland Act 2016, including substantial income tax powers





# Further devolution also brought the Fiscal Framework Agreement

- › Intended as a way to ensure that both powers and incentives remained aligned
  - Scottish Government was given power over income tax, now worth over £11bn at the time
  - But this meant that the reference point would have to take into account what revenues would have been in the absence of devolution
- › Also allows for borrowing:
  - On the current side, limited borrowing to fund income tax reconciliations: initially £300m, then increased to £600m
  - Scotland Reserve (budget exchange) up to £700m
  - On the capital side, more freedom: up to £450m a year, up to a maximum of £3bn
  - Since 2023-24, these have been updated with inflation (GDP deflator)



# The Scottish Budget process before tax devolution

Barnett-  
determined  
block grant

=

Scottish  
budget



# The Scottish Budget process after tax devolution



- › BGA is forecast by the OBR
- › Revenues raised in Scotland are forecast by the Scottish Fiscal Commission
- › Need to ensure they are based on similar assumptions, otherwise large forecast errors can occur
  - These only get reconciled a couple of years down the line based on final HMRC outturn
  - The idea was that they should be small, but that's not always been the case
  - The Fiscal Framework has meant the Scottish Budget and UK fiscal events are **more**, not less interlinked
  - Scottish Budget follows the UK Autumn fiscal event – usually around 3 weeks after, sometimes a bit more



