Social Security (Scotland) Bill

Financial Memorandum

Introduction

1. As required under Rule 9.3.2 of the Parliament's Standing Orders, this Financial Memorandum is published to accompany the Social Security (Scotland) Bill, introduced in the Scottish Parliament on 20 June 2017. The contents are entirely the responsibility of the Scottish Government and have not been endorsed by Parliament.

2. The following documents also accompany the Bill and are published separately:

- Explanatory Notes (SP Bill 18-EN);
- a Policy Memorandum (SP Bill 18-PM);
- statements on legislative competence by the Presiding Officer and the Cabinet Secretary for Communities, Social Security and Equalities (Angela Constance MSP) (SP Bill 18-LC).

3. The Policy Memorandum explains in detail the background to the Bill and the policy intention behind the Bill. The purpose of this Financial Memorandum is to set out the costs associated with the measures introduced by the Bill, and as such it should be read in conjunction with the Bill and the other accompanying documents.

Context

4. The Social Security (Scotland) Bill ("the Bill") is brought forward as a result of measures following the changes to the devolution settlement

enacted in the Scotland Act 2016.[1] These measures give the Scottish Parliament legislative competence over disability, industrial injuries and carer's benefits, benefits for maternity, funeral and heating expenses, and Discretionary Housing Payments. They also provide the ability to top up benefits which remain reserved to UK Parliament, and allow new benefits to be created in any area except old age pensions or where there is a connection to a matter reserved to UK Parliament (such as child support maintenance or reserved aspects of employment support). As a result of the changes in the devolution settlement, eleven existing social security benefits will become a devolved responsibility.

5. This Bill transposes the eleven social security benefits onto a Scottish legislative platform, allowing the Scottish Ministers to shape a distinctly Scottish benefits system, with dignity and respect being core to its approach. These are: Disability Living Allowance, Personal Independence Payment, Attendance Allowance, Severe Disablement Allowance and Industrial Injuries Scheme; Carer's Allowance; Sure Start Maternity Grants; Funeral Payments; Cold Weather Payments and Winter Fuel Payments; and Discretionary Housing Payments. The Bill includes powers to create new benefits for early years and to provide for top up of reserved benefits. It provides for a supplementary payment to persons receiving Carer's Allowance, pending the transposition of that benefit onto a Scottish legislative platform.

6. The Bill also sets out an overarching legislative framework for the administration of social security in Scotland, making provision for operational functions such as managing overpayments, fraud, error and appeals.

7. The Bill is arranged in five Parts as follows:

- Part 1 sets out the seven Scottish social security principles, provides for a Scottish social security charter and requires annual reporting on the performance of the Scottish social security system.

- Part 2 places a duty on the Scottish Ministers to give assistance to persons who are entitled to it, sets out eight types of assistance that are to be created, and provides for applications, determination

[1] http://www.legislation.gov.uk/ukpga/2016/11/contents/enacted

of entitlement and appeals. It also provides for recovery of assistance given in error and offences.

- Part 3 provides the Scottish Ministers with the ability to provide for top up of benefits that are reserved to the UK Parliament. It also makes provision for a supplement to be paid to persons in receipt of Carer's Allowance.

- Part 4 empowers local authorities to make payments to persons to assist with their housing costs, provides some restrictions on how that power is to be used and requires local authorities to publicise their rules for assistance.

- Part 5 deals with the technical matters normally dealt with at the end of Bills: it allows ancillary provision to be made by regulations, sets out the parliamentary procedures that are to apply to the regulation-making powers in the Bill, makes provision about when the Act resulting from the Bill will come into force and establishes its short title (i.e. the Act's official legal name).

8. Even though the Bill is, in places, enabling in the provisions it contains (with secondary legislation to follow), the Scottish Government has sought to provide as much detailed financial information available at this stage as possible. As the Bill does not set out the detail of the eligibility and rates for each of the benefits to be devolved, the number of individuals who might be able to claim for the benefit and therefore the associated costs have been estimated by the Scottish Government to provide this detailed financial information. In due course, however, the Scottish Parliament will have a series of further opportunities to scrutinise the budget allocated for setting up and running a Scottish social security system – for example, estimates for demand-led spending will be prepared by the Scottish Fiscal Commission and these forecasts can be scrutinised with the Scottish Government's Draft Budget and the Budget (Scotland) Bill laid before the Scottish Parliament annually.

Financial implications of new powers

9. The transfer of these powers will require the implementation of new infrastructure and systems to support their delivery, and this represents the largest and most complex programme of change the Scottish Government

has undertaken since devolution. In its March 2017 report "Managing new financial powers – an update"[2], Audit Scotland stated that "…establishing an agency and implementing the new social security system is an exceptionally wide-ranging and complex task". To ensure a safe and secure transition, the Scottish Government does not intend to take on delivery of all of the benefits to be devolved at the same time. A phased approach de-risks the implementation of a complex system.

