

The impact of COVID-19 on the public finances and the Fiscal Framework

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Introduction

The COVID-19 crisis and its impacts highlight the pressing need for rights based decision making to guide law, policy and financial decision making. Rights based policies backed by targeted financial resource will be critical to ensure inequalities are not exacerbated in both the short and longer terms. Human rights, in particular economic, social and cultural rights, enshrined in international law but not yet in domestic law, provide a strong legally grounded framework to guide fiscal policy. This submission sets out how rights can guide the fiscal responses to this crisis and economic recovery in longer term.

The 2012 and 2016 Scotland Acts delivered new financial and social security powers and responsibilities to the Scottish Parliament, resulting in a significant shift in the nature of Scottish public finances. This now means that the Scottish budget is becoming increasingly complex, with more available choice over taxation and spending, as well as how and when new financial powers can be used.

Even before the arrival of COVID-19, Audit Scotland noted that *“understanding the opportunities and risks associated with the operation of the Fiscal Framework, and how these are unfolding, is critical to the effective oversight of the Scottish public finances”*¹. This is ever more important in the context of the COVID-19 pandemic, where the significant impact of the virus – and responses taken to it – on Scotland’s health, wellbeing and economy will be felt in terms of its impact on public finances for many years to come.

The Commission and the ALLIANCE welcome the opportunity to respond to the Finance and Constitution Committee’s inquiry into the potential impacts of COVID-19 on the public finances and the Fiscal Framework. This focus is especially important in light of the postponement of some of the standard in-year budgetary oversight mechanisms, including the publication of: Scotland’s Medium Term Financial Strategy; the Scottish Fiscal Commission’s tax, spend and borrowing forecasts; and the planned Scottish Government multi-year Resource Spending Review (post-UK Spending Review).

The remainder of this response will focus on setting out **what makes a ‘good’ budget, and why taking a human rights based approach to fiscal scrutiny and public finance decisions would help navigate the current crisis and the economic recovery beyond.**

What makes for a ‘good’ budget?

A human rights based approach to budgeting stresses the important role that government plays in the economy, especially around redistribution and progressive taxation in order to invest in public goods and services, that as a society we agree are necessary to secure the realisation of rights. It involves considering whose voices are heard in, and how different groups are affected by, a government’s budgetary decisions, with reference to human rights standards in order to make that assessment.

Closely aligned to the terms of a “wellbeing economy”, human rights budgeting asserts that there are values, goals and objectives which extend beyond purely economic ideas that budgets must be pressed to serve. This requires a willingness to challenge and re-think some of the assumptions that current fiscal policy and budgeting are built on.

Human rights budgeting recognises that budgetary decisions have materially different outcomes for different groups. Government budgets are not always sensitive to this. In particular, the contributions that households, individuals (especially women) and communities make to the economy — by caring for people, for example — are not always recognised because they are not bought and sold through the market. For this reason, it is not uncommon for budgets to reinforce systematic inequalities between groups—in particular between men and women—and miss opportunities to use public financing to improve the position of disadvantaged and marginalised groups. As the Committee knows, COVID-19, and the responses being taken to it, is not affecting everyone in society in the same way, and there is already a disproportionate impact on people with protected characteristics and those living in the most deprived communities.

Why talk about human rights in public finance and budgets?

All governmentsⁱⁱ must *respect, protect and fulfil* human rights. The way they generate, allocate and spend money plays a key role in this.

Human rights are legal obligations that bind all future governments, regardless of who is in power. Those responsible for making and scrutinising public finance decisions, therefore, need to understand the ‘why and how’ of taking a human rights based approach, which starts from two quite simple assertions:

Human rights **principles** shape the **process** of budgeting.

Human rights **standards** shape the **goals** of the budget.

Human Rights Principles ensure that process and decisions are *transparent* and *accountable* and include the *meaningful and active participation* of rights holders (citizens).

Human Rights Standards bind any country — like the UK, including Scotland — that has signed up to the International Covenant of Economic, Social and Cultural rights (ICESCR) to take positive steps (including budgetary) to:

- satisfy minimum essential levels or a *minimum core* of each rightⁱⁱⁱ,
- increase the *availability, accessibility, acceptability and quality* of goods and services,
- *progressively realise* people’s rights—the minimum core is not a ceiling of achievement, but a basic floor of provision to build from,
- not take deliberately *retrogressive measures*, and
- use the ***maximum of their available resources*** to realise rights.

Designing a human rights compliant budget ensures that resources are used effectively and without discrimination.