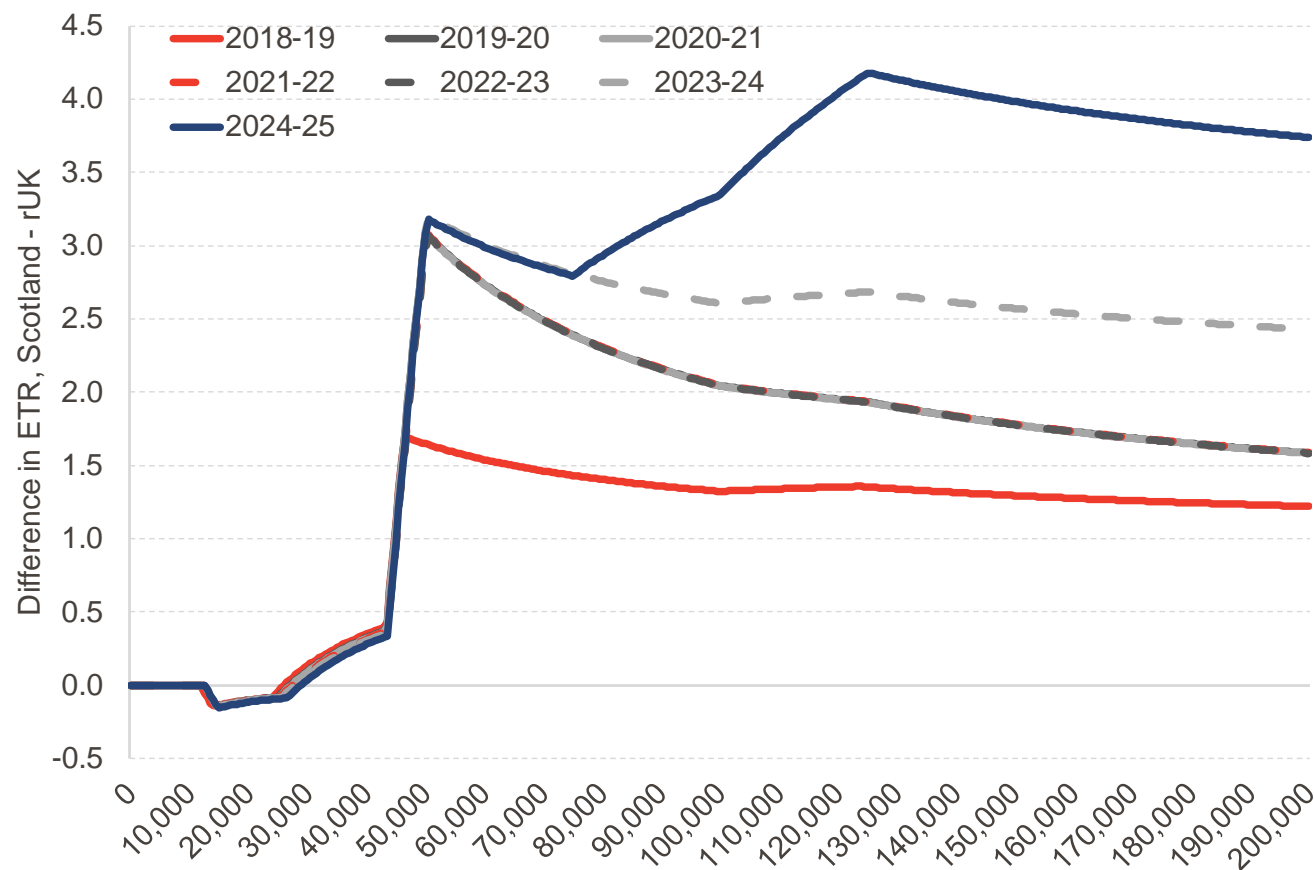
# Parliamentary scrutiny

- › One of the consequences of these interactions has been the need for greater scrutiny
- › To that extent, the Scottish Fiscal Commission (SFC) has been formed
  - Official forecaster, in a similar way to the OBR
- › But the Scottish Parliament has also had to beef up its analytical capabilities to support committee scrutiny of budget decisions
  - Tax and fiscal modelling capabilities in the Scottish Parliament Information Centre (SPICe)
  - Additional sessions at the Finance and Public Administration Committee, including with the SFC



# What have been the consequences of the framework?

- › The Scottish Government has made extensive use of its income tax powers
  - More bands, different rates and different thresholds
  - This has driven the net tax position to an estimated +£1.6bn in 2024-25, and the SFC expects it to grow
- › Social security powers have also been used extensively
  - Both replacement (e.g. Adult Disability Payment) and additional benefits (Scottish Child Payment)