10. Expenditure on the benefits to be devolved to Scotland is forecast in 2017-18 as approximately £2.9 billion, and represents 15.3% of total expenditure on benefits in Scotland. The table below provides an estimate of Department of Work and Pensions (DWP) expenditure in Scotland on the benefits to be devolved, based on current forecasts for 2017-18. The funding related to any devolved benefit which will transfer to the Scottish Government, will be DWP spending in Scotland on that benefit for the year prior to the year of devolution[3], so it cannot be assumed that the exact amounts in Table 1 will transfer. Recent changes to Winter Fuel Payments announced by the UK Government may significantly decrease the funding transferred for Winter Fuel Payments when they are devolved; it is possible that further changes to benefits by the UK Government prior to devolution to Scotland could occur and have a resultant impact on the funding to be transferred.

Table 1 – Forecast 2017-18 expenditure in Scotland on the benefits to be devolved and estimated case loads

	Estimate 2017-18	**Estimate 2017-18**	
Devolved benefit	**£m**	**Scottish Caseload (thousands)**	**Brief description & range of amounts (average)**
Attendance Allowance	489	126.7	To help with personal care for individuals aged 65 or over with a physical or mental disability.

[2] "Managing New Financial Powers: An Update"; Audit Scotland, March 2017

[3] With the exception of the Cold Weather Payment which is calculated differently reflecting the substantial volatility of the Cold Weather Payment.

			Higher rate £83.10, lower rate £55.65 per week.
Carers Allowance	256	76.3	To help an individual look after someone with substantial caring needs. The individual must be over 16 and spend at least 35 hours per week caring. £62.70 per week.
Cold Weather Payments	14	510.3	A payment for individuals on certain benefits when the temperature is either zero degrees Celsius or below for 7 consecutive days. £25 is paid for each 7 day period of very cold weather between 1 November and 31 March.
Disability Living Allowance	907	197.3	A tax-free benefit for disabled people over the age of 16 who need help with mobility or care costs. For those with parental responsibility for a disabled child under 16, help with the extra costs of looking after a child with disabilities who has additional care needs. Weekly rate varies from £22 – £141.10.
Discretionary Housing Payments	19	80.0	Additional help for those in receipt of Housing Benefit and have difficulty meeting their rent payments. Paid at the discretion of the LA.
Funeral Expenses Payments	3	4.3	For individuals on certain low income benefits who are responsible for arranging a funeral. The payment meets the costs for the purchase of a grave and burial or cremation

			fees. The amount awarded to meet these fees is uncapped. The payment also covers up to £700 towards other specific costs associated with a funeral.
Industrial Injuries Benefits	86	30.8	For individuals who are ill or disabled as a result of an accident or disease caused by work or while on an approved employment training scheme or course. Up to £169.70 per week.
Personal Independence Payment	904	168.5	Helps with some the extra costs caused by long term ill-health or disability for individuals aged 16-64. Weekly rates: standard £55.65; enhanced £83.10.
Severe Disablement Allowance	15	2.7	For working age individuals who are unable to work due to illness or disability. SDA is closed to new entrants. Weekly rates: single person £62.45; couple £124.90.
Sure Start Maternity Grant	2	5.8	Helps towards the costs of having a first child for individuals who are in receipt of certain benefits. A one off payment of £500.
Winter Fuel Payments	177	1,035.0	A tax-free payment to help pay for heating bills for those born on or before 5 July 1952. £100-£300 per annum depending on age of applicant.
Total	**2,870**	**2,237.7**	

11. The funding transfer from the UK Government, which will be carried out under the terms of the Fiscal Framework[4] agreement, will be phased according to when the Scottish Government begins delivery of each devolved benefit. The Scottish Government recognises the need to guard against financial risks; managing and mitigating financial risks will be essential in order to ensure the safe delivery of this programme of work.

12. In March 2016, it was announced that the Scottish Government would set up a new agency, which will sit at the heart of the overall social security system in Scotland. The benefits that will be administered by the agency include those supporting disabled people, older people, children, young people, families and those on low incomes. The agency's work will therefore be particularly supportive of the aim of a Fairer Scotland that offers improved opportunities and better quality of life for everyone regardless of their circumstances.

13. There are several financial elements to consider as a result of the devolution of social security:

- the cost of demand-led social security benefits paid to individuals within the new Scottish social security system: existing benefits; top ups to existing benefits, and new benefits that may be created by the Scottish Government in the future;
- the impact of demand-led spending on the Scottish Government's budgeting and financial management arrangements;
- the effect of the block grant adjustments and reconciliation process on the Scottish Budget and cash management;
- forecasting of demand-led expenditure and the role of the Scottish Fiscal Commission (SFC);
- the cost to the Scottish Government of setting up and running the Scottish social security system; and
- an assessment of any costs borne by Local Government, the UK Government and other bodies, individuals and businesses.

[4] The agreement between the Scottish Government and the United Kingdom Government on the Scottish governments fiscal framework; February 2016.