Before the development of the budget comes the development of laws, regulations, policies and plans that are shaped by human rights norms. The norms draw on the content of the specific rights and help to identify what a government should prioritise its spending on (minimum core and

non-discrimination) and work towards achieving (progressive realisation and non-retrogression). Understanding the way that government obligations are framed in international human rights law helps to set the scene for how these duties can be leveraged as a driver for more equitable, people-centred budgetary decisions in the Scottish context.

This approach also examines what effort has been made to generate resources.

- Does the taxation system raise the maximum available funds?
- Who are resources generated from? Are any groups impacted unjustly?
- Has tax evasion, avoidance and debt been reduced in line with EU standards?

Resources must also be spent the way they were intended to be. For example, unspent allocations highlight that a government has not made the 'maximum use of available resources'. In-year and mid-year reviews are crucial in highlighting whether budget allocations are being fully spent and if not, what plans exist to re-invest any surplus finance in rights (in a transparent, participative and accountable way).

Lack of resources is a common reason given by governments for being unable to fulfil their human rights obligations (especially economic and social rights, and particularly in times of economic crisis). This should not go unchallenged. In 2012, Spanish civil society used human rights budget analysis to challenge the government's assertion that austerity was the only public finance solution to reduce the public deficit. In partnership with tax inspectors, they demonstrated that if Spain had reduced the size of its shadow economy by ten percent (bringing it in line with EU standards), it could have generated €38 billion, exceeding the total budget cuts that year.^{iv}

Whilst there is ongoing uncertainty about the exact impact of COVID-19 on future devolved tax revenue (see Appendix 1), it is very clear that it will be considerable. The issue of how and who we tax in Scotland has been explored before, with limited steps taken towards a more progressive system of taxation. Scotland can choose to approach COVID-19 economic recovery by creating a more progressive system

that maximises available resources in line with its human rights obligations. Public and political support^v for the willingness to put conditions on financial bailouts for those who are resident in tax havens, highlights growing political will to explore the fairness of how revenue is generated as we enter the recovery phase.

To support the processes of budgeting and budget scrutiny, it helps to translate the human rights standards outlined above into a series of normative questions. The table below sets out questions based on the standards relevant to resource generation, allocation and spend.

Table 1: Assessing Budgets Against Norms^{vi}

	Generation	Allocation	Spending
Minimum Core	Is sufficient revenue generated to invest in realising basic levels of rights for all?	Do allocations prioritise the achievement of basic levels of rights for all?	Do financial management systems ensure efficient management of funds allocated?
Non-Discrimination	Who are resources generated from? Are particular groups unjustly impacted?	Do allocations prioritise closing the gaps in human rights enjoyment between different groups?	Have funds been redirected in a way that disproportionately impacts particular groups?
Progressive realisation and non-retrogression	Is (or could) government revenue increase?	Are allocations growing or shrinking? Are reductions justified (in human rights terms)?	Have financial management systems improved or weakened over time?

A time to re-focus on the budget process

A rights based approach involves focusing on the processes by which budgets are developed and scrutinised. Human rights principles support the development of transparent and accountable budgets which include the meaningful and active participation of rights holders.

Given the considerable amount added to the Scottish budget (£3.6 billion) by the UK Government in recent weeks, coupled with changes to the Scottish Government spending priorities over the last eight weeks, the Commission welcomes the publication of a summer budget revision. It is critical for Scotland's economic wellbeing and public confidence that this budget revision fully explores:

- How has new money been allocated?
- Have previous allocations been shifted and, if so, where to?
- What is no longer being funded?
- Have thorough equality and human rights impact assessments been completed in order to highlight the impact/s of these decisions?

It is important that the Scottish Government has been able to make quick financial decisions to support its economy, citizens and public services, at this difficult and uncertain time. It is equally and critically important that there is full transparency over the decisions that have been made to enable legislative, auditory and public oversight and ensure that the Scottish Government remains accountable for its decisions.

On May 14th 2020, the Commission wrote to all MSPs to raise awareness of recent research that explores how Scotland compares globally, through the Open Budget Survey (OBS), in transparency, oversight and public participation in the budget process.^{vii} The research shows that Scotland performs relatively well in budgetary oversight. However, when it comes to fiscal transparency and public participation, Scotland falls significantly short of globally recommended standards. Audit Scotland has highlighted that good in-year monitoring and decision making has become increasingly important in line with the complexity of

Scotland's Fiscal Framework.^{viii} One of the key reasons that Scotland's OBS fiscal transparency score was so low was due to the lack of publicly available key documents such as in-year and mid-year reports.

Having speedy access to the right information is especially important at this point in time, when so much uncertainty exists about the short and longer term impacts of COVID-19 on the Fiscal Framework and current public finances. Appendix 1 sets out some of this uncertainty.

