Scottish Fiscal Commission

Supplementary Publication: Fiscal Update – April 2020

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Summary

1. On 6 February 2020, to accompany the Scottish Budget, we presented our economic and fiscal forecasts and our assessment of the Scottish public finances.[1] Since then there has been a UK Budget on 11 March,[2] and the onset of the global COVID-19 pandemic which has led to a widespread public lockdown and the enforced closure of many businesses.

2. Both the Scottish and UK Governments have committed to significant increases in public spending and tax reliefs to provide the NHS with financial support to tackle the health crisis and both to mitigate the economic consequences of the lockdown policies and to enable businesses and individuals to quickly resume activity once these are relaxed. Some of the UK Government measures were announced in the UK Budget, but many have been announced subsequently.

3. This supplementary publication provides an update on the Scottish Budget position, accounting for the significant shift in UK and Scottish Government spending commitments since our last publication. As well as the spending associated with the COVID-19 response, we also include the changes in the Scottish Budget following the UK Budget on 11 March and the Budget deal agreed between the Scottish Government and the Green Party which amended the Budget Bill. The report also includes commentary on the possible effects of the COVID-19 pandemic on the economy and the Scottish Budget.

The Scottish Budget

4. Even in the absence of COVID-19, the Scottish Budget had grown in size and complexity as more of the fiscal framework came into operation from April 2020. Our February 2020 report expanded our fiscal commentary and covered in detail the 2020-21 Scottish Budget position at the time of the Budget. We

[1] Scottish Fiscal Commission (2020) Scotland's Economic and Fiscal Forecasts – February 2020 (link)

[2] HM Treasury (2020) Budget 2020: documents (link)

highlighted then the importance of continuing to monitor the Budget position over the year.

5. This publication is a continuation of that work and aims to aid understanding of the Scottish Budget and the significant changes taking place – both as a result of the UK Budget, and now to a greater extent the response to COVID-19. After the February 2020 Budget, the Scottish Government's Budget deal and the UK Budget increased resource funding by £159 million and capital funding by £88 million. This is a total increase of £247 million before accounting for COVID-19 related funding.

6. Since March the UK Government has significantly increased public spending to combat the effects of COVID-19, funded through increased UK Government borrowing. This increased spending largely affects the 2020-21 financial year. This is a fast-moving picture with considerable uncertainty about the progression of the pandemic and the timing and form of any relaxation of the current lockdown controls in Scotland, the UK and around the world. There is considerable uncertainty about the economic and fiscal effects for Scotland.

7. The Scottish Government has also announced a number of policies to mitigate the effects of COVID-19 on Scottish businesses and the economy.[3] The Scottish Government is currently expected to receive £3.5 billion in 2020-21 which can be used to fund these commitments and additional spending on health services.[4] The additional funding is received via Barnett consequentials, which are based on changes in UK Government spending in areas devolved to the Scottish Government, and does not directly relate to Scottish spending or Scottish economic performance.

8. The fiscal responses required by both Governments are highly uncertain as the duration and scale of the response to COVID-19 is unclear. The consequentials expected from the UK Government could therefore change significantly. Consequentials could be positive or negative – positive when the UK Government spends more than currently expected and negative when spending is lower than expected – this may also happen in areas not related to COVID-19. With uncertainty about the level of funding being received from the UK Government as well as the level of spending required in Scotland, it may be difficult for the Scottish Government to balance spending against available funding within the financial year. The Scottish Government cannot borrow to fund any additional COVID-19 related spending.

9. As well as funding from the UK Government, the other major component of the Scottish Budget is income tax. Income tax accounted for over £12 billion of the Scottish Budget 2020-21. We expect income tax revenues to be heavily affected, but the arrangements in the fiscal framework mean there will be no

[3] The main policy announcements are set out in the Annex.

[4] As at 21 April 2020.

effect on the Scottish Budget in 2020-21 as this funding is fixed for the year. Any changes to income tax funding for 2020-21 will be applied to the Scottish Budget in 2023-24 through a reconciliation. The reduction in Scottish income tax revenues should largely be offset by the change in funding based on UK revenues. The effect on the Scottish Budget will be different and smaller in magnitude than the total reduction in revenues, though there could be a sizeable positive or negative effect on the Scottish Budget depending on relative differences in Scottish and UK income tax performance in 2020-21.

10. In our last publication, the fully devolved taxes, Land and Buildings Transaction Tax and Scottish Landfill Tax, were forecast to raise £757 million in 2020-21.[5] Spending on devolved social security was forecast to be £3.5 billion. We expect there to be reductions in these revenues and increases in social security spending, but the structure of the devolution agreement means that these changes should largely be offset by changes in the corresponding Block Grant Adjustments (BGAs) because the UK Government would see similar reductions and increases. We might expect some differences between the exact effects in Scotland and the rest of the UK which could have positive or negative effects on Scottish funding but it is not possible to predict these differences at the present time.

11. The Office for Budget Responsibility (OBR) published a coronavirus reference scenario on 14 April showing the possible effects on the UK economy and the UK Government's public finances, of a three-month lockdown followed by another three-month period where these restrictions are partially lifted.[6] As the OBR has stressed, this is a scenario rather than a forecast since it is heavily based on assumptions that the downturn is confined to the second quarter of 2020 and a recovery takes place in the second half of 2020. These assumptions are not intended to be central. Their analysis, and similar analyses produced by the Fraser of Allander Institute (FAI), Resolution Foundation and others, seek to explain the ways the economy will be affected and the potential scale of the effects,[7] including the possible effects on UK Government spending and borrowing.

12. We could make broad estimates of the likely effects of COVID-19 on the Scottish economy, on tax revenues and on social security spending, but the net effects on the Scottish Budget will depend on the differences in effects between Scotland and the rest of the UK, as well as any differences in policy responses, which are very difficult to predict at this stage.

13. Much of the analysis to date has focused on the short-term effects of the crisis. We do not at the moment know how long the lockdowns in Scotland,

[5] Revenues from Non-Domestic Rates are managed separately through the Non-Domestic Rating Account.

[6] OBR (2020) Coronavirus reference scenario (link)

[7] Fraser of Allander Institute (2020) Coronavirus: quantifying the impact on the Scottish Economy – 7 April 2020 (link) and Resolution Foundation (2020) Doing more of what it takes (link)

the UK and around the world will last. It is possible that the lockdown restrictions could be eased and then tightened again. The extent to which the economy returns to normal, people are able to return to previous jobs and demand for goods and services rebounds to previous levels will determine the long-term effects of the crisis on our economy.