Demand-led costs on the Scottish administration

14. Ten[5] of the eleven benefits being devolved to Scotland are demand-led: spend is driven by the number of people who have a claim, based on rates and eligibility criteria set in legislation, rather than by the amount allocated in a budget. Budgets for demand-led spending are set based on forecast expenditure rather than spending limits. However, the benefits transferred to Scotland will need to be managed within the Scottish Government's DEL[6] budget limits in line with other demand-led programmes such as Educational Maintenance Allowances (EMAs) and Legal Aid. This is in contrast to demand-led spending at UK level which is often classified as Annually Managed Expenditure (AME).

15. Funding for existing benefits will be transferred through the Fiscal Framework but increases in demand-led spending and new policy choices which give rise to additional spending will require new budget cover, funded from the existing Scottish budget envelope.

Demand-led costs of the existing social security benefits being devolved to Scotland

16. Under the Fiscal Framework, the annual block grant to the Scottish Government will be adjusted to reflect the transfer of responsibility for social security. The adjustments for social security will involve two elements: an initial addition to the block grant baseline, and an indexation mechanism. Once the baseline is set, changes to the block grant funding which Scotland receives will ultimately be indexed to changes to per capita social security spending in the rest of the UK: a risk therefore arises because the funding that Scotland will receive will not be related to the actual level of social security expenditure in Scotland, or on anticipated spending needs in Scotland.

17. The Scottish Budget is also exposed to further cuts in devolved benefits by the UK Government either before or after devolution.

[5] Discretionary Housing Payments are not demand-led; payments are made on a case by case basis.

[6] Departmental Expenditure Limit.

Devolved benefits and the Block Grant

18. The initial baseline addition to the block grant for devolved social security payments will be the UK Government's spending on these areas in Scotland in the year immediately prior to the devolution of powers, with the exception of the Cold Weather Payment[7] which is calculated differently. Spending in Scotland in the year prior to devolution will be forecast by the Office for Budget Responsibility (OBR).

19. The UK and Scottish Governments have agreed that the block grant adjustment for benefits during the period up to and including 2021-22 should be indexed by using the Barnett / Comparable Model, while achieving the outcome delivered by the Indexed Per Capita (IPC) method. Post 2021-22, the operation of the Fiscal Framework will be reviewed, with any required changes to be jointly agreed between Governments.

20. The Barnett / Comparable Model will firstly be applied to UK Government spending on each of the benefits devolved to the Scottish Parliament. This means that a population share of any change in UK Government spending on each relevant benefit will be added to – or deducted from – the block grant baseline.

21. The second, concurrent, step will be to calculate the adjustments on the basis of the IPC model. Under the IPC model the initial block grant adjustment will be increased in line with the percentage growth in the equivalent UK Government benefit spending per head, multiplied by Scottish population growth.

22. If there is a difference between the Barnett / Comparable and IPC calculations, there will then be a reconciling adjustment to the Barnett / Comparable adjustments to ensure the mechanism delivers the IPC outcome.

23. The following tables set out forecasts for each benefit over the next four years, illustrating the current forecast trajectory of the benefits which

7 Reflecting the substantial volatility of the Cold Weather Payment, the initial baseline addition will be an average of the UK Government's spending in Scotland on this benefit from 2008-09 to the year prior to devolution.

will be transferred to Scotland, both in money terms and in caseload terms. The forecasts are calculated as a share of DWP forecasts[8] based on Scottish Government estimates of current Scottish caseloads. The specific dates of when each benefit will transfer to Scotland will be announced in due course and the funding will transfer over at the appropriate time through the block grant adjustment set out in the Fiscal Framework. These tables are an example of what might be transferred, assuming that current benefit levels and criteria at the UK level are unchanged.

Table 2a – Forecast of the potential funding transfers over the next four years, assuming no changes to eligibility criteria and rates by the UK Government

Devolved benefit	**Forecast 2018-19**	**Forecast 2019-20**	**Forecast 2020-21**	**Forecast 2021-22[9]**
	£m	**£m**	**£m**	**£m**
Attendance Allowance	504	522	547	565
Carers Allowance	276	291	302	313
Cold Weather Payments	14	14	14	14
Disability Living Allowance	614	519	508	499
Discretionary Housing Payments	20	20	14	14
Funeral Expenses Payments	4	4	4	5
Industrial Injuries Benefits	85	85	85	85
Personal Independence Payment	1,259	1,437	1,511	1,592

[8] DWP - Benefit expenditure and caseload tables 2017.

[9] In nominal prices.