Conclusion

Public finances in Scotland are increasingly complex and currently difficult to forecast. Therefore, understanding how rapid changes in both the health and economics of the nation will influence the budget throughout 2020/21 and beyond is challenging. There is an expectation of some difference between the economic impact in Scotland and the rest of the UK. This could be either positive or negative in relation to Scottish resource generation, but predicting these differences is not possible at present. However, as uncertain as things are and may remain, this cannot justify a lack of transparency, accountability and public participation in Scotland's budgetary process.

The Fraser of Allander Institute has highlighted that the Fiscal Framework — due to be reviewed in 2021/22 — was already proving insufficiently flexible before COVID-19.^{ix} When the review goes ahead (whether as planned or at another time), it would be enhanced by a good understanding of how well the Framework responded to this major economic crisis. A thorough evaluation of the Fiscal Framework's strengths and weakness in response to COVID-19 will support its improved development.

Transparency within and on-going monitoring of the Scottish Budget is critical as the situation evolves, especially as traditional methods of oversight and forecasting have been postponed (e.g. MTF). The Scottish Government must be held to account to provide regular and comprehensive updates about changes to its funding position, its spending decisions, and evolving budgetary risks. These updates should include an equality and human rights impact assessment of policy

decisions, including budgetary ones, in order to fully understand the impact on individuals, especially the most marginalised. This analysis must also set out where previously committed funds are now no longer being spent and the impact (and possible unintended consequences) of those changes.

The Commission and the ALLIANCE recognise that good rights based laws, policies and intentions can still result in unacceptable experiences for rights holders if they are not properly resourced, and that simply taking human rights standards into account when developing the budget is not a magic bullet. It can, however, help everyone ask the right questions and support effective, transparent, fair and accountable use of our national resources.

Appendix 1 – The knowns and uncertainties about Scotland’s Fiscal Framework and public finance and the impact of COVID-19

Known aspects of current public finance and Fiscal Framework	Relevant human rights standards & principles
<p>The Scottish budget is determined through a combination of the block grant (determined via the Barnett formula), devolved tax revenue and a ‘block grant adjustment’.</p> <p>The arrangements in the Fiscal Framework mean there will be no effect on the Scottish budget in 2020-21 as this funding is fixed for the year.</p> <p>The impact of COVID-19 on income tax revenues and LBTT, as well as non-domestic rates (though temporary relief) will be significant in Scotland – with likely reductions in tax revenues and increases in social security spending.</p> <p>The Scottish budget is protected against the risk of fiscal shocks that impact Scotland proportionately in the same way as the UK.</p> <p>The Scottish Government has limited borrowing powers to deal with fiscal uncertainty and volatility, but it cannot borrow to fund any additional COVID-19 related spending.</p>	<p>Resource Generation; Minimum Core</p>
<p>Increased spending by the UK Government has meant that the 2020/21 Scottish budget has proportionately grown by 11% (£3.6bn) since the budget was announced in February 2020.</p> <p>Any changes to income tax funding for 2020-21 will be applied to the Scottish budget in 2023-24 through a reconciliation.</p>	<p>Resource Generation; Progressive Realisation and Non-retrogression</p>

<p>The Scottish budget is not insured against the risk that COVID-19 might have a disproportionate fiscal impact on Scotland compared to the rest of the UK (rUK).</p> <p>There remain a number of unresolved issues in the Fiscal Framework, including: the timing of reconciliations between different indexation mechanisms, the timing and methodologies underpinning Scottish tax forecasts, and the timing of the calculation of some aspects of the Block Grant Adjustments. These are due to be negotiated after the 2021 Scottish Parliamentary elections.</p>	
<p>Most of the significant economic policy responses to COVID-19 are implemented by the UK Government covering the whole of the UK (e.g. the Job Retention Scheme, the Self-Employment income support scheme and changes to Universal Credit).</p> <p>The Scottish Government has made a number of large financial policy commitments in response to COVID-19, including: support to third sector organisations, grants for SMEs and increased pay for social care workers.</p>	<p>Resource Allocation; Minimum Core</p>
<p>Before the arrival of COVID-19, the Scottish Government (and those scrutinising the budget) had already expressed concern about the uncertain environment within which it had to prepare and publish its budget plans for 2020/21.</p> <p>Forecasting in the current crisis is impossible. As such, the Scottish Fiscal Commission has been absolved from updating its tax, spend and borrowing forecasts in May 2020.</p> <p>Scotland's Medium Term Financial Strategy (due in May 2020), which sets out risks associated with spending, revenues and borrowing, has been postponed.</p> <p>The UK Government's Spending Review planned for the summer of 2020 has been delayed.</p> <p>The planned Scottish Government multi-year Resource Spending Review (post-UK Spending Review) has been postponed.</p>	<p>Transparency</p>