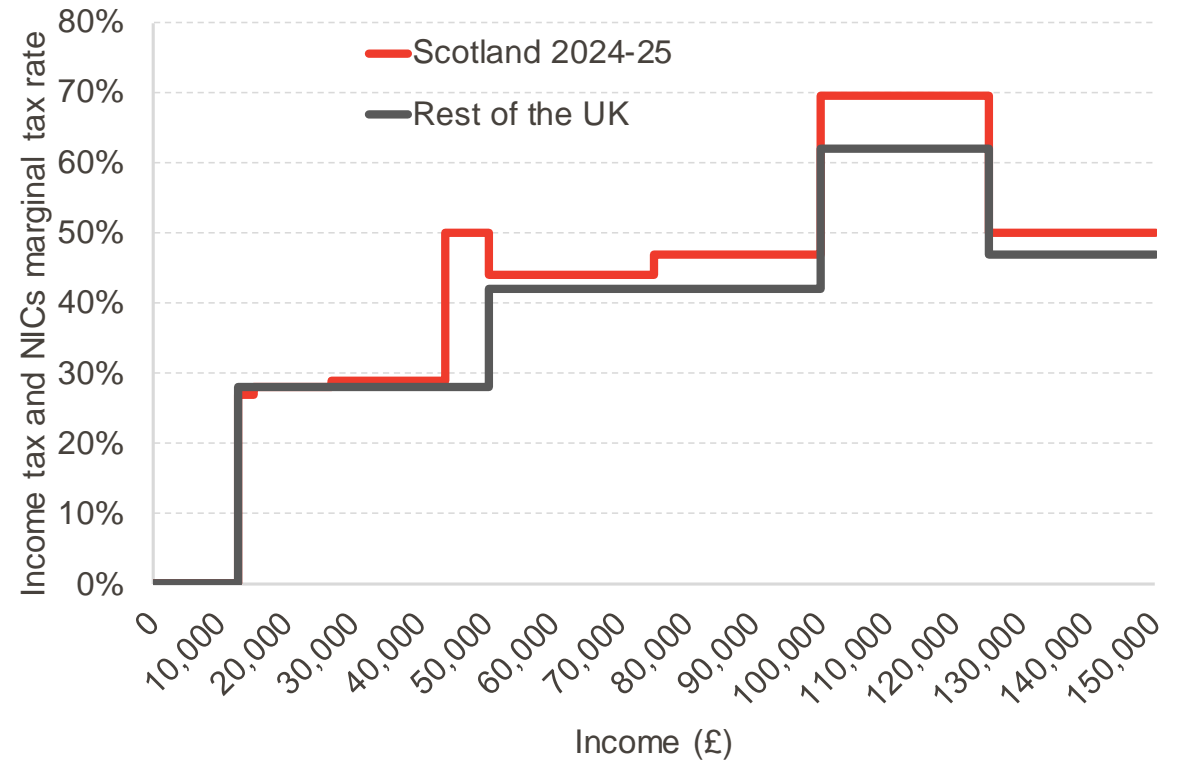


Source: HMRC, Scottish Government, FAI analysis



# Some unintended (?) consequences

- › The Scottish Government's main revenue lever is income tax – but National Insurance Contributions have a nearly identical tax base, and are reserved
  - Turbo-charged fiscal drag in Scotland due to higher rates and lower higher rate threshold, but this has misaligned thresholds
  - Fair to say no one's idea of a well-designed tax schedule for employees
  - And yet the Scottish Government has shown little intention of fixing this – even if it could do so without loss of revenue by adjusting rates either side



Source: Scottish Government, FAI analysis



# Issues going forward (1)

- › Income tax devolution gets all the headlines, partly because of the broad base and because the changes are quite striking
- › But social security devolution is probably just as consequential if not more so over the long run
  - The net position is increasingly negative (£700m by 2028-29), meaning that funding for devolved benefits from rGB equivalents will not cover Scottish equivalents
  - Managing the pressures out of a DEL-like budget is tricky, as welfare benefits are demand-led
  - Pay pressures plus an increasingly costly benefits system are taking an increasingly large proportion of the Scottish budget
  - And the requirement to balance current expenditure with revenues means that the amount left for other areas is being squeezed



# Issues going forward (2)

- › Borrowing limits (current and capital) are being grown in line with inflation – a positive step, but perhaps not the right indexation – GDP?
- › Further devolution of indirect taxes might be complicated for goods mobile across the UK
  - Final consumer destination? Clearance point? Difficult enforcement and Internal Market Act
  - Assignment is a poor proxy and probably unworkable (too volatile – see VAT)
- › The Fiscal Framework does not address in-year budgeting flexibilities
  - Could there be a role for resource borrowing and smoothing out spending over time? The Scotland Reserve (budget exchange) probably needs to be increased in size to have a meaningful role
  - Scottish Government still relies on in-year consequentials – need certainty over funding from Westminster, but planning on consequentials crystallising is not a good strategy as the effects if they don't can be very difficult to manage





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# International perspectives on the architecture for sound public finance

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Prepared for the Annual Conference of the Northern Ireland Fiscal Council, 22 October 2024

# Types and tasks of IFIs

- No single “best” model
- Fiscal councils and parliamentary budget offices
- Link to legislature affects configuration of tasks
- Sustainability analysis often a central task
- Forecasting role common, but rarely as official forecaster
- Rule compliance important for many national IFIs
- Positive, not normative