Severe Disablement Allowance	13	13	12	12
Sure Start Maternity Grant	3	3	3	3
Winter Fuel Payments	174	172	171	173
Total	**2,966**	**3,080**	**3,171**	**3,275**

Table 2b –DWP estimates of the forecast Scottish caseload in payment for the devolved benefits, assuming no changes to eligibility criteria by UK government

Devolved benefit[10]	**Forecast 2018-19 Caseload**	**Forecast 2019-20 Caseload**	**Forecast 2020-21 Caseload**	**Forecast 2021-22 Caseload**
	Thousands	**Thousands**	**Thousands**	**Thousands**
Attendance Allowance	127	128	129	130
Carers Allowance	80	83	85	86
Cold Weather Payments	502	494	485	485
Disability Living Allowance	129	106	103	100
Discretionary Housing Payments	80	80	80	81
Funeral Expenses Payments	4	4	4	4
Industrial Injuries Benefits	30	30	29	29
Personal Independence Payment	231	258	268	277
Severe Disablement Allowance	2	2	2	2
Sure Start Maternity Grant	6	6	6	6

[10] This forecast shows Scottish caseload in payment and does not represent the total caseload.

Winter Fuel Payments	1,012	997	987	1000
Total	**2,203**	**2,188**	**2,178**	**2,200**

24. By their nature, the cost of demand-led benefits will fluctuate both up and down relative to the level of funding provided through the block grant adjustment in that year. This represents a new risk for the Scottish Government as expenditure may not match the block grant adjustment.

25. Once a benefit is transferred to Scotland, a risk arises from the way the indexation of the block grant adjustment will be calculated: it is UK Government expenditure growth on devolved benefits that Scotland will be indexed against, not overall spend. Assuming that the policy on rates and eligibility remains unchanged from the rest of the UK, then there is a risk that if, over time, uptake is higher in Scotland or demographic differences mean that expenditure growth per capita on Social Security in Scotland is higher than in the rest of the UK then the funding transferred under the block grant would be insufficient. The gap would require to be funded from the existing Scottish budget envelope. Similarly, any new benefit or change to policy on rates or eligibility which increases the per capita expenditure on benefits in Scotland relative to the rest of the UK per capita expenditure would also require to be funded from the existing Scottish budget.

26. As the Scottish Government will have received a block grant adjustment on devolution of the benefits, where policy on rates and eligibility remains unchanged and growth in benefit expenditure per capita in Scotland is less than in the rest of the UK, then the Scottish budget would gain.

Demand-led costs of new Scottish social security benefits

27. The Scottish Government has initiated a programme of work to create the operational capability to deliver benefits in Scotland. Scottish Ministers will have powers to alter benefit payment rates, top up existing benefits or create new benefits within the scope of the legislative competence created by the Bill. Scottish Ministers have already committed to a number of policies they intend to deliver in the future through a Scottish social security

system[11]. For example, they have committed to increasing the annual value of Carers Allowance to the same value of Job Seekers Allowance and replacing the Sure Start Maternity Grant with an enhanced Best Start Grant. As these are policy changes, funding will need to be found from the existing Scottish budget envelope, as it would not be part of any UK budget transfer relating to the new powers.

28. Specific launch dates are still under development for these policy commitments. Table 3, below, sets out the forecast costs to Scottish Government in future years as an illustration of the likely value of these commitments with assumptions made on rates and eligibility, as these factors are not yet confirmed. The Scottish Government is working to determine the start dates of when these currently committed new or amended benefits will be introduced in Scotland, and further information will be made available in due course.

Table 3a – Illustrative estimated costs to existing Scottish Government budgets of currently committed, new or amended benefits payments

New or Adjusted Benefit Payment[12]	**Estimate 2018-19 Cost**	**Estimate 2019-20 Cost**	**Estimate 2020-21 Cost**	**Estimate 2021-22 Cost[13]**
	£m	**£m**	**£m**	**£m**
Carers Allowance Increase	37	32	33	34
Best Start Grant	17	17	17	17
Total	**54**	**49**	**50**	**51**

[11] From the SNP Manifesto 2016 and the Programme for Government.

[12] These are the additional costs as a result of new or adjusted payments and should be read in conjunction with Table 2a which details the existing costs.

[13] Cost estimates are at nominal prices, this is not indicative of when the benefit will be rolled out.

Table 3b – Illustrative estimated caseloads

New or Adjusted Benefit Payment	Estimate 2018-19 Caseload	Estimate 2019-20 Caseload	Estimate 2020-21 Caseload	Estimate 2021-22 Caseload
	Thousands	Thousands	Thousands	Thousands
Carers Allowance Increase	80	83	85	86
Best Start Grant	62	63	62	62
Total	**142**	**146**	**147**	**148**

29. Certain benefits are discretionary, such as the Discretionary Housing Payments being transferred under the Scotland Act 2016. The discretionary element allows administrators to make decisions on a case-by-case basis, meaning they can have some flexibility to provide support to individuals whose circumstances could not be adequately captured with prescriptive criteria set in legislation. An estimate of the likely need for these funds can be made, but in order to control expenditure and to ensure rigour in the decision making, the budget for discretionary benefits is capped; from a budgeting point of view, therefore, once a budget is set the spend on these areas is controllable. The operation of discretionary budgets does not preclude the ability for additional amounts to be made available to supplement budgets in year, through the budget revision processes.