14. For these reasons we are not providing updated forecasts as part of this publication. We note the Finance and Constitution Committee have also reached the conclusion that a revised set of forecasts from the SFC would not be appropriate at this time.[8]

15. However, is it more important than ever to continue the on-going monitoring of the Scottish Budget position. As the situation evolves and the implications become clearer, how the postponed Medium Term Financial Strategy (MTFS) and the Scottish Budget will be managed during this year will need to be considered. We are discussing the timing of our next set of forecasts with the Finance and Constitution Committee and the Scottish Government.

16. There is also uncertainty about the timing of UK fiscal events this year. The UK Government's Spending Review planned for this summer has been delayed. The Scottish Government previously intended to have a multi-year Resource Spending Review after the UK Spending Review; the Cabinet Secretary for Finance has now confirmed this will be postponed and the Scottish Government will focus on the Scottish Budget 2021-22.[9] The timing of the next UK Budget, due in the autumn, has not yet been announced and could differ from the usual schedule. We welcome the recommendation from the Scottish Parliament Finance and Constitution Committee to develop early proposals for the timing of the Scottish fiscal events this year.

17. As always we welcome feedback on our work. If you have any questions or comments, please get in touch with us at info@fiscalcommission.scot.

Dame Susan Rice DBE

Professor Francis Breedon

Professor Alasdair Smith

Professor David Ulph

23 April 2020

[8] Letter from the Convener of the Finance and Constitution Committee to the Cabinet Secretary for Finance – 8 April 2020 (link)

[9] Letter from the Cabinet Secretary for Finance to the Convener of the Finance and Constitution Committee – 1 April 2020 (link)

Contents

Chapter 1: Introduction

1.1 This supplementary publication provides an update on the position of the Scottish Budget, accounting for the significant shift in UK and Scottish Government spending commitments since our last publication in February 2020.

1.2 In Chapter 2 we consider the specific ways the Scottish Budget may be affected. We discuss the Scottish Government's response to date, the funding arrangements and the likely effect on devolved tax revenues and social security spending.

1.3 Chapter 3 sets out the updated Scottish Budget position. We have not updated our forecasts for the economy but the chapter does reflect the additional funding provided to the Scottish Government to manage the COVID-19 crisis. We step through the changes in the Budget since our last publication. Firstly, we present the Budget deal agreed to pass the Budget, secondly, the effects of the UK Budget and revised Office for Budget Responsibility (OBR) forecasts (not including additional COVID-19 spending) and finally the expected effects on the Scottish Budget of the UK Government's spending in response to COVID-19.

1.4 In this introduction we provide an overview of COVID-19 and the way it could affect the economy and government spending.

How COVID-19 may affect the economy

1.5 The COVID-19 pandemic has a direct effect on those who become ill, and requires large additional public spending on health services. It is also having a significant effect on economies throughout the world because of both the lockdown policies implemented to contain the spread of the virus and the accompanying package of government economic policies aimed at mitigating the consequences of the lockdown. In what follows we use the term COVID-19 to encompass all these effects, which together constitute a significant global economic crisis.

1.6 COVID-19 will affect all parts of the economy. It is an unprecedented combination of a supply-side shock, a demand-side shock and potentially a financial system shock, and will lead to significant changes in government fiscal policy and public debt. It will have profound and varying economic consequences in the short, medium and long-term.

1.7 The immediate effects of COVID-19 on the economy will be large and negative, and a significant global recession appears inevitable. The scale and duration of the recession, and the economic effects of COVID-19 more generally, is at present extremely uncertain. The effect on the economy will depend on the severity and duration of the pandemic and the extent of the necessary public health interventions balanced against the success of national and international economic interventions. Box 1.1 presents some of the early data indicating the magnitude of the COVID-19 shock.

1.8 Other commentators – including the Fraser of Allander Institute, the National Institute of Economic and Social Research and the OBR – have offered insightful commentary on the various mechanisms and channels through which the economy will be affected by COVID-19.[10] The Scottish Government has also published illustrative scenario analysis of the effect of COVID-19 on the Scottish economy alongside some helpful detailed commentary.[11]

The Government fiscal response and the economy

1.9 In March 2020 the UK and Scottish Governments announced a number of public health interventions restricting peoples movements and requiring a large number of businesses to suspend activity. If introduced in isolation, these public health measures would be expected to lead to a significant fall in economic activity; a collapse of income for many businesses and households, and a large number of job losses. These outcomes would make economic recovery difficult once the public health measures were relaxed.

1.10 Both Governments have therefore announced a series of significant economic interventions. These have focused on helping businesses manage their cash-flow by reducing non-domestic rates and offering loans, and supporting the incomes of employees and the self-employed. For Scotland, some of the economic support will be delivered through UK-wide policies while other policies in devolved areas will be delivered by the Scottish Government. Details on these policies are included in the Annex.

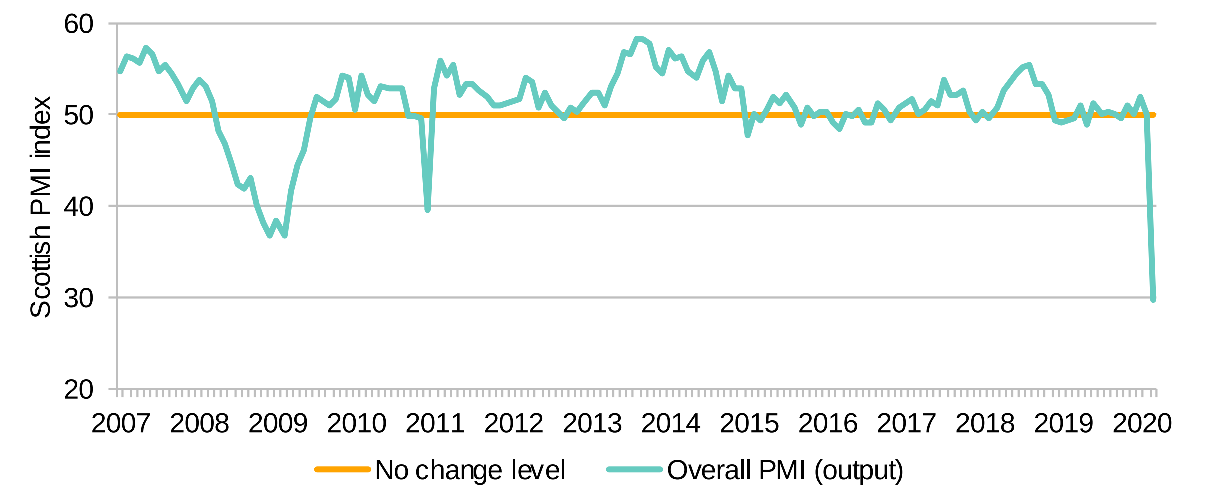
[10] Fraser of Allander Institute (2020) Coronavirus: quantifying the impact on the Scottish Economy – 7 April 2020 (link). National Institute of Economic and Social Research (2020) April 2020 GDP Tracker (link). OBR (2020) Coronavirus reference scenario (link).