Uncertain aspects of current public finance and Fiscal Framework	Relevant human rights standards & principles
<p>The impact of COVID-19 on devolved tax revenues.</p> <p>The sustained impact of COVID-19 on the global oil price.</p> <p>The fiscal responses to COVID-19 required by both the Scottish and UK Governments.</p> <p>The consequential (positive or negative) expected from the UK Government for future years.</p>	<p>Resource Generation; Minimum Core</p>
<p>The impact of a false re-start of the economy and resources if scientific evidence states that a second (and subsequent) wave requires restrictions to be reinstated.</p> <p>How quickly the Scottish economy will recover (and how similar/different that recovery compares to rUK).</p> <p>The potential gap in impact of COVID-19 on Scotland's economy vs rUK, which could mean Scotland risks suffering a disproportionate fiscal impact from the virus.</p>	<p>Resource Generation; Progressive Realisation and Non-retrogression</p>
<p>The duration of COVID-19, including future waves and in turn the duration and scale of the required response to COVID-19.</p>	<p>Resource Allocation; Minimum Core</p>
<p>The divergence in timescale of economic lockdown between Scotland and rUK and what this might mean for the resource allocation of both UK Government administered support e.g. the Job Retention Scheme, and Scottish measures such as business rates relief.</p>	<p>Resource Allocation; Progressive Realisation and Non-retrogression</p>

Uncertain aspects of current public finance and Fiscal Framework	Relevant human rights standards & principles
<p>The impact of COVID-19 on devolved social security expenditure.</p> <p>The impact of COVID-19 on health and social care expenditure, based on longer-term population ill/health (including the impacts of 'lockdown' on the mental health of the nations) – and the impact of any specific differences in such allocations between Scotland and rUK.</p>	<p>Resource Spend; Progressive Realisation and Non-retrogression</p>
<p>The timing of UK fiscal events this year (2020/21), including the next UK Budget, the postponed Spending Review (and subsequent multi-year Resource Spending Review in Scotland).</p> <p>When postponed policy commitments will be honoured (e.g. increased childcare provision and roll out of new benefits).</p>	<p>Transparency</p>
<p>If the 2021 Scottish Parliamentary elections will go ahead as planned (which could impact on the fiscal framework negotiations planned for negotiated after the 2021 Scottish Parliamentary elections).</p>	<p>Participation</p>

ⁱ Audit Scotland (2019) Briefing: Scotland's new financial powers Operation of the Fiscal Framework 2018/19, Edinburgh. See <https://www.audit-scotland.gov.uk/report/scotlands-new-financial-powers-operation-of-the-fiscal-framework-201819>

ⁱⁱ Government is meant in its widest sense, national and local.

ⁱⁱⁱ Guidance on what the minimum core should mean in practice is contained within General Comments of the various UN Treaty Body Committees:

<https://www.ohchr.org/EN/HRBodies/Pages/TBGeneralComments.aspx>

^{iv} http://cesr.org/sites/default/files/FACT_SHEET_SPAIN.pdf

^v See <https://www.independent.co.uk/news/business/news/scotland-tax-have-ban-coronavirus-bailout-fund-a9526006.html>; <https://www.theguardian.com/politics/2020/may/21/scotland-bans-covid-19-support-firms-tax-havens>; <https://www.dailymail.co.uk/news/article-8344973/Scotland-bans-companies-based-tax-havens-using-coronavirus-relief-funding.html>; <https://www.taxjustice.net/2020/05/21/scotland-joins-wave-of-countries-blocking-tax-haven-tied-corporations-from-receiving-covid-19-bailouts-tax-justice-network-responds/>

^{vi} <https://www.scottishhumanrights.com/media/1912/hrbw-paper-5-vfinal.docx>

^{vii} This work was supported by the Health and Social Care Alliance Scotland, Glasgow University, Glasgow Caledonian University and the New York based Center for Economic and Social Rights. The summary and full report can be accessed here:

<https://www.scottishhumanrights.com/media/2013/scotland-2019-obi-summary-report-vfinal.pdf>

<https://www.scottishhumanrights.com/media/2014/scotland-2019-obi-report-vfinal.pdf>

^{viii} Audit Scotland (2019) Briefing *ibid*.

^{ix} See <https://www.scottishparliament.tv/meeting/finance-and-constitution-committee-may-14-2020>