Scottish Fiscal Commission

Scotland's Economic and Fiscal Forecasts December 2018

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Foreword

The Scottish Fiscal Commission is the independent fiscal institution for Scotland. Our statutory duty is to provide independent and official forecasts of Scottish GDP, devolved tax receipts and devolved social security expenditure to inform the Scottish Budget. This report is our third set of forecasts, covering the years 2019-20 to 2023-24.

Our forecasts represent the collective view of the Scottish Fiscal Commission, comprising the four Commissioners. We take full responsibility for the judgements that underpin them.

Our judgement on the UK-EU negotiations was formed based on information available up to the time that our economy forecasts closed on 27 November 2018. The forecasts set out in this report were provided to the Scottish Government on 4 December 2018. We expect to produce our next forecasts in summer 2019 to support the Government's Medium Term Financial Strategy.

As with each fiscal event, our relationship with the Scottish Government has evolved further as we prepared this set of forecasts and we will continue to learn from what works well and what could be improved. In producing our forecasts we have put into practice the revised Protocol agreed with the Scottish Government in March this year.

Our forecasts rely on data from a range of providers and we are grateful for their support. In particular we would like to thank Revenue Scotland for their work to ensure that we were able to incorporate as much of their data as possible in the forecasts. We would also like to thank officials from the Scottish Government, Revenue Scotland, HMRC and the OBR for their constructive challenge of our judgments and for ensuring that we considered all the available evidence.

The Scottish Government's budget is increasingly determined by devolved tax receipts and social security spending. Our independent forecasts are now playing a greater role in the budget arithmetic and are reflected in the Scottish Budget published today.

We would like to thank once again the hard-working staff of the Commission for their support in the production of our forecasts and underpinning analysis.

Dame Susan Rice DBE	Professor Francis Breedon
Professor Alasdair Smith	Professor David Ulph

12 December 2018

Contents

Scotland's Economic and Fiscal Forecasts — December 2018

Economy

Economy	2018	2019	2020	2023	% growth
GDP	1.4	1.2	1.0	1.2	Growth has been revised up in the shorter term, growth in the longer term is subdued
Trend Productivity	0.3	0.7	0.9	1.2	Productivity growth gradually starts to increase after decade of slow growth
Nominal Earnings	2.0	2.3	2.5	3.1	Nominal earnings higher than in our May 2018 forecast, and expected to gradually increase
Real Earnings	-0.3	0.3	0.5	1.1	Real earnings growth expected to remain low by historic standards

Tax

Tax	2018-19	2019-20	2020-21	2023-24	£ million
Income Tax	11,452	11,684	12,285	13,805	In 2019-20, income tax revenue is expected to be £661 million lower compared to our May 2018 forecast
Non-Domestic Rates	2,827	2,785	2,887	3,332	New policy measures announced and data updates have reduced our forecast across the period
LBTT	569	643	680	787	Residential LBTT forecasts revised down, but new policies on ADS and non-residential LBTT increase forecasts
Scottish Landfill Tax	136	104	83	14	The Scottish Government's ban on the landfill of biodegradable municipal waste reduces the forecast from 2021

Social security

Social security	2018-19	2019-20	2020-21	2023-24	£ million
Carer's Allowance (inc. Supplement)	191	320	345	412	Carer's Allowance was devolved in September 2018. Carer's Allowance Supplement was introduced in 2018
Discretionary Housing Payments	61	63	65	69	Forecast increases driven by rise in the cost of mitigating the bedroom tax
Employability	19	19	28	0	In April 2018 Fair Start Scotland started accepting referrals for three years. Spending peaks in 2020-21

Policy Announcements - Tax

Policy Announcements - Tax	2019-20	2020-21	2023-24	£ million
Income Tax	68	71	84	Higher rate threshold is set at £43,430, the same as in 2018-19
Non-Domestic Rates	-42	-46	-44	Poundage set at 49.0p, continuation of transitional relief and the introduction of a relief for new fibre
LBTT	39	38	41	Increase in Additional Dwelling Supplement rate to four per cent. Changes to non-residential LBTT rates and thresholds

Policy Announcements - New Benefits

Policy Announcements - New Benefits	2019-20	2020-21	2023-24	£ million
Best Start Grant	12	13	15	Best Start Grant consists of three payments: Baby and Pregnancy, Early Learning and School-Age
Funeral Expense Assistance	6	6	7	Funeral Expense Assistance replaces Funeral Payments in 2019
Best Start Foods	4	5	4	Best Start Foods replaces Healthy Start Vouchers in 2019

Summary

Introduction

1 The Scottish Fiscal Commission is responsible for producing independent economic and fiscal forecasts to inform the Scottish Budget.

2 We produce five-year forecasts of Scottish Government tax receipts and social security expenditure, and the Scottish economy. We also assess the reasonableness of the Scottish Government's borrowing projections.

3 This summary and the full report set out our forecasts and assessments, and the main judgements and developments underpinning them. We are committed to being as open and transparent as possible. We provide further detail on our forecasts throughout this report, and provide workbooks including additional details and breakdowns are available on our website.

4 Our fiscal forecasts are an important determinant of the total budget that is available to the Scottish Government. The other main determinants of the Scottish Government's budget are the Block Grant and the Block Grant Adjustments, which are determined by the UK Government.[1] Our economy forecasts are a significant component of our fiscal forecasts. Our forecasts also determine whether there is a Scotland-specific economic shock, which would trigger additional borrowing powers.

Economy

5 Our forecast of GDP is shown in Table 1. Average annual GDP growth since 2010 has been around 1 per cent, below the rate of GDP growth in earlier decades. Following a strong performance in the production industry and exports in 2017 and 2018 so far, we forecast GDP growth of 1.4 per cent in 2018 and 1.2 per cent in 2019.

[1] Further information on how our forecasts factor into the Scottish Budget can be found from paragraph 31 onwards.

6 We do not expect this stronger growth to be sustained beyond 2019. We expect economic growth to be subdued in the longer term, averaging just over 1 per cent over the next five years.

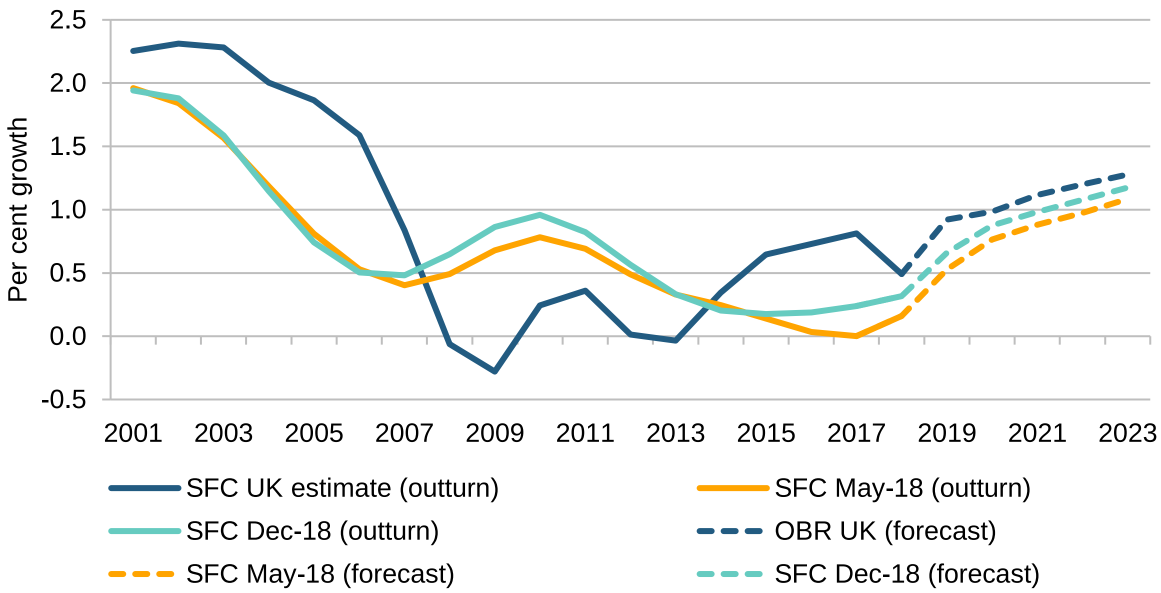
Table 1: Scottish GDP growth forecast, calendar year basis (per cent)

(%)	2017	2018	2019	2020	2021	2022	2023
GDP growth	1.4	1.4	1.2	1.0	1.0	1.1	1.2

Source: Scottish Fiscal Commission
Shading shows outturn available at time of publication.

7 Our expectation of relatively subdued growth over the next five years is primarily the result of slow productivity growth. As Figure 1 shows, trend productivity growth has been declining in Scotland since the early 2000s. We expect the growth rate of productivity to gradually increase over the next five years, and we have slightly revised up our forecast since May 2018.

Figure 1: Trend productivity growth in Scotland and the UK



Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – May 2018 (link), ONS (2018) Labour Productivity, UK: April to June 2018 (link), OBR (2018) Economic and Fiscal Outlook October 2018 (link).
The OBR does not publish a historical series for trend productivity growth. The series we provided is based on our smoothed series of ONS outturn data for UK actual productivity.

8 Other factors leading to a subdued longer-term economic outlook include slow population growth, particularly in the 16 to 64 age group, weak demand from the UK continental shelf oil and gas industry as a result of volatile oil prices, the effect of Brexit on the economy, and, weak growth in household incomes.

9 The potential effect of Brexit on Scotland remains highly uncertain. Our forecast over a five-year horizon broadly assumes a relatively smooth and orderly Brexit process. We consider a no-deal Brexit to be a downside risk to our forecast.

10 Although we continue to expect growth in the longer-term to be subdued, we do expect slightly higher growth throughout the forecast period than we did in May. Our headline economy forecasts are shown in Table 2, with comparisons to the forecasts we published in May.

Table 2: Headline economy forecasts, May 2018 and December 2018, calendar year, figures are per cent growth rates unless otherwise stated

GDP	2017	2018	2019	2020	2021	2022	2023
May 2018	0.8	0.7	0.8	0.9	0.9	0.9	0.9
December 2018	1.4	1.4	1.2	1.0	1.0	1.1	1.2
Trend productivity							
May 2018	0.0	0.2	0.5	0.8	0.9	1.0	1.1
December 2018	0.2	0.3	0.7	0.9	1.0	1.1	1.2
Average nominal earnings							
May 2018	1.1	1.6	1.9	2.2	2.6	2.9	3.2
December 2018	1.5	2.0	2.3	2.5	2.8	3.0	3.1
Average real earnings							
May 2018	-1.0	-0.5	0.0	0.3	0.6	0.9	1.1
December 2018	-0.6	-0.3	0.3	0.5	0.6	0.9	1.1
Employment (millions)							
May 2018	2.64	2.65	2.65	2.65	2.66	2.66	2.66
December 2018	2.64	2.64	2.65	2.65	2.66	2.66	2.66

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – May 2018 (link).
Shading shows outturn available at time of publication.

11 There have been three important developments since May 2018 which have led to these upward revisions:

- GDP growth over the last two years has been stronger than we expected in May 2018 following new data releases and revisions to past GDP data. This more positive performance has been driven, in part, by growth in the production industry and exports. As a result of these upward revisions to the data, we have increased our forecasts of economic growth in the near term.

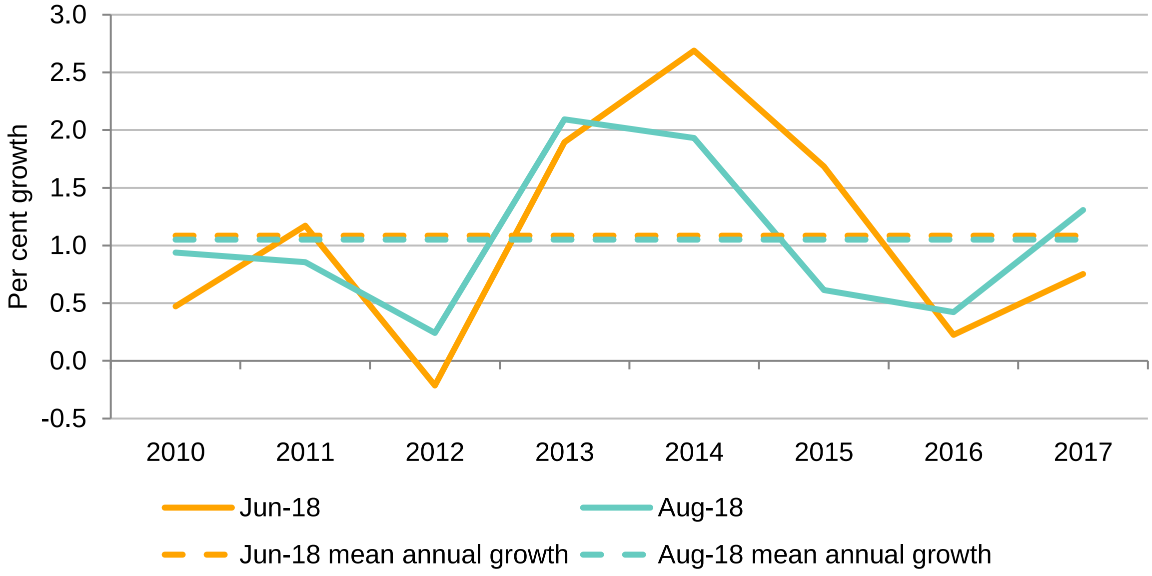
- Government expenditure in Scotland is expected to grow significantly faster than we had previously forecast. This has been driven primarily by increases in UK Government expenditure announced in the UK Budget in October 2018. Via the Block Grant, this also increases the budget for the Scottish Government. We expect this to support higher GDP growth over the next five years.

- Though growth in earnings remains slow, earnings data for 2018 have been a little stronger than we expected in May. In addition, stronger growth in GDP and productivity will support stronger growth in earnings. We have therefore revised our outlook for real earnings growth upwards by around 0.2 to 0.3 percentage points over the next few years.

Determinants of change in our forecasts: new GDP data

12 The latest GDP figures for Scotland show stronger growth in the economy over the last two years than the data available in May 2018 suggested, as shown in Figure 2.[2] This follows significant revisions to GDP estimates, primarily driven by changes to measures of activity in the construction industry. The revisions imply stronger GDP growth in 2017 than was estimated when we published our May 2018 forecasts.

Figure 2: Revisions to Scottish GDP



Source: Scottish Fiscal Commission, Scottish Government (2018) Scotland's Gross Domestic Product Quarter 1 2018, June 2018 (link), Scottish Government (2018) Quarterly National Accounts Scotland Quarter 1 2018, August 2018 (link).

13 GDP data for 2018 Q1 and Q2 suggest this higher GDP growth is continuing in 2018, with quarterly growth of 0.4 per cent and 0.5 per cent respectively. These higher than expected results have led us to revise up our near-term outlook for GDP growth, with our forecasts of GDP growth in 2019 increasing from 0.8 per cent to 1.2 per cent.

14 While GDP growth has recently increased, average growth since 2010 remains low. We do not think higher growth over the last six quarters on its own provides compelling evidence to alter our longer-term outlook at this time. Our outlook for GDP growth remains subdued over the longer term.

Determinants of change in our forecasts: higher government expenditure

15 At the UK Budget in October 2018, the UK Government saw an improvement in its underlying budget deficit in 2018-19 of £12 billion, with greater

[2] For further information see Scottish Fiscal Commission (2018) Forecast Evaluation Report (link)

improvements for later years. The UK Government has chosen to spend much of this gain. This increases total government spending in Scotland in two ways: the Scottish Government will receive extra funding via the Block Grant as a consequence of higher UK Government spending, and the expenditure of other UK Government departments in Scotland may also increase directly.

16 The primary drivers of the Scottish Government's budget are the Block Grant, our tax forecasts, and the corresponding Block Grant Adjustments (BGAs). Table 3 shows how the Block Grant, and the net effect of our tax forecasts and the BGA, have changed since our May 2018 forecasts.

Table 3: Changes in Scottish Government resource expenditure forecasts since May 2018

£ million	2019-20	2020-21	2021-22	2022-23	2023-24
Base resource spending limit (block grant)	27,633	28,822	29,688	30,596	31,631
Change since May 18	570	1,468	1,840	2,255	
Net BGA	271	281	284	310	329
Change since May 18	89	7	-127	-203	

Source: Scottish Fiscal Commission, Scottish Government.

The figures for 2019-20 are consistent with Budget 2019-20. Figures for 2020-21 onwards are Scottish Fiscal Commission forecasts. The Scottish Government's budget is also affected by funding for social security and some non-budget elements. The Block Grant accounts for most of the Scottish Government's base resource spending limit, but there are other minor elements included in these figures.

17 As a result of a significantly higher Block Grant, total government expenditure in Scotland is forecast to be greater over the next five years than we expected in May, leading to significantly higher spending and demand in the economy. Compared to our May 2018 forecast of real growth in government consumption of 0.8 per cent, we now expect real government consumption to grow by 1.4 per cent in 2019-20. Real government consumption growth has been revised up by between 0.5 and 1.1 percentage points in each year of the forecast.

18 Government expenditure accounts for around quarter of the economy, and so these large revisions to the outlook for government expenditure will create significant additional demand in the economy. We expect this not only to support higher demand driven GDP growth in the short term, but also to lead to slightly greater trend GDP growth in the longer term. As a result, we have revised up our forecast of trend productivity growth by 0.1 percentage points in each year from 2019-20 onwards.

Determinants of change in our forecasts: earnings

19 Table 4 shows the data on earnings available at the time of our May 2018 forecasts and the latest data available on earnings. In previous decades, average nominal earnings in Scotland have grown by around 4.0 to 4.5 per

cent annually. Since 2010, earnings growth has slowed significantly averaging around 1.7 per cent a year.

Table 4: Data on average nominal earnings in Scotland, annual growth (per cent)

Data source	Forecast	Average 2010 to 2015	2016	2017	2018
ASHE	May-18	1.2	2.5	1.0	
	Dec-18	1.2	2.5	0.9	*3.3*
RTI	May-18		1.1	2.0	
	Dec-18		0.7	2.1	*1.9*
LFS	May-18	1.8	4.0	-1.5	
	Dec-18	1.8	4.0	-1.5	*1.4*
QNAS COE based measure [1]	May-18	2.2	2.7	1.5	
	Dec-18	2.0	3.9	1.4	*0.5*
Average	May-18	1.7	2.6	0.8	
	Dec-18	1.7	2.8	0.7	*1.8*

Source: Scottish Fiscal Commission, ONS (2018) ASHE access via nomisweb (link), HMRC (2018) UK Real Time Information (link), ONS (2018) Labour Force Survey gross weekly earnings of full-time employees by region (link).
Italics for 2018 show part-year outturn data expressed as annualised values for comparison to previous years.
[1] QNAS only contain COE data for the whole economy. It does not report average annual earnings figures. The data we present in this table are based on Scottish Fiscal Commission calculations applied to QNAS COE data.

20 The data available in May 2018 showed a mixed picture on earnings, but with generally very weak earnings growth for 2017. In our May 2018 forecasts we made a significant downward revision to our outlook for earnings growth compared to our December 2017 forecast. This decision was based in part on the weak earnings data for 2017, but was also an evolution of our judgement, recognising the persistently weak growth in earnings since 2010. Table 2 also shows the latest figures including new part-year data for 2018 which suggest a strengthening of earnings growth in 2018 compared to 2017. The four data sources suggest growth in earnings of around 1.8 per cent, slightly stronger than our May 2018 forecast of 1.6 per cent. Higher growth in public sector pay also leads us to expect earnings growth to increase.

21 Table 5 shows our current and previous earnings forecasts.

Table 5: Average nominal earnings growth, successive forecasts (per cent)

(%)	2017	2018	2019	2020	2021	2022	2023
December 2017	2.0	2.2	2.4	2.6	2.8	3.1	
May 2018	1.1	1.6	1.9	2.2	2.6	2.9	3.2
December 2018	1.5	2.0	2.3	2.5	2.8	3.0	3.1

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – May 2018 (link), Scottish Fiscal Commission (2017) Scotland's Economic and Fiscal Forecasts – December 2017 (link).
Shading shows outturn available at time of publication.

22 For our latest forecasts, we retain our judgement from May that the outlook for earnings growth is weak, and that growth in earnings is lower than we might expect given growth in productivity and labour market conditions. Following recent stronger earnings data, we have slightly revised up our outlook for earnings growth in 2018.

23 Longer term, a small upwards revision to our forecast of productivity has fed through to stronger earnings growth. Overall, our December 2018 forecast of earnings growth is above our May 2018 forecast, but below our December 2017 forecast.

Brexit

24 The agreement between the UK Government and the EU in November 2018 is a significant development in the Brexit process. There are two parts to the agreement: the Withdrawal Agreement (WA) and a Political Declaration (PD).

25 While the WA and PD are important advances since our previous forecast, there remains much political uncertainty about the outcome. At present, there is no meaningful basis for making predictions of the development of the UK-EU economic relationship over the next few years on which we could produce our economy forecast. Even if we could foresee how the formal relationship might develop, the economic and fiscal implications would remain highly uncertain.

26 In creating their forecasts, the OBR assume that:

- the UK leaves the EU in March 2019
- new trading arrangements with the EU and others slow the pace of import and export growth
- the UK adopts a tighter migration regime than that currently in place

27 We continue to use the same broad-brush judgements as the OBR. These basic judgements encompass a range of potential outcomes and effects, all of which assume a relatively orderly and smooth exit from the EU. We consider a no-deal Brexit to be a downside risk to our forecast.

28 We are not attempting to pinpoint the exact effect of Brexit on the Scottish economy, not least because the full effects of Brexit are likely to play out over a long time horizon. Nor do we consider a counter-factual case of no Brexit. Our focus is the effect on the economy over the forecast horizon of five years. The Commission’s judgement is that the OBR’s broad-brush assumptions continue to provide a suitable starting point for incorporating the potential effects on Scotland.

29 The Commission captures the effect of Brexit through three channels:

1. Migration – we use the ONS 50 per cent EU migration variant, with projected lower EU migration than in the principal projection. This is slightly different to the principal population projection used by the OBR for the UK.

2. Productivity – we are forecasting slow growth in productivity, in part due to Brexit.

3. Trade – Using OBR assumptions, we forecast slower growth in Scottish international trade from the end of the transition period, currently scheduled to last until 31 December 2020.

30 We have already noted the downside risk of a no-deal Brexit, and this risk has increased since we began work on our forecasts in September 2018. Our judgement on the UK-EU negotiations was formed based on information available up to the time of the economy forecasts closing on 27 November 2018. The forecasts set out in this report were provided to the Scottish Government on 4 December 2018 and inform the Scottish Government's Budget 2019-20. We expect to produce our next forecasts in summer 2019 to support the Scottish Government's Medium-Term Financial Strategy.

Fiscal Forecasts: How they are used in the Scottish Budget

31 The Commission's fiscal forecasts directly inform the Scottish Government's Budget. In total we are forecasting £15.2 billion of the Scottish Budget will be raised by tax in 2019-20. These tax revenues reflect the expansion in tax powers over the last four years, with Land and Buildings Transaction Tax and Scottish Landfill Tax devolved from April 2015 and non-savings non-dividend income tax devolved from April 2017. Non-Domestic Rates have been devolved to the Scottish Parliament since its creation.

32 In our previous forecasts, our social security coverage was largely illustrative as few benefits had been devolved. More benefits are now devolved or will be devolved next year. The Scottish Government has reformed those benefits being devolved, widening eligibility criteria and increasing payment amounts.

- Carer's Allowance and the Sure Start Maternity Grant were devolved in 2018. The Sure Start Maternity Grant was replaced with the Best Start Grant – Pregnancy and Baby Payment from 10 December 2018.

- Carer's Allowance Supplement is a new benefit: the first payments were made in September 2018.

- The Scottish Budget 2019-20 includes plans to devolve Funeral Payments and replace this with Funeral Expense Assistance. Healthy Start Vouchers will be replaced with Best Start Foods and two additional payments will be introduced under Best Start Grant – the Early Learning Payment and School-Age Payment.

33 As a result our forecasts of social security expenditure have increased significantly. In total our social security forecasts are for £458 million expenditure in 2019-20. We estimate that the new and expanded social security plans will cost £90 million more than the funding received for these benefits.[3]

34 As more tax and spending powers are devolved, the Scottish Budget is increasingly affected not only by our forecasts, but also by the corresponding Block Grant Adjustments (BGAs). Figure 3 provides a stylised representation of the way the Scottish Budget is determined. For taxes these adjustments are reductions in the Block Grant, whilst for the larger social security benefits they are additions to the Block Grant.[4,5] The adjustments reflect the revenue the UK Government no longer receives because of the devolution of taxes to Scotland and the payments no longer made by the UK Government on devolved benefits.

35 Smaller social security benefits result in additions to the Block Grant, indexed using the Barnett formula and will not directly correspond to UK Government expenditure on the same benefit.[6]

36 The UK and Scottish Governments calculate the BGAs based on OBR forecasts of UK Government receipts and spending of the corresponding tax and benefit elsewhere in the UK. The BGAs are not based on the OBR's forecasts of Scottish taxes or benefits, which are produced as part of their work to forecast UK-wide public finances.

37 The BGAs are initially based on forecasts and a final reconciliation takes place once outturn data become available. Further details on reconciliations can be found below.

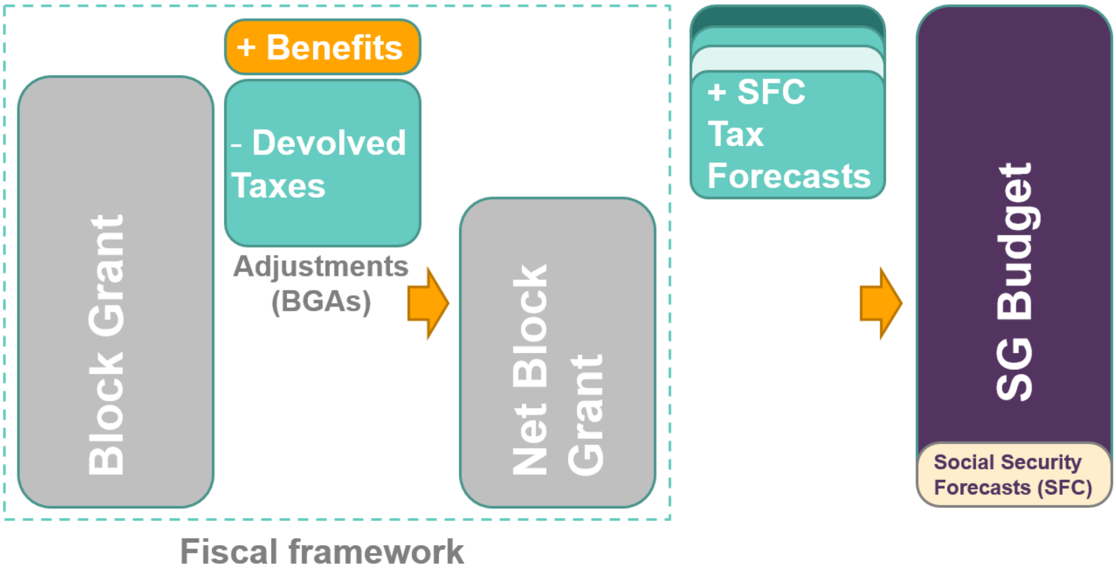
[3] This covers the funding received for Carer's Allowance, Carer's Allowance Supplement, Discretionary Housing Payments, Best Start Grant, Funeral Expense Assistance and Employability Services.

[4] Non-Domestic Rates (NDR) were devolved before the Scotland Act 2012 and are outwith the fiscal framework. This means there is no Block Grant Adjustment for the equivalent UK Government tax.

[5] Block Grant Additions will be made for Attendance Allowance, Carer's Allowance, Cold Weather Payments, Disability Living Allowance, Personal Independence Payment, Industrial Injuries Benefits, Severe Disablement Allowance and Winter Fuel Payments.

[6] Best Start Grant, Funeral Expense Assistance, Employability Services and Discretionary Housing Payments

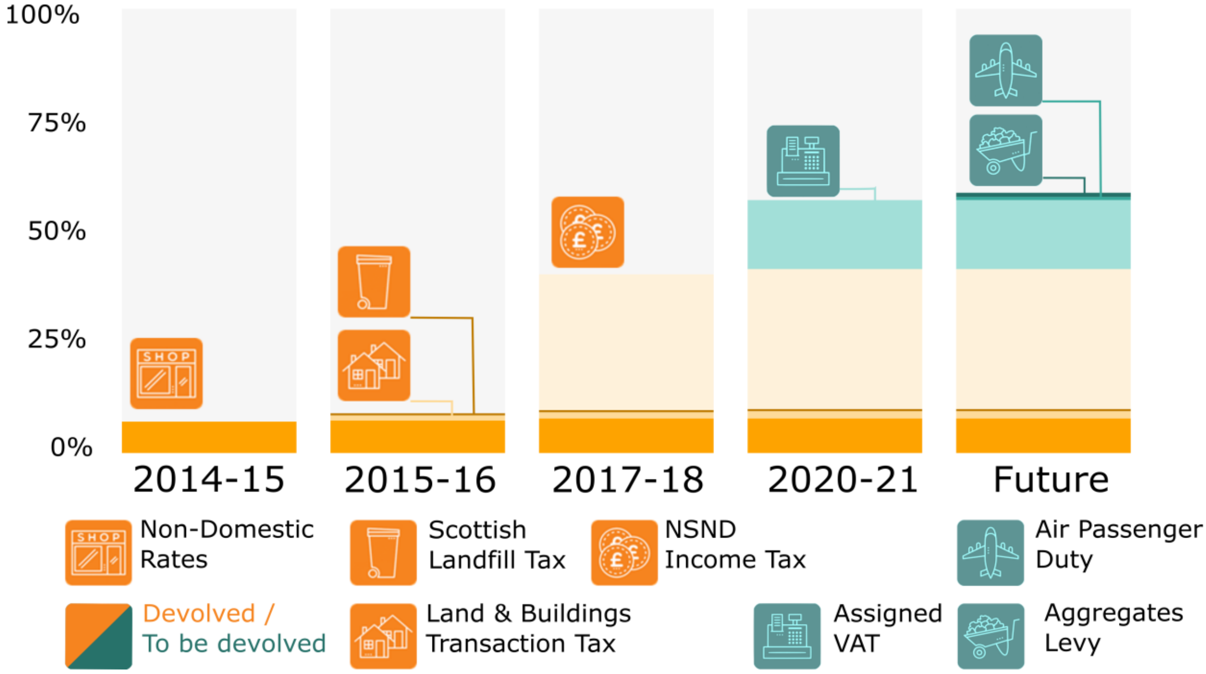
Figure 3: How is the Scottish Budget Determined?



Source: Scottish Fiscal Commission

38 Figure 4 illustrates how the devolution of tax powers has changed the proportion of the Scottish Budget determined by tax revenue.

Figure 4: Proportion of Scottish Budget determined by devolved and assigned tax revenue



Source: Scottish Fiscal Commission
Non-Domestic Rates have been devolved to the Scottish Parliament since its creation.

39 Three Scotland Act 2016 tax powers, assigned VAT, Air Passenger Duty and Aggregates Levy, are yet to be implemented. Once VAT assignment begins to affect the Scottish Budget, expected to be in 2020-21, assigned VAT will

be the second largest source of tax revenue after income tax with a forecast revenue of over £5 billion. These taxes will also give rise to BGAs.

40 Responsibility for the remaining benefits to be devolved will transfer to the Scottish Parliament by April 2020 at the latest.[7] In 2017-18 these benefits accounted for £2.6 billion of expenditure.[8] We will provide forecasts for these benefits in our publication next year alongside the Scottish Budget 2020-21.[9] This means that the Budget next year will include expenditure and BGA forecasts for significantly larger benefits.

Fiscal Forecasts: Overview of Block Grant Adjustments

41 Table 6 shows the forecasts for the devolved taxes and corresponding BGAs over the next five years. Forecast receipts are greater than the BGAs over the whole of this period. The differences reflect both policy decisions by the Scottish and UK Governments as well as differences in the underlying growth of tax revenues. For example the Scottish Government's announcement at this Budget of two changes to Land and Buildings Transaction Tax (LBTT) has increased our forecast of revenues, whilst the UK Government's policy on first time buyer relief resulted in a downward revision to Stamp Duty Land Tax receipts, and therefore to the corresponding BGA.

Table 6: Net position of tax forecasts and Scottish Government Block Grant Adjustments

£ million		2019-20	2020-21	2021-22	2022-23	2023-24
Income Tax	SFC forecast	11,684	12,285	12,746	13,242	13,805
	BGA forecast	11,501	12,089	12,478	12,954	13,493
	Net difference	182	196	268	288	312
Land & Buildings Transaction Tax	SFC forecast	643	680	716	751	787
	BGA forecast	567	596	632	667	721
	Net difference	76	85	84	83	66
Scottish Landfill Tax	SFC forecast	104	83	13	13	14
	BGA forecast	91	83	81	74	62
	Net difference	13	0	-68	-61	-48
Total	SFC forecast	12,430	13,049	13,475	14,006	14,605
	BGA forecast	12,159	12,768	13,191	13,695	14,276
	Net difference	271	281	284	310	329

Source: Scottish Fiscal Commission, Scottish Government.
Figures may not sum because of rounding. Net difference equals the Scottish Fiscal Commission forecast minus the BGA, a positive number represents additional revenues available to the Scottish Government.

[7] Explanatory memorandum to the Scotland Act 1998 (Agency Arrangements) (Specification) Order 2018 (link)

[8] Scottish Government (2018) Government Expenditure and Revenue Scotland 2017-18 (link)

[9] The benefits still to be devolved are: Attendance Allowance, Disability Living Allowance, Personal Independence Payment, Industrial Injuries Disablement Benefit, Severe Disablement Allowance, Cold Weather Payment and Winter Fuel Payment

42 Table 7 shows the forecast position for Carer’s Allowance, the only benefit devolved to date with a corresponding BGA. These figures show that forecast expenditure on the main Carer’s Allowance benefit is fairly consistent with the forecast BGA. This table does not include expenditure on the Carer’s Allowance Supplement. As this is a new benefit introduced by the Scottish Government it must be fully met from within the Scottish Government’s existing budget.

Table 7: Net position of social security forecasts and Scottish Government Block Grant Adjustments

£ million		2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Carer's Allowance	SFC forecast	157	283	305	324	344	364
	BGA forecast	157	290	307	328	348	359
	Net difference	-1	-6	-2	-3	-4	5

Source: Scottish Fiscal Commission, Scottish Government. Figures may not sum because of rounding.
Net difference equals the Scottish Fiscal Commission forecast minus the BGA, a positive number represents additional expenditure incurred by the Scottish Government.
The Carer's Allowance expenditure presented does not include the Carer's Allowance Supplement, the costs of which must be fully met from within the Scottish Government's Budget.

Fiscal Forecasts: Reconciliations

43 The BGAs are initially based on forecasts; these are updated as forecasts are revised and a final reconciliation takes place once outturn data are available.[10] The Scottish Budget in future years will also be affected by reconciliations relating to previous years’ forecasts of Scottish receipts and the BGAs. The largest reconciliations in the next couple of years are expected to relate to income tax. The first reconciliation for income tax will occur after the outturn data for 2017-18 become available next summer and will affect the Scottish Budget 2020-21.

44 Table 8 sets out the forecasts of Scottish income tax and the BGA used to set the Scottish Government’s Budget for 2017-18. At that time liabilities were forecast to be £107 million higher than the BGA. Since then the 2016-17 outturn data has been published resulting in significant downward revisions to forecasts of both Scottish liabilities and the BGA. In addition the OBR’s forecasts of UK Government liabilities have been revised upwards, whilst our forecasts of Scottish liabilities have been revised downwards. The latest forecasts are that the outturn BGA will be £38 million greater than outturn liabilities. Overall this suggests the reconciliation will result in an adjustment of minus £145 million to the Scottish Budget 2020-21.

45 Our forecast of income tax produced in February 2018 was used to set the budget for 2018-19. Since then our income tax forecast has been revised

[10] For the fully devolved taxes and benefits, the BGAs are updated at the UK Autumn Budget and an adjustment is made to the Scottish Government’s budget accordingly. In the case of income tax there is no effect on the Scottish Government’s budget until the final outturn data are available, at that time both the BGA and the forecast of receipts are updated.

down by £725 million whilst the corresponding BGA has been revised down by £254 million. The final reconciliation will be determined once outturn data are available in summer 2020. Based on the latest forecasts we expect this reconciliation to result in an adjustment of minus £472 million to the Scottish Budget 2021-22.

Table 8: Income tax reconciliations

£ million	Liabilities	BGA	Difference	Forecast reconciliation
2017-18 budget				
Forecasts used in budget	11,857	11,750	107	
Latest forecasts	11,008	11,046	-38	-145
2018-19 budget				
Forecast used in budget	12,177	11,749	428	
Latest forecast of outturn	11,452	11,495	-43	-472

Source: Scottish Fiscal Commission, Scottish Government, Scottish Government (2017) Draft Budget 2017-18: Updated Income Tax Policy Forecasts (link), Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts Supplementary Publication Updated Income Tax Forecasts (link).
Figures may not sum because of rounding.

Fiscal Forecasts: Tax

46 We forecast that £15.2 billion of the Scottish Budget will be raised by tax in 2019-20.

47 Table 9 shows a summary of the tax forecasts produced to inform the Scottish Budget.

Table 9: Summary of tax forecasts informing the Scottish Budget

£ million	2017-18 Outturn	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Income tax (NSND)	11,008	11,452	11,684	12,285	12,746	13,242	13,805
Non-Domestic Rates	2,762	2,827	2,785	2,887	3,087	3,295	3,332
Land & Buildings Transaction Tax	557	569	643	680	716	751	787
of which, Residential	258	267	296	324	349	373	398
ADS	95	94	122	123	127	130	134
Non-Residential	204	208	226	233	240	247	255
Scottish Landfill Tax	148	136	104	83	13	13	14
Total tax	**14,475**	**14,983**	**15,215**	**15,935**	**16,562**	**17,300**	**17,937**

Source: Scottish Fiscal Commission, Revenue Scotland (2018) Annual Report and Financial Statements 2017-18 (link), Scottish Government NDRi returns.
Figures may not sum because of rounding. Figure for income tax is forecast not outturn data, as liabilities data in 2017-18 are not yet available. See the income tax section for further detail.

48 In addition we produce two illustrative tax forecasts. The first is for assigned VAT receipts. The assignment of VAT is yet to commence so there is no effect on the Scottish Budget. Our second illustrative forecast is of the Scottish share of Air Passenger Duty (APD). Devolution of APD has been

deferred until the issue raised in relation to the Highlands and Islands exemption has been resolved.[11]

Table 10: Summary of illustrative tax forecasts

£ million	2017-18 Outturn	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Assigned VAT Receipts	5,383	5,631	5,801	5,966	6,122	6,279	6,434
Scottish share of Air Passenger Duty	277	302	312	322	336	349	364

Source: Scottish Fiscal Commission, HMRC, HM Treasury and Scottish Government.
Outturn in the context of assigned VAT receipts refers to a provisional estimate from the assignment outturn model which is still in development by HMRC, HM Treasury and the Scottish Government. Further details can be found in the VAT section of Chapter 3. Figure for Air Passenger Duty is not classed as outturn data. It is an estimate of the Scottish share of tax receipts.

Income tax

49 Table 11 presents our December 2018 income tax forecast, and shows how it has changed since May 2018.

Table 11: Income tax forecast comparison with May 2018

£ million	2016-17 Outturn	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
May 2018	11,267	11,467	11,969	12,345	12,805	13,335	13,936	14,547
2016-17 Outturn data	-548	-556	-570	-586	-608	-634	-663	-696
Economy forecast	0	102	83	142	141	126	86	17
UK policy adjustment	0	1	-15	-275	-85	-98	-120	-140
Scottish Budget 2019-20 policy	0	0	0	68	71	75	80	84
Other *	0	-6	-14	-9	-39	-58	-76	-8
December 2018	10,719	11,008	11,452	11,684	12,285	12,746	13,242	13,805
Change from May 2018	-548	-459	-517	-661	-519	-589	-694	-743

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – May 2018 (link). Outturn in 2016-17 is the published HMRC outturn NSND income tax liabilities estimate (link).
* Includes revisions to OBR triple lock pension forecast, CPI forecasts, HMRC Gift Aid estimates, and policy recostings. Further information is provided in Chapter 3.

50 Overall, we have revised down our income tax forecast since May 2018. Table 11 shows how a number of different factors have contributed to the revisions. New outturn data for 2016-17 and changes in UK income tax policy have reduced our forecast, while changes in Scottish income tax policy and a more positive outlook for the economy since May have

[11] Letter from Cabinet Secretary for Finance and Constitution to the Convener of the Finance and Constitution Committee 1 June 2018 (link)

increased our income tax forecast. In combination, we expect income tax liabilities to be £661 million lower in 2019-20 than in our May 2018 forecast.

Scottish Government higher rate threshold policy

51 In this budget the Scottish Government has announced a policy to set the higher rate threshold at £43,430 in 2019-20, the same as in 2018-19. Maintaining the higher rate threshold at this level raises money for the Government compared to our baseline assumption that the higher rate threshold would increase in line with inflation.

52 As a result of this policy, around 24,000 additional taxpayers will be higher rate taxpayers rather than intermediate rate taxpayers. The existing 343,000 higher and additional rate taxpayers will pay an extra £210 in tax as a result of this policy. In total, and accounting for behavioural change, we estimate that this policy will raise £68 million in 2019-20.

The effect of data revisions on the income tax forecast

53 In previous forecasts, the primary source of information on Scottish income tax was the Survey of Personal Incomes (SPI), a sample from HMRC's income tax systems. Since our May 2018 forecast, HMRC has, for the first time, published new income tax outturn data based on full administrative data using Scottish taxpayer codes. Now that the HMRC outturn data are available, they are the primary measure of total income tax liabilities in Scotland.

54 The HMRC outturn estimate for 2016-17 of £10,719 million was £548 million lower than our May 2018 SPI-based estimate for 2016-17. We discussed this in our September 2018 Forecast Evaluation Report, concluding that differences in the number of taxpayers between the two sources of data accounted for much of the difference.[12]

55 We have now calibrated our forecasts to match the available 2016-17 outturn data. This leads to a reduction of £586 million in our forecast of income tax in 2019-20.

56 There is no direct effect on the Scottish Budget as 2016-17 is the base year for the Block Grant Adjustment (BGA). Outturn data for 2017-18, expected in summer 2019, may have an effect on the budget via the reconciliation process. See Fiscal Forecasts: Reconciliations section for further information.

[12] Scottish Fiscal Commission (2018) Forecast Evaluation Report (link)

Policy and behavioural effects

57 In its October 2018 Budget the UK Government announced an increase in the UK higher rate threshold to £50,000 in 2019-20. With the higher rate threshold in Scotland set at £43,430 in 2019-20, there is a growing gap between the higher rate threshold in Scotland and the rest of the UK. This difference has two distinct effects on taxpayers.

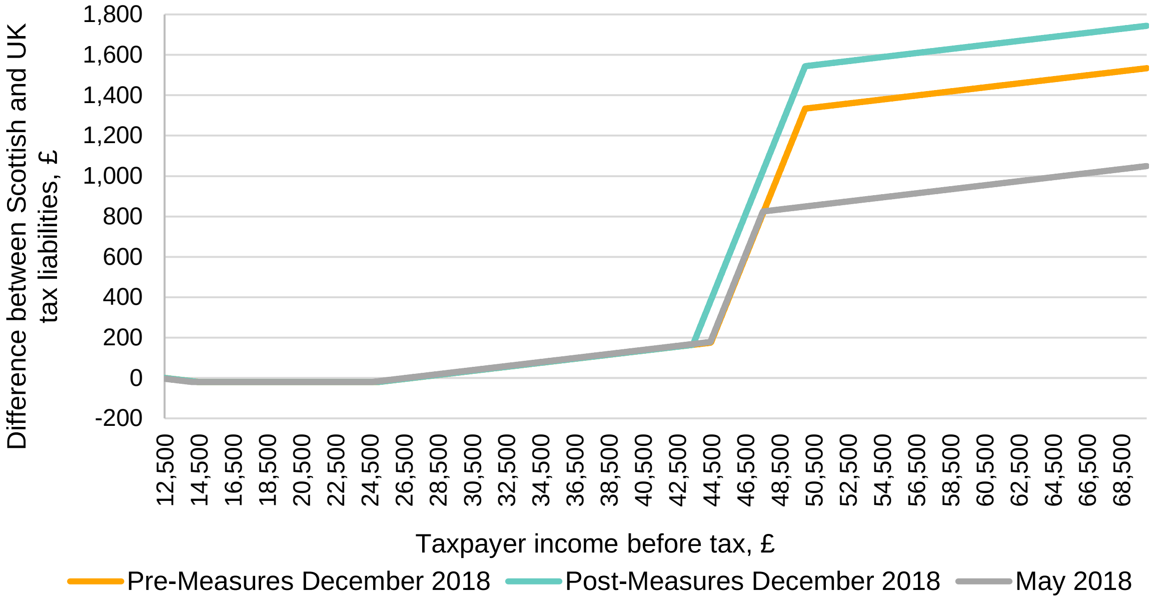
58 Firstly, because the National Insurance Contributions (NICs) Upper Earnings Limit (UEL) is aligned with the UK higher rate threshold, taxpayers in Scotland earning between £43,430 and £50,000 face a combined income tax and NICs marginal tax rate of 53 per cent, compared to 32 per cent for this income range in the rest of the UK.[13]

59 We expect that this higher marginal tax rate will start to affect taxpayer behaviour, for example decisions on how many hours to work. We estimate that in 2019-20 around 120,000 taxpayers in Scotland will be subject to this higher marginal rate. Using our standard approach to modelling taxpayer behaviour, we have estimated that this effect will lead to a reduction in income tax in Scotland of £7 million in 2019-20.

60 Secondly, there is a growing difference in income tax liabilities for higher earners in Scotland and the UK. For example, a taxpayer earning £50,000 is expected to pay around £1,540 more in income tax in Scotland in 2019-20 than in the UK, and this expected difference has increased by more than £695 since since our May 2018 forecast, as shown in Figure 5. We expect this to start to have an effect on tax residency decisions.

[13] In Scotland, taxpayers in this range will pay 41 per cent income tax and 12 per cent NICs, giving a combined marginal tax rate of 53 per cent. In the rest of the UK, the same taxpayers would pay 20 per cent income tax and 12 per cent NICs, giving a combined marginal tax rate of 32 per cent.

Figure 5: Income tax difference for Scottish and rUK taxpayers earning between £12,500 and £70,000 in 2019-20



Source: Scottish Fiscal Commission

61 Changes in taxpayer residence behaviour includes both changes in migration and, for those individuals who already split their lives between Scotland and the rest of the UK, decisions about how to report their primary residence to HMRC. We expect the latter category to account for most of the behaviour change in response to higher income tax in Scotland by higher and additional rate taxpayers. We estimate that changes in taxpayer residence behaviour will lead to a reduction of income tax in Scotland of £6 million in 2019-20.

62 In total, taking account of both of these effects, we expect the difference between the higher rate thresholds in Scotland and the rest of the UK to lead to a reduction of income tax in Scotland of £13 million in 2019-20.

Non-Domestic Rates (NDR)

63 Our forecast of NDR for 2019-20 is £2,785 million, £74 million lower than forecast in May 2018. The downward revision reflects data and modelling updates as well as Scottish Government policy changes. The largest change results from the Scottish Government's announcement that the tax rate, or poundage, will be set at 49.0p, reducing receipts by £35 million in 2019-20 relative to our baseline assumption of an increase in line with RPI.

64 The Scottish Government has also announced that transitional relief for the hospitality sector and offices in Aberdeen and Aberdeenshire will be extended to the end of 2021-22. Previously plans for the relief were only announced up to the end of 2018-19. This extension reduces the forecast by £7 million in 2019-20. An announced relief for new investment in fibre to be

introduced in April 2019 has a minimal effect on the forecast – we estimate the cost of the relief will reach £2 million by 2023-24.

65 The Scottish Government announced a number of reliefs in December 2017, some of which were introduced in response to the Barclay Review.[14] As new data become available we have reduced our estimate of the cost of the reliefs by £19 million in 2019-20, thus increasing NDR receipts. The largest change has been made to our costing of the Business Growth Accelerator. The reduction in this costing reflects lower than expected ratepayer awareness of the relief and IT infrastructure challenges in certain local authorities. Our costing for 2018-19 onwards has therefore been revised down, although we include an adjustment for increased take-up of the relief in future years.

66 Other data updates and modelling changes have reduced the forecast by £51 million. After accounting for policy changes there has been a net reduction of £74 million to the 2019-20 forecast.

67 The Commission forecasts what is known as the contributable amount of NDR. This can be thought of as the amount collected by local authorities through the course of the year which flows to the Scottish Government. The amount available to local authorities to spend – the distributable amount – is set by the Scottish Government before the start of the financial year.

68 Differences between the amount distributed by the Scottish Government and amounts collected by local authorities are shown after year-end in the audited publication of the NDR Rating Account.

69 Given our forecast of the contributable amount and the Scottish Government's proposed distributable amount, we now project a £100 million negative balance in the NDR Rating Account at the end of 2019-20. Should the projected negative balance in 2019-20 materialise this will have to be addressed by the Government at future Budgets. The audited balance of the account will in practice also depend on local authorities in-year estimates of NDR revenue collected.[15]

[14] Report of the Barclay Review of Non-Domestic Rates 2017 (link)

[15] Contributions to the pool are determined by local authorities own estimates of collections for the year ahead, submitted to the Scottish Government after the start of the financial year. Differences between this and final collections are reconciled the following year on the account. Because of this, the balance of the pool could be positive despite our projection of a negative balance if local authorities report a high level of collections on their start of year estimates.

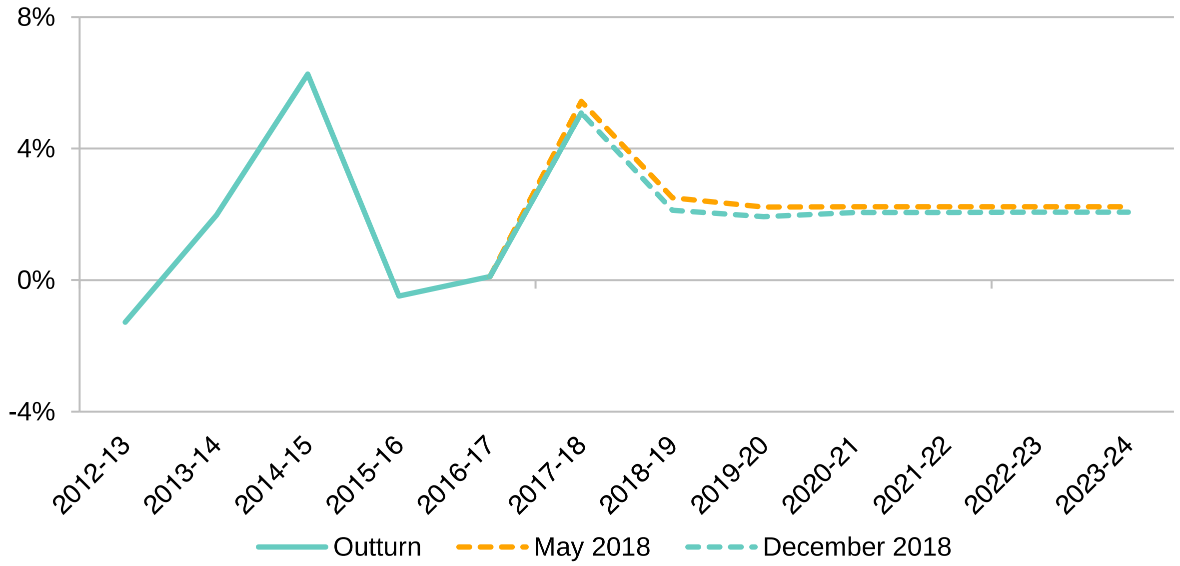
Land and Buildings Transaction Tax (LBTT)

Residential LBTT

70 Our forecast of revenues from residential LBTT in 2019-20 has been revised down from £342 million in May to £296 million. This is in part because of the weaker outlook for transactions and in part because of a revision to the forecast which now apportions slightly more transactions to the lower tax bands. A small reduction of £2 million in residential LBTT receipts in 2019-20 results from the Scottish Government's change to the Additional Dwelling Supplement tax rate and contributes to the downward revision.

71 The first half of 2018 saw considerable growth in average house prices driven by larger numbers of more expensive purchases, and smaller numbers of lower priced purchases. Our May forecasts reflected this higher growth, as shown in Figure 6. Since then average house prices have continued to grow, but at a lower rate. The third quarter of 2018 saw average house price growth of 1.8 per cent year-on-year. This has led us to revise down our short-term forecast of house price growth. Our forecasts assume that house price growth will return to around 2.1 per cent a year by the end of the five-year forecast horizon, slightly lower than our assumption of 2.2 per cent in May.

Figure 6: Scotland average house prices (annual per cent change)

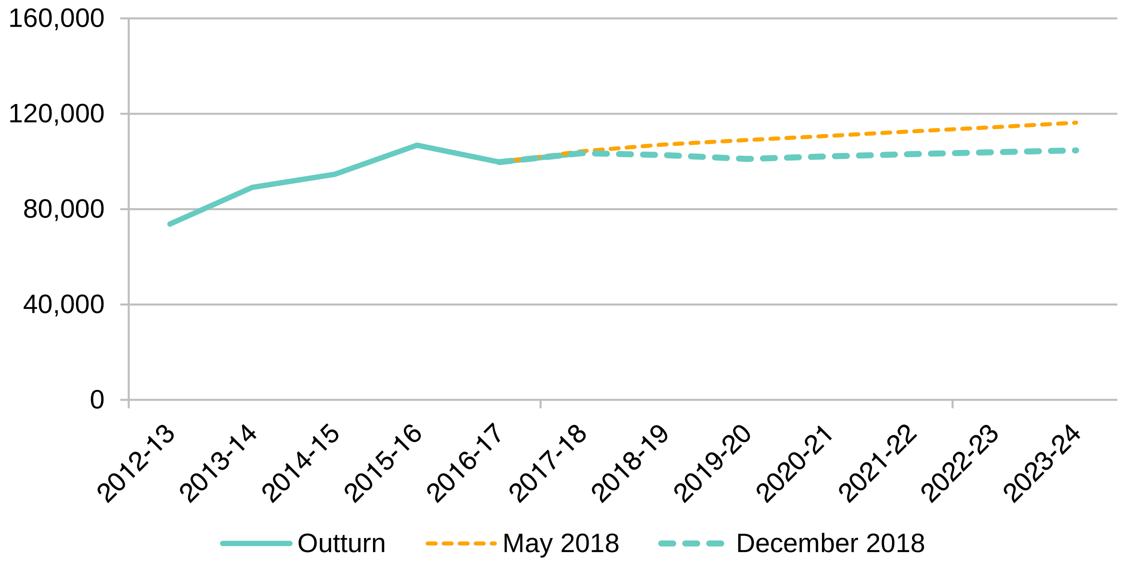


Source: Scottish Fiscal Commission, Registers of Scotland (link).
Registers of Scotland transaction statistics cover properties between £20,000 and £1,000,000. Registers of Scotland growth rates are based on date of registration while Commission's forecast is on effective date basis.

72 The number of transactions fell by 3.4 per cent in the first half of 2018-19, in line with the broader fall in UK property transactions over the same period. Our May forecast projected the drop to continue in the second quarter of 2018 but with growth returning thereafter, as illustrated in Figure 7. The

latest data are consistent with a more sustained fall in transactions in the near-term. Our transactions forecast has therefore been revised down, reducing LBTT receipts.

Figure 7: Scotland residential property transactions



Source: Scottish Fiscal Commission, Revenue Scotland effective date basis data from 2015-16 (link), HMRC Monthly Property Transactions Statistics for data before 2015-16 (link).

Additional Dwelling Supplement

73 Our forecast is for £122 million in Additional Dwelling Supplement (ADS) revenue in 2019-20. The Scottish Government will increase the tax rate on transactions liable for the ADS from 3 per cent to 4 per cent. We estimate this will increase ADS receipts by an average of £27 million per year from 2019-20 onwards. There is a small negative effect of £2 million on the main residential LBTT receipts through slightly lower transaction volumes and prices because of the increased tax rate.

74 The Scottish Government plans to introduce the increase in ADS rates from 25 January 2019, thus reducing the time for forestalling. We assume there is a limited effect between financial years with £1 million of combined residential LBTT and ADS revenue brought forward into 2018-19 from 2019-20. Within the financial year there is greater scope to move transactions. We estimate that £6 million revenue will be brought forward from February and March to January ahead of the introduction.

Non-residential LBTT

75 Non-residential LBTT receipts are forecast to be £226 million in 2019-20, increasing over the five-year forecast horizon to £255 million in 2023-24. Our pre-measures forecast is broadly unchanged from May 2018. The short-run forecast reflects the recent outturn data which saw spikes in the summer

months followed more recently by subdued receipts. These effectively cancel out and our in-year forecast for 2018-19, before any policy changes, is unchanged from May. In the medium term, prices and transactions grow in line with the Commission's economy forecast.

76 The Scottish Government has announced a change to the non-residential LBTT tax schedule. The lower tax band will apply to transactions up to £250,000, a reduction from £350,000. The lower tax rate is reduced from 3 per cent to 1 per cent, and the higher tax rate increased from 4.5 per cent to 5 per cent. These changes will come into effect on 25 January 2019. We estimate this raises £13 million in 2019-20, increasing to £15 million in 2023-24. We estimate a limited forestalling effect of £2.3 million revenue brought forward into January. Some lower value transactions will delay until after the tax change, and some higher value transactions will be brought forward.

Scottish Landfill Tax

77 Scottish Landfill Tax (SLfT) is an environmental tax levied on landfilled waste in Scotland, which is intended to help reduce the amount of waste landfilled. Our forecast is for receipts to fall from £104 million in 2019-20 to £14 million in 2023-24. There are two main drivers reducing landfilled waste and, therefore, SLfT receipts. Firstly, projected increases in incineration capacity mean that waste will be diverted from landfill to incineration plants being built in Scotland over the next five years. Secondly, the introduction of the Scottish Government's legislative ban on the landfilling of biodegradable municipal waste (BMW) from January 2021 is now included in our central forecast. Previously we included the ban as a sensitivity when we highlighted it was likely to result in lower receipts in future years.

78 Up to 2021 the reductions in receipts are driven by increases in incineration capacity. In 2021-22 receipts are expected to be £69 million lower than they would otherwise have been because of waste being diverted to incinerators. There are always some uncertainties around the precise timing for facilities coming on line, but the new capacity in our forecast comes from projects which are in construction or in advanced stages of procurement and therefore we expect them to become operational within our forecast horizon.

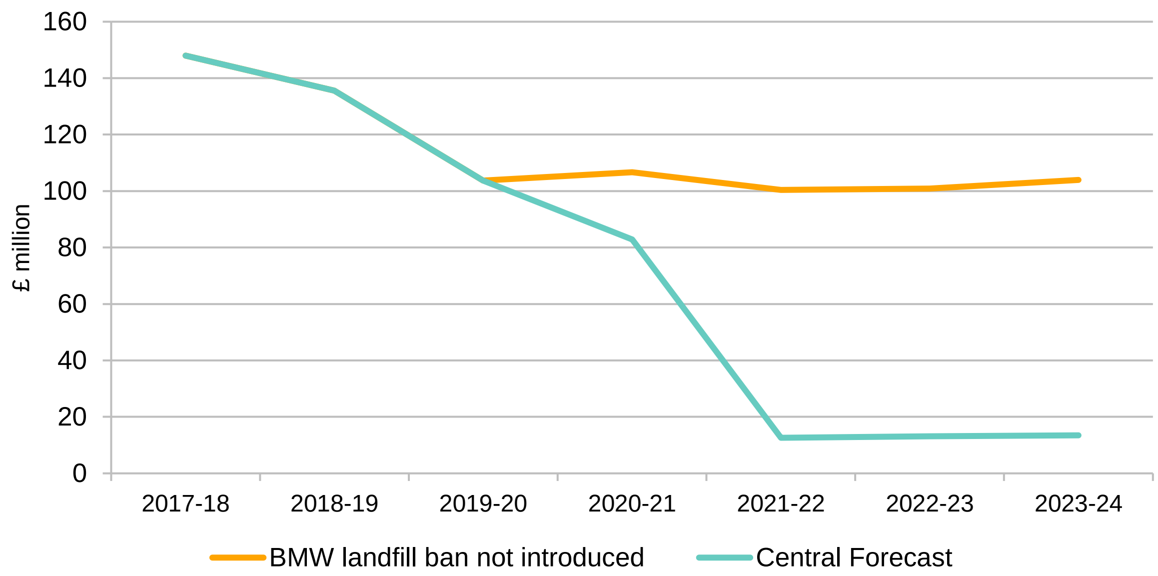
79 Despite these expected increases in incineration capacity, there are likely to be around one million tonnes of biodegradable municipal waste per year which cannot be legally landfilled in Scotland from January 2021, and for which no alternative treatment option exists in Scotland. In our previous forecasts we highlighted the effect this waste not being landfilled would have on our tax forecasts, and the need for greater evidence about how and where this waste would be diverted.

80 The ban affects receipts from 2020-21 onwards, with the full effect from 2021-22. There have been several developments which have led to this now

being included in our central forecast. The Scottish Environmental Protection Agency (SEPA) has now published guidance outlining the specific waste types affected along with more detail on its implementation and enforcement.[16] The Scottish Government has shared preliminary findings from a report examining options for waste affected by the ban. While the report does not identify where the waste will be sent, it identifies that sufficient capacity exists to handle waste with three options: landfill sites in northern England, incinerators in England and exports to Europe. We expect the costs of these three options to be higher than the current cost of landfilling in Scotland, so we do not expect diversion of waste to start until the ban comes into effect.

81 The ban results in a significant reduction in SLfT receipts – in 2021-22 receipts are £13 million. At this point we are fully incorporating the ban in our forecast. Given the uncertainties discussed above, sensitivity analysis is shown in Figure 8, demonstrating the impact on revenue if the ban is not implemented from 2021 as the Scottish Government intends. We estimate that without the ban receipts will be £88 million higher in 2021-22.

Figure 8: Effect of the BMW landfill ban not being introduced on SLfT receipts



Source: Scottish Fiscal Commission, Revenue Scotland (2018) Annual Report and Accounts 2017-18 (link).

Fiscal Forecasts: Illustrative tax forecasts

82 We produce two illustrative tax forecasts. The first is for assigned VAT receipts; but this process is yet to start so there is no effect on the Scottish

[16] SEPA published guidance (May 2018) on the BMW ban to help stakeholders understand what BMW is, why it will be banned and how the ban will be implemented (link)

Budget. Our second illustrative forecast is of the Scottish share of Air Passenger Duty (APD) where devolution of APD has been delayed.

Value Added Tax (VAT)

83 The Scotland Act 2016 assigns receipts from the first 10p of standard rate of Value Added Tax (VAT) and the first 2.5p of reduced rate of VAT in Scotland to the Scottish Government. Currently our forecasts have no direct effect on the Scottish Budget. 2019-20 is a transition year in which VAT assignment will be calculated and forecast but there will be no effect on the Scottish Budget. It is expected that the transitional period will last a year and from 2020-21 the Scottish Government will receive the VAT receipts assigned to Scotland with a corresponding BGA.

84 Our forecast for assigned VAT receipts in 2019-20 is £5,801 million, which will make VAT the second largest source of tax revenue for the Scottish Government, after income tax. Receipts will increase to £6,434 million in 2023-24. These increases are driven by our forecasts of household consumption and changes to consumer spending patterns.

85 VAT will continue to be collected by HM Revenue and Customs (HMRC) at the UK level. As tax returns are submitted by companies covering the whole of the UK it will not be possible to calculate VAT raised in Scotland. Assigned VAT receipts will initially be based on forecasts. Outturn data will be estimated by a model currently under development by HMRC, HM Treasury and the Scottish Government. We expect that revenue and BGA forecasts will then be reconciled to the outturn data estimate once available following broadly the same arrangements already in place for income tax.

Air Passenger Duty

86 Air Passenger Duty (APD) is paid by eligible passengers departing from UK airports. The Scottish Government has agreed with the UK Government to defer the devolution of APD.[17] The Commission produces an illustrative forecast of the Scottish share of APD.

87 Our forecast of Scottish APD receipts shows revenues increasing over the forecast horizon. Scottish passenger numbers have grown strongly in recent years at a time when Scottish GDP growth has been relatively subdued, we assume Scottish passenger numbers grow in line with UK GDP.

88 The forecast of Scottish APD has increased since May 2018 to reflect passenger data up to the end of June 2018 and the latest OBR determinants for UK GDP growth and inflation. With stronger than expected growth in

[17] Letter from Cabinet Secretary for Finance and Constitution to the Convener of the Finance and Constitution Committee 1 June 2018 (link)

Scottish passenger numbers, our forecast of the Scottish share in 2019-20 has risen by £19 million to £312 million.

Fiscal forecasts: Social security expenditure

89 The number of social security benefits devolved to Scotland has increased over the last year with the devolution of Carer's Allowance and the Sure Start Maternity Grant (SSMG), SSMG has been replaced with the Best Start Grant. The Scottish Government has introduced a new benefit – the Carer's Allowance Supplement and announced plans for two new benefits to be devolved in 2019 – Funeral Expense Assistance and Best Start Foods. The Best Start Grant will also be expanded in 2019.