[11] Scottish Government (2020) State of the Economy (link)

Box 1.1: Early indicators of the economic effects of COVID-19

The available data for the first quarter of 2020 are limited. They mostly cover the period before mid-March when the economic effects of the crisis began to emerge, though they still offer some useful insight to monitor and understand the effect of COVID-19 in a timely way. The latest Purchasing Managers' Index (PMI) for Scotland dropped to 29.7 in March, the largest decline in surveyed activity on record. The latest FAI Scottish Business Monitor registered a fall in activity during Q1 and a crash in expectations for the next six months. These findings suggest we may be in the early days of an even deeper recession than the 2009 financial crisis.

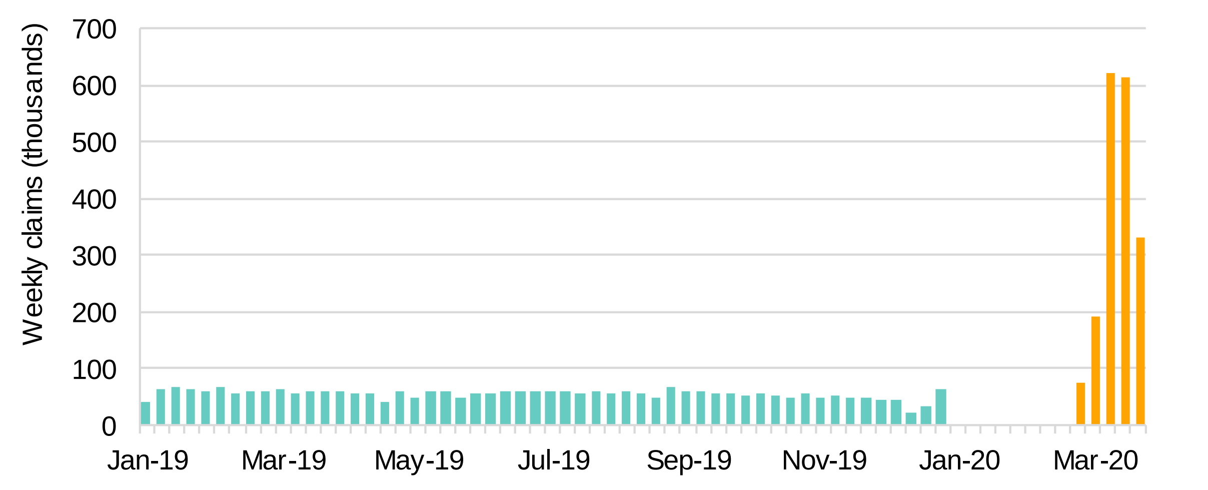
Figure 1.1: Purchasing Manager's Index (PMI) for Scotland up to March 2020



Source: IHS Markit and Royal Bank of Scotland (2020) PMI releases (link)

Similar signals have started to emerge for the labour market. New data released by the Department for Work and Pensions show a surge in the number of new claimants of Universal Credit benefits in Great Britain at the end of March.

Figure 1.2: Weekly number of claims made to Universal Credit in Great Britain



Source: Department for Work and Pensions (2020) Universal Credit statistics and management information (link)
Figures up to January 2020 are official statistics. Data for the COVID-19 period is management information and has not been derived using the same methodology.

1.11 The UK Government has announced plans to spend at least an additional £86 billion in 2020-21, to combat the effects of COVID-19, equivalent to around 4 per cent of GDP.[12] The additional funding received by the Scottish Government's currently amounts to £3.5 billion.[13]

1.12 These interventions have two aims: preventing a catastrophic and immediate collapse in the economy and living standards, and mitigating the effect on the economy after the initial shock. Furloughing those in employment will support them to remain closer to the labour market, and supporting business cash-flows will allow more businesses to survive. These measures will help economic activity resume more quickly as lockdown restrictions are lifted and will therefore reduce the effect of COVID-19 on the economy in the longer-term.

1.13 The support provided cannot fully reverse the effect of COVID-19 on the UK economy. There are major uncertainties about how long the lockdown will have to last, and how deep and long-lasting will be the resulting negative economic effects. The effect will vary substantially from sector to sector, with a significant effect on both the demand and supply side of the economy. There will have to be a careful balancing and targeting of monetary and fiscal policy in the coming years to rebuild the economy.

Looking ahead

1.14 COVID-19 will affect our fiscal and economic forecasts in a multitude of ways. Forecasting will be harder because few relevant recent historical comparators are available to help predict the effect of COVID-19 on the economy. The way that any shock affects the economy depends on underlying economic conditions, the nature of the shock itself and how it travels through the economy. For example the economic shock created by COVID-19 is not comparable to the Global Financial Crisis of 2008 or the oil crises of the 1970s, because the nature of the shock is fundamentally different. Any attempt to extrapolate the economic effects of COVID-19 from these historical episodes would be highly speculative.

1.15 COVID-19 is having a fundamental effect on the economy, which economists would term a structural break. Usually we look to past data to make predictions about the future, but in this case historic data will not be a good predictor of the future. Trends seen over recent years, for example in productivity or trade, are unlikely to hold in the near future. What's more, the relationships between different parts of the economy may change in unexpected ways. In the absence of historic precedent, considerable

[12] The £86 billion figure was set out in the OBR's coronavirus reference scenario published on 14 April 2020, some announcements prior to this date and all announcements after this date are not included in the £86 billion. OBR (2020) Coronavirus reference scenario (link)

[13] As at 21 April 2020.

judgement will be required to anticipate the novel ways the economy will be affected by COVID-19.

1.16 The data we rely on for our forecasts is also likely to be affected by COVID-19. Some data may be delayed or of lower quality because of issues with collection and processing. We could even have a permanent gap in some of our data series where data collection was cancelled. We are discussing data availability with our data providers and will report on any potential data issues in our upcoming Statement of Data Needs.

1.17 Data on economic activity, tax revenues and social security spending are only available with a lag, so it will be some time before we get official estimates of the effect of COVID-19 on the areas we forecast. For example, the first estimate of Scottish GDP in 2020 Q2 is expected to be published in September 2020. As data become available covering the early COVID-19 period, we will have a much better understanding of the effect of COVID-19, and our ability to forecast will improve. But even once available some estimates are likely to be subject to significant uncertainty and revision given the difficulty of estimating economic activity in such uncharted times. It is likely to be years before the full extent of the effect of COVID-19 can be estimated with any certainty.