Further impacts on the Scottish Government's budgeting and financial management

30. Demand-led social security expenditure of this scale represents a risk for the Scottish Government's budget because it introduces a new level of volatility into the public finances. In addition to the risks created by demand-led expenditure discussed above, further considerations are:

- reliance on forecasting demand-led social security;
- the funding and block grant adjustment (BGA) arrangements set out in the Fiscal Framework;
- uprating of benefits for inflation;

- policy differences; and
- demographic differences.

Forecasting

31. While the Scottish budget has historically included expenditure that is demand-led, this has not been on the same scale as the demand-led budgets for social security will be. As a result, the Scottish Government will be putting in place processes to manage and mitigate the risks around forecast variation. The forecasting of potentially volatile demand-led social security expenditure increases the risks around financial management because forecasts are estimates of future events based only on information that is known at the point when the forecasts were made.

32. Forecasts of benefits expenditure will come from three sources: the Scottish Government; the Scottish Fiscal Commission, which will produce independent forecasts of social security expenditure; and the UK Government (DWP / OBR forecasts).

33. The UK Government forecasts will be used to calculate the block grant adjustments. The Scottish Government will produce forecasts of benefits to support policy development and evaluation, and financial management. The Scottish Fiscal Commission will be responsible for the production of independent forecasts to inform the Scottish Government's Draft Budget and the Budget Bill.

34. Scottish Government analysis indicates that the UK Government forecasts for the benefits being devolved appears to have been affected by systematic downwards bias since 2014/15, of approximately 6.9% per year; the fact that the UK Government spends more than they forecast is important as there will be interactions between the Scottish Government Budget process, block grant adjustments based on UK Government forecasts and the forecasts prepared by the Scottish Fiscal Commission. This issue is discussed in the following section.

Funding and Block Grant Adjustments

35. As part of the Fiscal Framework, the UK and Scottish Governments agreed a set of fiscal tools to enable the Scottish Government to manage

the additional risks and volatility associated with the devolution of social security and fiscal powers. These tools are referred to in the framework as resource borrowing powers.

36. From 1 April 2017, the Scottish Government has the power to resource borrow up to £600 million each year within a statutory overall limit of £1.75 billion. The Fiscal Framework does not give the Scottish Government the general capability to borrow for a planned resource deficit. There are specific purposes and limits that dictate any resource borrowing. These purposes are for in-year cash management with an annual limit of £500 million; for forecast errors with an annual limit of £300 million and for any observed or forecast shortfall where there is or is forecast to be a Scotland-specific economic shock with an annual limit of £600 million.

37. Detailed arrangements for reporting and repaying resource borrowing are currently being finalised with the UK Government. These powers and arrangements are distinct from the capital borrowing powers, for which there are different powers and arrangements in place as part of the Fiscal Framework.

38. The borrowing powers for forecast errors are to cover the forecast error arising for devolved and assigned taxes as well as social security. Therefore, if in-year demand for benefits is higher than forecast, this borrowing power could be used to fund the gap, and resource DEL cover would have to be obtained. However, the borrowing power is relatively limited compared to the size of devolved social security and therefore the tolerance for forecast error will be limited.

39. The Scotland Reserve will apply from 2017-18 onwards and will enable the Scottish Government to smooth all types of spending. The Scotland Reserve will be capped, in aggregate, at £700 million for revenue and capital; annual drawdowns from the reserve will be limited to £250 million for resource. However, these amounts are relatively limited compared to the scale of the Scottish budget generally.

40. The block grant adjustments for social security set out in the Fiscal Framework will affect the Scottish Government’s financial management and budgeting. The initial baseline addition will generally be based on OBR forecasts of UK Government spending in Scotland on the relevant benefit in

the year prior to the devolution of powers[14]. The baseline year is the year prior to devolution. Indexation mechanisms will then be applied to determine the adjustments for following years.

41. The baseline addition will initially be reconciled to outturn once DWP's actual expenditure on each benefit is known. In general, DWP publishes the provisional outturn figures in the September after the end of the fiscal year. The provisional figures are generally confirmed in the following spring. The Fiscal Framework sets out, in paragraph C45, that "adjustments to the block grant for tax and benefits will provisionally be based on a forecast of relevant UK government receipts and expenditure in the rest of the UK and the latest available mid-year population estimate", and that "The adjustments will be calculated separately for all relevant areas of expenditure and revenue to aid transparency, and will then be applied to the Scottish Government's Resource block grant for the relevant financial year." Should the under-forecasting of UK benefit expenditure continue, this would result in the initial BGA being smaller than required. This creates a timing difference, which would be rectified later; paragraph C48 of the Fiscal Framework explains that once the outturn data is available, the block grant would be recalculated and the difference reconciled. The timing difference arising would therefore require to be managed, for example, by using the borrowing powers related to forecast error.