90 The Scottish Government has introduced reforms to all of these benefits, changing payment rates, the eligibility criteria, advertising the new benefits, introducing changes to the administration of the benefits and establishing a new delivery agency, Social Security Scotland. As these are new policies and new benefits there are no past data on these benefits on which to base our forecasts. In each case we examine the data on the previous UK benefit and make an assessment of the effect the above reforms will have.

91 There is a particular challenge in assessing take-up rates, that is the proportion of an eligible population who claim the benefit to which they are entitled. Take-up rates are typically estimates as in most cases we also have to estimate the size of the eligible population. To reach an independent judgement on likely take-up rates we asked the Scottish Government to provide us with information on all planned changes to each benefit. We reviewed all the relevant information before making our judgements. Once the first data become available from Social Security Scotland, we will review and revise our forecast assumptions.

92 Table 12 shows a summary of the social security forecasts produced to inform the Scottish Budget. Our forecasts of social security expenditure are of the total amount paid to, or in respect of, claimants, and do not include any administrative costs.

Table 12: Summary of social security forecasts of Scottish Government expenditure

£ million	2017-18 Outturn	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Carer's Allowance		157	283	305	324	344	364
Carer's Allowance Supplement		35	37	40	43	45	48
Discretionary Housing Payments	58	61	63	65	66	68	69
Best Start Grant		2	12	13	13	14	15
Funeral Expense Assistance			6	6	7	6	7
Scottish Welfare Fund	33	33	33	33	33	33	33
Scottish Government Social Security portfolio – total expenditure	**91**	**287**	**435**	**462**	**486**	**511**	**535**
Healthy Start Vouchers / Best Start Foods	4	4	4	5	4	4	4
Employability Services	12	19	19	28	22	9	0
Total expenditure	**107**	**310**	**458**	**494**	**512**	**523**	**539**

Source: Scottish Fiscal Commission, Scottish Government Scottish Welfare Fund Statistics (link), DWP Benefit Expenditure by Country and Region 2016-17 (link) Scottish Government unpublished expenditure for Discretionary Housing Payments, Healthy Start Vouchers and Employability Services. Figures may not sum because of rounding.

Total expenditure is equal to the Scottish Government's social security portfolio spend plus two other benefits that have been devolved under the Scotland Act 2016, Employability Services and Best Start Foods. Expenditure for Employability Services is part of the Finance, Economy and Fair Work portfolio spending plans. Expenditure for Healthy Start Vouchers/Best Start Foods is part of the Health and Sport portfolio spending plans.

Carer's Allowance

93 Carer's Allowance (CA) is paid to help individuals who care for someone who is disabled and has substantial caring needs. CA was devolved from September 2018 and the Scottish Government introduced a Carer's Allowance Supplement (CAS) to increase CA to match the 2018-19 rate for Jobseekers' Allowance, with an intention to uprate the value each year. The first payments of the CAS were made in September 2018.

94 In total we forecast expenditure on CA and the CAS to increase from £320 million in 2019-20 to £412 million in 2023-24. This increase is because more people are expected to receive CA payments and the weekly payment is increased annually in line with CPI inflation. We have also increased expenditure to allow for the roll-out of Universal Credit and the effect we expect this to have on the number of individuals receiving CA and CAS. Our forecasts of expenditure in 2018-19 are lower reflecting the devolution of CA part-way through the year.

Best Start Grant

95 The Best Start Grant will be paid to low income families at different stages in a child's life. The Scottish Government introduced the Pregnancy and Baby Payment component of the Best Start Grant from 10 December 2018. This replaced the UK Government's Sure Start Maternity Grant with higher

payments for first births, and new payments for the birth of second or subsequent children. We produced a costing in September 2018 to accompany the Scottish Government's secondary legislation on the grant.

96 The Scottish Government has announced details of two further payments to be introduced in 2019; the Early Learning Payment and the School-Age Payment. The Scottish Government has committed to introduce these grants 'by summer 2019'.[18] We assume these grants come into effect on 1 June 2019.

97 As the two new payments are new benefits, not replacing an existing UK scheme, our estimates of take-up rates are initially lower than those estimated for the Pregnancy and Baby Payment. Over the five year forecast horizon we expect take-up to increase as awareness of these payments improves. There is significant uncertainty on the take-up rates in the first year of devolution, and how take-up may change over the forecast horizon.

98 We expect the combined cost of the grants to be £12 million in 2019-20, compared to £2 million of funding received from the UK Government to account for the devolution of the Sure Start Maternity Grant.

Best Start Foods

99 Best Start Foods (BSF) is a payment worth £4.25 each week to support low income families and pregnant women to purchase healthy food. Families must be in receipt of a qualifying benefit. The Scottish Government has committed to introduce BSF by summer 2019. It will replace a similar UK-wide scheme – Healthy Start Vouchers (HSV). We assume the transition to BSF begins on 1 June 2019.

100 We forecast BSF will cost between £0.5 million and £0.6 million a year more than the existing HSV scheme. This increase in expenditure results from increased weekly payment amounts and increased eligibility partly offset by a lower assumed take-up rate than the existing benefit. The Department of Health and Social Care is responsible for administering the current HSV and it writes to all those eligible for HSV to encourage them to take up the benefit. The Scottish Government intends to replicate this process for BSF, but has no firm arrangements in place. Therefore, based on the current position, we assume take-up will be lower than under the existing benefit. Should the Scottish Government make arrangements to replicate the current process we would review and update our take-up assumption.

101 Scottish Government expenditure once Best Start Foods is introduced falls over the forecast horizon from £4.5 million in 2019-20 to £4.0 million in 2023-

[18] Scottish Government (2018) Early Years assistance: consultation on the Best Start Grant regulations (link)

24. This decrease is largely driven by a fall in the estimated number of eligible people across the period.

Funeral Expense Assistance

102 Funeral Expense Assistance (FEA) supports individuals on low incomes with funeral costs. To receive FEA individuals must be in receipt of a qualifying benefit. The Scottish Government has announced FEA will replace the UK Government benefit Funeral Payments (FP) by summer 2019. We assume it is introduced on 1 June 2019.

103 The forecast for FEA is influenced by the complex nature of the benefit, and the interactions with qualifying benefits and family relationships. FEA is expected to cost around £2 million more each year compared to FP. The main reason for the difference in expenditure is because of eligibility being widened under FEA. The take-up rate is initially estimated based on average take-up rates under FP over the last three years. Over the entire forecast horizon the take-up rate is gradually increased to account for increased awareness and accessibility of the benefit.

104 The FEA award is split into two components: reasonable costs for burial/cremation and ‘other’ (non-burial/cremation) costs likely to be used towards the cost of Funeral Director fees, coffin, flowers and so on. Starting with a flat payment of £700 in 2019-20, we have uprated the ‘other’ (non-burial/cremation) costs element of the award using CPI across the forecast horizon. Expenditure on Funeral Expense Assistance is forecast to increase from £6.2 million in 2019-20 to £6.6 million in 2023-24.

Employability Services

105 The Scottish Government has introduced a new voluntary service to provide employability support to help the long-term unemployed and people with disabilities to find sustainable employment. The Scottish Government has contracted external providers to deliver the service.

106 Two interim services were operational in 2017-18: Work First Scotland and Work Able Scotland. The Fair Start Scotland (FSS) service started in April 2018 and will accept referrals for three years. Contracts with, and payments to, providers will run for five years.

107 Forecast expenditure is based on the service design, the estimated number of individuals supported and the probabilities of those individuals entering into and sustaining employment. The overall forecast annual expenditure on Employability Services is £19 million in 2019-20 increasing £28 million in 2020-21 before declining over the rest of the forecast horizon.

Other benefits

108 Discretionary Housing Payments (DHPs) are grants awarded by local authorities to people in need of extra financial assistance with housing costs. The Scottish Government has committed to using DHPs to mitigate the removal of the spare room subsidy, commonly known as the 'bedroom tax'. Our forecasts show the cost of mitigating the bedroom tax increases over the forecast horizon, from £52 million in 2019-20 to £58 million in 2023-24. The Scottish Government's spending plans for other expenditure on DHPs remains unchanged at £10.9 million a year.

109 The Scottish Welfare Fund (SWF) was set up in April 2013 and provides grants for people on low incomes. Expenditure on the SWF has been constant at £33 million since 2013. The Scottish Government has set the 2019-20 budget for the SWF at £33 million, and has not informed us of any plans to change the level of funding for the SWF over the forecast period. Our forecast therefore assumes the Scottish Government's funding remains constant at £33 million per year. We do not assess the demand for the Scottish Welfare Fund or whether the funding from the Scottish Government is reasonable.

Borrowing

Capital borrowing

110 Capital borrowing is used by the Scottish Government to fund capital projects, for example to invest in schools, roads and hospitals. The Scottish Government has given us projections of its capital borrowing requirements up to 2019-20. We judge that these projections are within the limits set out in the fiscal framework, and are therefore deemed reasonable.

111 The Scottish Government borrowed the annual maximum of £450 million in 2017-18, to be paid back over 25 years. In 2018-19 and 2019-20 the Scottish Government plans to again borrow the annual maximum over a 25 year time horizon. This will result in a projected debt stock by the end of 2019-20 of £1.86 billion which is 62 per cent of the total statutory limit of £3 billion.

112 The Scottish Government will be able to continue to borrow the maximum amount per year until they reach the statutory borrowing cap. Beyond this point the annual amount available to borrow would be limited. The exact profile of repayments and the amount available for the Scottish Government to borrow will depend on the repayment period and the interest rate on future borrowing but if current borrowing levels continued the overall stock of debt would reach the cap by 2022-23.

Resource borrowing

113 The Scottish Government can borrow for resource spending, in-year cash management and forecast errors. These borrowing powers are extended in the event of a Scotland-specific economic shock. The Scottish Government have confirmed that they have not used resource borrowing powers to date and there are no plans for resource borrowing in 2019-20.

114 We have assessed whether we are forecasting a Scotland-specific economic shock. Given our forecasts for the Scottish economy and the most recent OBR forecasts for the UK economy, we are not forecasting a Scotland-specific economic shock.

Scotland Reserve

115 The Scotland Reserve is a cash reserve which can be used for underspends and when tax receipts are higher than forecast. It is subject to annual drawdown limits. The Scottish Government has provided information on the outturn balance of the Scotland Reserve for 2017-18 and projected drawdowns in 2018-19. There were a total of £464 million of payments into the reserve during 2017-18 and the aggregate balance was £538 million at the start of 2018-19.

116 Within the current financial year, 2018-19, the Scottish Government have projected they will draw down £85 million from the capital reserve and £250 million from the resource reserve. The drawdown from the resource reserve is the maximum allowed within the fiscal framework.

117 The Scottish Budget 2019-20 expects a drawdown of £220 million from the resource reserve and £93 million from the capital reserve. We have assessed that these projections are within the limits set by the fiscal framework, and are therefore reasonable.

Chapter 1 Introduction

What is in this report?

1.1 This report presents the official and independent economic and fiscal forecasts created by the Scottish Fiscal Commission to inform the Scottish Government's Budget 2019-20, published on 12 December 2018.

1.2 Alongside our forecasts, the report provides an explanation of the main assumptions and judgements made as part of the forecasting process. We also set out what has changed since the last set of forecasts we produced in May 2018.

1.3 The report is divided into the following sections:

Summary	A high-level summary of the forecasts produced by the Commission, and the main assumptions and judgements that underpin them.
Economy Chapter	Our five-year forecasts for the Scottish economy, including the underlying judgements and sensitivity analysis.
Tax Chapter	Our forecasts of receipts from the fully and partially devolved taxes within our remit, covering: o Income Tax o Non-Domestic Rates (NDR) o Land and Buildings Transaction Tax (LBTT) o Scottish Landfill Tax (SLfT) We also produce two illustrative forecasts: o VAT assignment o Scottish share of Air Passenger Duty (APD)

Social Security Chapter	Our forecasts for devolved social security expenditure: ○ Carer's Allowance and the Carer's Allowance Supplement ○ Discretionary Housing Payments ○ Employability Services ○ Best Start Grant ○ Funeral Expense Assistance ○ Best Start Foods ○ Scottish Welfare Fund
Borrowing Chapter	Our assessment of whether the Scottish Government's projections of borrowing are reasonable.
Annex A: Policy Costings	The policy costings the Commission has produced for this set of forecasts. This shows how much any individual policy will cost or raise, and how the Commission has arrived at that estimate.
Annex B: Policy Recostings	Our revised estimates of costings for policies previously costed. Recostings may be required because of new outturn data or revisions to key assumptions and judgements.
Annex C: Materiality and policy costings	Our approach to handling policies which have a very small fiscal effect.

Limitations of forecasting

1.4 The past is an imperfect guide to the future, with rapid changes in the global economy, society, politics and technology. Analytical models, based on historic data and theory, can help provide some insight into how the economy and public sector finances may change over time, but all have limitations. Forecasts cannot perfectly predict the future; the Commission's forecasts aim to present a balanced pathway through a broad range of possible outcomes.

1.5 Forecasting is an on-going process of intelligence gathering, learning from previous forecasts, reflection and refinement. Judgements will be made on the basis of the best evidence and intelligence available at the time of publication, but may change from one forecast to the next as the economy evolves and our understanding develops along with it. In each chapter, we have clearly laid out how our judgments have developed since our previous forecasts in May 2018.

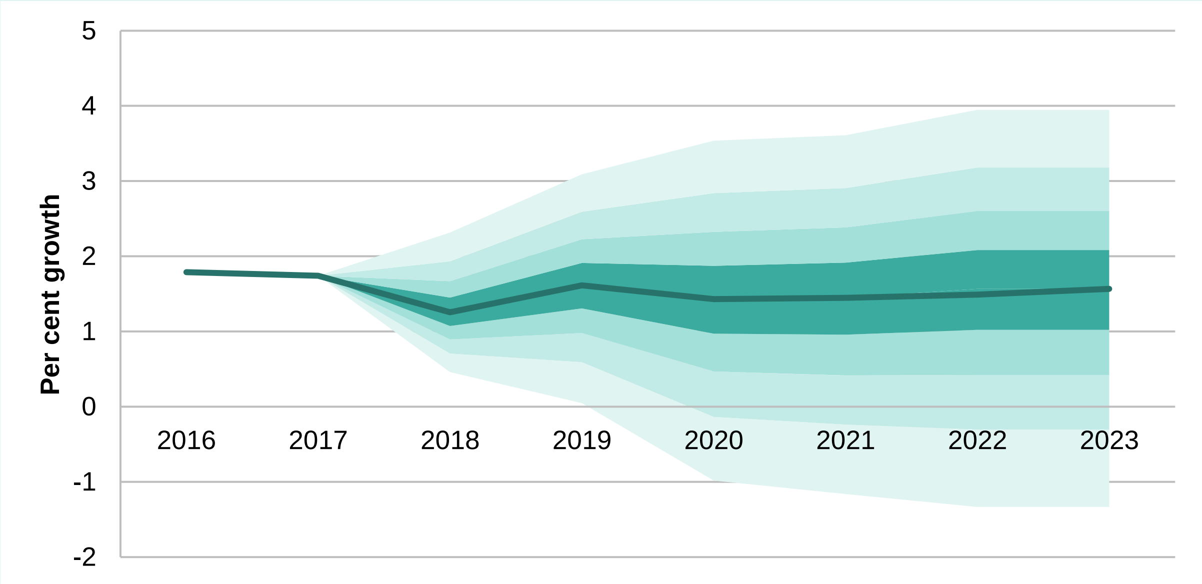
1.6 Another limitation to forecasting is the availability and accuracy of historic data. In our second Forecast Evaluation Report published in September 2018, we highlighted the effect that revisions to historic data can have on our forecasts.[19] Large revisions to economic data, and newly available data on outturn income tax liabilities in Scotland, had a significant effect on the accuracy of our forecasts. We continue to seek improvements to the economic, tax and social security data available for Scotland, as highlighted in our Statement of Data Needs.[20]

Box 1.1: OBR Forecasting – uncertainties and challenges

The Office for Budget Responsibility (OBR) emphasises in every Economic and Fiscal Outlook that since the future can never be known, all such forecasts are necessarily surrounded by uncertainty.[21] The OBR produces an evaluation of its forecasts once a year in its Forecast Evaluation Report and highlight how "the likelihood that any given forecast will turn out to be accurate in all respects is essentially negligible".[22]

In common with many forecasters the OBR publishes a fan chart such as Figure 1.1 that illustrates the uncertainty in their economy forecast.

Figure 1.1: OBR's real GDP growth forecast



Source: OBR (2018) Economic and Fiscal Outlook – October 2018 (link)

The OBR's fan chart shows the OBR's central expectation of UK GDP growth of 1.6 per cent in 2019. The probability of UK GDP growth being exactly 1.6 per cent in 2019 is low. The OBR expect that there is only a 50 per cent chance that UK GDP growth in 2019 will be within 0.8 percentage points of their central estimate.

[19] Scottish Fiscal Commission (2018) Forecast Evaluation Report (link)

[20] Scottish Fiscal Commission (2018) Statement of Data Needs (link)

[21] OBR (2018) Economic and Fiscal Outlook - October 2018 (link)

[22] OBR (2017) Forecast Evaluation Report (link)

We have looked at the average difference between forecasts and outturn data, known as forecast error, over nearly 30 years of UK revenue forecasts. Across all one-year-ahead UK revenue forecasts, there has been an average absolute forecast error of 3.3 per cent. We are responsible for forecasting tax revenue for Scotland of around £16 billion for 2019-20. While highly illustrative as we have a different mix of revenue forecasts, and taxes in Scotland are managed differently than in the UK, applying the average UK revenue forecast error to Scotland suggests it is not unreasonable to expect an average one-year ahead error in our tax forecasts of around £530 million. This is an average, and higher errors are possible. Of the 53 UK forecasts we looked at, there was an error of more than 5.0 per cent, or £810 million in a Scottish context, on 11 occasions.

We will follow the OBR and many other forecasters in giving an insight into forecast uncertainty by discussing the sensitivity of our forecasts to alternative assumptions and the risk factors for our forecasts. This is our third forecast, so we are not yet in a position to create fan charts based on our own historic forecast error. In the future, as we build up a large enough history of forecasts, we will look to produce fan charts.

The role of our forecasts in Scotland's Budget

1.7 Our forecasts are an important component in determining the total budget available to the Scottish Government to spend in each financial year. The Scottish Budget is also affected by the corresponding Block Grant Adjustments (BGAs). For taxes these adjustments are reductions in the block grant, whilst for the larger social security benefits these are additions to the block grant.[23,24]

1.8 The adjustments reflect the revenue the UK Government no longer receives because of the devolution of taxes to Scotland and the payments no longer made by the UK Government on devolved benefits. Smaller social security benefits result in additions to the block grant, indexed using the Barnett formula and will not directly correspond to UK Government expenditure on the same benefit.[25]

1.9 Figure 1.2 is a stylised representation of the way the Scottish Budget is determined. Adding the BGAs to the block grant produces the net block grant. The forecast BGAs are based on OBR forecasts of UK Government receipts

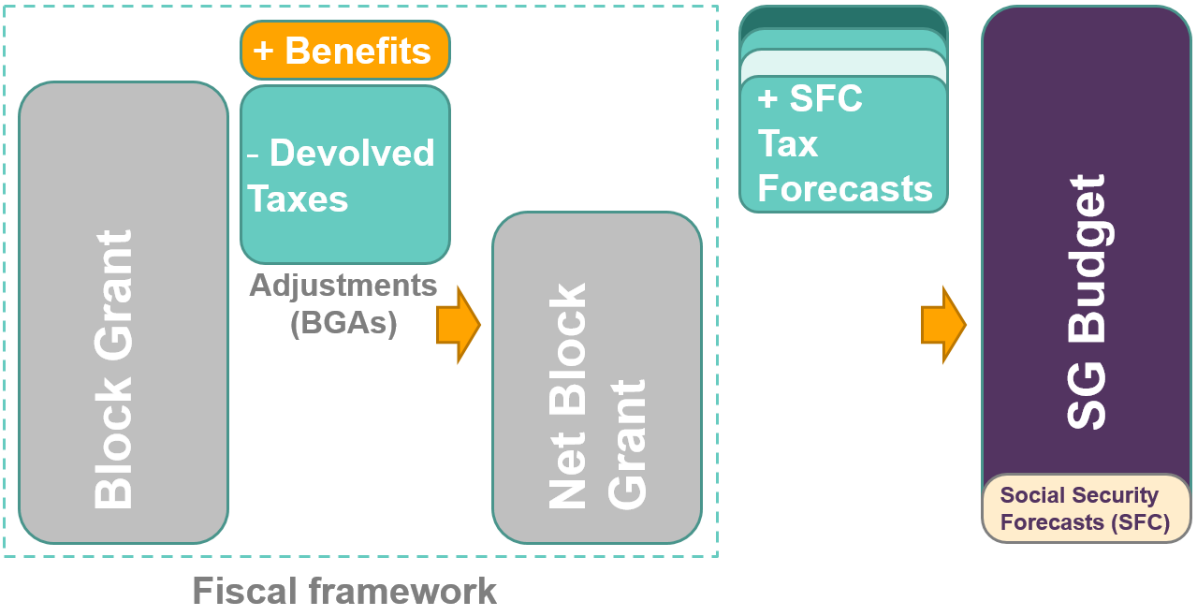
[23] Non-Domestic Rates (NDR) was devolved before the Scotland Act 2012 and is outwith the fiscal framework. This means there is no Block Grant Adjustment and no indexation mechanism with equivalent UK Government taxes.

[24] Block Grant Adjustments, in the form of additions, will be made for Attendance Allowance, Carer's Allowance, Cold Weather Payments, Disability Living Allowance, Personal Independence Payment, Industrial Injuries Benefits, Severe Disablement Allowance and Winter Fuel Payments.

[25] Best Start Grant, Funeral Expense Assistance, Employability Services and Discretionary Housing Payments

from corresponding taxes or spending on corresponding benefits, they do not relate to the OBR's forecasts of Scottish taxes or benefits. The OBR forecasts of receipts and spending are then used to calculate the BGAs. These calculations are undertaken by the UK and Scottish Governments; the OBR and the Commission have no involvement in this process. Once the net block grant is calculated, Scottish Fiscal Commission tax forecasts can be added to give an overall picture of the Scottish Government's budget.

Figure 1.2 How is the Scottish Budget Determined?



Source: Scottish Fiscal Commission

1.10 A comparison of our forecasts and the most up-to-date BGA estimates for income tax, LBTT and Scottish Landfill Tax are provided in Chapter 3. Chapter 4 on social security includes the forecast position for Carer's Allowance, the only benefit devolved to date with a corresponding BGA.

1.11 The Scottish Budget in future years will be affected by any reconciliations relating to previous years' forecasts of Scottish receipts and the BGAs. The largest reconciliations in the next couple of years are expected to relate to income tax where the first reconciliation will occur after the outturn data for 2017-18 become available next summer and will affect the Scottish Budget 2020-21. Further information on reconciliations is provided in Chapter 5.

1.12 As further taxes and social security benefits are devolved, and corresponding BGAs agreed, we will include detail on these in our future publications.

The process behind creating our forecasts for Budget 2019-20

1.13 In developing these forecasts, the Commission has engaged with the Scottish Government by following the process set out in the agreed and published

Protocol between the organisations.[26] This Protocol has been revised to reflect our experiences in our first year of statutory operation and the changes to the budget process which have since been agreed.

1.14 Since formal notification of the date of the Scottish Budget 2019-20 on 3 October, the Commission has had several rounds of meetings to discuss our forecasts. These have included discussions with the Scottish Government, Revenue Scotland and the Office for Budget Responsibility. In accordance with the Protocol, more detail of timings and attendees at different rounds of meetings is published on our website.[27]

1.15 Headline dates of interest are:

27 November	The economy forecasts were finalised to allow inclusion into the final fiscal forecasts.
28 November	The Scottish Government provided the Commission with finalised policy measures.
4 December	The Commission presented the Scottish Government with final forecasts to allow the finalisation of the Scottish Budget 2019-20.
7 December	The Commission's near-final report was shared with the Cabinet Secretary for Finance, Economy and Fair Work.
11 December	Phone call between Dame Susan Rice, Chair of the Commission and Cabinet Secretary for Finance, Economy and Fair Work.
11 December	A pre-release version of the Commission's report was shared with the Cabinet Secretary for Finance, Economy and Fair Work.
12 December	Scotland's Economic and Fiscal Forecasts – December 2018 published.

[26] Protocol for engagement between the Scottish Fiscal Commission and the Scottish Government Version 2.0 published March 2018 (link)

[27] Scottish Fiscal Commission (2018) Scottish Economic and Fiscal Forecasts – December 2018 (link)

Background to the Commission

1.16 In April 2017 the Scottish Fiscal Commission became responsible for producing independent economic and fiscal forecasts to inform the Scottish Budget.

1.17 The Commission produces independent forecasts of:

- Revenue from fully devolved taxes
- Non-savings non-dividend income tax
- Assigned VAT
- Onshore GDP
- Devolved social security expenditure[28]

1.18 We produce forecasts at least twice a year. We also produce annual Forecast Evaluation Reports, and from time to time publish occasional papers on related subjects.

1.19 The Scottish Fiscal Commission is structurally and operationally independent of the Scottish Government. The Commission was previously a non-statutory body, established in 2014 to scrutinise Scottish Government forecasts of devolved taxes following the Scotland Act 2012. More details about the remit and history of the Commission, including previous publications, can be found on our website: www.fiscalcommission.scot.

Professional Standards

1.20 The Commission is committed to fulfilling our role as an Independent Fiscal Institution, in line with the principles set out by the Organisation for Economic Cooperation and Development (OECD) for these institutions.[29] Our values are to be independent, transparent, accessible and open.

1.21 The Commission also seeks to adhere to the highest standards for analysis possible. While we do not produce official statistics, as we produce forecasts, the Commission and our work voluntarily complies as much as possible with the principles of the Code of Practice for Statistics.

1.22 The Commission has published a statement on our compliance with the Code of Practice for Statistics on our website.[30] This sets out how the Commission demonstrates voluntary compliance with as many parts of the code as possible.

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[28] The Commission's specific role in social security forecasting is defined in the Scottish Fiscal Commission (Modification of Functions) Regulations 2017 (link) and the Scottish Fiscal Commission (Modification of Functions) Regulations 2018 (link)

[29] OCED (2014) Recommendation on Principles for Independent Fiscal Institutions (link)

[30] Scottish Fiscal Commission (2018) Compliance with the Code of Practice for Official Statistics (link)

Comments & Contact

1.23 We welcome comments from users about the content and format of our publications. If there is additional information on our forecasts which you would find useful, please let us know.

1.24 All charts and tables in this publication have been made available in spreadsheet form on our website.[31] If you have any feedback, or would like to request further information about any of our analysis, please email info@fiscalcommission.scot.

[31] Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts - December 2018 (link)

Chapter 2
Economy

Introduction

2.1 We provide forecasts for Gross Domestic Product (GDP), wages, employment, hours worked and other economic variables that feed into the Commission's fiscal forecasts, as well as fulfilling the Commission's remit of providing forecasts of onshore GDP growth.

2.2 The following sections cover:

- Forecast context and summary
- Key judgements
- Developments in the Scottish economy
- Productivity and trend GDP
- Spare capacity in the economy
- The labour market
- Wages, earnings and household incomes
- GDP and the components of expenditure
- Second-round effects
- Forecast sensitivities
- Comparison to previous forecasts
- Comparison to OBR UK forecasts

2.3 In this chapter we focus on what has changed since our last forecast. We have described our approach to forecasting the economy in a series of papers over the last two years.[32] We will continue to publish papers as our approach develops.

[32] Scottish Fiscal Commission (2017) Current Approach to Forecasting (link) and Scottish Fiscal Commission (2018) Forecasting the long-run potential of the Scottish economy March 2018 (link)

2.4 The economy forecasts were finalised on 27 November 2018, with no published data being accepted after this date. This cut-off is to allow for a stable forecast on which the Government can finalise its Budget.

Forecast context and summary

2.5 This section provides:

- an overview of our economy forecasts
- headline forecast numbers
- an assessment of whether or not access to additional borrowing powers will be triggered by a Scotland-specific economic shock

2.6 Since our first forecast published in December 2017 we have presented a subdued outlook for the Scottish economy, driven by slow growth in GDP, productivity and wages over the last several years. Overall, an outlook for subdued growth remains the case in our forecasts presented in this report.

2.7 While our outlook remains subdued, our forecasts are more positive than they were in May 2018. This is because of a number of factors:

- Recent revisions to economic data mean that GDP growth over the last two years is now stronger than we believed in May. This has pushed up our forecasts of GDP and productivity in 2018 and 2019.

- Forecast government expenditure in Scotland is significantly higher than in May, and this supports an outlook of higher GDP growth in all years of the forecast. This is primarily driven by higher than previously announced UK government expenditure, feeding through to Scotland via the Block Grant.

- Available earnings data for 2018 are a little stronger than we expected back in May, and so we have revised up our forecast of average earnings growth by around 0.2 percentage points in 2018 and beyond.

2.8 Table 2.1 presents the Commission's headline economy forecasts including GDP, the labour market and earnings, compared to our forecasts published in May 2018.

2.9 We expect economic growth to be subdued in the longer-term. Average annual GDP growth since 2010 has been around 1.0 per cent, below expectations set for average GDP growth in earlier decades. We think it is likely that this relatively low level of growth will persist over the next five years.

2.10 While we expect growth to average around 1.0 per cent over the next five years, we forecast higher growth in 2018 and 2019. This follows a strong performance in the production industry and exports in 2017 and 2018 so far, which we do not expect to be sustained beyond next year.

Table 2.1: Headline economy forecasts, May 2018 and December 2018, per cent growth rates unless otherwise stated

GDP	2017	2018	2019	2020	2021	2022	2023
May 2018	0.8	0.7	0.8	0.9	0.9	0.9	0.9
December 2018	1.4	1.4	1.2	1.0	1.0	1.1	1.2
Trend productivity							
May 2018	0.0	0.2	0.5	0.8	0.9	1.0	1.1
December 2018	0.2	0.3	0.7	0.9	1.0	1.1	1.2
Average nominal earnings							
May 2018	1.1	1.6	1.9	2.2	2.6	2.9	3.2
December 2018	1.5	2.0	2.3	2.5	2.8	3.0	3.1
Average real earnings							
May 2018	-1.0	-0.5	0.0	0.3	0.6	0.9	1.1
December 2018	-0.6	-0.3	0.3	0.5	0.6	0.9	1.1
Employment (millions)							
May 2018	2.64	2.65	2.65	2.65	2.66	2.66	2.66
December 2018	2.64	2.64	2.65	2.65	2.66	2.66	2.66

Source: Scottish Fiscal Commission
Shading shows outturn available at time of publication.

2.11 The supplementary economy tables published alongside this document provide the main economy forecasts at calendar year, financial year and quarterly frequency.[33] These tables also contain the determinants from the economy forecasts that are used in the Commission's fiscal forecasts.

2.12 The fiscal framework provides additional borrowing powers for Scotland in the event of a Scotland-specific economic shock.[34] The fiscal framework defines an economic shock as rolling quarterly 4Q-on-4Q GDP growth of below one per cent and GDP growth in Scotland one percentage point below GDP growth in the UK.

2.13 Table 2.2 presents the Commission's forecasts of quarterly GDP growth and provides analysis of whether this would be considered a Scotland-specific economic shock.

- Criterion 1: 4Q-on-4Q growth in Scotland is below 1.0 per cent
- Criterion 2: 4Q-on-4Q growth in Scotland is 1.0 percentage point below the UK

[33] Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts - December 2018 Supplementary Economy Tables (link)

[34] Scottish Government (2016) Fiscal framework: agreement between the Scottish and UK Governments (link)

Table 2.2: Assessment of Scotland-specific economic shock

4 Quarter Growth Periods		4Q on 4Q growth in GDP (%)		Criteria		Shock
4 quarter period	Compared to	SFC Dec 2018 Scotland	OBR Oct 2018 UK	1	2	
2017Q2 - 2018Q1	2016Q2 - 2017Q1	1.3	1.0	N	N	N
2017Q3 - 2018Q2	2016Q3 - 2017Q2	1.4	0.8	N	N	N
2017Q4 - 2018Q3	2016Q4 - 2017Q3	1.4	1.8	N	N	N
2018Q1 - 2018Q4	2017Q1 - 2017Q4	1.4	1.8	N	N	N
2018Q2 - 2019Q1	2017Q2 - 2018Q1	1.4	2.0	N	N	N
2018Q3 - 2019Q2	2017Q3 - 2018Q2	1.3	2.1	N	N	N
2018Q4 - 2019Q3	2017Q4 - 2018Q3	1.3	1.6	N	N	N
2019Q1 - 2019Q4	2018Q1 - 2018Q4	1.2	1.6	N	N	N
2019Q2 - 2020Q1	2018Q2 - 2019Q1	1.1	1.6	N	N	N

Source: Scottish Fiscal Commission, OBR (2018) Economic and Fiscal Outlook October 2018 (link).
The GDP growth rates for Scotland in this table are based on our core forecasting model, where historical series are consistent with GDP data published in the August 2018 QNAS. Therefore GDP growth rates based on the latest available data from the October 2018 QNAS may differ slightly from those in the table. These small differences do not affect the Commission's forecasts, nor our assessment of Scotland-specific economic shock.

2.14 The Commission's assessment is that a Scotland-specific economic shock, as defined by the Fiscal Framework, is not expected to occur.

Key judgements

2.15 Table 2.3 summarises the main judgements we make about the Scottish economy over the next five years and shows how these have changed since our previous forecast in May 2018.

Table 2.3: Key economy forecast judgements

Issue	Judgement December 2018	Change since May 2018
1. Spare capacity	With our measure of spare capacity at +0.8 per cent of GDP in 2018, limited spare capacity in the Scottish economy is expected to continue to act as a drag on GDP growth	Our estimate of spare capacity has been revised down from +0.9 per cent for 2018
2. Trend productivity growth	From growth of 0.3 per cent in 2018 to growth of 1.2 per cent in 2023	Upwards revisions in each year of between 0.1 and 0.2 percentage points
3. Trend unemployment rate	4.25 per cent in all years	A downwards revision from 4.50 per cent
4. Earnings	Average nominal annual earnings growth increasing from 2.0 per cent in 2018 to 3.1 per cent in 2023, broadly aligning with productivity growth	Upwards revisions of 0.2 to 0.4 per cent in early years of the forecast following stronger than expected data for 2018
5. Population projections	ONS 2016-based population projections 50 per cent EU migration variant	No change
6. Forecasts of the UK	OBR UK Budget October 2018 forecasts	Updated from OBR UK Spring Statement March 2018 forecasts
7. Changing UK-EU relationship	Similar to the OBR: • The UK leaves the EU in March 2019 • New trading arrangements with the EU and others slow the pace of import and export growth • The UK adopts a tighter migration regime than that currently in place • Slower productivity growth	No Change
8. Impact of UK Continental Shelf Oil & Gas activity on the onshore economy	Limited growth in capital and operational expenditure in the UKCS will mean that less demand will be generated in the onshore Scottish economy by offshore activities than in the period 2010 to 2014	At the time of publication, oil prices at around $60/barrel are lower than when we published our May 2018 forecasts. As a result, we retain our subdued outlook for UKCS activity
9. Savings ratio	Broadly flat	No change
10. Second-round effects	No impact from new policy changes on the economy forecast	No change

Source: Scottish Fiscal Commission

Developments in the Scottish economy

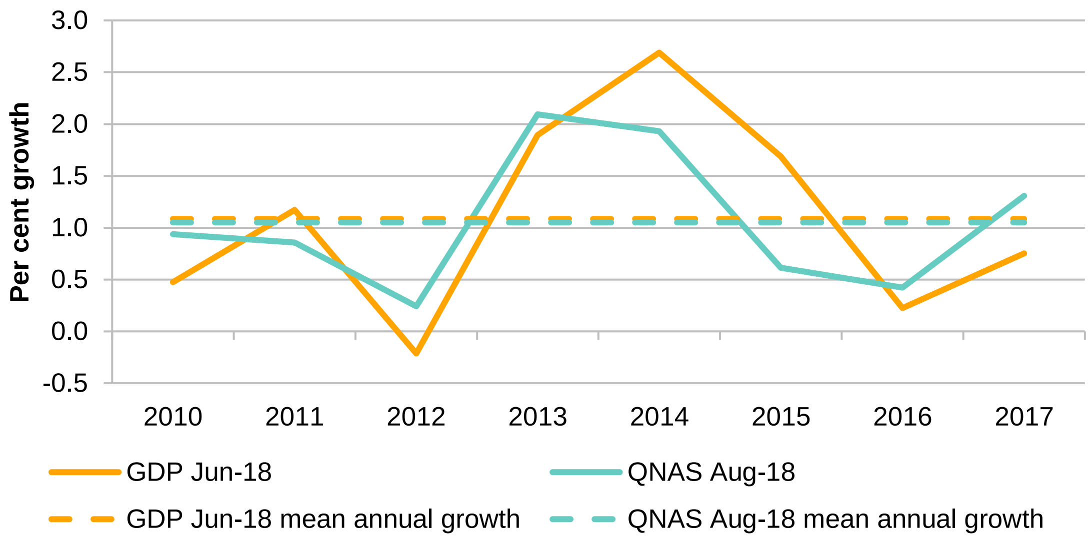
2.16 This section covers developments in the Scottish economy since our previous forecasts:

- Revisions to recent economic data
- The near-term outlook
- Oil prices and oil & gas activity
- Impact of the UK's changing relationship with the EU

Revisions to recent economic data

2.17 Figure 2.1 shows estimates of Scottish GDP growth as published by the Scottish Government in June 2018 and in August 2018. In the August 2018 publication, growth in 2017 was revised up from 0.8 per cent to 1.3 per cent, a revision of 0.6 percentage points. Other years, notably 2014 and 2015, were revised down.

Figure 2.1: Revisions to Scottish GDP



Source: Scottish Fiscal Commission, Scottish Government (2018) Scotland's Gross Domestic Product Quarter 1 2018, June 2018 (link), Scottish Government (2018) Quarterly National Accounts Scotland Quarter 1 2018, August 2018 (link).

2.18 This was primarily because of revisions to construction industry activity. Growth in construction industry activity in 2015 was revised down from 18.3 per cent to 6.2 per cent, while for 2017 it was revised up from 3.8 per cent to 4.3 per cent. While the construction industry only accounts for around six per cent of GDP, these large revisions had a significant impact on economic growth.

2.19 Typically, revisions to annual GDP growth between publications tend to be around 0.1 percentage points. The scale of the revisions published in August are exceptional. The revision to annual GDP growth in 2017 of 0.6 percentage points is larger than any other recent revision.

2.20 Despite the significant revisions to year-on-year growth, the longer-term picture for the Scottish economy is largely unchanged. While GDP growth has been revised up in some years and down in others, average growth in Scotland since 2010 is still around 1.1 per cent.

2.21 Economic data will always be subject to revision. Measures of construction industry activity and its impact on economic growth over the last few years are by no means settled. While we are likely to continue to see revisions to recent data, we do not expect these revisions to be of as large a magnitude to those in August 2018.

2.22 The upward revisions in 2016 and 2017 have raised the near-term outlook for the economy relative to our May 2018 forecast, as discussed in the next section. The revisions have not significantly affected our longer-term outlook, as discussed in our September 2018 Forecast Evaluation Report.[35]

The near-term outlook

2.23 We currently estimate long-term trend GDP growth in Scotland to be around 1.0 per cent. The latest data show the economy growing above this growth rate in 2017 and 2018, driven by a strong performance in the production sector and exports. We expect strong growth in the first half of 2018 to mean growth is above trend for 2018 as a whole, though growth may have started to soften in the second half of the year.

2.24 The Scottish economy grew by 1.4 per cent in 2017, above our expectations. The latest data show that the Scottish economy continued to perform robustly in the first two quarters of 2018, growing by 0.4 per cent in Q1 and 0.5 per cent in Q2.

2.25 The services sector is the largest component of the Scottish economy. Growth of 1.0 per cent in 2017 was followed by further expansions of 0.5 per cent in both Q1 and Q2 of 2018. Within the services sector, retail sales have remained resilient in the first half of 2018, despite weak income growth and challenging high street trading conditions.

2.26 Inflation as measured by the Consumer Price Index (CPI) averaged 2.7 per cent in 2017 and is expected to remain relatively high in 2018, before moderating from 2019 onwards. We expect this high inflation to dampen consumer spending and retail sales over the near term.

2.27 Following the recent data revisions, construction activity is no longer thought to have been a drag on GDP growth in 2016 and 2017, rather it is now estimated to have expanded in the last two years. Weather-related factors led to a fall in construction output of 2.6 per cent in the first quarter of 2018, but

[35] Scottish Fiscal Commission (2018) Forecast Evaluation Report - September 2018 (link)

the sector rebounded in the second quarter with output growing by 1.9 per cent.

2.28 After declining in 2015 and 2016, production industry output has subsequently recovered with growth of 2.0 per cent in 2017. The sector expanded further in the first and second quarters of 2018, by 1.0 per cent and 0.3 per cent respectively. The sector's performance has been driven by strong global economic growth, rising oil prices, and the sustained weakness in the value of Sterling boosting manufactured exports. The volume of Scotland's manufactured exports to the rest of the world grew by 8.5 per cent during 2017 and has continued to increase in the first two quarters of 2018. From the second half of 2018, growth in the production industry may start to diminish, given falling oil prices.

2.29 Looking ahead, the latest surveys of the Scottish economy point to softer growth in the third and fourth quarters of 2018, compared to the first half of the year. The Royal Bank of Scotland Purchasing Managers' Index (PMI) indicates that private sector business activity continued to increase during the second half of 2018, but at a weaker pace in September and October. The latest Confederation of British Industry (CBI) Industrial Trends Survey for Scotland suggests easing in growth of manufacturing output during the third quarter. According to the Scottish Government's Retail Sales Index, growth in the volume of retail sales in Scotland also slowed in the third quarter, with growth of 0.4 per cent in 2018 Q3 compared to 0.5 per cent in each of the first two quarters.

2.30 Business confidence and consumer sentiment also weakened during the third quarter of 2018. The Scottish Chambers of Commerce survey for 2018 Q3 reported a relatively sharp decline in Scottish business optimism, with manufacturing industries said to be holding back investment because of Brexit uncertainty. The Scottish consumer sentiment indicator also decreased in the quarter, by 1.4 points, with households most worried about the economy's performance and household's finances in the next twelve months.

2.31 Table 2.4 presents the Commission's short run quarterly economic forecasts for GDP, employment and nominal hourly wages. Given the outturn data for the first half of the year and our short-run forecasts, we forecast GDP growth to be 1.4 per cent in 2018.

Table 2.4: Quarter on quarter growth rates, outturn and forecast (per cent)

Quarter	GDP	Employment	Nominal wages
2017 Q1	0.8	0.1	0.4
2017 Q2	0.0	1.3	0.3
2017 Q3	0.5	0.2	0.5
2017 Q4	0.3	-0.3	0.9
2018 Q1	0.4	-0.3	0.3
2018 Q2	0.5	0.1	0.4
2018 Q3	0.3	0.0	0.7
2018 Q4	0.3	0.1	0.4

Source: Scottish Fiscal Commission, Scottish Government (2018) Quarterly National Accounts Scotland Quarter 2 2018 (link), ONS (2018) Labour Force Survey November 2018 (link).
Shading shows outturn available at time of publication.
Outturn GDP growth rates in this table are based on data published for 2018 Q2 in the October 2018 QNAS. Our short-run GDP forecasts are adjusted to account for these latest available data but the historic revisions published in October 2018 were not included in our forecast because of time constraints. Therefore annual GDP growth for 2018 based on the quarterly growth rates in this table may differ slightly from our forecast of 1.4 per cent.

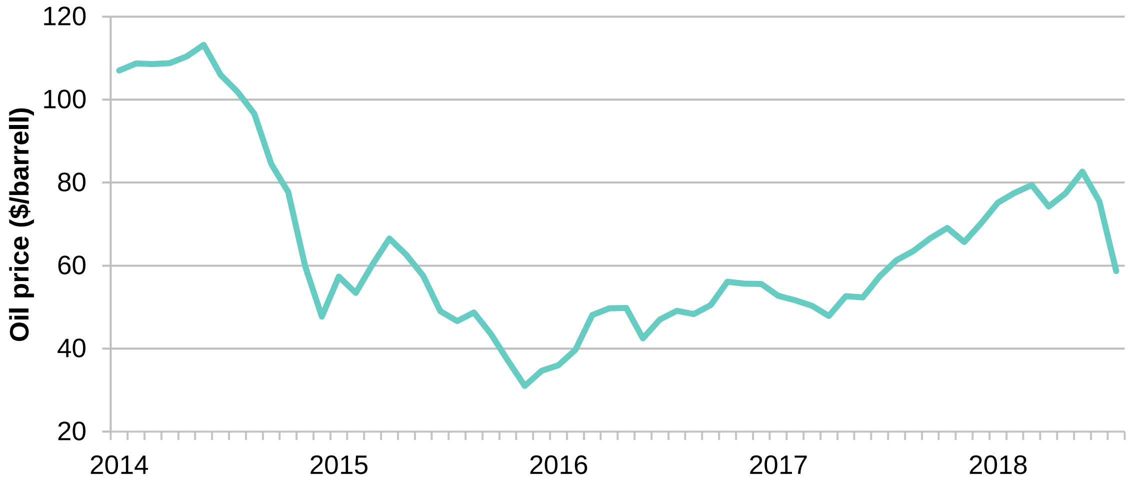
Oil prices and oil & gas activity

2.32 Our judgement on the oil and gas sector is a weak outlook for the UK Continental Shelf (UKCS) activity over the forecast horizon, because of significant uncertainty over oil price movements and its implications for capital investment projects.

2.33 After the sharp decline in 2015 and 2016, oil prices had been recovering over the past year, rising 35 per cent above their average level in 2017 to reach an average of $73/barrel over the 10 months of the year up to October 2018. Rising oil prices have contributed at least in part to the recent growth in the oil and gas related production industries of the economy.

2.34 Since early October, oil prices have fallen sharply, and were around $60/barrel at the time of writing. Any support for oil and gas activity from rising oil prices in the first half of this year is likely to have been significantly dampened by this recent fall. Given ongoing volatility in the oil price and the uncertainty this creates in the oil and gas industry, and broadly in line with our assumption in the May 2018 forecast, we think the outlook beyond 2018 remains subdued.

Figure 2.2: Monthly Europe (ICE) Brent prices ($/barrel)



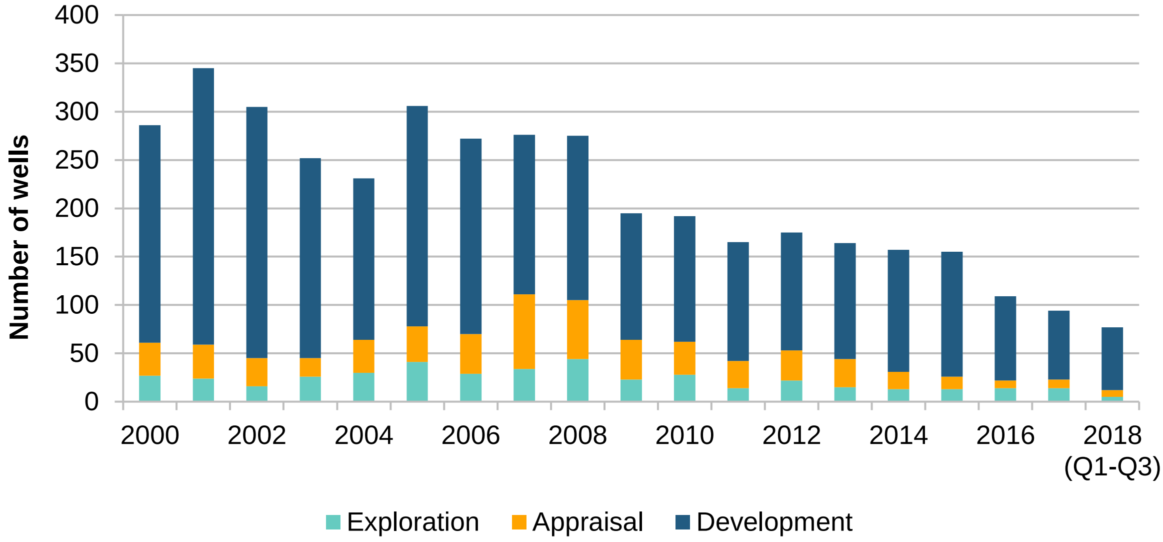
Source: Intercontinental Exchange (2018) Brent index (link)

2.35 Prior to sharp falls in the oil price over the last two months, rising oil prices were boosting confidence and optimism within the oil and gas sector. Returning confidence was expected to lead to an increase in UKCS expenditure in 2018 of about eight per cent, reversing the declining trend since 2014. Recent Oil and Gas Authority (OGA) data show that while decommissioning is expected to grow by 42 per cent in 2018, accounting for the bulk of the rise in expenditure, both capital expenditure and operating expenditure are also expected to increase in 2018, by about 3.6 per cent and 8.2 per cent respectively. Capital expenditure in particular is critical to onshore growth as it drives UKCS demand for supply chain output.

2.36 North Sea production performance has been resilient in 2017 and is forecast to remain robust in 2018. While efficiency improvements remain the main source of production gains, there has also been a significant drive from a number of new fields coming on stream. Increasing production, especially from new developments and rising expenditure, should continue to support the onshore economy in 2018.

2.37 Over the medium to long term, there remain significant challenges for the oil and gas industry. Oil price uncertainty has increased considerably in the last few months. Growing uncertainty and volatility of oil prices is likely to dampen confidence and profitability within the industry. Drilling activity also continues to decline as shown in Figure 2.3. Falling and volatile oil prices, lower confidence and declining drilling activity are likely to continue to limit demand created in the onshore economy by UKCS oil and gas activity over the next five years.

Figure 2.3: Drilling activity in the UKCS, number of wells started to be drilled in each year



Source: Oil and Gas Authority (link)

2.38 Overall, the Commission's judgement is that the positive contribution from the oil and gas sector on onshore GDP in the last two years will be short-lived, as prospects for offshore activity over the next five years remain weak. Broadly in line with our assumptions in the May 2018 forecast, we take a subdued view on the impact of the North Sea oil and gas sector on onshore output. Over the forecast horizon, we retain our judgement that the sector will be largely neutral for growth in the onshore economy.

Impact of the UK's changing relationship with the EU

2.39 In the referendum on 23 June 2016, a majority of votes cast were in favour of the UK leaving the EU. On 29 March 2017, the UK government triggered Article 50 to begin the process of the UK's departure from the EU scheduled to occur on 29 March 2019. The agreement between the UK government and the EU in November 2018 is a significant development in the Brexit process. There are two parts to the agreement: the Withdrawal Agreement (WA) setting the conditions for the exit of the UK from the EU in March 2019 and a Political Declaration (PD), outlining the intended nature of post-Brexit UK-EU relationships in trade, security, access rights to fishing waters, and other areas of co-operation.

2.40 While the WA and PD are important advances since our previous forecast, there remains much political uncertainty about the outcome and therefore economic uncertainty about the effects. The final deal has to be approved by both sides before 29 March 2019. The UK Parliament is expected to vote on the plan in December 2018 and, if backed by the UK Parliament, it then has to be ratified by the European Parliament. In the event of the deal failing to pass through both the UK and EU parliaments, it is possible that the UK will leave the EU without a deal, though there is a great degree of uncertainty about what would happen between December and March if the UK Parliament rejects the current agreement.

2.41 Therefore, at the time of preparation of this forecast, the outcome of Brexit and its implications for our forecast remain unknown. We continue to use the same broad-brush judgements as the OBR and as adopted in our previous forecasts. These basic judgements encompass a range of potential outcomes and impacts, all of which assume a relatively orderly and smooth exit from the EU. We consider a no-deal Brexit to be a downside risk to our forecast.

2.42 Below we discuss in more detail some of the salient aspects of the WA and PD, focusing on those most relevant to our forecast.

2.43 The WA addresses the 'divorce issues'. It covers the settlement of the UK's financial liabilities to the EU, and a commitment to protect the rights of EU nationals in the UK and Britons in the EU to continue living, working and studying. It also includes a transition period after Brexit day, currently a 21-month period up until 31 December 2020, during which there would very little change in the UK's relationship with the EU and during which the long-term relationship outlined in the PD would be negotiated in detail. The transition period can be extended once, for one or two more years, if a trade deal or a long-term solution on the Irish border is not in place by July 2020. During this period the UK will be able, in principle, to negotiate its own trade deals with other non-EU countries on the basis that these would not come into force until after the end of the transition period.

2.44 The WA contains provisions on the Irish border with the aim of avoiding the reintroduction of border checks between Northern Ireland and the Republic of Ireland. It is possible that, for this reason, the UK will remain in a customs union with the EU for a number of years after the end of the transition period.

2.45 The PD's framework for the longer-term UK-EU relationship includes the aspiration for a free-trade area with deep regulatory and customs cooperation. The PD is not legally binding; it will be the basis for a new trading and economic partnership to be fully negotiated during the proposed transition period. Therefore, it remains unclear what the new trade and regulatory regime will be after Brexit and how the UK-EU economic ties will be affected.

2.46 The PD also covers mobility arrangements, specifying that both sides want to preserve visa-free travel for short-term visits but that the principle of free movement of people will no longer apply. Current plans by the UK Government are for the UK's future immigration system to become more skills based. The outcome for EU citizens will become clearer as policy developments by the UK authorities and the UK's negotiations with the EU continue during the proposed transition period.

2.47 With so many issues about UK-EU trade relations and the UK regulatory regime still to be settled, and formal negotiations only beginning after 29 March 2019 provided the Brexit deal is ratified by both sides, the uncertainty around Brexit is still high and is likely to remain so for some time to come.

2.48 At present, there is no meaningful basis for making predictions of the development of the EU-UK economic relationship over the next few years on which we could base our economy forecast. Even if we could foresee how the formal relationship might develop, the economic and fiscal implications would remain highly uncertain.

2.49 In response to this uncertainty, the OBR uses broad-brush assumptions about the outcome of the negotiation process and the impact on the UK economy. These assumptions are that:

- the UK leaves the EU in March 2019
- new trading arrangements with the EU and others slows the pace of import and export growth
- the UK adopts a tighter migration regime than that currently in place

2.50 For our December 2017 and May 2018 forecasts, we adopted a similar set of assumptions about both the potential outcome of the negotiation process and the resultant impact on the economy. We are not attempting to pinpoint the exact impact of Brexit on the Scottish economy. Nor do we perform any scenario analysis of alternative hypothetical options for Brexit. Our focus is the impact on the economy over the forecast horizon of five years. The full effects of Brexit, both positive and negative, are likely to play out over a much longer time horizon. The Commission's judgement is that the OBR's broad-brush assumptions continue to provide a suitable starting point for incorporating the potential impacts on Scotland.

2.51 Following the existing basic assumptions, the Commission captures the impact through three channels:

1. Impact on migration – we use the ONS 50 per cent EU migration variant, with projected lower EU migration than in the principal projection. This is slightly different to the principal population projection used by the OBR for the UK.

2. Impact on productivity – we are forecasting slow growth in productivity, in part because of UK-EU exit.[36]

[36] UK inward investment in particular seems to have declined significantly since the referendum. Growth in business investment in Scotland has also continued to fall over the last two years. These factors are likely to slow productivity growth.

3. Impact on trade – Using OBR assumptions, we forecast slower growth in Scottish international trade from the end of the transition period, currently scheduled to last until 31 December 2020.

2.52 We have already noted the downside risk of a no-deal Brexit, and this risk has increased since we began work on our forecasts in September 2018. Our judgement on the UK-EU negotiations was formed based on information available up to the time of the economy forecasts closing on 27 November 2018. The forecasts set out in this report were provided to the Scottish Government on 4 December 2018 and inform the Scottish Government's Budget 2019-20. We expect to produce our next forecasts in summer 2019 to support the Scottish Government's Medium-Term Financial Strategy.

Productivity and trend GDP growth

2.53 In previous forecasts, we described an approach to estimating potential output and the output gap in Scotland. While our methodology is broadly unchanged, we have refined the way we talk about these concepts.

2.54 While the concept of potential output is helpful, some of the stricter theoretical implications of potential output are out of line with how we go about producing our forecasts in practice. We have decided that from now on we will refer to the softer notion of trend GDP, rather than potential output. Similarly, rather than referring to the output gap, we will discuss spare capacity in the economy. Our approach to modelling and estimating trend GDP and capacity is unchanged from what we have previously published about estimating potential output and the output gap.

2.55 To build a picture of trend GDP, we separately forecast population, the labour market and productivity. We set out our approach to modelling and forecasting longer term trends in the economy in a discussion paper we published in March 2018.[37] The approach used in these forecasts is largely unchanged since our March paper and our forecasts published in May 2018.

2.56 This section presents:

- an update on our outlook for productivity
- the Commission's judgement on long-term trend GDP

Productivity

2.57 The growth rate of productivity appears to have slowed since 2004, with the financial crisis exacerbating this trend. We estimate that trend productivity growth has averaged 0.5 per cent per year since 2008, compared to an average annual growth rate of 1.5 per cent over the 10 years prior to 2008. Broadly, as in our previous forecasts, we assume that productivity growth

[37] Scottish Fiscal Commission (2018) Forecasting the long-run potential of the Scottish economy March 2018 (link)

gradually increases from the low rates observed in recent years but remains well below its pre-crisis trend over the forecast period.

2.58 As shown in Figure 2.4, since our May 2018 forecasts we have slightly raised our outlook for trend productivity growth. This is for two reasons:

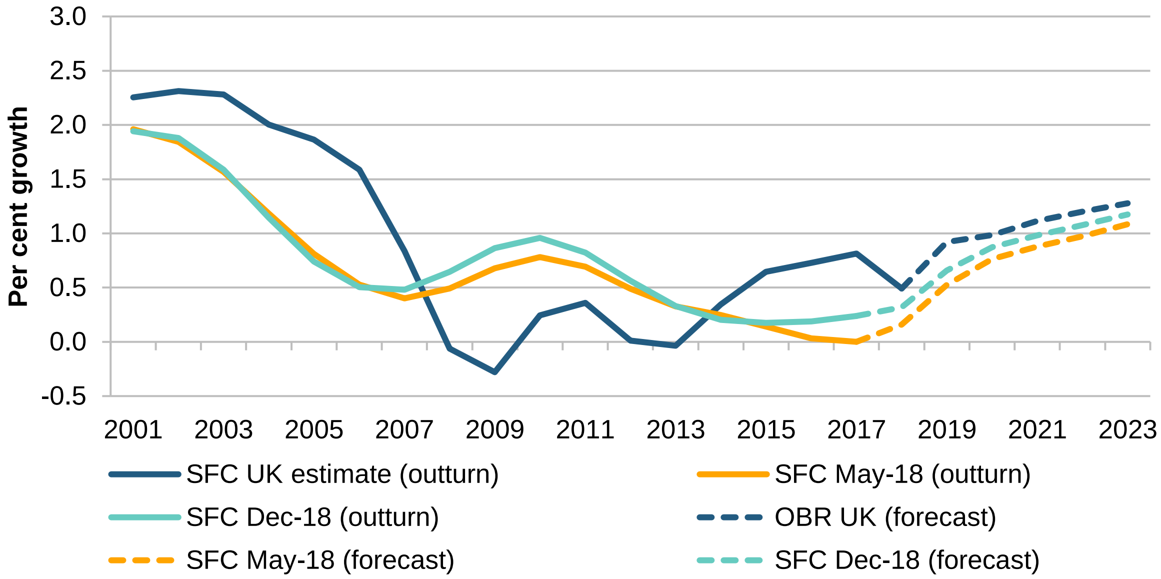
- We have slightly revised up our judgement on trend productivity growth in 2017 and 2018 as a result of stronger than expected growth in GDP and productivity over the last two years. This follows the large revisions to economic growth discussed in the previous section, although these revisions have not affected our longer term outlook. We have revised up our estimates of trend productivity growth by 0.2 percentage points in 2017 and 2018.

- From 2019 onwards, because of higher government spending, higher demand for economic output is expected to incentivise firms to expand their production capacity by intensifying labour and capital utilisation; increasing investment; and by operating more efficiently. The fiscal stimulus will increase output in the short term, with the positive effect on GDP growth expected to be sustained in the medium to longer term through higher productivity growth. Therefore we have revised up our forecast of trend productivity growth by 0.1 percentage points from 2019 onwards. Further information on higher government expenditure is available in the next section.

2.59 We expect that the changing relationship between the UK and the EU will weigh on productivity growth. An open and trading economy, with strong flows of foreign labour and investment, is generally believed to facilitate higher growth in productivity – all else being equal.

2.60 Lower levels of trade, migration and investment, and a lower level of economic openness more generally, strengthens our judgement that productivity in Scotland will continue to grow at a lower rate over the next five years than historic trends.

Figure 2.4: Productivity growth trend and forecast, Scotland and the UK (per cent)



Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – May 2018 (link), ONS (2018) Labour Productivity, UK: April to June 2018 (link), OBR (2018) Economic and Fiscal Outlook October 2018 (link).
The OBR does not publish a historical series for trend productivity growth. The series we provided is based on our smoothed series of ONS outturn data for UK actual productivity.

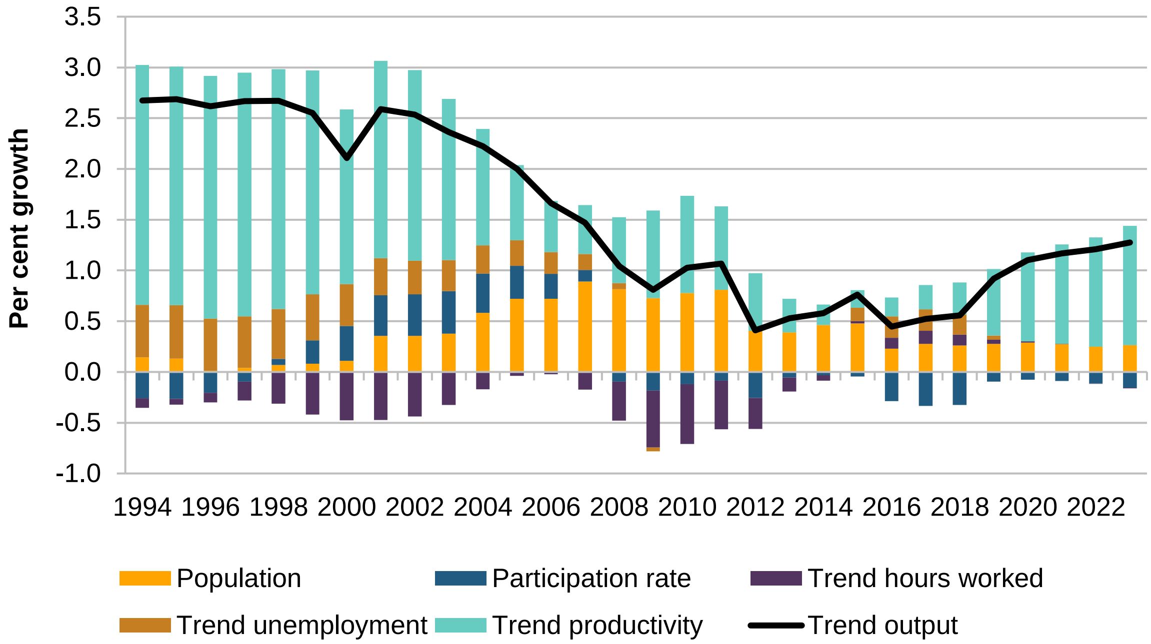
2.61 From growth of 0.3 per cent in 2018, we assume trend productivity growth reaches 1.2 per cent per year by the end of the forecast horizon. This remains below the 1998 to 2008 average of 1.5 per cent per year. Growth in trend productivity is a key uncertainty in our forecasts and we present sensitivity analysis in the section Forecast sensitivities.

Forecast of trend GDP

2.62 Our forecast of trend GDP growth is shown in Figure 2.5 and Table 2.5, which include the contribution of each component.

2.63 As well as higher productivity growth, we have revised down our assumption for the trend unemployment rate from 4.5 per cent to 4.25 per cent, given the ongoing low levels of unemployment and only modest wage growth. These changes increase trend GDP growth slightly.

