Scottish Fiscal Commission

Scotland's Economic and Fiscal Forecasts

January 2021

fiscalcommission.scot

This publication is available at www.fiscalcommission.scot

Any enquiries regarding this publication should be sent to us at: Scottish Fiscal Commission, Governor's House, Regent Road, Edinburgh EH1 3DE or info@fiscalcommission.scot

ISBN: 978-1-911637-26-4

Published by the Scottish Fiscal Commission, January 2021

Laying Number: SFC/2021/1

Version Log

Published	Version
January 2021	1.0
October 2021	1.1

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 revenues and devolved social security spending to inform the Scottish Budget.

This report is our fourth set of Scottish Budget forecasts. These forecasts are our first since the COVID-19 pandemic began in Scotland and they cover the years 2021-22 to 2025-26. They demonstrate the profound effects COVID-19 has had on the economy and the Scottish Budget. There is huge uncertainty about how the pandemic will develop, and in turn what future associated public health restrictions and fiscal support measures might be put in place. This in turn means our forecasts are subject to greater uncertainty than in a typical year. Throughout this report we discuss the assumptions and judgements we have made, and the associated risks. Our forecasts represent the collective view of the four Commissioners of the Scottish Fiscal Commission who take full responsibility for the judgements that underpin them.

While the staff of the Scottish Fiscal Commission have as always greatly supported us in producing these forecasts, we take this opportunity to acknowledge the exceptional level of dedication and hard work they have shown in doing so while working remotely.

Our forecasts rely on data from a range of providers and we are grateful for their support. We would also like to thank officials from the Scottish Government, Revenue Scotland, Social Security Scotland, DWP, HM Treasury, HMRC and the OBR for their constructive challenge of our judgments and for ensuring that we considered all the available evidence.

Susan Rice

Dame Susan Rice DBE

F. Breedon

Professor Francis Breedon

Alasdair Smith

Professor Alasdair Smith

David Ulph

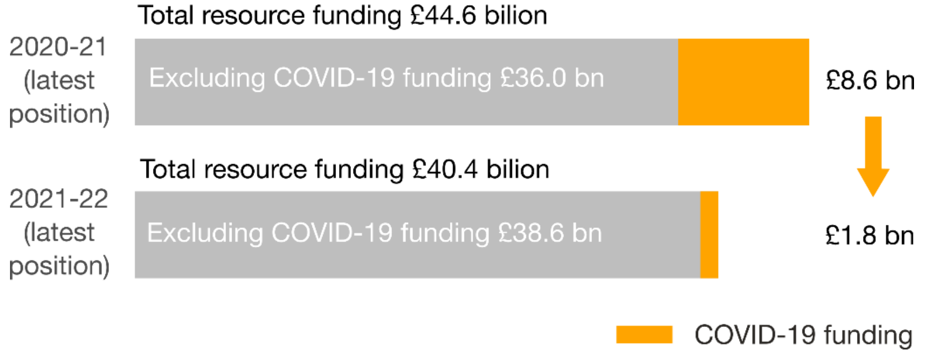
Professor David Ulph

28 January 2021

Fiscal Overview

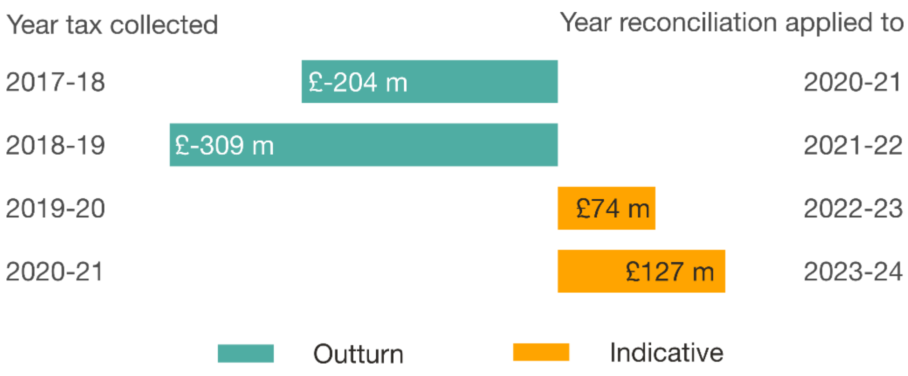
COVID-19 funding increased successively over the course of 2020-21, from £3.5 billion in April to the latest estimate of £8.6 billion.

The 2021-22 Scottish Budget is set based on £1.8 billion COVID-19 funding. Treasury confirmed £1.3 billion and £500 million is assumed by the Scottish Government



Income tax reconciliations adjust for differences between outturn and forecasts in previous years. We are expecting two positive reconciliations, related to tax collected in 2019-20 and 2020-21.

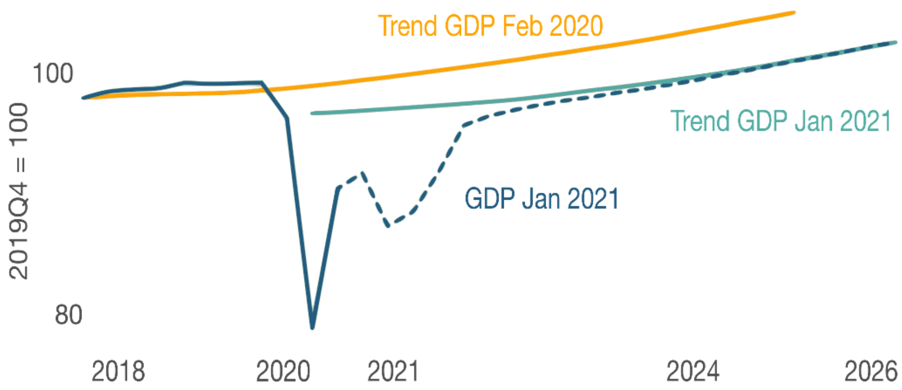
Estimates of future reconciliations are highly uncertain and will be finalised when outturn data are released.



Economy

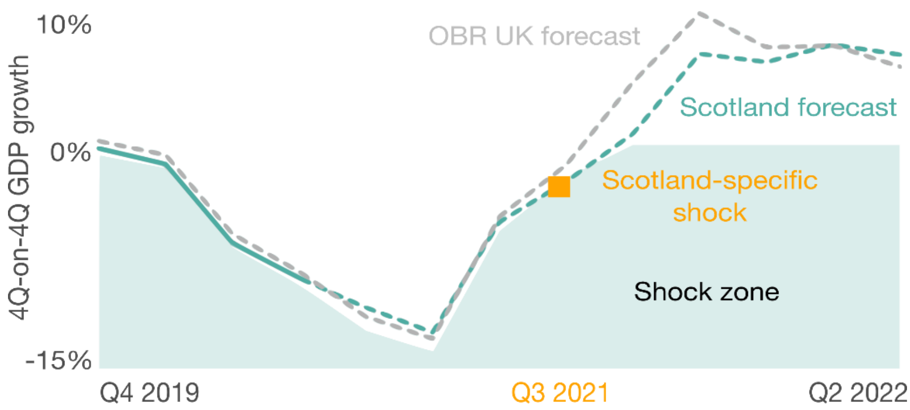
We expect the latest lockdown to reduce economic activity by 5 per cent in the first quarter of 2021.

We forecast that GDP grows by 2 per cent over 2021, 7 per cent in 2022, and recovers to its pre COVID level in 2024. By 2025, GDP is 4 per cent lower than we forecast in February.

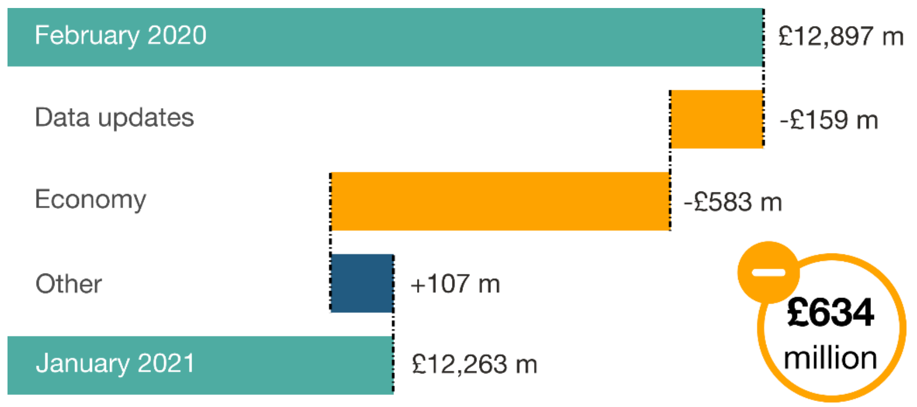


Differences between our and OBR's forecasts trigger a Scotland-specific economic shock in Q3 2021. This is mainly because we could account for the early-2021 restrictions.

This shock increases annual limits on resource borrowing by £300 million, and removes annual limits on the withdrawal of funds from the Scotland Reserve.

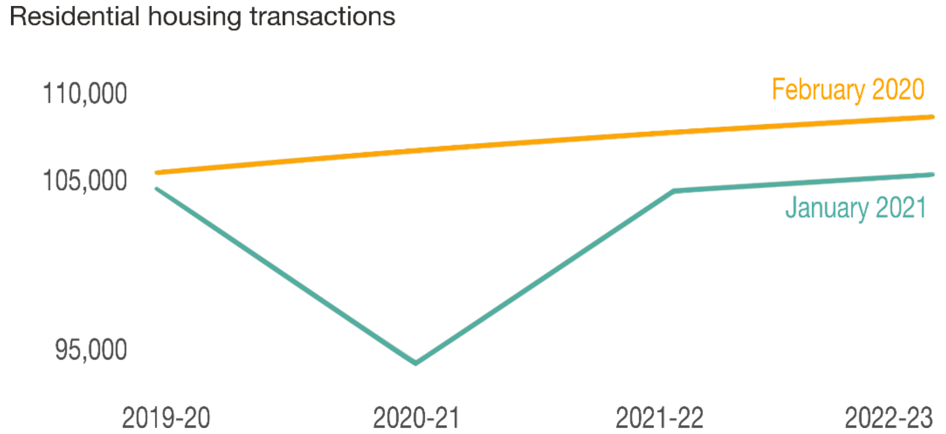


Tax



Our income tax forecast for 2021-22 has fallen by £634 million compared to our previous forecast, primarily because of falls in employment.

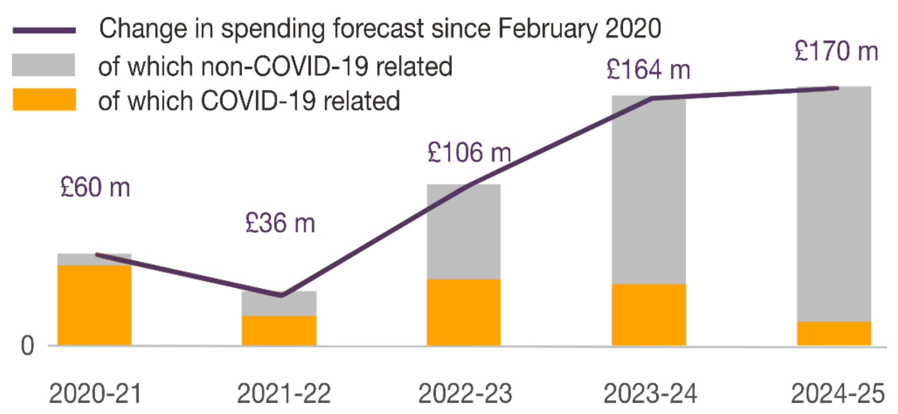
The forecast now uses the HMRC RTI data for 2019-20 and 2020-21, giving us more timely information on the effects of the furlough schemes.



The lockdown's effect on the housing market has been primarily via transactions which bounced back in 2021-22.

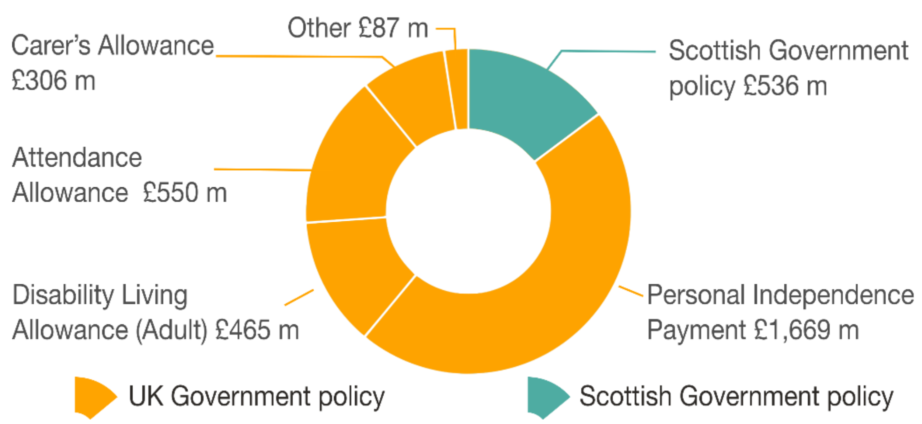
We expect the effect on average house prices to be more muted as incomes continue to be supported by the various job support schemes.

Social Security



COVID-19 has increased the number of people eligible for social security support as unemployment has increased and incomes have reduced.

There are also other COVID-19 related factors that reduce spending such as the lower inflation forecast and lower pension-age population.



In 2021-22, most social security spending, over £3 billion, will be based on UK Government policy and administered by DWP.

Personal Independence Payment is the most significant payment with an expected spend of £1.7 billion.

Fiscal Overview

Fiscal Overview	2020-21	2021-22	£ million
Resource funding (latest position)	44,579	40,431	Non-COVID-19 related funding increases by £2.6 billion and COVID-19 funding decreases by £6.8 billion

Economy

Economy	2020	2021	2022	2025	% growth
GDP	-10.7	1.8	7.5	1.7	GDP growth, shocked in 2020 by restrictions on economic activity, rebounds in 2022 before stabilising.
Trend Productivity	0.0	0.2	0.4	1.6	Trend productivity is subdued in the short term and then gradually rises.
Nominal Earnings	2.5	2.6	2.4	3.3	Average nominal earnings growth is supported by the furlough scheme in 2020 and then increases gradually.
Employment	-2.4	-1.5	1.2	0.2	Growth revised down in 2020 and 2021 to account for the effects of COVID-19 on the labour market.