1.18 Ultimately, our forecast errors in the coming years are likely to be larger than might have been expected in the absence of COVID-19.

Chapter 2: Factors which may affect the Scottish Budget

Spending commitments to manage COVID-19

2.1 Both the Scottish and UK Governments have committed to significant increases in public spending and tax reliefs to provide the NHS with the financial support to tackle the health crisis, to mitigate the economic consequences of the lockdown policies, and to enable businesses and individuals to quickly resume activity once these are relaxed. The package of support from both Governments significantly increases public spending in the UK and Scotland, starting from March 2020. We expect large effects will be seen in the 2020-21 financial year.

2.2 We detail some of the notable COVID-19 policy commitments announced so far by both the Scottish and UK Governments in the Annex to this report. These policies fall into three categories: spending by the UK Government which applies to the whole of the UK, spending by the UK Government on devolved areas which generate consequentials for the Scottish Government and spending by the Scottish Government on devolved areas. Chapter 3 discusses the effects on the Scottish Budget.

How are the Scottish Government's commitments funded?

2.3 The Scottish Budget is funded through a mixture of tax revenues and funding from the UK Government.[14] Funding received from the UK Government is largely calculated by the Barnett formula based on changes in UK Government spending in areas devolved to the Scottish Government.[15]

[14] Further information on how the Scottish Budget is funded can be found in Chapter 2 of our publication Scotland's Economic and Fiscal Forecasts – February 2020 (link)

[15] HM Treasury (2015) Statement of funding policy: funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly (link)

2.4 When the UK Government announces a change in spending in a devolved area, it either allocates more money to the UK department, or asks the department to reprioritise existing budgets, to deliver the new announcement. Where the UK Government increases departmental allocations, the Scottish Government receives a corresponding portion of that increase, known as consequential funding or consequentials. The Scottish Government can choose how to spend consequentials, either replicating the corresponding UK Government policy or spending the funding elsewhere.

2.5 The UK Government has announced plans to spend an additional £86 billion in 2020-21, to combat the effects of COVID-19.[16] The Scottish Government is expected to receive £3.5 billion in consequentials.[17] The fiscal responses required by both Governments are highly uncertain as the duration and scale of the response to COVID-19 is unclear. The consequentials expected from the UK Government could therefore change significantly. With uncertainty about the level of funding received from the UK Government as well as the level of spending required in Scotland, it may be difficult for the Scottish Government to balance spending against available funding within the financial year. The Scottish Government cannot borrow to fund any additional COVID-19 related spending.

Spending differences between Scotland and the rest of the UK

2.6 Under normal circumstances, the Scottish Government has responsibility to manage any differences between funding and spending, within the Scottish Budget throughout the financial year. Differences may be difficult to manage if the effects of COVID-19 and the policy responses are materially different between Scotland and the rest of the UK.

2.7 Such differences could arise from differences in demographics or economic structures. Scotland has a larger proportion of the population aged over 65 at 18.9 per cent compared to 18.2 per cent in England. The difference reverses for those aged over 85, this age group account for 2.3 per cent of the Scottish population and 2.4 per cent of the English population.[18] The Scottish population also has high levels of ill-health and disabilities with 73.3 people per 1,000 receiving Disability Living Allowance or Personal Independence Payment compared to 54.5 people in England.[19]

[16] The £86 billion figure was set out in the OBR's coronavirus reference scenario published on 14 April 2020, some announcements prior to this date and all announcements after this date are not included in the £86 billion. OBR (2020) Coronavirus reference scenario (link)

[17] As at 21 April 2020.

[18] ONS (2019) Estimates of the population for the UK, England and Wales, Scotland and Northern Ireland (link)

[19] DWP (2020) Stat-Xplore data for Disability Living Allowance and Personal Independence Payment entitled cases in Scotland and England in May 2018 (link)

2.8 The UK Government's announcement on the latest increased level of health funding committed that "public services will receive whatever they need to protect this country and its people from Coronavirus".[20] This raises the question of whether the spending needs of devolved administrations would be met by the UK Government (and if so, how would these be assessed), or whether the Scottish Government should expect to receive funding based on the levels of spending that needed to be undertaken in England.

Borrowing

2.9 The Scottish Government cannot borrow to fund any additional COVID-19 related spending. The fiscal framework allows the Scottish Government limited borrowing powers which can be used to fund capital spending and to mitigate the effects of forecast error for the devolved taxes and social security benefits. The Scottish Government already plans to borrow £207 million in 2020-21 to manage the income tax reconciliation applied this year. This leaves a remaining limit of £93 million the Scottish Government can borrow to fund any further forecast errors.[21]

2.10 The Scottish Government planned to draw £131 million in resource down from the Scotland Reserve in 2020-21. This money was committed in February, before either Government announced COVID-19 policies. An additional £102 million remains in the resource reserve, which could be drawn down in 2020-21 to fund spending policies, or manage reconciliations which will occur later in the year.

Effects on devolved tax revenues and social security spending

2.11 The Scottish Budget 2020-21 set in February 2020 was based, in part, on our forecasts of devolved tax revenue and social security spending. The Budget also depends on the OBR's forecasts of corresponding revenues and spending in the rest of the UK as the OBR's forecasts are used to set the Block Grant Adjustments (BGAs). Further discussion of the BGAs is included in Box 2.1. Neither our nor the OBR's forecasts, used in the Scottish Budget 2020-21, incorporated the effects of the COVID-19 crisis in the UK.

Box 2.1: Block Grant Adjustments

Block Grant Adjustments (BGAs) are adjustments to the Scottish Budget to reflect the tax and social security responsibilities devolved to the Scottish Parliament. Tax BGAs remove funding from the Barnett-determined Block Grant where the Scottish Government is now raising its own tax revenue. Social security BGAs add additional

[20] UK Government (2020) Chancellor provides over £14 billion for our NHS and vital public services (link)

[21] The Scottish Government can borrow up to £300 million each year to manage any forecast errors or reconciliations.

funding where the Scottish Government has become responsible for social security payments.

The Scottish Budget 2020-21 was set in February 2020 using provisional BGAs based on the latest available OBR forecasts at the time.[22] Following the UK Budget on 11 March the Treasury provided the Scottish Government with revised BGAs. The Scottish Government could either choose to continue to use the provisional BGAs or use the revised BGAs. The Cabinet Secretary for Finance wrote to the Finance and Constitution Committee confirming that the Scottish Government would continue to use the provisional BGAs to inform the Budget.[23] This means the income tax BGA will be unchanged from the February 2020 Scottish Budget until the income tax reconciliation, which will be known in summer 2022 and applied to the 2023-24 Budget.