Table 2. **Typical functions of IFIs**

Organisation		Functions					
		Analysis of long-term fiscal sustainability <sup>1</sup>	Role in macroeconomic and/or fiscal forecasts <sup>2</sup>	Role in monitoring compliance with fiscal rules <sup>3</sup>	Directly support legislature in budget analysis	Role in policy costing <sup>4</sup>	Role in costing election platforms
Australia	PBO	●	○	○	●	●	●
Austria	Fiscal Advisory Council	●	■	●	○	○	○
Belgium	High Council of Finance	●	○	●	○	○	○
Canada	PBO	●	□	○	●	●	○
Denmark	Danish Economic Council	●	□	●	○	○	○
Finland	National Audit Office of Finland	●	■	●	○	○	○
France	High Council of Public Finance	○	■	●	○	○	○
Ireland	Irish Fiscal Advisory Council	○	■	●	○	○	○
Italy	PBO	●	■	●	●	●	○
Korea	National Assembly Budget Office	●	□	○	●	●	○
Mexico	Center for Public Finance Studies	●	□	○	●	●	○
Netherlands	Bureau for Economic Policy Analysis	●	●	○	●	●	●
Portugal	Portuguese Public Finance Council	●	■	●	○	○	○
Slovak Republic	Council for Budget Responsibility	●	○	●	○	●	○
Spain	AIReF	●	■	●	○	○	○
Sweden	Swedish Fiscal Policy Council	●	■	●	○	○	○
UK	Office for Budget Responsibility	●	●	●	○	●	○
US	Congressional Budget Office	●	□	○	●	●	○
Total countries		18	18	18	18	18	18
● = Yes		16	2	12	7	9	2
○ = No		2	3	6	11	9	16
■ = Assess forecasts only		n.a.	8	n.a.	n.a.	n.a.	n.a.
□ = Prepare alternative forecasts		n.a.	5	n.a.	n.a.	n.a.	n.a.
● = Yes (%)		89%	11%	67%	39%	50%	11%
○ = No (%)		11%	17%	33%	61%	50%	89%
■ or □ = Other (%)		0%	72%	0%	0%	0%	0%

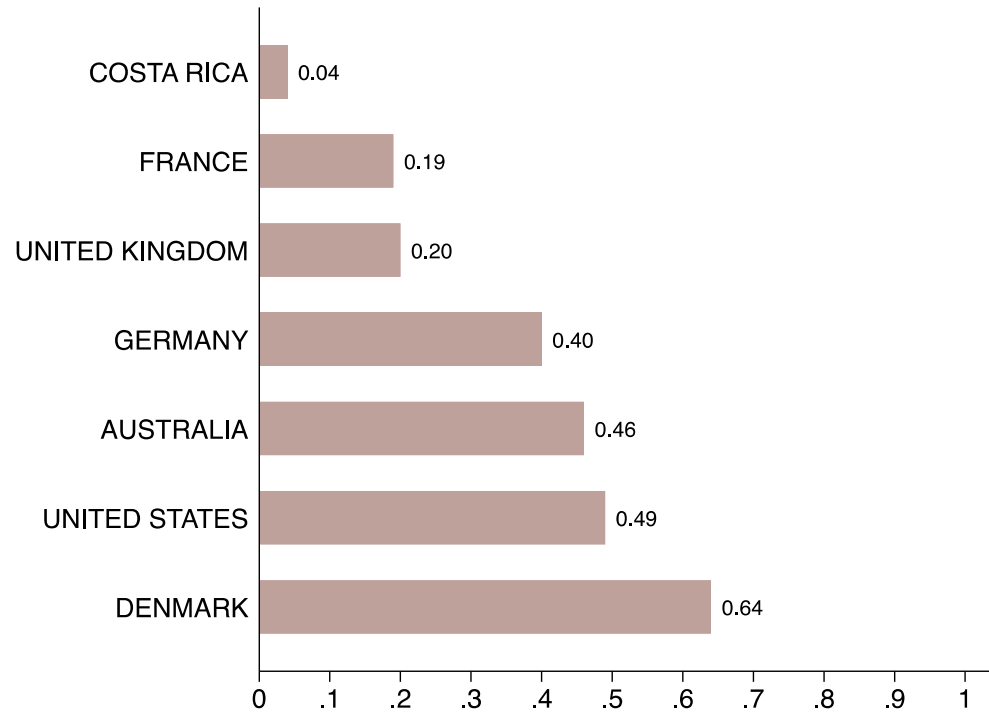
Source: Lisa von Trapp, Ian Lienert and Joachim Wehner (2016). 'Principles for Independent Fiscal Institutions and Case Studies', *OECD Journal on Budgeting* 15:2 (special issue).