Tax

Tax	2020-21	2021-22	2022-23	2025-26	£ million
Income Tax	11,850	12,263	12,907	14,718	Income tax revenues grow slowly because of increased unemployment.
Non-Domestic Rates	1,848	2,680	2,930	3,216	Forecast includes policy announcements for the retail, hospitality & leisure sectors and poundage set at 49p.
LBTT	517	586	629	740	Housing market seeing recovery following lockdown during 2020. Limited effect on average prices.
Scottish Landfill Tax	95	88	86	61	Downward revision in line with weaker outlook for the economy.
Policy announcements					
Non Domestic Rates		-251	-67	-71	Poundage set at 49p in 2021-22 with extended relief for the retail hospitality & leisure sectors.

Social Security

Social Security	2020-21	2021-22	2022-23	2025-26	£ million
All devolved social security assistance	3,495	3,614	3,810	4,249	Spending will increase over the next five years as more people receive social security support each year and most payment amounts increase with inflation.

Contents

Summary

Introduction

1 This report contains our official economic, tax and social security forecasts along with policy costings for the changes in tax and social security proposed in the Scottish Budget. Our forecasts are just one component of the Budget; we also discuss how the Scottish Budget is set and provide our assessment of the reasonableness of the Government's borrowing plans.

2 The 2021-22 Scottish Budget is being set at a time of great uncertainty about how the COVID-19 pandemic will evolve. Despite the development and roll-out of vaccines we expect both the Scottish and UK Governments to keep public health measures in place for much of 2021.

3 These public health measures have economic costs. Both Governments have introduced policies to reduce the economic effects of the public health measures on individuals, households and businesses. The most significant fiscal support from the UK Government has been the furlough schemes, allowing businesses to continue to pay employees even if they are unable to work because of public health restrictions. As part of the UK-wide fiscal response, the Scottish Government has received funding to provide support in devolved areas, including health services, local authority services and grants to businesses forced to close or operate with restrictions.

4 In spite of the response from the UK and Scottish Governments, we expect that the Scottish economy will have contracted by around 11 per cent in 2020 as a result of the COVID-19 crisis. This reduced economic activity continues into 2021, with the latest lockdown reducing GDP in the first quarter of 2021 by 5 per cent. The effect on GDP of this lockdown is less than the first as more sectors of the economy, including construction and manufacturing, remain open. We provide further information in this summary on our economy forecast and our expectations for recovery.

5 Funding for the public health measures comes largely from the UK Government. During this year, the funding the Scottish Government has received for COVID-19 has increased from £3.5 billion in April to £8.6 billion in December.[1] The UK Budget in March is likely to include additional UK spending on COVID-19 as it is clear the pandemic will continue in the next financial year. Increases in UK Government spending on COVID-19 will feed through to the Scottish Government. More funding later in the financial year is also probable.

6 This is the context in which the Scottish Government has to set its Budget and formulate its borrowing plans for 2021-22. In this summary, we first discuss the assumptions we've made about the outlook for COVID-19 and the effects of the pandemic on the Scottish economy. We then consider the position of the Scottish Budget and the challenges facing the Scottish Government in more detail. The Government must balance its budget so it cannot overspend. But it must also avoid large underspends. The Scotland Reserve has a maximum limit of £700 million, including capital, and this cap limits the scale of underspends which can be carried forward. A further implication is that the later in the financial year additional funding from the UK Government arrives, the more difficult it is for the Scottish Government to manage its budget.

[1] Scottish Fiscal Commission (2020) Fiscal Update – April 2020 (link)

COVID-19

7 Our previous forecasts were published in February 2020, before the seismic effects that COVID-19 would have on the world were widely understood. In the last year, we have witnessed significant economic and social change as a result of the pandemic and this affects all of our forecasts. COVID-19 has been the dominant factor in producing our forecasts for the next five years and we have had to make a significant number of judgements, ranging from how we interpret data and information from March 2020 onwards to how we expect Scotland to emerge from the series of economic and social restrictions imposed by the Scottish Government.

8 As part of our forecasting process we've made a number of assumptions about the likely outlook for Scotland. Our forecasts are based on a central scenario of assumptions about cases, excess deaths and restrictions. For 2021 we assume:

- Both the tougher restrictions and the roll-out of the vaccination will take time to have an effect. We expect to see elevated case numbers and excess deaths throughout 2021 Q1. From 2021 Q2, we assume cases and excess deaths will gradually fall to the levels seen from June to September 2020.
- From 2021 Q3, the virus will be broadly controlled, though this does not mean the pandemic is over. Throughout 2021 varying levels of regional and national restrictions will need to be implemented to continue to control the spread of the virus, even as the vaccine is rolled out.
- There are no further extensions to the current job protection schemes due to end at the end of April 2021.
- Vaccination against the virus began in late 2020. It will take time for this to take effect, not least because of limited supplies of any vaccines and the time it takes to vaccinate a large population. There are also uncertainties about the efficacy in reducing transmission and the duration of the vaccine.
- By 2021 Q4 COVID-19 is on the whole managed like a normal virus. Cases and deaths run at a low baseline level and restrictions, national or regional, are no longer required.

9 Our COVID-19 assumptions are a central case to enable us to produce our economy and fiscal forecasts for the Scottish Budget. If the COVID-19 pandemic and the associated restrictions develop in a way which is significantly different from these assumptions, the outlook for the economy, taxes and social security spending could be significantly different from our forecasts. We provide further detail on our COVID-19 assumptions and the risks surrounding these assumptions in Chapter 1.

10 From the above it is clear that we expect no quick return to "normality" for 2021-22. In the next section we discuss what this means for our economy forecast, and we then discuss the implications for the Scottish Budget and for our tax and social security forecasts.

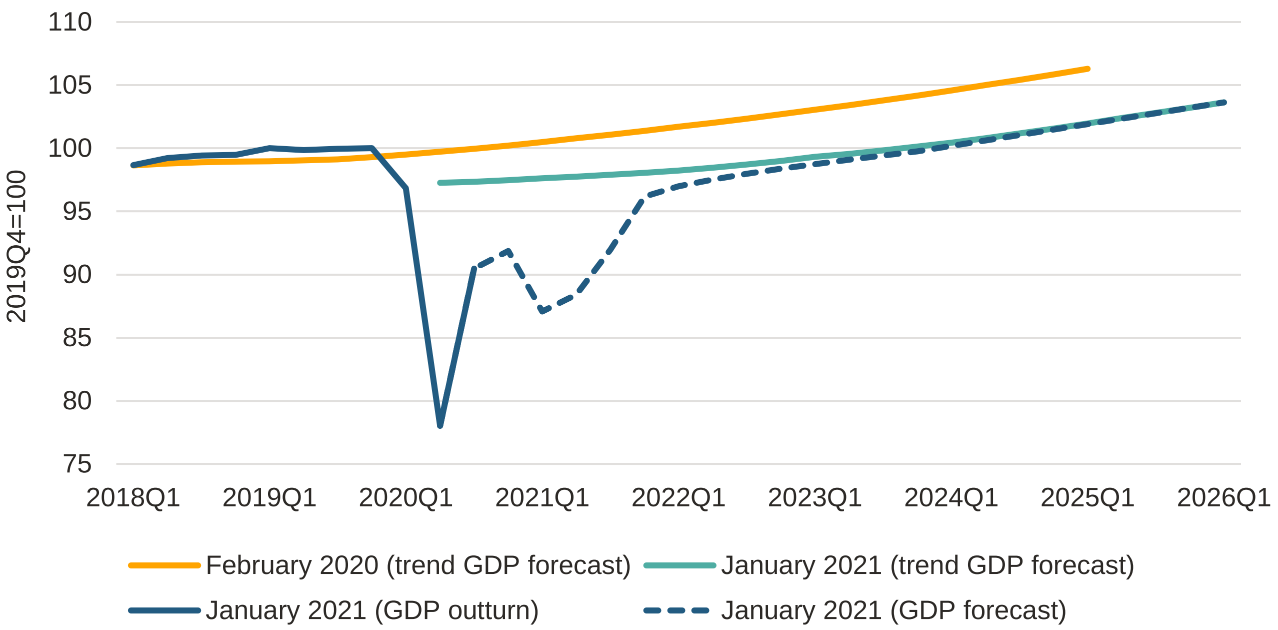
Economy

COVID-19

11 The Scottish and UK economies are both expected to contract by around 11 per cent in 2020 as a result of the COVID-19 crisis. As shown in Figure 1, Scottish GDP fell by almost a quarter during the

UK-wide lockdown in early 2020. As restrictions were lifted over the summer, GDP started to recover and grew for six consecutive months so that in 2020 Q3 Scotland had regained around two thirds of the lost output.

Figure 1: Trend and actual Scottish GDP, February 2020 and January 2021



Source: Scottish Fiscal Commission, Scottish Government (2020) First estimate of GDP: 2020 Q3 (link).

12 Restrictions started to tighten again across the UK in late 2020, with mainland Scotland and most of the rest of the UK in lockdown at the start of 2021. We expect this new lockdown to reduce economic activity in the first quarter of this year. As in April 2020, schools were closed in January 2021 and we expect them to remain closed throughout the first quarter. In contrast to the first lockdown, more sectors of the economy remain open, many businesses have adapted to the restrictions, and support schemes such as furlough are already in place. We expect GDP to fall in 2021 Q1 by around 5 per cent, a smaller fall than during the first lockdown.

13 Our forecast for 2021 as a whole is for growth of 1.8 per cent, picking up to 7.5 per cent in 2022, mainly fuelled by household consumption as higher-income consumers who accumulated savings during the lockdown months start spending again. In contrast, lower-income households who have been disproportionately affected by the COVID-19 crisis, were less able to save during the pandemic, and may have run down savings or borrowed to cover day-to-day expenses, so at best they can be expected to spend cautiously in order to restore their finances.

14 COVID-19 will have long-lasting effects on the Scottish economy. We don't expect Scottish GDP to recover to its pre-COVID-19 level until the start of 2024. Scottish GDP in 2025 will still be 4 per cent below where we expected it to be in our February 2020 forecast. Our long-term GDP outlook has changed because we assume there will be longer-term effects of the pandemic on the Scottish economy. In particular, compared to our previous forecast, we expect that:

- Productivity is around 2 per cent lower because of factors such as lower levels of capital investment, global trade and migration during the pandemic, and scarring effects from prolonged unemployment
- Labour force participation rates for those aged 16 to 24 are 0.9 per cent lower, in part because the long-term employability of younger people may be reduced by unemployment early in their working lives

- The long-run unemployment rate increases from 4.0 to 5.5 per cent in 2020, gradually moving to 4.4 per cent at the start of 2023
- The population aged 16 and over is 0.5 per cent lower for the reasons given in Box 3.1, which include COVID-related excess deaths and our assumption of zero net international migration in the short term

Figure 2: Headline economy forecasts, growth rates

Per cent	2019	2020	2021	2022	2023	2024	2025
GDP							
February 2020	0.9	1.0	1.1	1.2	1.2	1.2	
January 2021	0.8	-10.7	1.8	7.5	1.6	1.6	1.7
Average nominal earnings							
February 2020	2.8	3.0	3.1	3.2	3.3	3.3	
January 2021 [1]	4.2	2.5	2.6	2.4	2.7	3.0	3.3
Employment							
February 2020	0.4	-0.3	0.1	0.2	0.2	0.2	
January 2021	0.1	-2.4	-1.5	1.2	0.9	0.4	0.2

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2020) Scotland's Economic and Fiscal Forecasts – February 2020 (link).
Shaded cells refer to outturn available at time of publication.
[1] Average nominal earnings growth for 2019 as well as 2020 Q1 and Q2 are based on wages and salaries data from Scotland's Quarterly National Accounts and employees data derived from the Labour Force Survey and Annual Population Survey for Scotland. We used RTI mean pay data to inform our short-run forecast of average earnings growth in 2020 Q3.

15 The job retention schemes have largely, but not completely, protected the labour market from the economic consequences of the pandemic. Although headline unemployment figures from the Labour Force Survey have remained stable, income tax PAYE Real Time Information (RTI) indicates a decrease in paid employment since last April. There is also a fall in workforce jobs for Scotland and the UK.[2] We expect the unemployment rate to peak at 7.6 per cent in 2021 Q2 once the furlough schemes end. We have revised down our forecasts of employment growth in 2020 and 2021 to account for the effects of COVID-19 on the labour market.

16 Average nominal earnings have been relatively resilient to COVID-19, according to PAYE RTI data available up to October 2020, and are on course to grow in 2020 although at a slower rate than we expected last February. Our forecasts of average nominal earnings growth have been revised down in subsequent years, mainly reflecting lower productivity growth, lower public sector pay growth and higher unemployment compared to our previous forecast. With inflation currently very low, and lower than expected at the time of our previous forecast, real average earnings growth forecasts for 2020 and 2021 have been revised up.

Brexit

17 Another important development since our previous forecast is that the UK and EU have reached a free trade agreement which came into effect at the end of the transition period on 1 January 2021. Our recent forecasts already incorporated the long-run effects of Brexit on the Scottish economy

[2] ONS (2020) JOBS05: Workforce jobs by region and industry – December 2020 (link)

and, because the deal is within the range of our previously expected outcomes, we continue to use the same assumptions for this forecast. Further details on our economy forecasts can be found in Chapter 3.

Fiscal overview

18 Over the course of 2020-21 the UK Government's public health response and associated restrictions have evolved, and successive UK Government announcements resulted in additional funding for the Scottish Government. In July the UK Government announced a guaranteed minimum level of funding for COVID-19 of £6.5 billion to provide the Scottish Government with more certainty in its budget management. This has since been increased three times, most recently to £8.6 billion in December 2020. The 2020-21 Scottish Budget has now increased by 19 per cent since it was set in February 2020. Funding could increase again if spending by the UK Government is higher than expected in December.

19 There is variability in Scottish Government expenditure too, as public health decisions create a need for additional expenditure, for example in grants to businesses forced to close because of restrictions.

20 This is the context within which the Scottish Government has to manage and balance its budget for 2020-21 as well as set the 2021-22 Budget. In previous publications we have highlighted how the devolution of taxes and social security would make the Scottish Budget more variable. The £8.6 billion increase in funding for COVID-19 over the course of 2020-21 has far exceeded any changes we could have expected from tax and social security variations. The challenges and risks facing the Scottish Budget are on a new scale.

21 Our Fiscal Update published separately discusses in detail the changes to the 2020-21 Scottish Budget.[3]

22 In the Spending Review in November the UK Government announced the Scottish Government will receive £1.3 billion of COVID-19 funding for 2021-22.[4] Given the uncertainties in the evolution of the pandemic, and the tightening of restrictions across the UK since November, there may be further changes in funding. The scale of these changes is highly uncertain and depends on the UK Government's fiscal and public health responses to the crisis. Currently the furlough schemes are due to finish at the end of April, but the UK Government may still decide to extend those schemes again. The Scottish Government has assumed an additional £500 million of COVID-19 funding and we consider this to be a prudent estimate.