Figure 2.5: Trend GDP growth and contribution of components (per cent)



Source: Scottish Fiscal Commission

Table 2.5: Growth of trend GDP and contribution of components

		Contribution of component of trend GDP (per cent)				
	Potential output growth (per cent)	16+ population	16+ participation rate	Trend unemployment rate	Trend average hours worked	Trend productivity
2016	0.4	0.2	-0.3	0.2	0.1	0.2
2017	0.5	0.3	-0.3	0.2	0.1	0.2
2018	0.6	0.3	-0.3	0.2	0.1	0.3
2019	0.9	0.3	-0.1	0.0	0.0	0.7
2020	1.1	0.3	-0.1	0.0	0.0	0.9
2021	1.2	0.3	-0.1	0.0	0.0	1.0
2022	1.2	0.2	-0.1	0.0	0.0	1.1
2023	1.3	0.3	-0.2	0.0	0.0	1.2

Source: Scottish Fiscal Commission

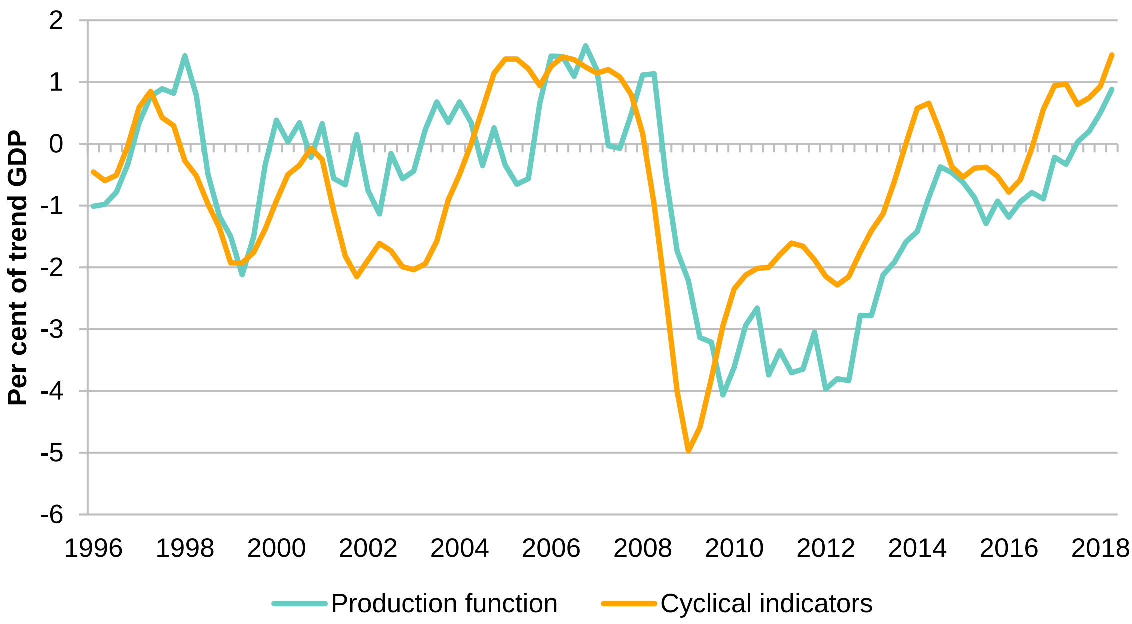
Spare capacity in the economy

2.64 After estimating trend GDP, we think about where the economy is in relation to this trend. If actual GDP is below trend, there is scope for faster growth in GDP by using the available capacity. If, on the other hand, there is little spare capacity in the economy, this is likely to limit growth.

2.65 As in our previous forecasts, we think that spare capacity in the economy is limited. This is supported by our assessment of the labour market, where the unemployment rate is currently very low, as well as by our modelling of trends in GDP and by available surveys of the economy. Our modelling of recent trends suggests the economy in 2018 is around 0.8 per cent above its trend level.

2.66 We also look at market intelligence and surveys of businesses in Scotland. We aggregate the results of these surveys together as an alternative indicator of spare capacity in Scotland. We refer to this as our cyclical indicators approach. Both of our approaches to estimating spare capacity suggest the economy is slightly above trend as shown in Figure 2.6.

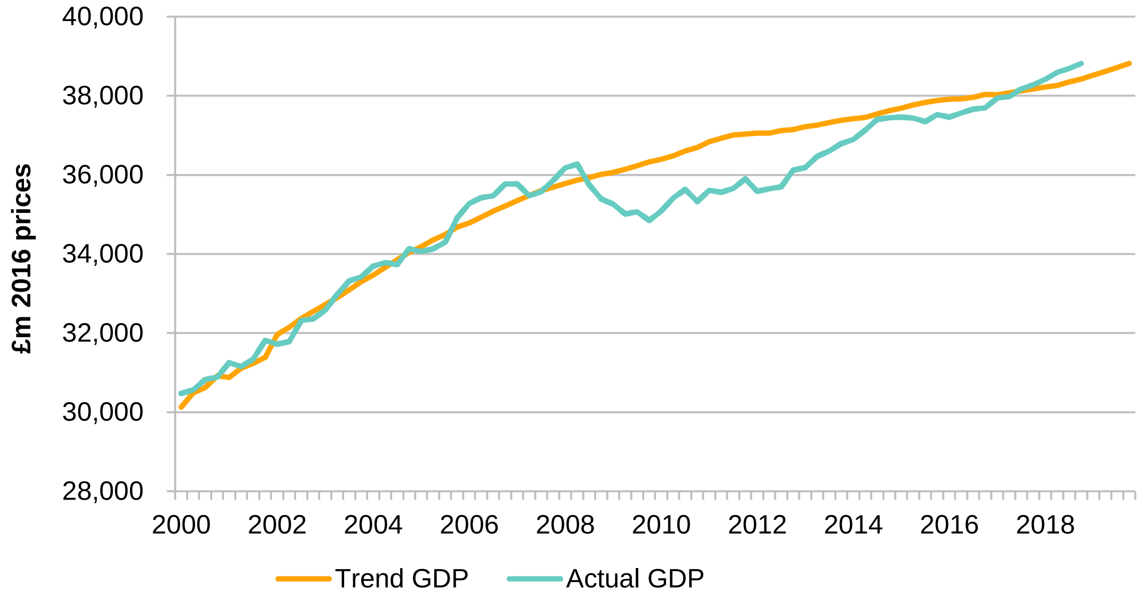
Figure 2.6: Comparison of spare capacity measures for Scotland (per cent of trend GDP)



Source: Scottish Fiscal Commission

118 While the production function provides our primary estimate of spare capacity, analysis of cyclical indicators gives us additional confidence in our judgement. Figure 2.7 shows actual output and our estimates of trend GDP.

Figure 2.7: Actual and trend GDP (£ million 2016 constant prices)



Source: Scottish Fiscal Commission, Scottish Government (2018) Quarterly National Accounts Scotland Quarter 1 2018 (link).
Actual GDP series includes Scottish Fiscal Commission short-run GDP forecast.

2.67 Our judgement is that the economy, after a period below trend, is now operating close to capacity. Growth of trend GDP and the amount of spare capacity today are both important factors in our five year forecast. While we have revised up our outlook for trend GDP growth, limited spare capacity will continue to restrict the rate at which the economy can grow.

The labour market

2.68 Overall, employment in Scotland has grown strongly in recent years, though it has been slightly lower in 2018 than we expected in our May 2018 forecast. The latest set of quarterly economic indicators published by the Scottish Chamber of Commerce highlighted that recruitment difficulties continue to be a concern in a number of sectors. The unemployment rate in Scotland is near historic lows of around 4 per cent. The low rate of unemployment and continued recruitment difficulties indicate limited spare capacity in the labour market.

2.69 We highlighted in May 2018 that, despite low capacity in the labour market, wage growth remained weak. Since May, we have seen growth in wages increase, though it remains some way below where we would expect it to be based on historic trends. Given the ongoing low levels of unemployment, and only modest wage growth, we have revised our judgement on the long-run rate of unemployment from 4.50 per cent to 4.25 per cent.

2.70 Labour market participation levels are expected to continue to gradually increase, and unemployment is expected to remain low. As a result, employment is expected to continue to grow, although at a slower rate than over the last few years. This is shown in Figure 2.8.

Figure 2.8: Employment and participation level, outturn and forecast (thousands of individuals)

Source: Scottish Fiscal Commission, ONS (2018) Labour Force Survey November 2018 (link), ONS (2018) Regional labour market statistics in the UK: November 2018, HI11 (link).

Earnings and household incomes

2.71 Real earnings growth has been weak since 2010, with most years seeing falls. In May 2018 we revised down our outlook for real earnings growth compared to our December 2017 forecasts. Growth was weaker than we would have expected given labour market conditions and productivity growth, and we reflected this in our forecasts.

2.72 As shown in Table 2.6, nominal earnings growth remains subdued relative to its historic value, of around 4 per cent annually. While our overall outlook remains weak, we have revised up our outlook for earnings growth relative to our forecasts published in May 2018.

Table 2.6: Forecast average earnings growth, successive forecasts (per cent)

	2017	2018	2019	2020	2021	2022	2023
December 2017	2.0	2.2	2.4	2.6	2.8	3.1	
May 2018	1.1	1.6	1.9	2.2	2.6	2.9	3.2
December 2018	1.5	2.0	2.3	2.5	2.8	3.0	3.1

Source: Scottish Fiscal Commission

2.73 In May 2018 we estimated growth in average annual earnings of 1.6 per cent in 2018. This was a downwards revision from the 2.2 per cent growth we had forecast in December 2017. Given the partial outturn data we now have for 2018, suggesting growth of around 1.8 per cent, we have revised our forecast up for the year as a whole to 2.0 per cent. This is slightly above our May 2018 forecast, but remains below our December 2017 forecast.

2.74 The available data and the evolution of our forecasts is shown in Table 2.7:

- New Annual Survey of Hours and Earnings (ASHE) data for 2018 shows nominal average annual earnings growth increasing from 0.9 per cent growth in 2017 to 3.3 per cent in 2018. The 2018 figure is provisional and likely to be revised.

- HMRC's latest Real Time Information (RTI) data shows Pay As You Earn (PAYE) earnings growth in Scotland of 1.9 per cent in 2018. This is slightly weaker than the 2.1 per cent growth in 2017.

- The latest Labour Force Survey (LFS) gross weekly earnings data now show earnings growth becoming positive at 1.4 per cent in 2018 after a weak performance of -1.5 per cent in 2017.

- In line with upwards revisions to GDP growth over the last two years, Compensation Of Employees (COE), our headline measure of earnings in the economy forecasts, has been revised up since May 2018 from growth of 2.7 per cent in 2016 to growth of 3.9 per cent. Earnings growth implied by COE has slowed again slightly at the start of 2018.

2.75 ASHE and LFS both indicate earnings growth increasing from 2017 to 2018, while RTI suggests earnings growth remained at around 2 per cent between years. COE is currently suggesting earnings growth lower in 2018 compared to 2017.

2.76 As a result of the moderate strengthening of wage data since our May 2018 forecast, we have slightly revised up our outlook for nominal earnings growth in 2018 from 1.6 per cent to 2.0 per cent. This upwards revision is followed by moderately higher wage growth in later years of the forecast.

Table 2.7: Data on average nominal earnings in Scotland, annual growth (per cent)

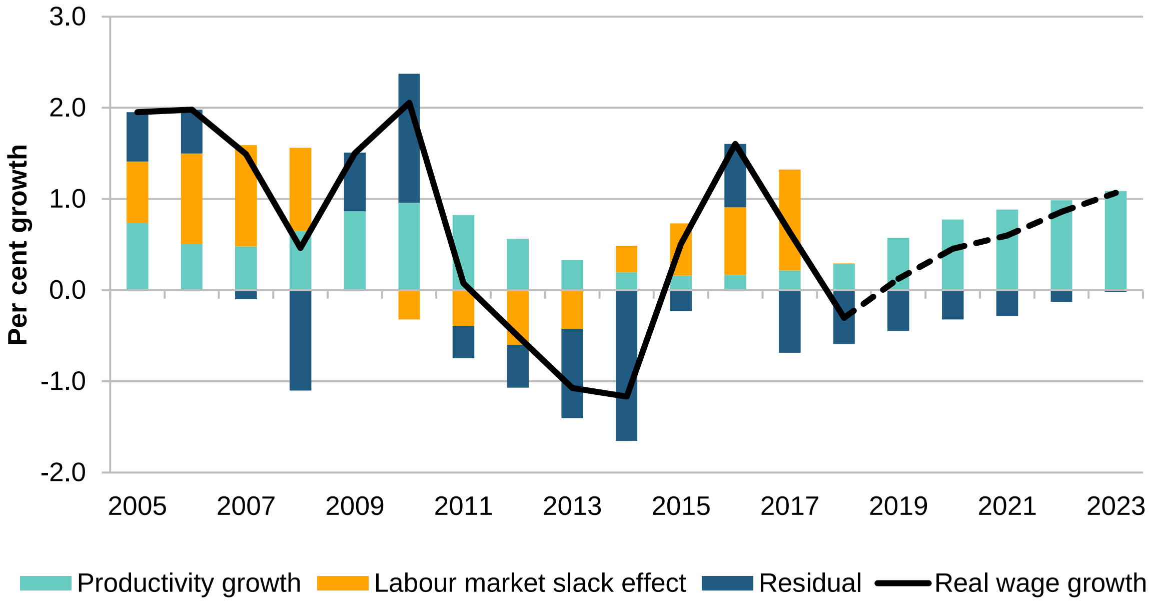
Data source	Forecast	Average 2010 to 2015	2016	2017	2018
ASHE	May-18	1.2	2.5	1.0	
	Dec-18	1.2	2.5	0.9	3.3
RTI	May-18		1.1	2.0	
	Dec-18		0.7	2.1	*1.9*
LFS	May-18	1.8	4.0	-1.5	
	Dec-18	1.8	4.0	-1.5	*1.4*
QNAS COE based measure [1]	May-18	2.2	2.7	1.5	
	Dec-18	2.0	3.9	1.4	*0.5*
Average	May-18	1.7	2.6	0.8	
	Dec-18	1.7	2.8	0.7	*1.8*
SFC	Dec-17		3.2	2.0	2.2
	May-18		3.3	1.1	1.6
	Dec-18			1.5	2.0

Source: ONS (2018) ASHE access via nomisweb (link), HMRC (2018) UK Real Time Information (link), ONS (2018) Labour Force Survey Gross weekly earnings of full-time employees by region (link), Scottish Fiscal Commission.
Italics for 2018 are part-year data expressed as annualised growth rate for comparison to previous years. ASHE data are up to April 2018. LFS is average Gross Weekly Earnings.
[1] QNAS only contain COE data for the whole economy. It does not report average annual earnings figures. The data we present in this table are based on Scottish Fiscal Commission calculations applied to QNAS COE data.

2.77 As discussed in our previous forecast, real wage growth has been weaker since 2010 than we would expect given growth in productivity and labour market conditions. This is illustrated in Figure 2.9. The residual category captures a number of factors that could have been acting as a drag on wage growth, which include:

- Ongoing uncertainty and low confidence in the economy
- Rising non-wage labour costs and limited business profitability
- Changes in the oil & gas industry following the fall in oil prices from 2014 onwards and declining UKCS expenditure
- Downward pressure on wages from the increasing trend towards automation and artificial intelligence technologies in business processes
- A rise in low-paid ‘gig-economy’ work

Figure 2.9: Contributions to real wage growth, outturn and forecast (per cent)



Source: Scottish Fiscal Commission

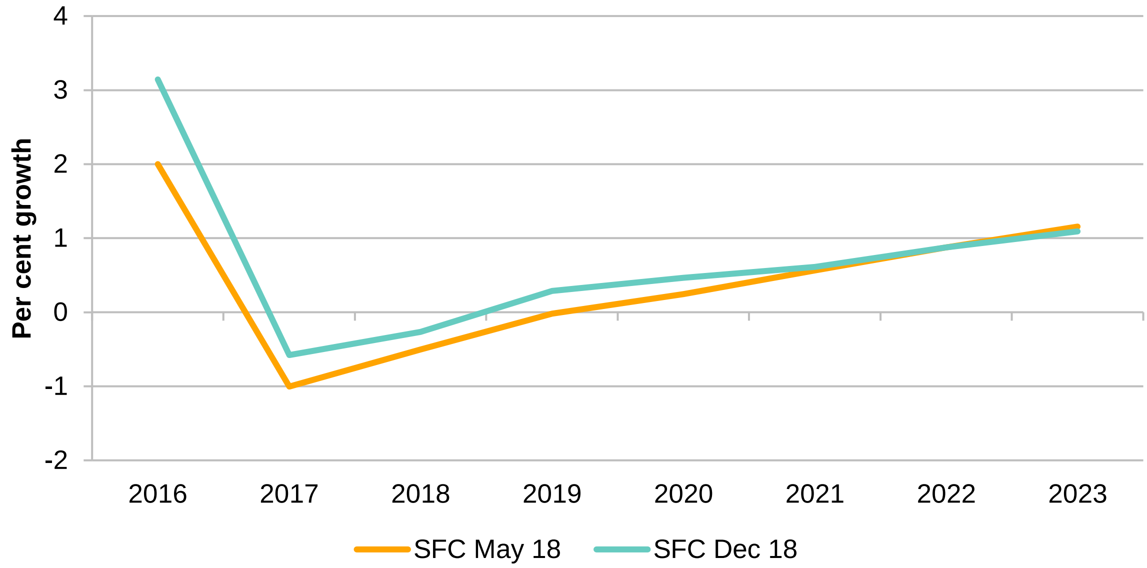
2.78 Looking ahead, we expect the overall drag on wage growth relative to productivity to lessen, as shown in Figure 2.9 by the shrinking of the residual category from 2018 onwards, allowing wage growth to increase. This more positive outlook for wage growth relative to the last eight years is driven by:

- Ongoing tightness in the labour market starting to feed through to higher wage growth.
- Higher public sector pay in Scotland having a direct effect on the pay of those in scope in the public sector, as well as indirect spillover effects on the pay of those in the private sector.
- The National Living Wage is set to increase by 4.4 per cent in 2018, increasing wages for some of those in employment on lower incomes.
- Demographic change means that the labour market will see a shift from younger workers to older workers. Our forecasts suggest that between 2010 and 2025, there will be 120,000 fewer individuals aged 16-24, and 280,000 more individuals aged over 55 in the labour market. On average, those in their 50s earn around 40 per cent more than those in their 20s. We expect this shift in the labour market to increase average earnings over the next five years.

2.79 Our upward revisions to productivity will feed through to real earnings growth. We have revised up earnings growth in the first three years of the forecast, but it remains similar to our May forecast in later years.

2.80 With inflation broadly flat at around two per cent, we expect real wage growth to pick up from -0.3 per cent in 2018 to 1.1 per cent in 2023. Our forecast of real wage growth is shown in Figure 2.10.

Figure 2.10: Forecast real wages, May 2018 and December 2018, annual growth (per cent)



Source: Scottish Fiscal Commission

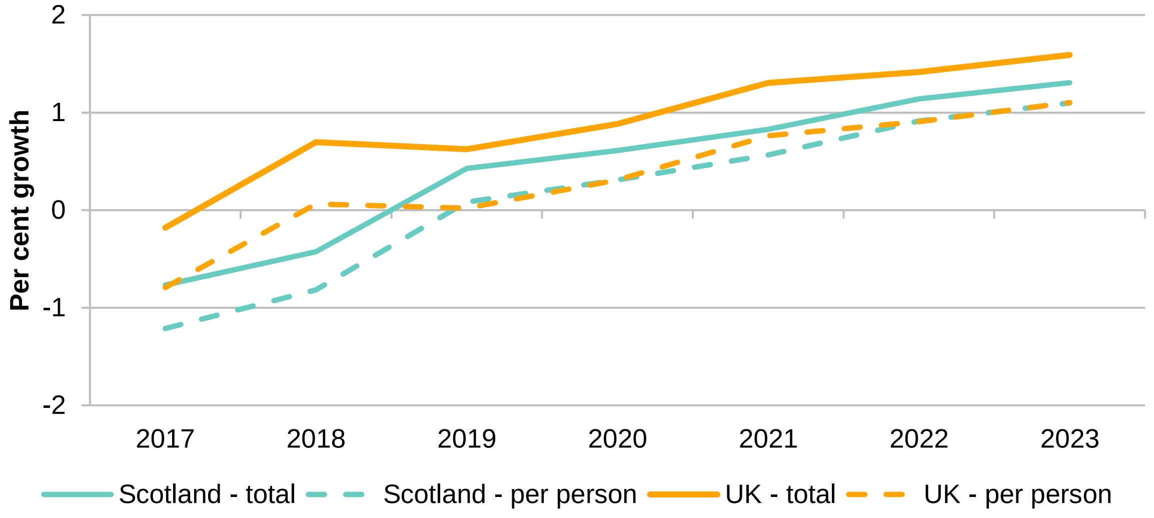
2.81 As shown in Figure 2.10, our estimates and forecasts of wage growth are slightly more positive than in May 2018. In summary, this is because of:

- Slightly more positive than expected earnings data for 2018.
- An upwards revision to our outlook for productivity growth.
- A more rapid contraction of the drag placed on real wage captured by the residual category in Figure 2.9 than we expected in May 2018.

2.82 Real disposable household income (RDHI) takes into account income from employment, income from other sources such as dividends, and changes in direct household taxes and social security transfers including pensions. Gradually rising growth in real wages and employment means gradual growth in average RDHI, shown in Figure 2.11.

2.83 Average hours worked in Scotland have been falling for some time, though this trend is expected to flatten out over the forecast horizon. Changes in average hours worked are not expected to significantly affect total household earnings.

Figure 2.11: Real disposable household income growth, Scotland and OBR UK forecasts, total and per person (per cent)



Source: Scottish Fiscal Commission, OBR (2018) Economic and Fiscal Outlook October 2018 (link).

2.84 In line with the OBR, we forecast limited growth in RDHI per person driven by slow growth in real wages. Because of slower population growth in Scotland, growth in total RDHI is only slightly above growth in RDHI per person. Growth of RDHI is the main determinant of aggregate consumption.

GDP and the components of expenditure

2.85 The Commission forecasts consumption, investment, government spending and net trade separately. These sum to create a pathway for GDP.

Consumption

2.86 During the period 2010 to 2017, consumption growth has been largely supported by households reducing their savings, running down their financial assets, or borrowing more. As in our previous forecasts, we expect households to continue to reduce their savings, although at a slowing rate, supporting consumption growth at the start of the forecast horizon.

2.87 With real disposable household income either falling or flat and the savings ratio already close to a historic low, growth in consumption is expected to be slow over the short to medium term. From 2020 onwards, growth in RDHI picks up, but consumption growth remains modest as part of the higher incomes will be given over to rebuilding savings.

Investment (private gross capital formation)

2.88 Private sector gross capital formation (GCF), more loosely referred to as investment, is a volatile component of GDP. Historically, investment has been a small component of GDP growth, contributing on average 0.2 percentage points to annual GDP growth.

2.89 The business investment part of GCF has been weak in Scotland in recent years, largely falling since 2015. The housing investment component has grown steadily since 2012, partly because of support from Scottish Government funded schemes such as the affordable housing supply programme.

2.90 In the medium term, on-going economic uncertainty driven by Brexit and a subdued outlook for UKCS activity is likely to limit business investment growth in Scotland. Overall, private investment growth is expected to be largely flat over the forecast horizon, neither contributing to nor subtracting from GDP growth from 2020 onwards.

Government

2.91 The public sector, including consumption and investment spending, accounts for around a quarter of the economy, based on a GDP by component of expenditure approach. Government expenditure is driven less by the economic cycle, and more by policy decisions by the UK and Scottish Governments.

2.92 General government expenditure in Scotland includes spending by all levels of government: Scottish Government expenditure, expenditure by other UK Government departments in Scotland, and spending by local authorities in Scotland. The impact of changes in direct household taxes and social security spending is captured through its impact on RDHI as discussed in the previous section.

2.93 At the UK Autumn Budget in October 2018, UK tax revenues for 2018-19 had been revised up, while projections of baseline expenditure had been revised down. This provided the UK government with an unexpected fiscal windfall of around £12 billion in 2019-20. In response, the UK Government increased expenditure above its previous plans in real terms for the next five years, with the majority of this additional expenditure allocated to the NHS.

2.94 This higher expenditure affects Scotland in two ways. The Scottish Government will receive extra funding via the Block Grant as a consequential of higher UK Government spending, and the expenditure by other UK Government departments in Scotland may also increase directly.

2.95 For UK Government and local authority spending in Scotland, we use the latest OBR forecasts from October 2018.

2.96 For Scottish Government expenditure in 2019-20, our figures are consistent with the Scottish Government's Budget 2019-20. From 2020-21 onwards, we forecast Scottish Governments expenditure by projecting:

- the Block Grant: which we broadly expect to grow in line with UK government expenditure
- Block Grant Adjustments (BGAs): provided by the Scottish Government based on the latest OBR forecasts of growth in UK government tax receipts
- Our own forecasts of Scottish tax revenue

2.97 Table 2.8 shows changes since our May 2018 forecast, focussing on the Scottish Government's resource budget.

Table 2.8: Change in main components of the Scottish Government's resource budget (£ million)

	2019-20	2020-21	2021-22	2022-23	2023-24
Base resource spending limit	27,633	28,222	29,688	30,596	31,631
Change since May 18	*570*	*1,468*	*1,840*	*2,255*	
Net BGA	271	282	284	310	329
Change since May 18	*89*	*8*	*-127*	*-203*	

Source: Scottish Fiscal Commission
Figures may not sum because of rounding. The figures for 2019-20 are consistent with Budget 2019-20. Figures for 2020-21 onwards are Scottish Fiscal Commission forecasts. The Scottish Government's budget is also affected by funding for social security and some non-budget elements.

2.98 The base resource spending limit primarily reflects the Block Grant. The net BGA shows the effect of the latest estimates of the BGA combined with our forecasts. This includes the Scottish Government policy announcements at the 2019-20 Budget.

2.99 As shown in Table 2.8, changes in UK Government expenditure announced in October 2018 result in a significant increase in the Scottish Government's base resource spending limit in 2019-20. The Scottish Government's Budget has not been set beyond 2019-20. Figures in Table 2.8 from 2020-21 onwards are based on the Commission's projections of the Scottish Government's resource budget.

2.100 The Scottish Government's budget will also be increasingly affected by reconciliations of the BGA to outturn data. The first reconciliation to income tax outturn data will take place after summer 2019, likely to be in the Scottish Budget 2020-21. Reconciliations are discussed in depth in Chapter 5. Our current forecasts of government consumption expenditure do not take into account the effect of reconciliations. This is because of the uncertainty about how the timing of reconciliations will affect the budget. We hope to develop an approach to include reconciliations in full in our summer 2019 forecasts. Including the reconciliations will have a very small effect on our current economy forecasts.

2.101 To build our forecast of GDP, we are looking to forecast government consumption expenditure and government capital expenditure consistent with Quarterly National Accounts Scotland. Starting from our forecasts of total expenditure by each level of government, we do additional modelling to move from total government expenditure to government consumption expenditure and government capital expenditure. Our forecasts of government consumption and capital expenditure are shown in Table 2.9, in current and constant prices.

2.102 The capital spending figures include the capital borrowing available under the provisions of the Scotland Act 2016. The Scottish Government has provided capital borrowing and repayment plans up to 2019-20. Decisions on how much to borrow beyond this point will be taken in future budgets. The Scottish Government borrowed the annual maximum in 2017-18 and plans to do the same in 2018-19 and 2019-20. This will result in a projected debt stock of £1.86 billion by the end of 2019-20 which is 62 per cent of the total statutory limit of £3 billion.

2.103 For our economy forecasts beyond 2019-20, we have assumed the Scottish Government continues to use the maximum possible capital borrowing, in line with its current behaviour. We also assume annual borrowing continues to be agreed with a repayment period of 25 years with equal repayments. We therefore expect the Scottish Government will borrow the annual limit of £450 million in every year up to 2022-23, taking the assumed repayment schedule into account, and to borrow the remaining available amount of around £139 million in 2023-24 to reach the £3 billion aggregate cap.[38] Lower borrowing in 2023-24 will mean, all else being equal, lower GDP growth forecasts than would otherwise have been the case. Further detail on Scottish Government borrowing is provided in Chapter 5.

[38] The exact amount available to borrow in 2023-24 will depend on the repayment profile and the interest rate available at the time of borrowing. See Chapter 5 for more details.

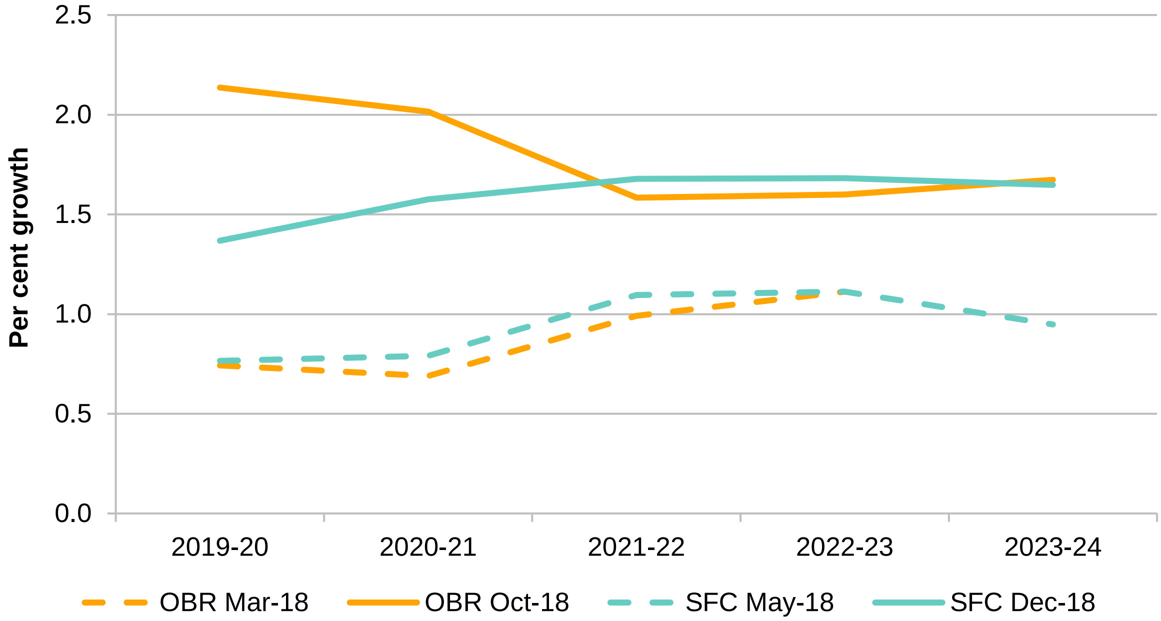
Table 2.9: Scottish Government's Budget 2019-20 public sector spending plans and Scottish Fiscal Commission forecasts (£ million)

	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
General Govt Consumption (current prices)	35,988	36,700	37,882	38,924	40,157	41,514	42,919	44,342
General Govt Consumption (constant prices)	39,595	40,156	40,810	41,368	42,019	42,725	43,443	44,159
General Govt Investment (current prices)	5,839	6,267	6,574	6,865	7,168	7,395	7,559	7,766
General Govt Investment (constant prices)	9,723	10,328	10,473	10,702	10,937	11,109	11,232	11,385

Source: Scottish Fiscal Commission, Scottish Government (2018) Quarterly National Accounts Scotland Quarter 1 2018 (link), OBR (2018) Economic and Fiscal Outlook October 2018 (link).
With regards to General Government Investment in particular, the figure for 2016-17 and 2017-18 in current prices are taken from the Scottish Government's 2018 Q1 QNAS publication. The corresponding figures in constant prices, which provide the starting point for our level forecasts, are taken directly from our core forecasting model, therefore the constant-price level forecasts in this table can differ from deflated nominal values.

2.104 While overall the UK Government continues to implement policies to reduce the fiscal deficit, it has moved in the direction of a relative fiscal expansion since our previous forecasts, resulting in significantly higher public spending in Scotland. Figure 2.12 shows our forecasts of government consumption expenditure in Scotland in our May 2018 and December 2018 forecasts. This combines UK, Scottish and local government consumption expenditure.

Figure 2.12: Total Government consumption expenditure, Scotland and OBR UK forecasts, constant-price growth rates (per cent)



Source: Scottish Fiscal Commission, OBR (2018) Economic and Fiscal Outlook October 2018 (link).

2.105 Higher forecast Government consumption expenditure in Scotland is almost entirely driven by changes in our forecasts of the Block Grant, as shown in Table 2.8. As shown in Figure 2.12, our upwards revision to our forecasts of growth in government consumption expenditure is broadly in line with revisions to UK government consumption expenditure growth in the OBR's latest forecasts.

2.106 The Scottish Government provided us with information on their spending plans for 2019-20. The difference in growth rates of government consumption expenditure between Scotland and the UK in 2019-20 is due in part to the planned allocation of additional funding to cover increased employer pension contributions of Government departments. This is currently captured in the whole of UK series, but as details of the funding allocation are not yet available, it is not captured in the Scottish Government's funding in this forecast.

2.107 The overall size of the Scottish economy in our forecasts is determined by growth in trend GDP. The change in government consumption expenditure is sufficiently large that it has led us to revise our projection of trend GDP. As a result of the fiscal expansion, the size of the economy over the next five years will be larger than we expected in May 2018.

2.108 As a result of the fiscal expansion, we have revised up our forecast of trend GDP growth in each year from 2019 onwards.

Net trade

2.109 Historically, trade has had a net negative impact on Scottish GDP growth, with growth in imports exceeding growth in exports. Net trade is made up of trade with the rest of the UK as well as international trade. Trade with the rest of the UK is by far the largest component. These two components are considered separately.

2.110 The changing UK-EU relationship is likely to affect Scottish international trade. The Commission uses the OBR's forecasts of UK international trade, reflecting the OBR's Brexit assumptions, as a starting point for modelling Scottish trade with the rest of the world. Changing trade agreements, possibly leading to the UK and Scotland being more closed to trade, will have a negative effect on both gross exports and gross imports, reducing the total volume of international trade, but with an ambiguous effect on net trade. In addition, an on-going lower Sterling level is likely to support exports growth and limit imports growth. In aggregate, Scotland's net international trade is expected to be broadly neutral for GDP growth over the forecast horizon.

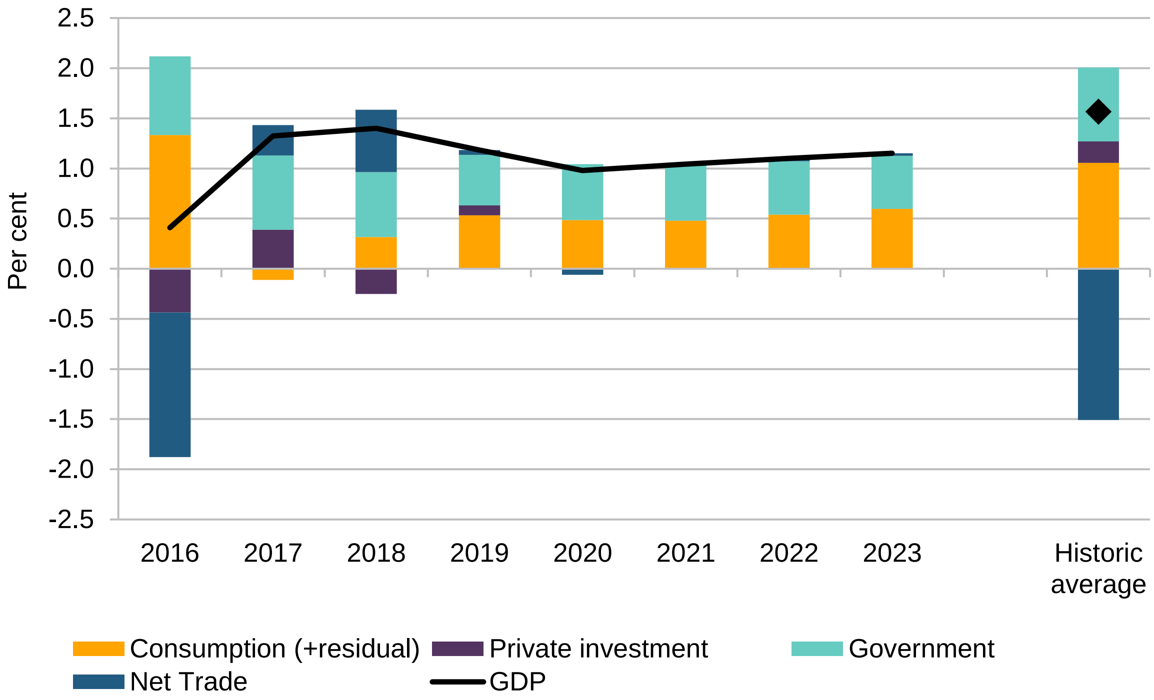
2.111 Scotland has long had a negative trade balance with the rest of the UK and this gap has been widening rapidly in recent years, with a negative effect on growth in GDP. Households in Scotland are expected to have slower growth in incomes than their counterparts in the rest of the UK over the next five years. The likely effect will be to slow the growth of the negative trade balance with the rest of the UK. We therefore forecast net trade with the rest of the UK to flatten out over the next five years.

2.112 Overall, Scottish net trade is expected to play a minor role in GDP growth over the forecast.

GDP growth

2.113 Figure 2.13 shows the contribution of each of these components to growth in GDP.

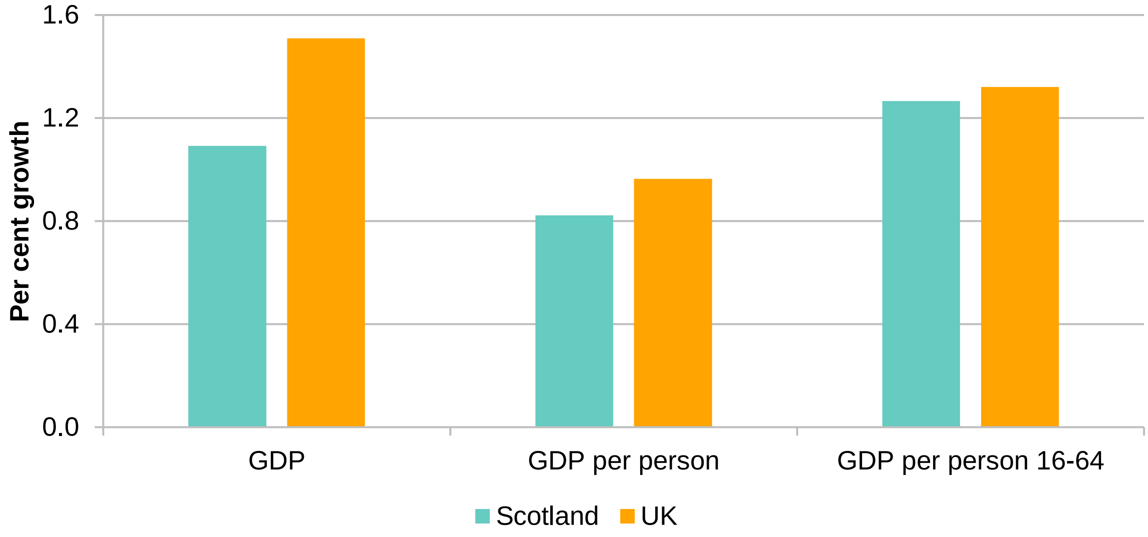
Figure 2.13: Contributions by component of expenditure to growth in GDP (per cent)



Source: Scottish Fiscal Commission
Historic average is based on growth from 1998 to 2017.

2.114 Compared to the OBR's forecasts for the UK, we forecast slower GDP growth for Scotland. As shown in Figure 2.14, this is in part because of slower population growth, and in particular slower growth of the 16-64 population in Scotland. Comparing growth in GDP per person, on average, we still forecast slower growth in Scotland than in the UK, though the size of the growth gap is significantly reduced. When looking at growth in GDP per person for those aged 16 to 64, our forecasts for Scotland are even closer to the OBR's forecasts for the UK on average.

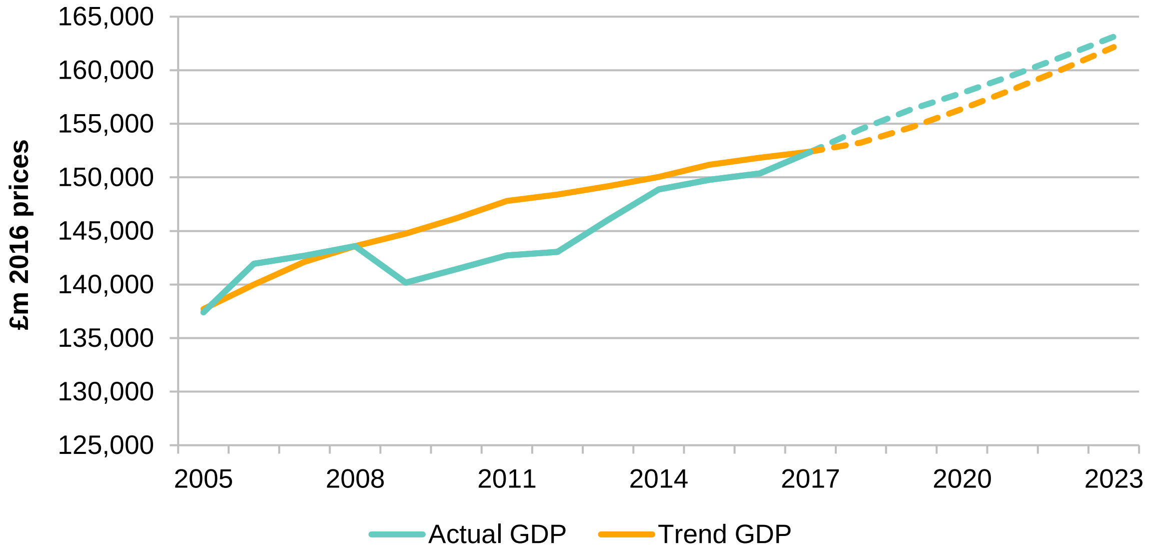
Figure 2.14: Growth in GDP and GDP per person, Scotland and OBR UK forecasts, average growth rates from 2019 to 2023 (per cent)



Source: Scottish Fiscal Commission, OBR (2018) Economic and Fiscal Outlook October 2018 (link), ONS (2017) 2016-based Population Projections, principal population projections UK (link).
The OBR does not publish a figure for GDP per person aged 16 to 64. The figure we provide takes the OBR series for real GDP and divides this by the ONS principal projections for 16-64 population.

2.115 As shown in Figure 2.15, the Commission estimates that actual GDP is currently slightly above its trend. The deviation of actual GDP from its trend is forecast to gradually narrow over the forecast horizon as GDP growth returns closer to its long-run trend growth rate.

Figure 2.15: Trend and actual GDP, outturn and forecast (£ million 2016 constant prices)



Source: Scottish Fiscal Commission

Second round effects

2.116 Second round effects take account of recently announced changes in Scottish or UK Government policy that are judged to be of sufficient magnitude to affect the economy forecasts. Second round effects primarily capture any feedback from a change in policy on the economic determinants underlying the tax forecasts.

2.117 The effect of fiscal policies on the macroeconomy are hard to judge, often have long time-scales before effects are fully realised and will only have an indirect impact on tax revenues. Therefore, the Commission will only include such effects where we judge them to have a significant impact on tax revenues.

2.118 At its October 2018 Budget, the UK Government announced an increase in spending. We have adjusted our forecast to take account of this increased expenditure across the UK and Scotland.

2.119 A number of fiscal policies have been announced by the Scottish Government at Budget 2019-20. The policy with the largest fiscal effects is the income tax policy to maintain the higher rate threshold at £43,430, expected to raise around £68 million in 2019-20. Lower household income and spending as a result of this policy will be largely offset by higher government income and spending.

2.120 In aggregate, these policies are not considered to be of sufficient magnitude to include as second round effects in the economy forecast.

2.121 There were a number of policies announced at Budget 2018-19, particularly on income tax and public sector pay. At the time, the Commission did not include second round effects of these policies. The Commission judged that the policies were not of sufficient magnitude to have a significant effect on the outlook for the economy. These policies are now part of our baseline economy forecast, and so there is no specific economy forecast adjustment to account for them.

Forecast sensitivities

2.122 The Commission is required to present a single set of forecasts for the economy, but in reality these represent a central point within a broad range of possible outcomes. The forecasts are primarily based on assuming recent underlying trends continue, with adjustments where evidence or judgement dictates. It is likely that in some instances the underlying trends the Commission has identified will change in unexpected ways in the coming years and the outcome for the economy will be different.

2.123 We make a number of judgements about the likely future pathway of the economy. We run additional analysis around our key judgements to illustrate the sensitivity of the forecast to them. This section presents the sensitivity of GDP, employment and average earnings to variants of four key judgements: migration, trend unemployment, average hours and productivity. Results in this section are presented on a financial year basis.

2.124 The Commission's central population forecast is based on the ONS 50 per cent EU migration projection variant. The effect of higher migration is illustrated using the ONS principal projection and similarly the effect of lower migration is illustrated using its low migration variant.

2.125 Trend unemployment is another uncertainty in the forecast and has a significant impact on the long-run employment level. The variants considered are for a trend unemployment rate of 3.25 per cent in a low scenario and 5.0 per cent in a high scenario. These variants compare to our current central assumption of 4.25 per cent.

2.126 Average hours worked are expected to stay flat over the forecast. The high average hours variant assumes average hours will approximately return to pre-crisis average hours. This represents an increase of 0.4 hours worked to 31.9 weekly hours by 2023-24. The Commission considers a symmetric fall of 0.4 hours by the end of the forecast horizon for the low hours variant.

2.127 In the central forecast, productivity is assumed to increase from a growth rate of 0.4 per cent in 2018-19 to 1.2 per cent by 2023-24. In the low productivity variant, the growth rate of productivity is assumed to reach 0.5 per cent by 2023-24, consistent with average growth seen post-2008. In the high productivity variant, the growth rate of productivity is assumed to converge to 1.5 per cent by 2023-24, in line with pre-2008 average growth.

2.128 The impact of these variants on GDP, employment, and average earnings are shown in Table 2.10 and Figures 2.16 to 2.18. The impact on income tax liabilities of these variants is shown in Chapter 3.

Table 2.10: Economic forecast variants, average growth rates of GDP, employment and average earnings from 2018-19 to 2023-24 (per cent)

	Central forecast average	Sensitivity	Low variant	High variant
GDP	1.1	Migration	1.0	1.2
		Unemployment	1.3	1.0
		Average hours	0.9	1.3
		Productivity	0.7	1.7
Employment	0.1	Migration	0.0	0.2
		Unemployment	0.3	0.0
		Average hours	0.1	0.1
		Productivity	0.1	0.1
Average earnings	2.7	Migration	2.7	2.7
		Unemployment	2.7	2.7
		Average hours	2.5	2.9
		Productivity	2.2	3.2

Source: Scottish Fiscal Commission

Figure 2.16: Average deviation from central forecast of annual GDP growth from 2018-19 to 2023-24 (percentage points)

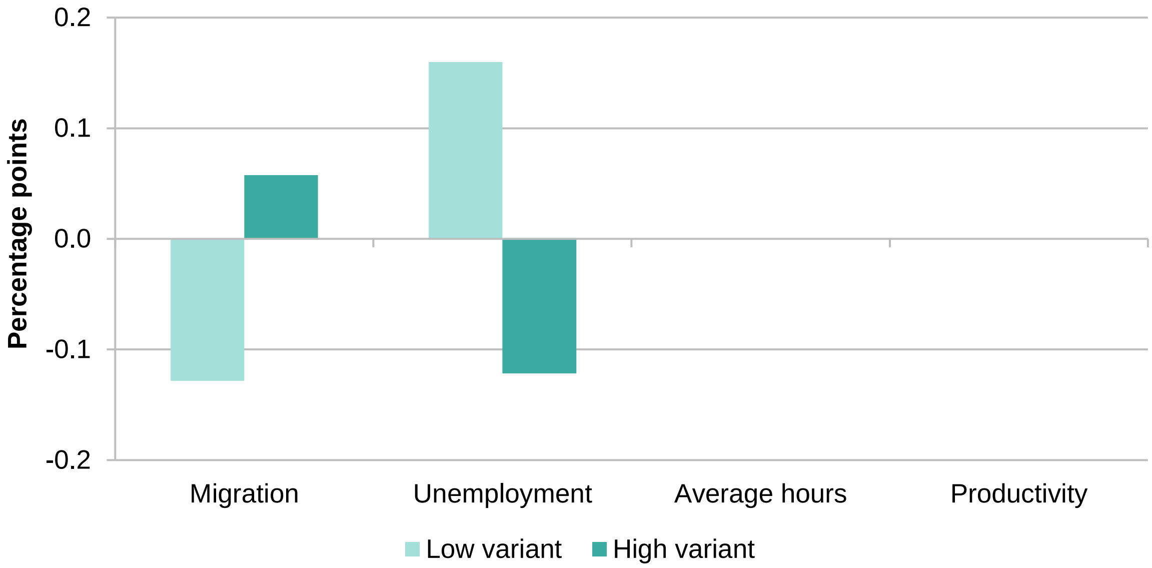
Source: Scottish Fiscal Commission

2.129 The central forecast is for GDP to grow at an average rate of 1.1 per cent per year from 2018-19 to 2023-24.

2.130 The migration and unemployment variants have a limited effect on GDP growth. The high and low average hours worked variants have a larger effect on GDP growth, up to an annual average of 0.2 percentage points over the forecast horizon.

2.131 The varying productivity assumptions have by far the greatest effect on the GDP growth rate. The Scottish economy would grow by an annual average of 0.5 percentage points more under the high productivity scenario, while it would grow by about 0.4 percentage points less under the low productivity scenario.

Figure 2.17: Average deviation from central forecast of employment growth from 2018-19 to 2023-24 (percentage points)



Source: Scottish Fiscal Commission

2.132 The central forecast for average annual growth in employment is 0.1 per cent. Employment growth is affected by our migration and unemployment variants, with productivity and average hours having no direct effect in our model.[39]

2.133 The direction of impact of the migration and unemployment variants on employment is the same as the effect on GDP growth, though the magnitudes differ. The effect of migration and unemployment on GDP comes directly from their effect on employment level growth.

[39] This is unrealistic as a higher level of productivity is likely to increase wages and draw more individuals into the labour market. Such secondary effects are not captured in these simple sensitivities; the variants only illustrate the direct effect on trend growth of the variants. Such considerations do not alter the broad message of the forecast sensitivities.

Figure 2.18: Average deviation from central forecast of average nominal annual earnings growth from 2018-19 to 2023-24 (percentage points)

Source: Scottish Fiscal Commission

2.134 The central forecast for average annual growth in nominal earnings is 2.7 per cent over the forecast horizon.

2.135 Contrary to employment level growth, productivity and average hours variants have a significant effect on average nominal earnings growth. The migration and unemployment variants have no direct effect on the growth rate of average nominal earnings.

2.136 The effect of average hours and productivity variants on average nominal earnings is similar to their effect on GDP growth.

Comparison to previous forecasts

2.137 Table 2.11 compares key variables from our latest forecast to the Commission's previous forecast published in May 2018.

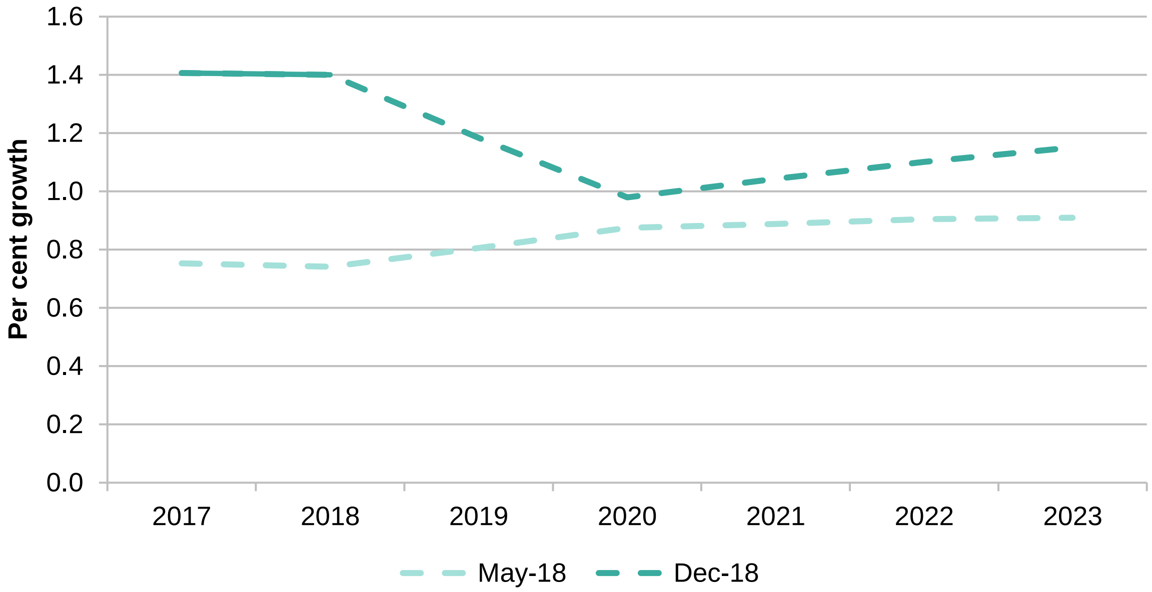
Table 2.11: Comparison between December 2018 and May 2018 economy forecasts, per cent growth rates unless otherwise stated

		2017	2018	2019	2020	2021	2022	2023
GDP	May 18	0.8	0.7	0.8	0.9	0.9	0.9	0.9
	Dec 18	1.4	1.4	1.2	1.0	1.0	1.1	1.2
Employment ('000s)	May 18	2,640	2,650	2,649	2,653	2,657	2,660	2,663
	Dec 18	2,640	2,641	2,646	2,652	2,656	2,660	2,663
Unemployment (% rate)	May 18	4.1	4.3	4.5	4.5	4.5	4.5	4.5
	Dec 18	4.1	4.2	4.3	4.3	4.3	4.3	4.3
Average nominal annual earnings	May 18	1.1	1.6	1.9	2.2	2.6	2.9	3.2
	Dec 18	1.5	2.0	2.3	2.5	2.8	3.0	3.1
Average real annual earnings	May-18	-1.0	-0.5	0.0	0.3	0.6	0.9	1.1
	Dec-18	-0.6	-0.3	0.3	0.5	0.6	0.9	1.1

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – May 2018 (link).
Shaded cells represent outturn as was available at the time of publication.

2.138 Figure 2.19 compares GDP growth rates from the two forecasts.

Figure 2.19: Forecast comparison, SFC Dec 2018 and SFC May 2018, GDP growth (per cent)

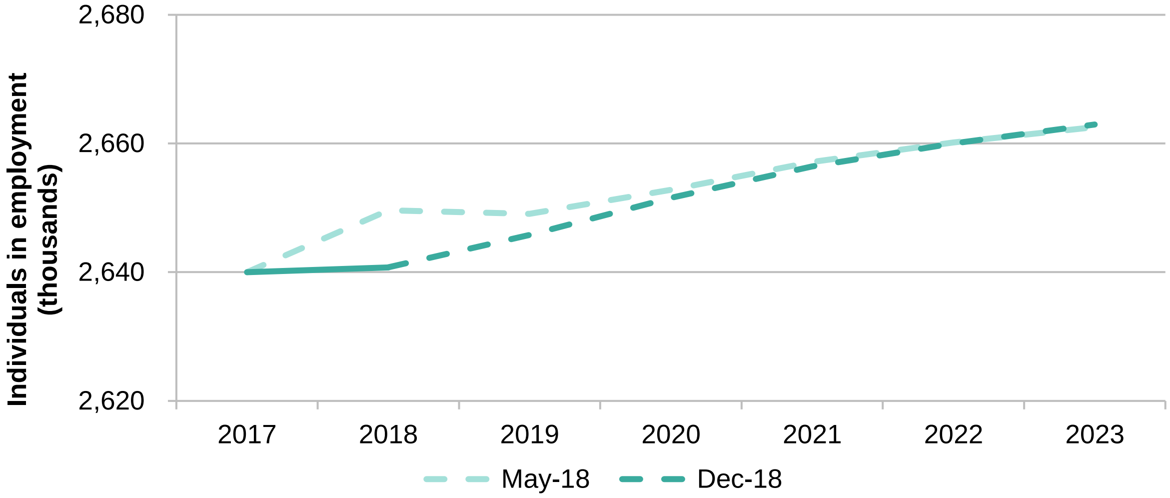


Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – May 2018 (link).

2.139 The latest forecasts by the Commission show higher GDP growth in the near term compared to our previous forecast, following stronger recent outturn data than previous available estimates suggested. The longer-term profiles of GDP growth in our May 2018 and December 2018 forecasts are closer, as we still expect GDP growth over the next five years to average around 1.0 per cent.

2.140 Growth in employment and average earnings are the most important economic determinants in forecasting income tax. Figure 2.20 shows comparisons of employment levels from the two forecasts.

Figure 2.20: Forecast comparison, SFC Dec 2018 and SFC May 2018, employment level (thousands)

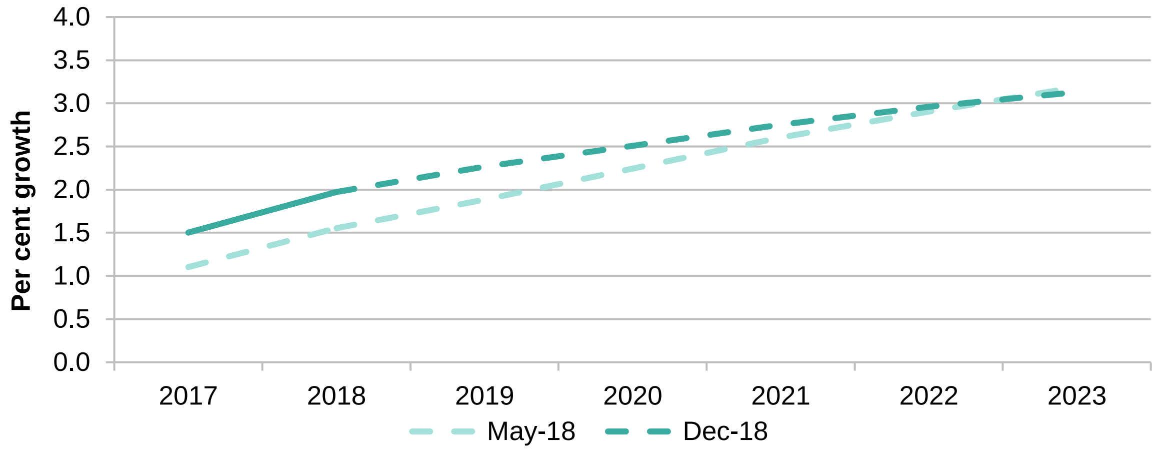


Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts - May 2018 (link).

2.141 We forecast the employment level to grow at a similar rate from 2020 onwards compared to our previous forecasts. We expect stronger growth in 2019 because of the reduction in our long-run unemployment level assumption.

2.142 Figure 2.21 compares forecasts of average nominal earnings.

Figure 2.21: Forecast comparison, SFC Dec 2018 and SFC May 2018, average nominal annual earnings growth (per cent)



Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts - May 2018 (link).

2.143 The Commission has revised up average nominal earnings growth in the first years of the forecast as a result of a moderate strengthening of wage data since our May 2018 forecast. Our outlook for average nominal earnings growth is described in the Earnings and household incomes section.

Comparison to OBR UK forecasts

2.144 This section compares our economic forecasts for Scotland with the OBR's forecasts for the UK.

2.145 We are forecasting a weaker economic outlook for Scotland compared to the OBR's forecast for the UK. This is primarily because of slower growth in population and productivity than the UK.

2.146 Table 2.12 summarises the forecasts for Scotland and the UK by the Commission and the OBR for five of the main economic determinants: GDP growth, GDP per person growth, employment level, real hourly wage growth and average nominal annual earnings growth.

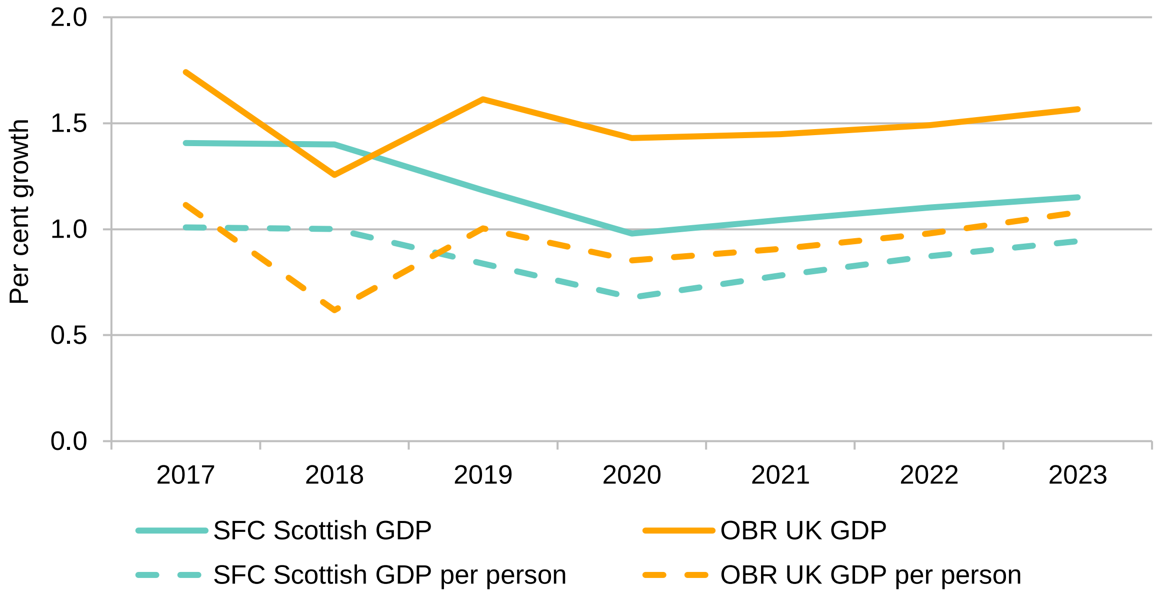
Table 2.12: Comparison between SFC Dec 2018 Scotland and OBR Oct 2018 UK economy forecasts, per cent growth rates unless otherwise stated

		2017	2018	2019	2020	2021	2022	2023
GDP	OBR Oct 2018	1.7	1.3	1.6	1.4	1.4	1.5	1.6
	SFC Dec 2018	1.4	1.4	1.2	1.0	1.0	1.1	1.2
GDP per person	OBR Oct 2018	1.1	0.6	1.0	0.9	0.9	1.0	1.1
	SFC Dec 2018	1.0	1.0	0.8	0.7	0.8	0.9	0.9
Employment	OBR Oct 2018	32.1	32.4	32.7	32.9	33.0	33.1	33.2
(millions)	SFC Dec 2018	2.6	2.6	2.6	2.7	2.7	2.7	2.7
Real wages [1]	OBR Oct 2018	0.5	1.1	0.5	0.7	0.7	0.9	1.1
	SFC Dec 2018	-0.6	-0.3	0.3	0.5	0.6	0.9	1.1
Average nominal	OBR Oct 2018	2.7	2.6	2.5	2.8	3.0	3.1	3.2
annual earnings	SFC Dec 2018	1.5	2.0	2.3	2.5	2.8	3.0	3.1

Source: Scottish Fiscal Commission, OBR (2018) Economic and Fiscal Outlook October 2018 (link).
Shaded cells represent outturn as was available at the time of publication.
[1] The OBR does not publish a figure for real hourly wage growth. The figure we provide for 'real wages' takes the OBR series for nominal average hourly earnings and deflates this using the Consumer Expenditure Deflator.

2.147 Growth in Scottish GDP is expected to be significantly lower than in the UK. This is primarily because of slower population growth in Scotland. Growth in per person GDP in Scotland is expected to converge with the UK, but will remain lower because of slower productivity growth in Scotland. This is shown in Figure 2.22.

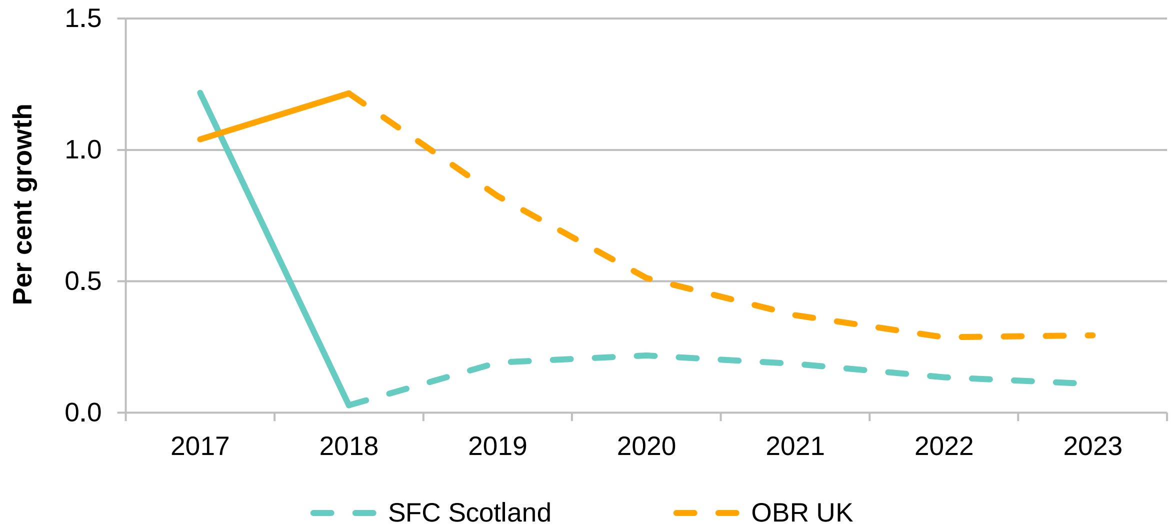
Figure 2.22: Forecast comparison, SFC Dec 2018 Scotland and OBR Oct 2018 UK, GDP and GDP per person growth (per cent)



Source: Scottish Fiscal Commission, OBR (2018) Economic and Fiscal Outlook October 2018 (link).

2.148 As shown in Figure 2.23, the Commission forecasts employment growth in Scotland below the OBR's forecast for the UK. Again, this is mainly because population is forecast to grow faster in the UK.