The BGAs for the fully devolved taxes and social security remain unchanged from the Scottish Budget in February, as shown in Table 3.1. These will be updated following the UK Autumn Budget and the corresponding OBR forecasts. This update is known as an in-year reconciliation.

We can consider how the OBR's forecasts have changed between the Scottish Budget and the March UK Budget and what the expected in-year reconciliation would have been on this basis. Tables 2.1 and 2.2 show the change in the total BGA for the fully devolved taxes (excluding income tax) and the devolved benefits, overall the combined effect is to reduce the Scottish Budget by £206 million.[24]

It's important to note that neither our nor the OBR's forecasts to date account for the effects of COVID-19. As such, we expect both our and the OBR's forecasts to change significantly. This means both reconciliations and Scottish Government revenues and spending are likely to change for 2020-21. The net effect of these on the Scottish Budget depends on how much reconciliations and changes to Scottish revenue or spending cancel one another out.

At the time of the Budget in February the Scottish Government chose to defer the 2019-20 in-year reconciliation until 2020-21, and included the £30 million positive

[22] The social security BGAs were based on the OBR's March 2019 forecasts: Office for Budget Responsibility (2019) Economic and fiscal outlook – March 2019 (link) and the tax BGAs were based on the OBR's revised forecasts published alongside the Welsh Budget in December 2019: Office for Budget Responsibility (2019) Welsh taxes outlook – December 2019 (link)

[23] Letter to the Convener of the Finance and Constitution Committee from the Cabinet Secretary for Finance – 3 April 2020 (link)

[24] The updated BGAs are calculated based on the OBR's March 2020 published forecasts. The DWP have since published their forecasts of spending in England and Wales. The latest forecasts published by the DWP are different to the OBR's because they reflect some differences in accounting methodology but also are updated for later information. The latest DWP forecasts include updated estimates of the split of spending between Disability Living Allowance and the Personal Independence Payment. We expect the OBR to incorporate this information into their next forecasts and the BGAs will be adjusted accordingly. This will change the updated BGAs, even before accounting for any changes because of COVID-19.

reconciliation based on the provision BGAs in the 2020-21 Budget. That reconciliation is unchanged, but the updated 2019-20 BGAs now suggest the final reconciliation, which will be calculated once final outturn data are available, will reduce the 2021-22 Budget by £25 million.

Table 2.1: Updated fully devolved tax BGAs compared to provisional BGAs

£ million	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Provisional	-624	-644	-681	-711	-749	
Updated	-640	-679	-715	-768	-802	-847
Difference	-16	-36	-33	-57	-54	

Source: Scottish Government

Table 2.2: Updated devolved benefit BGAs compared to provisional BGAs

£ million	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Provisional	286	3,203	3,357	3,535	3,718	
Updated	277	3,033	3,107	3,204	3,307	3,417
Difference	-9	-170	-250	-331	-411	

Source: Scottish Government

2.12 BGAs are based on the UK Government's revenue and spending. Where Scotland and the rest of the UK are similarly affected by COVID-19 the BGAs should move broadly in line with changes in Scottish revenue or spending, largely mitigating the effect on the Scottish Budget. The risk for the Scottish Budget is of Scottish revenue or spending being disproportionately affected compared to the rest of the UK, as Scottish-specific effects will not be reflected in the BGAs. At this point it is not possible to know whether the effects in Scotland will differ from the rest of the UK, and therefore whether the revenue and spending effect will match changes in the BGAs.

2.13 We summarise some possible effects on devolved tax revenue and social security spending in Table 2.3. It's important to note that any estimates at this stage would be highly uncertain, as the crisis is in its early stages. We therefore summarise the potential ways revenue and spending could be affected but attach no estimates of the scale of the effects.

2.14 The oil and gas sector is likely to be affected by the large drop in oil prices, and tourism is likely to see a significant contraction as both international and domestic travel are restricted. Oil and gas and tourism are both important industries for Scotland, forming a larger part of the Scottish economy than the UK economy, and this could lead to a larger negative shock in Scotland than the UK. On the other hand, Scotland has a larger public sector than the UK, which could mitigate the shock. At present it is too early to tell if the economic effects of the crisis will differ in Scotland and the rest of the UK.

2.15 The Scottish Government's borrowing powers are limited to £300 million a year to manage any differences in revenues or social security spending to forecasts. These powers to borrow for forecast error are only extended in the event of a Scotland-specific economic shock.[25] Given the likely size of the economic shock generated by COVID-19, a Scotland specific economic shock is a possibility – though it will be some time before data are available to ascertain this.

Table 2.3: Potential effects of COVID-19 on devolved tax revenue and social security spending[26]

Area	Important drivers	Potential effect on area
Income tax	• Reduced employment as businesses close temporarily, become insolvent or reduce their workforce. • Reduced earnings as businesses reduce wages, reduce hours and suspend trading.	Reduced revenue
Non-Domestic Rates	• Government policy and reliefs. So far, the Scottish Government has announced reliefs amounting to £875 million. • Business insolvency may result in empty properties, which may be eligible for empty property relief. • Businesses struggling financially may not make payments.	Reduced revenue
Land and Buildings Transaction Tax	• Reduced number of transactions for both residential and non-residential properties, while restrictions of movement are in place. • Residential property prices are likely to be uncertain in the longer term, and will depend on incomes, expectations, interest rates and unemployment levels.	Reduced revenue
Scottish Landfill Tax	• Reduced commercial waste as businesses cease trading temporarily. • Increased household waste while movement is restricted. • Some recycling services have been suspended, which may increase the volume of waste diverted to landfill.	Unknown
Social security with	• DWP is pausing reviews and reassessments for some benefits, which may increase spending as individuals	Increased spending

[25] A Scotland-specific economic shock is defined as GDP growth in Scotland on a rolling four quarter basis being both below 1 per cent and 1 percentage point less than GDP growth in the UK.

[26] In this table we summarise only the possible effects of COVID-19 on each devolved tax revenue or social security spending. We do not include the effect of the BGAs, because at this stage it is not possible to determine if Scotland and the rest of the UK will be affected differently.

corresponding BGAs[27]	who may have had their claim otherwise reduced or ended continue to receive support. • Higher uptake of benefits, driven by increased awareness and accessibility of benefits during the crisis. • An increase in number of deaths among the elderly and people with pre-existing conditions could reduce spending as claims are ended earlier.	
Social security without corresponding BGAs[28]	• Increase in take-up of qualifying benefits, such as Universal Credit will lead to a larger population eligible to claim support. • Higher take-up of benefits, driven by increased awareness and accessibility of benefits during the crisis. • An increase in number of deaths could increase spending on Funeral Support Payments.	Increased spending

Source: Scottish Fiscal Commission

[27] The majority of spending on social security funded by BGAs is related to disability, ill-health and caring. These benefits are administered by DWP on behalf of the Scottish Government.