[3] Scottish Fiscal Commission (2021) 2020-21 Fiscal Update (link)
[4] UK Government (2020) Spending Review 2020 (link)

Figure 3: Funding for the 2021-22 Scottish Budget

£ million	Resource	Capital	Total
Barnett-determined block grant and non-COVID funding	30,923	4,973	35,896
Other and non-Barnett funding	1,002	0	1,002
COVID-19 funding	1,828	0	1,828
Borrowing	319	450	769
Scotland reserve drawdown	231	200	431
SFC tax forecasts	12,937		12,937
Tax and fines, forfeitures and fixed penalties BGAs	-12,430		-12,430
Social security BGAs	3,310		3,310
Final reconciliations	-319		-319
NDR distributable amount	2,631		2,631
Financial transactions		208	208
Total funding	40,431	5,831	46,262

Source: Scottish Fiscal Commission, Scottish Government.
BGAs is an acronym for Block Grant Adjustments. Detailed information on resource and capital funding can be found in Chapter 2.

Scotland-specific economic shock

23 The OBR's November 2020 forecasts were made before the current lockdown, and so took a more optimistic view of prospects for the UK economy in 2021 than we are taking now. As a result of the difference between our forecast and the OBR's forecast, the criteria for a 'Scotland-specific economic shock' are met for the first time:

- annual GDP growth in Scotland, on a four-quarters-on-four-quarters basis (4Q-on-4Q), is below 1.0 per cent
- 4Q-on-4Q growth in Scotland is 1.0 percentage point or more below the UK

24 Based on what we observed in 2020, we believe the outlook for Scottish GDP and UK GDP are broadly similar and most of the difference between our forecasts for Scotland and the OBR's UK forecasts is likely to be accounted for by the fact that the two forecasts were based on different announcements about what health measures would be in place in early 2021. The Scotland-specific economic shock may not be present once the OBR updates its forecasts in March 2021, or once outturn data are available.

Borrowing

25 The fiscal framework provides additional borrowing and Scotland Reserve powers for Scotland in the event of a Scotland-specific economic shock.[5] The resource borrowing limit for forecast error increases from £300 million to £600 million for the next three financial years. In addition the annual drawdown limits from the Scotland Reserve are removed for the same period. Even if future

[5] The agreement between the Scottish Government and the United Kingdom government on the Scottish Government's fiscal framework (link)

forecasts or outturn data no longer trigger a shock in 2021-22, the relaxation of limits will not be revoked.

26 The Scottish Government plans to borrow £319 million in 2021-22, largely to manage the negative income tax reconciliation from 2018-19. As borrowing can only occur in the case of negative forecast errors, this is currently the maximum permitted borrowing. Any further negative forecast errors would permit further borrowing during 2021-22 up to the limit of £600 million.

27 The Scottish Government must balance its budget so it cannot overspend. But it must also avoid large underspends. The Scotland Reserve has a maximum limit of £700 million, including capital, and this cap limits how much underspend can be carried forward from one year to the next. While the removal of the annual drawdown limits in 2021-22 allows the Scottish Government to use any funds in the Reserve, the £700 million limit remains a constraint that is particularly significant in comparison to the scale of change seen in the budget this year.

28 The Scottish Government is using the Reserve and resource borrowing to manage the Budget during a challenging year. We consider their plans based on the information available are reasonable. But we recognise that the on-going uncertainty means these plans may change significantly and recommend that the position of the 2021-22 Budget is monitored and reviewed over the course of the financial year. Further details on the Scottish Government's borrowing plans can be found in Chapter 2.

Income tax

29 Income tax revenues in 2021-22 will contribute around £12.3 billion to the Scottish Budget. Figure 4 summarises the change in our income tax forecast since February 2020 and further information can be found in Chapter 4.

Figure 4: Change in NSND income tax revenue since February 2020

£ million	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
February 2020	11,378	11,677	12,365	12,897	13,447	14,059	14,722
January 2021	11,556	11,838	11,850	12,263	12,907	13,481	14,080
Change since previous forecast	178	161	-516	-634	-540	-578	-642

Source: Scottish Fiscal Commission, HMRC (2020) Scottish Income Tax Outturn Statistics (link)
Shaded cells refer to outturn available at time of publication. Figures may not sum because of rounding.

30 We have used information on income tax growth rates for 2019-20 and 2020-21 in HMRC's Real Time Information (RTI) data to inform our forecast because of uncertainty from COVID-19 and the improved consistency of the RTI tax data with outturn data. Previously, we based our forecast on the most recently available income tax outturn data, which in this case would be 2018-19. The latest RTI data decrease our income tax forecast by £340 million in 2021-22.

31 The COVID-19 pandemic reducing employment and earnings has also affected our income tax forecast. In 2021-22, we've reduced our income tax forecast by £583 million relative to our February 2020 forecasts as a result of changes to the outlook for earnings and employment. Other factors, such as the alignment to outturn income tax data, increase our forecast by £289 million bringing the total downward revision to £634 million.

Comparison with BGAs

32 Our income tax forecast for 2021-22 is £475 million higher than the BGA deducted from the Budget. This compares to our latest forecast where Scottish income tax revenues are only £173 million higher than the BGA in 2020-21.

33 Differences between the BGA and revenue could reflect differential performance of the respective economies and also policy differences. However, there have been no policy changes in either the UK or Scotland that would affect 2021-22 revenues, nor do we forecast a significant divergence in overall economic performance. We believe therefore that the difference between forecast tax revenues and the BGA largely arise because of the significant uncertainty around COVID-19 and its effects on the data and judgements used in our and the OBR's income tax modelling. We discuss the reasons behind the differences in detail in Chapter 4 and the budgetary implications of this divergence in Chapter 2.

34 When comparing our 2021-22 forecasts to the OBR's November forecasts for the UK, we're expecting slower growth in Scottish GDP, but significantly faster growth in income tax revenues. The furlough schemes in particular have led to a significant disconnect between growth in GDP on the one hand, and growth in earnings, employment and income tax revenues on the other hand. As a result, we wouldn't necessarily expect trends in GDP to be mirrored in trends in income tax revenues. In addition, we made our forecasts two months after the OBR made theirs, and so we included additional information on further COVID-19 restrictions, the extension to the furlough scheme, and additional RTI income tax data.

35 After the March Budget when updated OBR forecasts and an updated BGA forecast become available, the Scottish Government can choose whether to revise the Budget and use the updated BGA. We expect the Scottish Budget will need to be reviewed and revised over the course of 2021-22 as the public health and fiscal policy responses develop. We recommend that careful consideration be given to reviewing, as part of the overall reassessment of the Budget position, which income tax BGA is used.

Other devolved taxes and social security

Other devolved taxes

36 We expect revenues for the other devolved taxes to increase by 36 per cent in 2021-22 compared to 2020-21. The exception is Scottish Landfill Tax, which is expected to gradually decline over the next five years as more waste is diverted to alternatives other than landfill. Our forecasts for Non-Domestic Rates and Land and Buildings Transaction Tax reflect our expectation that the Scottish economy will continue to recover from the COVID-19 pandemic.

Figure 5: Summary of tax forecasts informing the Scottish Budget 2021-22

£ million	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Non-Domestic Rates	1,848	2,680	2,930	3,224	3,231	3,216
Land and Buildings Transaction Tax	517	586	629	664	701	740
Scottish Landfill Tax	95	88	86	72	74	61
Total	2,460	3,354	3,646	3,960	4,005	4,017

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

37 The Scottish Government has announced policy changes for Non-Domestic Rates that include freezing the poundage and a three month extension to the relief for airports and properties in the retail, hospitality and leisure sectors. We expect these to reduce tax revenues by £251 million in 2021-22. Further details can be found in Annex A.

38 Comparing the BGAs with our revenue forecasts can illustrate how much more or less funding the Scottish Government will have available. In current circumstances, any comparison should be made with caution as the BGAs are based on the OBR's November 2020 economy assumptions while our forecasts consider more up to date information. For 2021-22, we are estimating our forecasts for Land and Buildings Transaction Tax and Scottish Landfill Tax will be £64 million higher than the BGA for these taxes.

Social security

39 In 2021-22 we estimate £3.6 billion will be spent by the Scottish Government on social security. Our forecasts for the Scottish Budget 2021-22 are shown in Figure 6 and further information can be found in Chapter 5. Our forecasts show the total amount paid to, or in respect of, people receiving social security support in Scotland, and does not include any administrative costs.

40 Spending on three disability payments, Personal Independence Payments, Disability Living Allowance and Attendance Allowance, dominates the social security portfolio and accounts for 80 per cent of spending. Even modest changes in our forecasts for one or more of these payments are likely to be material and are less likely to offset each other than if we were looking at a budget with a more diversified range of social security payments.

Figure 6: Summary of social security forecasts informing the Scottish Budget 2021-22

£ million	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Scottish Government Social Security portfolio	3,379	3,492	3,694	3,916	4,031	4,155
Attendance Allowance	534	550	568	583	599	618
Carer's Allowance	299	306	322	342	359	376
Child Disability Payment [1]	208	231	269	302	325	348
Disability Living Allowance (Adult)	509	465	426	391	357	325
Personal Independence Payment	1,574	1,669	1,807	1,916	2,008	2,105
Scottish Child Payment	9	68	105	184	183	182
Other payments [2]	246	203	197	198	199	200
Fair Work, Communities and Health portfolio [3]	117	121	115	105	98	94
Total social security spending	3,495	3,614	3,810	4,020	4,129	4,249

Source: Scottish Fiscal Commission

Figures may not sum because of rounding.

[1] Child Disability Payment includes spending on the UK Government Disability Living Allowance (Child) until all children are receiving the new payment.

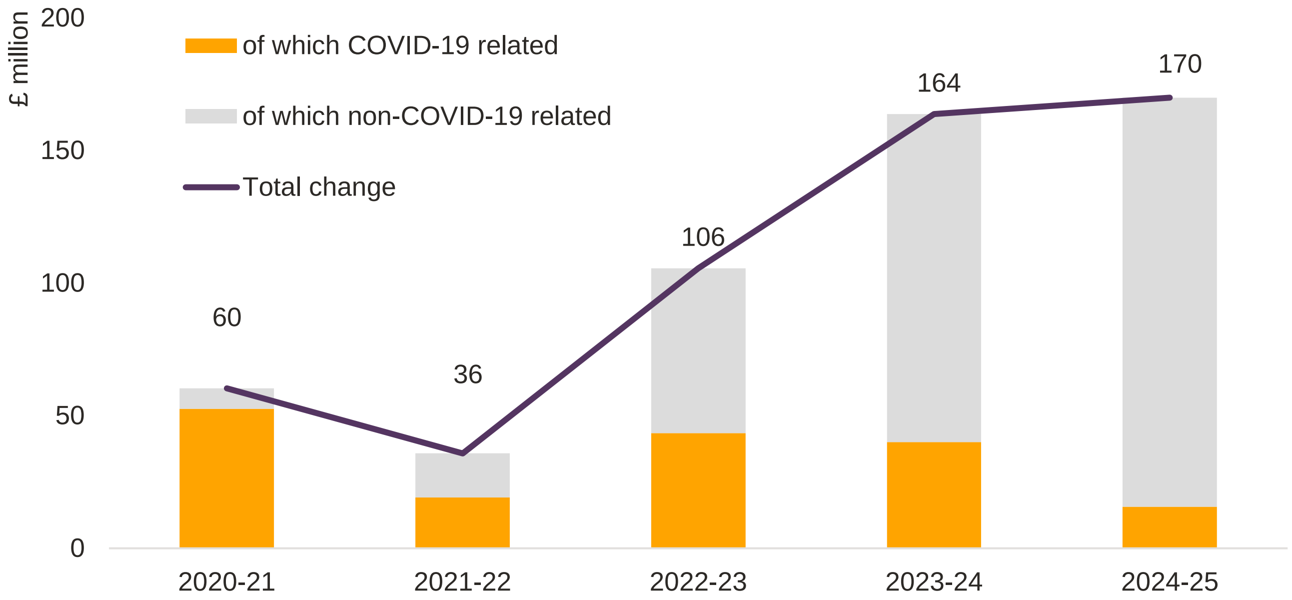
[2] Other payments are Best Start Grant, Carer's Allowance Supplement, Child Winter Heating Assistance, Funeral Support Payment, Industrial Injuries Disablement Scheme, Scottish Welfare Fund, Self-Isolation Support Grant and Severe Disablement Allowance.

[3] Our legislative scope also requires that we produce forecasts for other devolved social security payments. For this forecast these additional payments are Best Start Foods, Discretionary Housing Payments and Fair Start Scotland.[6]

41 COVID-19 has undoubtedly increased the number of people eligible for working-age social security support as unemployment has increased and those who are in work may find their income has reduced as result of the restrictions. An increase in eligibility will increase spending only if people apply for devolved payments to which they have become entitled. COVID-19 may have led to increased awareness of the assistance available and reduced some of the perceived stigma around social security support. There are other changes that we attribute to COVID-19 that reduce social security spending. For example, inflation is currently very low, and lower than we expected in our February 2020 forecasts, which decreases payment rates in all future years and reduces spending.

[6] Fair Start Scotland is in the Finance, Economy and Fair Work portfolio. Discretionary Housing Payments are in the Communities and Local Government portfolio. Best Start Foods is in the Health and Sport portfolio.

Figure 7: Change in spending forecast because of COVID-19 since February 2020



Source: Scottish Fiscal Commission

42 For 2021-22, the BGAs and spending forecasts are closely aligned. The overall BGA of £3,310 million is £1 million higher than our spending forecast.

43 Social security payments such as the Best Start Grant, the Scottish Child Payment and Fair Start Scotland are funded through the Scottish Government's general block grant, so there are no direct changes in funding from the UK Government to cover any increase in spending in these areas. We estimate spending on these payments will be £305 million in 2021-22 which is an increase of 15 per cent, £40 million, since our February 2020 forecast.

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 2021-22 Scottish Budget, published on 28 January 2021.

1.2 In addition to our forecasts, we set out what has changed since the last Scottish Budget in February 2020. We provide an overview of the main assumptions and judgements made as part of the forecast process. Given the context in which it is produced, in this particular report we also detail our assumptions about the COVID-19 pandemic and its effect on the economy, tax revenues and social security spending.

1.3 The report contains the following chapters:

Summary	Our economic and fiscal forecasts, the fiscal overview and the main stories from this round of forecasts.
Fiscal Overview	Explains how the Scottish Budget 2021-22 has been set. This includes the role of our forecasts, block grant adjustments and reconciliations. We also assess the Scottish Government's planned borrowing and use of the Scotland Reserve.
Economy	Our five-year forecasts for the Scottish economy, including the underlying judgements.
Tax	Our forecasts of devolved tax revenue.
Social Security	Our forecast of devolved social security spending.
Annex A: Policy Costings	Our estimates of 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 policies previously costed. Re-costings may be required because of new outturn data or revisions to assumptions and judgements.
Annex C: Materiality	Our approach to handling policies which have a very small fiscal effect.
Annex D: Monte Carlo simulations of income tax reconciliations	Our analysis of the likely variations of income tax reconciliations.