# Features and challenges of the UK context

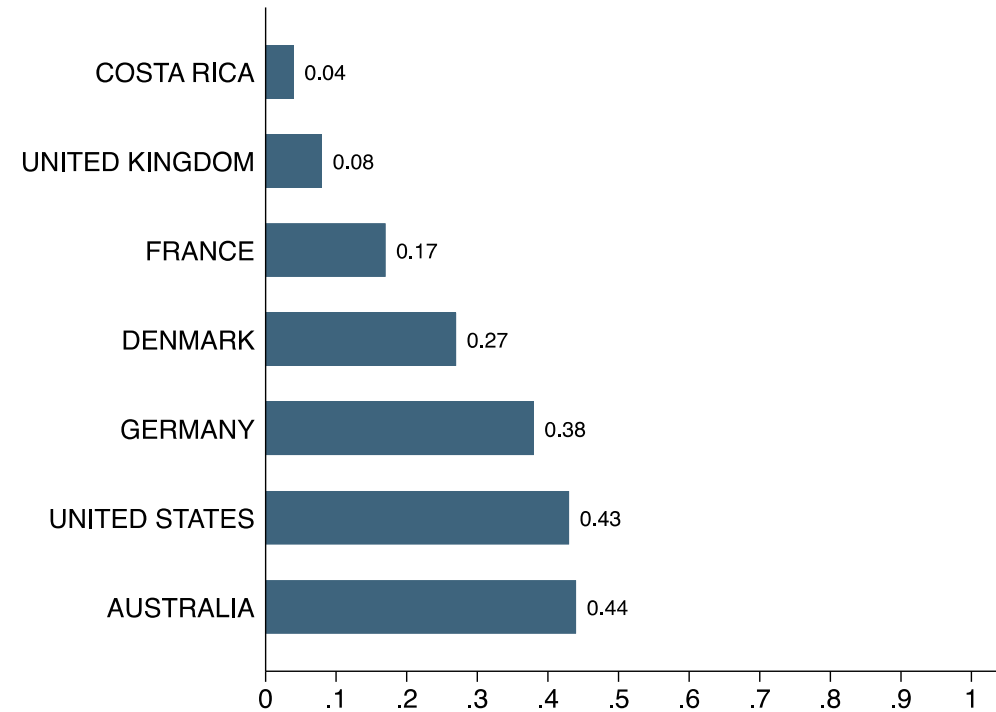
- Highly centralised in fiscal terms
- Asymmetrical devolution
- High grant dependence
- Barnett formula linked to spending reviews
- Executive driven system
- Weak regional representation at the centre

# Fiscal decentralisation in selected countries

Subnational expenditures (% of total)



Subnational revenues (% of total)