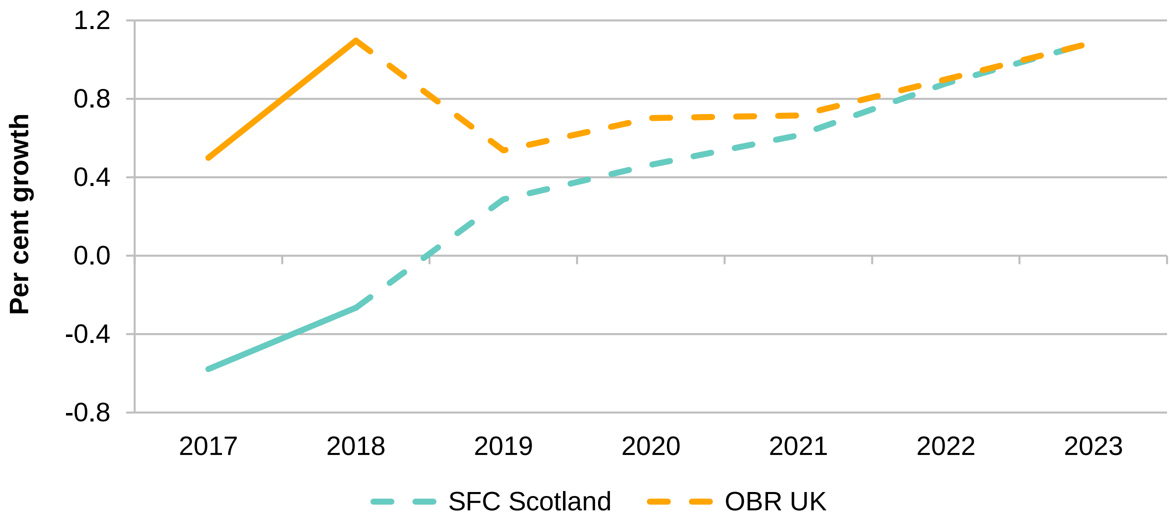
Figure 2.23: Forecast comparison, SFC Dec 2018 Scotland and OBR Oct 2018 UK, employment growth (per cent)



Source: Scottish Fiscal Commission, OBR (2018) Economic and Fiscal Outlook October 2018 (link).

2.149 Real wage growth in Scotland was negative in 2017 and 2018, reflecting weak growth in productivity and nominal wages. It is expected to turn positive in 2019 and to grow in a similar manner as in the UK for the rest of the forecast period. This is shown in Figure 2.24.

Figure 2.24: Forecast comparison, SFC Dec 2018 Scotland and OBR Oct 2018 UK, real hourly wage growth (per cent)



Source: Scottish Fiscal Commission, OBR (2018) Economic and Fiscal Outlook October 2018 (link).
The OBR does not publish a figure for real hourly wage growth. The figure we provide for ‘real wages’ takes the OBR series for nominal average hourly earnings and deflates this using the Consumer Expenditure Deflator.

2.150 Forecasts for the UK are an important component in the Commission’s forecasts for Scotland. We will continue to monitor developments in the UK as a whole and reflect on what these mean for the outlook for Scotland.

Chapter 3
Tax

Introduction

3.1 This chapter presents the Scottish Fiscal Commission's tax forecasts. A summary of the forecasts produced to inform the Scottish Budget is shown in Table 3.1.

Table 3.1: Summary of tax forecasts informing the Scottish Budget

£ million		2017-18 Outturn	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Income tax (NSND)		11,008	11,452	11,684	12,285	12,746	13,242	13,805
Non-Domestic Rates		2,762	2,827	2,785	2,887	3,087	3,295	3,332
Land & Buildings Transaction Tax		557	569	643	680	716	751	787
of which,	*Residential*	258	267	296	324	349	373	398
	ADS	95	94	122	123	127	130	134
	Non-Residential	204	208	226	233	240	247	255
Scottish Landfill Tax		148	136	104	83	13	13	14
Total Tax		14,475	14,983	15,215	15,935	16,562	17,300	17,937

Source: Scottish Fiscal Commission, Revenue Scotland (2018) Annual Report and Financial Statements 2017-18 (link), Scottish Government NDRi returns.
Figures may not sum because of rounding. Figure for income tax is forecast not outturn data, as liabilities data in 2017-18 are not yet available. See the income tax section for further detail.

3.2 In addition we produce two illustrative tax forecasts. The first is for assigned VAT receipts. The assignment of VAT is yet to commence so there is no effect on the Scottish Budget. Our second illustrative forecast is of the Scottish share of Air Passenger Duty (APD). Devolution of APD has been deferred until the issue raised in relation to the Highlands and Islands exemption has been resolved.[40] The illustrative tax forecasts are shown in Table 3.2.

Table 3.2: Summary of illustrative tax forecasts

£ million	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Assigned VAT Receipts	5,383	5,631	5,801	5,966	6,122	6,279	6,434
Scottish share of Air Passenger Duty	277	302	312	322	336	349	364

Source: Scottish Fiscal Commission, HMRC, HM Treasury and Scottish Government
The 2017-18 figure for assigned VAT receipts refers to a provisional estimate from the assignment outturn model which is still in development by HMRC, Treasury and the Scottish Government. See the VAT section for further details. Figure for Air Passenger Duty is not classed as outturn data. It is an estimate of the Scottish share of tax receipts.

3.3 The sections in this chapter will explain the methods used to produce the forecasts, any differences from earlier forecasts, the impacts of new policy measures, and comparisons to OBR forecasts. The economic determinants described in Chapter 2 informing our fiscal forecasts are available on a financial year basis in supplementary tables on our website.[41]

3.4 Table 3.3 summarises all changes since May for the forecasts informing the Scottish Budget. Table 3.4 summarises the changes in our illustrative forecasts – as we have not produced a forecast of assigned VAT receipts before this only covers the Scottish share of Air Passenger Duty.

Table 3.3: Change from previous tax forecasts 2017-18 to 2023-24

£ million	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Income tax	-459	-517	-661	-519	-589	-694	-743
Non-Domestic Rates	-12	38	-74	-44	-23	-12	-7
Land & Buildings Transaction Tax	7	-45	-13	-17	-22	-30	-41
of which, Residential	0	-45	-46	-49	-56	-65	-75
ADS	4	-2	22	19	19	19	18
Non-Residential	4	3	12	13	14	16	17
Scottish Landfill Tax	6	22	11	-12	-75	-73	-75
Total change in tax forecasts	-458	-502	-737	-592	-708	-810	-865

Source: Scottish Fiscal Commission. Figures may not sum because of rounding

Table 3.4: Change from previous illustrative tax forecasts 2017-18 to 2023-24

£ million	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Scottish share of Air Passenger Duty	0	17	19	21	24	28	30

Source: Scottish Fiscal Commission. Figures may not sum because of rounding

[40] Letter from Cabinet Secretary for Finance and Constitution to the Convener of the Finance and Constitution Committee 1 June 2018 (link)

[41] Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 (link)

Tax forecasts and the Block Grant Adjustments

3.5 As discussed in Chapter 1, our forecasts are an important component in determining the total budget available to the Scottish Government. The Budget is also affected by forecasts of the Block Grant Adjustments. These are based on OBR forecasts of UK Government receipts; they do not relate to the OBR's forecasts of Scottish taxes, see Box 3.1.

Box 3.1: OBR forecasts of devolved taxes

Chapter 1 explains the operation of the fiscal framework, and the respective roles of the Scottish Fiscal Commission and the OBR. The OBR also produces forecasts of receipts from devolved taxes, not because this is a requirement of the fiscal framework but rather because their role as the UK-level fiscal forecaster requires them to produce forecasts of all revenue streams raised in the UK, whether they are set and administered by the UK Government, devolved administrations, or local government.

All OBR forecasts of devolved taxes are set out in detail in their Devolved Tax and Spending publication, which is produced alongside each UK fiscal event. The OBR also publish a forecast of Carer's Allowance expenditure in Scotland. As further social security benefits are devolved to the Scottish Parliament the OBR may expand their work into other social security expenditures.

In each tax section, differences to the OBR forecasts are discussed and explained. Such differences may be because of modelling approaches, timing, data used or differences in judgements made. As set out in Chapter 1, the OBR revenue forecasts of devolved taxes are not used as part of the Block Grant Adjustment calculations. These are based on the OBR forecasts of UK Government receipts of corresponding UK taxes.

3.6 Table 3.5 shows the forecasts for the devolved taxes and corresponding BGAs over the next five years. Forecast receipts are greater than the BGAs over the whole of this period. The differences reflect both policy decisions by the Scottish and UK Governments as well as differences in the underlying growth of tax revenues. For example the Scottish Government's announcement at this Budget of two changes to Land and Buildings Transaction Tax (LBTT) has increased our forecast of revenues, whilst the UK Government's policy on first time buyer relief resulted in a downward revision to Stamp Duty Land Tax receipts, and therefore to the corresponding BGA.

3.7 The net difference for each tax reflects all policy changes announced since the initial deduction year by both the Scottish and UK Governments. For income tax, this includes the combined effect of changes to Scottish Government income tax policy announced in the 2017-18, 2018-19 and 2019-20 Budgets. It also includes changes in UK income tax policy, for example the increases in the personal allowance and the higher rate threshold in the UK Autumn Budget 2018.

Table 3.5: Net position of tax forecasts and Scottish Government Block Grant Adjustments

£ million		2019-20	2020-21	2021-22	2022-23	2023-24
Income Tax	SFC forecast	11,684	12,285	12,746	13,242	13,805
	BGA forecast	11,501	12,089	12,478	12,954	13,493
	Net difference	182	196	268	288	312
Land & Buildings Transaction Tax	SFC forecast	643	680	716	751	787
	BGA forecast	567	596	632	667	721
	Net difference	76	85	84	83	66
Scottish Landfill Tax	SFC forecast	104	83	13	13	14
	BGA forecast	91	83	81	74	62
	Net difference	13	0	-68	-61	-48
Total	SFC forecast	12,430	13,049	13,475	14,006	14,605
	BGA forecast	12,159	12,768	13,191	13,695	14,276
	Net difference	271	281	284	310	329

Source: Scottish Fiscal Commission, Scottish Government. Figures may not sum because of rounding.
Net difference equals the Scottish Fiscal Commission forecast minus the BGA, a positive number represents additional revenues available to the Scottish Government.

3.8 The BGAs are initially based on forecasts and a final reconciliation takes place once outturn data become available. Further details on reconciliations can be found in Chapter 5.

Income Tax

Forecast

Table 3.6: Non-Savings Non-Dividend income tax outturn and forecast

£ million	2016-17 Outturn	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
	10,719	11,008	11,452	11,684	12,285	12,746	13,242	13,805

Source: HMRC (2018) Scottish income tax (link), Scottish Fiscal Commission.

Background

3.9 The Scotland Act 2016 transferred new tax powers to the Scottish Parliament. From 2017-18, the Scottish Parliament took full responsibility for non-savings and non-dividend (NSND) income tax rates and thresholds, with the exception of the personal allowance. Since April 2017, the Scottish Government receives all revenue from income tax on the NSND income of Scottish taxpayers.

3.10 The responsibility for defining the income tax base, including setting or changing income tax reliefs and the personal allowance continues to rest with the UK Government. HMRC remains responsible for the collection and management of Scottish income tax. It is HMRC's responsibility to decide who is a Scottish taxpayer as defined in legislation. The Scotland Act 2012 defines a Scottish taxpayer as someone who is a UK taxpayer and has their main place of residence in Scotland.[42]

3.11 The Scottish Government implemented policy changes to income tax for 2017-18 and 2018-19. For 2017-18, all rates and most bands were set at the same level as the UK. The only difference was the higher rate threshold, which was left unchanged in cash terms from 2016-17 at £43,000, in comparison to an increase by inflation. In 2018-19, a new five band income tax policy was introduced.

3.12 In the Scottish Budget 2019-20 the Scottish Government announced a policy to set the higher rate threshold at £43,430, the same as in 2018-19. Setting the higher rate threshold at this level raises money for the government as compared to our baseline assumption that the higher rate threshold would have increased in line with inflation. In 2019-20 we estimate this policy will raise £68 million, rising to £84 million by 2023-24.

[42] Scotland Act 2012 Section 25, 80D (link)

Forecast

3.13 Developments since May have led to a downward revision of our NSND income tax liabilities forecast for all years. Table 3.7 presents in detail the differences between our May 2018 forecast and the latest forecast.

Table 3.7: Changes in NSND Income tax forecast since May 2018

£ million	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
May 2018	11,267	11,467	11,969	12,345	12,805	13,335	13,936	14,547
2016-17 outturn data	-548	-556	-570	-586	-608	-634	-663	-696
Economy forecast	0	102	83	142	141	126	86	17
UK policy adjustment	0	1	-15	-275	-85	-98	-120	-140
CPI	0	0	0	-12	-18	-30	-37	-43
Tax-Motivated Incorporations[43]	0	-2	-4	-5	-15	-27	-35	49
Other[44]	0	-2	2	-2	0	1	3	-1
2017-18 policy recosting[45]	0	-2	-3	22	5	10	7	5
2018-19 policy recosting	0	0	-10	-12	-11	-12	-15	-17
December 2018 pre-measures	10,719	11,008	11,452	11,615	12,214	12,671	13,162	13,720
2019-20 policy	0	0	0	68	71	75	80	84
December 2018 post-measures	10,719	11,008	11,452	11,684	12,285	12,746	13,242	13,805
Change from May 2018	-548	-459	-517	-661	-519	-589	-694	-743

Source: Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – May 2018 (link), Scottish Fiscal Commission.
Figures may not sum because of rounding.

3.14 The main factor behind the downward revision was the release of new 2016-17 outturn data for income tax, reducing the forecast by £586 million in 2019-20. The UK policy adjustment is mainly as a result of the UK Personal Allowance increase in 2019-20, but it also includes small consequential

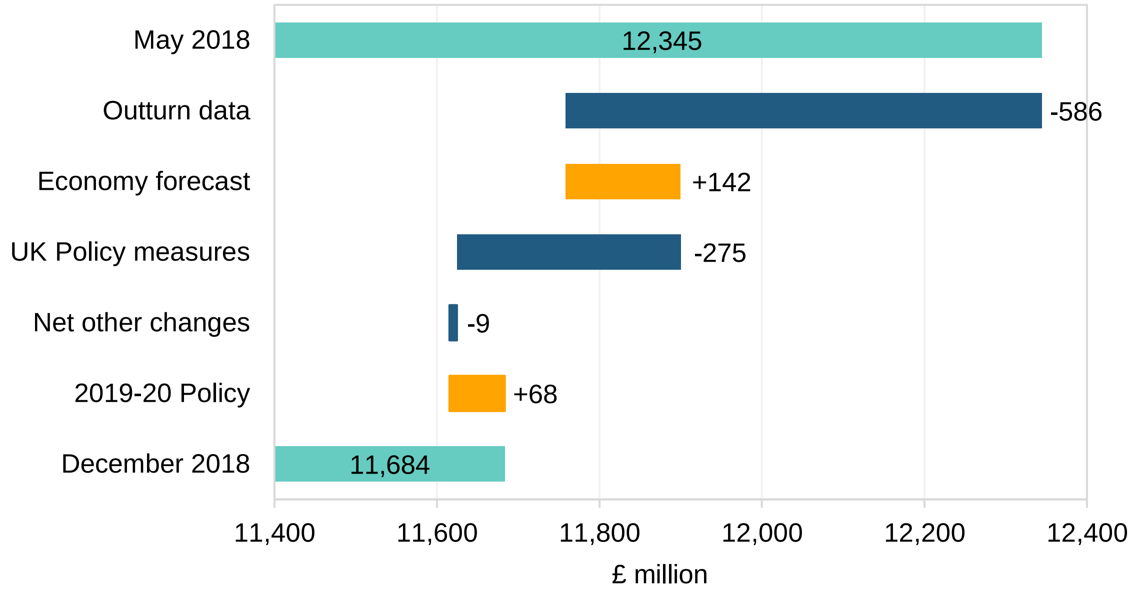
[43] The increase in 2023-24 year is as a result of receiving new data for this year from HMRC. This replaces the previous Commission assumptions about the path of Tax-Motivated Incorporations.

[44] Includes revisions to OBR triple lock pension forecasts, HMRC Gift Aid estimates, and model developments.

[45] The increase to 2017-18 policy recosting (freeze of higher rate threshold at £43,000) in 2019-20 is as a result of the above inflation UK Personal Allowance increase. This policy costing uses a UK statutory indexation baseline of the Basic Rate Limit and Personal Allowance to calculate the higher rate thresholds. The baseline at May 2018 for 2019-20 was a higher rate threshold of £46,330. This was revised to £46,800 following the Personal Allowance increase, resulting in the policy raising more revenue.

Scottish taxpayer behavioural adjustments. Further details can be found below and in Table 3.7. Income tax policy changes announced in the 2019-20 Budget are expected to raise £68 million in 2019-20. This along with other factors affecting our forecast shown in Table 3.9, are discussed in depth below. Figure 3.1 shows the relative scale of these factors for 2019-20.

Figure 3.1: Changes in NSND income tax forecast of 2019-20 since May 2018



Source: Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – May 2018 (link), Scottish Fiscal Commission.

2019-20 income tax policy

3.15 In the Scottish Budget 2019-20 the Scottish Government announced a policy to set the higher rate threshold at £43,430, the same as in 2018-19. Setting the higher rate threshold at this level raises money for the government as compared to our baseline assumption that the higher rate threshold would have increased in line with inflation. Table 3.8 shows our previous baseline assumption about the higher rate threshold, along with the new policy.

Table 3.8: Higher rate threshold baseline and policy comparison

£	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Baseline	43,430	44,481	45,351	46,268	47,247	48,228
Policy	43,430	43,430	44,280	45,175	46,131	47,089
Threshold difference	0	-1,051	-1,071	-1,093	-1,116	-1,139

Source: Scottish Fiscal Commission.
Figures may not sum because of rounding.

3.16 We have costed this policy using the behavioural assumptions as set out in our March 2018 paper 'How we forecast behavioural responses to income tax policy'.[46] Table 3.9 shows both the static costing, which assumes taxpayers do not change their behaviour, and a post-behavioural costing.

Table 3.9: Income tax 2019-20 policy costing

£ million	2019-20	2020-21	2021-22	2022-23	2023-24
Static costing	75	78	83	87	93
Behavioural change	-6	-7	-7	-8	-8
Post-Behavioural costing	68	71	75	80	84

Source: Scottish Fiscal Commission.
Figures may not sum because of rounding.

3.17 The full methodology of this costing and further breakdowns can be found in Annex A.

Developments since May 2018

3.18 Our approach to creating the income tax forecast was set out in our 'Current Approach to Forecasting' publication.[47] The modelling is based on detailed taxpayer data published by HMRC called the Survey of Personal Incomes (SPI). We use a publicly available version of this dataset called the Public Use Tape (PUT). The latest available PUT is for 2015-16.

3.19 For 2016-17, we align our 2015-16 PUT-based forecast to the finalised outturn data on income tax liabilities published by HMRC, as discussed in Box 3.2. From 2017-18 onwards, we use forecasts of earnings and employment from our economy forecasts to estimate incomes and tax liabilities in future years.

3.20 While our overall approach is broadly unchanged, there have been some developments, including new data, since our previous forecasts in May 2018. The rest of this section discusses the impact of these changes.

2016-17 finalised outturn data

3.21 On 12 July 2018 HMRC published its first full outturn data for non-savings non-dividend (NSND) income tax liabilities in Scotland, covering the year 2016-17.[48] For the first time, this was based on full administrative data using Scottish taxpayer codes. Now that these data are available, they are the primary measure of total income tax liabilities in Scotland.

3.22 The finalised 2016-17 outturn figure of £10,719 million is £548 million lower than our May 2018 forecast. Our Forecast Evaluation Report (FER) concluded that a significant proportion of the 2016-17 error was because of the

[46] Scottish Fiscal Commission (2018) How we forecast behavioural responses to income tax policy (link)

[47] Scottish Fiscal Commission (2017) Current Approach to Forecasting (link)

[48] HMRC (2018) Scottish income tax technical note (link)

underlying data used in the forecast.[49] Our evaluation shows that our estimates of the number of taxpayers in 2016-17 was a greater source of error than our estimates of their individual incomes or liabilities.

3.23 Following the publication of the new outturn data, we are now able to, for the first time, align our forecasts to a finalised outturn figure. This has led to a downward adjustment in our forecasts of £548 million in 2016-17, rising to £696 million in 2023-24. As outturn data will now be published on a regular basis and we can calibrate our forecasts to this, we do not expect adjustments of a similar magnitude to be common in future. We have developed a methodology that ensures consistency between the outturn data and our forecast. Box 3.2 discusses this in more detail.

Box 3.2: Methodology to align forecast to income tax outturn data

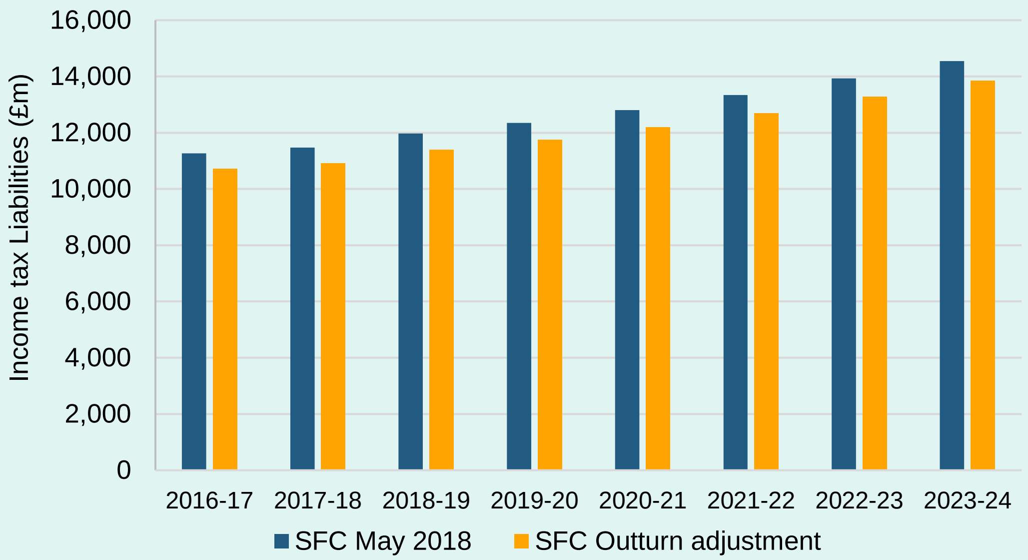
Our alignment approach adjusts our projected distribution of taxpayer incomes in 2016-17, based on the 2015-16 PUT, to match the 2016-17 Scottish income tax outturn taxpayer populations and liabilities.

The corrected taxpayer populations and liabilities in this adjusted 2016-17 data means that our model produces scaled down estimates of income tax liabilities for future years of our forecast, and ensures greater coherence with the available data for policy costings.

Correcting the taxpayer populations decreases the forecast by £502 million, accounting for most of the 2016-17 forecast error of £548 million. For the remaining £46 million difference, we scale taxpayer incomes so that the final tax liabilities match outturn. The overall effect on our forecast of the alignment, excluding policy recostings, is shown in Figure 3.2.

[49] Scottish Fiscal Commission (2018) Forecast Evaluation Report (link)

Figure 3.2: Effect of outturn alignment on income tax forecast



Source: Scottish Fiscal Commission

Our approach of adjusting the underlying base data differs from the OBR who adopted a top-down scaling approach. Our internal sensitivity analysis of both approaches suggest negligible differences.

Economy forecast

3.24 Forecasts of the number of people in employment and earnings growth are significant components of our NSND income tax forecast. Our income tax forecast has been updated using our latest economy forecast discussed in Chapter 2.

3.25 While overall our income tax forecast has been revised down since May 2018, upward revisions to earnings growth in 2019-20 in our economy forecast has increased our income tax forecast by £142 million in 2019-20.

UK tax policies

3.26 We undertake additional modelling for certain policy measures introduced by the UK Government which affect Scottish NSND income tax liabilities.

3.27 Using the OBR’s policy measures database, our approach calculates the relevant adjustments needed to account for previous UK Government policy measures that have affected income tax liabilities since 2016-17, the latest year of income tax outturn data.[50]

3.28 In addition to the policy measures database which only contains the original policy costing, OBR have provided us with updated policy recostings for particularly significant policies. These include the Budget 2014 pension

[50] OBR (2017) Policy measures database (link)

flexibility measure and the Budget 2015 Annual Allowance restriction for additional rate taxpayers. Updating our database with these latest recostings resulted in a downward revision to our forecast of £55 million in 2019-20 rising to £102 million in 2023-24. Following each UK fiscal event we will continue to make use of the latest policy recostings information available.

3.29 In the 2018 UK Autumn Budget, the UK Government announced a number of income tax measures:

- **Increase of the Personal Allowance to £12,500 in 2019-20:** The Personal Allowance remains reserved to the UK Government. The change has been incorporated into our forecast and we estimate it will reduce the forecast by £199 million in 2019-20. In addition, there is a small positive corresponding behavioural effect of around £3 million in 2019-20. UK Government plans for the personal allowance to remain at £12,500 in 2020-21 in comparison to our baseline assumption of an increase in line with CPI inflation. This means that the difference between our baseline assumption and the actual path of the personal allowance is largest in 2019-20, and then becomes steadily narrower in later years, leading to a decrease in the relative cost of the policy.

- **Increase of the rUK higher rate threshold to £50,000 in 2019-20:** Although the Scottish Government retain control of the Scottish Higher rate threshold, we have estimated two behavioural responses to the increase in the UK higher rate threshold. The first is the effect on behaviour of the widening of the combined 53 per cent marginal rate income range resulting from National Insurance Contributions (NICs) and income tax. The second is the changes in residency behaviour as a result of the tax difference between Scotland and UK increasing. Cumulatively these behavioural effects reduce our forecast by £13 million in 2019-20.

- **Other UK Budget 2018 policies:** We estimate the effect of other UK Budget 2018 policies using information published by the OBR in Table 2.4 in their October Devolved Taxes forecast.[51] The most significant of these policies is the reform to off-payroll working, which will reduce the scope for certain taxpayers in the private sector to 'incorporate' and move the majority of their liabilities away from NSND income tax. These rules have been in place in the public sector since April 2017. In their policy costings uncertainty ratings database, OBR have assessed that the uncertainty of this measure as 'Very High', the highest rating for measures certified in Budget 2018.[52] Adjusting this UK costing to be

[51] Source: OBR (2018) Devolved Tax and Spending Forecasts October 2018 (link)

[52] OBR (2018) Policy costings uncertainty ratings database (link)

applicable to Scotland adds additional uncertainty. As it reduces the number of tax-motivated incorporations this leads to an increase in our NSND income tax forecast.

3.30 A summary of the UK tax policy adjustments is provided in Table 3.10.

Table 3.10: Summary of UK policy adjustment

£ million	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
UK historic policies	1	-15	-55	-65	-78	-90	-102
UK Budget 2018: Personal Allowance	0	0	-199	-68	-69	-70	-77
UK Budget 2018: Other policies	0	0	-11	60	62	54	54
Behavioural Response: UK Personal Allowance	0	0	3	1	1	1	1
Behavioural Response: UK £50k National Insurance	0	0	-7	-7	-7	-8	-9
Behavioural Response: rUK/Scotland tax migration	0	0	-6	-6	-6	-7	-9
Total UK policy adjustment	1	-15	-275	-85	-98	-120	-140

Source: OBR (2018) Devolved Tax and Spending Forecasts October 2018 (link), Scottish Fiscal Commission.
Figures may not sum because of rounding.

Rest of UK tax policy behavioural adjustment

3.31 We expect the growing difference between the higher rate threshold in Scotland and the UK to have an impact on the behaviour of Scottish taxpayers. A £50,000 higher rate threshold in the rest of the UK may lead to changes in Scottish taxpayer behaviour in two distinct ways:

- In 2019-20, Scottish income tax taxpayers will face a combined marginal tax rate of 53 per cent between the higher rate thresholds in Scotland of £43,430 and in the UK of £50,000 when taking account of both income tax and national insurance contributions.
- All taxpayers earning above the higher rate threshold in Scotland of £43,430 will pay more income tax in Scotland than they would in the UK. We expect this to start to affect residency decisions.

Impact of 53 per cent marginal tax rate on Scottish taxpayer behaviour

3.32 National insurance contributions remain a reserved UK power, and so rates and bands are consistent across the UK. As an illustrative example for an employed individual, Table 3.11 shows the rates of National Insurance paid by income comparing 2018-19 and 2019-20.

Table 3.11: Illustrative example of employed individual's National Insurance rates comparing 2018-19 and 2019-20[53]

National Insurance definition	Annualised gross income band 2018-19 (£)	Annualised gross income band 2019-20 (£)	Rate
Between Primary Threshold (PT) and Upper Earnings Limit (UEL)	8,424 to 46,350	8,632 to 50,000	12%
Above Upper Earnings Limit (UEL)	46,350 +	50,000 +	2%

Source: Scottish Fiscal Commission

Notes: This table is a stylised example for employed individuals below state pension age. Self-employed, non-taxpayers and individuals above the state pension age are subject to different NICs regimes.

3.33 Employed individuals pay 12 per cent employee NICs on earnings between the PT and UEL, with a payment of 2 per cent on any earnings above the UEL. The UK Government aligns the NICs UEL with the income tax higher rate threshold, which for 2019-20 will be £50,000.

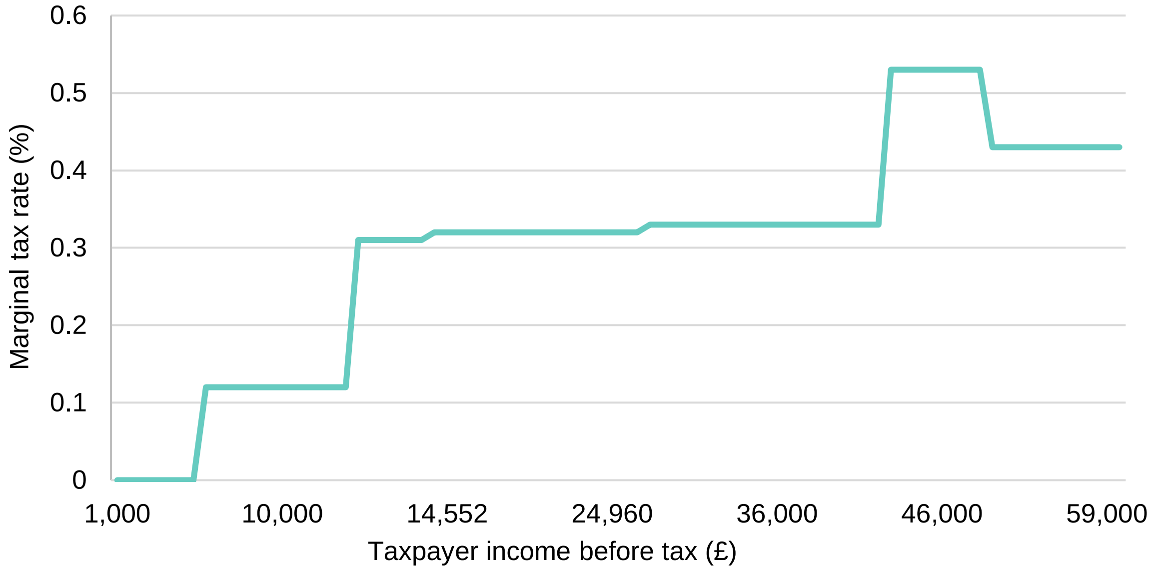
3.34 This means that for UK taxpayers in 2019-20, above the personal allowance and below £50,000 they will face a combined income tax and NICs marginal tax rate of 32 per cent, made up of 20 per cent income tax and 12 per cent NICs. Above £50,000 and below £150,000, UK taxpayers will face a combined marginal tax rate of 42 per cent, made up of 40 per cent income tax and 2 per cent NICs.

3.35 For Scottish taxpayers, they will begin to pay the 41 per cent higher rate of income tax from £43,430, but continue to pay 12 per cent NICs up to £50,000. This means that, for the income range £43,430 to £50,000, Scottish taxpayers will face an effective 53 per cent marginal tax rate.

3.36 For incomes above £50,000, NICs drops to 2 per cent, and combined marginal tax rates fall to 43 per cent, shown in Figure 3.3.

[53] This table is a stylised example for employed individuals aged between and the state pension age. Self-employed, non-taxpayers and individuals above the state pension age are subject to different NICs regimes.

Figure 3.3: Combined income tax and NICs marginal tax rate in Scotland in 2019-20



Source: Scottish Fiscal Commission

3.37 We estimate that in 2019-20 around 120,000 taxpayers in Scotland will find themselves subject to this high marginal rate. Such a high marginal rate may affect taxpayer behaviour at the intensive margin, for example in deciding how many hours to work, tax planning, avoidance and evasion effort.

3.38 We have used our standard approach to modelling taxpayer behaviour change to estimate the impact of this on tax liabilities in Scotland. We generally expect only modest behavioural change for taxpayers earning in the £43,430 to £50,000 range.

3.39 We judge a Taxable Income Elasticity (TIE) of 0.025 to be appropriate for this particular behaviour effect, based on the TIEs we have used in the past. This leads to an overall reduction in tax liabilities in Scotland of £7 million in 2019-20.

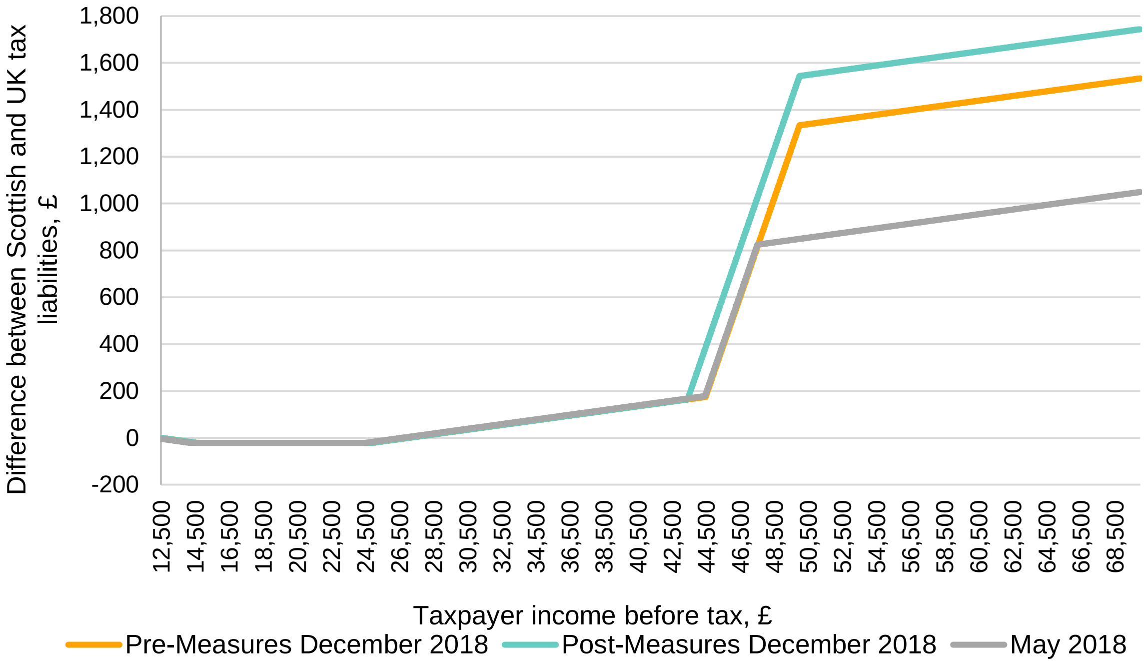
Impact of lower taxes in rUK on Scottish taxpayer behaviour

3.40 Figure 3.4 shows the difference in income tax liabilities by gross income in Scotland and the UK, showing how things have changed since the baseline assumptions used in our May 2018 forecast. While taxpayers in Scotland earning between £12,500 and £26,993 in 2019-20 will pay less tax than in the UK, taxpayers earning over this will pay more. The differences increase rapidly in the £40,000 region as taxpayers move into higher rate tax.

3.41 For example, in our May 2018 forecast we anticipated a Scottish taxpayer earning £50,000 in 2019-20 would pay £849 more than an equivalent rUK taxpayer. As a result of the UK £50,000 higher rate threshold policy and the

Scottish Government policy to keep the higher rate threshold at £43,430, the difference for a £50,000 Scottish taxpayer has increased by £695 to £1,544.

Figure 3.4: Scotland and rUK tax difference for taxpayers earning between £12,500 and £70,000 in 2019-20



Source: Scottish Fiscal Commission.

3.42 All else equal, significantly lower income tax in the UK for gross incomes above the £43,430 Scottish higher rate threshold will affect incentives to locate in Scotland. We consider three different types of behaviour change in response to this difference in taxation:

- **Migration from Scotland to rUK:** Taxpayers currently resident in Scotland who move to rUK as a result of tax differences. We estimate that there are currently 250,000 taxpayers earning over £50,000 in Scotland who could pay less income tax in the rest of the UK.

- **Migration from rUK to Scotland:** Taxpayers currently in rUK who would have moved to Scotland in the future, but now decide not to as a result of higher income tax. There are around 4.9 million higher rate and additional rate taxpayers in the UK, of whom a small minority will relocate to Scotland each year.[54]

- **Tax residency change:** Taxpayers who have flexibility about where they report their location to HMRC within the UK, and for whom reporting an rUK rather than Scottish address may need only a small change in

[54] HMRC (2018), Survey of Personal Incomes 2015-16 Statistics Table 3.2 (link)

behaviour, notably taxpayers who already own properties in both Scotland and rUK.

3.43 In the short term, we expect tax residency responses to have the greatest impact on liabilities. For those individuals who already split their lives between Scotland and the rest of the UK, swift, small changes in behaviour may allow them to pay less tax. This could include elements of tax planning, avoidance or evasion. Using our current approach to modelling behaviour, we expect this behaviour to reduce liabilities in Scotland by £5.4 million in 2019-20 and beyond.

3.44 In the longer run, small changes in migration patterns will also start to affect liabilities. In 2016-17 around 47,000 individuals moved to Scotland from the rest of the UK, with around 35,000 individuals moving the other way.[55] Even very small changes in these flows could have an effect on tax liabilities. We expect the impact of changes in migration behaviour to build up over time, increasing from £0.6 million in 2019-20 to £3.1 million in 2023-24.

3.45 Table 3.12 summarises our forecast of the impact on income tax liabilities of behavioural changes in response to the increased difference between higher rate thresholds in Scotland and the UK.

Table 3.12: Impact on tax liabilities of changes in location behaviour

£ million	2019-20	2020-21	2021-22	2022-23	2023-24
Immediate tax residency change	-5.4	-4.6	-4.7	-5.1	-5.6
Longer term migration effect to and from Scotland	-0.6	-1.0	-1.6	-2.3	-3.1
Total	-6.0	-5.6	-6.3	-7.4	-8.6

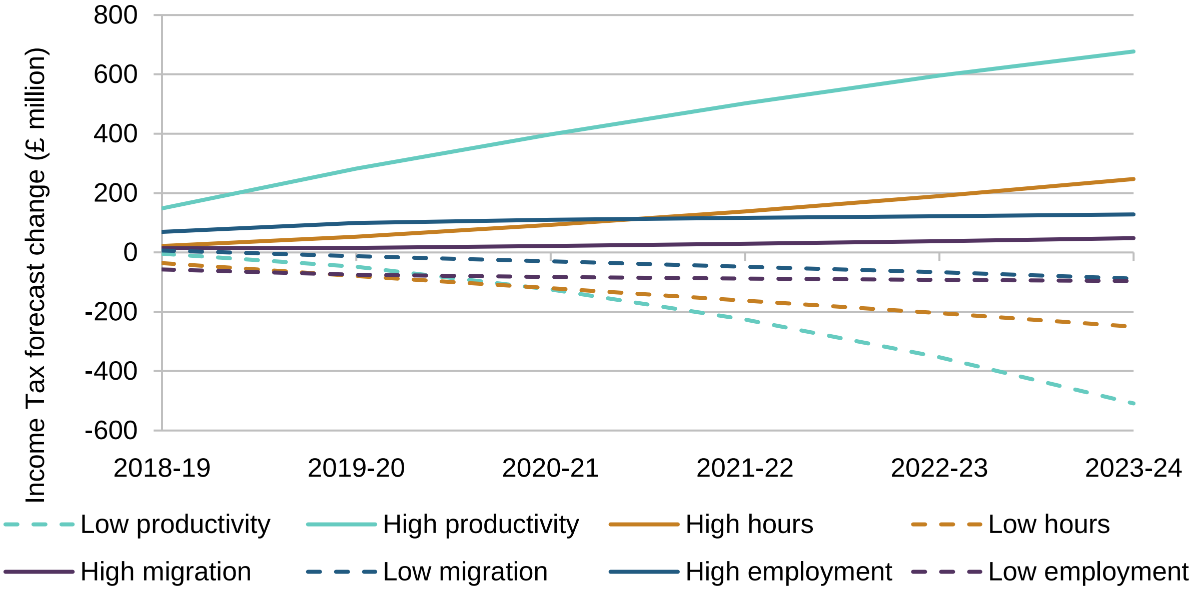
Source: Scottish Fiscal Commission.
Figures may not sum because of rounding.

Forecast uncertainty

3.46 In this section, we assess the sensitivity of our income tax forecast to the alternative economy scenarios considered in Chapter 2. Figure 3.5, shows how our forecast would change when adjusting our economic inputs for each alternative scenario outlined in Chapter 2. The changes shown give the effects of changing only one variable at a time. We do not explicitly model the effects of interactions between variants.

[55] NRS (2018) Migration between Scotland and the Rest of the UK (link)

Figure 3.5: Income tax sensitivity analysis



Source: Scottish Fiscal Commission.

3.47 Our forecast is most sensitive to changes in our assumption about productivity growth. In the high productivity scenario, income tax liabilities are on average estimated to be around £149 million higher in 2018-19, rising to around £677 million by 2023-24. Across the forecast horizon this amounts to a cumulative increase of £2.6 billion. In the low productivity scenario we estimate a cumulative decrease of around £1.2 billion.

3.48 Other alternative scenarios have smaller implications for income tax receipts. The migration and employment scenarios lead to small changes, approximately £100 million per year by 2023-24. The impact of average hours worked is more significant, leading to an impact of approximately £250 million by 2023-24. The interaction between different scenarios may be important: if productivity growth remains low, but hours worked is higher to compensate, then the effects could offset one another.

3.49 Our forecast is also sensitive to our assumptions about the scale of behavioural changes. Table 3.13 shows how our estimates of behavioural responses change when we assume different taxable income elasticities. The elasticities used to obtain our central estimate are outlined in our March 2018 publication 'How we forecast behavioural responses to income tax'.[56] The high and low variants are obtained by adding increasing or decreasing the central elasticity by 50 per cent.

[56] Scottish Fiscal Commission (2018) How we forecast behavioural responses to income tax policy - March 2018 (link)

Table 3.13: Sensitivity of behavioural responses in 2019-20

Description of behaviour	High variant	Central estimate	Low variant
2017-18 Policy costing	-12	-8	-4
2018-19 Policy costing	-75	-50	-25
2019-20 Policy costing	-9	-6	-3
Behavioural Response: UK Personal Allowance	5	3	2
Behavioural Response: UK £50k National Insurance	-11	-7	-4
Behavioural Response: rUK/Scotland tax migration	-9	-6	-3
Total change to liabilities	-111	-74	-37

Source: Scottish Fiscal Commission.
Figures may not sum because of rounding.

3.50 All the cases outlined above are hypothetical, to illustrate possible impacts from each variable on income tax liabilities. These capture the uncertainty around the future path of income tax receipts, and should not be taken as alternative forecasts.

Comparison to OBR forecast

3.51 As part of their role as UK-level fiscal forecaster, the OBR also produce a forecast of Scottish income tax receipts. Table 3.14 compares our latest forecast with the OBR forecast presented in their October 2018 devolved tax and spending publication.[57]

Table 3.14: SFC and OBR Scottish NSND income tax forecasts

£ million	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
SFC December 18	11,008	11,452	11,684	12,285	12,746	13,242	13,805
OBR October 18	11,122	11,817	11,898	12,495	12,926	13,430	13,988
Difference	-114	-365	-214	-210	-180	-188	-183

Source: OBR (2018) Devolved Tax and Spending Forecasts October 2018 (link), Scottish Fiscal Commission.
Figures may not sum because of rounding.

3.52 Our forecast is consistently lower than the OBR's forecast, with an average difference of £208 million over the forecast horizon. There are a few reasons why our forecasts are different:

- **Modelling differences:** In our forecasts we use a bottom-up micro simulation forecast based on our SPI model. This allows the Commission to develop an income tax model which takes account of

[57] OBR (2018) Devolved Tax and Spending Forecasts October 2018 (link)

Scottish demographics and the distribution of income of Scottish taxpayers. The OBR takes a ‘top-down’ approach by first producing a forecast of the NSND income tax for the whole UK and then estimating a Scottish share which is applied to this forecast.

- **Data:** Our forecasts are based on the 2015-16 SPI, and are projected forward using Scottish specific economic determinants which we produce as part of our economy forecasts. The OBR forecast of future earnings growth is based on UK economic determinants. This means that our forecast reflects Scotland-specific factors, such as our assessment that wage growth will be weaker in Scotland than in the rest of the UK, which the OBR’s forecast does not. The OBR also use data available from HMRC covering the whole of the UK in creating their forecast whereas our forecasts mainly use Scottish-specific data.

- **Policy costings:** The OBR’s forecast does not account for the policy change announced in this Budget. This is because their forecasts were published on 29 October 2018, before the freeze to the higher rate threshold was announced. Excluding policy change from the comparison would reduce our forecast, and subsequently increase the difference by £68 million in 2019-20, rising to £84 million in 2023-24.

Non-Domestic Rates

Forecast

Table 3.15: Non-Domestic Rates forecast

£ million	2017-18 Outturn	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
	2,762	2,827	2,785	2,887	3,087	3,295	3,332

Source: Scottish Fiscal Commission, Scottish Government NDRi returns.

Background

3.53 Non-Domestic Rates (NDR) are paid by the owner, tenant or occupier of non-domestic properties. The amount of tax paid is dependent on the rateable value (RV) of the property, the tax rate (also known as poundage) and any reliefs or exemptions for which the property is eligible.[58] While NDR are collected and ultimately spent by local authorities, the Scottish Government retains control over the administration of the tax. This includes control over decisions such as the poundage, the system of reliefs available to ratepayers, and the date at which a revaluation of properties will take effect.[59]

3.54 Independent Assessors assign RV to every non-domestic property in Scotland (with some exemptions). The total rateable value of non-domestic properties in Scotland is the tax base for NDR. The method used to assess RV depends on the type of property being valued, but the RV can be thought of as being broadly equivalent to the annual rental value of the property in question.[60] Rateable values are reassessed on a regular basis, with every five years historically being the most common period in between revaluations.

3.55 Ratepayers have the right to appeal the RV of their property if they believe it should be lower than valued by the Assessor. In Scotland the two main types of appeal are revaluation appeals, which can only be lodged within six months of a revaluation taking place, and running roll appeals which can be lodged at any point during the revaluation cycle.[61] Currently an appeal submitted by a ratepayer can only result in the rateable value of their property either being reduced or staying the same.

[58] Rateable value is defined in the Valuation and Rating (Scotland) Act 1956 (link)

[59] Though local authorities do have the power to introduce their own locally funded reliefs under the Community Empowerment (Scotland) Act 2015 (link)

[60] Details of the methods used to value properties is available on the Scottish Assessors Association website (link)

[61] Running roll appeals are lodged on the grounds of error, new interest, or a material change in circumstances (MCC). Appeals on the grounds of error must be lodged whilst the roll is in force. Appeals for MCC must be lodged no later than six months after the roll ceases to be in force.

3.56 Since our May 2018 forecast, the Scottish Government has conducted a public consultation on the implementation of 15 of the 30 recommendations of the Barclay Review.[62] These include items such as reform of charitable relief, the creation of a General Anti-Avoidance Rule, and various administrative changes including reform of the current appeals system. The Barclay Review expected some of these measures to raise significant revenue, with the general anti-avoidance rule alone estimated to raise £21 million in 2020-21.

3.57 The Scottish Government plans to lay primary legislation in early 2019, to allow for implementation of these remaining recommendations of the Barclay Review. Once information regarding the detail and timing of any further changes to the rates system is available, they will be included in our forecasts. Several Barclay recommendations relating to reliefs were implemented from April 2018 and were included in our December 2017 forecast.

Description of modelling approach

3.58 The approach taken to forecast NDR has previously been set out in detail both in our September 2017 paper and our December 2017 forecast publication.[63] Data from the Scottish Assessors Association (SAA) on the tax base are used to estimate the amount of gross NDR income to be collected, taking account of growth in the tax base and losses from revaluation appeals.[64]

3.59 Various deductions to this forecast of gross income are then made to account for the factors that reduce the amount of NDR income collected by local authorities. This includes factors such as expenditure on mandatory reliefs, write-offs and refunds resulting from overpayments in previous years.

3.60 The final step in the model accounts for the effect of a revaluation on NDR income. To do this, it is assumed that the Scottish Government will set the poundage following a revaluation in order to maintain revenue neutrality. With a revenue-neutral poundage, the only effect of a revaluation on NDR income is through the resolution of appeals, which cause revenues to be high early in the cycle before declining as increasing numbers of appeals are resolved. Table 3.16 shows this effect, with revenue in year one of a revaluation cycle four per cent higher than in a scenario where no revaluation takes place.[65]

[62] For further detail see: Scottish Government (2018) Barclay Implementation: A consultation on non-domestic rates reform (link)

[63] See Scottish Fiscal Commission (2017) Current Approach to Forecasting (link) and Scottish Fiscal Commission (2017) Scotland's Economic and Fiscal Forecasts – December 2017 (link)

[64] The Non-Domestic Rates Returns (NDRI returns) report data on the amount of NDR income collected each year. There is a cycle of 4 returns to collect estimates and then final amounts of NDR income – The Provisional Contributable Amount, Mid-year Estimate, Notified and Audited (Certified) Returns (link)

[65] Policy around revaluations in Scotland has often focused on maintaining revenue-neutrality, though this was foregone at the last two revaluations in favor of matching the English poundage. The formula used to calculate

Table 3.16: Effect of a revaluation on NDR Income

Per cent	Year 1	Year 2	Year 3	Year 4	Year 5
Difference compared with no revaluation scenario	4	1	-2	-2	0

Source: Scottish Fiscal Commission

3.61 By incorporating the effect of a revaluation on NDR income in this way, our forecast should reflect the expected revenues collected in the absence of any policy changes by the Scottish Government at the next revaluation.

Description of main modelling and data updates

3.62 We have made a number of updates to our forecasting model since our May 2018 forecast. First, our in-year forecast of gross NDR income is now based on the mid-year estimates reported by local authorities. Second, we have included some adjustments in the forecast to reflect historical patterns in the data. Our appeals loss forecast is now adjusted to reflect the historic difference between revaluation appeals data published by the Scottish Government (which is the most timely) and the appeals losses reported on local authorities audited NDR returns.[66] Finally, we adjust the mid-year estimate for expenditure on empty property relief, to reflect the fact that these data are consistently lower than the final audited outturn figures. Table 3.17 summarises the effect of these changes.

3.63 These developments follow our 2018 Forecast Evaluation Report in which we showed that the two largest sources of short-term forecast error were the forecasts of gross income (£38 million error) and empty property relief (£15 million error).[67] Our analysis has shown that moving the in-year forecast for gross income to the mid-year estimate would have reduced our December 2017 forecast error for 2017-18 from £38 million to £23 million. For empty property relief, we have moved away from using the mid-year estimate to a projection based on the most recently available audited return because of our analysis revealing a systematic underestimate of the relief granted in the mid-year estimates.

3.64 The modelling changes with the largest effect on the development of our forecast since May are the forecast method for empty property relief and an adjustment we have made to reconcile two different data sets on appeals

revenue neutral poundage is defined in legislation covering England and Wales, Local Government Finance Act 1988, Schedule 7 Part 1 (link)

[66] Investigations have highlighted one cause of this difference is local authority income returns to the Scottish Government including appeals resulting from material change of circumstances, while the Assessors' returns on appeals to the Scottish Government cover revaluation appeals only.

[67] See pages 53-56 of Scottish Fiscal Commission (2018) Forecast Evaluation Report (link)

losses. The largest effect of the latter falls in 2019-20 and 2020-21, reducing our forecast by £27 million and £31 million respectively.

3.65 Data updates reduce the forecast for 2019-20 by £16 million. The major contributors to this change are the inclusion of the mid-year estimates for 2018-19, and an adjustment for the resolution of historic telecoms appeals relating to the two previous revaluation cycles.

3.66 We have updated our costing of the Business Growth Accelerator to incorporate the initial data from local authorities on relief claimed. As these data are only partial, we have calculated the average proportion of Business Growth Accelerator relative to gross income across the local authorities that have reported figures for the half year. We apply these to the local authorities that have reported gross income, but not Business Growth Accelerator figures. Finally, we scale this up to reflect that we have only partial data for the year.

3.67 We have seen evidence that take-up of the Business Growth Accelerator is lower than we expected at the time of our May forecast. This appears to be in part because of a combination of lower than expected ratepayer awareness of the relief along with IT infrastructure challenges in certain local authorities.[68] We expect take-up to improve over the forecast period and have uprated our costing in later forecast years to reflect this.

Forecast

3.68 The Commission's forecast of NDR income is presented in Table 3.17. The forecast has developed since May as a result of the inclusion of new data, and the modelling changes described in the previous section. Several of the policy costings produced for our last forecast have also been updated to include the latest available data.

[68] As a result of the issues we have discussed, around half of local authorities reported figures for Business Growth Accelerator granted in the first half of 2018-19.

Table 3.17: Change in NDR forecast

£ million	2017-18 Outturn	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
May 2018	2,774	2,788	2,859	2,931	3,110	3,307	3,339
Data updates	-12	34	-16	20	16	26	26
Modelling changes		-19	-35	-39	-14	-14	-8
Policy re-costings		23	19	20	20	20	20
December 2018 Pre-measures	2,762	2,827	2,827	2,932	3,132	3,339	3,376
Policy costings			-42	-46	-45	-44	-44
December 2018 Post-measures	2,762	2,827	2,785	2,887	3,087	3,295	3,332

Source: Scottish Government NDRi returns, Scottish Fiscal Commission.
Figures may not sum because of rounding.

3.69 As part of Budget 2019-20, the Scottish Government has announced that transitional relief for the hospitality sector and offices in Aberdeen and Aberdeenshire will be extended to the end of 2020-21. This limits increases to gross bills for eligible properties to a real terms cap of 12.5 per cent per year. In practice this means an eligible property will pay no more than a 53 per cent increase on their 2016-17 NDR bill in 2019-20 (compound of three 12.5 per cent caps and the measures of inflation used to uprate the poundage). This extension to transitional relief reduces NDR income by £7 million in 2019-20, falling to £3 million by the end of the revaluation cycle in 2021-22. Further details can be found in Annex A.

3.70 Other changes announced for this Budget include setting the poundage at 49.0 pence in 2019-20. This is lower than the RPI-linked uprating of the poundage that we had previously assumed. We estimate the cost of this change will reduce NDR income by £35 million in 2019-20. A new ten-year 100 per cent relief has also been created for investment in fibre, which we expect to have no net impact on income in 2019-20, but rising to £2 million by the end of the forecast. Further detail can be found in Annex A.

Box 3.3: Calculation of the Distributable Amount in 2019-20

The Commission forecasts what is known as the 'contributable amount' for NDR, which can be thought of as being the amount collected by local authorities that subsequently flows to the Scottish Government. The contributable amount collected by local authorities is pooled at a national level, before being redistributed by the Scottish Government as part of the Local Government Finance Settlement. The amount of NDR income redistributed to local authorities as part of this settlement is known as the 'distributable amount'.

In our previous reports we have outlined how our forecast is used by the Scottish Government to inform what amount can be distributed to local authorities for the year ahead.[69] Government can distribute more or less than the forecast contributable amount in any given year, as long as the total amount collected is subsequently distributed back to local government. Notwithstanding this flexibility, the calculation of the distributable amount by Government also takes account of three factors:

1. The estimated closing balance on the account from the previous financial year
2. Estimated prior year adjustments to be carried over to the account from the year before
3. The amount forecast to be raised in the year ahead

At the last Budget, the Scottish Government chose to set the distributable amount at a level so the account was projected to be balanced at the end of 2018-19.[70] This year, the distributable amount set by Government leads to a projected negative balance of £100 million on the account at the end of 2019-20, as shown in Table 3.18. The Scottish Government plans to bring the account back into balance by 2021-22.

Table 3.18: Illustrative projected balance of the Non-Domestic Rating Account

£ million	2016-17	2017-18	2018-19	2019-20
Provisional contributable amount **(A)** [71]	2,754	2,844	2,883	2,785
Net impact of prior year adjustments **(B)** [72]	6	-23	-82	-56
Distributable amount **(C)**	2,769	2,666	2,636	2,853
Annual balance **(D)** **(A + B - C)**	-8	155	165	-124
Cumulative balance **(E)** **(E from year before + D)**	-297	-141	24	-100

Figures may not sum because of rounding. Shaded cells indicate outturn. The presentation differs slightly to that in the published audit of the NDR rating account, mainly due to the presentation of line B – 'net prior year adjustments'.

As outlined in our previous reports, the audited balance of the pool will be determined by several factors in practice. These include not only our forecast

[69] Scottish Fiscal Commission (2018) Forecast Evaluation Report (link)

[70] The calculation of the 2018-19 distributable amount, showing how our forecasts were used is shown in Scottish Government (2017) Scottish Budget: Draft Budget 2018-19, Table 10.18 (link)

[71] Provisional contributable amount is reported by local authorities to the Scottish Government after the start of the financial year and determines level of contributions to the pool.

[72] Differences between the provisional contributable amount and final audited figures from the previous year are reflected in this line.

accuracy, but also start of year estimates provided by local authorities to the Government after the start of the financial year (the provisional contributable amount in Table 3.18). Contributions to the pool are determined by local authorities own estimates of collections for the year, submitted to the Scottish Government after the start of the financial year. Because of this, the balance of the pool could be positive despite our projection of a negative balance if local authorities report a high level of collections on their start of year estimates.

Should the projected negative balance in 2019-20 materialise this will have to be addressed by the Government at future Budgets. This does not necessarily affect the local government settlement directly, but would need to be managed as part of the overall Scottish Government Budget.

Uncertainties

3.71 Our forecast for NDR is subject to several uncertainties. Perhaps the largest potential impact on NDR income is the assumption relating to the amount of RV expected to be lost to appeal. The effect this has on NDR income is determined by both the size and timing of appeals losses. As revaluation appeals are backdated to the effective date of the property, the later an appeal is resolved in the cycle the greater the effect it has on NDR income.[73]

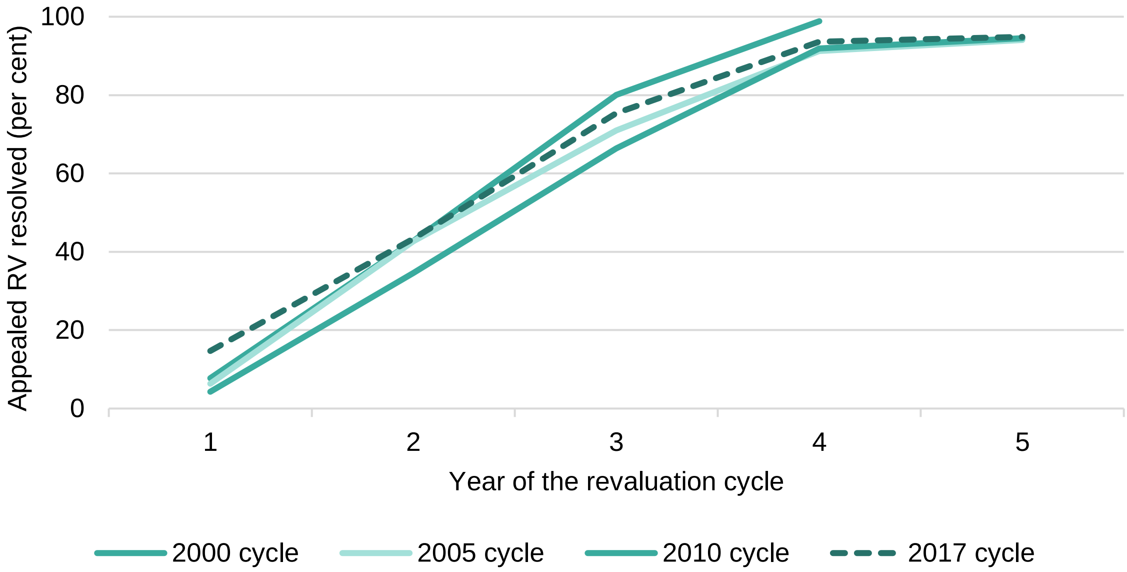
3.72 The resolution of revaluation appeals has followed a broadly similar path at each of the last three revaluations, with the majority of appeals heard by the end of the fourth year of the cycle. A statutory timetable governs the disposal of appeals between revaluations, ensuring some degree of predictability.[74]

3.73 Our current forecast assumes the pattern for the 2017 revaluation will be similar to that experienced at previous revaluations. One slight difference seen so far has been the high value of appeals resolved in year one of the cycle relative to previous cycles, as shown in Figure 3.6. This resulted from a small number of successful appeals relating to high-value electricity and telecommunications entries on the valuation roll. Other than this, our forecast assumes the timing of appeals losses to be broadly similar to previous cycles. Data beyond the fourth year of the 2000 cycle is not available.

[73] The effective date refers to the first day on which an entry in the valuation roll has effect for rate charging purposes.

[74] The Valuation Timetable (Scotland) Order 1995, as amended (link)

Figure 3.6: Resolution of revaluation appeals at last four revaluation cycles



Source: Scottish Government (2018) Non-Domestic Revaluation Appeals (link), Scottish Fiscal Commission

3.74 A sensitivity analysis is shown in Table 3.19, demonstrating the effect on our forecast of NDR income if appeals for the 2017 revaluation were resolved in line with the patterns seen at previous cycles instead of our current assumed profile. Despite the timing of appeals being broadly similar, slight differences affect the forecast amount of income collected by local authorities.

Table 3.19: Effect of timing of revaluation appeals on forecast NDR income

£ million	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
2000 revaluation cycle profile	-13	-31	-13	N/A	N/A	N/A
2005 revaluation cycle profile	-16	22	-11	-14	-12	-5
2010 revaluation cycle profile	-3	2	-59	-26	-17	-11

Source: Scottish Fiscal Commission

3.75 Additional uncertainty is introduced because of variation in the total amount of RV lost to appeal at each revaluation. Our December 2017 publication showed how even a one per cent difference to the amount of RV lost to appeal could significantly affect NDR income.[75] Given these uncertainties, we will keep our approach to incorporating appeals losses in our forecast under review. Our approach may change at future forecasts because of new data, and judgements on the progress of appeals relating to the 2017 cycle.

[75] See Scottish Fiscal Commission (2017) Scotland's Economic and Fiscal Forecasts – December 2017, paragraph 3.91 on page 120 for further details (link)

Land and Buildings Transactions Tax (LBTT)

3.76 Land and Buildings Transactions Tax (LBTT) is payable upon purchase of a residential property, or purchase or lease of a non-residential property. There are three components of LBTT:

- Residential LBTT, which is charged on the purchase of a residential property.
- Additional Dwelling Supplement (ADS), which is charged on the purchase of an additional property, such as a buy-to-let or a second home.
- Non-residential LBTT, which is charged on the purchase or lease of non-residential land or property, for example factories, offices and farms.

Table 3.20: LBTT forecasts

£ million	2017-18 Outturn	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Total LBTT revenue raised	557	569	643	680	716	751	787
of which:							
Residential (excluding ADS)	258	267	296	324	349	373	398
Additional Dwelling Supplement (ADS)	95	94	122	123	127	130	134
Non-residential	204	208	226	233	240	247	255

Source: Scottish Fiscal Commission, Revenue Scotland (2018) Annual Report and Financial Statements 2017-18 (link).
Figures may not sum because of rounding.

3.77 We forecast LBTT revenues on a basis consistent with the audited figures published in Revenue Scotland's Annual Reports.[76] These statistics will not exactly match those published monthly on Revenue Scotland's website, which are published based on the date the tax returns are received to allow for timely publication of data.[77] One important difference is that in the monthly statistics, ADS reclaims and other amendments accrue to the month of the original return.

[76] Revenue Scotland (2018) Annual Report and Financial Statements 2017-18 (link)

[77] For further detail on the differences, see Box 3.2 on page 58 of Scottish Fiscal Commission (2018) Forecast Evaluation Report (link)

Residential LBTT

Table 3.21: Residential LBTT forecast (excluding ADS)

£ million	2017-18 Outturn	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
	258	267	296	324	349	373	398

Source: Scottish Fiscal Commission, Revenue Scotland (2018) Annual Report and Financial Statements 2017-18 (link).

Background

3.78 Residential LBTT is paid on a residential property or land purchase over £145,000. LBTT was introduced on 1 April 2015 and replaced Stamp Duty Land Tax (SDLT) in Scotland.[78]

3.79 Before December 2014, SDLT tax rates were applied to the entire purchase price of the home.[79] Residential LBTT tax rates are applied only to the portion of the home purchase price that falls into each tax band. For example for a £150,000 home, the first £145,000 is taxed at zero per cent and the final £5,000 is taxed at two per cent.

3.80 The pre-December 2014 tax system was referred to as a 'slab' system because of the sudden jumps in tax paid should the house price reach the next tax threshold. The post-December system is known as a 'slice' system, on account of the relevant tax rate applying only to the specified portion of the purchase price.