1.4 Some additional information such as comparisons to OBR forecasts and sensitivity analysis are in our supplementary tables, available for download from our website. If there is any additional information you are looking for that is not in this report or the supplementary tables, please get in touch with us at info@fiscalcommission.scot.

1.5 We usually publish two forecasts a year – one in May to accompany the Scottish Government's Medium Term Financial Strategy (MTFS) and one in December to accompany the Scottish Budget. The COVID-19 pandemic meant that the May 2020 MTFS was postponed by the Cabinet Secretary for Finance and has been published with the Scottish Budget on the 28 January 2021.[7] Throughout

[7] Letter from Cabinet Secretary for Finance to Scottish Fiscal Commission – 1 April 2020 (link)

this report, we compare our latest January 2021 forecasts, published with the 2021-22 Scottish Budget, to those we published in February 2020, with the 2020-21 Scottish Budget.

The process behind creating our forecasts this year

1.6 On 11 November 2020, we received eleven weeks' notice from the Cabinet Secretary for Finance of a Scottish Budget and MTFS on 28 January 2021. Throughout this period, our interaction with the Scottish Government has been guided by our Protocol for engagement.[8]

1.7 Since the initial formal notification of the date of the Scottish Government's Budget, the Commission has had several rounds of meetings to discuss our forecasts. Attendees have included the Scottish Government, Revenue Scotland, Social Security Scotland and the Office for Budget Responsibility. In accordance with the Protocol, more detail of timings and attendees is published on our website.[9]

1.8 To finalise our forecasts ready for publication, we need a cut-off date for incorporating new data and information into the forecasts. Our data cut-off was 7 January 2021. We were given pre-release access to information on the self-isolation support grant and Land & Building Transaction Tax (LBTT) revenues and transactions. These data helped to inform our social security forecasts and LBTT forecasts. No other new data or information available after 7 January 2021 were included in our forecasts.

1.9 Headline dates of interest are:

11 November 2020	Cabinet secretary for Finance wrote to advise that the Scottish Government intended to publish its Budget 2021-22 and Medium Term Financial Strategy on 28 January.
22 December 2020	Dame Susan Rice wrote a letter to the Finance and Constitution Committee in response to the publication of the Committee's Pre-budget scrutiny 2021-22 report.
7 January 2021	Deadline for inclusion of new data in the forecasts. Closer of economy forecasts.
18 January 2021	The Scottish Government provided the Commission with finalised policy measures.
19 January 2021	The Commission presented the Scottish Government with final forecasts to allow the finalisation of the Scottish Government's Budget.
26 January 2021	The Commission's near-final report was shared with the Scottish Government.
26 January 2021	Call between Dame Susan Rice, Chair of the Commission and Cabinet Secretary for Finance.
27 January 2021	A pre-release version of the Commission's report was shared with the Cabinet Secretary for Finance.
28 January 2021	Scotland's Economic and Fiscal Forecasts – January 2021 published.

COVID-19

1.10 Our forecasts are affected by the economic and social restrictions imposed by the Scottish Government because of COVID-19. As part of our forecasting process we have made broad-brush

[8] Protocol for engagement between the Scottish Fiscal Commission and the Scottish Government Version 4.0 – September 2020 (link)
[9] Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – January 2021 (link)

assumptions about the likely outlook for the economic and social effects of public health restrictions in Scotland and the UK, informed by the number of cases and deaths. Our central assumptions are summarised in Figure 1.1.

1.11 COVID-19 has already had and will continue to have significant effects on the economy and society. Even if restrictions can be lifted by the end of 2021, as in our central case, the effects of COVID-19 will be felt for a long time to come.

Figure 1.1: Central COVID-19 assumptions

	Assumption
1. Second-wave	• COVID-19 new cases and deaths remain elevated throughout 2021 Q1. • During 2021 Q2, new cases and deaths gradually return to the level seen from June to September 2020.
2. Subsequent waves	• We assume no subsequent waves with significantly elevated numbers of new COVID-19 cases and deaths following the 2020 Q4 to 2021 Q1 second wave.
3. National and regional restrictions	• Mainland Scotland and the UK remain in lockdown, or protection level/tier 4 throughout 2021 Q1. • During 2021 Q2, restrictions gradually ease. By 2021 Q3, local regions within Scotland remain typically in levels 0 to 2, with some areas moving into levels 3 and 4 for brief periods.
4. Job protection schemes and business support	• The latest job protection schemes are in place until the end of April 2021. • In our central case, with restrictions easing over the course of 2021, we don’t assume any further job protection schemes are introduced beyond those already announced. • The existing business support schemes continue while restrictions are in place such as grants paid depending on the level of restrictions in the area a business operates in. • The Self-isolation support grant will continue to be paid during 2021-22 as there will still be cases and individuals required to self-isolate.
5. Treatments	• New treatments will continue to be developed that improve outcomes.
6. Vaccinations	• Vaccination is rolled out to the adult population during 2021. We assume all vulnerable groups up to and including the over 50s have at least the first dose by the end of May 2021. • The easing of economic and social restrictions will be gradual as the vaccine is rolled out beyond the more vulnerable groups. • We assume that by 2021 Q4 a sufficient proportion of the population, and particularly the vulnerable groups, have been vaccinated to allow a significant easing of restrictions. • The vaccines continue to be effective against new variants of the virus or can be modified relatively easily to provide cover.
7. Minimising of restrictions	• By 2021 Q4 the virus is suppressed to the extent that strict health control measures are no longer required – it is managed like a normal virus within the UK. Some continuing international travel restrictions may be required from time to time.

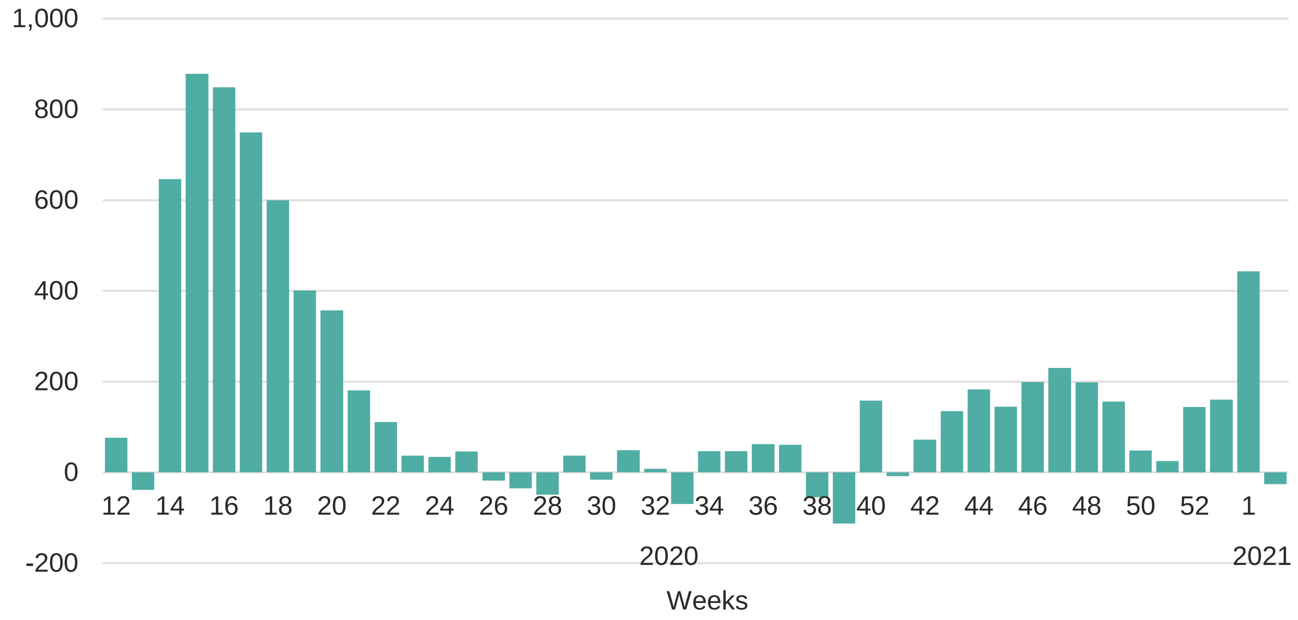
Source: Scottish Fiscal Commission

What has happened so far

1.12 The number of COVID-19 cases and deaths in Scotland first started to rise in early March 2020, with the UK and Scotland entering lockdown in mid-March. Excess deaths reached a peak of over 800 weekly deaths in April.[10] By June, the first wave of COVID-19 subsided, and weekly deaths in Scotland were close to their five year average. With excess deaths near zero, the UK and Scottish Governments started to ease some restrictions over the summer.

1.13 In late September 2020, new cases and excess deaths starting to rise in a second wave of the COVID-19 pandemic. In December, the situation was further exacerbated by a new more contagious variant of COVID-19 and the likely prevalence of additional social mixing over the festive period. Figure 1.2 compares deaths from all causes in Scotland to the average over the last five years. This provides a simple measure of excess deaths related to COVID-19.

Figure 1.2: Weekly excess deaths in Scotland from March 2020 – five year average comparison



Source: Scottish Fiscal Commission, National Records Scotland (2020) Deaths involving coronavirus (COVID-19) in Scotland (link).

1.14 As new cases continued to rise in late December and early January, the Scottish and UK Governments introduced tougher restrictions to suppress the virus. From 5 January, most of Scotland and most of the UK were put into lockdown with guidance to stay at home except for essential purposes.

1.15 In the first wave cases and deaths in Scotland followed a broadly similar pattern to the UK as a whole. In the second wave, the relative number of cases and deaths in Scotland has been lower than in the UK although following similar trends. The public health restrictions in place remain very similar across the UK, and we don't expect COVID-19 to be a significant source of divergence between Scotland and the UK.

1.16 This second lockdown differs to the first in a number of ways. Many more businesses and industries may continue to operate under the latest restrictions, for example construction and manufacturing.

[10] Excess deaths are measured by comparing deaths from all causes to the five-year average number of deaths in the same time period.

This means the effect of the COVID-19 lockdown on our forecasts in early 2021 will be significantly less than the early 2020 lockdown.

1.17 In November and December a series of vaccine trials announced positive results, with the first vaccine being approved for use in the UK on 2 December. The vaccine roll-out began in December 2020 with the most vulnerable groups being vaccinated first.

Outlook for COVID-19 and restrictions – the central case

1.18 Both the tougher restrictions and the roll-out of the vaccinations will take time to have an effect. We expect to see elevated cases and excess deaths throughout 2021 Q1. From 2021 Q2, we assume cases and excess deaths will gradually fall to the levels seen from June to September 2020.

1.19 We assume that from 2021 Q3 the virus will be broadly controlled, though this does not mean the pandemic is over. We assume that over 2021 varying levels of regional and national restrictions will need to be implemented to continue to control the spread of the virus, and there may also be international travel restrictions.

1.20 The job protection schemes first launched by the UK Government in March 2020 have been adapted and extended a number of times as the pandemic has progressed. The current job protection schemes are due to end in April 2021. In our central case, we assume there are no further extensions to the current job protection schemes.

1.21 Vaccination against the virus began in late 2020. It will take time for this to take effect, not least because of limited supplies of any vaccines and the time it takes to vaccinate a large population. There are also uncertainties about how long the vaccines will protect people and their effect upon transmission of the virus.

1.22 We assume that by the end of 2021 COVID-19 is on the whole managed like a normal virus. Cases and deaths run at a low baseline level and restrictions, national or regional, are no longer required.

Upside and downside risks to the forecast

1.23 Our central case rests on broad-brush assumptions about the outlook for cases, deaths and restrictions over 2021. However, there is significant uncertainty, and our central case allows for a reasonable degree of variation in these factors.

1.24 A materially different pathway of COVID-19 and restrictions would mean the pathway of the economy, taxes and social security spending could be significantly different from our forecasts.

1.25 Downside risks to our central case include:

- The second wave lasts significantly longer than currently assumed.
- There are subsequent waves of rising COVID-19 cases and deaths during 2021, leading to more and stricter restrictions than assumed in our central case. These subsequent waves could be triggered by new more infectious or more harmful variants.
- Vaccination or other strategies are insufficient to bring COVID-19 to the point where it can be managed like a normal virus from the end of 2021, for example because vaccines are less effective against the new variants. Scotland and the UK continue to require some level of

restrictions including international travel restrictions to manage the virus beyond the end of 2021.

1.26 If these COVID-19 outcomes occur, the pathway of the Scottish economy, taxes and social security spending is likely to be significantly different from our forecasts. In these downside scenarios, it is likely that there would be additional policy responses from the UK and Scottish Government's, including further extensions of the job protection schemes.

1.27 Equally, there are upside risks to our forecast, including:

- The second wave subsides quickly in February.
- Vaccination or other interventions allow restrictions and other health control measures to be lifted earlier in 2021.

How COVID-19 affects our forecasts

1.28 Figure 1.3 provides an overview of how COVID-19 has affected our forecasts. In Chapters 3, 4 and 5 we describe in detail how COVID-19 affects our individual forecasts. The assumptions and judgements made in these individual forecast areas are consistent with the central case broad-brush assumptions set out above.