42. Where UK Government in-year spending diverges from forecast, an update to the BGA will be applied in-year at Supplementary Estimates, as described in paragraph C61 of the Fiscal Framework. This could result in Scotland receiving either a positive or negative consequential. However, if payments of *benefits* specific to the Scottish social security system are higher than forecast in-year, the funding would need to be found within the existing Scottish budget envelope and additional DEL budget cover obtained.

[14] With the exception of the devolution of Discretionary Housing Payments which are being treated as a Machinery of Government change. For Cold Weather Payments, the Fiscal Framework states that the baseline addition will be calculated differently, being the average of the spending on Cold Weather Payments in Scotland from 2008-09 to the year prior to devolution and reconciled to outturn.

43. There is a risk that UK Government policy changes which occur after the Scottish Government's budget has been set may lead to UK expenditure being less than forecast, which would require reconciling adjustments. The Fiscal Framework states in paragraph C62 that "in-year reconciliation adjustments will not automatically apply to any policy changes introduced by the UK government after the Scottish Government's budget. The Scottish Government may determine whether the adjustment will be made in-year to the block grant or whether this will be incorporated within the end-year reconciliation". The UK government policy change would then also be included within the forecasts for subsequent years utilised for block grant adjustments.

Uprating for inflation

44. The Bill provides Scottish Ministers with the power to vary the rates of assistance, which can be used to deliver the Government's commitment to uprate disability and employment-injury assistance in line with inflation.

45. The higher inflation which has been forecast by the Bank of England is likely to create pressure on social security expenditure in the future, and while the block grant adjustments for existing benefits would take inflation into account, the methodology of uprating of benefits for inflation is a source of financial risk as future policy differentials between Scotland and the UK for uprating could result in additional pressures on the Scottish Budget.

Policy differences

46. In a similar way to other policies, a risk arises from the potential difficulty in changing the trajectory of social security expenditure once the Scottish system is established; for example, changing eligibility criteria once a benefit has been introduced could be a difficult decision, and the creation of new benefits would be a long term commitment. Under the Fiscal Framework, the Scottish Budget would be exposed to the risk created by a lower trajectory of social security spending per capita in the rest of the UK affecting the block grant, so any policy that is more generous in Scotland relative to comparable spending in the rest of the UK would affect the amount of money available for other areas of spend.

Demographic differences

47. Demographic differences which affect the relative numbers of benefit claims in Scotland compared to the rest of the UK, such as an aging population, would have an impact on the Scottish Budget. As an illustration, demographic projections undertaken by the National Records of Scotland show that the number of people of pensionable age and over, per 1,000 people of working age, is projected to increase from 311 in 2015 to 397 in 2039[15]. Most of the benefits being devolved to Scotland support older people, people with disabilities and carers. As the relative proportion of working age people decreases, the funding of the social security system would face increased pressure in the future. In addition, the aging population will increase pressures in other devolved areas, such as health and social care. This is a complex policy area, and future policy decisions on social security will need to take into account the complex interactions between social security expenditure, tax, and economic growth.

Costs on the Scottish administration

48. There is an important distinction between the social security agency and the social security system: the agency is the means by which the Scottish social security system will be delivered in Scotland. How the overall system will operate is under development following the social security consultation undertaken between July and October 2016.

49. As the Minister for Social Security announced in the Scottish Parliament on 27 April 2017, the preferred option for the social security agency is a central agency with enhanced phone and on-line support which incorporates local face-to-face pre-claims and support services in existing public sector locations. The options for improving assessments (the process, medical or otherwise, by which eligibility for some of the benefits will be determined) are currently being explored, in partnership with the Disability and Carers Benefits Expert Advisory Group and Experience Panels.

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[15] Scotland's Population, 2015 infographic report, NRS, as shown on the SG website at http://www.gov.scot/Topics/People/Equality/Equalities/DataGrid/Age/AgePopMig

50. A significant amount of work was undertaken to reach this decision in the form of a two-stage options appraisal, culminating in an Outline Business Case (OBC)[16] which selected the preferred delivery model. The OBC followed the standard HM Treasury guidance and is aligned to both the Green Book and the five case model. A systematic, evidence-based approach was taken, using a multi-criteria framework to take into account the relevant socio-economic factors, enabling us to take into account the differences the options would make to the Scottish public's experience of social security delivery. The chosen delivery model represents the best value for money of the options considered, and is capable of delivering well against the National Outcomes.

51. The Scottish Government will incur implementation costs in establishing the Scottish social security system, in addition to the costs incurred in administering the system each year. The Smith Commission made clear that there should be "*…a share of the associated implementation and running costs in the* policy *area being devolved, sufficient to support the functions being transferred, at the point of transfer.*" The Fiscal Framework provides a baseline £66 million[17] for administration costs and a one-off amount of £200 million for implementation for all the newly-devolved powers. These amounts represents a fair financial settlement in the context of the wider flexibilities delivered by the Fiscal Framework. The sums do not however represent the full costs of implementation or administration and represent a share, rather than the totality, of implementation and on-going delivery. Any additional sums required would need to be funded from the existing Scottish budget envelope. Any required funds will be allocated as part of the normal Scottish Government budget process.