3.81 The rates and bands for residential LBTT are:

- zero per cent on transactions up to £145,000
- two per cent on the portion above £145,000 up to £250,000
- five per cent on the portion above £250,000 up to £325,000
- 10 per cent on the portion above £325,000 up to £750,000
- 12 per cent on the portion above £750,000

3.82 From the end of June 2018, the tax schedule changed for First Time Buyers as a result of the introduction of a relief that effectively raised the zero-tax threshold from £145,000 to £175,000.

The Scottish Housing Market

3.83 Since our May 2018 forecast, activity in the Scottish housing market has dampened. Mean house price growth has progressively slowed from 7.6 per

[78] For further information about residential LBTT, visit the Revenue Scotland website (link)

[79] Previous Commission reports have discussed the changes to the tax system in 2014 and 2015. Scottish Fiscal Commission (2017) Forecast Evaluation Report 2017 (link)

cent year-on-year in the first quarter of 2018 to 1.8 per cent year-on-year in the third quarter.

3.84 Throughout 2018, there was an increase in the number of purchases valued above £250,000 at a time when the volume of transactions valued below £250,000 was falling. When the number of higher value properties bought increases and lower value properties decreases, mean house prices go up. Latterly, the growth in the volume of transactions above £250,000 has slowed, reducing the rate of increase in mean house prices.

3.85 The number of transactions fell by 3.4 per cent in the first half of 2018-19. This drop was a result of a 4.6 per cent decrease in the number transactions with a value below £250,000. This section of the market accounts for 80 per cent of total transactions. In May 2018 we forecast a drop in transactions in the second quarter of 2018 and growth thereafter. The latest available data are consistent with a more sustained fall in the number of transactions in the near term.

3.86 The lower than expected outturn for transactions was a common feature across the entire UK housing market. Transactions for the UK as a whole fell by 3.0 per cent in the first half of 2018-19, which came in contrast to a rise expected by the Office for Budget Responsibility (OBR) in both their November 2017 and March 2018 forecasts.[80] This led the OBR to revise down its 2018-19 transactions growth forecast from 1.1 per cent to minus 1.7 per cent in its latest forecasts.[81]

Modelling approach

3.87 Our residential LBTT forecast is built from: a forecast of mean house prices, a forecast of the total number of transactions and a forecast of the share of transactions falling into higher and lower price brackets, which is captured by the ratio of the median house price to the mean house price.[82]

3.88 Our approach to forecasting residential LBTT has been updated since May 2018. In light of analysis carried out as part of our 2018 Forecast Evaluation Report and the latest outturn data, our main change has been to our transactions forecast, for which we have changed the projection model used to inform our forecast judgements. We have made a smaller-scale adjustment to our forecast model for the median price.

3.89 We project the number of transactions as a percentage of the dwelling stock (also known as the turnover rate). Growth in the dwelling stock is projected using household formation projections from National Records of Scotland, and

[80] HMRC Monthly property transactions completed in the UK with value of £40,000 or above (link)

[81] OBR (2018) Economic and Fiscal Outlook October 2018 (link)

[82] For further detail, see Scottish Fiscal Commission (2017) Current Approach to Forecasting (link)

these are combined with our turnover rate projections. As with our previous approach, this model distinguishes between the pre- and post-crisis periods.

3.90 The introduction of a slice tax system in December 2014 removed the bottlenecks around the previous tax thresholds. In Scotland the largest bottleneck was at £125,000, just below the median price at the time of £138,000. The removal of these bottlenecks has increased the share of transactions in the mid and lower price brackets. We have updated our model for forecasting the ratio of the median price to the mean price accordingly.

Forecast

3.91 The forecast for residential LBTT is shown in Table 3.22, along with how the forecast has developed since May 2018. There is a downward revision to our revenue forecast across the forecast horizon.

Table 3.22: Residential LBTT receipts forecasts (excluding ADS)

£ million	2017-18 Outturn	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
May 2018	258	312	342	373	405	438	473
Prices		-34	-21	-20	-22	-25	-29
Transactions		-13	-26	-30	-35	-41	-49
Fiscal drag		0	1	1	1	1	2
FTB recosting		0	0	0	0	1	1
Other		2	1	1	1	2	2
December 2018 pre-measures	258	267	297	326	351	375	400
ADS Policy change		0	-2	-1	-1	-2	-2
December 2018 post-measures	258	267	296	324	349	373	398
Total change		-45	-46	-49	-56	-65	-75

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – May 2018 (link), Revenue Scotland (2018) Annual Report and Financial Statements 2017-18 (link).
Figures may not sum because of rounding.

3.92 Residential LBTT revenue raised in the first half of 2018-19 was 1.5 per cent lower than the same period last year and below our May forecast.[83] This is mainly down to a lower number of transactions than previously anticipated and a greater proportion of lower value transactions. While our revenue forecast for 2018-19 is £45 million lower than our May forecast, it will still imply growth in revenue of 3 per cent on the previous financial year.

3.93 House price growth in the first two quarters of 2018-19 was slightly lower than we expected in May 2018. Our longer-term judgement for mean house price growth is broadly unchanged from May. As a result of the weaker outturn

[83] Revenue Scotland Monthly Statistics: September 2018 publication (link)

data, our 2018-19 mean price growth forecast has been revised down to 2.1 per cent from 2.5 per cent in May.

3.94 We model the distribution of transactions across tax brackets using the ratio of the median house price to the mean house price. We have revised the forecast ratio upwards, meaning we are apportioning a greater share of transactions than before towards the lower tax brackets, which reduces our revenue forecast. Combined with the revisions to our mean price forecast, this reduces our 2019-20 residential revenue forecast by £21 million.

3.95 In May, we revised down our transactions forecast. The number of transactions has continued to fall and is now lower than we expected at that time. As a result, we have developed our modelling approach, and we have further revised down our forecast for transactions. These changes contribute a £26 million decrease to forecast revenue in 2019-20.

3.96 As in previous forecasts, the current methodology accounts for the behavioural response to fiscal drag.[84] We use the same behavioural elasticities as the OBR to assess the sensitivity of buyers to house price changes.[85] If prices and consequently taxes increase, some buyers may choose to either lower their offers to accommodate the higher tax bill, or might not buy a house at all. As our price growth forecasts have decreased, the scale of revenue forgone as a result of the response of home buyers to fiscal drag is lower than the estimates presented in May 2018. This increases our revenue forecast by an additional £2 million by 2023-24.

3.97 The costing of the First Time Buyers relief has been updated to reflect the lower price and transactions forecasts and the changes to the median to mean price ratio. At this point, outturn data for the relief have not been included in the costing as there is not sufficient data for us to be confident that it is representative. We have estimated that the relief reduces the LBTT revenue forecast by an average of £6 million per year over the forecast horizon, approximately £0.4 million less than previously forecast.[86] This costing will be reviewed as more outturn data become available.

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[84] Fiscal drag occurs when the tax paid on a transaction increases over time as a result of growth in prices, pushing the transaction up the tax schedule. This may cause some home buyers to offer a lower price for the house than they otherwise would, to offset, in part, the increased tax due, or even refrain them from purchasing a property.

[85] Over the summer, we undertook a project to examine whether there was a case to change the main behavioural elasticities for policy costing used by the Commission and if so, what these might be. Following a careful examination of the available Scottish data, we concluded that at the current juncture, there is insufficient basis to move away from using the OBR/HMRC elasticities for the UK as a whole.

[86] The updated figures are set out in Annex B.

Scottish Government policy

3.98 The Scottish Government has announced an increase in the ADS tax rate from 25 January 2019 from three per cent to four per cent. While this does not alter the residential LBTT tax schedule per se, the ADS policy change lowers the residential LBTT revenue forecast by between £1 million and £2 million each year.[87] This is because of an estimated reduction of around 800 transactions in each year as a result of the increase in the ADS rate. Further details on our estimates of the revenue impact of the ADS policy change can be found in Annex A.

Forecast uncertainty

3.99 The main areas of uncertainty in the Commission's residential LBTT forecasts come from the three model determinants: mean prices, the ratio of the median house price to the mean house price and transactions. Should any, or all, of these determinants differ from our forecast, this will feed through to differences in our revenue forecast.

3.100 To demonstrate the relative sensitivity of the model to each determinant, we have conducted an illustrative exercise to show the percentage point revision required for each of the forecast determinants in order to increase our 2019-20 revenue forecast by £20 million.[88]

Table 3.23: Percentage point difference in forecast growth rates to produce a £20 million revenue forecast increase in 2019-20

Percentage point	Mean price	Median price	Transactions
Difference from SFC forecast	0.6	-0.9	4.3

Source: Scottish Fiscal Commission

3.101 Table 3.23 shows that the major area of forecast uncertainty is mean house price growth.[89] Residential LBTT is a progressive tax, so small changes in the forecast for house price growth lead to larger changes in the forecast for LBTT revenues. The second major area is the forecast for the shape of the distribution of transactions (determined by the 'median price'). Again, it is the fact that LBTT is progressive that causes small changes to have amplified effects on the revenue forecast. The revenue forecast is least sensitive to transactions growth. A 0.6 percentage point difference in house price growth

[87] While residential LBTT revenue falls, ADS revenue increases with the higher rate of tax.

[88] For this exercise, we vary each determinant in turn, holding the others constant. The choice of £20 million is arbitrary, as the purpose of the exercise is to highlight the relative sensitivities of the forecast to the determinants.

[89] On the importance of house price growth for forecast errors see also Scottish Fiscal Commission (2017) Forecast Evaluation Report (link) and Paragraphs 3.110 and 3.111 on page 127 of Scottish Fiscal Commission (2017) Scotland's Economic and Fiscal Forecasts – December 2017 (link)

has the same effect on the forecast as a 4.3 percentage point difference in transactions growth.

3.102 There is also uncertainty for the residential forecast stemming from the UK's changing relationship with the European Union. Our forecasts for prices and transactions are consistent with existing trends in the market. As with the macroeconomic forecast, we make no explicit adjustment to our projections for Brexit and we consider a no deal Brexit to be a potential downside risk to our forecast.

Comparison with OBR forecasts

Table 3.24: Commission and OBR residential LBTT forecasts (excluding ADS)

£ million	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
SFC December 2018	258	267	296	324	349	373	398
OBR October 2018	258	251	273	300	331	367	412
Difference		16	22	24	18	6	-14

Source: Scottish Fiscal Commission, OBR (2018) Devolved Tax and Spending Forecast October 2018 (link), Revenue Scotland (2018) Annual Report and Financial Statements 2017-18 (link).
Figures may not sum because of rounding.

3.103 The Commission's forecasts are £22 million higher in 2019-20 than those made by the OBR. The principal areas of difference in forecasting approach are:

- different modelling approaches and judgements for house prices and transactions
- the OBR's use of UK price and transactions growth rates
- the OBR's forecast coming before the announcement of the ADS policy change

Additional Dwelling Supplement

Table 3.25: Additional Dwelling Supplement (ADS) forecast

£ million	2017-18 Outturn	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
	95	94	122	123	127	130	134

Source: Scottish Fiscal Commission, Revenue Scotland (2018) Annual Report and Financial Statements 2017-18 (link).

Background

3.104 The Additional Dwelling Supplement (ADS) was introduced on 1 April 2016 and applies to purchases of additional residential properties worth £40,000 or more. The rate is set at 3 per cent on the full value of the property purchase.

3.105 ADS is also payable in the case where someone who owns only one property completes the purchase of their new property before selling their existing home. In this case, provided the existing home is sold within 18 months of the purchase of the new property (referred to as 'replacing a main residence'), the buyer has up to five years following the ADS transaction to reclaim the ADS paid. The Commission forecasts net revenue – total ADS received less ADS repayments.

Table 3.26: Additional Dwelling Supplement (ADS) gross, repayments and net forecast

£ million	2017-18 Outturn	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Gross ADS	125	126	160	165	171	176	180
Repayments	30	32	39	42	44	45	47
Net ADS	95	94	122	123	127	130	134

Source: Scottish Fiscal Commission, Revenue Scotland (2018) Annual Report and Financial Statements 2017-18 (link).

Scottish Government policy

3.106 The Scottish Government has announced an increase in the Additional Dwelling Supplement (ADS) rate from 3 per cent to 4 per cent. This will come into effect on 25 January 2019. The change will be made via secondary legislation. All other elements of the existing ADS policy remain unchanged. Details of our costing can be found in Annex A.

Modelling approach

3.107 The ADS model is broadly unchanged since our May 2018 forecast. We use the forecasts for mean house prices and total transactions generated by the residential LBTT model.

3.108 We have updated our repayment rate projection in light of the most recently available data. In our last forecast, we assumed that all reclaims would fall within 18 months of purchasing a new home, the period in which the replacement of the main residence has to occur for the buyer to be eligible to reclaim ADS. We have extended the ADS repayment period to 21 months as the data have shown the repayment rate continuing to rise marginally after the initial 18 months.[90] The adjustment to our repayment rate forecast to account for the introduction of the Second Homes Main Residence Relief Order in June 2017 has been removed.[91] We believe the additional number of people claiming the relief has now largely been captured in the data and the uplift is no longer required.

Forecast

3.109 The Commission's forecast of net ADS is shown in Table 3.27 along with how the forecast has developed since May 2018. Our net ADS forecast in 2019-20 is £22 million higher, as a result of the expected effect of the change in the ADS rate from 3 per cent to 4 per cent as of 25 January 2019.

Table 3.27: ADS forecasts

£ million	2017-18 Outturn	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
May 2018	95	97	100	104	108	112	116
House prices		-1	0	0	0	0	0
Transactions		-5	-8	-8	-9	-10	-12
Repayment Rate		0	2	2	2	2	2
Other		2	0	0	0	-1	-1
December 2018 pre-measures	95	92	94	97	100	103	106
Policy changes		2	27	26	27	27	28
December 2018 post-measures	95	94	122	123	127	130	134
Total change		-2	22	19	19	19	18

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2017) Scotland's Economic and Fiscal Forecasts – May 2018 (link). Revenue Scotland (2018) Annual Report and Financial Statements 2017-18 (link).
Figures may not sum because of rounding.

3.110 The net ADS revenue pre-measures forecast for 2019-20 has decreased by £6 million primarily because of our lower residential transactions forecast. These reductions are in part offset by our forecast for a lower repayment rate than we assumed in May and the extension of the repayment period from 18

[90] Additional home buyers have up to five years to reclaim ADS paid, provided the replacement of the main residence occurs within the 18 month window.

[91] The Land and Buildings Transaction Tax (Additional Amount Second Homes Main Residence Relief) (Scotland) Order 2017 (link)

to 21 months, which have the effect of increasing net ADS revenue by £2 million.

3.111 We estimate that the policy change will affect all 23,000 additional dwelling transactions in 2019-20 and increase ADS revenue by £27 million in 2019-20. In the absence of any behavioural response, the tax change by itself would raise an estimated £35.3 million in net revenue. The effect of the behavioural responses by buyers in the market lowers our estimate of net ADS revenue by £7.3 million. Tax changes lead to behavioural responses and both the volume of transactions and the price of those transactions will be affected by the increased tax rate. We estimate the increase in the rate of tax will lead to a loss of around 800 additional dwelling transactions per year and a reduction in the ADS mean market price of £3,600 from 2019-20 onwards, relative to what it otherwise would have been.

3.112 While we expect some forestalling in advance of the tax change, we expect most of this will affect transactions that would have taken place in February and March of 2018-19. Full details can be found in Annex A.

UK Government policy

3.113 The UK Government introduced changes to mortgage interest relief for buy-to-let landlords in its 2015 Summer Budget. These changes are being phased in between April 2017 and April 2020. In 2019-20, landlords will able to offset 25 per cent of their mortgage interest payments from their rental income before being taxed, rather than 100 per cent as under the old rules. The remaining 75 per cent will be given as a UK 20 per cent basic rate tax reduction. By 2020-21, all financing costs incurred by a landlord will be given as a UK 20 per cent basic rate tax reduction. This policy has been accounted for in our NSND income tax forecast.

3.114 Our assessment of the effect of this policy remains unchanged. Our forecast assumes that landlords are already aware of these changes and that there are no additional market level reactions over and above those captured in existing market trends and the Commission's forecast.

Forecast uncertainty

3.115 While the main sensitivities are the forecasts of house prices and transactions, the net ADS forecast is not as sensitive to changes in price as the main residential LBTT forecast, as ADS rate is a flat rate rather than a progressive tax. Second, the ADS forecast depend on the estimate of the proportion of revenue that will be reclaimed. Finally, as with the residential LBTT forecast, there is uncertainty to our forecast stemming from the UK's changing relationship with the EU.

Comparison with OBR forecasts

3.116 Table 3.28 shows that the OBR net revenue forecasts are lower than those made by the Commission. This is primarily driven by differing forecasts for house price and transactions growth and the OBR's forecast coming before the Scottish Government's announcement of a change in policy. There is a small difference in the repayment rate, with the Commission's set higher as a result of different modelling assumptions.

Table 3.28: Commission and OBR forecasts for net ADS revenues

£ million	2017-18 Outturn	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
SFC December 2018	95	94	122	123	127	130	134
OBR October 2018	95	93	98	104	110	117	125
Difference		2	24	19	17	13	8

Source: Scottish Fiscal Commission, OBR (2018) Devolved Tax and Spending Forecasts October 2018 (link), Revenue Scotland (2018) Annual Report and Financial Statements 2017-18 (link).
Figures may not sum because of rounding.

Non-residential LBTT

Table 3.29: Non-residential LBTT forecasts

£ million	2017-18 Outturn	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
	204	208	226	233	240	247	255

Source: Scottish Fiscal Commission, Revenue Scotland (2018) Annual Report and Financial Statements 2017-18 (link).

Background

3.117 Non-residential LBTT applies to purchases or leases of commercial land and properties such as shops or offices, agricultural land, forests or any other transaction where the main subject matter of transaction consists of, or includes, an interest on land that is non-residential.[92]

Scottish Government policy

3.118 The Scottish Government has announced a change to the tax rates and bands for non-residential conveyances.[93] These changes will come into effect on 25 January 2019. They will be made via secondary legislation. All other elements of the existing non-residential LBTT policy remain unchanged, including tax rates and bands on lease transactions.

Table 3.30: Non-residential tax rates and bands for conveyances

Current		From 25 January 2019 onwards	
Tax Band (£)	Tax Rate (per cent)	Tax Band (£)	Tax Rate (per cent)
0 to 150,000	0	0 to 150,000	0
150,000 to 350,000	3	150,000 to 250,000	1
Above 350,000	4.5	Above 250,000	5

Source: Revenue Scotland, Scottish Government.

3.119 The changes will reduce the starting threshold for the upper rate from £350,000 to £250,000 and increases the upper rate from 4.5 per cent to 5 per cent. The lower threshold rate (now applying from £150,000 to £250,000) reduces from 3 per cent to 1 per cent. The tax rates continue to apply to the portion of the purchases falling into the respective tax band.

3.120 The Scottish Government plans to introduce two reliefs over the course of 2019 following further consultation. First, a relief for the 'seeding' (initial transfer) of properties into a Property Authorised Investment Fund or Co-owned Authorised Contractual Scheme (CoACS). Second, a relief for when

[92] Further information on the relevant rates and bands for conveyances and leases can be found on Revenue Scotland website (link).

[93] A conveyance refers to the legal transfer of a property from one owner to another. This includes, but is not limited to, purchases of non-residential property.

units in CoACS are exchanged. Once the draft legislation is set and a date for the policy change agreed, the Commission will make a judgement on whether to cost the reliefs.

Modelling approach

3.121 Our methodology for forecasting non-residential LBTT receipts is unchanged since May 2018.[94] Our in-year revenue forecast is constructed by estimating receipts for the remainder of the financial year, based on the proportion of revenues that have historically fallen into this period.[95]

3.122 We calculate a base year, from which our five-year forecast is generated. The base year distribution has been updated to reflect recent changes in the non-residential prices and transactions profiles. The base year combines the distributions of prices and transactions for 2016-17, 2017-18 and the available data for 2018-19. Previously the base year averaged only the 2015-16 and 2016-17 distributions. As in May, our forecast for 2019-20 and beyond grows our base-year estimate using a projection for price and transactions growth, based initially on a statistical model and then, from 2020-21, in line with the Commission's economic growth forecasts for Scotland.

Forecast

3.123 Table 3.31 shows the sources of the change in our non-residential LBTT forecasts since May. Including the Scottish Government's policy change, the 2019-20 forecast is £12 million higher than our May forecast.

3.124 Excluding the change in tax policy, our forecast for 2019-20 revenue has decreased by £1 million as a result of a lower forecast for the rate of growth in prices and transactions. Those falls were largely offset by the increase to our estimate of the base year for the forecast, which incorporates more recently available data.

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[94] Further details on our modelling approach can be found in paragraphs 3.101 to 3.106 in Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – May 2018 (link)

[95] At the time of publication, the Commission has data from Revenue Scotland on an effective date basis up to August 2018, which we have supplemented using data for September and October 2018 from the Revenue Scotland monthly LBTT statistics publication (link).

Table 3.31: Changes to non-residential LBTT forecasts since May 2018

£ million	2017-18 Outturn	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
May 2018	204	206	214	220	226	231	238
Prices			-11	-11	-11	-11	-11
Transactions			-6	-6	-5	-5	-5
Leases uprating			4	4	4	5	5
Base year			12	11	10	10	10
Other		0	0	1	2	2	2
December 2018 pre-measures	204	206	213	220	226	232	240
Policy changes		2	13	14	14	15	15
December 2018 post-measures	204	208	226	233	240	247	255
Total change		3	12	13	14	16	17

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – May 2018 (link), Revenue Scotland (2018) Annual Report and Financial Statements 2017-18 (link).
Figures may not sum because of rounding.

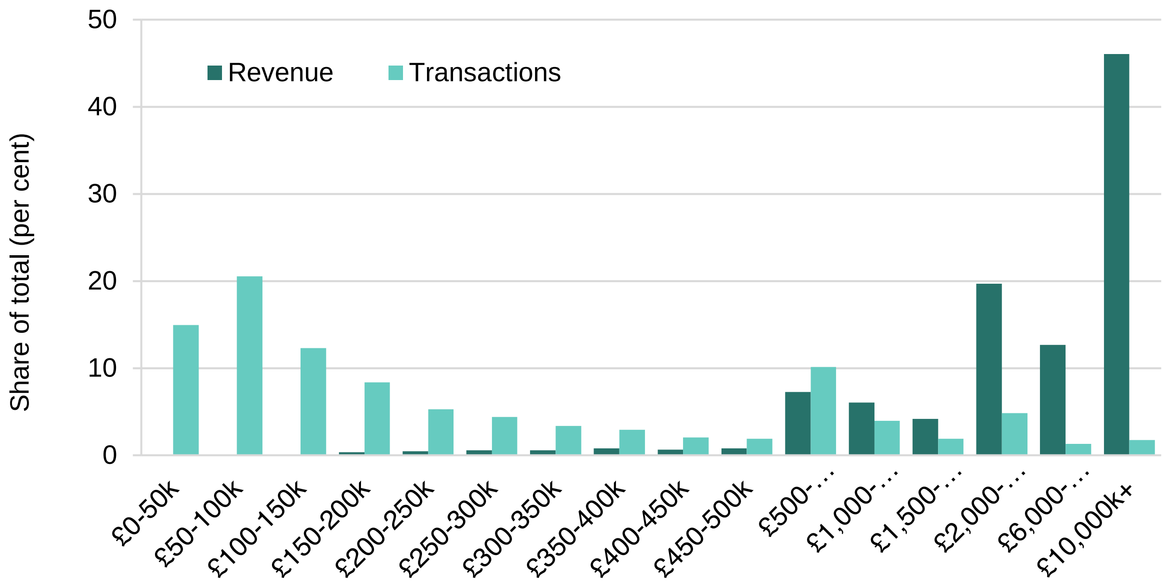
3.125 As in May, our medium and long-term forecasts rely on the Commission's economic forecasts. We forecast that transactions grow in line with growth in real economic activity. Increases in our economic forecast increase the transactions growth forecast relative to May 2018, but this is not enough to offset the effect from the downward revision to our short-term forecast. The long-term non-residential price growth forecast comes from the Commission's forecast for the GDP deflator. The in-year price forecast for 2018-19, which is generated from a short-term projection model, has been revised down to 2.8 per cent from 6.3 per cent in May 2018.

3.126 We estimate the change in policy will raise £13 million in 2019-20. While the policy change represents a lower rate of tax for transactions below £350,000, it will raise rates on transactions above this value. We expect that the policy change will lead to 30 more transactions per year below £350,000 and a loss of 25 transactions per year above. We anticipate that almost all of the forestalling occurs within 2018-19. Further details can be found in Annex A.

Forecast uncertainty

3.127 The major uncertainty in forecasting non-residential LBTT revenues is the influence of a very small number of high value transactions. In 2017-18, the top tax band for purchases accounted for 31 per cent of all conveyance transactions but 98 per cent of total net non-residential LBTT raised. This adds significant volatility to the LBTT revenue data, making it difficult to predict.

Figure 3.7: Non-residential LBTT transactions and revenue distribution 2017-18



Source: Revenue Scotland (link).

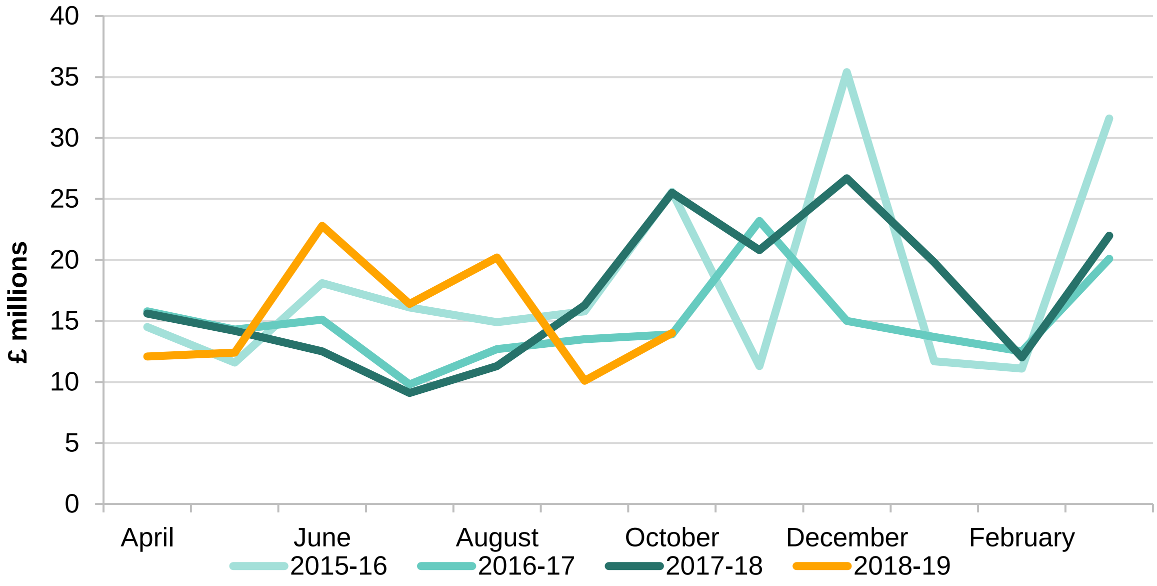
3.128 Figure 3.8 highlights the monthly profile of receipts from April 2015 onwards. In previous years, most of the revenue has been raised from large value transactions at the corporate and financial year ends in December and March.

3.129 We have previously highlighted one potential area of risk to our forecast is the introduction in April 2018 of the three year lease reviews.[96] We continue to monitor incoming data and note that in the year to October, while an additional 2,260 additional LBTT returns have been received, the effect on revenue raised has been negligible.

3.130 There is also uncertainty from the UK's changing relationship with the EU. We note that primary buyers who give a non-UK address on their LBTT return account for around one quarter of non-residential LBTT declared due. While we have not made any adjustment to our projections for Brexit, we consider this to be a key area of uncertainty to the non-residential LBTT forecast.

[96] See Revenue Scotland Guidance LBTT6014 – Three yearly review of the tax chargeable (link)

Figure 3.8: Non-residential LBTT receipts



Source: Revenue Scotland (2018) LBTT Statistics – October 2018 (link).
Effective date data available up to August 2018. Data for September 2018 onwards is based on date of return.

Comparison with OBR forecasts

3.131 Our 2019-20 forecast for non-residential LBTT is £20 million lower than that of the OBR. This difference is a result of our forecast incorporating more recently available outturn data and the OBR's forecast coming before the Scottish Government's announcement of a change in policy. Subsequent years forecasts are also lower and the primary reason for this is that our calculation of our base year is lower than the respective figure estimated by the OBR. The difference comes as a result of differing methods for calculating this figure, with the OBR using an in-year forecast for 2018-19, while the Commission uses an uplifted average of distributional data from 2016-17 onwards.

Table 3.32: Comparison of OBR and Commission LBTT forecasts

£ million	2017-18 Outturn	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
SFC December 2018	204	208	226	233	240	247	255
OBR October 2018	204	247	246	248	255	262	271
Difference		-39	-20	-14	-15	-15	-15

Source: Scottish Fiscal Commission, Revenue Scotland (2018) 2017-18 Annual Report (link), OBR (2018) Devolved Tax and Spending Forecasts October 2018 (link).
Figures may not sum because of rounding.

Scottish Landfill Tax

Table 3.33: Forecast of Scottish Landfill Tax

£ million	2017-18 Outturn	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
	148	136	104	83	13	13	14

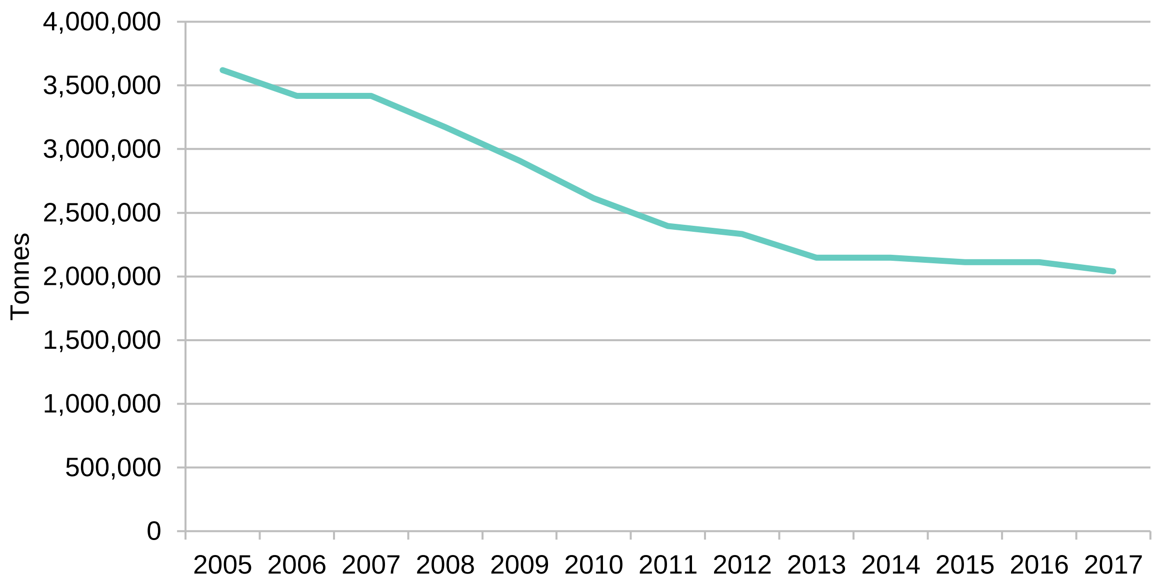
Source: Scottish Fiscal Commission, Revenue Scotland (2018) Annual Report and Accounts 2017-18 (link).

Background

3.132 Scottish Landfill Tax (SLfT) is a tax on the disposal of waste to landfill, with the amount of tax payable determined by the weight of waste being disposed and the type of waste. In 2019-20 the standard rate of tax has been set at £91.35 per tonne, with a lower rate of £2.90 per tonne for certain inert materials such as rocks and soils.

3.133 SLfT is an environmental tax, aimed at reducing the amount of waste landfilled and the associated environmental damage. Figure 3.9 shows that since 2005 landfill volumes have fallen consistently, although there is recent evidence that this reduction has begun to stall in Scotland.

Figure 3.9: Mixed Waste Landfilled in Scotland



Source: SEPA Waste Landfilled in Scotland 2017 (link)
Mixed waste constitutes two SEPA reporting categories: ‘household and similar wastes’ and ‘sorting residues’, and is used here as a proxy for standard rated waste.

3.134 Despite the apparent slowing of this trend, the Commission is forecasting significant reductions in the amount of waste landfilled over the next five years, with planned increases in the capacity of waste treatment facilities expected to divert waste away from landfill. This alternative treatment to landfill across Scotland is in part a reaction to the increasing cost of the tax on disposal via landfill. It also indicates that local authorities and waste management companies are beginning to plan ahead in response to the changing regulatory landscape and the ban on the landfill of biodegradable municipal waste (BMW) from 2021.[97]

Description of modelling approach

3.135 Our model uses available outturn data from Revenue Scotland to estimate the amount of standard and lower rate waste landfilled in 2018-19. Data from the first two quarters of 2018-19 are scaled up to the full year using the average proportion of annual landfilled waste that has historically been in these quarters. As discussed in our 2018 Forecast Evaluation Report, we have changed our approach to use data from Revenue Scotland rather than HMRC to estimate the share of waste landfilled each quarter.[98]

3.136 This baseline is projected forward over the forecast period, with adjustments to reflect anticipated changes to waste generation and household recycling rates. Our current forecast assumes waste generation remains largely flat over the forecast because of the current economic outlook, with household recycling continuing to grow. Data on household recycling released since our last forecast shows a slight slowing of the rate of increase in recycling. We have therefore similarly reduced the pace of growth for household recycling in our model.

3.137 Further adjustments are made to account for anticipated increases in the capacity of incineration facilities across Scotland, which are expected to divert standard rate waste away from landfill. The Commission has worked with experts within the Scottish Environment Protection Agency (SEPA) to ensure these projections of future incinerator capacity are up-to-date and as far as possible reflect the likely timescales for these facilities coming on line. This aspect of the forecast will continue to be reviewed and updated regularly, given the uncertainties involved with the precise start dates for these facilities.

Table 3.34: Impact of increasing incineration capacity on SLfT revenue

£ million	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Reduction in SLfT revenue	0	-20	-56	-58	-69	-74	-76

Source: Scottish Fiscal Commission.

3.138 The final step in our forecast adjusts landfill volumes for the effect of the introduction of the ban on the landfilling of biodegradable municipal waste from 2021. Our previous forecast did not include the ban as we awaited additional detail on implementation plans from Scottish Government, instead

[97] The Waste (Scotland) Regulations 2012, Regulation 4 (link)

[98] Scottish Fiscal Commission (2018) Forecast Evaluation Report (link)

we included the ban in our sensitivity analysis. Our current approach to factoring the ban into our forecasts assumes all waste covered by the ban, and not already diverted to increased incineration capacity, is diverted from landfill from the date the ban takes effect in January 2021.

3.139 To estimate the amount of waste that will be affected by the introduction of the ban we have used data provided by SEPA, who are the Official Statistics producer of Waste Landfilled in Scotland Statistics.[99] The amount of waste falling under the ban has been estimated using guidance published earlier in the year by SEPA.[100] This outlined which European Waste Catalogue (EWC) codes would fall within the scope of the ban.[101]

3.140 This shows a total of 1.7 million tonnes of BMW landfilled in 2017-18, roughly 96 per cent of all standard rated waste landfilled in that year. We project this forward using the forecast of our pre-incineration baseline for standard rated waste. This takes into account slightly increased waste generation and increases to household recycling.

3.141 After accounting for changes to waste generation, recycling, incineration, and the effect of the BMW landfill ban in the baseline, a forecast of revenue is made by applying the relevant tax rate to the forecasted amount of landfilled waste. The current policy assumption is that the tax rates are matched to those announced by the UK Government, and then in subsequent years uprated in line with the latest OBR forecast of RPI.[102] The maximum contributions allowed to the Scottish Landfill Communities Fund (SLCF) are deducted from this total to arrive at a final forecast of revenue.[103]

Forecast

3.142 The Commission's forecast of SLfT is shown in Table 3.35, along with how the forecast has developed since May 2018.

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[99] SEPA (2018) Waste Landfilled in Scotland Statistics (link)

[100] SEPA published guidance (May 2018) on the BMW ban to help stakeholders understand what BMW is, why it will be banned and how the ban will be implemented (link)

[101] One final adjustment to this is made for a particular EWC code, 19 12 12. This is only partly in scope of the ban. The percentage that will have to be diverted has been estimate using the proportion of this waste code that is from a municipal source.

[102] OBR (2018) Economic and Fiscal Outlook October 2018 (link)

[103] Under the SLCF, landfill operators can voluntarily contribute a capped proportion of their tax liability to the fund and claim 90 per cent of the contribution as a tax credit.

Table 3.35: Changes in Scottish Landfill Tax forecasts

£ million	2017-18 Outturn	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
May 2018	142	114	93	95	87	87	88
Data updates	6	7	5	6	6	6	6
Incinerator capacity update		9	0	0	0	0	0
Methodology changes		5	6	7	7	8	9
Effect of BMW landfill ban				-24	-88	-88	-90
December 2018	148	136	104	83	13	13	14
Total change	6	22	11	-12	-75	-73	-75

Source: Scottish Fiscal Commission, Revenue Scotland (2018) Annual Report and Accounts 2017-18 (link).
Figures may not sum because of rounding.

3.143 The main change to the early years of the forecast has been the inclusion of the most recent published data from Revenue Scotland (2018-19 Q1 and Q2). This has increased the forecast by approximately £7 million in 2018-19. Using data from Revenue Scotland to scale up the first two quarters to a full year also raises the forecast by £5 million, relative to the approach we used in May. Delays to the full operation of several incineration sites in our model scheduled to commence operation this year have further increased our forecast for 2018-19 by £9 million.

3.144 The factor affecting the later years of our forecast is the inclusion of the effect of the BMW landfill ban in our central revenue forecast. This lowers revenue in 2020-21 by £24 million and by £90 million in the final year of the forecast, 2023-24. This aspect of our forecast will be regularly reviewed as the evidence base continues to develop and the timing of diversion from landfill becomes clearer.

Forecast Uncertainty

3.145 The Scottish Government has legislated for a ban on the landfilling of biodegradable municipal waste from 2021 onwards, with the ban being written into permits issued by SEPA to landfill sites allowing them to operate. This waste will require to be diverted to alternative treatment options, which will particularly affect local authorities who manage large amounts of BMW through the kerb-side collection of landfill waste, as well as commercial waste operators. This represents the biggest uncertainty in our forecast and we estimate that there is likely to be around one million tonnes of BMW per year which cannot be legally landfilled in Scotland from January 2021.

3.146 Since our December 2017 forecast there have been several developments in relation to the ban. Firstly, SEPA have published guidance outlining the specific waste types affected along with more detail on its implementation and enforcement.[104]

3.147 Secondly, the Scottish Government has commissioned a waste markets study in order to clarify the ways in which this diversion of waste from landfill can be achieved. Preliminary findings from this study have been shared with us. These identify four options for diversion of waste: landfill sites in northern England, incinerators in England, exports to Europe and the construction of new Scottish incinerator facilities. The last option is a longer-term solution. Construction of incinerators has long lead times. No Scottish incinerator facilities, above those already factored into our forecasts, are expected to be operational in time for the ban coming into effect in January 2021. Of the remaining three options, the findings we have seen show sufficient capacity exists to handle the waste requiring diversion from Scotland but provides no conclusions about which options will be adopted. We expect the costs of these three options to be higher than the current cost of landfilling in Scotland because of the cost of processing and transportation, so we do not expect diversion of waste to start until the ban comes into effect.

3.148 Thirdly, a number of local authorities have begun preparations for the ban; they have invested in treatment facilities and expect to fully comply with the ban. The preliminary results from the waste study suggest this accounts for around 55 per cent of household residual waste landfilled. But a number of local authorities do not yet have plans in place and are likely to require one or more of the three options identified outwith Scotland. Information on preparations by private waste management companies is more limited, but they are expected to be relying on options outwith Scotland.

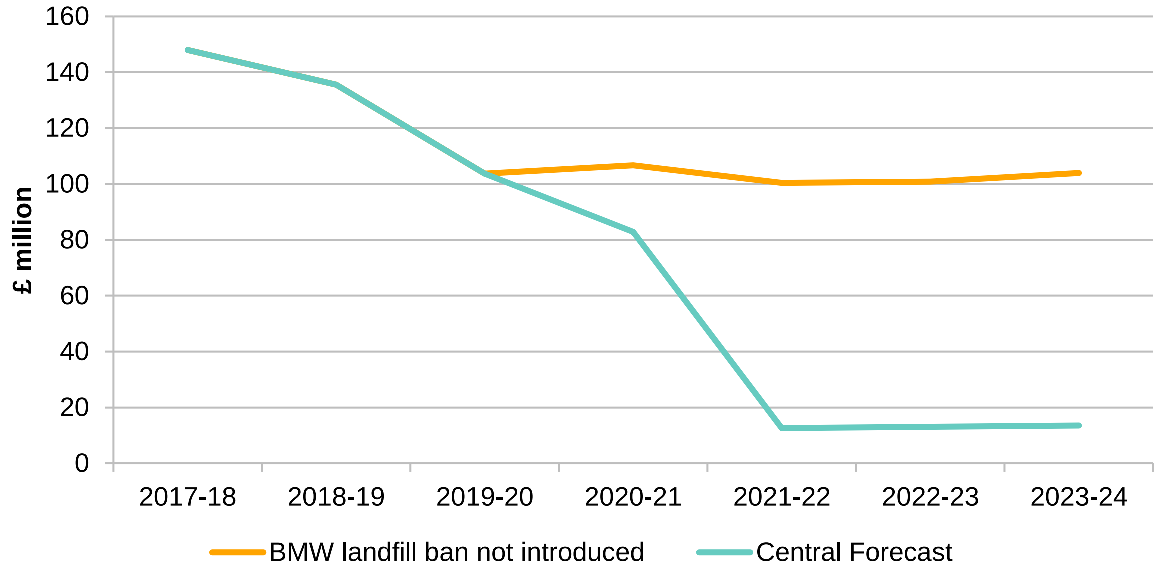
3.149 There is a degree of uncertainty associated with our forecast of estimated amounts of BMW landfilled waste. We have compared the baseline amount calculated using SEPA data against a comparable data from Revenue Scotland and found a small but consistent amount of variation. These two datasets are on slightly different bases and we have chosen to use SEPA data as this is the official source of waste landfilled in Scotland statistics.[105]

3.150 Our forecast is highly sensitive to our assumption about the ban. The ban results in a significant reduction in SLfT receipts – in 2021-22 receipts are £13 million. Figure 3.10, demonstrates the impact on revenue if the ban is not implemented from 2021 as the Scottish Government intends. Should the ban not come into effect, we estimate receipts in 2021-22 will be £100 million, which is £88 million higher than our current central forecast.

[104] SEPA published guidance (May 2018) on the BMW ban to help stakeholders understand what BMW is, why it will be banned and how the ban will be implemented (link)

[105] SEPA (2017) Waste landfilled in Scotland official statistics (link)

Figure 3.10: Effect of the BMW landfill ban not being introduced



Source: Scottish Fiscal Commission, Revenue Scotland (2018) Annual Report and Accounts 2017-18 (link).

Table 3.36: Impact of Biodegradable Municipal Waste ban

£ million	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Central forecast	148	136	104	83	13	13	14
BMW ban not introduced	148	136	104	107	100	101	104
Difference	0	0	0	-24	-88	-88	-90

Source: Scottish Fiscal Commission, Revenue Scotland (2018) Annual Report and Accounts 2017-18 (link).
Figures may not sum because of rounding.

3.151 We will continue to consider new information on factors such as the development of waste infrastructure in Scotland, alongside updates to the plans of local authorities and waste management companies. We may update our approach to incorporating the ban in our forecasts in the future.

3.152 The other factor driving the forecast is the timing and size of additional incineration capacity. These are large complex construction projects that can encounter significant delays for a variety of reasons. Delays in the construction of the first sites due for completion has already resulted in our model estimating diversion from landfill being lower in 2017-18 and 2018-19 than would have otherwise been the case.

3.153 Restrictions placed upon imported recyclable materials by the Chinese Government may also have an impact on our forecast. The recycling industry has been forced to respond to this by identifying new international markets to manage waste currently exported to China. While landfilling and incineration of separately collected recyclable material is currently banned in Scotland, if the decision by the Chinese Government results in certain recycling collections no longer being profitable it could result in greater volumes of mixed waste being landfilled.[106] This could have a knock-on effect with other importing countries introducing full or temporary bans. Our current forecast makes no adjustment for the potential impact of this on tax revenues, but we will continue to monitor this situation as the response from industry to this development becomes clearer.

3.154 Typically, there is a difference between the amount of tax that should, in theory, be collected and what is actually collected. Such gaps can arise for a number of reasons such as avoidance and evasion. Estimates published by HMRC show that the percentage tax gap for Landfill Tax in the UK, excluding Scotland, was around 11 per cent.[107] Since Landfill Tax is devolved, recent estimates do not include Scotland and although there is no current estimate of the gap in SLfT, it would not be unreasonable to assume that a gap does exist. Coupled with taxpayer behaviours, changes to the size of this gap could impact our forecast.

Comparison with OBR forecasts

3.155 The OBR also produce a forecast of SLfT, published as part of their Devolved Tax and Spending Forecast Publication. A comparison between forecasts is shown in Table 3.37.

Table 3.37: Comparison between Commission and OBR SLfT forecasts

£ million	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
SFC December 2018	136	104	83	13	13	14
OBR October 2018	147	116	119	112	112	114
Difference	12	13	36	99	99	100

Source: Scottish Fiscal Commission, OBR (2018) Devolved Taxes and Spending Forecast October 2018 (link). Figures may not sum because of rounding.

3.156 The OBR's latest forecast did not account for the BMW ban which results in a considerable difference in the respective forecasts from 2020-21 onwards. Other differences between the forecasts result from slightly different methods used to scale up available data from Revenue Scotland covering 2017-18, while an additional quarter of data (2018-19 Q2) has also become available since the OBR published its latest forecast in October. Different determinants are also used to grow waste generation with the OBR taking a population based approach.

[106] A ban on material collected separately for recycling being landfilled or incinerated was introduced from 2014 as a consequence of the Waste (Scotland) Regulations 2012 (link)

[107] HMRC (2018) Measuring tax gaps 2018 edition: Tax gap estimates for 2016-17 (link)

VAT

Table 3.38: VAT receipts assigned to Scotland – outturn and forecast

£ million	2016-17 Outturn	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
	5,033	5,383	5,631	5,801	5,966	6,122	6,279	6,434

Source: Scottish Fiscal Commission, HM Treasury, HMRC and Scottish Government
Outturn in this context refers to a provisional estimate from the assignment outturn model which is still in development, further information can be found in the background section.

Background

3.157 The Scotland Act 2016 states that receipts from the first 10p of standard rate of Value Added Tax (VAT) and the first 2.5p of reduced rate of VAT in Scotland will be assigned to the Scottish Government.[108]

3.158 VAT will be the second largest source of tax revenue for the Scottish Government, after income tax. 2019-20 will be part of a transitional period where VAT raised in Scotland will be calculated but there will not be an effect on the Scottish Government's Budget. This section sets out our first forecast of VAT revenue assigned to Scotland.

3.159 VAT being assigned rather than devolved means the Scottish Government will not have any policy control over VAT. The Scottish Government will not have the ability to change the rates of VAT in Scotland, change which goods or services fall under the different rates or which goods and services are liable/exempt from VAT.

3.160 VAT will continue to be collected by HM Revenue and Customs (HMRC) at the UK level and it will not be possible to calculate VAT raised in Scotland from tax returns.

3.161 As there are no outturn VAT receipts data for Scotland, the amount of VAT assigned to Scotland must be estimated. The methodology for estimating VAT assignment is currently under development by HMRC, HM Treasury and Scottish Government officials prior to ministerial sign-off by the Joint Exchequer Committee.[109] The approach uses a range of sources to model the proportion of UK expenditure across the different sectors that occurs in Scotland. Neither the Commission nor the Office for Budget Responsibility (OBR) have control over the judgements or approaches taken within this model. We refer to the model here as the assignment outturn model. More

[108] Scotland Act 2016 Part 2 Section 16 (link)

[109] The Joint Exchequer Committee is made up of UK Government and Scottish Government Ministers.

details on the VAT assignment methodology have been published by HM Treasury.[110]

3.162 The Commission has responsibility for producing forecasts of the VAT that will be assigned to Scotland from the last available assignment outturn model up to the present year, and for five years into the future. Our forecast model is referred to here as the assignment forecast model.

3.163 The figures from the assignment outturn model used here have been shared with the Commission and the OBR, part way through the development programme, in order to allow us to produce our forecasts. Further development is being carried out by analysts within HMRC, HM Treasury and Scottish Government to refine and finalise the estimates and this may affect the figures. Until this work is complete it is not possible to confirm the outturn data which provides the basis for our forecast. We expect that finalised assignment outturn data will be published in early 2019 following Joint Exchequer Committee sign off.

Modelling approach

3.164 We published a paper on our approach to creating forecasts of assigned VAT in September 2018.[111] Our approach is broadly unchanged from what is in this paper and is explained briefly below.

3.165 The assignment outturn model and our forecast are based on the concept of a 'VAT total theoretical liability' (VTTL). The VTTL is the total value of VAT that could theoretically be collected from the tax base. The VTTL estimated by the assignment outturn is a regional version of the UK VTTL with some methodological differences. The assignment outturn model provides an estimate of VAT-liable expenditure in Scotland that comes from different sectors and to make up the Scottish VTTL. For our forecast we split this expenditure into five sectoral groupings and grow total estimated expenditure in each sector in line with appropriate determinants from our economic forecasts. The determinants of each sector are set out in Table 3.39.

3.166 Growth in a sector's overall expenditure is not necessarily the same as growth in its vatable expenditure because of potential changes in spending patterns over time. Any changes in relation to the division of expenditure between standard rate, reduced rate and zero rated goods will affect VAT revenue. For example, if consumers were to shift their spending away from durables, which tend to be standard rated, to necessities such as food, which tend to be zero rated, VAT revenue would decline. How the standard rated equivalent expenditure grows in line with overall consumption is referred to as the

[110] HM Treasury (2018) Scottish VAT assignment – Summary of VAT assignment model (link)

[111] Scottish Fiscal Commission (2018) Approach to forecasting VAT assignment (link)

standard rated share. The standard rated share is an important judgement in our forecast and our approach is laid out in Table 3.39.

Table 3.39: Determinants of expenditure and standard rated share by sector

Sector	Growth determinant	Standard rated share
Household sector	Nominal household consumption (from our economy forecast)	Grows in line with the UK standard rated share
Exempt sector	Nominal GDP (from our economy forecast)	Held constant at the level of the last outturn year
Government sector	Nominal government consumption (from our economy forecast)	Held constant at the level of the last outturn year
Housing sector	Growth rate is held constant at the average rate of the last five outturn years	Held constant at the level of the last outturn year
Foreign Tourism	Tourism data (International Passenger Survey) for years available after the last year of assignment model data. For the longer term forecast, nominal exports to the rest of the world (from our economy forecast)	Held constant at the level of the last outturn year

Source: Scottish Fiscal Commission

3.167 The assignment outturn model makes certain adjustments to the estimates of vatable expenditure which we also include in our forecast. This includes a reduction for legitimate reasons that VAT may not be collected, such as traders below the VAT registration threshold,[112] and expenditure on leisure activities in Scotland by households from the rest of the UK. These adjustments are held constant as a proportion of total vatable expenditure within our forecast. Forecast expenditure at the standard rated equivalent is multiplied by the VAT fraction to provide our forecast of the Scottish VTTL on a consistent basis as the assignment outturn model.[113]

Forecast

Forecast of the VTTL

3.168 Table 3.40 shows the provisional estimates of expenditure subject to VAT at the standard rated equivalent for 2016 and our forecast from 2017 to 2023. In 2016 household consumption accounted for 68 per cent of VAT liabilities (before adjustments), and Government and exempt sectors account for another 13 per cent each. Adjustments for legitimate reasons that VAT would

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[112] The VAT registration threshold is currently £85,000. Traders below this threshold generally do not charge VAT on their goods and services, or reclaim tax on inputs. UK Government VAT registration thresholds (link)

[113] Expenditure is forecast at the standard rated equivalent inclusive of VAT. To calculate the VAT which should have been paid on this expenditure we multiply the it by the VAT fraction (VAT rate/1+ VAT rate):

*Standard rated equivalent expenditure * (0.2 / (0.2 + 1))*

For more details on this conversion see our occasional paper Scottish Fiscal Commission (2018) Approach to forecasting VAT assignment (link) not be collected reduced the VTTL estimate by five per cent. The relative contribution of these sectors and the adjustments to the VTTL remain broadly consistent over the forecast period.

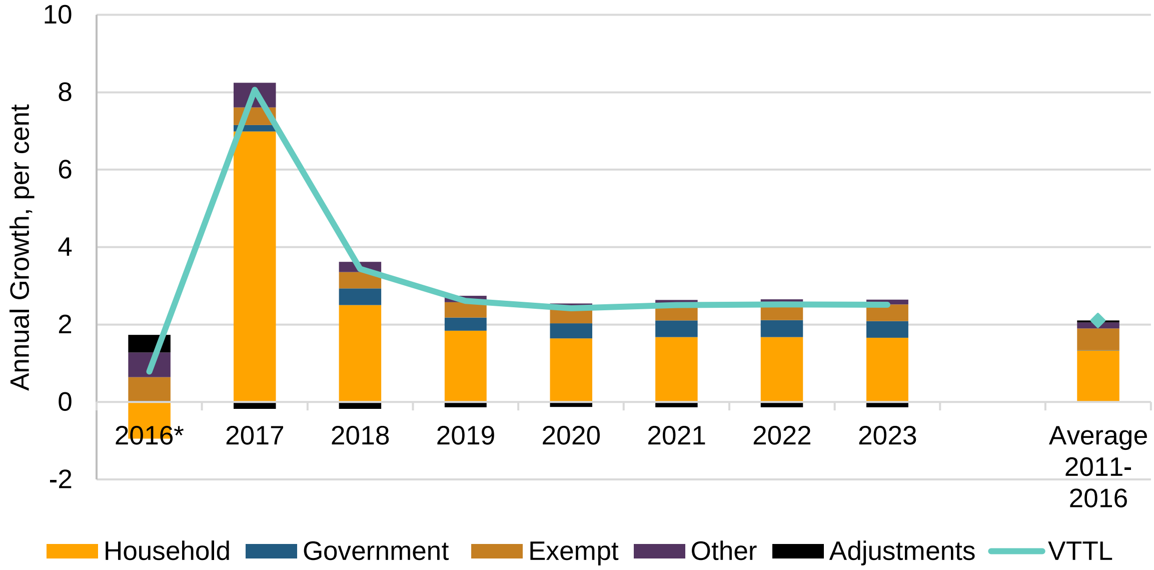
Table 3.40: Forecast of VTTL by component

£ millions	2016 Outturn	2017	2018	2019	2020	2021	2022	2023
Household	8,065	8,852	9,156	9,388	9,600	9,822	10,049	10,280
Government	1,520	1,539	1,591	1,634	1,684	1,741	1,800	1,860
Exempt	1,589	1,640	1,691	1,741	1,792	1,846	1,902	1,961
Other expenditure	710	782	813	835	851	867	884	902
Adjustments	-624	-645	-667	-684	-701	-719	-737	-756
Total VTTL	11,259	12,167	12,585	12,913	13,226	13,557	13,898	14,246

Source: Scottish Fiscal Commission.
Outturn in this context refers to a provisional estimate from the assignment outturn model. VTTL refers to the Scottish component of VAT total theoretical liability calculated on a consistent basis as the assignment outturn model.

3.169 We forecast that growth in expenditure subject to VAT will be relatively constant at around 2.5 per cent between 2019 and 2023, as shown in Figure 3.11. As we explain below, the rapid growth in 2017 can be explained by a low estimate of household expenditure at the standard rated equivalent in the assignment outturn model for 2016.

Figure 3.11: Contribution of each sector to annual growth in VTTL (calendar year)



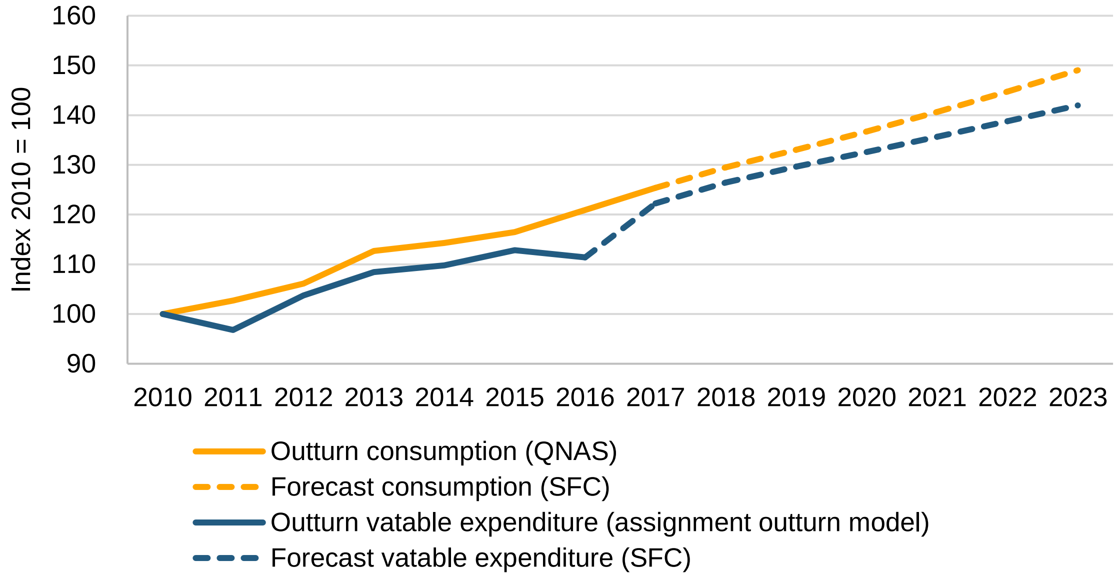
Source: HM Treasury, HMRC and Scottish Government; Scottish Fiscal Commission.
*2016 refers to provisional estimates from the assignment outturn model.

3.170 Household expenditure accounts for the majority of the estimated expenditure liable for VAT and therefore our forecast of this sector is the major driver of our forecast of the overall VTTL. Growth in VAT revenue from household expenditure will depend on two factors:

- Growth in total household consumption
- Change in the proportion of this expenditure which is at the standard rated equivalent

3.171 As discussed, the proportion of expenditure liable for VAT at the standard rated equivalent is a major judgement in our forecast. Figure 3.12 shows how the spending at the standard rated equivalent has fluctuated as a proportion of total household expenditure in Scotland over the years of outturn data available.[114]

Figure 3.12: Comparison of household consumption and vatable expenditure



Source: HM Treasury, HMRC and Scottish Government; Scottish Fiscal Commission; Scottish Government (2018) Quarterly National Accounts Scotland Quarter 1 2018 (link).

3.172 The assignment outturn model estimate of standard rated equivalent household expenditure was particularly low for 2016 in comparison to overall household consumption as reported in Quarterly National Accounts Scotland (QNAS). Assuming both estimates are correct, there would need to have been a dramatic shift in spending patterns away from durable goods and towards essentials, which tend to be zero rated, to explain this pattern. The assignment outturn model estimate is largely based on the living costs and food survey, where only 360 Scottish households responded in 2016-17. Our judgement is that the low 2016 estimate is likely to be because of fluctuation

[114] Scottish Government (2018) Quarterly National Accounts Scotland Quarter 1 2018 (link)

in the estimate based on a relatively small sample size rather than a dramatic shift in spending patterns.

3.173 Our forecast takes an average standard rated share from 2010 to 2016 as the baseline for projecting the growth in the standard rated share forward using the growth rates from the HMRC's standard rated share model. The result of this judgement is that growth in VAT from the household sector is appears strong in the first year of our forecast, 2017.

3.174 For 2018 and beyond, our forecast of standard rated equivalent household expenditure is driven by a combination of the total household consumption forecast from our economy forecasts and the OBR and HMRC's forecast change in the standard rated share at the UK level. In line with our subdued outlook for growth in GDP and household incomes, we expect only slow growth in consumption over the next five years.

3.175 The standard-rated share forecast is produced by HMRC for the OBR. Changes in the standard rated share are projected using an econometric model, primarily driven by their forecast for spending on durable goods (such as cars). There is a lack of data at sufficient granularity for Scotland and we make the assumption in our forecast that the patterns of spending in Scotland will mirror those in the rest of the UK.

3.176 The exempt sector and government sector account for the majority of expenditure liable for VAT not already accounted for by household expenditure in the VTTL. Our forecast assumes that the standard rated share remains constant at the level of the latest assignment outturn model estimates. Therefore our forecasts of these sectors are entirely driven by the GDP and government consumption forecasts from the economy forecasts.

Forecast of assigned VAT receipts

3.177 Table 3.41 shows how we move from our forecast of VTTL to receipts. We assume a three month lag between expenditure and receipts, and therefore that the VTTL for a given calendar year equates to receipts in the overlapping financial year.

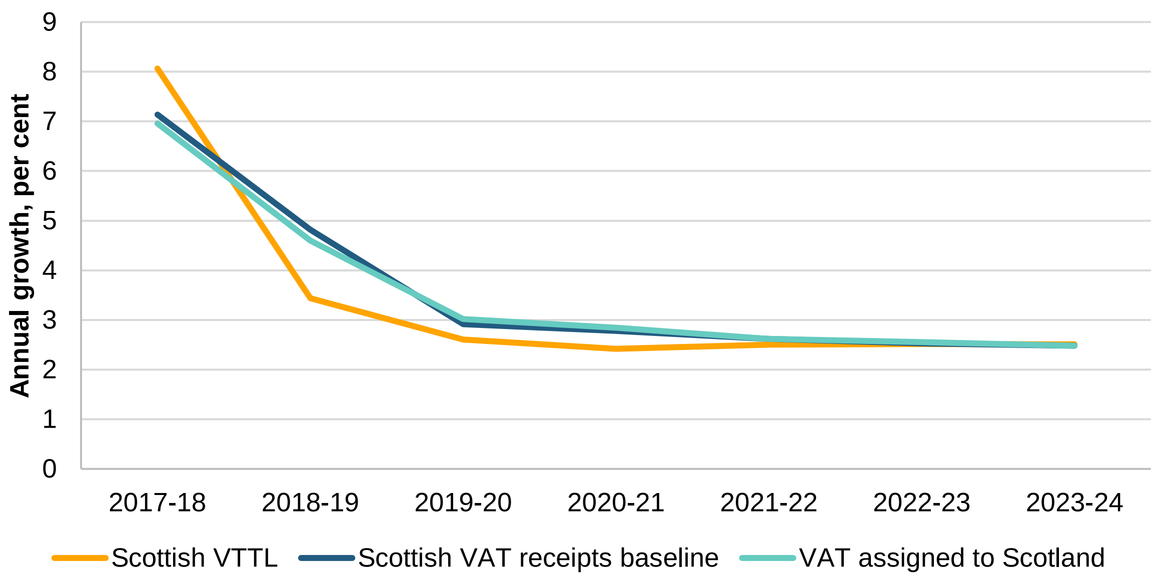
Table 3.41: Forecast of assigned VAT receipts

£ million	2016-17 Outturn	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
VTTL	11,259	12,167	12,585	12,913	13,226	13,557	13,898	14,246
Tax gap forecast	- 1,193	- 1,382	- 1,281	- 1,279	- 1,268	- 1,286	- 1,317	- 1,353
Baseline receipts	10,066	10,785	11,304	11,634	11,958	12,271	12,581	12,893
UK policy changes	0	- 18	- 43	- 33	- 26	- 26	- 24	- 25
Receipts final	10,066	10,767	11,262	11,602	11,932	12,244	12,557	12,869
Percentage assigned	50%	50%	50%	50%	50%	50%	50%	50%
VAT assigned to Scotland	**5,033**	**5,383**	**5,631**	**5,801**	**5,966**	**6,122**	**6,279**	**6,434**

Source: Scottish Fiscal Commission

3.178 The VTTL does not include any adjustments for error, fraud, evasion, avoidance and debt to HMRC and therefore will always be higher than outturn VAT receipts. The percentage difference between the VTTL and the actual receipts represents an estimated VAT gap.[115] As there are no VAT receipts outturn data for Scotland, the VAT gap is forecast to follow the growth rate of the OBR's tax gap forecast for the UK.[116]

Figure 3.13: Growth in VTTL, baseline VAT receipts and assigned VAT



Source: Scottish Fiscal Commission.

3.179 HMRC reported an increase in the tax gap between 2016-17 and 2017-18 and the OBR forecast that this will drop back down in 2018-19. HMRC analysis suggests that this pattern is because of a tax debt in 2017-18 that appears to

[115] HM Revenue & Customs (2018) Measuring tax gaps: Tax gap estimates for 2016-17 (link)

[116] OBR (2018) Economic and Fiscal Outlook October 2018 (link)

be reversing this year. The effect of this on our forecast is that the growth in receipts is slightly lower than the growth in VTTL in 2017-18 and slightly higher in 2018-19 as shown in Figure 3.13.

3.180 Between 2018-19 and 2021-22 the OBR forecast that new compliance measures will result in a slight closing of the tax gap. This leads to our forecast of growth in baseline receipts being slightly higher over this period than growth in VTTL.