Figure 1.3: Overview of the effect of COVID-19 on our main forecasts

Area	Effects on forecast
Economy	• By 2025, GDP is around 4 per cent lower and productivity around 2 per cent lower than it would have been without COVID-19. • Unemployment peaks at 7.6 per cent in 2021 Q2 before gradually declining. • Average earnings are resilient despite the scale of the economic shock, with only a moderate downward adjustment in average earnings. • Higher income households increased their savings during the 2020 lockdown restrictions spend their accumulated savings in 2021, supporting higher consumption.
Income tax	• Lower employment primarily as a result of COVID-19 reduces our forecast by £458 million in 2021-22. With earnings more resilient, earnings changes only reduce the income tax forecast by £125 million in 2021-22. • Lower income groups have seen their incomes more affected by COVID-19 than higher earners. As lower income groups have lower effective tax rates, the effect of falling incomes focussed on lower income groups on total income tax revenues is less than if the effect on incomes was spread more evenly. We capture this effect in part by aligning our forecast for 2020-21 to the RTI tax revenue data.
Devolved taxes	• Residential LBTT transactions initially fell sharply in the first lockdown in 2020. With the lifting of restrictions in the summer of 2020 and the temporary increase in the LBTT starting threshold, transactions grew strongly in the second half of the year. Overall, we expect residential LBTT revenues to fall by 12 per cent in 2020-21. • The amount of waste sent to landfill fell by over 40 per cent in the first quarter of 2020-21, driven in particular by the construction and hospitality sectors. We expect SLfT revenues to fall by 20 per cent in 2020-21. • A number of NDR policies have been introduced to support businesses during the COVID-19 pandemic. Overall, COVID-19 policies reduce NDR revenue by £953 million in 2020-21 and by £251 million in 2021-22.
Social security	• We expect COVID-19 may increase the longer-term need for disability or carer assistance, for example through direct health effects or indirect economy effects. There has also been a short-term effect on the number of applications for disabilty benefits which reduces spending, but operational changes made by the Department for Work and Pensions have increased spending. • Most of the people who have died of COVID-19 have been people aged 75 or over with underlying health conditions. It is likely that a significant proportion will have been receiving disability benefits such as Attendance Allowance, and we estimate spending will be lower as a result. • The Scottish Government introduced additional funding in 2020-21 for the Scottish Welfare Fund, Carer's Allowance Supplement and Discretionary Housing Payments. • We expect increases in eligibility and take-up for low income benefits such as Best Start Grant and higher spending on Discretionary Housing Payments to mitigate the bedroom tax. • The Scottish Government has delayed the launch of the Scottish Child Payment and Child Disability Payment which decreases spending in the short term.

Source: Scottish Fiscal Commission

Chapter 2
Fiscal overview

Introduction

2.1 The 2021-22 Scottish Budget is being set at a time of great uncertainty about how the COVID-19 pandemic will evolve. Despite the development and roll-out of vaccines we expect both the Scottish and UK Governments to keep public health measures in place for much of 2021. These public health measures have economic costs. Both Governments have introduced policies to reduce the economic effects of the public health measures on individuals, households and businesses. The most significant fiscal support from the UK Government has been through the furlough schemes, which allow businesses to continue to pay employees who are unable to work because of public health restrictions. As part of the UK-wide fiscal response, the Scottish Government has received funding to provide support in devolved areas, including health services, local authority services and grants to businesses forced to close or to operate with restrictions.

2.2 This is the context within which the Scottish Government has to manage and balance its budget for 2020-21 as well as set the 2021-22 Budget. In previous publications we have highlighted how the devolution of taxes and social security would make the Scottish Budget more variable. The £8.6 billion increase in funding for COVID-19 over the course of 2020-21 has far exceeded any changes we could have expected from tax and social security variations. The challenges and risks facing the Scottish Budget are on a new scale.

2.3 Over the course of 2020-21 the UK Government's public health response and associated restrictions have evolved, and successive UK Government announcements resulted in additional funding for the Scottish Government. In July the UK Government announced a guaranteed minimum level of funding for COVID-19 of £6.5 billion to provide the Scottish Government with more certainty in its budget management. This has since been increased three times, most recently to £8.6 billion in December 2020. Funding could increase again if spending by the UK Government is higher than expected in December. The later in the financial year additional funding from the UK Government arrives the more difficult it is for the Scottish Government to manage its budget.

2.4 There is variability in Scottish Government expenditure too, as public health decisions create a need for additional expenditure, for example in grants to businesses forced to close because of restrictions.

2.5 This unprecedented variability in both funding and expenditure needs makes it difficult for the Scottish Government to balance its budget in 2020-21 as well as to plan for 2021-22. Additional funding is important and welcome, but the later it comes in the budget year, the harder it is to spend it effectively.

2.6 Our Fiscal Update, published separately, discusses in detail the changes to the Scottish Government's budget for 2020-21.[11]

2.7 Turning now to the setting of the 2021-22 Scottish Budget, in the Spending Review in November 2020 the UK Government announced the Scottish Government will receive £1.3 billion of COVID-19 funding for 2021-22. Given the uncertainties in the evolution of the pandemic, and the tightening of restrictions across the UK since November, there may be further changes in funding.

[11] Scottish Fiscal Commission (2021) 2020-21 Fiscal Update (link)

The scale of these changes is highly uncertain and depends on the UK Government's fiscal and public health responses to the crisis. Currently the furlough schemes are due to finish at the end of April, but the UK Government may still decide to extend those schemes again. The Scottish Government has assumed an additional £500 million of COVID-19 funding and we consider this to be a prudent estimate.[12]

2.8 The forecasts set out here are our best predictions of the revenue we expect to be raised and the level of spending we expect in 2021-22. These forecasts directly affect the Scottish Budget, as do forecasts of UK Government revenues and spending produced by the OBR last November at the time of the UK Spending Review. Differences between the two sets of forecasts have resulted in a £302 million benefit to the Scottish Budget, as the gap between our forecast of Scottish income tax revenues and the Block Grant Adjustment (BGA) is now estimated to be £302 million larger in 2021-22 than in 2020-21. We believe the relatively higher level of tax revenues compared to the BGA largely arise because of the significant uncertainty around COVID-19 and its effects on the data and judgements used in both our and the OBR's income tax modelling. We do not expect Scottish tax revenues actually to perform significantly differently to UK wide tax revenues in 2021-22, and this difference could reduce when, alongside the UK Budget in March, the OBR publish updated forecasts.

2.9 Income tax revenues and the BGA are set in the Budget until outturn data are available in 2023, although the Scottish Government could choose to use the updated BGA following the next OBR forecast in March.[13] As the public health and fiscal policy responses develop we expect the Scottish Budget will need to be reviewed and revised over the course of 2021-22. We recommend that careful consideration is given to reviewing the income tax BGA as part of the overall reassessment of the Budget position.

2.10 The OBR's November 2020 forecasts were made before the current lockdown, and so took a more optimistic view of prospects for the UK economy in 2021 than we are taking now. As a result of the difference between our forecast and the OBR's, the criteria for a Scotland-specific economic shock have been met for the first time, giving the Scottish Government additional borrowing powers. The resource borrowing limit for forecast error increases from £300 million to £600 million for the next three financial years. In addition the annual drawdown limits from the Scotland Reserve are removed for the same period.

2.11 This is the context in which the Scottish Government has set its Budget and formulated its borrowing plans for 2021-22. The Scottish Government must balance its budget so it cannot overspend. But it must also avoid large underspends. The Scotland Reserve has a maximum limit of £700 million, including capital, and this cap limits how much underspend can be carried forward from one year to the next. While the removal of the annual drawdown limits in 2021-22 allows the Scottish Government to better utilise any funds in the Reserve, the £700 million limit remains a constraint that is particularly significant in comparison to the scale of change seen in the budget this year.

[12] The Spending Review included £21 billion of unallocated funding to support the response to COVID-19. The Scottish Government is receiving 4 per cent of the allocated COVID-19 funding in 2021-22, assuming the same ratio applies to the remaining unallocated funding would result in a further £800 million for the Scottish Government. UK Government (2020) Spending Review 2020 (link).

[13] Because the Scottish Budget has been set before the UK Budget the BGAs are considered provisional, and after the UK Budget the Scottish Government can choose whether to adopt the updated BGAs based on the OBR's March 2021 forecasts. In practice this only affects income tax, as the BGAs for the fully devolved taxes and benefits will be updated during 2021-22 anyway.

2.12 This chapter discusses separately the budget position, for resource and for capital funding. We set out the funding arrangements and assess the Government's borrowing plans for each component.

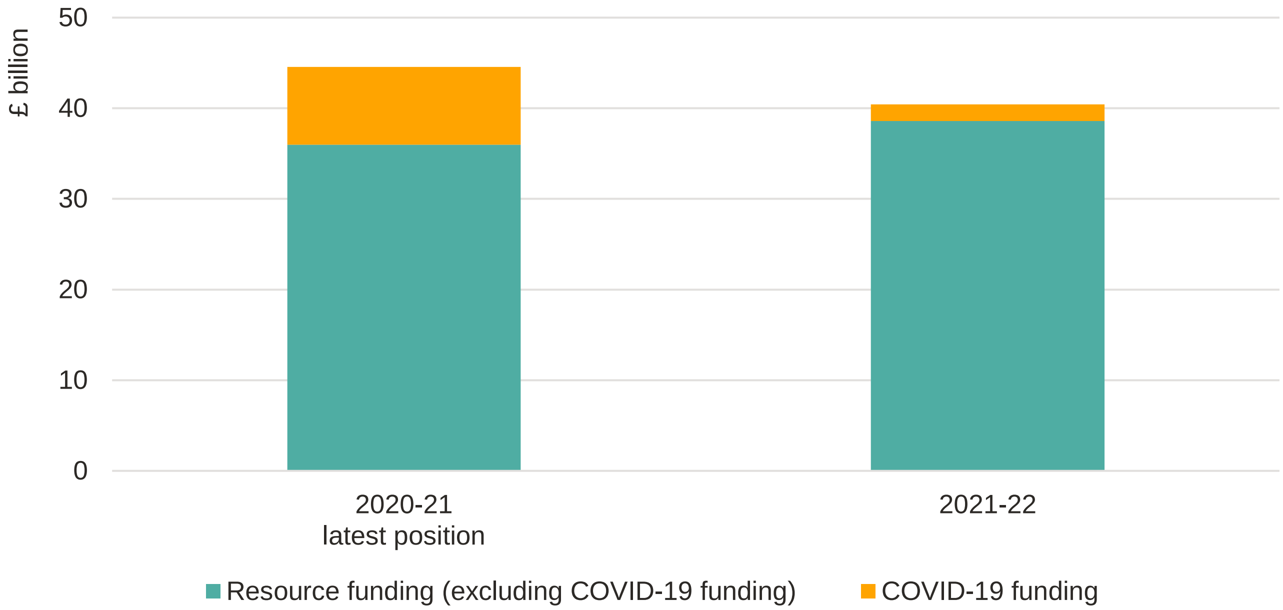
Resource funding for the 2021-22 Scottish Budget

Total resource funding

2.13 Resource spending covers day-to-day costs (such as wages, spending on goods and services, and grants and subsidies).[14] Resource spending is funded through the resource block grant from the UK Government, devolved tax revenues, resource borrowing and any drawdown from the Scotland Reserve. Resource funding amounts to £40 billion in the 2021-22 Scottish Budget.

2.14 Funding for COVID-19 spending has been an important part of the Scottish Budget this year, and will continue into 2021-22. The resource budget excluding COVID-19 funding increases by around £3 billion between 2020-21 and 2021-22. Figure 2.1 compares resource funding for the 2020-21 and 2021-22 Scottish Budgets, splitting between funding for COVID-19 spending and other funding.

Figure 2.1: Resource funding for the 2020-21 and 2021-22 Scottish Budgets



Source: Scottish Fiscal Commission, Scottish Government.
The comparison between 2020-21 and 2021-22 is in nominal terms.

2.15 The latest position of the 2020-21 Scottish Budget includes £8.6 billion of COVID-19 funding, which is the guaranteed level of funding from the UK Government. This funding accrued throughout 2020-21 based on successive spending announcements to support the policy responses to COVID-19. The 2021-22 Scottish Budget is set with an initial allocation of £1.8 billion of COVID-19 funding, of which £1.3 billion is based on the UK Government's November 2020 Spending Review and £0.5 billion is based on an assumption by the Scottish Government.[15] It is likely that COVID-19 funding will further increase, scale of these changes is highly uncertain and depends on the UK Government's fiscal and public health responses to the crisis. As the COVID-19 funding is lower than in 2020-21, the overall resource budget has decreased by around £4 billion between 2020-21 and 2021-22. The resource funding excluding COVID-19 has increased.

---

[14] UK Government (2020) Statement of funding policy: funding the Scottish Government, Welsh Government and Northern Ireland Executive (link)

[15] UK Government (2020) Spending Review 2020 (link)

2.16 Since the UK Government's Spending Review there has been a shift in the outlook for the pandemic with further restrictions across the whole of the UK. It is possible the UK Budget scheduled for 3 March 2021 will contain further announcements which increase COVID-19 funding for Scotland in 2021-22. Figure 2.2 sets out detailed changes to the resource budget between 2020-21 and 2021-22.

Figure 2.2: Resource funding in 2020-21 and 2021-22

£ million	2020-21 latest position	2021-22	Difference
Barnett-determined block grant and non-COVID funding [1]	29,816	30,923	1,107
Other and non-Barnett funding [2]	778	1,002	224
COVID-19 funding [3]	8,600	1,828	-6,772
SFC tax forecasts [4]	12,977	12,937	-40
Tax and non-tax BGAs [5]	-12,825	-12,430	394
Social security BGAs	3,185	3,310	124
Final reconciliations [6]	-177	-319	-142
Resource borrowing	207	319	112
Resource reserve drawdown	149	231	82
NDR distributable amount	1,868	2,631	763
Total resource funding	44,579	40,431	-4,147

Source: Scottish Fiscal Commission, Scottish Government.
This table is on a cash basis, comparisons in real terms can be found in the Scottish Government's Budget documents.
[1] The Barnett-determined block grant in 2021-22 was set based on the UK Government's November 2020 spending review (link).
[2] Other and non-Barnett funding for 2021-22 includes: EU replacement farm funding (£570 million), EU replacement fisheries funding (£14 million), bew review (£26 million), rail resource grant (£80 million), Scotland Act Implementation (£66 million), migrant surcharge (£22 million), funding for fisheries (£7 million), machinery of government transfers (£3 million), Queen's and Lord Treasurer's Remembrancer (£5 million), anticipated donations from recipients of NDR reliefs (£185 million) and forecast revenues for fines, forfeitures and fixed penalties and proceeds of crime (£25 million).
[3] 2021-22 COVID funding includes: £1,328 million confirmed funding from the UK Government's spending review and £500 million anticipated funding.
[4] Includes Scottish income tax, Land and Buildings Transaction Tax (LBTT) and Scottish Landfill Tax (SLfT) revenues. LBTT and SLfT revenue forecasts are updated in-year but the 2020-21 income tax forecast remains fixed at the level forecast in February 2020, before the COVID-19 crisis. This means the tax forecast in 2021-22 appears lower than in 2020-21. We expect revenues from the fully devolved taxes to increase next year as the economy recovers.
[5] Non-tax refers to fines, forfeitures and fixed penalties and proceeds of crime. The 2020-21 income tax BGA remains fixed at the level set in 2020-21.
[6] 2020-21 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). 2021-22 Includes final reconciliations for: 2018-19 income tax revenues and BGA (-£309 million), 2019-20 Land and Buildings Transaction Tax BGA (-£6 million), 2019-20 Scottish Landfill Tax BGA (-£2 million), 2019-20 Carer's Allowance BGA (-£3 million) and 2019-20 fines forfeitures and fixed penalties (£2 million).