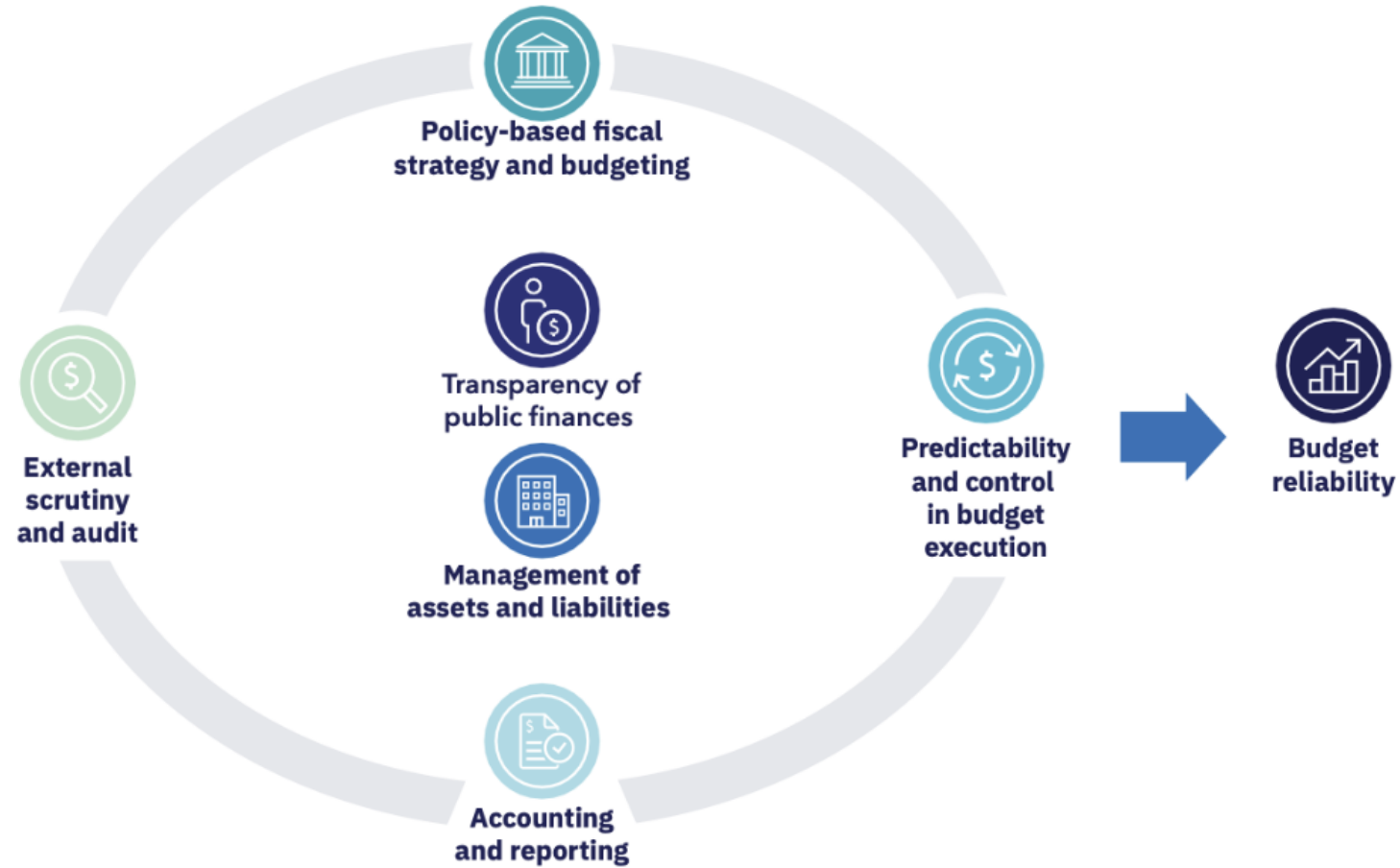


Source: OECD Fiscal Decentralisation Database. Consolidated state and/or local government expenditure (left) and revenue (right) as percentage of total for general government in 2022.

# Fiscal architecture

- Key actors in the budget cycle
  - Executive (central budget authority and spending departments)
  - Legislature (finance and other committees)
  - Supreme Audit Institution
- Other relationships, e.g.
  - Intergovernmental relations (national, regional, local)
  - Wider public sector (public corporations)
  - Media, think tanks, broader public
  - Statistical bodies
- How does the IFI fit into the wider fiscal architecture?

**FIGURE 1:** PEFA pillars and the budget cycle





# Concluding remarks

- Early design decisions are crucial
- Arrangements intended as provisional quickly become permanent and can be harder to change later
- Define key institutional relationships but also keep an eye on the wider systemic challenges in the UK context