3.181 VAT is assigned rather than devolved. This means the Scottish Government will not have the power to introduce policies directly affecting VAT revenue. For UK Government policies which change the VAT base or the tax gap we apply a share of the OBR's costing to the forecast of VAT assigned to Scotland. Our default assumption is that policies will have the same effect in Scotland as in the rest of the UK. The most significant UK Government policies for our forecast are:

- The change to VAT refund rules for Scotland police and fire services. As this applies to Scottish organisations 100 per cent of the cost of this policy is assumed to count towards VAT receipts assigned to Scotland. This policy led to a reduction in forecasted receipts across all years of the forecast. The amount of this reduction was £40 million in 2018-19, rising to £46 million by the end of the forecast period.
- Reform to vehicle excise duty for new cars purchased from 2017. The cost of this policy in Scotland is assumed to be proportional to the VAT assigned to Scotland in the latest outturn data. This policy results in a reduction in receipts of £34 million in 2017-18 falling to £20 million by the end of the forecast period.

3.182 The effect of these policies is reduced by various other minor policy changes, which generally increase VAT revenue. The Scottish share of UK policy costings applied in this forecast are shown in supplementary Table S3.9.

3.183 In line with the Scotland Act 2016, our forecast assumes 50 per cent of the VAT revenue raised in Scotland will be assigned to the Scottish Government.[117]

Assigned VAT and the Scottish Government's Budget

3.184 The fiscal framework agreement between the UK and Scottish Governments states that VAT assignment will be implemented in 2019-20. 2019-20 will be a transitional period where VAT assignment will be calculated and forecast but there will be no effect on the Scottish Government's Budget. The transitional

[117] Scotland Act (2016) Part 2 Section 16 (link)

period is expected to last a year and from 2020-21 the Scottish Government will receive the revenue from half the VAT receipts assigned to Scotland.[118]

3.185 From the end of the transitional period the block grant the Scottish Government receives from the UK Government will be reduced to reflect the VAT receipts the UK Government has forgone in Scotland.

3.186 The outturn figures from the VAT assignment outturn model are likely to be published with a delay of around two years, for example, the 2017-18 estimates will be expected towards the end of 2019 and feed into our forecasts for 2020-21. The VAT revenue assigned to the Scottish Government will therefore initially be based on our forecasts and the Block Grant Adjustment (BGA) will be based on the OBRs forecast of comparable receipts for the rest of the UK.

3.187 The revenue and BGA forecasts will then be reconciled to the outturn data produced by the assignment outturn model once available. This process follows broadly the same arrangements already in place for Scottish non-savings non-dividend income tax receipts.

Key assumptions

3.188 The Commission is required to make judgements where there is uncertainty or limited evidence.

3.189 Because of the lack of Scottish specific outturn data for VAT, the Commission assumes that the following determinants of VAT assignment in Scotland will follow the same patterns as VAT revenue in the rest of the UK:

- Tax gap
- Standard, reduced and zero rated shares in household expenditure
- Policy costings, although adjustments to make these more specific to Scotland are made where data allows.

Forecast uncertainty

Variability in the assignment outturn model

3.190 As discussed earlier, outturn receipts will not be available for VAT raised in Scotland. This means that both the baseline and the evaluation for our forecasts will be based on estimates from a statistical model. Neither the Commission nor the Office for Budget Responsibility (OBR) have control over the judgements or approaches taken within this model.

3.191 Household expenditure accounts for the majority of VAT revenue assigned to Scotland. Any approach to assigning household expenditure liable to VAT to

[118] The fiscal framework states that the first 10p of the standard rate of VAT and the first 2.5p of the reduced rate of VAT will be assigned to the Scottish Government's Budget. At the current standard rate of VAT of 20 per cent and reduced rate of 5 per cent this is half the receipts. This may vary if UK changes VAT rates. (link)

Scotland will rely heavily on the living costs and food survey (LCF) to estimate the proportion of UK expenditure occurring within Scotland.[119]

3.192 The LCF is conducted by the Office for National Statistics (ONS) for the whole of the UK and provides regional breakdowns of spending. There is substantial variability in the estimates for Scotland between years, see Figure 3.12. This will be due, in part, to the relatively small number of Scottish households included in the historic dataset. Although 1,000 households were sampled, only 360 responded in 2016-17.

3.193 HMRC and the Scottish Government have jointly funded a boost to double the LCF sample in Scotland from 2017-18 onwards. This will increase the survey coverage and should, to some extent, reduce the effect of statistical variability within the sample. We expect that there will continue to be sizeable variation in the estimates for Scotland. Despite doubling the size of the sample, the expected 600-700 households is still a reasonably small sample.

3.194 Sample size is not the only source of volatility. Actual Scottish consumption patterns, including spending patterns and disposable income, may change from one year to the next. It will not be possible to determine how much volatility is because of actual consumption patterns and how much is because of sample size. This variability will affect both the baseline for our forecast and our forecast evaluation.

The UK's changing relationship with the EU

3.195 As the final outcome of the Brexit negotiations remain unknown it is impossible to estimate what effect there will be on our forecast of Scottish VAT. In addition to the wider uncertainty around how leaving the EU will affect the UK and Scottish economy,[120] it is not currently known how goods from the EU will be treated for VAT purposes. Importing firms do not at present pay VAT on goods imported from the EU. Goods imported from outside the EU require VAT to be paid on the good before it is claimed back at a later date.

3.196 If the arrangement changed, and EU imports were treated the same as imports from the rest of the world, this would be likely to alter when VAT receipts reach the Exchequer. The cash flow effect could lead to a behavioural response from importing companies. There is also further uncertainty around the administration and enforcement of such changes.

3.197 HMRC have published a technical note on VAT for businesses if there is no Brexit deal.[121]

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[119] ONS (2017) Living costs and food survey (link)

[120] See Chapter 2 for a more detailed discussion of the potential effect on the Scottish economy

[121] HMRC (2018) VAT for Businesses if there's no Brexit deal (link)

Comparison with OBR forecasts

Table 3.42: Commission and OBR forecasts of VAT assigned to Scotland

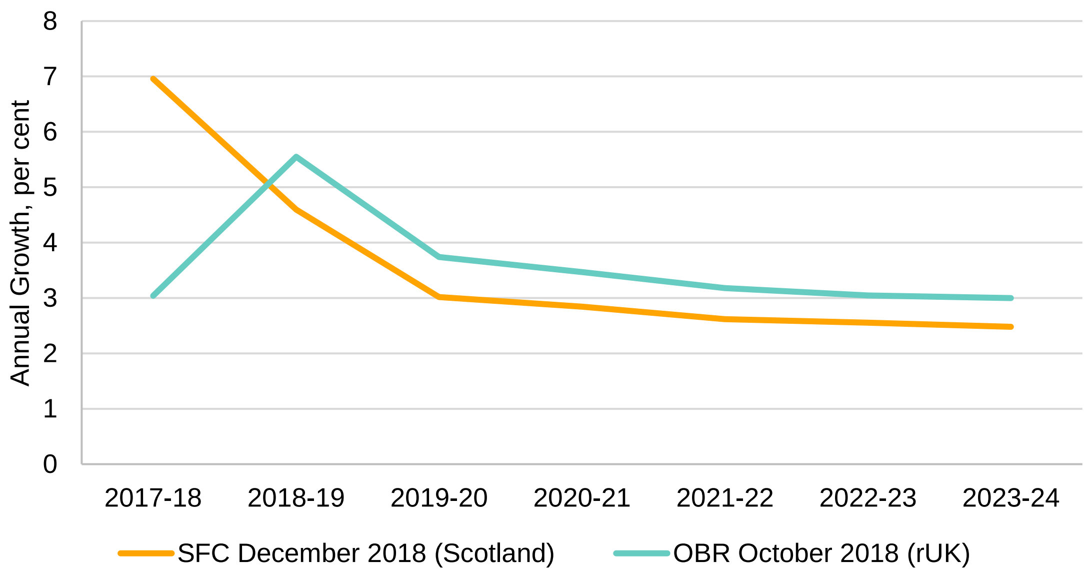
£ million	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
SFC December 2018	5,033	5,383	5,631	5,801	5,966	6,122	6,279	6,434
OBR October 2018	5,123	5,266	5,546	5,740	5,926	6,100	6,270	6,442
Difference	-90	117	85	60	40	22	9	-8

Source: Scottish Fiscal Commission, OBR (2018) Economic and Fiscal Outlook – October 2018 (link).

3.198 Differences between the Commission's forecasts for Scotland and those made by the OBR are shown in Table 3.42. These difference are a result of differences in approach to forecasting VAT assignment:

- At the time of their October forecasts the OBR were only able to produce an illustrative projection rather a fully considered forecast.[122] This approach uses the UK forecast and applies a constant share to Scotland with a minor adjustment for population.
- The baseline figures used by the OBR are based on financial year figures from HMRC's assignment model, while the Commission has used calendar year figures to reflect the delay between expenditure and receipts.

Figure 3.14: VAT assigned to Scotland compared to VAT raised in the rest of the UK



Source: Scottish Fiscal Commission, OBR (2018) Economic and Fiscal Outlook (link).

[122] OBR (2018) Devolved Tax and Spending Forecasts October 2018, paragraph A.2 (link)

3.199 The high growth in assigned VAT in 2017-18 reflects our assumption that the dip in household vatable expenditure seen in 2016-17 is a result of volatility in the data and is likely to be reversed in 2017-18. Throughout the rest of the forecast period the growth in VAT assigned to Scotland is lower than the growth in VAT receipts in the rest of the UK as shown in Figure 3.14.

3.200 Lower growth in Scotland can be largely attributed to household consumption being expected to grow more slowly over the forecast period, largely as a result expected lower population growth. The household sector accounts for about 68 per cent of vatable expenditure.

3.201 The other two main sectors for vatable expenditure are government and exempt expenditure. The determinants for these, government consumption and GDP, respectively, are also expected to grow more slowly than the UK equivalents over the medium term. For government expenditure it should be noted the OBR use government procurement for the UK forecast rather than total government consumption used by the Commission in the forecast for Scotland.

Air Passenger Duty

Table 3.43: Forecast of Scottish APD

£ million	2017-18*	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
	277	302	312	322	336	349	364

Source: Scottish Fiscal Commission
*Figure for Air Passenger Duty is not classed as outturn data. It is an estimate of the Scottish share of tax receipts.

3.202 Air Departure Tax (ADT) was due to replace UK Air Passenger Duty (APD) in Scotland from April 2018. The introduction of ADT in Scotland has been deferred until the state-aid issue raised in relation to the Highlands and Islands exemption has been resolved.[123] We have therefore produced illustrative forecasts of APD paid in Scotland.

3.203 APD is a tax paid on eligible passengers on flights departing from UK airports. The amount of tax paid depends on the passenger's class of travel and their final destination. Destinations fall into two bands based on flight distance from London. The higher band applies to countries whose capital city is further than 2,000 miles from London. Passengers departing the Highlands and Islands airports are exempt.[124] As APD applies to the final destination, connecting flights are exempt. There are a number of other exemptions to APD, such as passengers under the age of 16 travelling in the lowest class.

3.204 The class of travel determines the rate of APD paid. The reduced rate applies where passengers are travelling in the lowest class available. The standard rate applies to passengers travelling in any other class of travel and the higher rate applies to private jets.[125]

Forecast of Scottish APD

3.205 APD tax forms are returned on a company-by-company basis, with one tax return for all their business in the UK. There are therefore no historic data on APD receipts or passengers paying APD in Scotland. The Civil Aviation Authority (CAA) airport data provide total passenger numbers for all Scottish airports on a monthly basis from January 1997 onwards.[126] The data

[123] Letter from Cabinet Secretary for Finance and Constitution to the Convener of the Finance and Constitution Committee 1 June 2018 (link)

Letter from Cabinet Secretary for Finance and Constitution to the Convener of the Finance and Constitution Committee 22 November 2017 (link)

[124] HMRC (2018) Guidance: Exemptions from Air Passenger Duty (link)

[125] HMRC (2018) Guidance: Rates for Air Passenger Duty (link)

[126] Civil Aviation Authority (2018) UK Airport Data (link)

represent all passengers travelling and not all passengers chargeable for APD. It does not provide information on the band or class of travel.

3.206 The CAA departing passenger survey is used to estimate the number of passengers exempt from the tax and to calculate the tax paid by the remaining chargeable passengers.[127] The survey runs every year interviewing passengers departing from certain UK airports. The survey covered Scottish airports in 2005, 2009, 2013 and 2015-16. Data are currently being collated for the 2018 survey. This is the next survey to feature Scottish airports.

3.207 Further details on our approach to forecasting Scottish APD can be found in our previous publications.[128] Our approach to estimating the Scottish share of APD is consistent with the methodology used by the Scottish Government in Government Expenditure and Revenue Scotland (GERS) publication.[129]

3.208 Table 3.44 shows how our forecast of Scottish APD has changed since May 2018.

Table 3.44: Changes in APD forecasts since May 2018

£ million	2017-18*	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
May 2018	277	285	292	301	311	322	335
Data updates	0	17	19	21	24	28	30
December 2018	277	302	312	322	336	349	364
Total change	0	17	19	21	24	28	30

Source: Scottish Fiscal Commission; Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts May 2018 (link).
Figures may not sum because of rounding. *Figure for Air Passenger Duty is not classed as outturn data. It is an estimate of the Scottish share of tax receipts.

3.209 The inclusion of passenger numbers up to the end of June 2018 and OBR determinants for UK GDP growth and inflation from the 2018 Budget are the most significant data updates and account for most of the change since the May 2018 forecast.[130]

3.210 Scottish passenger numbers continue to grow strongly after subdued annual growth in the first three months of 2018, likely to be because of the poor weather experienced in March 2018. Our forecast assumes that growth in Scottish passenger numbers persists over the forecast period.

[127] We also use data from HMRC to estimate a child exemption adjustment. HMRC (2018) Principal tax reliefs (link)

[128] See Scottish Fiscal Commission (2017) Current Approach to Forecasting (link) and Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – May 2018 (link).

[129] Scottish Government (2018) Government Expenditure & Revenue Scotland 2017-18 (link)

[130] Office for Budget Responsibility (2018) Economic and Fiscal Outlook: supplementary economy tables (link)

3.211 Other data updates include the HMRC release of an updated estimate for child exemption for 2017-18. This estimate is very similar to 2016-17 and therefore has minimal impact on the forecast.[131]

Forecast uncertainty

3.212 The current estimates of Scottish APD receipts are based on a combination of administrative and survey data. The accuracy of the estimates will only be known once the tax is devolved and separately collected for Scotland. Once data from the 2018 CAA Departing Passengers Survey are available, we will review and update our estimates of Scottish APD receipts.

Comparison with OBR forecasts

Table 3.45: Comparison with OBR forecasts of Scottish APD

£ million	2017-18*	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
SFC December 2018	277	302	312	322	336	349	364
OBR October 2018	299	326	343	355	372	389	407
Difference	-23	-24	-31	-33	-37	-39	-43

Source: Scottish Fiscal Commission, OBR (2018) Devolved Tax and Spending Forecast October 2018 (link).
Figures may not sum because of rounding. *Figure for Air Passenger Duty is not classed as outturn data. It is an estimate of the Scottish share of tax receipts.

3.213 The differences in the estimate of receipts in 2017-18 as the baseline for the forecasts remains the main source of the differences between the OBR and our forecasts.[132] The OBR continue to use the mid-point between the HMRC and Scottish Government approaches to estimate the Scottish share of UK APD receipts to produce their central forecast, and this results in a higher estimate. Our approach uses the CAA Passenger Survey, which includes domestic travel and is therefore less likely to overestimate the share of Band B passengers. However, the CAA survey is less timely than the International Passenger Survey (IPS).[133] The CAA are currently collating data from a survey of Scottish airports throughout 2018 and we will work closely with the OBR to review methodologies, with a view to making further improvements to estimates of the Scottish share of APD.

[131] HMRC (2018) Principal tax reliefs (link)

[132] The OBR continue to use the mid-point between the HMRC and Scottish Government approaches to estimate the Scottish share of UK APD receipts to produce their central forecast. Based on 2017-18 data, the OBR estimate the Scottish share of UK APD receipts to be 8.9 per cent. For further information see Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts May 2018 (link).

[133] Most recent published CAA surveys by airport: Glasgow and Edinburgh 2015-16, Aberdeen 2013 & Prestwick 2009. Travel trends 2017 using IPS data covering Scottish Airports was last released by ONS in August 2017 (link)

3.214 Growth over the forecast horizon is broadly similar as both forecasts are based on OBR forecasts of UK GDP growth. In October the OBR also increased their UK forecast for APD because of stronger than expected passenger numbers. Therefore the differences between the two forecasts are similar to the position in May 2018.

Chapter 4
Social Security

Introduction

4.1 This chapter presents the Scottish Fiscal Commission's social security forecasts. A summary of our expenditure forecasts is shown in Table 4.1. These cover the benefits already devolved and those due to be devolved in 2019.

4.2 The Commission is responsible for producing forecasts of devolved social security expenditure in Scotland. In accordance with our regulations, we have produced forecasts for the benefits devolved under the Scotland Act 2016 as well as the Scottish Welfare Fund which was devolved to the Scottish Parliament in 2013. For the Scottish Budget 2019-20, the Scottish Government does not include Employability Services and Best Start Foods in their social security portfolio. We have presented these separately in Table 4.1 to give a fuller picture.

4.3 Responsibility for the remaining benefits to be devolved will transfer to the Scottish Parliament by April 2020 at the latest.[134] Next year, we will provide forecasts for these benefits in our publication alongside the Scottish Budget 2020-21.[135]

[134] Explanatory memorandum to the Scotland Act 1998 (Agency Arrangements) (Specification) Order 2018 (link)

[135] The benefits still to be devolved are: Attendance Allowance, Disability Living Allowance, Personal Independence Payment, Industrial Injuries Disablement Benefit, Severe Disablement Allowance, Cold Weather Payment and Winter Fuel Payment.

Table 4.1: Summary of social security forecasts

£ million	2017-18 Outturn	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Carer's Allowance		157	283	305	324	344	364
Carer's Allowance Supplement		35	37	40	43	45	48
Discretionary Housing Payments	58	61	63	65	66	68	69
Best Start Grant		2	12	13	13	14	15
Funeral Expense Assistance			6	6	7	6	7
Scottish Welfare Fund	33	33	33	33	33	33	33
Scottish Government social security portfolio – total benefit expenditure	**91**	**287**	**435**	**462**	**486**	**511**	**535**
Healthy Start Vouchers / Best Start Foods	4	4	4	5	4	4	4
Employability Services	12	19	19	28	22	9	0
Total benefit expenditure	**107**	**310**	**458**	**494**	**512**	**523**	**539**

Source: Scottish Fiscal Commission, Scottish Government (2018) Scottish Welfare Fund Statistics (link), Scottish Government unpublished expenditure for Discretionary Housing Payments, Healthy Start Vouchers and Employability Services.
Figures may not sum because of rounding.
Total expenditure is equal to the Scottish Government's social security portfolio spend plus two other benefits that have been devolved under the Scotland Act 2016, Employability Services and Best Start Foods. Expenditure for Employability Services is part of the Finance, Economy and Fair Work portfolio spending plans. Expenditure for Healthy Start Vouchers/Best Start Foods is part of the Health and Sport portfolio spending plans.

4.4 This year, 2018, has been a critical year in the devolution of the social security benefits covered by the Scotland Act 2016. The primary legislation that sets out the principles and a general framework for devolved social security has been passed by the Scottish Parliament.[136] The agency which will deliver devolved social security benefits, Social Security Scotland, is now operational. In Box 4.1 we highlight the main changes for devolved social security in Scotland since our May 2018 publication.

Box 4.1: What has changed since our last publication?

Two benefits have been devolved to the Scottish Parliament:

Carer's Allowance was devolved to the Scottish Parliament on 3 September 2018. We forecast Scottish Government spending on Carer's Allowance from early September 2018 onwards.

[136] Social Security (Scotland) Act (2018) (link)

Sure Start Maternity Grant was devolved to the Scottish Parliament from 10 December 2018 and is now the Best Start Grant (BSG) Pregnancy and Baby Payment. In our supplementary publication in September 2018, we estimated that the benefit expenditure in 2019-20 would be £3.1 million higher for BSG Pregnancy and Baby Payment compared to Sure Start Maternity Grant.[137]

New benefits have been created:

These are benefits created by the Scottish Parliament under the powers in the Scotland Act 2016. The first of these newly created benefits, Carer's Allowance Supplement, started being paid to eligible individuals on 13 September 2018.

More details available for the benefits to be devolved in 2019-20:

We forecast expenditure for a number of benefits where the Scottish Government has announced plans for devolution in 2019-20. For these benefits, we have received policy details from the Scottish Government but we have not been provided with a start date in 2019-20. In the absence of further information from the Scottish Government we have assumed a start date of 1 June 2019. These include:

- Funeral Expense Assistance
- Best Start Grant – Early Learning and School-Age Payments
- Best Start Foods

The Scottish Government also plans to introduce a Young Carer Grant by Autumn 2019. We have not provided a forecast for this benefit because it does not meet our materiality threshold for costing. Further information can be found in Annex C.

4.5 In Table 4.2 we provide the change in forecast expenditure since our May 2018 publication by each social security benefit. Compared to our May 2018 publication, our forecast for total social security expenditure has increased in all years, apart from 2018-19. Our 2018-19 and 2019-20 expenditure forecasts for Carer's Allowance have reduced because of data updates and model developments.

[137] Scottish Fiscal Commission (September 2018) Supplementary Costing – Social Security – Best Start Grant (Pregnancy and Baby Payment) – September 2018 (link)

Table 4.2: Change in social security forecast expenditure since May 2018 by benefit

£ million	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Carer's Allowance	-1	-2	2	6	10	15
Carer's Allowance Supplement	0	0	0	1	2	2
Discretionary Housing Payments	0	0	0	0	0	0
Best Start Grant	1	10	10	11	12	13
Funeral Expense Assistance		1	1	1	1	1
Scottish Welfare Fund	0	0	0	0	0	0
Scottish Government social security portfolio – total change	0	8	14	19	25	30
Healthy Start Vouchers / Best Start Foods	0	0	1	1	1	1
Employability Services	0	0	0	0	0	0
Total change	-1	8	14	20	25	31

Source: Scottish Fiscal Commission

Figures may not sum because of rounding.

For Best Start Grant we published a supplementary costing of the Pregnancy and Baby Payment in September 2018. However for consistency with the other benefits, we have considered the change from our May 2018 publication.

The dates of devolution in 2018-19 for Carer's Allowance and Best Start Grant have been confirmed since our May 2018 publication. We have adjusted our May 2018 expenditure forecasts to reflect these dates. The figures in this table show the difference between the adjusted May forecasts and our December forecasts.

4.6 The increase in expenditure is largely driven by further devolution of social security benefits to the Scottish Parliament and a change in our approach to forecasting Carer's Allowance and Carer's Allowance Supplement.

4.7 As noted in Box 4.1, three more social security benefits are to be devolved to the Scottish Parliament by summer 2019. By 2023-24, we estimate the expenditure for Best Start Foods, Funeral Expense Assistance and Best Start Grant Early Learning Payments and School-Age Payments will be over £11 million higher than the expenditure we forecast for the comparable UK benefits. This is shown in Table 4.3 and further information on our policy costings of the new benefits can be found in Annex A.

Table 4.3: Summary of social security policy costings

£ million	2019-20	2020-21	2021-22	2022-23	2023-24
Policy costing for Best Start Grant – Early Learning and School-Age Payments	6.9	6.8	7.3	7.9	8.6
Policy costing for Best Start Foods	0.3	0.6	0.5	0.5	0.5
Policy costing for Funeral Expense Assistance	1.7	1.8	2.0	2.1	2.3
Total change	8.9	9.2	9.8	10.6	11.4

Source: Scottish Fiscal Commission
Figures may not sum because of rounding.

4.8 The approach taken to forecast expenditure varies by benefit and has developed since our May 2018 forecast. We have set out our approach to forecasting social security expenditure in the occasional paper we published in September 2018.[138] In this report, we highlight our main judgements and any changes in our approach since September.

4.9 In the following section we compare the funding for devolved social security with our expenditure forecasts. In the remainder of Chapter 4, we provide further information on the forecasts for each benefit and the changes since May 2018. For Carer's Allowance, we provide a comparison to the OBR's Scottish expenditure forecast published in October 2018.

Social security funding

4.10 Our forecasts of social security expenditure that feed into the Scottish Government's budget are of the total amount paid out to claimants. The net effect of social security devolution on the Scottish Budget is determined by considering our forecasts along with the funding that the Scottish Government expects to receive from the UK Government and administrative costs that are determined by the Scottish Government.

4.11 The Scottish Government will be allocated more funding from the UK Government as it will have higher expenditure as a result of the devolution of social security. The Scottish Government receives a Block Grant for each financial year and this is adjusted to reflect the transfer of greater fiscal powers to the Scottish Parliament. For social security, these Block Grant Adjustments (BGAs) are additions to the Block Grant.

4.12 If the Scottish Parliament chooses to use its powers to top-up reserved benefits or create new benefits there would be no corresponding BGA. The first example of this is the introduction of the Carer's Allowance Supplement,

[138] Scottish Fiscal Commission (2018) Approach to Forecasting Social Security (link)

which is a new benefit, and is fully funded from the existing Scottish Government budget.

4.13 For the social security benefits that will have explicit funding transferred from the UK Government to the Scottish Government in 2019-20, the total funding amount is £331 million. This is £90 million lower than the expenditure we have forecast for these benefits in 2019-20 and this additional cost will be met by the Scottish Government.

Table 4.4: Comparison of UK Government funding and total benefit expenditure

£ million	2019-20
Total funding received from the UK Government	331
Total benefit expenditure	421
Difference	**-90**

Source: Scottish Fiscal Commission.
Total funding is a summary of the Carer's Allowance funding and the Machinery of Government Transfers shown in Tables 4.5 and 4.6. Total benefit expenditure is from Table 4.1 for Carer's Allowance, Carer's Allowance Supplement, Discretionary Housing Payments, Best Start Grant, Funeral Expense Assistance and Employability Services. We have excluded Scottish Welfare Fund and Healthy Start Vouchers / Best Start Foods as they do not have explicit funding transfers.

Block Grant Adjustments

4.14 The fiscal framework agreement between the Scottish Government and the UK Government provides information on the Block Grant Adjustment (BGA) process.[139]

4.15 For each benefit, there will be an initial baseline addition to the Block Grant. This is equivalent to forecast expenditure in Scotland the year prior to devolution. The initial baseline addition is then indexed each year by considering the change in UK Government spending on the benefit and differences in population growth in Scotland and the rest of the UK. The initial baseline addition is reconciled to outturn data once available.

4.16 The indexation of the BGAs uses the OBR's forecasts of UK Government expenditure on each comparable social security benefit. The calculation does not use their forecasts of Scottish social security expenditure. Forecasts of Scottish social security expenditure are determined by the

[139] The Agreement between the Scottish Government and the United Kingdom Government on the Scottish Government's fiscal framework and corresponding annexes (link). Note that there is a different approach for Cold Weather Payments where the baseline addition will be an average value over a time period rather than solely the year prior to devolution.

Scottish Fiscal Commission and are presented in the remainder of this chapter.

4.17 Block Grant Adjustments will be made for the following benefits:

- Attendance Allowance
- Carer’s Allowance
- Cold Weather Payments
- Disability Living Allowance and Personal Independence Payment
- Industrial Injuries Benefits
- Severe Disablement Allowance
- Winter Fuel Payments

4.18 Table 4.5 shows a comparison of our forecasts to the BGA estimates for Carer’s Allowance, these forecasts do not include expenditure on the Carer’s Allowance Supplement.

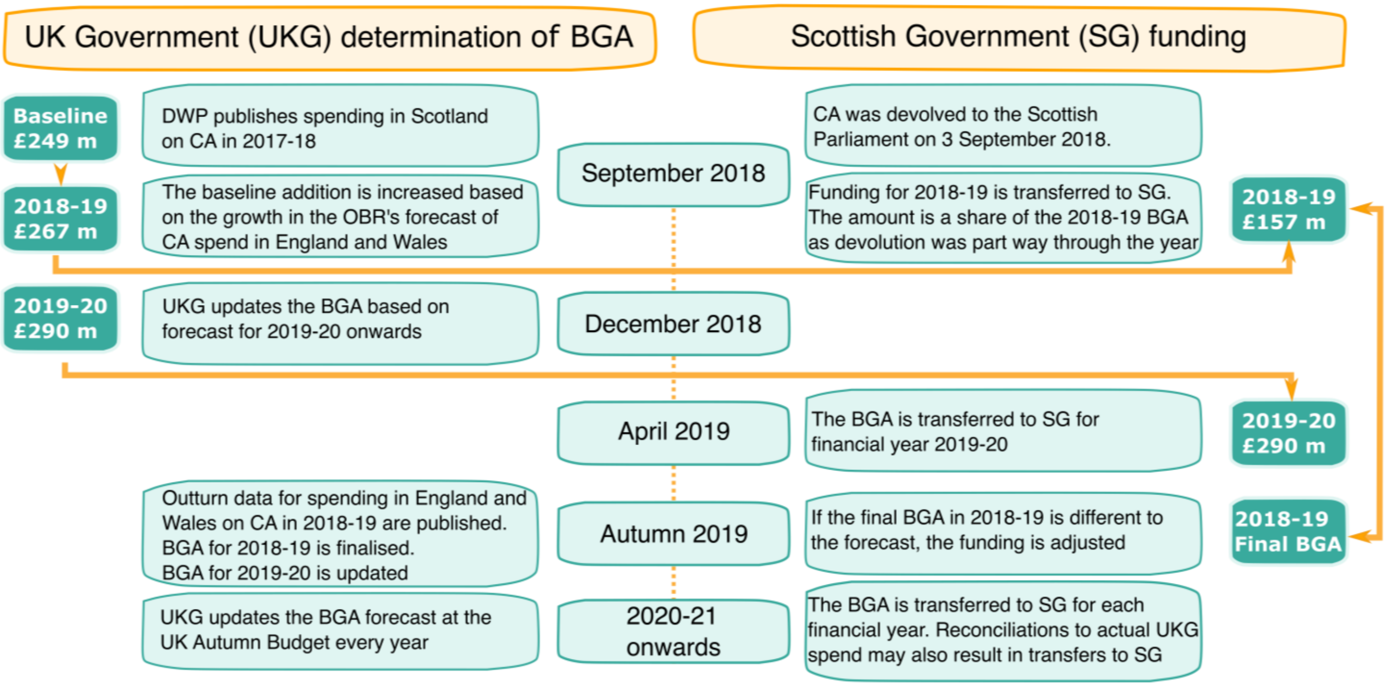
Table 4.5: Comparison of forecasts to Scottish Government BGA estimates

£ million		2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Carer’s Allowance	SFC Forecast	157	283	305	324	344	364
	BGA	157	290	307	328	348	359
	Difference	-1	-6	-2	-3	-4	5

Source: Scottish Fiscal Commission, Scottish Government.
Figures may not sum because of rounding.
The difference equals the Scottish Fiscal Commission forecast minus the BGA, a positive number represents additional expenditure incurred by the Scottish Government. The Carer's Allowance expenditure presented does not include the Carer's Allowance Supplement, the costs of which must be fully met from within the Scottish Government's budget.

4.19 We show an example of how this process works for Carer’s Allowance in Figure 4.1.

Figure 4.1: The Block Grant Adjustment process for Carer's Allowance



Sources: Scottish Government, DWP (2018) Benefit expenditure by country and region 2017-18 (link)

Machinery of Government Transfers

4.20 Funding for four other areas is transferred to the Scottish Government using a mechanism called a Machinery of Government (MoG) Transfer. The areas transferred in this way are Best Start Grant, Funeral Expense Assistance, Employability Services and Discretionary Housing Payments. These areas are treated differently because of the way the funding is classified by the UK Government.[140]

4.21 Responsibility for Discretionary Housing Payments and Employability Services in Scotland was passed to the Scottish Government from April 2017, and MoG transfer amounts were agreed for the spending review period covering 2017-18 to 2019-20. Thereafter this will be included in the Block Grant and will not be separately identifiable. The normal application of the Barnett formula will apply to changes in corresponding UK Government spending.

4.22 Funding for Best Start Grant has been agreed between the UK Government and the Scottish Government from the start date for the Pregnancy and Baby Payment (Early Learning and School-Age Payments commence later) to the end of the spending review period. The funding transfer is based on the

[140] This is covered under paragraph C.14 of the Fiscal Framework: agreement between the Scottish and UK Governments (link)

planned expenditure on Sure Start Maternity Grant in England and Wales for the same period and historic volumes of payments in Scotland.

4.23 A similar approach will be taken for Funeral Expense Assistance funding in 2019-20, using planned expenditure for Funeral Payments and relevant historic data. The funding amount is yet to be agreed between the UK Government and the Scottish Government as the date of devolution in summer 2019 is not confirmed.

4.24 Our forecasts also cover Healthy Start Vouchers, which will be replaced with Best Start Foods. The Healthy Start scheme is administered by the Department of Health and Social Care but currently paid for by the Scottish Government. There is therefore no funding transfer to account for Best Start Foods.

Table 4.6: Comparison of forecasts to Machinery of Government (MoG) Transfers

		£ million	2018-19	2019-20
		SFC Forecast	61	63
	Discretionary Housing Payments	MoG Transfers	20	20
		Difference	-41	-44
		SFC Forecast	19	19
	Employability	MoG Transfers	13	14
		Difference	-6	-5
		SFC Forecast	2	12
	Best Start Grant	MoG Transfers	1	2
		Difference	-1	-10
		SFC Forecast		6
	Funeral Expense Assistance	MoG Transfers		6
		Difference		-1
		SFC Forecast	**82**	**101**
	Total	**MoG Transfers**	**34**	**41**
		Difference	**-48**	**-60**

Source: Scottish Fiscal Commission, UK Government (2017) Block Grant Transparency: December 2017 publication (link), Scottish Government.
Figures may not sum because of rounding.
Best Start Grant: Expenditure for 2018-19 only relates to the Pregnancy and Baby Payments as the other payments do not start being paid until 2019-20.
Funeral Expense Assistance: This will start to be paid in 2019-20 so there is no funding for 2018-19. The MOG figure in the table is an estimate provided by the Scottish Government as the actual transfer amount will not be available until the devolution date in 2019 is agreed between the UK and Scottish Governments.

Carer's Allowance

Forecast

Table 4.7: Forecast Scottish Government expenditure on Carer's Allowance and Carer's Allowance Supplement

£ million	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Carer's Allowance (CA)	157	283	305	324	344	364
Carer's Allowance Supplement (CAS)	35	37	40	43	45	48
Total expenditure	191	320	345	367	389	412

Source: Scottish Fiscal Commission
Figures may not sum because of rounding.
Carer's Allowance was devolved to the Scottish Parliament on 3 September 2018, the expenditure for 2018-19 is proportioned accordingly.

Background

4.25 Carer's Allowance (CA) is a weekly payment, worth £66.15 in 2019-20, paid to people who care for someone who is disabled.[141]

4.26 CA was devolved to the Scottish Government on 3 September 2018. The Department for Work and Pensions (DWP) will continue to administer the weekly payments on behalf of the Scottish Government, until Social Security Scotland takes over delivery.

4.27 The Scottish Government started paying a Carer's Allowance Supplement (CAS) in 2018 to 'top up' the amount paid to carers in Scotland. CAS is paid in two lump sums each financial year to everyone receiving Carer's Allowance in Scotland on qualifying dates.[142] The Scottish Government has confirmed eligible carers will receive payments equivalent to an extra £8.70 per week in 2019-20.

Changes since our last forecast

Data and model updates

4.28 We have updated our May 2018 forecast to take account of new data releases from DWP showing:

[141] UK Government (2018) Benefit and pension rates 2019 to 2020 (link). The Scottish Government is applying the same CA rates set by the UK Government for 2019-20.

[142] The qualifying dates for 2018-19 were 16 April 2018 and 15 October 2018. Scottish Government (2018) Who can get Carer's Allowance Supplement (link).

- the number of individuals receiving CA in Scotland in August 2017, November 2017, February 2018 and May 2018 (which we call the caseload)
- annual expenditure in 2017-18 [143]

4.29 We have also updated our forecasts of the CA and CAS payment amounts to allow for the OBR's CPI forecast published in October 2018.[144]

4.30 We have made two minor model developments since our last forecast:

- We adjusted the claimant data from DWP to smooth an out-of-trend data point in August 2017. We discussed this issue in our May 2018 publication.[145]
- We updated our approach to adjust for differences between the DWP claimant and expenditure data. The DWP claimant data are taken as a snapshot each quarter whereas the expenditure figures cover the total cost in a financial year. The 2017-18 expenditure figures were slightly higher than we expected and we have revised our calculation to account for this.

Universal Credit

4.31 We have also introduced an adjustment to allow for the roll-out of Universal Credit. The roll-out of Universal Credit could affect the CA caseload in two different ways:

- **Carer's element:** Universal Credit contains a carer's element with similar qualifying criteria to CA, which means that individuals can receive the same amount with the Universal Credit carer's element as they would receiving Universal Credit and CA separately. Some individuals may choose to claim the Universal Credit carer's element instead of CA. This may decrease the CA caseload as individuals opt to claim support as part of their Universal Credit application.
- **Severe disability premia:** If the person being cared for has a severe disability premium included in their legacy benefit, then it is not possible for the carer to also claim CA or Universal Credit carer's element.[146]

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[143] Quarterly data taken from DWP Stat-Xplore. Annual expenditure from DWP (2018) Benefit expenditure by country and region 2017-18 (link)

[144] In line with the UK Government's current policy, the weekly CA payment rate is projected over the forecast horizon by uprating the payment amount at the start of each financial year in line with the OBR's CPI forecast from September of the previous financial year.

[145] Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts - May 2018 Box 1.3 (link)

[146] Severe disability premiums/additions can be included in Income Support, Income-Based Jobseeker's Allowance, Income-related Employment and Support Allowance, Pension Credit or Housing Benefit.

Severe disability premia do not exist in Universal Credit. As Universal Credit rolls-out, we may expect people who are currently caring for someone who is in receipt of severe disability premia to start claiming CA or Universal Credit carer's element.

4.32 We have assumed an increasing addition to the CA caseload over the forecast period as shown in the 'Universal Credit adjustment' line of Table 4.8. We used information from the OBR on the adjustment made to their Great Britain CA forecast to inform the size of the adjustment. We assume the increase in caseload would happen towards the end of the forecast period as individuals with severe disability premia are likely to be one of the later groups to be migrated to Universal Credit.[147] Increases in the CA caseload would also increase the expenditure for CAS.

Updates from the Scottish Government

4.33 CA was devolved to the Scottish Parliament at the start of September 2018. We adjusted the Scottish Government's expected spend in 2018-19 so that it reflects the period from start September 2018 to the end of March 2019. This is referred to in Table 4.8 as the '2018-19 adjustment'.

4.34 Since our May 2018 forecast, the Scottish Government has confirmed the eligibility dates in 2018-19 for CAS. We have assumed that the eligibility dates in future financial years will also be mid-April and mid-October, as they were in 2018-19.[148]

4.35 The following tables show the change in CA and CAS expenditure since our May 2018 forecast.

Table 4.8: Change in CA forecast expenditure (excluding CAS)

£ million	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
May 2018	267	285	303	318	334	349
Data and model updates	-1	-2	-3	-4	-5	-5
Universal Credit adjustment		0	5	10	15	20
2018-19 adjustment	-109					
December 2018	157	283	305	324	344	364

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts - May 2018 (link).
Figures may not sum because of rounding.

[147] UK Government (2018) Universal Credit: Written statement – HCWS745 (link)

[148] In our previous forecast, in the absence of confirmed dates, we assumed eligibility dates of end May and end November.

Table 4.9: Change in CAS forecast expenditure

£ million	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
May 2018	34.9	37.3	39.6	41.6	43.7	45.8
Data and model updates	-0.1	-0.3	-0.2	-0.1	-0.3	-0.6
Assumption update – eligibility dates	-0.2	-0.2	-0.2	-0.1	-0.1	-0.1
Universal Credit adjustment		0.0	0.7	1.3	2.0	2.6
December 2018	34.6	36.9	39.9	42.6	45.3	47.7

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts - May 2018 (link).
Figures may not sum because of rounding.

Forecast Breakdown

Table 4.10: Forecast expenditure on CA and CAS

£ million	2017-18 Outturn	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Carer's Allowance (CA)	249	266	283	305	324	344	364
Carer's Allowance Supplement (CAS)		35	37	40	43	45	48
Total expenditure	249	300	320	345	367	389	412
Yearly increase			20	25	22	22	22
Of which							
Increasing caseload			12	18	15	14	14
Uprating			7	7	7	8	8

Source: Scottish Fiscal Commission, DWP (2018) Benefit Expenditure by Country and Region 2017-18 (link).
Figures may not sum because of rounding.
2018-19 expenditure is for the full year and differs from the Scottish Government's 2018-19 expenditure shown in the earlier tables in this section.

4.36 In Table 4.10, the figure for 2018-19 is our forecast of the total amount that claimants will receive in that year. Since CA was devolved in September 2018 it is only the expenditure after that date which falls on the Scottish Budget, with the latter figure being shown in Table 4.7. From 2019-20 onwards, the total amount received by claimants will equal the total benefit expenditure falling on the Scottish Budget.

4.37 Total expenditure is forecast to increase by £112 million over the forecast period from 2018-19 to 2023-24. The main drivers for this change are an increase in the number of people we expect to receive CA, also referred to as the caseload, and the annual uprating of both the weekly CA payment and the twice-yearly CAS payment.

Increasing caseload

4.38 We expect the caseload to increase over the forecast horizon, as shown in Table 4.11.

Table 4.11: Forecast number of individuals in Scotland expected to receive CA

Thousands	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
	79	82	87	91	94	98

Source: Scottish Fiscal Commission.
CA is paid on a weekly basis throughout the year so we have provided the average caseload in the financial year.

4.39 The forecast shown in Table 4.11 is a continuation of the increasing trend we have observed in the CA caseload in recent years. The caseload has been increasing for several reasons, mainly:

- Increases in the female state pension age over this period.
- Increases in the number of people in receipt of eligible disability benefits requiring care.
- Increases in the number of individuals caring and taking up CA support.

4.40 Since November 2018, the state pension age for males and females has been equalised at age 65. This is relevant as CA is subject to overlapping benefit rules, individuals are not able to receive both a full state pension and CA. If the state pension age increases, individuals will be able to claim CA for longer.

4.41 Furthermore, the state pension age for both males and females increases to age 66 from March 2019 to October 2020.[149] This will increase expenditure as individuals who are approaching retirement will remain in the caseload for an extra year until they are age 66.

4.42 There has also been an increase in the number of individuals in receipt of eligible disability benefits over this period. This increase is observed in both Scotland and the rest of Great Britain. As the caseloads for disability benefits such as Disability Living Allowance (DLA), Personal Independence Payment (PIP) and Attendance Allowance (AA) increase, the number of individuals requiring care and support also increases. We discussed this further in our May 2018 publication.[150]

[149] UK Government (2014) State Pension age timetable (link)

[150] Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – May 2018 (link)

4.43 More generally, we are seeing an increase in the number of individuals caring and taking up CA support. The roll-out of Universal Credit may have an effect on this and we discuss further in the 'Forecast uncertainty' section below.

Uprating

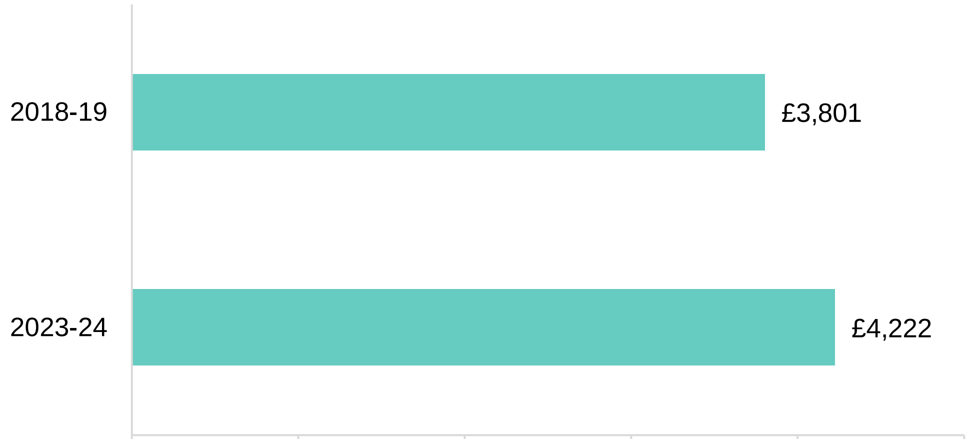
4.44 As mentioned earlier in this section, we need to forecast how both CA and CAS payments will be increased in line with inflation, also referred to as uprating. Assuming the payments are fully uprated with inflation, and drawing on the OBR's forecast of CPI inflation, Table 4.12 shows our forecasts for CA and CAS payments.

Table 4.12: Forecast CA and CAS payments

£	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
CA payment (weekly)	64.60	66.15	67.45	68.80	70.25	71.75
CAS payment (twice-yearly)	221.00	226.20	231.40	236.60	241.80	245.70

Source: Scottish Fiscal Commission, UK Government (2017) Benefit and pension rates for 2018 to 2019 (link), UK Government (2018) Benefit and pension rates for 2019 to 2020 (link), Scottish Government (2018) Extra financial support for carers (link), Scottish Government.

Figure 4.2: Annualised amount that an eligible carer in Scotland could expect to receive



Source: Scottish Fiscal Commission
We have combined the weekly CA payments and the twice yearly CAS payments in the previous table to show the annualised amount that an eligible carer could expect to receive.

Forecast uncertainty

4.45 We set out some of the common areas of uncertainty for our social security forecasts in Box 4.2.

Box 4.2: General uncertainties for forecasting social security expenditure

Demographics matter: Many of the benefits we are forecasting are linked to particular demographic groups, for example a large proportion of female claimants, or targeted at older or younger age groups. To capture the effect of changing demographics over the forecast horizon, many of our modelling approaches incorporate population projections.[151] Any changes in demographics not incorporated in these projections may change expenditure differently to our forecasts.

Assessing eligibility: Eligibility for some of the benefits we are forecasting depends, in part, on individuals' entitlement to other benefits. We use survey information to estimate the proportion of the relevant population in receipt of qualifying benefits.[152] There are limitations to this approach given it is survey data and reflects only a sample of the total Scottish population. Uncertainties about the population in receipt of qualifying benefits will affect our forecasts of expenditure.

Take-up of benefits: The proportion of the eligible population which applies for and receives a given benefit is known as the take-up rate.[153]

$$\textbf{Take-up rate} = \frac{\textit{Number of claimants}}{\textit{Estimated eligible population}}$$

Take-up rates are often challenging to calculate as little information is available on the proportion of the population who could receive support but are not doing so. There are particular uncertainties where the Scottish Government is changing benefit entitlement or application processes, and there are increased uncertainties around the take-up rates we are required to forecast.

Universal Credit: We do not forecast expenditure on Universal Credit as it is a reserved benefit. Universal Credit provides support to people who are on a low income or are out of work. It is being rolled out in stages across the UK and is replacing other legacy benefits. The roll out of Universal Credit creates additional uncertainties in some of our forecasts for the following reasons:

- being in receipt of Universal Credit is included in the qualifying criteria for several of the benefits we forecast
- there are more options for individuals who are taking on caring roles and seeking support because of the removal of severe disability premia under

[151] In line with our economy forecasts, we use the 50 per cent future EU migration variant of ONS 2016-based population projections. ONS (2017) 2016-based Population Projections, 50 per cent EU Migration Variant Population projections Scotland (link)

[152] DWP Family Resources Survey (link)

[153] For further information on the factors that may affect take-up rates, refer to Box 4.4 in Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts May 2018 (link)

Universal Credit and the introduction of a carer's element for Universal Credit.

The effect of devolution: Social Security Scotland, the executive agency that will deliver social security benefits in Scotland, has been established in 2018. The agency is currently administering the Carer's Allowance Supplement and the Best Start Grant Pregnancy and Baby Payment and its remit will continue to expand as more benefits are devolved.

Changes to the design and delivery of the benefits once devolved are likely to affect future levels of expenditure. The Social Security (Scotland) Act (2018) introduced a commitment to uprate certain benefits in line with inflation and a duty on Scottish Ministers to promote the take-up of devolved assistance.[154] The Scottish Government has also confirmed that assessments for disability support will be carried out by Social Security Scotland.[155]

We will update our forecasts as more information becomes available regarding take-up of devolved benefits, further policy and administrative changes the Scottish Government plans to make, and as Social Security Scotland takes on more responsibility for delivering social security in Scotland.

4.46 Expenditure on CA depends on the value of the weekly payment and any changes in inflation or policy will affect our expenditure forecast. The Scottish Government is yet to set an uprating policy for CA or CAS. Under the Social Security (Scotland) Act 2018, Scottish Ministers have a duty before the end of each financial year to consider the effects of inflation on all devolved benefits and to bring forward legislation to uprate certain benefits including carer's assistance.[156] The relevant parts of the Act to enable this will commence in 2019-20 and come into effect for 2020-21. If the Scottish Government's uprating proposal differs from our current assumption, based on current UK policy, then this would affect expenditure.

4.47 The number of individuals who will receive Carer's Allowance is closely linked to the number of individuals receiving disability benefits and Universal Credit. The UK welfare system is going through a period of significant reform, with Universal Credit replacing six existing means-tested benefits and tax credits and Personal Independence Payment replacing Disability Living Allowance for working-age individuals.

4.48 As noted in the OBR's forecasts, there is significant uncertainty in the forecasts for disability benefits and Universal Credit. This creates uncertainty for our forecasts of how many people we expect to receive CA in Scotland.

154 Social Security (Scotland) Act (2018) (link)

155 Scottish Government (2018) Social Security Scotland to deliver disability assessments (link)

156 Social Security (Scotland) Act 2018 Section 78 (link)

This is one of the main risks to our CA forecast and we discuss Universal Credit in more detail below.

Universal Credit

4.49 Based on discussions with the OBR we have increased our forecast expenditure as a result of the Universal Credit roll-out. There is very limited data available to date to inform this assumption and we will continue to monitor this as more local authority areas in Scotland move to Universal Credit.

4.50 We note that there are a large number of individuals who are in receipt of Severe Disability Premium in Great Britain (GB) as shown in Table 4.13. If we take a Scottish population share of this we may expect that there are around 45,000 individuals in Scotland in this situation. Our adjustment of £20 million by the end of the forecast period would equate to an increase in the CA caseload of around 5,000 individuals. This is a net position reflecting:

- An increase in the caseload as there are potentially an additional 45,000 individuals who may have a carer that would now qualify for CA support or Universal Credit carer's element

- A decrease in the caseload as some carers may now choose support through Universal Credit carer's element rather than CA

Table 4.13 People in receipt of severe disability premium in Great Britain

Benefit	Income-related Employment and Support Allowance	Income Support	Jobseeker's Allowance
Date	February 2018	November 2017	November 2017
	500,000	18,000	10,000

Source: DWP (2018) People on income-related ESA and Enhanced or Severe Disability Premium, or both (link). Information is not available for Housing Benefit.

Comparison to OBR forecast

4.51 The OBR published a forecast of CA expenditure in Scotland in their October 2018 devolved tax and spending publication.[157]

4.52 The OBR forecast Scottish CA by taking a percentage share of their forecast for GB. They adjust the percentage share to account for slower growth in Scotland's working-age population relative to GB as a whole.

[157] OBR (2018) Devolved tax and spending forecasts October 2018, Chapter 5 (link)

4.53 As we have different modelling approaches, our forecast is different to the OBR's. We will continue to work with the OBR to explore the reasons for these differences and whether there is relevant information in their forecasting approach for GB that we can incorporate in our future forecasts.

Table 4.14: Forecast comparison (excluding CAS)

£ million	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
SFC December 2018	266	283	305	324	344	364
OBR October 2018	267	290	308	329	349	359
Difference	-2	-7	-3	-4	-5	5

Source: OBR (2018) Devolved tax and spending forecasts October 2018 – charts and tables. Table 5.4: Scottish Carer's Allowance spending (excluding Carer's Allowance Supplement) (link), Scottish Fiscal Commission.
Figures may not sum because of rounding.
For comparison we have included the full year forecast for 2018-19 instead of the forecast shown elsewhere in this section which has been proportioned to allow for devolution occurring mid-way through 2018-19.

Discretionary Housing Payments

Forecast and Scottish Government's funding plans

Table 4.15: Forecast expenditure on Discretionary Housing Payments – bedroom tax mitigation

£ million	2017-18 Outturn	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Bedroom tax mitigation	49	50	52	54	55	57	58

Sources: Scottish Fiscal Commission, unpublished 2017-18 data from the Scottish Government.

Table 4.16: Scottish Government's funding plans for other Discretionary Housing Payments spend

£ million	2017-18 Outturn	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Other spend	9	11	11	11	11	11	11

Source: Scottish Government, unpublished 2017-18 data from the Scottish Government.
The outturn figure for 2017-18 includes recovered funding of £1.7 million - the Scottish Government provided £10.9 million of funding for spend other than to mitigate the bedroom tax, compared to the £9.2 million spent by local authorities.

Background

4.54 Discretionary Housing Payments (DHPs) are grants awarded by local authorities to people in receipt of certain benefits who need financial assistance with housing costs. The Scottish Government provides funding to local authorities who pay out the grants and are responsible for managing the budget throughout the year.

4.55 The UK Government introduced the removal of the spare room subsidy also known as the 'bedroom tax' from April 2013. The bedroom tax reduces the amount of Housing Benefit or housing component of Universal Credit for claimants living in social housing categorised as having one or more spare bedrooms.

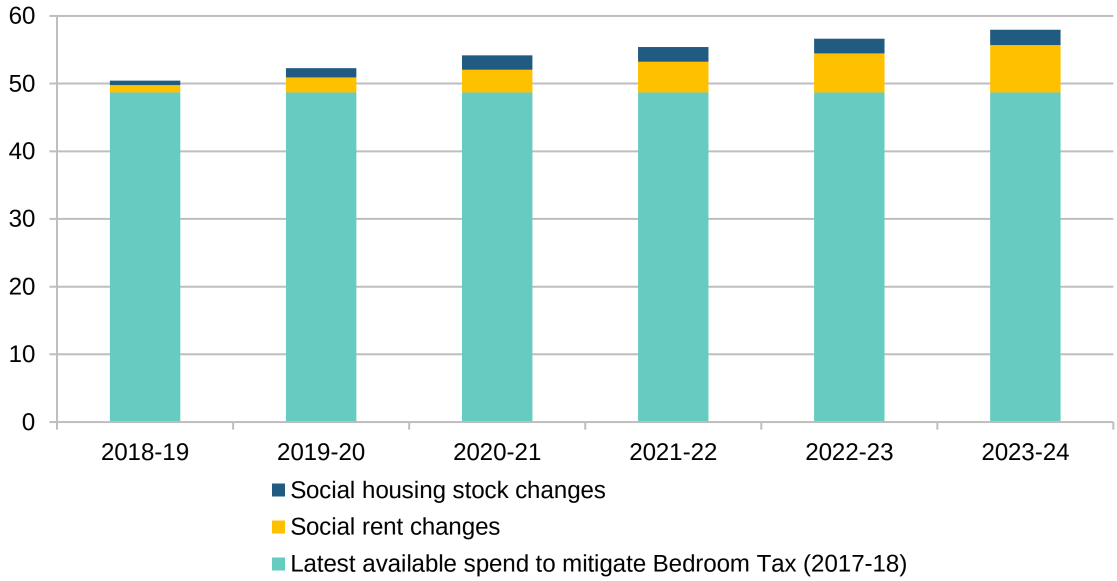
4.56 The budget for DHPs is split into two parts. The first is demand-led and dedicated to the mitigation of the bedroom tax. Our forecast for this expenditure is shown in Table 4.15. The second is a discretionary fund for all other DHP claims.

4.57 The Scottish Government has set the 2019-20 budget for the discretionary fund at £10.9 million. The Scottish Government has not informed us of any plans to change the level of funding for the discretionary fund over the forecast period. We present the Scottish Government's funding plans in

Table 4.16. We do not assess the demand for the discretionary fund and whether the funding from the Scottish Government is reasonable.

4.58 The rest of this section considers our forecast of expenditure to mitigate the bedroom tax. Our approach is based on the most recent information on what was actually spent to mitigate the bedroom tax in Scotland. To project this forward, we allow for the two main factors that could have an effect on future expenditure: changes in social rent levels and changes in social housing stock. This is shown in Figure 4.3.

Figure 4.3: Components of our expenditure forecast to mitigate the bedroom tax (£ million)



Source: Scottish Fiscal Commission

Changes since our previous forecast

4.59 We have updated our forecasts to include the most recent data from three sources:

- expenditure to mitigate the bedroom tax in the most recent outturn year (2017-18)
- social housing rent levels
- levels of social housing stock

4.60 The effect of these changes on forecast expenditure is shown in Table 4.17.

Table 4.17: Change in forecast expenditure to mitigate the bedroom tax

£ million	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
May 2018	50.5	52.2	53.8	55.1	56.5	57.8
Outturn data	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3
Social housing stock changes	0.3	0.6	0.9	0.9	0.9	0.9
Social housing rent assumption	-0.1	-0.1	-0.2	-0.3	-0.4	-0.5
December 2018	50.5	52.3	54.2	55.4	56.7	57.9
Total change	-0.1	0.1	0.3	0.3	0.2	0.1

Source: Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts - May 2018 (link), Scottish Fiscal Commission.
Figures may not sum because of rounding.

4.61 In our previous forecast, we made an adjustment to take into account the Scottish Government's commitment to increase the stock of social housing in Scotland. We assumed the number of social housing units increased to 619,000 by the end of financial year 2020-21 based on discussions with the Scottish Government and a report commissioned by the Scottish Federation of Housing Associations, Shelter Scotland, and others.[158]

4.62 Our assumption for the number of social housing units in 2020-21 onwards is unchanged. New outturn data since our last forecast have shown continued slow growth in the social housing stock in 2016-17 and 2017-18. As a result we expect higher increases in the social housing stock in 2018-19 and 2019-20 to reach our end assumption of 619,000 social housing units in 2020-21.

Scottish Government policy

4.63 The Scottish Government's intention is that the bedroom tax will be mitigated at source through Universal Credit. Once this happens, and Universal Credit is fully rolled out, there would no longer be a need to use Discretionary Housing Payments to mitigate the bedroom tax.

4.64 The bedroom tax will continue to be mitigated in full using DHPs until at least May 2020, which is the earliest date the UK Government has stated they would be able to deliver the operational changes to the Universal Credit system.[159] Given the uncertainty around the date when the Universal Credit system will be updated and also when the Universal Credit roll out will be complete, we assume DHPs continue to be the only source of funding to

[158] Shelter Scotland (2018) Review of Strategic Investment Plans for Affordable Housing (link)

[159] Scottish Government (2018) Letter from Minister for Social Security to Convener on 'bedroom tax' – 3 April 2018 (link)

mitigate the bedroom tax. We will review and update this assumption for our future forecasts.

Forecast uncertainty

4.65 Aside from the uncertainties mentioned in Box 4.2 there are specific risks relating to the forecast of expenditure to mitigate the bedroom tax.

4.66 We assume the cost of mitigating the bedroom tax grows by the average increase in social housing rent over the last two years. If social housing rent changes by a different amount then expenditure may deviate from our forecast.

4.67 We assume a constant relationship between the number of social housing units and the number of households affected by the bedroom tax. There are limited data available on the tenants who will move into the new social housing units. We do not know if new tenants will be equally likely to meet the criteria for bedroom tax mitigation support (under-occupying the property and in receipt of housing benefit or the housing component of Universal Credit) as current tenants. We will keep this assumption under review for future forecasts.

4.68 We assume that all individuals who are entitled to support from the Scottish Government to mitigate the bedroom tax take up that support. We understand there may be differences across local authorities because of the roll out of Universal Credit. If individuals are applying for Housing Benefit then they will be doing this through their local authority who will make them aware of the support they can provide to mitigate the bedroom tax. Individuals who are in a Universal Credit roll-out area will be applying to DWP for Universal Credit and would then need to be aware of the support available and make a separate application to their local authority. We will review this assumption when we receive further outturn data at a local authority level from the Scottish Government.

4.69 The Scottish Government committed to increase the stock of social housing in Scotland by the end of financial year 2020-21. For this forecast we have maintained our assumption of a social housing stock of 619,000 properties by the end of 2020-21. We may revisit this assumption if growth in the social housing stock in 2018-19 continues to be low.

Best Start Grant

Forecast

Table 4.18: Forecast expenditure on Best Start Grant

£ million	2019-20	2020-21	2021-22	2022-23	2023-24
Pregnancy and Baby Payment	5.4	5.8	5.9	6.3	6.5
Early Learning Payment	3.7	3.4	3.7	4.0	4.3
School-Age Payment	3.2	3.5	3.7	3.9	4.3
Total	12.4	12.6	13.2	14.2	15.1

Source: Scottish Fiscal Commission
Figures may not sum because of rounding.

Background

4.70 The Best Start Grant (BSG) is a series of one-off payments to help low income households with the costs associated with having a child. To qualify, families must have been awarded at least one of the qualifying benefits.[160] Support available includes a Pregnancy and Baby Payment, an Early Learning Payment and a School-Age Payment as shown in Figure 4.4.

Figure 4.4: Components of BSG

Source: Scottish Government (2018) Help for low income families (link)

4.71 BSG Pregnancy and Baby Payment was introduced on 10 December 2018 and replaced the UK Government's Sure Start Maternity Grant.[161] In September 2018, the Scottish Government introduced secondary legislation

[160] The main qualifying benefits are: Income Support, Income based JSA, Income related ESA, Child Tax Credit, Working Tax Credit, Pension Credit, Housing Benefit and Universal Credit.

[161] Scottish Government (2018) Help for low income families (link)

to the Scottish Parliament for the Pregnancy and Baby Payment.[162] We simultaneously published our costing for the introduction of this policy.[163]

Scottish Government policy changes

4.72 The Scottish Government has announced details of two further grants which will be introduced in 2019, the Early Learning Payment and the School-Age Payment.[164] We have provided a policy costing for these grants in Annex A.

Changes since our last forecast

4.73 In September 2018, we published a supplementary publication showing the increased cost of introducing the BSG Pregnancy and Baby Payment compared to Sure Start Maternity Grant.

4.74 Our expenditure forecast for the Pregnancy and Baby Payment has been updated to include new outturn data and a small error has been corrected in our forecast model. We have also adjusted our 2018-19 calculations to incorporate the start date of 10 December 2018. The updated figures are shown in Table 4.19.

Table 4.19: Forecast expenditure on BSG Pregnancy and Baby Payment

£ million	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
September 2018		5.6	5.9	6.0	6.4	6.6
December 2018	1.6	5.4	5.8	5.9	6.3	6.5
Difference	1.6	-0.1	-0.1	-0.1	-0.1	-0.1

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2018) Supplementary Costing - Social Security – Best Start Grant (Pregnancy and Baby Grant) – September 2018 (link).
Figures may not sum because of rounding.

Forecast

4.75 Table 4.18 shows our forecast for Best Start Grant. The forecast increases from £12.4 million to £15.1 million across the forecast period. This increase is largely driven by our assumption that take up will increase over the period, resulting in more claims. Table 4.20 shows the number of BSG payments we expect over the forecast period.

[162] The Early Years Assistance (Best Start Grants) (Scotland) Regulations 2018 (link)

[163] Scottish Fiscal Commission (2018) Supplementary Costing – Social Security – Best Start Grant (Pregnancy and Baby Grant) – September 2018 (link)

[164] Scottish Government (2018) Early Years assistance: consultation on the Best Start Grant regulations (link)

Table 4.20: Number of BSG payments

Thousands	2019-20	2020-21	2021-22	2022-23	2023-24
Pregnancy and Baby Payment	13	13	14	14	15
Early Learning Payment	15	13	15	16	17
School-Age Payment	13	14	15	16	17
Total number of payments	40	41	43	46	49

Source: Scottish Fiscal Commission.
Figures may not sum because of rounding.

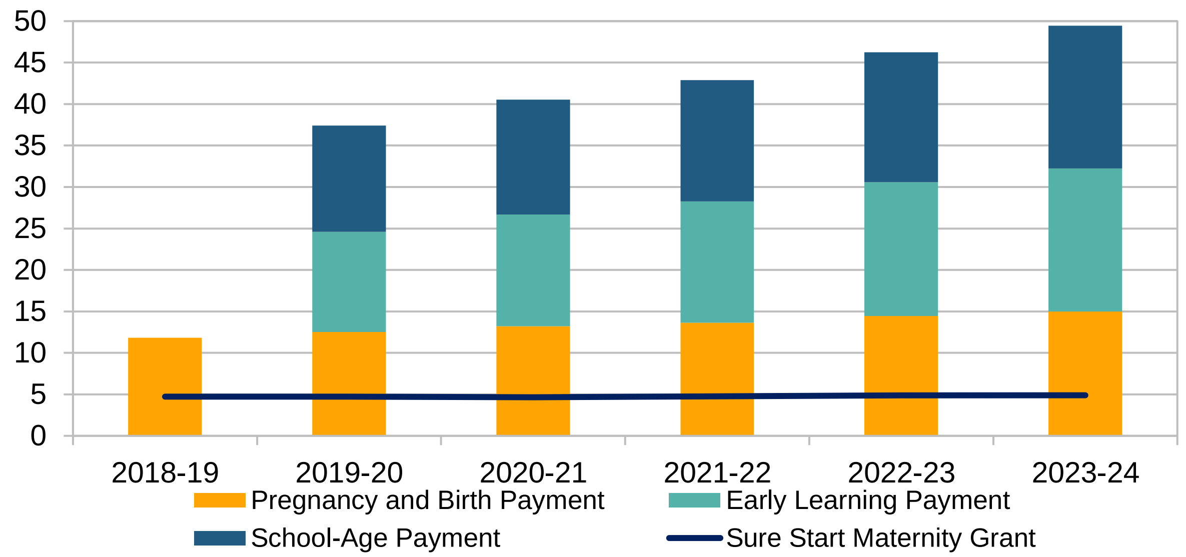
4.76 Table 4.21 provides the expected expenditure for BSG compared with the forecast of expenditure had the comparable UK policy, Sure Start Maternity Grant, continued. Figure 4.5 compares the number of payments that we expect to be made each financial year for Sure Start Maternity Grant and Best Start Grant.