Scottish Fiscal Commission Forecasts and Block Grant Adjustments

2.17 Discussion of changes to forecasts and funding in 2020-21 can be found in our Fiscal Update.[16] This section focuses on the 2021-22 Scottish Budget and Box 2.1 explains how our forecasts are incorporated into the Budget.

[16] Scottish Fiscal Commission (2021) 2020-21 Fiscal Update (link)

2.18 We forecast that in 2021-22 the Scottish Government will raise £15.6 billion in devolved tax revenues and spend £3.6 billion on devolved social security. Our tax forecasts are discussed in Chapter 4, and our social security forecasts in Chapter 5, including comparisons between individual forecasts and the Block Grant Adjustments.

Box 2.1: How our forecasts affect the Scottish Budget

Devolved tax revenues fall into three categories:

- **Managed in-year**: fully devolved tax revenues (Land and Buildings Transaction Tax and Scottish Landfill Tax) are collected during the year by Revenue Scotland. The corresponding Block Grant Adjustments (BGAs) are updated once during the financial year, and once after the financial year. The Scottish Government has to manage any differences between revenues and BGAs during the year.

- **Fixed for the Budget year**: our forecast of income tax revenues and the forecast BGAs are used to set the Scottish Budget. The UK Government transfer the funding based on the forecast and this remains fixed for the financial year. Once outturn data are available the Budget is adjusted through a reconciliation. For 2021-22 income tax this will take place in 2024-25.

- **Managed via the Non-domestic Rates (NDR) rating account**: NDR revenues are collected by local authorities during the year. Prior to the start of the year the Scottish Government set the amount of NDR revenues which will be returned to local authorities, the 'distributable amount', based on our forecasts. Any differences between the 'distributable amount' and the revenue collected are managed via the NDR rating account in future years and do not affect the Budget in-year.

Social security payments fall into two categories:

- **Funded via Block Grant Adjustments**: the Scottish Government receives additional funding for the largest social security payments from the UK Government, based on spending in England and Wales.[17] The BGAs are initially based on OBR forecasts and are updated once during the financial year, and once after the financial year as outturn data becomes available. The Scottish Government has to manage any differences between spending and BGAs during the year.

- **Not funded via Block Grant Adjustments**: several social security payments were devolved to the Scottish Government through the general Block Grant. There is no direct change in funding based on changes in England and Wales. The Scottish Government has to manage any changes in spending during the year. In addition the Scottish Government has introduced new payments which do not receive any funding from the UK Government.[18]

[17] Social security with block grant adjustments include: Attendance Allowance, Carer's Allowance, Personal Independence Payment, Severe Disablement Allowance, Industrial Injuries Disablement Scheme, Disability Living Allowance (Adult) and Child Disability Payments.

[18] New payments include Carer's Allowance Supplement, Scottish Child Payment, Child Winter Heating Assistance, Best Start Grant nursery payment and Best Start Grant school payment.

2.19 Resource funding for the 2021-22 Scottish Budget is set out in Figure 2.2. Our tax revenue forecasts, amounting to £12.9 billion make up a significant component of funding. We also forecast NDR revenues which are used to set the NDR distributable amount, accounting for £2.6 billion of resource funding. Our social security forecasts are used to set spending allocations in the 2021-22 Scottish Budget.

2.20 In addition to our forecasts, resource funding is also determined by the Block Grant Adjustments (BGAs): the hypothetical amounts of tax revenue raised and social security spending paid out in Scotland if the taxes and social security payments had not been devolved. They are calculated using the OBR's forecasts of devolved taxes revenue and social security spending in the rest of the UK.[19]

2.21 Figure 2.3 shows we are forecasting income tax, LBTT and SLfT revenues in 2021-22 at £12,937 million, £539 million larger than the latest BGA forecasts of £12,398 million produced in November 2020. This difference is larger than our latest estimate of the difference between revenues and the BGAs for 2020-21 which totals £307 million. LBTT revenues are forecast to be £71 million higher than the LBTT BGA in 2021-22, this difference largely reflecting different policy and tax rates in Scotland and England.

Figure 2.3: 2021-22 tax and social security forecasts compared to block grant adjustments

£ million	SFC forecasts	Block Grant Adjustments	Net effect on budget
Taxes with Block Grant Adjustments [1]	12,937	-12,398	539
Social security with Block Grant Adjustments [2]	-3,308	3,310	1

Source: Scottish Fiscal Commission, Scottish Government.
Figures may not sum because of rounding.
[1] Income tax, Land and Buildings Transaction Tax and Scottish Landfill Tax.
[2] Attendance Allowance, Carer's Allowance, Personal Independence Payment, Severe Disablement Allowance, Industrial Injuries Disablement Scheme, Disability Living Allowance (Adult) and Child Disability Payments.

2.22 Our income tax forecast is £475 million higher than the BGA used in the Budget, compared with our latest forecast for 2020-21 where we forecast Scottish income tax revenues will be £173 million higher than the BGA. Differences between the BGA and revenue could reflect differential performance of the respective economies and also policy differences. However, there have been no policy changes in either the UK or Scotland that would affect 2021-22 revenues, nor do we forecast a significant divergence in overall economic performance.

2.23 We believe therefore that the difference between forecast tax revenues and the BGA largely arise because of the significant uncertainty around COVID-19 and its effects on the data and judgements used in our and the OBR's income tax modelling. The timing of the two forecasts will also have had an effect: specifically the second national lockdown happened after the OBR's November forecasts. We discuss the reasons behind the differences in detail in Chapter 4. Our discussion here focuses on the budgetary effects of the difference.

2.24 The fiscal framework arrangements mean income tax revenues, and the income tax BGA, are fixed in the Scottish Budget until outturn data are available, although the Scottish Government could chose to use the updated BGA following the next OBR forecast in March. The data for 2021-22 will be available in summer 2023 and a reconciliation will be applied in 2024-25.

[19] The BGAs are based on the OBR's forecasts of UK Government revenue and spending. Where taxes or social security payments are devolved to either Wales or Northern Ireland then devolved revenues and spending are excluded from the OBR's forecasts and the BGA calculations.

2.25 Currently the net position in 2021-22 is forecast to be around £300 million higher than the net position in 2020-21. If this proves too high and the net position returns to something like the 2020-21 level there would be a negative reconciliation of the order of £300 million in 2024-25.[20] The Scottish Government would have had £300 million of additional funding to support spending in 2021-22 and if the net position based on the current forecast proves to be too high this will be repaid three years later. Were the situation to be reversed, and the net position considered too low or negative, then the Scottish Government would face a reduction in the size of their Budget relative to what was expected.

2.26 The fiscal framework does not envisage situations where our forecasts and the BGAs are made on different basis and the differences have to be managed within the Scottish Budget. An additional provision was agreed between the Scottish and UK Government in 2019. Following the March Budget when updated OBR forecasts and an updated BGA forecast are available, the Scottish Government can choose whether to revise the Budget and use the updated BGA. We expect the Scottish Budget will need to be reviewed and revised over the course of 2021-22 as the public health and fiscal policy responses develop. The scale of those changes is likely to be significantly larger than the £300 million set out above. We recommend that careful consideration be given to reviewing the decision on which income tax BGA is used as part of the overall reassessment of the Budget position.

Non-Domestic Rates

2.27 Non-Domestic Rates (NDR) is not covered by Block Grant Adjustments like other devolved taxes because it has been the responsibility of the Scottish Government since the start of devolution in 1999. Funding for NDR is instead included in the Barnett-determined Block Grant, with any changes in funding based on UK Government policy.

2.28 In March 2020 the UK Government announced reliefs in England for hospitality, leisure and retail properties to mitigate some of the effects of COVID-19 on businesses. The £8.6 billion of COVID-19 funding allocated to Scotland included funding which reflected the cost of these NDR reliefs based on the English reliefs. In March 2020 the Scottish Government announced a similar relief for aviation and properties in the retail, hospitality and leisure sectors. Local authorities' mid-year estimates suggest that this relief reduced NDR revenues by £904 million in 2020-21.[21] The Scottish Government has announced a policy to extend the relief for the first three months of 2021-22 which we estimate will cost £185 million. The UK Government has not announced any NDR reliefs for the retail, hospitality and leisure sectors in 2021-22.

2.29 NDR revenues are collected by local authorities, pooled centrally by the Scottish Government and then redistributed to local authorities. NDR revenues are managed through the NDR rating account, also known as the NDR pool.[22,23]

2.30 We forecast the amount of revenue collected by local authorities, which is known as the contributable amount. The Scottish Government sets the distributable amount, the amount that is redistributed back to local authorities based on our forecasts of the contributable amount. The

[20] This negative reconciliation would emerge because either our forecast is too high or the BGA is too low or a combination of the two. The difference between the 2021-22 and 2020-21 net position is one way to calculate the potential reconciliation. An alternative way to calculate it is the change in the forecast 2021-22 net position between February 2020 and January 2021 which would be £320 million. Both methods arrive at similar results.

[21] Local authorities' mid-year estimates indicate that £927 million was claimed in RHL relief, but we estimate that the automatic application of this relief led to £23 million less being claimed in other reliefs, giving a net reduction of £904 million.

[22] An explanation of the NDR rating account can be found in Scottish Government (2019) Non-Domestic Rating Account: 2018-19 (link).

[23] The latest estimate on the position of the NDR rating account can be found in **Chapter 4**.

Scottish Government also consider the balance of the pool, which accounts for any forecast errors in previous years.[24] The distributable amount is set in the Budget and remains unchanged during the financial year, so the Scottish Government do not need to manage any NDR forecast error during the year.[25] In March 2020 as a result of the COVID-19 crisis the Scottish Government made an exceptional change to the NDR distributable amount after the Budget Bill had passed. Given the timing of the UK Budget it is possible late changes are made again to the NDR distributable amount, if, for example, the UK Government make changes to NDR in England for 2021-22 resulting in additional funding for the Scottish Government.

Income tax reconciliations

2.31 Because the Scottish Budget is set in advance of the financial year, it is based on forecasts of revenue and spending. As one of the largest component of the Budget, income tax remains fixed for the financial year. Once outturn information on revenues become available, the forecast funding is brought in line with outturn with a reconciliation applied to the following Scottish Budget. The outturn data for income tax are only available after the deadline for Self-Assessed income tax returns and payments.

2.32 The 2017-18 income tax outturn gave rise to the first income tax reconciliation in 2020-21, and reconciliations now form an important part of the Scottish Budget each year. The 2018-19 income tax outturn shown in Figure 2.5 resulted in a reconciliation of -£309 million shown in Figure 2.4 and account for the majority of the final reconciliation of -£319 million which been applied to the 2021-22 Scottish Budget.[26]

2.33 For future years, the latest forecasts result in two positive income tax reconciliations, related to revenues collected in 2019-20 and 2020-21.

2.34 The 2019-20 expected reconciliation arises because our forecast of income tax revenues has increased by £155 million since the budget was set in in December 2018, compared to a BGA increase of £80 million. For 2020-21, both our forecast and the OBR's forecast have been revised down since February 2020, but our forecast has been revised down by £516 million, compared with a BGA reduction of £643 million, leading to a £127 million expected positive reconciliation.

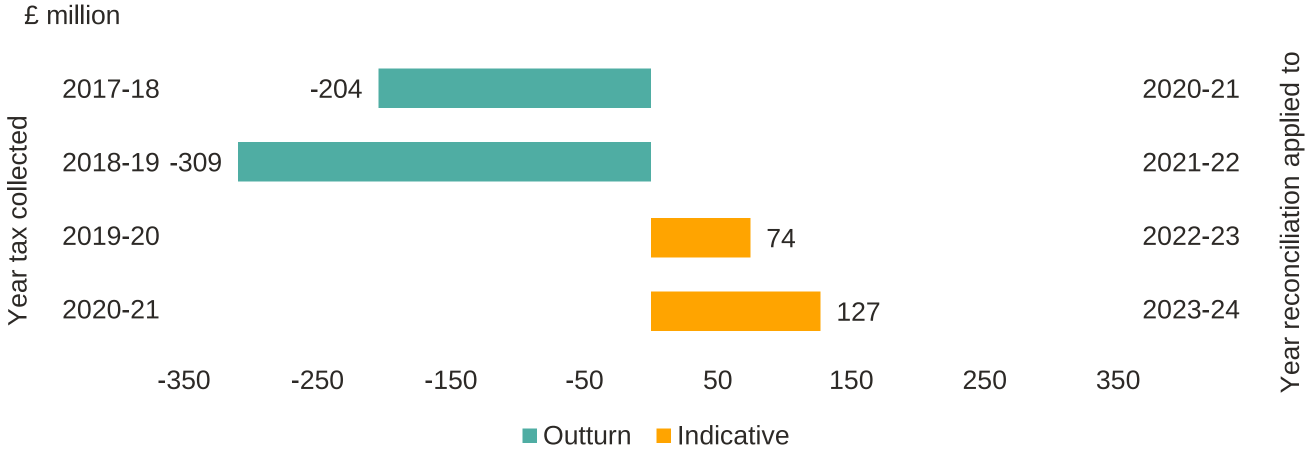
---

[24] Although our forecasts of the contributable amount are used by the Scottish Government to set the distributable amount, for the position of the pool in any given year is based on local authorities estimates of the NDR they will collect produced at the start of the financial year.

[25] The distributable amount was reduced in March 2020 following the Scottish Government announcement to introduce NDR reliefs for retail, hospitality and leisure for 2020-21. Further information on the position of the NDR pool can be found in **Chapter 4**.

[26] The -£319 million reconciliation is made up of: 2018-19 income tax revenues and BGA (-£309 million), 2019-20 Land and Buildings Transaction Tax BGA (-£6 million), 2019-20 Scottish Landfill Tax BGA (-£2 million), 2019-20 Carer's Allowance BGA (-£3 million) and 2019-20 fines forfeitures and fixed penalties (£2 million).

Figure 2.4: Indicative and outturn income tax reconciliations, by year of collection



Source: Scottish Government, Scottish Fiscal Commission.
Income tax reconciliations are applied with a three-year delay. Reconciliations from 2017-18 and 2018-19 have been applied to the 2020-21 and 2021-22 Scottish Budgets respectively.

Box 2.2: Income tax reconciliations – quantifying the uncertainty

Income tax reconciliations are adjustments to the Scottish Budget for outturn income tax data, these can be positive or negative and we expect income tax reconciliations to be volatile. The values involved can be large, of the two income tax reconciliations applied so far, the largest reduced the Scottish Budget by £309 million. As this is only the second reconciliation, it's difficult to get a sense of how big income tax reconciliations might be in the future, or how much they may vary.