[28] Social security which is not funded by BGAs is administered by Social Security Scotland and eligibility largely depends on receipt of a qualifying benefit, such as Universal Credit.

Chapter 3: Latest position of the Scottish Budget

3.1 Our February 2020 report summarised funding for the Scottish Budget 2020-21.[29] There have been a number of subsequent developments.

- The Scottish Budget deal agreed on 26 February for the Stage 1 Bill debate contained additional spending commitments, mainly funded by revised assumptions on the NDR distributable amount and UK budget consequentials.
- The UK Budget contained announcements that resulted in additional consequential funding for the Scottish Government. These policy announcements include both COVID-19 policies and other non-COVID-19 changes.
- As discussed in Chapters 1 and 2, there have been major new policy developments responding to COVID-19, announced following the UK Budget. Many of these policies will result in additional funding for the Scottish Government.

3.2 This chapter describes how these developments have affected the Scottish Budget funding position, and changes in consequentials. We discuss resource and capital funding in turn.

3.3 The Scottish Government's 2020-21 borrowing position remains unchanged since the 6 February 2020 Budget. There have been no changes to their planned borrowing and only a small increase in the planned drawdown from the Scotland Reserve.

Latest resource funding position

3.4 Table 3.1 summarises the Scottish Government's resource funding included in Budget 2020-21. To compare the funding arrangements from our 6 February

[29] Scottish Fiscal Commission (2020) Scotland's Economic and Fiscal Forecasts – February 2020 (link)

2020 publication we have grouped all COVID-19 related developments together and show these after the changes from the UK Budget on 11 March.

Table 3.1: Latest Resource funding plans for 2020-21

£ million	6 February 2020	Budget deal: change from 6 February	UK Budget: change from Budget deal	All COVID-19 measures: change from UK Budget	Total change from 6 February	Latest position
Barnett-determined Block Grant [1]	29,569					29,569
Assumed or actual consequentials	142	+ 48	+ 36	+ 3,520	+ 3,604	3,746
SFC tax revenue forecasts [2]	13,123					13,123
Tax and non-tax BGAs	-12,991					-12,991
Social Security BGAs	3,203					3,203
Reconciliations [3]	-177					-177
Resource borrowing	207					207
Drawdown from Scotland Reserve	106	+ 25			+ 25	131
Other [4]	736					736
NDR Distributable amount [5]	2,790	+ 50		-972	- 922	1,868
Total resource funding	36,707	+ 123	+ 36	+ 2,548	+ 2,707	39,414

Source: Scottish Government, Scottish Fiscal Commission.

[1] Agreed with HM Treasury based on September 2019 Spending Round. Discussed further in Box 2.1.

[2] Scottish Fiscal Commission tax revenue forecasts cover income tax, Land and Building Transaction Tax, and Scottish Landfill Tax. Non-Domestic Rates are not included in the revenue forecasts as these are used separately to set the distributable amount for Non-Domestic Rates.

[3] Includes final reconciliations for: 2017-18 income tax revenue and BGA (-£204 million), 2018-19 Land and Building Transaction Tax BGA (-£3 million), 2018-19 Scottish Landfill Tax BGA (-£2 million), 2018-19 fines, forfeitures and fixed penalties (FFFPs) BGA (£2 million), 2018-19 Carer's Allowance BGA (£0 million), and indicative in-year reconciliations deferred from 2019-20 (£30 million) in February 6 column. Final in-year reconciliations were calculated following the UK Budget, reducing by £25 million.

[4] Includes Rail Resource Grant (£80 million), fiscal framework administration costs (£66 million), Migrant Surcharge (£22 million), deferred consequentials from 2019-20 Supplementary Estimates (£58 million), Queen's and Lord Treasurer's Remembrancer (£5 million), Machinery of Government Transfers (£8 million), Pillar 1 Farm payments (£472 million), and Scottish Government's forecast of revenues from FFFPs (£25 million).

[5] NDR Distributable amount was increased by £50 million as part of the Budget deal, following the COVID-19 consequentials to the Scottish Government to fund NDR reliefs the distributable amount was reduced by £972 million.

3.5 COVID-19 consequentials are a significant increase to the resource funding plans, representing around 10 per cent of the existing Barnett-determined Block Grant.

3.6 We discuss the effect of each of these developments in turn below.

Budget Deal

3.7 On 26 February 2020 the Cabinet Secretary for Finance announced a Budget deal had been reached with the Green Party.[30] This deal included several new spending commitments shown in Table 3.2.

Table 3.2: Government resource spending commitments at Budget Deal

Policy	£ million
Increased funding for Local Government	95
Introduction of the National Concessionary Travel Scheme	15
Increased funding for Scottish Police Authority	13
Total	123

Source: Scottish Government

3.8 The letter provided information on how the above spending commitments would be funded. In addition to the information provided in the letter, the Scottish Government provided us with further explanations and reasoning behind the additional funding for both capital and resource spending. These further explanations were helpful and we hope that in future Budget events they will be routinely provided. We are working with the Government to ensure we are aware of all sources of funding that may change in the future, including revised analysis on expected UK consequentials. Table 3.3 sets out the sources of funding for the Budget deal.

Table 3.3: Budget deal resource funding sources

	£ million
Increase in NDR distributable amount	50
Revised underspend from 2019-20 / Drawdown from Scotland Reserve	25
Revised assumptions about UK Budget consequentials.	48
Total	123

Source: Scottish Government

UK Budget – excluding COVID-19 policies

3.9 The UK Budget took place on 11 March 2020 and was described by the OBR as “the largest sustained fiscal loosening since the pre-election Budget of March 1992”.[31,32] The UK Budget provided large increases in departmental spending plans for general spending, even without accounting for the

[30] Scottish Government (2020) Letter from Cabinet Secretary of Finance to the Finance and Constitution Committee – 26 February 2020 (link)

[31] OBR (2020) Economic and Fiscal Outlook – March 2020 (link)

[32] HM Treasury (2020) Budget 2020: documents (link)

announcements on the first COVID-19 support policies. These commitments resulted in additional resource consequentials for the Scottish Government.

Table 3.4: Resource consequentials for Scottish Government

£ million	6 February Budget	Budget deal	UK Budget
	142	190	226

Source: Scottish Government

3.10 Table 4.4 shows how the confirmed resource consequentials from the UK Budget were comfortably higher than the Scottish Government's previous assumptions at the original Budget on 6 February 2020 and the Budget deal on 26 February 2020. The UK Budget has confirmed around £84 million more in consequentials than originally assumed, and £36 million more than assumed in the Budget deal on 26 February.

