UK Budget 2021 and implications for Scotland – Fraser of Allander Institute

A budget act in three parts

Rishi Sunak's 2021 budget was delivered in three parts.

First were measures taken to continue to protect the livelihoods of individuals and businesses whilst health restrictions remain in place. Many of these measures had been pre-announced, including a six month extension to furlough and to the uplift to Universal Credit. Others, including announcements of further business support grants and extensions of business rates and stamp duty reliefs will have implications for the Scottish budget – discussed below.

The second part was entitled 'fixing the public finances'. This was where the Chancellor highlighted the need for fiscal restraint in future years, given the likelihood that the economy will be permanently smaller as a result of Covid.

The main measures here were on income tax (where allowances and thresholds will be frozen in 2022/23 and beyond), and on corporation tax, where the headline rate will increase from 19% currently to 25% in 2023. As noted by the OBR, these measures will take tax as a percentage of national income to its highest level since the late 1960s.

But across the budget and November Spending Review in combination, the government has also cut more than £15 billion a year from departmental resource spending plans from 2022-23 onwards, compared to its pre-pandemic plans.

In combination, the tax and spending measures in the Budget will raise £32bn per year by 2025. By this point the OBR forecasts that annual borrowing will have fallen to only £74bn, or 2.8% of GDP, with debt at around 100% of GDP.

Of course, there are huge uncertainties in all of this – on the pace of the economic recovery, the feasibility of the proposed spending plans, and the costs of servicing government debt. The spending plans in particular look ambitious, particularly when we consider that the government has made no allowance for covid-related spending beyond 2021/22 (despite an acceptance that vaccination programmes may be required for some years to come). Whether the plans will be delivered remains to be seen, but for now the Chancellor seems keen to demonstrate he can oversee fiscal consolidation.

The third part of Sunak's speech was about 'building the future economy'. There were measures to support infrastructure investment, particularly in the 'green economy' through a new UK-wide investment bank (replacing the European Investment Bank) and various other measures. The final showpiece announcement came in the form of 8 new freeports in England.

But Sunak's vision for a 'future economy' made no mention of welfare or social security. The uplift to Universal Credit is still seen very much as a temporary policy for exceptional times, the need for which will erode once the economy is back to normal. This was a return to an old normal, rather than the 'new normal' that many hoped the pandemic might usher in.

So what were the implications for Scotland?

More consequentials

First, the budget brings with it further Barnett consequentials, boosting the Scottish budget in 2021/22.

The chancellor announced another £1.2bn of Barnett consequentials for the Scottish budget in 2021/22. This is well above the £500m that the Scottish Government had assumed that they would get when the draft Scottish budget was published.

It also comes in addition to the £1.2bn of consequentials announced for Scotland by the UK Government in February. Whilst these consequentials technically related to the 2020/21 financial year, the Scottish Government will be able to transfer this funding into 2021/22.

Since the draft Scottish budget was published therefore, it has been boosted by some £2.4bn. Half of this relates to 'late' consequentials for 20/21 that the Scottish Government has chosen to carry into 21/22, and half of which relates to new announcements in today's budget.

Cabinet Secretary for Finance Kate Forbes has already outlined how the £1.2bn of late consequentials will be allocated in 2021/22 (see Annex B of the Scottish Parliament Finance Committee's budget report). And of the £1.2bn consequentials confirmed today, £500m had already been accounted for in the draft budget. So that leaves around £700m of new spending allocation. It remains unclear how this remaining allocation is split between resource and capital.

Tax policy implications

The implications on the tax side are less significant, but important nonetheless.

UK income tax personal allowance and thresholds were unchanged from those trailed in November. As such, the difference in tax liability between Scotland and rUK in 2021/22 remains unchanged.

But non-domestic rates reliefs for the retail, hospitality and leisure (RHL) sector are on-course to be more generous in Scotland over the full course of 2021/22 than they are in England. Whilst Kate Forbes has announced the continuation of 100% rates reliefs for RHL businesses in Scotland for the full year, Rishi Sunak confirmed that, in England, the 100% rates relief would continue only for the first three months of the financial year. After that, rates reliefs of 66% will apply to eligible RHL businesses in England.

On Stamp Duty, the Chancellor announced that the extension of the nil rate band on residential property transactions from £125,000 to £500,000 will continue until June, and then to £250,000 until September. This announcement will increase the resources available to the Scottish Government (this is because the reduction in the UK Government's revenues from stamp duty will reduce the 'block grant adjustment', the amount deducted from the Scottish block grant). This paves the way for Kate Forbes to announce a similar extension to the nil rate band of Land and Buildings Transactions Tax in Scotland (the Scottish budget 2021/22 envisaged that the temporary extension of the nil rate band of LBTT during 2020/21 would end on 1 April 2021).

A Scottish freeport?

The budget's flagship announcement was on the creation of eight new 'freeports' in England. Freeports are, according to the government, 'secure customs zones located at ports where business can be carried out inside a country's land border, but where different customs rules apply'.

Typically, importers bringing goods into a freeport do not have to pay duties until the goods leave the freeport and enter the domestic market. This can bring advantages if it allows UK-based businesses to process goods and then re-export them (without the burden of customs duties), or to bring then into the UK market facing lower duties on a processed product than would have been faced by the raw product.

So freeports might boost job creation and economic activity. But the risk is that they simply lead to relocation of economic activity from elsewhere in the UK – whilst requiring additional public sector infrastructure and investment costs to maintain.

The Chancellor stated that he would work creatively with the devolved governments to identify locations for freeports in Scotland, Wales and Northern Ireland. It remains unclear to what extent this process will create tensions between the UK and devolved governments, either in terms of the number and location of freeports, or in terms of the concept itself. The UK Government argues that the opportunity to create freeports is a boon of Brexit, whilst critics would argue that their creation is an admission of the problems that Brexit has created for UK business.

Summary

This was a budget of two parts. In the short-term, further covid-related allocations are designed to support the economy during ongoing restrictions – and these provide the Scottish Government with further resources during 2021/22.

In years beyond that, this was a budget that aims to rebuild the economy by leveraging investment, whilst raising more from tax and tightening the screw on public services spending. But there is no role in the future economic vision for welfare policy or public services spending.

Plenty then to debate as we head towards the Scottish parliament elections in May.

(Source: UK Budget 2021 and implications for Scotland)