Costs on the Scottish Government of setting up the Scottish social security system

52. Implementation costs are the one-off costs to deliver an operational Scottish social security system, and will be driven by decisions on what is to be procured, the procurement route, and on the specification of detailed design work. This work is complex and the recent determination of the form

[16] Outline Business Case for the agency for social security in Scotland

[17] Or part thereof, at levels to be agreed between the Scottish and UK Governments, in the years leading up to full implementation.

that the agency will take was a key milestone. Further decisions will be taken at the appropriate times throughout the duration of the social security programme.

53. The main components of the implementation costs are expected to be information technology, estates, and staffing for the implementation programme. Work is on-going to determine the requirements for IT and estates which will achieve best value for money.

54. The social security programme is working to develop its design and procurement requirements for the IT systems required to deliver social security safely and securely. Building a robust and future-proofed system which delivers a high volume of payments will be a complex task: for example, the Scottish social security agency will be making more payments in a week than the Scottish Government currently makes in a year. Initial high-level estimates indicate that the IT implementation for the Scottish social security system, including an appropriate level of optimism bias, could cost in the region of £190 million for a four-year programme running to 2020-21; it should be emphasised that this is an initial estimate which could change materially, and firm estimates of cost will only become clear as the key decisions are taken and detailed plans developed. In addition, in line with HMT guidance, the level of optimism bias will be reduced as the costs are agreed, as the Scottish Government moves toward final delivery.

55. Work is on-going to determine where in Scotland the agency should be located, and the cost of estates is clearly contingent on that decision. Initial high level estimates indicate that the estates-related implementation costs, for leased property, could be around £14 million, but this would depend on the location, type of property, type of procurement (for example, lease versus build) and the extent of fit-out and other works required.

56. The third main area of implementation costs is the staffing of the social security programme. The total costs of the staff deployed on the programme is estimated to be in the region of £104 million over the four years to 2020-21.

57. At this stage, the estimates of implementation costs set out above total £308 million and will change materially as further decisions are taken and the programme of work to specify and procure the infrastructure required for Scotland's new social security system evolves.

58. At this early stage, it is not possible to provide a more detailed breakdown or phasing of the costs described above because the information is commercially sensitive while the procurement processes are on-going; commercial sensitivity is necessary in order to obtain maximum public value. The incorporation of the implementation funding into the Scottish Budget and any subsequent allocation for social security will be visible through the normal Budget process, as will any additional amounts that may be required.

Costs on the Scottish Government of running the social security system

59. The OBC for the agency focused on the steady state costs of running the agency once established (from 2020-21) under a prudent set of assumptions. The final costs are dependent on decisions on policy, delivery and operations that have yet to be made. The options appraisal set out the potential steady state running costs of the different options in order to provide an informed body of evidence to support the decision of what form the agency would take, including assumptions around caseloads and the costing of the functions and capabilities.

60. Following the development of the options, the Current Activity Based Model (CAB-M) was developed to enable them to be costed. CAB-M is an Excel based model which uses detailed activity-based information from DWP[18] on the administration of the benefits which will be devolved to Scotland. This activity-based information from DWP has been used to estimate the activity needed for Scotland to administer the benefits going forward by applying caseload forecasts for devolved benefits in Scotland in 2020-21 to estimate steady state costs.

61. In steady state, depending on the model of delivery for assessments, the point estimate costs of the preferred option range between £144 million and £156 million per annum[19] dependent on the model of assessments.

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[18] Information provided in confidence between Governments and not published by DWP.

[19] The CAB-M model updated to 2016/17 prices. The OBC for the Agency was in 2014/15 prices.

The cost range for the preferred option does not include optimism bias or contingency for expenditure on enabling systems.

Table 6 – Breakdown of preferred option steady state point estimate cost ranges by expenditure type.

Expenditure Category	**Steady State Annual Cost Range (Point Estimates)**[20] **£m**
Operating Costs[21]	83 to 84
Pre Claim Support Services	21
Assessment Services	25 to 34
Estates Services	15 to 17
Total	**144 to 156**

62. It would be desirable to validate these cost estimates against what it costs DWP to deliver the same benefits in Scotland. However, DWP can only provide cost data on the administration of benefits for the whole of the UK; they are unable to provide a Scotland-specific estimate. In the absence of this information, the Scottish Government estimate, from modelling, that the current DWP administration cost for the devolved benefits in Scotland is approximately £159 million per annum[22]. Against this benchmark, the upper point estimate costs of a Scottish social security agency of £156 million per annum is broadly comparable to DWP; furthermore, from Scottish Government scrutiny of the DWP Annual Report and Accounts the Scottish Government estimates that the DWP cost of

[20] The CAB-M model updated to 2016/17 prices.