3.11 After the February 2020 Budget, the Scottish Government's Budget deal and the UK Budget increased resource funding by £159 million. The additional £159 million is comprised of £84 million in additional consequentials, £25 million from additional drawdown of the Scotland reserve and £50 million from the NDR Distributable amount.

COVID-19 resource consequentials

3.12 The UK Government has announced an extensive package of support to tackle the COVID-19 virus. Fiscal policy measures were announced at the UK Budget and have been significantly expanded in a series of announcements since then. In total the Scottish Government have an additional £3.5 billion funding from consequentials for the 2020-21 Budget.

3.13 COVID-19 policy measures which apply to the whole of the UK, such as the Coronavirus Job Retention Scheme, do not generate consequentials for the Scottish Government. Policies which apply to devolved areas, such as the Local Authority hardship fund, generate corresponding consequentials for the Scottish Government.

3.14 There remains significant uncertainty around the required level of health spending from both the UK and Scottish Government. The Secretary of State for Health and Social Care has given permission to the Department Health and Social Care to break department expenditure limits in 2019-20 in order to respond to COVID-19.[33] The funding provided to the NHS and other public services in 2020-21 has already been increased significantly from part of an initial £5 billion to over £14 billion. The consequentials for the Scottish

[33] Department of Health and Social Care (2020) Letter from Secretary of State for Health and Social Care to Permanent Secretary of Department of Health and Social Care and Chief Executive of NHS – 29 March 2020 (link)

Government have already increased accordingly, and could increase further if funding is further increased in England. The Cabinet Secretary of Finance for Scotland has said that health costs in Scotland may run past existing agreed consequential funding.[34]

3.15 Given the unique circumstances full information on the health spending from both Governments will only be understood over time. The consequentials we report here contain significant levels of uncertainty.

3.16 Table A.1 and A.2 in Annex A summarise the COVID-19 policy measures taken by the UK Government, separated by those that generate consequentials and those that don't. Of the known consequentials, the Scottish Government have received £3.5 billion.

Latest capital funding position

3.17 Table 3.5 summarises the Scottish Government's capital funding included in Budget 2020-21. Unlike resource funding, the Capital funding position does not contain any COVID-19 related consequentials.

Table 3.5: Latest Capital funding plans for 2020-21

£ million		6 February 2020	Budget deal – change from 6 February	UK Budget - change from Budget deal	Total change from 6 February	Latest position
Capital	Barnett-determined Block Grant [1]	4,408				4,408
	Assumed or actual consequentials	326	+7	+ 76	+ 83	409
	Financial Transactions (FTs) [1]	606		+ 5	+ 5	611
	Fossil Fuel Levy	0	+ 43	- 43	0	0
	Capital borrowing	450				450
	Drawdown from Scotland Reserve (capital and FTs) [2]	37				37
	Other [3]	-10				-10
	Total capital funding	5,817	+ 50	+ 38	+ 88	5,905

Source: Scottish Government, Scottish Fiscal Commission.
[1] Agreed with HM Treasury based on September 2019 Spending Round.
[2] Includes planned drawdowns of £5 million for general capital spending and £32.2 million for FTs.
[3] Includes Glasgow City funding (£15 million) and repayment of Financial Transactions to HM Treasury (-£25 million).

[34] Scottish Government (2020) Letter from Cabinet of Finance to the Chief Secretary to Treasury – 12 March 2020 (link)

Budget Deal Capital commitments

3.18 The Scottish Government announced two additional spending commitments totalling £50 million in the Budget Deal on 26 February 2020.

Table 3.6 Budget Deal Capital spending commitments

Policy	£ million
Projects to support net-zero ambitions	45
Scottish Police Authority	5
Total	50

Source: Scottish Government

3.19 The letter from the Cabinet Secretary for Finance announcing the Budget deal, contains some information on how these Capital commitments will be financed, but does not provide a detailed breakdown.[35] The Scottish Government have provided us with additional detail on the assumed funding, presented in Table 3.7.

Table 3.7: Budget deal capital funding sources

£ million	Information provided by Scottish Government	SFC Assumptions on spending allocation
Revised underspend from 2019-20 / Drawdown from Scotland Reserve (Capital and FTs)	0-10	0
Anticipated income from fossil fuel levy	Up to 43	43
Revised assumptions about UK Budget consequentials.	10-30	7
Total	63 - 83	50

Source: Scottish Government, Scottish Fiscal Commission.

3.20 The information on the Capital funding sources had a range of between £63 and £83 million of additional capital funding, in comparison to the spending commitment of £50 million. The Scottish Government's response to us stated that:

> "As the assumptions about 2019-20 underspend, UK Budget consequentials and Fossil Fuel Levy income relate to processes that are ongoing and they are therefore best considered within a range. The precise funding mix that will be used may therefore be subject to some variance over the course of 2020-21."

[35] Scottish Government (2020) Letter from Cabinet Secretary of Finance to the Finance and Constitution Committee – 26 February 2020 (link)

3.21 For the purposes of mapping the funding sources to the spending commitments we have assumed the full £43 million is received from Fossil Fuel Levy, with the remaining £7 million from UK budget consequentials.

UK Budget capital funding

3.22 After the February 2020 Budget, the Scottish Government's Budget deal and the UK Budget increased capital funding by £159 million.

3.23 Similar to resource funding, the UK Budget introduced a number of measures that generated capital consequentials. These are predominantly related to health, housing and transport.

Table 3.8: Capital funding sources for Scottish Government

£ million	6 February Budget	Budget deal	UK Budget
	326	333	409

Source: Scottish Government

3.24 The confirmed capital funding from the UK budget were comfortably greater than the Government's previous assumptions at the original Budget on 6 February 2020 and the Budget deal on 6 February 2020.

3.25 Unlike the £333 million capital funding at the Budget deal, the £409 million confirmed following the UK Budget does not include the Fossil Fuel Levy. The Scottish Government have said that they expect further details on the Fossil Fuel Levy over the summer. As with resource consequentials, the capital consequentials will be updated again later in the financial year – should the UK Government not spend as much in capital as it anticipated at the Budget then these consequentials could be negative and reduce capital funding.

Annex A: COVID-19 policy commitments

Spending commitments to manage COVID-19

A.1 Both the Scottish and UK Governments have announced a series of commitments to support individuals and businesses during the COVID-19 crisis. The package of support from both Governments significantly increases public spending in the UK and Scotland, starting from March 2020. We expect large effects be seen in the 2020-21 financial year.