Income tax reconciliations are the result of errors in our forecasts of Scottish income tax revenues and errors in the forecasts of the BGA. While we don't yet know the likely variation of reconciliations, we do have a better sense of the likely range of errors in both ours and the OBR's income tax forecasts which inform the BGA. We simulated 100,000 income tax reconciliations, based on some simple assumptions about income tax forecast errors, to provide an indication of the possible scale and variation of future income tax reconciliations. Further information on these simulations and sensitivities are provided in Annex D.

The key conclusions emerging from these simulations are as follows:

- Over time reconciliations should be positive as often as they are negative.
- We estimate that negative reconciliations exceeding £300 million – the Government's normal annual borrowing limit – could occur around three times every ten years.
- Larger negative reconciliations exceeding £600 million could occur around once every ten years.
- Positive reconciliations exceeding these thresholds should occur with similar frequency.

Based on historic data, we see that income tax forecasting errors can be persistent over time. In other words, a negative forecasting error in one year is likely to be followed by several other negative forecasting errors. A series of negative or positive reconciliations in a row are therefore more likely, and we have already seen this in 2017-18 and 2018-19. In the future, we may see a series of positive reconciliations.

2.35 All other devolved taxes and social security payments with BGAs follow a different process, where funding is updated twice: first during the financial year, then again once outturn information is available. These funding updates will apply to the 2021-22 Scottish Budget when the OBR updates its forecasts, which we would typically expect in autumn 2021. The scale will depend on the size of the revision to the OBR's forecasts.

Resource Assessment

2.36 The Scottish Government's resource funding position remains highly uncertain. In previous publications we have discussed the uncertainty that tax and social security devolution would bring to the Budget, but that uncertainty has been overtaken by the scale and variations in COVID-19 funding. At the same time the Scottish Government is managing spending which is more variable, and the scale of that spending will depend on the public health measures in place for the rest of the year. The Scottish Government must balance its budget and cannot overspend. Underspends can be paid into the Scotland Reserve, up to a total limit of £700 million including capital. It is within this context that our assessment focuses on the Scottish Government's use of the Reserve to manage any underspends in its Budget. We also discuss the Scottish Government's borrowing plans in light of the triggering of the Scotland-specific economic shock.

Box 2.3: Assessing the reasonableness of the Scottish Government's borrowing plans

Our remit requires us to assess the reasonableness of the Scottish Government's borrowing projections. Independent fiscal institutions typically consider the whole picture of a Government's public finances and judge borrowing plans against any fiscal rules by assessing the effect on the deficit and debt stock and any potential future limitations on spending. However, the Scottish Government is a devolved administration with borrowing powers limited to those set out in the fiscal framework.

To assess borrowing plans we first consider if the plans are within the fiscal framework limits and then consider a range of factors affecting borrowing and spending plans including: previous borrowing and use of the reserve, likely underspends, forecast reconciliations and other pressures facing the Scottish Budget. We then provide our assessment which comments on the pressures on the borrowing powers both in the current financial year and future years, the potential scale of those pressures and any associated risk.

Our assessments reflect judgements which will be specific to the context of the year we are considering. There will always be a range of borrowing plans which could be considered reasonable, but which would have varying degrees of potential pressures and risks associated with them. Our assessment approach is to highlight and discuss the relevant issues each year.

Resource Reserve

2.37 The Scottish Government is required to maintain a balanced budget, matching its spending to available funding each year. As the Scottish Government cannot overspend its budget, outturn spending comes in below the allocated Budget which results in underspends, a natural part of normal budget management. The Scottish Government therefore needs to have provision to transfer unspent funds from one financial year to the next. The Scotland Reserve was introduced in 2017-18, as a new mechanism to allow the Scottish Government to save any underspends, build up funds and draw them down in future years.

Box 2.4: Scotland-specific economic shock in practice

A Scotland-specific shock is defined in the Fiscal Framework agreement by two criteria: annual GDP growth in Scotland, on a four quarters on four quarters basis (4Q-on-4Q), is below 1.0 per cent and 4Q-on-4Q growth in Scotland is 1.0 or more percentage points below the UK.[27] Based on our and the OBR's latest forecasts, a shock is triggered for 2021-22. We discuss in Chapter 3 the reasons why the shock has been triggered.

The triggering of the shock increases the limit of resource borrowing and removes the annual drawdown limit from the Scotland Reserve. The Scottish Government can now borrow up to £600 million each year to manage tax and social security forecast errors, an increase from £300 million, but the overall £1.75 billion debt cap remains in place. The £250 million drawdown limit for resource on the Scotland Reserve is temporarily waived, but the aggregate £700 million cap remains in place.

Once a shock is triggered, the relaxation of limits applies to the financial year in which the shock is triggered plus the following two financial years, 2021-22 to 2023-24 in this case. Even if future forecasts or outturn data no longer trigger a shock in 2021-22, the relaxation of limits will not be revoked.

2.38 The Scotland Reserve has a total limit of £700 million, which includes resource and capital funds.[28] There are no restrictions on how the reserve is split between resource and capital or payments into the reserve, up to the £700 million limit. Under normal circumstances, a maximum of £250 million resource funding can be drawn down in one year, but when a Scotland-specific economic shock has been triggered, which our economy forecast has for 2021-22, the drawdown limit is waived for three years. The Scottish Government's planned use of the resource reserve in 2020-21 and 2021-22 is shown in Figure 2.5.

Figure 2.5: Historic and planned use of the resource reserve

£ million	2019-20	2020-21	2021-22
Opening balance	381	217	231
Drawdowns	-249	-149	-231
Additions [1]	85	162 [1]	
Closing balance	217	231	0

Source: Scottish Fiscal Commission, Scottish Government.
Shaded cells refer to outturn available at time of publication.
[1] Additions to the reserve for 2020-21 are still uncertain and will be finalised as underspends emerge towards the end of the year. In this table we show the minimum addition required in 2020-21 to permit the drawdown in 2021-22.

2.39 Late changes to funding associated with the tightening of lockdown at the start of 2021 make it likely that further underspends will emerge for 2020-21, so more funds will be paid into the Scotland Reserve. Any level of underspend, up to the £700 million total limit, can be carried in 2021-22, and the drawdown limit has been removed for the next three years.

[27] The agreement between the Scottish Government and the United Kingdom government on the Scottish Government's fiscal framework (link)
[28] The Scotland Reserve cannot have a negative balance.

2.40 As the aggregate limit remains in place, the balance of the Scotland Reserve must be brought sufficiently low by the end of each financial year, to ensure space for future underspends, without breaching the £700 million limit. As both the 2020-21 and 2021-22 budgets are facing significant uncertainty, underspends may be more volatile than in previous years, which increases the risk that they exceed the £700 million total limit and risk the Scottish Government losing funding which cannot be carried over.

Resource borrowing

2.41 The Scottish Government can borrow to manage tax and social security forecast errors. Under normal circumstances, borrowing is limited to £300 million per annum and £1.75 billion in total. In the case of a Scotland-specific economic shock, the annual borrowing limit is increased to £600 million for the year of the shock and the following two financial years, but the overall cap remains unchanged.

2.42 Resource borrowing is available for the combined effect of all negative forecast errors. The Scottish Government is planning to borrow £207 million in 2020-21.[29] The balance of all forecast errors in 2020-21 would allow the maximum £300 million to be borrowed, which is an additional £93 million above what is planned.[30] There is still opportunity for the Scottish Government to utilise the £93 million before the end of the financial year. Alternatively if the Scottish Government had a large underspend they may choose to borrow less than £207 million to reduce that underspend and therefore reduce the amount carried forward in the Scotland Reserve.

2.43 The Scottish Government is planning to use its extended borrowing powers in 2021-22 and borrow £319 million, the value of the final reconciliations. As further forecast errors emerge in-year, the Scottish Government will be able to borrow greater amounts, up to the £600 million limit.

2.44 Our forecasts this year are subject to greater uncertainty than in a typical year, and it is likely that positive and negative forecast errors will arise in both our forecasts and the forecasts of the BGAs.

2.45 The next two income tax reconciliations are currently forecast to be positive. In future years the Scottish Government plan to use resource borrowing powers to manage negative income tax reconciliations. Analysis of the likely scale of future income tax reconciliations presented in **Box 2.2** and **Annex D** highlight the risk that the resource borrowing limits are unlikely to be sufficient to manage income tax reconciliations. This analysis suggests around 3 in 10 years the limit of £300 million may be exceeded, and around 1 year out of 10 in which the limit of £600 million is exceeded.

---

[29] A final reconciliation of -£207 million was applied to the 2020-21 Scottish Budget. These forecast errors allow the planned borrowing.

[30] Considering negative forecast errors only, a total of £302 million of negative forecast errors have occurred to date in 2020-21. Of these £145 million relates to our devolved tax forecasts, £90 million to our social security forecasts and £67 million in negative changes to the social security BGAs. Positive forecast revisions largely cancel out these negative revisions, but only negative revisions are counted for borrowing.

Box 2.5: Conclusion of resource assessment

The Scottish Government is planning to use resource borrowing to manage final reconciliations, which are £207 million in 2020-21 and £319 million in 2021-22, which would bring total resource debt to £505 million, well below the £1,750 million aggregate limit. Even if the Scottish Government borrowed the maximum of £300 million in 2020-21 and £600 million in 2021-22, they still would not reach the aggregate limit. We're forecasting positive income tax reconciliations will be applied to the 2022-23 and 2023-24 Scottish Budgets, which may reduce the amount of borrowing in these years.

We've highlighted the significant uncertainty faced in the 2020-21 Scottish Budget, including the potential for large underspends. As the drawdown limits of the Scotland Reserve have been removed, additions to the reserve can be increased and carried into 2021-22. The aggregate limit of £700 million is the most which can be carried forward between financial years. In addition, the balance of the Reserve must be brought down before the end of 2021-22 to allow space for future underspends.

To ensure a balanced budget the Scottish Government may increase or reduce their planned borrowing. They could reduce borrowing to manage underspends, or increasing borrowing to manage for shortfalls in funding, if negative forecast errors relating to tax or social security provide access to necessary borrowing.

The Scottish Government is using the Reserve and resource borrowing to manage the Budget during a challenging year. We consider their plans based on the information available are reasonable. But we recognise that the on-going uncertainty means these plans may change significantly and recommend that the position of the 2021-22 Budget is monitored and reviewed over the course of the financial year.

Capital funding for the 2021-22 Scottish Budget

2.46 Capital spending covers long-term investment, such as hospitals, roads and research and development. Funding for capital spending in the 2021-22 Scottish Budget is around £6 billion, which has reduced by around £40 million compared to 2020-21.

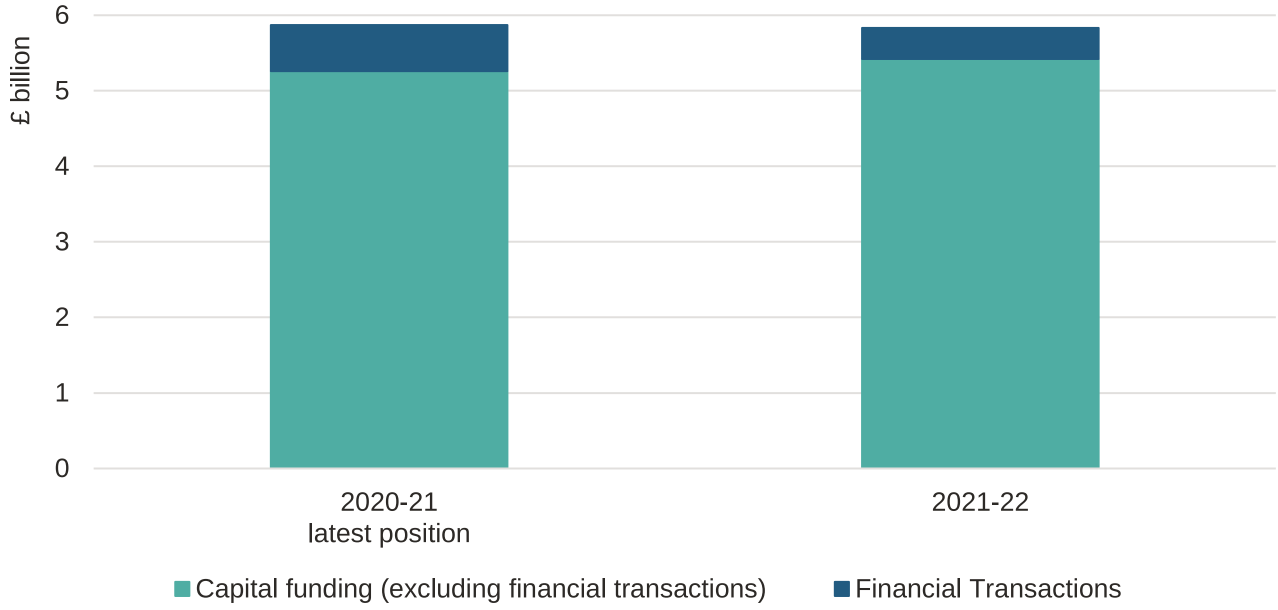
2.47 This reduction is driven by a lower allocation of funding for financial transactions, £208 million in 2021-22 compared to £612 million in 2020-21.[31,32] The Scottish Government has offset some of this reduction in funding by drawing down £200 million in financial transactions from the Scotland Reserve. Financial transactions are a type of funding which can only be used to make loans to or equity investments in private sector entities.[33] Excluding financial transactions funding and the Reserve drawdown, capital funding has increased by £164 million, or 3 per cent. Figure 2.6 illustrates this change in capital funding, split between financial transactions and other capital funding.

[31] This change is linked to funding allocated to the Ministry of Housing Communities and Local Government at the UK Government's Spending Review which reduced funding for Help to Buy in England. UK Government (2020) Spending Review 2020 (link).

[32] 2020-21 financial transactions funding includes £1 million of COVID-19 related funding and £611 million of previously allocated funding.

[33] Scottish Government (2020) Scottish Budget 2020-21 (link).

Figure 2.6: Capital funding for the 2020-21 and 2021-22 Scottish Budgets



Source: Scottish Government, Scottish Fiscal Commission.
The comparison between 2020-21 and 2021-22 is in nominal terms.

2.48 Detailed changes to the capital budget between 2020-21 and 2021-22 are set out in Figure 2.7.

Figure 2.7: Capital funding in 2020-21 and 2021-22

£ million	2020-21 latest position	2021-22	Difference
Barnett-determined block grant and non-COVID funding	4,886	4,973	87
Other and non-Barnett funding [1]	-10	0	10
Financial transactions	611	208	-403
COVID-19 funding [2]	10	0	-10
Capital borrowing	300	450	150
Capital reserve drawdown [3]	74	200	126
Total capital funding	5,871	5,831	-40

Source: Scottish Fiscal Commission, Scottish Government.
This table is on a cash basis, comparisons in real terms can be found in the Scottish Government's Budget documents.
[1] 2020-21 other and non-Barnett funding includes Glasgow City funding (£15 million) and repayment of Financial Transactions to HMT (-£25 million).
[2] COVID-19 funding in 2020-21 is £9 million capital and £1 million financial transactions.
[3] The capital drawdown in 2021-22 is £200 million of financial transactions.