Table 4.21: Comparison of Sure Start Maternity Grant and Best Start Grant

£ million	2019-20	2020-21	2021-22	2022-23	2023-24
Sure Start Maternity Grant	2.4	2.4	2.4	2.5	2.5
Best Start Grant	12.4	12.6	13.2	14.2	15.1
Difference	10.0	10.2	10.8	11.8	12.7

Source: Scottish Fiscal Commission
Figures may not sum because of rounding.

Figure 4.5: Number of Sure Start Maternity Grant and Best Start Grant payments (000's)



Source: Scottish Fiscal Commission

Forecast uncertainty

4.77 The main judgements for our BSG forecast are the take-up rates. These refer to the proportion of the eligible population who apply for, and receive, support.

4.78 We provided details on how we reached our judgement for the take-up rates for the Pregnancy and Baby Payment in our September 2018 policy costing publication.[165] We discuss how we set the take-up rates for the Early Learning Payment and the School-Age Payment in Annex A. Table 4.22 details the rates we have assumed for this forecast.

Table 4.22: BSG take-up rates

Take-up rates (%)	2019-20	2020-21	2021-22	2022-23	2023-24
Pregnancy and Baby Payment	49	51	53	55	57
Early Learning Payment	46	50	54	58	62
School-Age Payment	46	50	54	58	62

Source: Scottish Fiscal Commission
The take-up rates for the Pregnancy and Baby Payment differ slightly from those published in our September 2018 policy costing (link). This is because of a model error that we have now fixed.

4.79 There are particular uncertainties with this forecast as BSG will be one of the first benefits to be administered by Social Security Scotland. We will monitor how the benefit expenditure in the first year compares to our estimates and will use this information to inform our future judgements for BSG and for other benefits to be devolved.

[165] Scottish Fiscal Commission (2018) Supplementary Costing – Social Security – Best Start Grant (Pregnancy and Baby Grant) – September 2018 (link)

Best Start Foods

Forecast

Table 4.23: Forecast expenditure on Best Start Foods

£ million	2017-18 Outturn	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Healthy Start Vouchers	4.0	3.8	2.0				
Best Start Foods			2.5	4.6	4.4	4.2	4.0
Total	4.0	3.8	4.5	4.6	4.4	4.2	4.0

Source: Scottish Fiscal Commission

Background

4.80 Best Start Foods (BSF) will provide weekly payments worth £4.25 to eligible families where the mother is pregnant and/or has children aged under three. These payments will be pre-loaded on to a smartcard every four weeks and can be used to purchase a range of healthy foods. To qualify, families must have been awarded at least one of the qualifying benefits.

Scottish Government policy changes

4.81 The Scottish Government has committed to introduce BSF by summer 2019. Once introduced, it will replace the UK Government's Healthy Start Vouchers scheme. We have provided a policy costing for BSF in Annex A.

Changes since our last forecast

4.82 In our May 2018 publication, we provided a forecast of the comparable UK benefit, Heathy Start Vouchers. We have updated our model to include new outturn figures from the Department of Health and Social Care and 2017-18 outturn expenditure.

4.83 We have performed some minor model developments, changing the way we calculate the number of recipients for both children and pregnant women. In light of new outturn data, we revised some of our assumptions such as the take-up rate. We assume the take-up rate for Healthy Start Vouchers is 68 per cent for each year of the forecast. These updates are immaterial and are shown in Table 4.24.

Table 4.24: Forecast expenditure on Healthy Start Vouchers

£ million	2019-20	2020-21	2021-22	2022-23	2023-24
May 2018	4.0	3.9	3.7	3.6	3.4
December 2018	4.2	4.0	3.9	3.7	3.5
Difference	0.2	0.2	0.1	0.1	0.1

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts - May 2018 (link).
The expenditure for Healthy Start Vouchers in this table is for the full year assuming BSF is not introduced. This provides a baseline forecast to compare against BSF expenditure.

4.84 To provide a cost for BSF we have developed our existing Healthy Start Model. Information on our approach to forecasting BSF can be found in Annex A.

Forecast

4.85 Table 4.23 shows our forecast for Best Start Foods and Healthy Start Vouchers. The Scottish Government is already responsible for expenditure on Healthy Start Vouchers.

Forecast uncertainty

4.86 The main judgement for our BSF forecast is the take-up rates. We assume the take-up rate remains constant at 62 per cent over the forecast period. This is lower than the take-up rate we assumed for Healthy Start Vouchers. We discuss how we set this rate in our policy costing in Annex A.

4.87 There are particular uncertainties with this forecast as BSF will be one of the first benefits to be administered by Social Security Scotland. We will monitor how the benefit expenditure in the first year compares to our estimates and will use this information to inform our future judgements for BSF and for other benefits to be devolved.

Funeral Expense Assistance

Forecast

Table 4.25: Forecast expenditure on Funeral Expense Assistance

£ million	2019-20	2020-21	2021-22	2022-23	2023-24
	6.2	6.3	6.6	6.5	6.6

Source: Scottish Fiscal Commission

Background

4.89 Funeral Expense Assistance (FEA) will support individuals on low incomes with funeral costs. The Scottish Government has announced that they plan to replace Funeral Payments (FP) in Scotland with FEA by summer 2019; the forecast is based on an assumed commencement date of 1 June 2019.

4.90 To receive FEA individuals must have been awarded one of the qualifying benefits.[166] They must also be responsible for the cost of the funeral. The amount paid in FEA is split into two components. The first covers reasonable burial or cremation costs; the second is a flat rate amount for 'other' expenses associated with the funeral such as funeral director costs, flowers and venue hire.

Modelling approach

4.91 The forecast for FEA is influenced by the complex nature of the benefit, the interactions with qualifying benefits and family relationships. To forecast expenditure on FEA in Scotland, we use the ONS projections to estimate the number of deaths in Scotland over the forecast period.[167]

4.92 The number of funerals eligible for FEA is then estimated by multiplying the projected number of deaths by estimated percentages of those in receipt of qualifying benefits. These percentages represent eligibility for FEA and are calculated using results from the Policy Simulation Model (PSM) and information on family relationships from the Understanding Society Survey (USS).[168]

[166] Scottish Government (2018) Funeral Expense Assistance: Section 5: FEA Regulations (link). Qualifying Benefits – Income Support, Income based Jobseeker's Allowance, Income related Employment and Support Allowance, Pension Credit, Child Tax Credit, Disability or severe disability element of Working Tax Credit, Universal Credit, Housing Benefit.

[167] ONS (2017) 2016-based Population Projections, 50 per cent EU Migration Variant Population projections Scotland (link)

[168] UK Data Archive: Understanding Society Survey (link)

4.93 The take-up rate is initially estimated at 53 per cent based on average take-up rates under FP over the last three years. Over the entire forecast horizon this take-up rate is gradually increased to 55 per cent to account for increased awareness and accessibility of the benefit. Multiplying the take-up rate by the number of eligible deaths provides a forecast of the number of individuals expected to receive FEA.

4.94 Finally, starting from the 2017-18 FP average award, we assume the average award increases by 0.9 per cent per year before accounting for the uprating of the 'other' (non-burial/cremation) cost element of the award. The 0.9 per cent yearly increase reflects the average change in average FP award over the last four years. We uprate the 'other' (non-burial/cremation) costs element using CPI forecasts. The forecast average award payments are then multiplied by the projected number of individuals expected to receive FEA to produce the final expenditure forecast. Additional information on this policy costing can be found in Annex A.

Changes since our last forecast

4.95 In May 2018 we produced an illustrative forecast of expenditure on FP in Scotland. Since May we have made a number of updates to our forecast model before we produced the costing for FEA to be introduced in 2019. Table 4.26 shows the changes to our FP forecast.

Table 4.26: Change in forecast expenditure on Funeral Payments (FP)

£ million	2017-18 Outturn	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
May 2018	5.0	5.1	5.4	5.4	5.3	5.4	5.4*
Data updates	-0.2	-0.4	-0.8	-0.8	-0.6	-0.7	-0.8
Methodology changes	0	-0.1	-0.1	-0.2	-0.2	-0.2	-0.3
December 2018	4.8	4.7	4.5	4.5	4.5	4.4	4.3
Total change	-0.2	-0.5	-0.9	-0.9	-0.8	-1.0	-1.1

Source: DWP (2018) Social Fund figures for Scotland – response to Scottish Fiscal Commission (link), Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts - May 2018 (link), Scottish Fiscal Commission.
Figures may not sum because of rounding. There was a very minor transcription error with the forecast expenditure for 2023-24 in our May 2018 publication. The published figure of £5.3 million should have read £5.4 million.[169]

4.96 The main differences from May 2018 relate to data updates. We are now using updated PSM data based on the 2015-16 Family Resources Survey (FRS). The data have revealed that the number of eligible deaths were far

[169] This did not significantly affect our forecast and did not have budgetary implications. The response aligns with the categorisation of such an error as described by the Commission's voluntary compliance with best practice set out in the Office for Statistics Regulation's Code of Practice for Statistics (link)

higher than previously estimated, especially in 2015-16 and 2016-17. Such increases in estimated eligibility, with no corresponding increase in awards, have reduced estimated take-up rates compared to previous forecasts.

4.97 Other data updates have had minimal effect on our forecasts and include the use of detailed benefit combination data recently published on Stat-Xplore, incorporating data from wave seven of the USS and updating our model to use 2017 National Records of Scotland deaths data.[170]

4.98 We have incorporated 2017-18 outturn data received from DWP.[171] These data showed an overall reduction in the amount spent on FP in Scotland in 2017-18. This was driven by a reduction in caseload which outweighed a small increase in average payment.

4.99 Looking at the last ten years of available data, the annual change in the average FP award in Scotland varies between minus one per cent and plus eight per cent. We previously used an average change over the last ten years to project forward average payment amounts. We now use the average change in award since 2014-15 as the annual change has been more consistent over this period. This reduces the assumed annual increase in the average payment from 2 per cent to 0.9 per cent.

Table 4.27: Forecast expenditure on Funeral Expense Assistance compared to Funeral Payments

£ million	2019-20	2020-21	2021-22	2022-23	2023-24
Funeral Payments	4.5	4.5	4.5	4.4	4.3
Funeral Expense Assistance	6.2	6.3	6.6	6.5	6.6
Total change	1.7	1.8	2.0	2.1	2.3

Source: Scottish Fiscal Commission
Figures may not sum because of rounding.

4.100 FEA is expected to cost around £2 million more each year compared to FP. A higher caseload as a result of eligibility being widened under FEA is the main reason for this increase. We expect that in each year of the forecast period the number of individuals eligible for FEA will be around 40 per cent higher than those eligible under FP.

4.101 The uprating of the ‘other’ non-burial/cremation component of the award also contributes to the increase in expenditure. The overall effect of this is minimal compared to the expected effect of increased eligibility under FEA. Full details of the costing for FEA can be found in Annex A.

[170] National Records of Scotland (2018) Deaths Time Series Data (link)

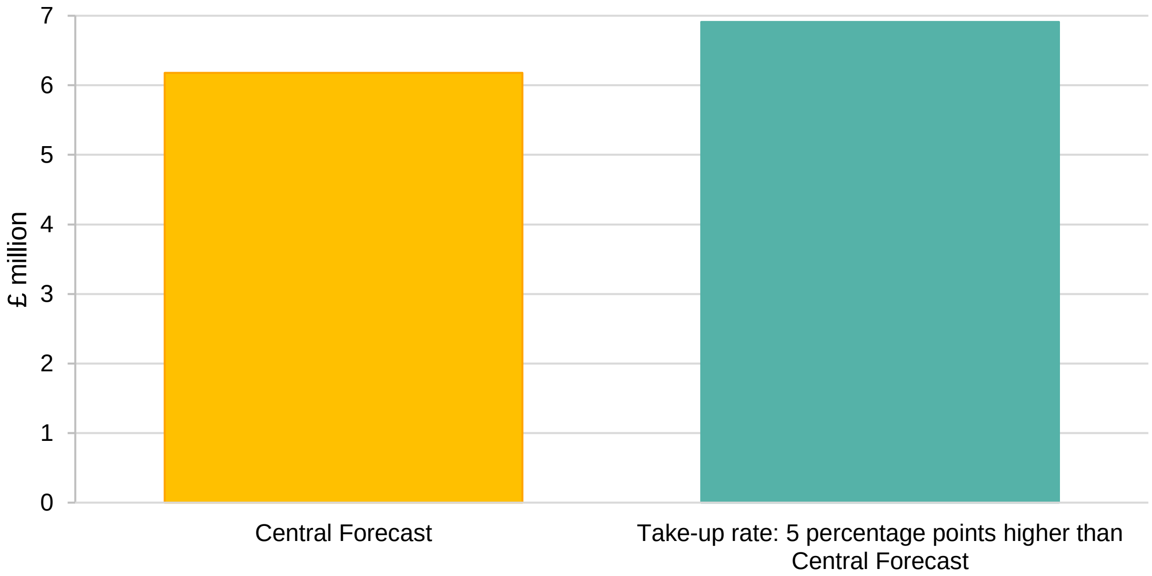
[171] DWP (2018) Social Fund figures for Scotland – response to Scottish Fiscal Commission (link)

Forecast uncertainty

4.102 There are a number of uncertainties around the forecast for FEA. The main uncertainty relates to the take-up rate for FEA. The Scottish Government has widened eligibility through a more open hierarchy system compared to the current FP system. Further details are set out in Table A.33 with a comparison of FEA and FP policy. How aware potential recipients are of these changes, and their eligibility under the new scheme, will have a marked effect on the take-up rate. Funeral directors are likely to play a significant role in informing people about the benefit and the Scottish Government has engaged with this stakeholder group through the development of FEA regulations.

4.103 The UK Government made a change to FP to allow recipients to receive contributions from relatives, friends or charities without these being deducted from the FP. The effect of this policy change under FP will not be known until 2018-19 outturn data become available from DWP. FEA has the same policy, and this may increase take-up rates and the average award amount. Sensitivity analysis presented in Figure 4.6 shows that if the take-up rate in the first year of FEA operation was five percentage points higher than assumed in our central forecast, this would increase expenditure in 2019-20 by £0.7 million.

Figure 4.6: FEA expenditure in 2019-20, take-up rate sensitivity



Source: Scottish Fiscal Commission

4.104 The risks around Universal Credit and the estimated proportion of individuals in receipt of qualifying benefits are mentioned in Box 4.2.

4.105 The forecast assumes a start date of 1 June 2019, based on the Scottish Government's commitment to deliver the benefit 'by summer 2019'. There still remains uncertainty regarding the start date of FEA. Variation from this assumed start date will have an effect upon the forecasted expenditure.

4.106 The average amount paid in FP in Scotland since 2013-14 has changed year on year by between minus one per cent and plus two per cent. If the average payment was to grow at a different rate to our estimate (0.9 per cent) this would affect expenditure.

4.107 Additional detail on uncertainties for the forecast are outlined in the policy costing in Annex A.

Employability Services

Forecast

Table 4.28: Forecast expenditure on Employability Services

£ million	2017-18 Outturn	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
	12	19	19	28	22	9	0

Source: Scottish Fiscal Commission and Scottish Government.

Background

4.108 The Scottish Government's Fair Start Scotland service launched on 3 April 2018.[172] There were two transitional services, which accepted referrals during 2017-18.[173]

4.109 Fair Start Scotland (FSS) is a voluntary service designed to help people with disabilities or who are at risk of long-term unemployment find sustained employment. The Scottish Government has contracted external providers to deliver the service.

4.110 The service is designed around participants' needs and there are three broad categories of support provided. This segmentation reflects the range of circumstances of the people who volunteer. For most participants, pre-employment support is provided for up to 12 months followed by a further 12 months of support in employment, should the participant agree.

4.111 The FSS service has been allocated a £96 million budget by the Scottish Government to accept referrals over three years. Contracts with providers are for five years.[174]

Modelling approach

4.112 The employability expenditure forecasts presented in our December 2017 and May 2018 forecast reports were based on data provided by the Scottish Government on the contracts in place. These data included assumptions about how many people in each category would voluntarily receive support, obtain a job and achieve sustained employment.[175]

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172 Employability in Scotland (2017) Background on Scotland's Devolved Employment Services (link)

173 For further details on the transitional services, see Scottish Fiscal Commission (2017) Scotland's Economic and Fiscal Forecasts – December 2017, page 170 (link)

174 For further details on the financial background and modelling work which informed provider contracts for Fair Start Scotland, see Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – May 2018, pages 174 and 175 (link)

175 For further details on the Employability Services modelling approach and assumptions, see Scottish Fiscal Commission (2018) Approach to Forecasting Social Security, pages 27 and 28 (link)

4.113 In developing our latest forecast, the Commission worked closely with the Scottish Government to make best use of monthly data on the number of service starts, job starts and sustained outcomes to date. By monitoring these figures and comparing performance against expectation, the Commission has worked collaboratively with the Scottish Government to develop expenditure forecasts.

Forecast

Table 4.29: Forecast expenditure on Employability Services

£ million	2017-18 Outturn	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Fair Start Scotland	0.3	15.7	19.2	27.7	21.9	8.6	0
Work Able Scotland	2.5	0.3	0	0	0	0	0
Work First Scotland	8.8	3.3	0	0	0	0	0
Total expenditure	11.6	19.3	19.2	27.7	21.9	8.6	0

Source: Scottish Fiscal Commission.
Figures may not sum because of rounding.

4.114 Table 4.29 details the forecast of spending for Fair Start Scotland, Work Able Scotland (WAS) and Work First Scotland (WFS). There are three main points to note. Firstly, the forecast spend for Fair Start Scotland is £93 million, slightly under the announced £96 million budget.[176] This stems from the service providers' proposed costs to deliver FSS, based on their estimates of the expected level of referrals/starts and the number of sustained job outcomes. Secondly, payments peak in the middle of the forecast horizon. This reflects individuals entering services at a different point as well as the time necessary to enter into employment, and to achieve the key milestones when performance fees are disbursed. Thirdly, payments continue into 2021-22 and 2022-23, which is after the referral period ends. This is because there will be a number of cases in which participants are referred to the service during the latter part of 2020-21 and then achieve the sustained outcome milestones.

4.115 There have been minimal revisions made to the expected expenditure on Employability Services. This is because forecasts currently reflect contracts set by the Scottish Government and agreed with service providers. Since the Fair Start Scotland service was only launched in April 2018 there are limitations to the performance information currently available.[177] Evidence

[176] Employability in Scotland (2017) About Fair Start Scotland (link)

[177] The first sustained job outcome milestone is for a participant to achieve 13 weeks of employment in a 16 week period. Factoring in time for support to be delivered to the participant ahead of finding employment underlines the current early status of the FSS service in terms of delivery to date.

provided by the Scottish Government shows current expenditure is broadly in line with the monthly profile for the 2018-19 forecast.

Table 4.30: Change in Employability Services forecast expenditure

£ million	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
May 2018	11.3	19.6	19.2	27.7	21.9	8.5	0
Data and service provider forecast updates	0.3	-0.3	0	0	0	0.1	0
December 2018	11.6	19.3	19.2	27.7	21.9	8.6	0
Total change	0.3	-0.3	0	0	0	0.1	0

Source: Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – May 2018 (link), Scottish Fiscal Commission.
Figures may not sum because of rounding.

4.116 Expenditure on WFS during 2017-18 was marginally higher (£0.3 million) than originally forecast. This was because of slightly more starts to the service than previously anticipated by service providers

4.117 The 2018-19 expenditure forecast for WFS has been reduced by £0.2 million and the WAS forecast reduced by £0.1 million because service providers achieved fewer employment outcomes than they originally profiled during the first half of the year. This is likely to result from a combination of reasons, including delays with providers claiming outcome payments and the commencement of Fair Start Scotland in 2018-19.

4.118 There has been a minimal increase (£0.1 million) to the 2022-23 forecast of expenditure on FSS because of a rounding error in the May 2018 forecast.

Forecast uncertainty

4.119 The voluntary nature of the service may lead the eventual number of people being referred and then agreeing to participate being lower than expected. Original assumptions about take-up were based on previous DWP schemes, in particular the New Deal for Disabled People. The evidence base underpinning this was limited, owing to few comparable previous voluntary schemes.

4.120 The second source of sensitivity for the forecasts is the effectiveness of the service providers at supporting participants into sustained employment. For Fair Start Scotland this forecast risk may be alleviated by a longer service period than for WFS and WAS. The monthly performance monitoring system put in place by the Scottish Government will also play a very important role in mitigating this risk. We anticipate that this risk will more likely affect the profile of spending rather than the total amount spent.

4.121 Our employability forecasts will always be reliant, to an extent, on information from the Scottish Government on how they expect expenditure on the services to develop. The service is delivered by contracted providers and monitored by the Scottish Government. The Scottish Government has some levers to influence the performance of providers, and therefore the level of expenditure. This has a more direct effect on expenditure than we see for social security benefits, where, for example, the Government may or may not be successful with a strategy to increase take-up of benefits.

4.122 We will continue to monitor expenditure on the service, in particular the assumptions around the risks identified. The current forecast of FSS expenditure will continue to be considered alongside the monthly performance/financial information being provided by the Scottish Government. We will continue to work closely with the Scottish Government to further develop the FSS expenditure forecast as the service matures.

Scottish Welfare Fund

Scottish Government's funding plans

Table 4.31: Scottish Government's funding plans for the Scottish Welfare Fund

£ million	2017-18 Outturn	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
	33	33	33	33	33	33	33

Source: Scottish Government (2018) Scottish Welfare Fund Statistics Annual Update 2017/18 (link), Scottish Government.

In our May 2018 publication the figures included £100,000 of Family Reunion Grant funding. The Scottish Government has now confirmed that this will be met from the Equalities budget rather than the Social Security budget and this has been corrected above.

4.123 The Scottish Welfare Fund (SWF) was set up in April 2013, following the devolution of parts of the UK Government's Social Fund. The SWF helps people on a low-income who are in crisis because of a disaster or emergency and helps vulnerable people set up home or continue to live independently in their community. Similar to DHPs, the Scottish Government provides funding to local authorities who then award the discretionary payments.

4.124 The Scottish Government has set the 2019-20 budget for the SWF at £33 million. The fund has stayed constant at £33 million since 2013-14.

4.125 The Scottish Government has not informed us of any plans to change the level of funding for the SWF over the forecast period. We present the Scottish Government's funding plans in Table 4.31. We do not assess the demand for the Scottish Welfare Fund nor whether the funding from the Scottish Government is reasonable.

Chapter 5
Borrowing

Background

5.1 The Commission is required to assess the reasonableness of the Scottish Government's projections of its borrowing.[178]

5.2 We fulfil this role by assessing any borrowing which Ministers can project in advance. In our economy chapter, we assess if there is a Scotland-specific economic shock that would allow the Scottish Government increased borrowing powers.

5.3 Our assessment of reasonableness will consider the level of borrowing relative to the statutory caps set out in the Scotland Act 2016 and the associated fiscal framework. The caps are detailed in Table 5.1 and 5.4.

5.4 Where appropriate, we will also consider how broader fiscal factors may affect the resources available to the Scottish Government.[179] For example, in this report we examine the payments into, and draw down of funds from, the Scotland Reserve. We will continue to review the scope of this assessment and our commentary on broader fiscal factors will expand in future publications whenever we consider there to be a public benefit.

Capital borrowing limits

5.5 Capital borrowing is used by the Scottish Government to fund capital projects, for example to invest in schools, roads and hospitals.

5.6 Capital borrowing can be funded from the National Loans Fund (NLF), commercial loans or the issue of bonds subject to a statutory aggregate cap.[180] The cap was increased with the Scotland Act 2016 and currently

[178] Scottish Fiscal Commission Act 2016 section 2(2)(b) (link)

[179] Fiscal factors are defined in the Scottish Fiscal Commission Act 2016 (link) as: "anything which the Scottish Ministers use to ascertain the amount of resources likely to be available for the purposes of sections 1 to 3 of the Public Finance and Accountability (Scotland) Act 2000" (link)

[180] Scotland Act 2012, Part 3 Borrowing (link)

stands at £3 billion.[181] In addition to the aggregate cap, an annual limit of £450 million is set out in the fiscal framework agreement between the Scottish and UK governments.[182] Table 5.1 summarises the Scottish Government's capital borrowing powers.

Table 5.1: Capital borrowing provisions in the Scotland Act 2016 and the fiscal framework

Capital borrowing
Statutory overall capital borrowing limit of £3 billion
Annual limit of 15 per cent of the overall borrowing cap – equivalent to £450 million a year
The term of any loan is normally 10 years, but where the lives of the assets being purchased through the loan justify longer or shorter terms, these can be agreed

Source: Scotland Act 2016, Part 2 Borrowing (link), Scottish Government and UK Government (2016) The Agreement between the Scottish Government and the United Kingdom Government on the Scottish Government's fiscal framework (link).

Capital borrowing assessment

5.7 The Scottish Government's historic borrowing and borrowing plans, along with repayment schedules and cumulative stock of debt are shown in Table 5.2.

5.8 The Scottish Government agreed a notional borrowing arrangement with HM Treasury in 2015-16 and 2016-17 as part of managing the budgetary impact of Office for National Statistics (ONS) classification decisions on a number of Non-Profit Distributing (NPD) projects, including the Aberdeen Western Peripheral Route. The ONS assesses how bodies and transactions should be classified in the National Accounts.[183] A number of NPD projects,[184] including the Aberdeen Western Peripheral Route, were classified to the public sector. This resulted in the Scottish Government needing to score the capital value of these projects within capital budgets. Notional borrowing was agreed to help manage the impacts that flow from that decision. The notional borrowing counts towards the capital borrowing cap but does not have a cash impact on the Scottish Government's budget.[185]

[181] Scotland Act 2016, Part 2 Borrowing (link)

[182] Scottish Government and UK Government (2016) The Agreement between the Scottish Government and the United Kingdom Government on the Scottish Government's fiscal framework (link)

[183] Office for National Statistics (2015) National Accounts Sector Classification (link)

[184] The NPD model was introduced as an alternative to, and has since superseded, Private Finance Initiative (PFI) as a funding model for infrastructure investment in Scotland. More information is available on the Scottish Government's website. (link)

[185] The amounts shown were recorded against borrowing limits to be notionally repaid over 30 years (linked to the life of the underlying NPD contracts).

Table 5.2: Scottish Government capital borrowing

£ million		2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
		Outturn	Planned*		Borrowing plans not provided			
Borrowing		450	450	450				
Agreed repayment period (years)		25	25	25				
Interest rate		1.9	2.0	2.5				
Repayments								
2015-16 borrowing	Principal	9.4	9.4	9.4	9.4	9.4	9.4	9.4
	Interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2016-17 borrowing	Principal	11.1	11.1	11.1	11.1	11.1	11.1	11.1
	Interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2017-18 borrowing	Principal		7.1	14.3	14.6	14.9	15.2	15.5
	Interest		7.7	8.3	8.1	7.8	7.5	7.2
2018-19 borrowing	Principal			14.3	14.6	14.9	15.2	15.5
	Interest			8.9	8.6	8.4	8.1	7.8
2019-20 borrowing	Principal				13.1	13.5	13.8	14.2
	Interest				11.2	10.8	10.5	10.2
Total	Principal	20.5	27.6	49.1	62.8	63.8	64.7	65.7
	Interest	0.0	7.7	17.2	27.9	27.0	26.1	25.2
Debt stock								
start of year		607	1,036	1,459	1,859	1,797	1,733	1,668
end of year		1,036	1,459	1,859	1,797	1,733	1,668	1,602
Percentage (%) of debt cap at end of year **		35	49	62	60	58	56	53

Source: Scottish Government. Figures may not sum because of rounding.
* These are the planned borrowing levels for 2018-19 and 2019-20 but could change. Interest rates for these years are based on the Scottish Government's borrowing projections.
** Debt cap is £3 billion.

5.9 The Scottish Government borrowed £450 million in 2017-18,[186] which is the maximum allowed under the fiscal framework rules. This was drawn down on 8 March 2018 and will be paid back over 25 years.

5.10 The following information on the borrowing plans up to 2019-20 has been provided by the Scottish Government:

[186] Scottish Government (2018) Fiscal Framework Outturn Report (link)

- Borrowing in 2018-19 and 2019-20 is expected to be repaid over a 25 year time horizon, linked to the life of the assets that are likely to be built. This flexibility on repayment period is built in to the fiscal framework.

- The Scottish Government plans to make full use of the £450 million capital borrowing powers in 2018-19, although has not yet drawn down this borrowing.

- The Scottish Government expects to make full use of its borrowing powers again in the 2019-20 Budget.

- Final borrowing levels for 2018-19 and 2019-20 may change.

- The Scottish Government has assumed an annual interest rate of 2.0 per cent for 2018-19 borrowing and 2.5 per cent for 2019-20 borrowing in its affordability modelling. The Scottish Government believe these interest rates are prudent in comparison to recent interest rates of around 1.8 per cent.

- All capital borrowing to date has been from the NLF.

5.11 The Scottish Government has not provided any information on capital borrowing beyond 2019-20, but has stated this will be considered as part of the 2019 Spending Review process and that it will provide more detail within the Medium Term Financial Strategy document in spring 2019.[187]

5.12 We note:

- The Scottish Government borrowed £450 million in 2017-18, which is the maximum allowed under the fiscal framework rules.

- The Scottish Government also plans to borrow the maximum allowed in 2018-19 and in 2019-20.

5.13 The Government's projections of capital borrowing comply with the terms set out in the fiscal framework.

5.14 The Government will have borrowed 62 per cent of the total statutory limit on capital borrowing by the end of 2019-20, three years after the expansion in capital borrowing limits.

5.15 The Scottish Government will be able to continue to borrow the maximum amount per year until it reaches the statutory borrowing cap of £3 billion. Beyond this point the annual amount available to borrow would be limited. The

[187] The Scottish Parliament (2018) Public audit and post-legislative scrutiny committee (link)

exact profile of principal repayments and the amount available for the Scottish Government to borrow will depend on the repayment period and the interest rate offered by the NLF at the point of agreement.[188]

5.16 The £450 million the Scottish Government borrowed in 2017-18 was borrowed over 25 years as a fixed interest loan with a rate of 1.90 per cent. We note that the standard term of capital loans in the fiscal framework is 10 years. Had the Scottish Government borrowed the same amount over 10 years, the interest rate would have been 1.27 per cent.[189]

Table 5.3: Illustration of potential borrowing and repayments under 10 or 25 year repayment schedules.

£ million	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
25 year repayment schedule								
Potential borrowing	450	450	450	450	450	139	114	120
Illustrative interest rate (%)*	1.85	1.85	1.85	1.85	1.85	1.85	1.85	1.85
Total repayments of principal**	28	49	64	79	95	110	114	120
Percentage (%) of debt cap	49	62	75	87	99	100	100	100
10 year repayment schedule								
Potential borrowing	450	450	450	450	450	450	383	282
Illustrative interest rate (%)*	1.22	1.22	1.22	1.22	1.22	1.22	1.22	1.22
Total repayments of principal**	28	77	121	165	209	254	265	282
Percentage (%) of debt cap	49	61	72	82	90	96	100	100

Source: Scottish Fiscal Commission
* Illustrative interest rates for 10 or 25 year equal repayment plans taken from the Debt Management Office and correspond to NLF rates which were available on the 14 November 2018.
** Repayments include those on existing capital borrowing.

5.17 Table 5.3. provides an illustrative example of the maximum capital borrowing which would be possible if the Scottish Government borrowed with either a 10 year or 25 year repayment schedule. Under this illustrative projection a 25 year repayment profile would result in the potential borrowing being capped from 2023-24 because the debt cap would be reached. A 10 year repayment profile would result in higher annual repayments but potential borrowing not being capped until 2024-25. The interest rates used in Table 5.3 are recent NLF rates but are likely to differ from those available at the time of borrowing. The Scottish Government chose to use higher interest rates in its affordability modelling.

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[188] Current NLF lending rates from the Debt Management Office are updated daily and are available at their website. (link)

[189] Current and historical interest rates from the National Loans Fund are available on the UK debt management office's website. (link)

5.18 Our economy forecasts use the 25 year projection in Table 5.3. This assumes the Scottish Government borrows the maximum amount every year until 2023-24 when capital borrowing is £139 million. Lower borrowing in 2023-24 will mean, all else being equal, lower GDP growth forecasts than would otherwise have been the case. See Chapter 2 for further details.

Resource borrowing

5.19 The Scottish Government has the power to borrow for resource spending for the following reasons:

- In-year cash management.
- Forecast error in relation to devolved and assigned taxes and devolved social security expenditure arising from forecasts of Scottish receipts/expenditure and corresponding UK forecasts for the Block Grant Adjustments.
- Any observed or forecast shortfall in devolved or assigned tax receipts or devolved social security expenditure incurred where there is, or is forecast to be, a Scotland-specific economic shock.

Table 5.4: Resource borrowing provisions

Resource Borrowing
Statutory overall resource borrowing limit of £1.75 billion
Annual limit of £500 million for in-year cash management
Annual limit of £300 million in relation to forecast errors – increases to £600 million in the case of a Scotland-specific economic shock
Annual limit for all resource borrowing (in-year cash management and forecast errors) of £600 million
Flexible repayment period of between three and five years, decided by Scottish Ministers

Source: Scotland Act 2016, Part 2 Borrowing (link), Scottish Government and UK Government (2016) The Agreement between the Scottish Government and the United Kingdom Government on the Scottish Government's fiscal framework (link).

5.20 Resource borrowing can only be funded from the NLF. The current limits on resource borrowing are shown in Table 5.4.

Resource borrowing assessment

5.21 The Scottish Government has confirmed it has not used resource borrowing powers to date and that there are no plans for resource borrowing in 2019-20.

5.22 We are not forecasting an economic shock to allow access to the additional resource borrowing set out in Table 5.4. The definition of a Scotland-specific economic shock is discussed in the forecast context and summary section of Chapter 2.

5.23 The Scottish Government is able to borrow up to £300 million per year for forecast errors in relation to devolved or assigned tax revenues and devolved social security spending, increasing to £600 million in the case of a Scotland-specific economic shock.[190]

5.24 For each fiscal event, revenue from income tax and fully devolved taxes and spending on devolved social security are forecast by the Commission. Block Grant Adjustments (BGA) are agreed between the Scottish and UK Governments based on the OBR's forecasts for corresponding UK Government tax revenues and social security expenditure. These forecasts are then reconciled to the outturn data once this becomes available. We outline the actual and forecast budget impacts of the budget reconciliation process for income tax and fully devolved taxes below. More information on the reconciliation process is available in the Scottish Government's fiscal framework outturn report.[191]

Fully devolved taxes

5.25 Land and Buildings Transaction Tax (LBTT) and Scottish Landfill Tax (SLfT) were fully devolved from 2015-16.

5.26 Tax revenues are collected by Revenue Scotland and transferred directly to the Scottish Government. For 2017-18 LBTT revenues were £50 million more and SLfT were £1 million less than had been forecast in December 2016. The combined difference between forecast and outturn receipts for fully devolved taxes resulted in an additional £49 million in revenue which the Scottish Government added to the Scotland Reserve in 2017-18.

5.27 Alongside final tax revenues becoming available, BGAs are updated based on the UK government outturn receipts. For fully devolved taxes BGAs are updated twice, once following the UK Autumn Budget based on updated OBR forecasts and then a second final reconciliation once the UK Government's outturn data are available.

5.28 The first BGA reconciliation for 2017-18 was minus £46 million for LBTT and plus £15 million for SLfT. The combined effect resulted in the Scottish Government receiving £31 million less in its Block Grant for 2018-19. The outturn data for the UK Government's receipts are now available and this results in a second and final reconciliation. For LBTT this is plus £7 million for LBTT and minus £9 million for SLfT. The combined effect of the second

[190] Scotland Act 2016, Part 2 Borrowing (link)

[191] Scottish Government (2018) Fiscal Framework Outturn Report (link)

reconciliation will result in the Scottish Government receiving £2 million less in its Block Grant for 2019-20.

Income Tax

5.29 The Scottish Parliament became responsible for income tax rates and thresholds with the exception of the personal allowance in 2017-18. The Scottish Government receives all revenues from non-saving non-dividend (NSND) income tax from Scottish taxpayers.

5.30 Table 5.5 shows the latest estimates of the income tax reconciliation. The net balance between the reconciled BGA and the outturn revenue/spend determines the funding the Scottish Government should have received. For 2017-18 the combination of the BGA forecast and income tax liabilities forecast made in February 2017 led to a net positive budget position of £107 million. Since this time both the forecast of BGA and the Scottish income tax liabilities forecast have been adjusted downward, but the reduction in the income tax liabilities forecast has been greater than the reduction in the BGA forecast.

5.31 These latest forecasts would result in the Scottish Government receiving £145 million less in its Block Grant for 2020-21 and £472 million less in its Block Grant for 2021-22. This shortfall could be made up through resource borrowing, drawdowns from the reserve, or though savings made elsewhere in the budget. The final scale of this reconciliation will be known when the outturn data for 2017-18 are available in summer 2019. The reconciliation for 2018-19 will not be available until summer 2020.

5.32 We note that for 2017-18 income tax, the latest forecast of liabilities is £849 million lower than the forecast used in the 2017-18 Budget, compared to an estimated BGA forecast difference of minus £704 million. If, when the outturn data becomes available the actual balance between the change in BGA and the change in liabilities differs, the reconciliation could be substantially smaller or larger. The reconciliation forecast of minus £145 million presented here is substantially less than the minus £267 million presented in the fiscal framework outturn report, which was based on the latest forecasts available at that time.[192]

[192] Scottish Government (2018) Fiscal Framework Outturn Report (link)

Table 5.5: Latest income tax forecasts compared with the forecasts used in the 2017-18 and 2018-19 Budget

£ million	Revenue	BGA	Difference	Forecast reconciliation
2017-18 Budget				
Forecasts used in Budget	11,857	11,750	107	
Latest forecast of outturn	11,008	11,046	-38	-145
Change	-850	-704		
2018-19 Budget				
Forecast used in Budget	12,177	11,749	428	
Latest forecast of outturn	11,452	11,495	-43	-472
Change	-726	-254		

Source: Scottish Fiscal Commission, Scottish Government, Scottish Government (2017) Draft Budget 2017-18: Updated Income Tax Policy Forecasts (link), Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts Supplementary Publication Updated Income Tax Forecasts (link).
Figures may not sum because of rounding.

Future spending and tax powers

5.33 Three Scotland Act 2016 tax powers, assigned VAT, Air Passenger Duty and Aggregates Levy, are yet to be implemented. Once VAT assignment begins in 2020-21, assigned VAT will be the second largest source of tax revenue after income tax with a forecast revenue of over £5 billion. These taxes will also give rise to BGAs.

5.34 For social security, the first benefit with a BGA was devolved this year, Carer's Allowance. From April 2020 the Scottish Government will be responsible for the remaining benefits to be devolved. As noted in Chapter 4, several of these benefits will have BGAs and be subject to the reconciliation process.

5.35 The increased devolution of tax and spending powers will result in a larger number of reconciliations being required and is likely to result in greater volatility in the Scottish Government's resource budget. This volatility may result in the Scottish Government needing to use resource borrowing powers in future years.

5.36 We will continue to monitor tax and social security reconciliations, and any use of resource borrowing, as more years of outturn data on revenue and spending and BGA forecast differences become available.

The Scotland Reserve

5.37 The Scotland Reserve came into effect in 2017-18 and replaced both the Scotland Act 2012 cash reserve and the Budget Exchange Mechanism. The Scotland Reserve provides the Scottish Government with a cash reserve to build up funds when devolved revenues are higher than forecast and draw down funds when devolved revenues are lower than forecast. It also allows the Scottish Government to carry forward any underspends in both resource and capital budgets.

Table 5.6: Scotland Reserve provisions in the fiscal framework

Resource
No annual limits for payments into the reserve
Annual limit to drawdown of £250 million
Annual drawdown limits waived in face of Scotland specific economic shock
Capital
No annual limits for payments into the reserve
Annual limit to drawdown of £100 million
Annual drawdown limits waived in face of Scotland specific economic shock
Aggregate
The Scotland Reserve is capped in aggregate at £700 million

Source: Scottish Government and UK Government (2016) The Agreement between the Scottish Government and the United Kingdom Government on the Scottish Government's fiscal framework (link)

5.38 The Scotland Act 2012 enabled the Scottish Government to make discretionary payments into a cash reserve in advance of new powers being devolved. Until 2017-18 the Scottish Government was able to carry forward underspends, up to an agreed cap. This process was described as the Budget Exchange Mechanism. The maximum resource budget which could be carried forward was 0.6 per cent of resource spending by the Scottish Government. The maximum capital budget was 1.5 per cent of Scottish Government capital spending.[193] Our May 2018 publication contains more information on the historic use of the Budget Exchange Mechanism.[194]

5.39 The Scotland Reserve is held within the UK Government's Exchequer and is separated between resource and capital, financial transactions form part of the capital reserve.

5.40 Payments may be made into the resource reserve from the resource budget, which includes tax receipts. Funds can be drawn down to fund resource or capital spending. Similarly, payments may be made into the capital reserve from the capital budget but can only be drawn down to fund capital spending.

[193] HM Treasury (2015) Statement of funding policy: funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly (link)

[194] Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – May 2018 (link)

Table 5.7: Use of the Scotland Reserve in 2017-18

£ million	Resource	Capital	Financial transactions	Total
2017-18 opening balance	74			74.0
2017-18 additions to the reserve	366	86.5	11.4	463.9
2017-18 closing balance	440	86.5	11.4	537.9
Additions to the resource reserve were made up of:				
Scotland Act 2016 Implementation Funding	100			
2017-18 LBTT outturn	50			
2017-18 SLfT outturn	-1			
2017-18 Penalties and Interest on devolved taxes	2			
2017-18 Liberty House Guarantee Fee Income	2			
2017-18 Planned Underspend to support 2018-19 spending plans	140			
2017-18 Additional Uncommitted Underspend	73			

Source: Scottish Government.

5.41 The current limits on payments into and drawdowns from the Scotland Reserve are shown in Table 5.6.

5.42 The opening balance of the reserve at the start of 2017-18 was £74 million. This was paid into the reserve in 2015-16 through excess tax receipts from LBTT (£44 million) and SLfT (£30 million).

5.43 The Scottish Government's use of the reserve during the first year of full operation in 2017-18 is summarised in Table 5.7. These figures have been provided to us by the Scottish Government and reflect the final outturn as confirmed to HM Treasury.

5.44 In May 2018, we reported that the Scottish Government estimated £305 million was paid into the resource reserve in 2017-18. The resource estimate was revised up by £53 million in the fiscal framework outturn report and by a further £8 million in the final outturn figure of £366 million now reported by the Scottish Government.

5.45 For capital spending we reported in May 2018 that the Scottish Government estimated £72 million was paid into the Reserve in 2017-18. This estimate was revised up to £95 million in the fiscal framework outturn report and reduced by £8.5 million in the final figure of £86.5 million reported by the Scottish Government.

5.46 The Scottish Government provided the following information on the use of the reserve during 2018-19:

- The estimated drawdown from the resource reserve is £250 million.

- The estimated drawdown from the capital reserve is £85 million.

- The Scottish Government has not provided information on the level of any underspend. Therefore it is not possible to estimate payments into the reserve or the closing balance for 2018-19 at this point.

5.47 The Scottish Government has provided the following information on its planned use of the reserve in 2019-20:

- The 2019-20 Budget anticipates a drawdown of £220 million in resource, £46 million in capital and £47 million in financial transactions from the reserve.

- These amounts will be a mix of underspend arising in 2018-19 and existing reserve balances.

- The level of these drawdowns may change depending on the final levels of underspend from 2018-19. The larger the underspend generated in 2018-19 the lower the drawdown of existing reserve balances is likely to be.

Scotland Reserve assessment

5.48 We note that:

- In May 2018 the Scottish Government informed the Commission of a planned drawdown of £68 million from the capital reserve in 2018-19. This estimate has now increased to a planned £85 million drawdown. This is still within the £100 million limit set by the fiscal framework.

- The planned drawdown from the resource reserve in 2018-19 has increased from £238 million in May to £250 million which is the maximum allowed within the fiscal framework.

5.49 The Scotland Reserve replaced both the cash reserve and the Budget Exchange Mechanism. Therefore, it is expected that the Scotland Reserve will be used to transfer funds between financial years.

5.50 The Scottish Government has stated the planned drawdown from the resource reserve in 2018-19 includes £100 million to support the implementation of new powers as laid out in the fiscal framework.[195] This amount was paid as a one-off transfer in 2017-18. Adjusting for this would

[195] Scottish Government and UK Government (2016) The agreement between the Scottish Government and the United Kingdom Government on the Scottish Government's fiscal framework (link)

bring the planned resource drawdown to slightly higher than the historic use of the Budget Exchange Mechanism, where an average of £124 million in resource funding was transferred between years in the four years prior to 2017-18.

5.51 We note that the Scottish Government plan to draw down a further £220 million in 2019-20 from the resource reserve, which is £30 million less than the maximum allowed under the rules set out in the fiscal framework. For capital spending the planned drawdown of £93 million in 2019-20 is £7 million less than the maximum allowed under the rules set out in the fiscal framework.[196]

[196] Financial transactions count towards the capital drawdown limits. The planned £93 million is made up of £46 million in capital and £47 million in financial transactions.

Annex A
Policy Costings

Introduction

A.1 This annex sets out the methodology we used to produce the costings of new policies included in our forecasts. It shows the different steps and judgments taken to arrive at our costings of new Government policy proposals. As ever, we welcome discussion about the approaches and judgements we have taken.

Previous policy costings

A.2 Our May 2018 publication included costings for policies announced by the Scottish Government at their Medium Term Financial Strategy.

A.3 In September 2018, we costed part of the new Best Start Grant (BSG). This is a form of Early Years Assistance which is provided for in the Social Security (Scotland) Act 2018.[197] Early Years Assistance will replace the UK Government's Sure Start Maternity Grant in Scotland. The Scottish Government laid secondary legislation in the Scottish Parliament for Early Years Assistance (Best Start Grants) on 11 September 2018. On the same day, we published a supplementary policy costing of the benefit expenditure for the BSG Pregnancy and Baby Payment proposed in that secondary legislation.[198]

A.4 Where we have previously provided a policy costing, any further changes will be captured in Annex B on policy recostings. This section only provides costings for policy changes which we have not previously costed.

A.5 Annex C sets out our approach to handling policies with a very small fiscal impact that we do not consider to be material in cost. It also sets out the

[197] Social Security (Scotland) Act (2018) (link)

[198] Scottish Fiscal Commission (2018) Supplementary Costings: Social Security Best Start Grant (Pregnancy and Baby Grant) – September 2018 (link)

Scottish Government's policy on the Young Carer's Grant and explains why we have not produced a costing for this policy.

New policy costings

A.6 Table A.1 provides a summary of new policy costings included in our forecasts. Negative figures indicate costs to the Scottish Budget, whilst positive figures indicate gains.

Table A.1: Policy costings to accompany the Scottish Budget 2019-20

£ million	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Income tax:						
Setting the higher rate threshold at £43,430		68.2	71.5	75.4	79.7	84.4
Non Domestic Rates:						
Poundage for 2019-20		-34.6	-40.0	-40.9	-42.8	-42.3
Continuation of transitional relief		-7.0	-5.5	-3.1		
Rates relief for new fibre investment		0.0	-0.5	-0.9	-1.3	-1.8
Land and Buildings Transaction Tax:						
Increase in the Additional Dwelling Supplement	2.3	25.4	24.2	25.3	25.6	26.0
New tax rates and bands for non-residential LBTT	2.2	13.2	13.7	14.3	14.8	15.3
Social Security:						
Introduction of Best Start Grant Early Learning and School-Age Payments		-6.9	-6.8	-7.3	-7.9	-8.6
Introduction of Best Start Foods		-0.3	-0.6	-0.5	-0.5	-0.5
Introduction of Funeral Expense Assistance		-1.7	-1.8	-2.0	-2.1	-2.3
Overall effect of new policy proposals	4.6	56.4	54.3	60.3	65.4	70.2

Source: Scottish Fiscal Commission
Figures may not sum because of rounding.
Additional Dwelling Supplement figures include effect on Residential Land and Buildings Transaction Tax.

Income tax

Title of measure

Setting the higher rate threshold at £43,430 for 2019-20

Measure description

A.7 The Scottish Government has announced a higher rate threshold of £43,430 in 2019-20, the same as in 2018-19. This higher rate threshold is below our baseline assumption that the higher rate threshold would increase in line with inflation in 2019-20 to £44,481. Setting the higher rate threshold at this level results in more higher rate taxpayers and all those earning above the existing higher rate threshold paying more income tax. This increases income tax receipts. We continue to assume the higher rate threshold will increase by inflation for the remaining forecast years.

A.8 This costing assumes there are no implementation and administration costs, or interactions with UK policies, which will cause changes to liabilities collected.

A.9 Table A.2 sets out our baseline assumption for the higher rate threshold under no policy change, and under this proposed policy.

Table A.2: Higher rate threshold baseline and policy comparison (£)

	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Baseline	43,430	44,481	45,351	46,268	47,247	48,228
Policy	43,430	43,430	44,280	45,175	46,131	47,089
Threshold difference	0	-1,051	-1,071	-1,093	-1,116	-1,139

Source: Scottish Government

A.10 The policy parameters provided by the Scottish Government apply only to 2019-20. We produce a forecast up to 2023-24. Therefore, while not a policy, we judge that the following set of assumptions form a suitable baseline for future rates and thresholds:

- In line with UK Government policy, a personal allowance of £12,500 in 2020-21, the same as in 2019-20, and an annual inflation uplift of the personal allowance using the OBR September CPI inflation forecast thereafter. This method of uplift is consistent with the UK Personal Allowance indexation policy.[199]
- We assume the higher rate threshold will increase in line with the OBR's September CPI inflation forecasts from 2020-21 onwards.

[199] HMT (2018) Budget 2018: policy costings Annex A (link)

- All other thresholds increase in line with the OBR's September CPI inflation forecasts; the only exception is the threshold for the top rate of tax, which we assume remains fixed at £150,000.
- No changes to tax rates.

The cost base

A.11 The cost base is all taxpayers who are considered resident in Scotland for the purposes of taxation. Our income tax model produces a detailed forecast of the number of taxpayers, their incomes and their current tax liabilities.[200] Using a forecast of the distribution of taxpayers and their incomes allows us to estimate the cost of this policy.

A.12 Table A.3 shows how many taxpayers are expected to be in each band in each year of the forecast based on our income tax model. Setting the higher rate threshold at £43,430 in 2019-20 means taxpayers earning between £43,430 and £44,481 will now be higher rate taxpayers, who would otherwise have been intermediate rate taxpayers. We estimate that around 24,000 people will be in this group in 2019-20.

Table A.3: Forecast number of income tax taxpayers by tax band

	2019-20	2020-21	2021-22	2022-23	2023-24
Starter rate	257,100	261,500	264,100	267,800	266,600
Basic rate	1,024,500	1,039,800	1,046,000	1,050,800	1,055,200
Intermediate rate	863,700	894,100	906,700	918,300	932,800
Move to higher rate	23,500	25,700	26,600	27,700	29,200
Higher rate	327,600	336,400	346,500	357,300	370,700
Top rate	15,800	17,000	18,400	20,100	22,000
Total	**2,512,200**	**2,574,400**	**2,608,400**	**2,642,100**	**2,676,500**

Source: Scottish Fiscal Commission.
Figures may not sum because of rounding.

The costing

A.13 The static costing is the cost of the policy assuming the affected taxpayer population does not change their behaviour in response to the policy change. We produce this costing by calculating the change in tax liabilities between the baseline scenario and the policy scenario. Table A.4 and A.5 show the thresholds used in the baseline and policy scenarios. The only difference between Table A.4 and A.5 is the higher rate threshold.

[200] Further details of our modelling approach can be found in the income tax section in Chapter 3 of Scottish Fiscal Commission (2017) Scotland's Economic and Fiscal Forecasts – December 2017 (link) and Scottish Fiscal Commission (2017) Current Approach to Forecasting (link)

Table A.4: Income tax rates and thresholds – baseline

	2019-20	2020-21	2021-22	2022-23	2023-24
Starter rate (%)	19	19	19	19	19
Starter rate threshold (£)	12,500	12,500	12,760	13,030	13,310
Basic rate (%)	20	20	20	20	20
Basic rate threshold (£)	14,549	14,590	14,893	15,209	15,535
Intermediate rate (%)	21	21	21	21	21
Intermediate rate threshold (£)	24,944	25,188	25,705	26,249	26,804
Higher rate (%)	41	41	41	41	41
Higher rate threshold (£)	44,481	45,351	46,268	47,247	48,228
Top rate (%)	46	46	46	46	46
Top rate threshold (£)	150,000	150,000	150,000	150,000	150,000

Source: Scottish Fiscal Commission

Table A.5: Income tax rates and thresholds – policy

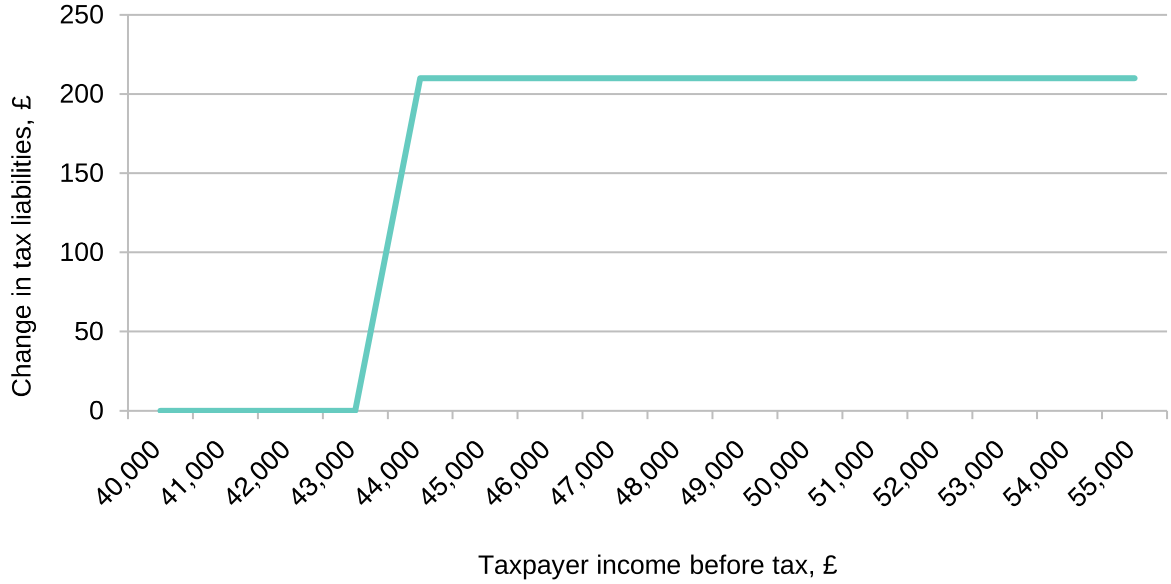
	2019-20	2020-21	2021-22	2022-23	2023-24
Starter rate (%)	19	19	19	19	19
Starter rate threshold (£)	12,500	12,500	12,760	13,030	13,310
Basic rate (%)	20	20	20	20	20
Basic rate threshold (£)	14,549	14,590	14,893	15,209	15,535
Intermediate rate (%)	21	21	21	21	21
Intermediate rate threshold (£)	24,944	25,188	25,705	26,249	26,804
Higher rate (%)	41	41	41	41	41
Higher rate threshold (£)	43,430	44,280	45,175	46,131	47,089
Top rate (%)	46	46	46	46	46
Top rate threshold (£)	150,000	150,000	150,000	150,000	150,000

Source: Scottish Fiscal Commission

A.14 In comparison to the baseline scenario, taxpayers in 2019-20 with gross incomes above £43,430 will pay 20 per cent extra on each pound earned up to a maximum of £210.[201] All taxpayers earning above £44,481 will see an increase of their tax liabilities of £210. Taxpayers earning below £43,430 will see no change in their liabilities as a result of this policy. Figure A.1 is a stylised illustration of how the policy will affect a taxpayer's income tax liability, depending on their income.

[201] For this particular illustrative comparison, we make some stylised assumptions, for example we assume there are no corresponding interactions with income deductions such as pension contributions.

Figure A.1: Individual taxpayer liability change as a result of policy



Source: Scottish Fiscal Commission

A.15 We calculate the additional tax liabilities from all affected taxpayers commonly referred to as the 'Static costing', see Table A.6. This assumes that there will be no change in taxpayer behaviour.

Table A.6: Static costing of income tax policy by income range, £ million

Income range 2019-20 (£)	Tax band	2019-20	2020-21	2021-22	2022-23	2023-24
43,430 – 44,481	Move to higher rate	2	3	3	3	3
44,482 – 150,000	Higher rate	69	72	76	80	84
150,000+	Top rate	3	4	4	4	5
Static costing		**75**	**78**	**83**	**87**	**93**

Source: Scottish Fiscal Commission.
Figures may not sum because of rounding.

A.16 The final step is to take account of how the affected taxpayers may change their behaviour as a result of paying more tax. We published a paper in March 2018 detailing how we cost changes to behaviour as a result of income tax policies.[202] The assumptions we used to cost this policy are consistent with that paper.

A.17 We estimate two broad types of behavioural change. The first is responses to changes in how much tax someone pays on £1 of extra earnings, called marginal effective tax rate (METR). This can affect decisions about how much to earn, known as the intensive margin. We also model the effect of changes in a taxpayers total income tax liabilities, which is summarised by their

[202] Scottish Fiscal Commission (2018) How we forecast behavioural response to income tax policy (link)

average effective tax rate (AETR). This can affect decisions about whether or not to be in employment, or residency decisions, and these are known as extensive margin responses.

A.18 The only group who exhibit an METR response are the taxpayers earning between £43,430 and £44,481 who will now become higher rate taxpayers. For the intensive METR response, we apply a taxable income elasticity of 0.015, in line with our existing behavioural assumptions, and calculate the corresponding behavioural response.

A.19 Table A.7 shows the scale of the intensive METR behavioural response.

Table A.7: Effect of METR behaviour on tax liabilities by income range, £ million

Income range 2019-20 (£)	Tax band	2019-20	2020-21	2021-22	2022-23	2023-24
43,430 – 44,481	Move to higher rate	-1	-2	-2	-2	-2
METR effect		**-1**	**-2**	**-2**	**-2**	**-2**

Source: Scottish Fiscal Commission

A.20 For the extensive AETR response we use an extensive factor of 0.06 for existing higher rate taxpayers and 0.25 for top rate taxpayers. We calculate the corresponding behavioural response showing how much less revenue would be raised, as shown in Table A.8. All taxpayers earning above £44,481 are captured in this response.

Table A.8: Effect of AETR behaviour on tax liabilities by income range, £ million

Income range 2019-20 (£)	Tax band	2019-20	2020-21	2021-22	2022-23	2023-24
44,482 – 150,000	Higher rate	-4	-4	-5	-5	-5
150,000+	Top rate	-1	-1	-1	-1	-1
AETR effect		**-5**	**-5**	**-6**	**-6**	**-6**

Source: Scottish Fiscal Commission.

Figures may not sum because of rounding.

A.21 The total change in revenue because of the cumulative METR and AETR behavioural response is shown in Table A.9.

Table A.9: Effect of behaviour on tax liabilities by income range, £ million

Income range 2019-20 (£)	Tax band	2019-20	2020-21	2021-22	2022-23	2023-24
11,850 – 13,850	Starter rate	0	0	0	0	0
13,850 – 24,000	Basic rate	0	0	0	0	0
24,000 – 43,430	Intermediate rate	0	0	0	0	0
43,430 – 44,481	Move to higher rate	-1	-2	-2	-2	-2
44,482 – 150,000	Higher rate	-4	-4	-5	-5	-5
150,000+	Top rate	-1	-1	-1	-1	-1
Total behavioural effect		**-6**	**-7**	**-7**	**-8**	**-8**

Source: Scottish Fiscal Commission.
Figures may not sum because of rounding.

A.22 Combining the static and behavioural costings results in the final post-behaviour costing shown in Table A.10.

Table A.10: Final costing of income tax policy, £ million

£ million	2019-20	2020-21	2021-22	2022-23	2023-24
Static costing	75	78	83	87	93
Behavioural change of which:	-6	-7	-7	-8	-8
METR effect:	-1	-2	-2	-2	-2
AETR effect:	-5	-5	-6	-6	-6
Post-behavioural costing	**68**	**71**	**75**	**80**	**84**

Source: Scottish Fiscal Commission.
Figures may not sum because of rounding.

Uncertainties around the costing

A.23 The key uncertainty in the costing is the taxpayer behavioural response. We discussed the evidence around our approach in our March 2018 report. The behavioural response could be either higher or lower than estimated. Although we will continue to monitor the available evidence on behaviour, it is difficult to isolate behavioural responses amongst other factors that affect tax revenues, even where extensive data are available.

A.24 The costing is derived from our main income tax forecasting model, using our latest forecasts of Scottish wages and employment. Forecasts for these components are subject to their own uncertainties which may affect the costing presented above.

A.25 We will continue to update this costing at future fiscal events, until the 2019-20 outturn information is available in summer 2021.

Non-Domestic Rates (NDR)

Title of measure

Setting the poundage at 49.0 pence in 2019-20

Measure description

A.26 The Scottish Government has confirmed the poundage will be set at 49.0 pence in 2019-20. This is lower than if the poundage had been uprated by either CPI or RPI.

A.27 Our baseline assumption was the Scottish Government's previous policy, which was to uprate the poundage by RPI in 2019-20 before switching to uprating by CPI from 2020-21 onwards. This, and the poundage used in our forecast following the policy announcement, are shown in Table A.11. From 2020-21 onwards, current Government plans are for the poundage to be uprated using CPI.

Table A.11: Poundage for NDR, pence

	2019-20	2020-21	2021-22	2022-23	2023-24
Poundage before announcement	49.6	50.6	51.6	52.7	53.8
Poundage after announcement	49.0	49.9	50.9	52.0	53.1

Source: Scottish Government

The cost base

A.28 This measure affects the entire NDR tax base, so the cost base for this measure is our latest forecast of NDR income.

The costing

A.29 The costing compares NDR income over our five-year forecast between two scenarios:

- the Scottish Government's policy baseline, which was to uprate the poundage by RPI in 2019-20
- Poundage of 49.0 pence in 2019-20

A.30 For both scenarios, OBR forecasts of Q3 CPI are used to estimate the poundage in subsequent years.

A.31 Comparison between these two scenarios shows NDR income to be £35 million lower in 2019-20 as a result of this change. This reduction in revenue is carried through each year of the forecast.

Table A.12: Costing for setting poundage at 49.0 pence in 2019-20

£ million	2019-20	2020-21	2021-22	2022-23	2023-24
Effect on NDR income	-35	-40	-41	-43	-42

Source: Scottish Fiscal Commission

Uncertainties around the costing

A.32 There is a low level of uncertainty attached to this costing, given that the poundage for 2019-20 has been confirmed by Government as opposed to being based on a forecast of inflation. The main uncertainty from 2020-21 onwards comes from the forecast for CPI inflation.

Title of measure

Continuation of transitional relief to the end of the current revaluation cycle

Measure description

A.33 At the 2017-18 Budget the Scottish Government announced transitional relief for the hospitality sector and offices in Aberdeen and Aberdeenshire following the 2017 revaluation. The relief was set at a 12.5 per cent real terms cap in the gross NDR bill faced by eligible properties. This was extended again at the 2018-19 Budget, and has now been confirmed as continuing until the end of the current revaluation cycle in 2021-22.[203]

A.34 In practice this means an eligible property in 2019-20 will pay no more than a 53 per cent increase on their 2016-17 NDR bill. Table A.13 outlines the actual and forecast real-terms caps that will apply to the relief.

Table A.13: Real-terms caps for transitional relief

Per cent	Transitional relief cap	Annual increase in poundage	Real-terms transitional relief cap on 16-17 gross bill
2017-18	12.5	2.0	15
2018-19	12.5	3.0	33
2019-20	12.5	2.1	53
2020-21	12.5	1.8	75
2021-22	12.5	2.0	101

Source: Scottish Government, OBR (2018) Economic and Fiscal Outlook October 2018, supplementary economy tables (link).
As per Scottish Government policy, CPI is used as the measure of inflation in all years apart from 2019-20, which was calculated using the poundage rates for 2018-19 and 2019-20. OBR forecasts of Q3 CPI are used to uprate the poundage in years post 2019-20.

The cost base

A.35 We calculated the cost base for this relief by estimating the number of properties that:

- would be liable for NDR from 2018-19;
- would experience an increase in NDR greater than the cap; and,
- are hospitality sector properties or offices in Aberdeen and Aberdeenshire.