A.2 This Annex sets out our understanding of:

- UK-wide COVID-19 policies announced by the UK Government
- Non UK-wide policies announced by UK Government that generate consequentials for the Scottish Government
- Scottish Government COVID-19 policies

A.3 The tables are not an extensive list of every policy announced by both Governments, and support may have dramatically changed following publication. It also does not fully account for the expected increase in UK and Scottish health spending.

Table A1: UK-wide COVID-19 policies announced by the UK Government

Category of support	Policy	Description
Financial support for businesses during coronavirus	Coronavirus Business Interruption Loan Scheme	This scheme helps small and medium-sized businesses, with an annual turnover of up to £45 million, affected by coronavirus (COVID-19) to access finance of up to £5 million.
	Coronavirus Large Business Interruption Loan Scheme	This scheme will help large businesses, with an annual turnover of between £45 million and £500 million, affected by coronavirus (COVID-19) to access loans of up to £25 million.
	COVID-19 Corporate Financing Facility	Under the COVID-19 Corporate Financing Facility (CCFF), the Bank of England will buy short-term debt from large companies.

	Coronavirus Job Retention Scheme	If a business cannot maintain current workforce because operations have been severely affected by COVID-19, they can furlough employees and apply for a grant that covers 80 per cent of their usual monthly wage costs, up to £2,500 a month, plus the associated Employer National Insurance contributions and pension contributions on that subsidised furlough pay. Initially announced for three months, the scheme has already been extended until the end of June.
	Coronavirus Statutory Sick Pay Rebate Scheme	The Coronavirus Statutory Sick Pay Rebate Scheme will repay employers the current rate of SSP that they pay to current or former employees for periods of sickness starting on or after 13 March 2020.
	Deferral of VAT payments	For UK VAT registered businesses who have a VAT payment due between 20 March 2020 and 30 June 2020 can defer the payment until a later date.
Support for Self-Employed individuals	Delay Second payment on account	Self-employed individuals who have a tax payment due in July (the second payment on account), can choose to delay this. They will have until 31 January 2021 to pay it.
	Self-employment Income Support Scheme	This scheme will allow individuals to claim a taxable grant worth 80 per cent of trading profits up to a maximum of £2,500 a month. It will be available for 3 months, but may be extended. The grant will be subject to Income Tax and National Insurance contributions but does not need to be repaid.
Support for benefit payments	Changes to how benefits are administered	The DWP has announced a number of measures to support individuals currently claiming and applying for benefits. These changes include: relaxed rules around benefit limits and sanctions, a pause in face-to-face health assessments, an increase to the standard allowance for Universal Credit and basic element in working tax credit and an increase in housing allowances for the housing element of Universal Credit or Housing Benefit claimants.

Source: UK Government (2020) Financial support for businesses during coronavirus (COVID-19) (link), UK Government (2020) Chancellor sets out extra £750 million coronavirus funding for frontline charities (link), Department for Work and Pensions (2020) Employment and benefits support (link)

Table A2: UK-wide COVID-19 policies announced by the UK Government that generate consequentials for Scottish Government

UK Policies	Scottish Consequential £ million
Public services	
Health services	450
Local authorities	310
Railway services	340
Other	55
Business support	
Business support grants (total cost)	1,205
Business rates reliefs (total cost)	1,045
Charity support	65
Fisheries support	0.5
Individuals	
Local authority hardship fund	50
Total	
Total	3,520

Source: HM Treasury

Table A3: Scottish Government COVID-19 policies

Category of support	Policy
Support for businesses	£1.9 billion State-backed loans £2.2 billion package of support for businesses • 100 per cent Non-Domestic Rates relief for all retail, hospitality, leisure and airport properties • 1.6 percent Non-Domestic Rates relief for all properties. • £10,000 Small Business Grants to all Small Business Bonus Scheme relief recipients; all Rural Relief recipients & all properties eligible for SBBS but in receipt of Nursery/ Disabled Relief / Fresh Start/ Business Growth Accelerator and/or in Enterprise Areas. • £25,000 grants to the Retail, Hospitality, Leisure and Aviation sectors for those with a rateable value between £18,000 and £51,000 Around £220 million of further grants being made available for businesses - including the recently self-employed. The new package of measures includes £111 million to extend the Small Business Grant scheme and for the Retail Hospitality and Leisure Grant Scheme to ensure that, in addition to a 100 per cent grant on the first property, small business rate payers will be eligible to a 75 per cent grant on all subsequent properties.

Support for welfare and wellbeing	£350 million fund for communities affected by COVID-19. This includes: • £50 million Hardship Fund – given directly to local authorities. • £45 million additional support for the Scottish Welfare Fund. • £50 million set aside for additional pressure on devolved Social Security benefits and Council Tax Reduction. • £40 million Supporting Communities Fund for small scale community groups to support people at risk and build resilience. • £50 million Community Wellbeing Fund will help charities/ third sector/ social enterprises. • £70 million Food Fund. • £20 million Third Sector Resilience Fund. • £25 million Reserve Fund.
Utilities	£60 million water industry package agreed to help businesses facing difficulties with water charges. Scottish Water has agreed to suspend pre-payment charges for licensed providers for 2 months, beginning with the April payment.
Transport	Financial support package for the bus industry which will maintain Scottish Government financial support (concessionary reimbursement and bus subsidy) at the levels forecast prior to the impact of COVID-19. Ferry Fares are being frozen on the Clyde and Hebrides Ferry Services.
Fisheries	£5 million Seafood Sector Fund. Including an initial payment of 50 per cent of two months' average earnings will be made to owners of all full time Scottish registered fishing vessels of <12m. £10 million Scottish Seafood Business Resilience Fund provides grants/ loans to business within the onshore seafood processing industry.
Mental health	£3.8 million funding for mental health services.
Creative Scotland	Creative Scotland COVID-19 Impact Funds of £11 million.
Employability	Fair Start Scotland – financial support measures for Fair Start Scotland Service Providers.
Student support	£5 million Emergency Funds for students to help those facing hardship.

Source: Scottish Government

Abbreviations

BGA	Block Grant Adjustment
DWP	Department for Work and Pensions
FFFP	Fines Forfeitures and Fixed Penalties
FT	Financial Transactions
GDP	Gross Domestic Product
NDR	Non-Domestic Rates
OBR	Office for Budget Responsibility
SBBS	Small Business Bonus Scheme
SFC	Scottish Fiscal Commission
SSP	Statutory Sick Pay
UK	United Kingdom
VAT	Value Added Tax

A full glossary of terms is available on our website:

https://www.fiscalcommission.scot/explainers/glossary/

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