[21] Includes all core operating costs and digital costs.

[22] The CAB-M model updated to 2016/17 prices.

administration of non-pensioner benefits is in the region of 6.3% of the amount being administered. The estimate of the steady state running costs of the agency for Social Security in Scotland is 5% of the value of benefits being administered.

63. This comparison demonstrates that the cost estimates for running a Scottish social security agency are credible.

Costs on the Scottish Fiscal Commission

64. The Scottish Fiscal Commission is a Non-Ministerial Department within the Scottish Administration with responsibility for the production of independent forecasts of revenues from the fully devolved taxes, revenues from non-savings non-dividend income tax in Scotland, onshore GDP and demand-led social security expenditure.

65. The Scottish Fiscal Commission will incur costs in order to produce these forecasts. These costs will begin from the year before each social security benefit is devolved as there will be set-up costs as well as on-going costs. The majority of costs incurred will relate to staffing. In addition a small share of the total non-staff costs incurred by the Commission will result from the requirement to prepare forecasts of social security expenditure; these will include office equipment, IT, training and other running costs associated with the employment of staff. The profile of the costs incurred by the Commission will depend on the timetable for the devolution of social security. As this is currently unknown, it is not possible for the Commission to accurately determine the future costs likely to be incurred at this stage.

Costs on local authorities

66. The preferred option for the agency incorporates face-to-face pre-claims and support services in existing public sector locations. Existing public sector locations may include local authority premises. It is a working assumption that local authorities would recharge the agency under a Memorandum of Understanding or similar agreement for the costs incurred in facilitating the provision of face-to-face pre-claim and support services from premises which they operate; estimates of these costs are built into the estimates of the agency steady state running costs discussed earlier.

Costs on the UK Government

67. Where the UK Government provides services on behalf of the Scottish Government, there will be a Memorandum of Understanding or similar agreement in place to define the scope of services to be provided and associated cost. This agreement will detail the mechanism by which the UK Government calculates and subsequently recovers from the Scottish Government the cost of the services provided. For example work required by DWP as part of the Scottish Government's social security programme will be costed and agreed as necessary.

68. The Fiscal Framework agreement between the UK Government and Scottish Government details that there should be no detriment as a result of UK Government or Scottish Government policy decisions post devolution.

69. Specifically, where either Government makes a policy decision that affects the tax receipts or expenditure of the other, the decision-making government will either reimburse the other if there is an additional cost, or receive a transfer from the other if there is a saving. These financial consequences of policy decisions have been termed policy spillover effects.

70. The main categories of policy spillover effects are:

- Direct effects – these are the financial effects that will directly and mechanically exist as a result of policy change (before any associated change in behaviours); and
- Behavioural effects – these are the financial effects that result from people changing behaviours following a policy change.

71. Other indirect or second-round effects may also arise from policy changes, and the Governments have agreed that the financial consequences of these should not be included in the scope of the 'no detriment' principle. This is because of the difficulty in demonstrating and agreeing both causality and the scale of any financial impact.

72. The Scottish Government is currently considering with UK Government the production of guidance setting out how the Fiscal Framework provisions on policy spillovers should be applied in practice.

Final arrangements will be agreed by Scottish and UK Ministers at the Joint Exchequer Committee (JEC).

Costs on other bodies, individuals and businesses

73. It is expected that the introduction of a Scottish social security system will cause additional requests for information and support. This could impact on existing advice services although the Scottish social security agency will help mitigate this impact through the provision of pre-claims support services. The extent of additional support required will be dependent on the timing and extent of change to the social security system in Scotland. The Scottish Government will continue to engage with advice service provider, as the programme to implement the social security system in Scotland progresses.

74. The preferred option for the agency may include co-location with local authorities, but may also include co-location with other public sector bodies. As for local authorities, the expectation is that the full cost incurred in facilitating the provision of face-to-face pre-claim and support services would be recharged to the agency.

75. Under the existing UK system, where a right to appeal exists, an individual is able to make an appeal to an independent body, the First Tier Tribunal (FTT), to seek to overturn the benefit decision. The Scottish Government's initial response to the consultation, published on 22 February, set out that: "if someone disagrees with our decision after it has been reviewed, then they will be able to appeal against it".

76. The mechanism designed and implemented for a Scottish appeal process will have an impact on the Scottish Courts and Tribunal Services (SCTS). All tribunals administered by SCTS are funded by the relevant policy areas within the Scottish Government. Until the funding for a social security tribunal is baselined with the SCTS, each year discussions with SCTS will require to take place to agree the funding required based on the forecast activity of the relevant tribunal. The Scottish Government is at present unable to quantify the financial impact and will continue consulting with SCTS as plans develop in this area. The Scottish Government will also engage with the UK Government on the funding transfer that may be appropriate to reflect the devolution of a social security tribunal.

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