A.36 We matched snapshots of the valuation roll from April 2017 and March 2017 (prior to the revaluation), then removed entries that do not appear on a

[203] Scottish Government (2018) Business rates cap announcement 26 October 2018 (link)

snapshot of the 2018 roll. Filtering for properties in the hospitality sector and offices in Aberdeen and Aberdeenshire that will experience increases to their NDR bill greater than the transitional cap in each year of the policy, gives the cost base for this relief. This is shown in Table A.14.

Table A.14: Number of properties experiencing an increase in NDR bill greater than transitional relief cap

	Hospitality sector	Aberdeen / Aberdeenshire offices
2019-20	3,148	174
2020-21	2,076	116
2021-22	1,400	90

Source: Scottish Fiscal Commission analysis of the Valuation Roll.

The costing

A.37 We start by estimating the cost of capping the change in gross bills between 2016-17 and each year for which the policy has been confirmed.[204] In 2019-20 this is equal to £13.7 million for the hospitality sector and £0.2 million for offices in Aberdeen and Aberdeenshire. As outlined in our December 2017 publication, there are several factors that will reduce the cost of this policy in practice: some properties will already be claiming the Small Business Bonus Scheme, the amount of transitional relief that can be claimed for a property is limited by EU state aid rules, and the likely take-up rate.[205]

A.38 To account for these, we first use a data source named the billing system, which contains a record of entries on the valuation roll claiming relief at a set point in time. This allows us to account for properties already claiming the Small Business Bonus Scheme. Incorporating this information reduces our static costing by £1.7 million in 2019-20.

A.39 Secondly, we account for state aid factors which limit the amount businesses can claim to a maximum of €200,000 over a rolling three-year period.[206] State aid limits apply to the amount of relief that can be claimed by a business rather than an individual property. With the data available we cannot capture this distinction, so we apply the state aid limit to individual properties. Incorporating this effect reduces our costing by an additional £1.2 million in 2019-20.

[204] The Gross Bill is the NDR payable before reliefs are taken into account. It is calculated as the rateable value of the property multiplied by the relevant tax rate (the 'poundage').

[205] See paragraphs A.42 to A.44 on page 202 of Scottish Fiscal Commission (2017) Scotland's Economic And Fiscal Forecasts – December 2017 (link)

[206] The €200,000 limit is calculated on the day of offer of the relief using the European Commission exchange rate from that day. For our costing, we have used the average exchange rate this year as at 27 November 2018 which is equal to £176,977

A.40 We make a final adjustment to account for other factors that will reduce expenditure on the relief, including awareness among ratepayers of their eligibility, the administration of the relief and other factors. We calculate the difference between a costing for transitional relief in 2017-18 assuming full take-up and the audited local authority expenditure figures. We assume this take-up rate continues for future years, and apply this to our costing in future years. In 2019-20 this reduces our costing by £4 million.

A.41 The final costing for extending transitional relief until the end of this revaluation cycle is presented in Table A.15.

Table A.15: Costing for extension of transitional relief

£ million	2019-20	2020-21	2021-22
Hospitality	-6.9	-5.4	-3.1
Offices in Aberdeen and Aberdeenshire	-0.1	-0.1	-0.0
Total	-7.0	-5.5	-3.1

Source: Scottish Fiscal Commission

Uncertainties around the costing

A.42 There are two main areas of uncertainty. We are unable to fully account for the number of properties that will be ineligible for transitional relief because of EU State Aid rules. This is because there are insufficient data available. The cost of the reliefs may therefore be lower than our estimates.

A.43 The take-up rate for the relief is the other source of uncertainty. Data on relief claimed by ratepayers in the hospitality sector presented in our Forecast Evaluation Report suggest the take-up rate was lower than assumed in our December 2017 costing, which was estimated using the same methodology as this costing. The Commission will continue to monitor outturn data once available and publish an evaluation of this costing once final outturn data for 2019-20 is available from local authorities in December 2020.

Title of the measure

100 per cent rates relief for new fibre investment for ten years

Measure description

A.45 The Scottish Government has announced a relief for new fibre investment, applying for ten years from April 2019. The relief is also available for fibre that has been laid prior to April 2019 which is not yet lit (known as 'dark fibre') and is subsequently lit after 1 April 2019.[207] Where fibre forms a part of an entry on the valuation roll it is anticipated Assessors will be required to attribute a portion of the rateable value to fibre to allow relief entitlement to be calculated.

The cost base

A.46 The cost base for this measure is the growth in rateable value (RV) owing to new fibre.

The costing

A.47 The starting point for this costing is the RV of fixed-line telecoms entries on the valuation roll that are attributable to fibre. Certain entries are made entirely of fibre, while others such as the entry for BT consist of the total value of their copper, fibre, and related telecoms infrastructure assets.

A.48 To estimate RV attributable to fibre, we combine the RV of entries on the roll made up entirely of fibre, while for entries where the RV is split between multiple assets we take a proportion of the total RV.[208] We use data from Ofcom on the availability of ultrafast broadband in Scotland as a proxy for the proportion of telecoms RV that may be related to fibre assets.[209] Based on this method, RV attributable to fibre is estimated at £39 million in 2018-19.

A.49 Various operators in this industry have announced plans for investment in fibre broadband. It is unclear to what extent these ambitions will be realised and, if they are, what the associated effect would be on RV.[210] There is also a lack of Scottish-specific information as the majority of statements from operators give ambitions for investment at the UK level only. Over the last revaluation cycle, the entries identified for this costing experienced only limited growth in their RV.

A.50 Given these uncertainties and the lack of available evidence we have taken a simple approach to producing our costing. We use our current forecast for

[207] Fibre is described as being 'lit' if it is transmitting a signal and 'dark' if it is not. As the cost of installing the fibre is high, companies will lay an excess amount of cable over and above what is immediately required.

[208] We note that the two highest value entries on the VR that include fibre (BT and Virgin Media) have entries split across multiple assets.

[209] Ofcom (2018) Connected Nations update: October 2018 (link)

[210] ISPreview (2018) Who is building – UK summary of full fibre broadband plans and investment update (link)

private gross fixed capital formation in Scotland to grow the estimate of RV attributable to fibre in 2018-19, giving an estimate of additional fibre RV of £0.9 million in 2019-20. This is multiplied by the poundage and large business supplement to give an initial estimate for the cost of the relief of £0.4 million.

A.51 An additional effect of the policy is modelled to account for the interaction with expenditure on the Business Growth Accelerator, which currently provides 100 per cent relief for 12 months to newly constructed properties. Without the introduction of fibre relief, any investment in new fibre could potentially have claimed the Business Growth Accelerator, meaning fibre relief reduces expenditure on the Business Growth Accelerator. In 2019-20 this leads to a net cost of nil, rising to £0.5 million in 2020-21.

Table A.16: Costing for fibre relief

£ million	2019-20	2020-21	2021-22	2022-23	2023-24
Effect on Business Growth Accelerator	0.4	0.4	0.4	0.4	0.4
Fibre relief	-0.4	-0.9	-1.3	-1.8	-2.2
Net cost of fibre relief	0.0	-0.5	-0.9	-1.3	-1.8

Source: Scottish Fiscal Commission

A.52 Given the lack of evidence that we can use in producing our costing, we have cross-checked our results against published estimates for the cost of the relief completed by HM Treasury for England.[211] We scale this estimate for Scotland, based on the Scottish share of fixed line telecoms RV, which results in an estimate at a similar scale to our costing presented above.

Uncertainties around the costing

A.53 Given the limited data available, there are several uncertainties for this costing. Firstly, the estimate of current fibre RV on the valuation roll is based on proxy information that could over or understate the true value. Secondly, current RV attributable to fibre may be lowered as the result of successful appeals relating to the 2017 revaluation.[212] Thirdly, our method of estimating the growth in RV may also underestimate investment in this sector given the ambitious plans announced by some operators in this industry. The wide-scope of the relief, covering both newly laid fibre and also dark fibre, may incentivise operators to expand investment beyond what they had previously planned. Finally, although our costing for Scotland is the expected scale when compared to Treasury estimates for England, the broader scope of the relief in relation to newly lit dark fibre could mean the costs are greater in practice.

[211] HM Treasury (2016) Autumn Statement 2016: policy costings (link)

[212] Based on information as at 4 December 2018, BT has already had a successful revaluation appeal that reduced its RV from £64 million at the start of the revaluation to £47 million.

Land and Buildings Transactions Tax (LBTT)

Title of measure

Increase in the Additional Dwelling Supplement (ADS) rate from three per cent to four per cent

Measure description

A.54 ADS is chargeable where a transaction is for an additional dwelling sold for over £40,000. Examples include a homeowner purchasing a buy-to-let property or a holiday home. ADS is also payable when someone who owns only one house completes on the purchase of their new house before selling their existing home. In this case, provided the existing home is sold within 18 months of the purchase of the new home (referred to as a ‘transfer of main residence’), the buyer can reclaim the ADS paid up to five years after the ADS transaction. We refer to revenue raised prior to repayments as ‘gross’, and once refunds are claimed as ‘net’.

A.55 The Scottish Government will raise the tax rate on ADS from three per cent to four per cent. This will come into effect on 25 January 2019. All other elements of the tax remain unchanged.

The cost base

A.56 The cost base is all transactions for which ADS is declared due. In 2017-18, there were 23,750 such transactions and a similar number of transactions is expected in 2018-19 and 2019-20. This represents 23 per cent of all properties submitting a residential LBTT return.

The costing

A.57 We start by estimating the distribution of gross ADS (before any refunds), based on our forecasts for prices and transactions. We then apply a three per cent tax rate to the transactions that fall before 25 January 2019 and a four per cent tax rate thereafter. We also adjust our costing to account for forestalling in advance of the policy change (transactions being brought forward to avoid the new higher tax). The effect of these changes on net ADS revenue is shown in Table A.17.

Table A.17: ADS rate change effect on net ADS revenue

£ million	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Additional net ADS revenue	2.2	27.3	25.5	26.7	27.4	28.1
of which:						
Additional net revenue	1.6	27.8	25.5	26.7	27.4	28.1
Forestalling	0.6	-0.6	0.0	0.0	0.0	0.0

Source: Scottish Fiscal Commission.
Figures may not sum because of rounding.

A.58 To calculate the longer-term response by taxpayers to the policy change (the behavioural effect) we compare the effective tax rates under the old and new systems. We estimate how many ADS transactions will be lost as a result of the higher tax rate, and what the effect on average ADS-liable house prices will be, using the OBR elasticities.[213] See paragraphs A.67 to A.69 for further information on these longer term behavioural effects.

Table A.18: ADS rate change effect on net ADS revenue (excl. forestalling)

£ million	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Change in gross ADS	1.8	33.6	34.1	35.9	36.9	37.9
of which:						
Static costing	2.7	42.6	43.9	45.3	46.6	47.9
Behavioural effect	-0.9	-9.0	-9.9	-9.4	-9.7	-10.0
Change in repayments	-0.2	-5.7	-8.6	-9.2	-9.5	-9.8
of which:						
Static costing	-0.2	-7.3	-11.0	-11.6	-12.0	-12.3
Behavioural effect	0.1	1.6	2.4	2.5	2.5	2.6
Change in net ADS	1.6	27.8	25.5	26.7	27.4	28.1

Source: Scottish Fiscal Commission.
Figures may not sum because of rounding.
The revenue impact of the change in repayments is negative because the Scottish Government will have to pay relatively more in repayments because of the higher ADS rate.

A.59 We then adjust for transactions where a transfer of main residence will occur in the following 18 months and a claim made within five years. We use the repayment rates from our main ADS forecast, applied to the gross revenue change, to estimate how much ADS is reclaimed and how quickly it is

[213] OBR (2017) Supplementary forecast release – SDLT elasticities (link)

reclaimed. It takes 21 months for repayments for tax paid at the four per cent rate to fully filter through into our costing.[214]

A.60 We estimate that excluding forestalling, an additional £27.8 million net ADS revenue will be raised in 2019-20.

Residential LBTT

A.61 As ADS-liable transactions also pay the main residential LBTT, the effect of the policy change on transactions and prices also has an effect on residential LBTT. The net effect, accounting for forestalling, is a reduction in revenues of £1.8 million in 2019-20.

Table A.19: ADS rate change post-behavioural effect on residential LBTT

£ million	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Change in residential LBTT	0.1	-1.8	-1.3	-1.4	-1.8	-2.1
of which:						
Net revenue	-0.1	-1.5	-1.3	-1.4	-1.8	-2.1
Forestalling	0.3	-0.3	0.0	0.0	0.0	0.0

Source: Scottish Fiscal Commission.
Figures may not sum because of rounding.

Forestalling

A.62 We have used the experience of the introduction of ADS in 2016-17 to estimate the scale of forestalling. While the current policy change differs to 2016-17, it is a good comparator as it affects the same section of the market.

A.63 Our methodology follows the approach laid out in the OBR's working paper on property market forestalling.[215] To estimate the number of transactions brought forward, we have increased the standard behavioural elasticity for transactions based on the historical precedent of the introduction of the ADS on 1 April 2016. Data on that event suggests an elasticity nearly three times larger than the standard one. We use an elasticity of 18 as opposed to the standard elasticity of 7.

A.64 We estimate that 500 transactions will be brought forward into January 2019 to avoid the tax increase. The majority of forestalled transactions are expected to be brought forward from February and March, which fall within 2018-19. We estimate that £2 million in net ADS revenue will be brought forward into

[214] As set out in Chapter 3, we have extended our repayment period in our model by three months to 21 months, in light of more recently available data.

[215] See paragraph 2.30 on page 16 of OBR (2016) Working Paper No. 10 – Forestalling ahead of property tax changes (link)

January. The revenue loss from February and March will be slightly larger, at £2.7 million, owing to the higher tax rate in that period.

A.65 Of the 500 forestalled transactions, we estimate that just 90 will be brought forward from 2019-20 into 2018-19. This reduces our 2019-20 ADS costing by £0.6 million. The main reason for such a low number of transactions is the mid-January implementation date. Introducing the change six weeks after announcement means the capacity to forestall transactions planned for April or May is likely to be low, even accounting for a high responsiveness of ADS taxpayers to rate changes.

A.66 Forestalling leads to a revenue gain of £0.8 million in 2018-19 and a revenue loss of £0.9 million in 2019-20. Both main residential and ADS revenues are affected. Table A.20 shows the contributions of each to the overall estimate.

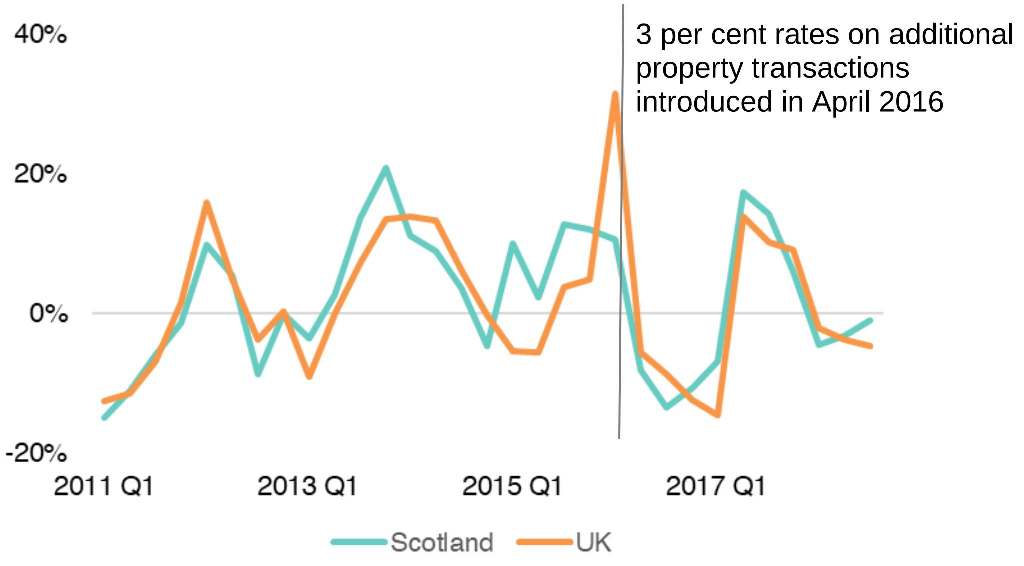
Table A.20: Breakdown of revenue effect of forestalling

£ million	2018-19	2019-20
Residential LBTT	0.3	-0.3
ADS	0.6	-0.6
Total	0.8	-0.9

Source: Scottish Fiscal Commission.
Figures may not sum because of rounding.

A.67 We do not make any further adjustment to our forestalling estimate to account for the possible impact on home movers via buyer chains. There are two reasons, firstly the number of additional property purchases that forestall is very small. Secondly, whereas in the UK, the introduction of the Additional Property Surcharge in 2016 saw a temporary surge in home mover transactions, there was no equivalent reaction of note in Scotland, see Figure A.2.

Figure A.2: Change in home mover mortgaged transactions in Scotland and the UK (year-on-year per cent change)



Source: UK Finance (link)

Long-term effect on transactions

A.68 We estimate that approximately 800 ADS-liable transactions will be lost annually from 2019-20 onwards as a result of the tax increase. The tax change applies only to the ADS segment of the market (23 per cent of all transactions) rather than the market as a whole. The rest of the market (first time buyers and home movers) is in a position to absorb most of the 800 average annual lost ADS transactions. We assume that 50 per cent of transactions lost to ADS will be initially replaced in the residential market and that the replacement rate will increase to 75 per cent from 2020-21. Table A.21 in the uncertainties section illustrates how our costing would change if this assumption were to vary by 25 percentage points either side.

A.69 First time buyers (FTB) that may purchase some of the lost ADS transactions face a different tax schedule. This is because of the FTB relief available, meaning that the zero tax threshold is effectively raised to £175,000. To assess the share of displaced transactions purchased by FTBs, we match the distribution of ADS transactions with the distribution of FTB transactions from our FTB relief costing. The replacement of lost transactions by FTBs claiming relief has a negligible effect on the costing.

Effect on house prices

A.70 We estimate that the average price of additional property transactions in 2019-20 will be £3,600 lower than it otherwise would have been, as buyers adjust to accommodate the extra tax payable. The overall market average price for homes will be reduced by £800.

Uncertainties around the costing

A.71 There is uncertainty about the extent of the behavioural response to the policy change. The costing uses OBR elasticities for the UK. Following a careful examination of the available Scottish data, we have concluded that at this current juncture, there is insufficient basis to move away from using the OBR elasticities for the UK as a whole. We note that the OBR places a high degree of uncertainty around these estimates and agree with this judgement.

A.72 There is uncertainty around the extent of the replacement of lost ADS transactions. We assume that the ADS policy does not have an effect on new housing supply coming onto the market, and that over the long-term 75 per cent of lost ADS transactions will be picked up in the main residential market. Table A.21 presents sensitivity analysis for the policy costing, using a selection of alternative replacement rates. Shaded cells show our policy costing.

Table A.21: Policy costings under different assumptions for the replacement rate, £ million

Replacement rate assumption (%)	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
50	2.3	25.4	22.2	23.4	23.8	24.1
75	2.6	27.5	24.2	25.3	25.6	26.0
100	2.9	29.6	26.2	27.1	27.5	28.0

Source: Scottish Fiscal Commission

The replacement rate is the percentage of lost ADS transactions purchased by another buyer. The table covers the effect on ADS and residential LBTT revenue. Cells shaded in light green show our policy costing.

A.73 There is uncertainty about the number of home mover transactions that may be linked via a chain to ADS transactions. The experience of the UK around the introduction of the three per cent surcharge on additional properties shows that there is a potentially significant connection between the ADS market and the home mover market. As reliable data on buyer chains do not exist, we characterise this issue as a risk to our costing: any effect this may have would be on residential LBTT revenue raised.

A.74 The final uncertainty is that the policy costing is based on our forecasts for the housing market and ADS receipts. Thus, the estimates here will depend on the accuracy of our forecasts for house prices, transactions and the share of gross ADS paid that is subsequently reclaimed.

Title of measure

Change to non-residential LBTT tax rates and bands

Measure description

A.75 Non-residential LBTT is a tax applied to commercial land and buildings transactions (including commercial conveyances and leases) where a chargeable interest is acquired. Property in a land transaction is non-residential if the main subject matter of the transaction consists of, or includes an interest in, land that is non-residential property, or the transaction is one of a number of linked transactions and the main subject matter of any of these transactions consists of or includes such an interest.

Table A.22: Current non-residential tax rates and bands for conveyances

Tax Band (£)	Tax Rate (%)
0 to 150,000	0
150,000 to 350,000	3
Above 350,000	4.5

Source: Revenue Scotland (link)

A.76 The Scottish Government has announced a new tax structure applying to conveyances. This reduces the starting point of the upper rate threshold from £350,000 to £250,000, and increases the upper rate from 4.5 per cent to 5 per cent. The lower threshold rate (which will now apply on conveyances valued between £150,000 and £250,000) is reduced from 3 per cent to 1 per cent. The tax rates apply to the portion of the purchases falling into the respective tax band. These changes will come into effect on 25 January 2019. They will be made via secondary legislation. All other elements of the existing non-residential LBTT policy remain unchanged.

Table A.23: Tax rates and bands for conveyances from 25 January 2019

Tax Band (£)	Tax Rate (%)
0 to 150,000	0
150,000 to 250,000	1
Above 250,000	5

Source: Scottish Government

A.77 Under the new system, conveyances valued above £350,000 will be paying more tax, and conveyances transactions between £150,000 and £350,000 will pay less.

The cost base

A.78 The cost base is all conveyances for which non-residential LBTT is declared due. In 2017-18 there were 3,570 transactions.[216] Of these 1,460 were below

[216] Revenue Scotland effective date data (link)

£350,000 and in the lower rate tax band and 2,110 were in the higher rate band.

The costing

A.79 The costing is based on our forecast for the distribution of non-residential transactions. We apply the current tax system to conveyances that fall before 25 January 2019 and the new tax system thereafter. This provides us with the static policy costing. Using our forecast for the 2019-20 distribution, we have estimated that in 2019-20 1,520 transactions will see a tax cut, and 2,230 transactions will see a rise for January onwards.

A.80 To calculate the longer-term response by taxpayers to the policy change (the behavioural effect) we compare the effective tax rates under the old and new systems. We use the OBR elasticities for prices and transactions.[217] These allow us to estimate the number of transactions that will be either lost or gained as a result of the policy change as well as the effect on the average market price. The behavioural effect on transactions and prices reduces LBTT revenue by around £5 million each year from 2019-20 onwards, as shown in Table A.24.

Table A.24: Breakdown of policy costing for non-residential LBTT conveyances

	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Static costing	3	18	18	19	20	20
Behavioural effect	-1	-5	-5	-5	-5	-5
Change in non-residential LBTT	2	13	14	14	15	15

Source: Scottish Fiscal Commission.
Figures may not sum because of rounding.

A.81 Many non-residential transactions claim relief and we make an adjustment in our forecast model to reflect this. Owing to the relatively modest scale of change in effective tax rates for higher value transactions, we maintain our assumption that the distribution of reliefs claimed in the past is representative of the pattern of reliefs we will observe in the future.

Forestalling

A.82 We make an adjustment to reflect forestalling in advance of the policy change, based on uplifted OBR transaction elasticities. We have assumed that the forestalling all occurs within 2018-19. We estimate that around 20 transactions above £350,000 will be brought forward from February and March into January, and that around 10 transactions below £350,000 will be postponed

[217] OBR (2017) Supplementary forecast information release – elasticities for Stamp Duty Land Tax (link)

until after 25 January 2019 in response to the tax changes to avoid paying higher taxes.

A.83 Our behavioural elasticity for forestalling is higher than that in the rest of the costing. This is consistent with previous documented episodes in the residential market, in which behavioural responses are often greater than the longer term average.[218] We use a similar assumption to that used in our ADS costing. In our costing, all transactions brought forward come from February and March 2019.

A.84 This leads to a minimal adjustment to our 2018-19 costing. As all of the forestalling occurs in 2018-19, there is no adjustment made to the 2019-20 costing. It is important to note that although the net adjustment to our in-year forecast is very small, our forestalling estimate is that £2.3 million in LBTT is lost from February and March and brought forward into January.[219] This is around 1 per cent of annual non-residential LBTT revenue raised.

Effect on transactions

A.85 The effect of the policy change is to increase the number of transactions below £350,000 by an average of 30 per year, and reduce the number of transactions above £350,000 by on average 25 per year from 2019-20 onwards.

Effect on prices

A.86 The effect of the policy change is to reduce the average market price in our forecast by 0.6 per cent in 2019-20.

Uncertainties around the costing

A.87 There is uncertainty around the behavioural elasticities we use in our costing. The costing outwith forestalling uses OBR elasticities for the UK. We note that the OBR places a high degree of uncertainty around these estimates and agree with this judgement. There is no strong evidence to support a precise forestalling elasticity. We have uplifted the commercial transactions elasticities in our forestalling estimates to reflect that there may be a larger incentive to forestall higher value transactions, as the amount of tax saved would be larger.

A.88 The influence of a very small number of high value transactions in the forecast creates additional uncertainties. As set out in Chapter 3, December and March are months in which many very high value transactions occur. A small number of unanticipated high value March transactions being brought forward

[218] See paragraph 2.30 on page 16 of OBR (2016) Working Paper No. 10 – Forestalling ahead of property tax changes (link)

[219] The revenue added in January is slightly smaller in absolute value than that lost in February and March owing to the difference in tax rates before and after.

ahead of the tax change might lead to greater in-year revenue forestalling than previously anticipated.

A.89 Once the tax change is announced we expect some transactions to be forestalled ahead of the introduction of the tax change. We have assumed that all of the forestalling happens within the 2018-19 financial year. Alternatively, it could be assumed that some transactions may also be brought forward from April 2019. In this case, we estimate £0.5 million of revenue would be brought forward from 2019-20 into 2018-19.

Social Security

Title of measure

Introduction of Best Start Grant Early Learning and School-Age Payments

Measure description

A.90 Best Start Grant (BSG) consists of three grants paid to low income families at different points in a child's life. BSG is a form of early years assistance which is provided for in the Social Security (Scotland) Act 2018.

A.91 In September 2018, we costed the Pregnancy and Baby Payment which refers to the early years assistance given in connection with having, or expecting to have, a new baby.[220]

A.92 We now provide costings for the Early Learning Payment (given in connection with a child aged between two and three and half years old) and the School-Age Payment. Details on the full proposals for the Early Learning Payment and the School-Age Payment can be found in the Scottish Government consultation.[221]

A.93 We describe below the policy details that we expect to have an effect on expenditure.

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[220] Scottish Fiscal Commission (2018) Supplementary Costings: Social Security Best Start Grant (Pregnancy and Baby Grant) – September 2018 (link)

[221] Scottish Government (2018) Early Years Assistance, Consultation on the Best Start Grant Regulations (link)

Table A.25: Early Learning Payment and School-Age Payment policy description

Policy detail	Early Learning Payment	School-Age Payment
Payment amount	£250	£250
Qualifying Benefits	a) Child Tax Credit b) Working Tax Credit c) Income based Jobseeker's Allowance d) Income related Employment Support Allowance e) Income Support f) Pension Credit g) Universal Credit at an award level greater than £0 in the month of or the month before the application is made h) Housing Benefit	Same as Early Learning Payment
Application window	One and a half year window: The day of the child's second birthday to six months after its third birthday. The long nursery window is to capture the two common ages for starting nursery, depending on whether parents qualify for a free nursery place when the child is two or three.	Nine month window: 1 June in the year the child would normally start school (August) until 28 February in the year after.

Source: Scottish Government (2018) Early Years Assistance, Consultation on the Best Start Grant Regulations (link).

The cost base

A.94 Expenditure for the Early Learning and School-Age Payments is based on the number of children in Scotland whom we expect to be eligible. We consider the number of children at the relevant ages and how many of these children are living in households that are in receipt of one of the qualifying benefits listed in Table A.25. We then consider how many parents would take-up the support.

A.95 We use population projections from the Office for National Statistics (ONS) to determine the number of children in each year of the forecast aged two to three and a half years old for the Early Learning Payment and children who are five years old, on average, for the School-Age Payment.[222]

A.96 We use information from the Family Resources Survey and the Policy Simulation Model (PSM) from the Department for Work and Pensions (DWP) to inform our assumptions of how many children we expect to be living in a household in receipt of one of the qualifying benefits for BSG.[223]

The costing

A.97 Table A.26 provides the forecast expenditure for BSG Early Learning and School-Age Payments.

Table A.26: BSG Early Learning and School-Age Payments policy costing

£ million	2019-20	2020-21	2021-22	2022-23	2023-24
Early Learning Payment	3.7	3.4	3.7	4.0	4.3
School-Age Payment	3.2	3.5	3.7	3.9	4.3
Total	6.9	6.8	7.3	7.9	8.6

Source: Scottish Fiscal Commission.
Figures may not sum because of rounding.

A.98 We have expanded the model we use to produce forecasts for Sure Start Maternity Grant and the BSG Pregnancy and Baby Payment. We described that modelling approach in our occasional paper that we published in September 2018.[224] We consider the population who are in scope, how many of these individuals would be eligible and then how many parents would take-up the support.

A.99 Finally, we calculate expenditure by multiplying the expected number of payments in each forecast year with the payment amount of £250. The Scottish Government currently has no plans to uprate the payment amount, although this decision will be revisited annually as part of the Scottish Budget process.

Take-up rates

A.100 We use the term ‘take-up rate’ to refer to the estimated proportion of the eligible population who claim a benefit. Once we have estimated the number of eligible children (as described above), we apply a take-up rate to this group to determine the number of payments expected in each forecast year.

[222] ONS (2017) 2016-based Population Projections, 50 per cent EU Migration Variant Population projections Scotland (link)

[223] DWP Family Resources Survey (link)

[224] Scottish Fiscal Commission (2018) Approach to Forecasting – Social Security – September 2018 (link)

A.101 We estimate take-up rates as there are not currently data on uptake of Sure Start Maternity Grant or the new BSG payments. Surveys such as the Family Resources Survey are the best source of information to help inform our assumptions but even these have limitations. The Early Learning and School-Age Payments are new benefits and there have not been comparable UK benefits on which we could base take-up rate estimates.

A.102 The Scottish Government will actively be promoting take-up based on an agreed marketing and communication plan. The stages of this plan are well developed for 2019-20 with a take-up campaign in spring. Some of this communication will be direct through media such as radio and newspapers, as well as raising awareness with supporting organisations such as health services, local authorities and third sector organisations.

A.103 As noted for our costing of the Pregnancy and Baby Payment, the current UK benefit, Sure Start Maternity Grant, is well embedded in the financial inclusion work done by health visitors.[225] BSG will take its place in the routine enquiries carried out by health professionals about financial issues.

A.104 The application process is expected to be easier for BSG than for similar UK benefits such as Sure Start Maternity Grant. Social Security Scotland will take applications online, on the phone and through paper forms. For the Early Learning and School-Age Payments, applicants have to tick the benefits they receive for the children they are responsible for, along with basic information about the child such as their age. Verification will be performed by Social Security Scotland rather than individuals having to evidence receipt of the qualifying benefits.

A.105 The School-Age Payment for children starting school in August has a nine month application window and the Early Learning Payment has a one and a half year application window. Longer application windows would typically result in a higher take-up rate as there is more time for individuals to become aware of the support and make an application.

A.106 The Scottish Government plans to align the application process for BSG and Best Start Foods. Our policy costing for Best Start Foods can be found in the next section of this annex. Best Start Foods will be paid up until the child reaches age three so this may potentially increase take-up for Best Start Grant. In Year 1 (2019-20) there will be a managed migration of Healthy Start Voucher recipients to Best Start Foods; as they re-apply for Best Start Foods they can apply for BSG on the same form.

A.107 There are inevitable downwards pressures on take-up that accompany any new system or process. Claimants may initially apply to DWP instead of

[225] Scottish Fiscal Commission (2018) Supplementary Costing – Social Security – Best Start Grant (Pregnancy and Baby Grant) – September 2018 (link)

Social Security Scotland. It may take time for the new benefit to be advertised and communicated to the individuals who are potentially eligible for support.

A.108 As a result, and in the absence of other information, the Commission has assumed a starting take-up rate of 46 per cent in 2019-20 and for each subsequent year a four percentage point uplift to take-up rates, as displayed in Table A.27.

Table A.27: Take-up rates for the Early Learning and School-Age Payments

(%)	2019-20	2020-21	2021-22	2022-23	2023-24
	46	50	54	58	62

Source: Scottish Fiscal Commission.

Uncertainties around the costing

A.109 The main uncertainty in this costing is how many of the eligible individuals will claim BSG. There are particular uncertainties with these estimates as BSG will be one of the first benefits to be administered by Social Security Scotland. We will monitor how the take-up of the benefit compares to our estimates and will use this information to inform our future judgements on take-up rates for other benefits to be devolved.

A.110 We have assumed that the marketing and communication plan described above takes place. Were these steps not to happen, we would expect take-up to be lower at the outset because individuals and supporting organisations may not know or understand about the new payments and how to apply.

A.111 There is also uncertainty about the date the Scottish Government will introduce the Early Learning and School-Age Payments. The Scottish Government has committed to introduce the benefit by summer 2019, but has not announced the start date.[226] In the absence of this information, we have assumed a start date of 1 June 2019.

A.112 We have considered the sensitivity of our forecast to this assumption. Table A.28 provides expenditure figures for 2019-20 if different start dates were assumed. This table shows the materiality of our assumption of 1 June 2019, compared to other possible alternatives in mid-summer and late summer.

[226] Scottish Government (2017) A nation with ambition: the Government's Programme for Scotland 2017-2018 (link)

Table A.28: Sensitivities for 2019-20 expenditure based on different start dates

£ million	Mid-summer: 15 July 2019	Late summer: 31 August 2019
Early Learning Payment	3.4	3.0
School-Age Payment	3.2	3.2
Total	6.6	6.2
Difference compared to our central forecast (1 June 2019)	-0.4	-0.8

Source: Scottish Fiscal Commission.

A.113 For the School-Age Payment we have made a simplifying assumption that the expenditure would remain unchanged if the start date differs from 1 June 2019 as it is only the application window that would be shortened. The group of children who would be eligible, reaching school-age in August 2019, would be unchanged.

Title of measure

Introduction of Best Start Foods

Measure description

A.114 Best Start Foods (BSF) is a new benefit which will provide £4.25 weekly to eligible pregnant mothers and children under three. These payments will be pre-loaded on to a smartcard every four weeks and can be used to purchase a range of healthy foods. BSF is part of a wider scheme called Welfare Foods which was devolved to Scotland through provisions in the Scotland Act 2016. The equivalent UK benefit is called Healthy Start Vouchers (HSV).

A.115 Table A.29 sets out the common features and differences between BSF and HSV. These are the policy details that we expect to have an effect on expenditure. Details on the full proposals for BSF are available in the Scottish Government consultation.[227]

Table A.29: HSV and BSF policy comparison

Policy detail	Healthy Start Vouchers	Best Start Foods
Weekly Payment amount	£3.10	£4.25 – the weekly payment amount will be pre-loaded on a smartcard every four weeks.
Qualifying Benefits Qualifying benefits common to both HSV and BSF: • Income Support, • Income-based Jobseeker's Allowance, • Income-related Employment Support Allowance • Child Tax Credit up to a maximum income of £16,190 per annum.	a) Universal Credit with an income limit of £408 per month	a) Universal Credit with an income limit of £610 per month b) Both maximum child tax credit and maximum working tax credit and income under £6,420 c) Housing Benefit with an income limit of £16,190 per annum. d) Pension credit
Eligible people For both HSV and BSF: • All mothers under 18 regardless of benefits • Two vouchers are provided for babies under one	Pregnant women and families who are in receipt of a qualifying benefit, will receive payments per child up until the child turns four.	Pregnant women and families who are in receipt of a qualifying benefit, will receive payments per child up until the child turns three.

Source: Scottish Government (2018) Welfare Foods, a Consultation on meeting the needs of children and families in Scotland (link).

[227] Scottish Government (April 2018) Welfare Foods – a consultation on meeting the needs of children and families in Scotland (link)

The cost base

A.116 Estimated expenditure on BSF is based on the number of pregnant women and children whom we expect to be eligible.

A.117 For the population in scope, we consider the number of children under one and number of children under three.[228] We use population estimates and projections from the ONS to determine how many children will be at these ages in each year of the forecast.

A.118 We then consider what proportion of this group we expect to be receiving one of the qualifying benefits detailed in Table A.30. Information from the Family Resources Survey and Department of Health and Social Care informs this assumption.

The costing

A.119 Table A.30 shows the cost of introducing BSF. In general, the introduction of BSF increases expenditure by around £0.5 million per year.

A.120 As 2019-20 will be the transition year in which BSF commences and the Scottish Government continues to fund HSV, our 2019-20 estimates compare Scottish Government expenditure for HSV only (the status quo) against a scenario with both HSV and BSF expenditure.

Table A.30: Policy costing for BSF in Scotland

£ million	2019-20	2020-21	2021-22	2022-23	2023-24
Healthy Start Vouchers	4.2	4.0	3.9	3.7	3.5
Best Start Foods	4.5	4.6	4.4	4.2	4.0
Policy costing	0.3	0.6	0.5	0.5	0.5

Source: Scottish Fiscal Commission.
Figures may not sum because of rounding.

A.121 We described our approach to forecasting HSV in our September 2018 occasional paper.[229] To forecast BSF, the same methodology is used but amended to incorporate the higher weekly payment amounts, reduction in age of children receiving support and our updated assumptions.

A.122 Based on Department of Health and Social Care data we identify the number of pregnant women receiving vouchers, and assume the share of vouchers allocated to pregnant women remains constant. Once we have estimated the number of people eligible, we apply a take-up rate to determine the number of payments expected in each forecast year. We then calculate expenditure by

[228] As shown in Table A.29, two vouchers are issued to parents of children under one.

[229] Scottish Fiscal Commission (2018) Approach to Forecasting Social Security (link)

multiplying the average number of weekly payments in each forecast year by an annualised payment amount.

A.123 The Scottish Government has confirmed it has no plans to uprate the payment amounts for BSF, so no uprating for subsequent years is included.

Take-up rates

A.124 Table A.31 shows the take-up rates we have used for this policy costing.

Table A.31: Take-up rates for Best Start Foods and Healthy Start Vouchers

Benefit	Take-up rate (%)
Healthy Start Vouchers	68
Best Start Foods	62

Source: Scottish Fiscal Commission

A.125 As a new benefit, there is currently no available information to set this assumption, so we estimate this rate by considering the historic take-up rate for HSV and other factors that we believe may have an effect on take up.

A.126 We considered a number of factors while determining the forecast take-up rates for Best Start Foods:

- The Scottish Government is engaging with health services, particularly with midwives and health visitors, as they play an important role in communicating and raising awareness of HSV. BSF will replace HSV as part of the routine enquiries carried out by midwives and health visitors about financial issues.

- The Scottish Government will move from a paper voucher to a smartcard system for BSF. The smart card will resemble a bank card and be automatically topped up every four weeks. The move to a smartcard may increase take-up as it is easier to use, offers more flexibility and reduces stigma. It can be used in any food retailers that have a card machine and this is a wider group of retailers than was available for HSV, again offering more options for individuals to use their cards.

- In Year 1 (2019-20) there will be a managed migration of HSV recipients to BSF, where individuals will need to re-apply to Social Security Scotland. The need to re-apply could reduce uptake. The higher weekly value could incentivise individuals to transition.

- There will be a single application for Best Start Foods and Best Start Grant. A single process will provide opportunities for combining promotion of these benefits, fewer forms for individuals to complete and could potentially increase take-up.

- The Best Start Foods application form can be made by phone, on paper and online, whereas Healthy Start Vouchers was a paper form only. Social Security Scotland will take responsibility for obtaining proof of pregnancy and receipt of qualifying benefits for BSF. The change in process removes a barrier which could increase uptake.

A.127 Understanding take-up rates is an evolving process, where the Commission makes a judgement based on the information available at that time. We are aware of other factors that may affect take-up in the future, but we do not have sufficient detail to include at this stage. For this reason we have assumed the take-up rate remains constant over the forecast period. These other factors are as follows:

- The Department of Health and Social Care receives information from HMRC or DWP, which details who is receiving HSV qualifying benefits and therefore eligible for the benefit. The Department of Health and Social Care then write to all eligible people, encouraging them to apply for HSV. The high take-up rate is attributed to this process. The Scottish Government is looking to replicate this process for Best Start Foods and has begun engaging with relevant organisations.

- The Scottish Government has plans to implement communication strategies beyond retailers and health professionals at a later date. These plans are not yet finalised as focus has been placed on the secure transition of people already receiving HSV.

Uncertainties around the costing

A.128 As discussed in the Best Start Grant policy costing, the main uncertainty around the costing is the percentage of eligible individuals who will claim BSF.

A.129 The Scottish Government has not announced the date it intends to introduce Best Start Foods. In the absence of this information from the Scottish Government, we have assumed a start date of 1 June 2019. The Scottish Government has committed to introduce the benefit by summer 2019.[230]

A.130 The Scottish Government has not confirmed plans of how it will transition existing recipients of HSV over to BSV. In the absence of this information we have assumed that existing HSV recipients will be transferred over gradually to BSF in the second half of 2019, from 1 July to 31 December 2019. Deviation from these dates may affect the accuracy of our forecast for 2019-20.

A.131 We also assume that those individuals who would not be eligible for BSF, as their child is aged over three, would continue to receive HSV until 31

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[230] Scottish Government (April 2018) Welfare Foods – a consultation on meeting the needs of children and families in Scotland (link)

December 2019. We have also estimated the number of new claimants for BSF (those who have not been eligible for HSV) based on information from the Family Resources Survey.

A.132 Applying the respective HSV and BSF take-up rates results in our estimate of expenditure for each benefit. Table A.32 shows the estimated expenditure in 2019-20.

Table A.32: Total Scottish Government expenditure for 2018-19 and 2019-20 split between Best Start Foods and Healthy Start Vouchers

£ million	2018-19	2019-20
Best Start Foods		2.5
Healthy Start Vouchers	3.8	2.0
Total	3.8	4.5

Source: Scottish Fiscal Commission.
Figures may not sum because of rounding.

Title of Measure

Introduction of Funeral Expense Assistance

Measure Description

A.133 Funeral Expense Assistance (FEA) supports individuals on low incomes with funeral costs. FEA will replace DWP's Funeral Payment (FP) support in Scotland when it is introduced in 2019.

A.134 FEA will be paid to applicants where either they or their partner have been awarded one of the qualifying benefits listed in the regulations.[231] They must also be responsible for the cost of the funeral.

A.135 Table A.33 describes the policy details we expect to have an effect on expenditure. Full details on the proposals for Funeral Expense Assistance can be found in the Scottish Government consultation.[232]

Table A.33: FEA and FP policy comparison

Policy detail	Funeral Payments	Funeral Expense Assistance
Eligibility	A family hierarchy structure is used. If there is more than one person at a level in the hierarchy, DWP checks that all of the individuals at that level are in receipt of a relevant qualifying benefits	A family hierarchy structure will be used but only the individual responsible for the cost of the funeral (or their partner) is required to be on a relevant qualifying benefit.
Payment amount	Reasonable costs for burial or cremation cost (rather than actual costs). 'Other' (non-burial/cremation) element part of the award is capped at up to £700. Capped amount of up to £120 if the deceased had a pre-paid funeral plan.	Reasonable costs for burial or cremation cost (rather than actual costs). Flat rate for 'other' (non-burial/cremation) element of £700 to be uprated in line with CPI. Flat rate of £120 to eligible applicants where the deceased had a pre-paid funeral plan.
Application Window	Extended from three to six months from 2 April 2018.	Six months from the date of the funeral.

Source: Scottish Government (2018) Funeral Expense Assistance Regulations: Consultation (link).

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231 Scottish Government (2018) Funeral Expense Assistance: Section 5: FEA Regulations (link). Qualifying Benefits – Income Support, Income based Job Seekers Allowance, Income related Employment and Support Allowance, Pension Credit, Child Tax Credit, Disability or severe disability element of Working Tax Credit, Universal Credit, Housing Benefit.

232 Scottish Government (2018) Funeral Expense Assistance Regulations: Consultation (link)

The cost base

A.136 We estimate expenditure for Funeral Expense Assistance by considering the take-up by eligible applicants based on their relationship with deceased individuals in Scotland. Our forecast of the DWP Funeral Payment (FP) benefit is used as the baseline to inform assumptions around take-up rate and change in average payments over time.

The costing

A.137 Table A.34 provides the expected expenditure for FEA, compared with the expenditure for FP. The difference is the policy costing.

Table A.34: Funeral Expense Assistance policy costing

£ million	2019-20	2020-21	2021-22	2022-23	2023-24
Funeral Payments	4.5	4.5	4.5	4.4	4.3
Funeral Expense Assistance	6.2	6.3	6.6	6.5	6.6
Policy costing	1.7	1.8	2.0	2.1	2.3
of which:					
increased caseload	1.7	1.8	1.9	1.9	2.1
uprating 'other' award	0.0	0.1	0.1	0.2	0.3

Source: Scottish Fiscal Commission.
Figures may not sum because of rounding.

A.138 In our FEA modelling we use National Record Scotland (NRS) data on deaths in Scotland across all age bands and combine this with ONS data for forecasted deaths in Scotland until 2025.[233]

A.139 In the case of deaths of individuals aged 16 or under we assume that the parents will take responsibility for the funeral. Information from the Family Resource Survey (FRS) is used to determine the likelihood a child was living in a household in receipt of qualifying benefits. We combined this information with the number of under 16 year old deaths to establish the number of parents who would be eligible to claim.

A.140 In the case of couples we assume that the surviving spouse will take responsibility for the funeral. Information from the FRS is used to determine the likelihood that couples in the same household are in receipt of qualifying benefits. This output is multiplied with projected deaths of individuals over 16 years old giving us an estimate of the number of individuals whose spouses would be eligible to claim.

[233] ONS (2017) 2016-based Population Projections, 50 per cent EU Migration Variant Population projections Scotland (link)

A.141 In the case of single adults we assume that there is a broader group of individuals who could take responsibility for the funeral including adult children, adult parents, siblings or close friends. We consider the likelihood of a single adult having these people willing to take responsibility for their funeral using Understanding Society Survey (USS) data.[234] This is then combined with the FRS data to determine eligibility. To capture the eligibility criteria, we assume the probability that relations of single adults are on qualifying benefits is independent of whether other relations are on qualifying benefits.

A.142 All the eligible deaths (children, couples and single adults) are added together to establish the total eligible deaths. We estimate the number of individuals eligible for FEA will be around 40 per cent higher than under FP eligibility criteria.

A.143 We estimate the average take-up rate for FP over the last three years (2015-16 to 2017-18) to be 53 per cent. The FEA take-up rate could be affected by a number of factors, most notably the 40 per cent increase in eligible individuals and how well the devolved benefit is publicised. The take-up rate profile used in our forecast is presented in Table A.35. This assumes that take-up in the first year of FEA operation will be the same as the average take-up rate for FP. We then assume the FEA take-up rate increases by a total of two percentage points by the end of the forecast period.

Table A.35: Forecast take-up rates and caseloads for Funeral Expense Assistance

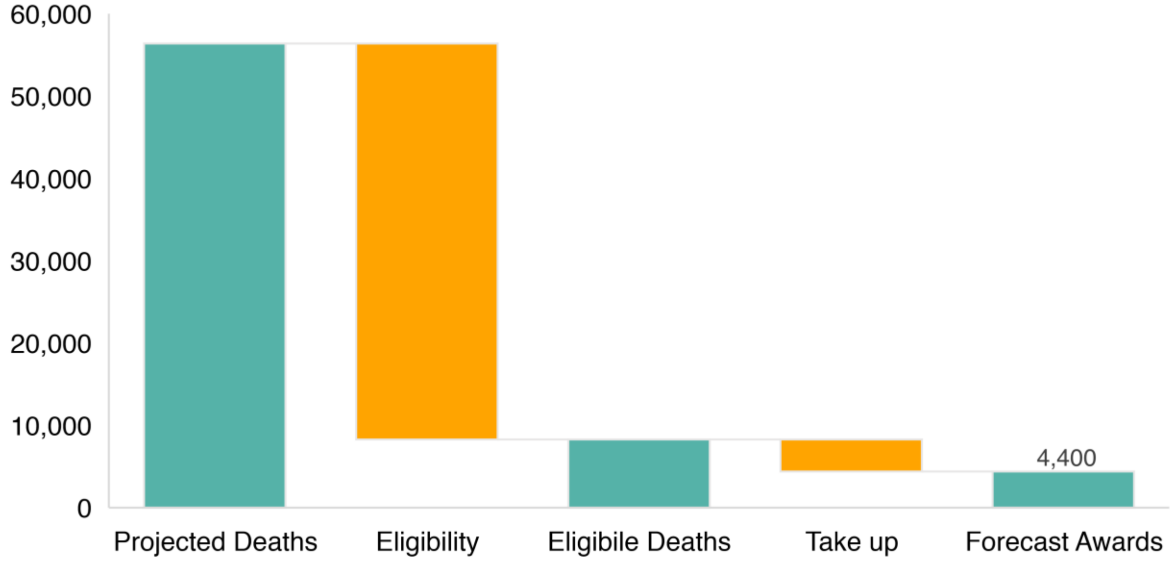
	2019-20	2020-21	2021-22	2022-23	2023-24
Take-up rate (%)	53	54	54	55	55
Caseload	4,400	4,400	4,500	4,400	4,400

Source: Scottish Fiscal Commission

A.144 With the number of eligible individuals expected to increase by around 40 per cent each year relative to FP and the effect of pre-commencement awareness raising difficult to quantify, we have decided to anchor the take-up rate for FEA on the average take-up rate for FP. Our model estimates that the take-up rate for FP reduced by two percentage points between 2016-17 and 2017-18. For all of these reasons, we see 2019-20 as very much transitional in nature and Figure A.3 quantifies how our model steps through from a projected number of deaths to a forecast number of awards in the first year of FEA operation.

[234] UK Data Archive: Understanding Society Survey (link)

Figure A.3: Forecast of the number of 2019-20 awards



Source: Scottish Fiscal Commission

A.145 The take-up rate profile we have decided to follow increases over time. This is based on the Scottish Government plans to improve the application process for FEA and enhance the awareness of the devolved benefit over time through the implementation of their forward looking communications plan. The plan states that the Scottish Government intend to raise awareness for FEA by putting articles in the trade press to be read by those working in the funeral industry. There are also plans to engage with personal finance journalists to encourage them to write about the scheme. FEA Roadshows will be conducted to raise awareness to those in the industry and the Scottish Government wants to engage with stakeholders such as NHS communications teams to raise awareness to frontline staff. Such awareness raising will take time and we believe this assumption is central, given the available information.

A.146 We apply the take-up rate profile in Table A.35 to the total estimated number of eligible individuals to establish a caseload forecast. The forecasted average payments are multiplied by the caseload to establish total forecast expenditure over the period. We assume the average award increases by 0.9 per cent per year before accounting for the uprating of the 'other' (non-burial/cremation) cost element of the award. The 0.9 per cent yearly increase reflects the average change in average FP award over the last four years.

A.147 Starting with a flat payment of £700 in 2019-20, we have uprated the 'other' (non-burial/cremation) costs element of the award using CPI across the forecast horizon. The 'other costs' element of the award is likely to be used towards the cost of funeral director fees, coffin, flowers etc. As Table A.35 shows, the uprating of this part of the total award accounts for a small proportion of the policy costing, relative to the driving factor of increased caseload.

Uncertainties around the costing

A.148 The main uncertainty for this costing relates to the take-up rate of FEA. We have kept our initial take-up rate the same as the latest three-year average FP take-up rate because of uncertainty from the transitional nature of the first year. Through the rest of the forecast period we have increased the take-up rate in line with our expectation of improved awareness of the benefit.

A.149 The Scottish Government has announced it intends to introduce Funeral Expense Assistance by summer 2019.[235] In the absence of information on a specific start date, we have assumed the benefit commences at the start of summer: 1 June. Any variation from the assumed start date is likely to affect expenditure.

A.150 Those who are already eligible under DWP's Funeral Payment, could delay their application so it is made to Social Security Scotland rather than DWP. As it stands there would appear to be little incentive for this group to delay their applications since we expect that the outcome payment would be almost identical under FEA as under the current model. We also understand individuals are encouraged to submit their applications by funeral directors and it would seem unlikely for them to encourage any of their clients to delay applications.

A.151 There is a further uncertainty with the first year (2019-20) of operation as there will be individuals who would not be eligible under the DWP FP system, but would be eligible under widened eligibility for FEA. These individuals will be able to apply assuming the funeral occurred no later than six months before the FEA commencement date.

A.152 Our FEA model produces results on a financial year basis. We are assuming that the benefit commences on 1 June 2019 (two months into the financial year). If we accept that there is no incentive to delay applying this would suggest a downwards adjustment should be made to the 2019-20 financial year caseload. We have explored this and concluded that such a reduction is likely to offset by applications from individuals who were not eligible under FP but are eligible under FEA, where the funeral occurred no later than six months before the FEA commencement date. Therefore no adjustment has been made to our 2019-20 forecast.

A.153 We have based our take-up rate assumption for FEA on estimates of DWP FP take-up. These data do not include the effect of extending the claim period from three to six months from the date of the funeral. This change was only announced by DWP on the 2 April 2018, should there be a significant number

[235] Scottish Government (2018) Funeral Expense Assistance Regulations: Consultation (link)

of potential claimants who previously did not submit applications within three months of the funeral and who now apply within the extended application window, then this would increase take-up and expenditure.[236]

A.154 A second change announced by DWP in April 2018, which could potentially increase take-up and expenditure, sees recipients of FP being able to receive contributions from relatives, friends or charities without these contributions being deducted from the payment. This regulation is being mirrored under FEA. Again no 2018-19 outturn data are currently available for us to assess the effect of this change but we do not expect it to have a significant bearing on expenditure. We will review outturn on the average award made to claimants under this change once these data become available.

A.155 Our estimate of eligible deaths is developed by applying secondary analysis from the FRS and USS to death projections. This coupled with the fact we are working with restricted FP outturn data means that there is inherent uncertainty within the forecast model which is providing an estimate of overall eligibility each year. It does not take into account some of the intricate detail such as whether the appropriate person wants to take responsibility for the funeral. We do not account for National Assistance Funerals in our forecast as the limited evidence suggests that this would not make a material difference to our model output. Similarly we do not make specific adjustments to account for people with funeral plans. Support is still available if the deceased had a pre-paid funeral plan but it is a reduced award. Up to £120 can be claimed as a non-burial/cremation award under FP and this is a flat rate of £120 under FEA.

[236] UK Government (2018) Press release: Claiming Funeral Expense Payment to be made easier (link)

Annex B
Policy Recostings

Introduction

B.1 A policy recosting is a revised estimate of a policy that has previously been costed. There are two main reasons why we may recost previously announced or implemented measures:

- Changes or additional administrative outturn data available since the introduction of the policy (or previous forecast). For example, we will not receive outturn data on the 2017-18 higher rate threshold policy until summer 2019.
- We revise key judgements or assumptions relating to our previous policy costing – particularly in response to new evidence.

B.2 This Annex sets out the latest policy recosting estimates and how they have changed from the previous costing. All of the policy recostings contained in this Annex fall under the first category (administrative outturn data not yet available). We publish this Annex twice a year as part of our Scotland's Economic Fiscal Forecast (SEFF) series.

Table B.1: Latest policy recostings

£ million	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Income Tax*							
2017-18 Higher rate threshold freeze	52	56	83	75	85	92	100
2018-19 five band policy, of which	0	203	207	218	229	241	254
Introduction of starter rate	0	-48	-48	-51	-52	-54	-56
Introduction of intermediate rate	0	132	132	141	148	155	162
Higher rate threshold adjustment	0	51	53	55	58	61	65
Increase in higher rate	0	66	68	70	73	76	80
Introduction of top rate	0	2	2	2	2	2	2
NDR**							
Business Growth Accelerator and Empty New Build relief	0	-24	-28	-29	-30	-31	-32
LBTT							
Relief for first time buyers, of which	0	-5	-6	-6	-7	-7	-7
Residential component	0	-5	-6	-6	-6	-6	-7
ADS component	0	0	0	0	0	0	0

Source: Scottish Fiscal Commission.
Figures may not sum because of rounding.
* These recostings are not a direct comparison to the rUK income tax policy. For the 2017-18 Higher rate threshold policy, the baseline assumed is statutory CPI indexation. For 2017-18, the UK Government increased the higher rate threshold greater than statutory indexation to £45,000. The full static costing, behavioural reduction and post-behavioural income tax costing breakdowns can be found in Scottish Fiscal Commission (2018) Supplementary tables S3.2 and S3.3 December 2018 (link)
** Our recosting has estimated the cost of these together because in many cases the award of one will be linked to the other. Some properties will start claiming empty new build relief before transitioning to business growth accelerator as they become occupied.

Table B.2: Change from previous costing

£ million	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Income Tax							
2017-18 Higher rate threshold freeze*	-2.4	-2.7	22.0	5.3	10.3	6.7	4.7
2018-19 five band policy, of which	0.0	-10.0	-12.5	-11.3	-12.5	-14.5	-17.3
Introduction of starter rate	0.0	0.6	1.5	0.8	0.8	0.8	0.9
Introduction of intermediate rate	0.0	-3.6	-7.5	-4.9	-5.4	-6.1	-7.3
Higher rate threshold adjustment	0.0	-2.5	-2.3	-2.5	-2.8	-3.2	-3.7
Increase in higher rate	0.0	-4.2	-3.7	-4.2	-4.5	-5.3	-6.4
Introduction of top rate	0.0	-0.4	-0.5	-0.5	-0.6	-0.7	-0.8
NDR							
Business Growth Accelerator and Empty New Build relief	0.0	22.9	18.9	19.7	19.6	20.3	19.7
LBTT							
Relief for first time buyers, of which	0.0	0.0	-0.3	-0.4	-0.5	-0.5	-0.6
Residential component	0.0	0.0	-0.3	-0.4	-0.5	-0.6	-0.6
ADS component	0.0	-0.1	0.1	0.0	0.0	0.0	0.0

Source: Scottish Fiscal Commission.

Figures may not sum because of rounding.

* The increase to 2017-18 policy recosting (freeze of higher rate threshold at £43,000) in 2019-20 is as a result of the above inflation UK Personal Allowance increase. This policy costing uses a UK statutory indexation baseline of the Basic Rate Limit and Personal Allowance to calculate the higher rate thresholds. The baseline at May 2018 for 2019-20 was a higher rate threshold of £46,330. This was revised to £46,800 following the Personal Allowance increase, resulting in the policy raising more revenue.

Annex C Materiality and policy costings

Introduction

C.1 The Commission produces policy costings alongside our forecasts to show the impact changes made by the Scottish Government have on tax receipts and social security expenditure. We produce forecasts to accompany the Scottish Budget, and cost policies announced at these fiscal events.

C.2 In addition, we produce costings to accompany secondary legislation in areas within our remit where we have not already costed the policy. Our first such costing was published in May 2018 on changes to group relief within Land and Buildings Transaction Tax.[237] Our second costing was published in September 2018 on the introduction of the Best Start Grant, Pregnancy and Baby Payment.[238]

C.3 Annex A of our report sets out the costings for policies announced since our last publication, which we have not already costed. Annex B provides information on revised estimates of previously costed policies, known as recostings.

C.4 The tax receipts devolved and assigned to Scotland will amount to over £20 billion a year, once fully implemented. The social security expenditure being devolved to Scotland equates to around £3 billion a year. Some policies announced by the Scottish Government will have a very small fiscal effect. This annex sets out our approach to handling policies we do not consider to be material in cost. It also sets out the Scottish Government's policy on the Young Carer's Grant and explains why we have not produced a costing for this policy.

[237] Scottish Fiscal Commission (2018) Supplementary Costings: Non-Residential Land and Buildings Transaction Tax Group Relief (link)

[238] Scottish Fiscal Commission (2018) Supplementary Costings: Social Security Best Start Grant (Pregnancy and Baby Grant) (link)

Materiality Policy

C.5 The Commission has set thresholds under which policies will be deemed to be immaterial and therefore will not be costed.

C.6 Where a policy is estimated to cost less than £0.5 million per year it is considered negligible and therefore will not be costed. For policies with an estimated cost of £2 million or lower per year, a decision will be made whether to cost the policy or not.

C.7 Our decision as to whether or not to cost a policy requires some, or all, of the following criteria to be met:

- High degree of confidence that the cost of the policy is low, even if there is a high degree of uncertainty as to the precise cost.
- The cumulative changes being made do not push the policy above the materiality threshold.
- Limited risk of significant behavioural response.

C.8 The Commission's approach to corrections and revisions published in our statement of compliance with the Code of Practice for Statistics categorises errors based on material/not material and important/not important.[239] This policy of materiality will also be applied in those circumstances.

C.9 Details of any policies the Commission has decided not to cost will be included in this Annex in subsequent publications. We will keep under review both our materiality policy, and the policies we have previously not costed to ensure that none of these are now above the thresholds.

Young Carer's Grant

C.10 The Scottish Government is consulting on the development of a Young Carer's Grant (YCG).[240] As it stands, the YCG provides a £300 one-off payment, which can be applied for annually by young carers aged 16-17 or 18 and still at school, who meet certain qualifying criteria. The Government has committed to make YCG payments by autumn 2019.

Based on the available information we consider that the Young Carer's Grant will cost less than £0.5 million in each year of the forecast. Therefore we will not produce forecasts of expenditure on this benefit. We will keep this under review as further information and data become available.

[239] Scottish Fiscal Commission (2018) Compliance with the Code of Practice for Statistics (link)

[240] Scottish Government (2018) Consultation on Young Carer Grant Regulations (link)

Abbreviations

AA	Attendance Allowance
ADS	Additional Dwelling Supplement
ADT	Air Departure Tax
AETR	Average Effective Tax Rate
APD	Air Passenger Duty
ASHE	Annual Survey of Hours and Earnings
BGA	Block Grant Adjustment
BMW	Biodegradable Municipal Waste
BSF	Best Start Foods
BSG	Best Start Grant
CA	Carer’s Allowance
CAA	Civil Aviation Authority
CAS	Carer’s Allowance Supplement
CBI	Confederation of British Industry
COE	Compensation of Employees
CPI	Consumer Price Index
DHP	Discretionary Housing Payment
DLA	Disability Living Allowance
DWP	Department for Work and Pensions
ESA	Employment and Support Allowance
EU	European Union
EWC	European Waste Catalogue
FEA	Funeral Expense Assistance
FER	Forecast Evaluation Report
FP	Funeral Payments
FRS	Family Resource Survey
FSS	Fair Start Scotland
FTB	First Time Buyers
GB	Great Britain
GCF	Gross Capital Formation
GDP	Gross Domestic Product
GERS	Government Expenditure & Revenue Scotland
HMRC	Her Majesty’s Revenue and Customs
HSV	Healthy Start Vouchers
ICE	Intercontinental Exchange
IPS	International Passenger Survey
IT	Information Technology
JSA	Jobseeker’s Allowance

LBTT	Land and Buildings Transaction Tax
LCF	Living Costs and Food survey
LFS	Labour Force Survey
MCC	Material Change of Circumstances
METR	Marginal Effective Tax Rate
MOG	Machinery of Government
NDR	Non-Domestic Rates
NDRi	Non-Domestic Rates Income
NHS	National Health Service
NLF	National Loans Fund
NPD	Non-Profit Distributing
NPISH	Non-Profit Institutions Serving Households
NRS	National Records of Scotland
NSND	Non-Savings and Non-Dividends
OBR	Office for Budget Responsibility
OECD	Organisation for Economic Co-operation and Development
OGA	Oil and Gas Authority
ONS	Office for National Statistics
PAYE	Pay As You Earn
PD	Political Declaration
PFI	Private Finance Initiative
PIP	Personal Independence Payment
PMI	Purchasing Managers' Index
PSM	Policy Simulation Model
PT	Primary Threshold
PUT	Public Use Tape
QNAS	Quarterly National Accounts Scotland
RHDI	Real Household Disposable Income
RPI	Retail Price Index
RTI	Real Time Information
RV	Rateable Value
SAA	Scottish Assessors Association
SDLT	Stamp Duty Land Tax
SEFF	Scotland's Economic and Fiscal Forecasts
SEPA	Scottish Environmental Protection Agency
SFC	Scottish Fiscal Commission
SG	Scottish Government
SLfT	Scottish Landfill Tax
SLCF	Scottish Landfill Communities Fund
SPI	Survey of Personal Incomes
SSMG	Sure Start Maternity Grant
SWF	Scottish Welfare Fund
TIE	Taxable Income Elasticity
UEL	Upper Earnings Limit
UK	United Kingdom
UKCS	UK Continental Shelf
UKF	UK Finance
USS	Understanding Society Survey
VAT	Value Added Tax
VR	Valuation Roll

VTTL	VAT Total Theoretical Liability
WA	Withdrawal Agreement
WAS	Work Able Scotland
WFS	Work First Scotland
YCG	Young Carer's Grant

A full glossary of terms is available on our website:

www.fiscalcommission.scot/about-us/glossary-of-terms/

Voluntary compliance with the Code of Practice for Statistics

The Commission seeks to adhere to the highest standards for analysis possible. While we do not produce official statistics (we produce forecasts), the Commission and our work voluntarily complies as much as possible with the UK Statistic Authority's Code of Practice for Statistics. Further details and our statement of voluntary compliance can be found on our website.

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