Capital Assessment

Capital Reserve

2.49 The capital part of the Scotland Reserve covers both capital and financial transactions, and can be used to carry underspends between years and support capital spending plans. Under normal circumstances an annual drawdown limit of £100 million applies, except in the case of a Scotland-specific economic shock, when the drawdown limit is removed. Our forecasts have triggered a Scotland-specific economic shock in 2021-22, the Scottish Government now plan to drawdown £200 million for financial transactions.

2.50 Figure 2.8 sets out the planned use of the capital and financial transaction reserve in 2020-21 and 2021-22.

Figure 2.8 Historic and planned use of the capital and financial transaction reserve

£ million		2019-20	2020-21	2021-22
Capital	Opening balance	65	80	10
	Drawdowns	-60	-70	0
	Additions	74	0	
	Closing balance	80	10	10
Financial transactions	Opening balance	159	136	202
	Drawdowns	-120	-4	-200
	Additions	97	70	
	Closing balance	136	202	2

Source: Scottish Fiscal Commission, Scottish Government.
Figures may not sum to totals because of rounding.
Shaded cells refer to outturn available at time of publication. Additions to the reserve for 2020-21 are still uncertain and will be finalised as underspends emerge towards the end of the year.

Capital borrowing

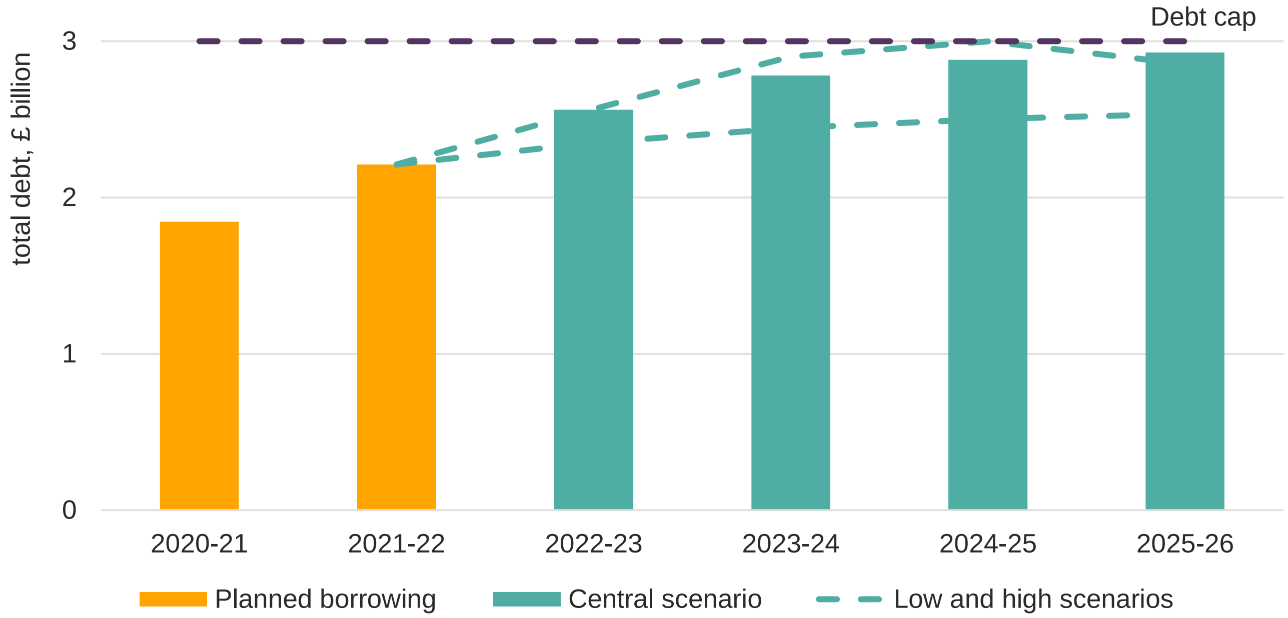
2.51 The Scottish Government can borrow for capital spending up to a maximum of £450 million each year with a total limit of £3 billion. The Scottish Government now plans to borrow £300 million in 2020-21, which is lower than the £450 million originally planned, and the planned borrowing of the maximum £450 million in 2021-22. After borrowing these amounts, total capital debt will increase to £2.2 billion.

2.52 The Scottish Government set out self-imposed principles for capital borrowing in its 2021-22 Medium Term Financial Strategy.[34] These principles apply to the years until 2025-26 and include: borrowing between £250 million and £450 million each year, ensuring a reserve of £300 million is available at the end of this period, in 2026-27. These are a relaxation of previous rules which required the Scottish Government to have reserves of £300 million each year until 2026-27.

2.53 We set out three scenarios below, which consider future borrowing. We set out a high, low and central scenario, which adhere to the new principles as set out in the 2021 Medium Term Financial Strategy. Under the high scenario we assume the maximum £450 million is borrowed each year until 2024-25 when the debt cap is reached, then very limited borrowing from 2024-25 onwards to ensure the reserve of £300 million is available in 2026-27. The central scenario is based on Scottish Government projections, as set out in the 2021-22 Medium Term Financial Strategy, and the low scenario assumes £250 million borrowing each year.

[34] Scottish Government (2021) Scotland's Fiscal Outlook - The Scottish Government's Medium-Term Financial Strategy (link)

Figure 2.9: High, low and central capital borrowing scenarios



Source: Scottish Fiscal Commission, Scottish Government.

Box 2.6: Conclusions of capital assessment

The Scottish Government is making plans in uncertain circumstances, with funding and spending likely to change significantly over the course of 2021-22. Although the response to COVID-19 has largely consisted of resource spending, capital funding and spending may be significantly affected by restrictions on economic activity notably construction.

The Scotland Reserve is primarily used to carry underspends between financial years. As the total limit of the reserve is not split by resource and capital, allowing the balance of the capital reserve to rise too high may limit the level of resource underspend which can be carried between financial years. The Scottish Government expects the capital reserve will have a balance of £211 million at the end of 2020-21, and the Scottish Government plan to drawdown £200 million in financial transactions in 2021-22.[35] This should leave the balance of the reserve low enough to manage future underspends.

The Scottish Government's borrowing plans will bring total capital debt to £2.2 billion, which is close to the £3 billion limit. In previous years (2019-20 and 2020-21) the Scottish Government initially announced plans to borrow the maximum allowed, but revised borrowing down later in the year, which means we may see borrowing of less than the planned £450 million in 2021-22. In the scenario where the maximum is borrowed from 2022-23 onwards, total debt will reach the £3 billion cap by 2024-25.

On balance, the Scottish Government's capital borrowing plans are reasonable but as the total level of debt gets closer to the debt cap, the risk associated with limited future borrowing is increased.

[35] The planned closing balance of the capital reserve in 2020-21 is £211 million. This doesn't exactly match the closing balances set out in Figure 2.8 because of rounding.

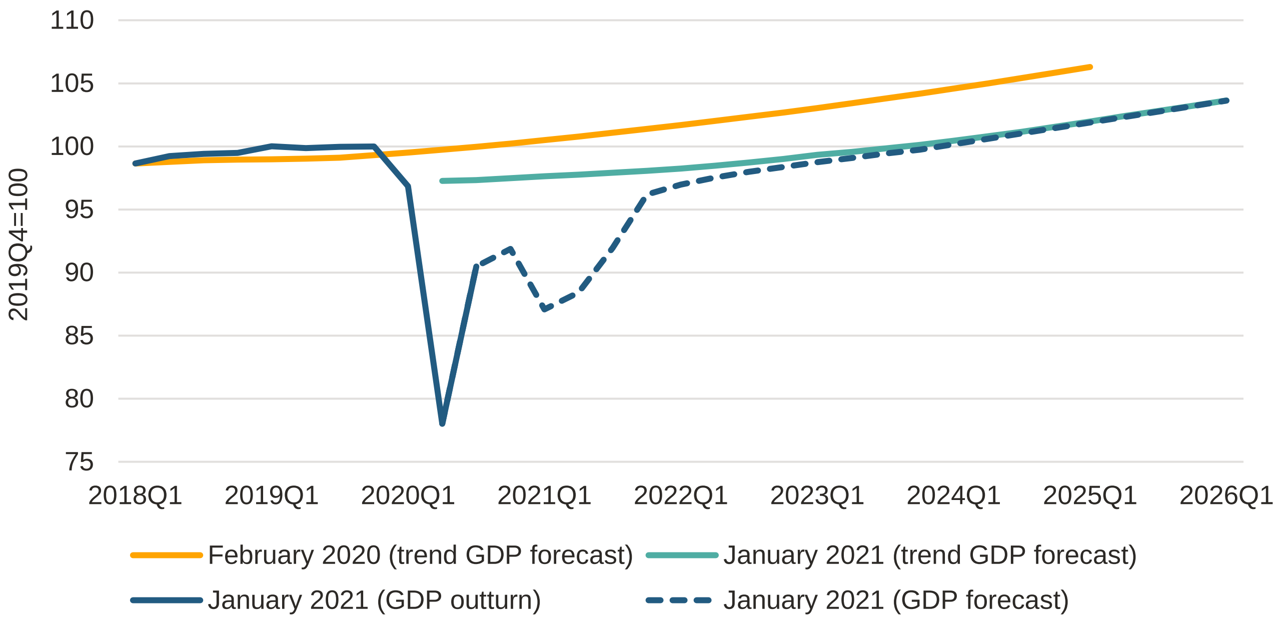
Chapter 3
Economy

Forecast summary

3.1 COVID-19 is having a significant effect on the Scottish and UK economies. Figure 3.1 summarises our GDP forecast, showing both the short and long term effects of COVID-19 on Scottish GDP relative to our February 2020 trend GDP forecast.

3.2 Chapter 1 provides a discussion of our central COVID-19 case and underlying assumptions. We expect public health measures to manage the pandemic will continue until the end of 2021, with strict restrictions required at least until April.

Figure 3.1: Trend and actual Scottish GDP, February 2020 and January 2021



Source: Scottish Fiscal Commission, Scottish Government (2020) First estimate of GDP: 2020 Q3 (link).

3.3 Scottish GDP fell by almost a quarter during the UK-wide lockdown in early 2020. As restrictions were lifted over the summer, GDP started to recover and grew for six consecutive months, so that in 2020 Q3 Scotland had regained around two thirds of the lost output.

3.4 Restrictions started to tighten again across the UK in late 2020, as cases rose and a new variant of COVID-19 was discovered in the UK, with mainland Scotland and most of the rest of the UK in lockdown at the start of 2021. We expect this new lockdown to reduce economic activity in the first quarter of this year.

3.5 As in April 2020, schools were closed in January 2021 and we expect them to remain closed throughout the first quarter. In contrast to the first lockdown, more sectors of the economy remain open, many businesses have adapted to the restrictions, and support schemes such as furlough are already in place. We expect GDP to fall in 2021 Q1 by around 5 per cent, a smaller fall than during the first lockdown. GDP will then continue to recover. Our forecast for 2021 as a whole is for growth of 1.8 per cent, picking up to 7.5 per cent in 2022, mainly fuelled by household consumption as higher-income consumers who accumulated savings during the lockdown months start spending again. In contrast, lower-income households – who have been disproportionately affected by the COVID-19 crisis – were less able to save during the pandemic, and may have run down savings or borrowed to cover day-to-day expenses, so at best they can be expected to spend cautiously in order to restore their finances.

3.6 Figure 3.2 presents further detail on our economy forecast.

Figure 3.2: Headline economy forecasts, growth rates unless otherwise specified

Per cent	2019	2020	2021	2022	2023	2024	2025
GDP							
February 2020	0.9	1.0	1.1	1.2	1.2	1.2	
January 2021	0.8	-10.7	1.8	7.5	1.6	1.6	1.7
Trend productivity							
February 2020	0.3	0.6	0.9	1.1	1.2	1.3	
January 2021	0.0	0.0	0.2	0.4	0.8	1.2	1.6
Average nominal earnings							
February 2020	2.8	3.0	3.1	3.2	3.3	3.3	
January 2021 [1]	4.2	2.5	2.6	2.4	2.7	3.0	3.3
Average real earnings							
February 2020	1.0	1.1	1.0	1.2	1.2	1.2	
January 2021	2.6	2.4	1.7	0.8	0.9	1.1	1.3
Employment							
February 2020	0.4	-0.3	0.1	0.2	0.2	0.2	
January 2021	0.1	-2.4	-1.5	1.2	0.9	0.4	0.2
Unemployment rate							
February 2020	3.7	4.0	4.0	4.0	4.0	4.0	
January 2021	3.6	6.0	7.1	5.9	5.0	4.7	4.5

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2020) Scotland's Economic and Fiscal Forecasts – February 2020 (link).
Shaded cells refer to outturn available at time of publication.
[1] Average nominal earnings growth for 2019 as well as 2020 Q1 and Q2 are based on wages and salaries data from Scotland's Quarterly National Accounts and employees data derived from the Labour Force Survey and Annual Population Survey for Scotland. We used RTI mean pay data to inform our short-run forecast of average earnings growth in 2020 Q3.

3.7 COVID-19 will have long-lasting effects on the Scottish economy. We don't expect Scottish GDP to recover to its pre-COVID-19 level until the start of 2024. In 2025, Scottish GDP will still be 4 per cent below where we expected it to be in our February 2020 forecast. Our long-term GDP outlook has changed because we assume there will be longer-term effects of the pandemic on the Scottish economy. In particular, compared to our previous forecast, we expect that:

- Productivity is around 2 per cent lower because of factors such as lower levels of capital investment, global trade and migration during the pandemic, and scarring effects from prolonged unemployment

- Labour force participation rates for those aged 16 to 24 are 0.9 per cent lower, in part because the long-term employability of younger people may be reduced by unemployment early in their working lives

- The long-run unemployment rate increases from 4.0 to 5.5 per cent in 2020, gradually moving to 4.4 per cent at the start of 2023

- Population 16+ is 0.5 per cent lower for the reasons given in Box 3.1, which include COVID-19 related excess deaths and our assumption of zero net international migration in the short term

3.8 The job retention schemes have largely, but not completely, protected the labour market from the economic consequences of the pandemic. Although headline unemployment figures from the Labour Force Survey have remained stable, PAYE Real Time Information (RTI) indicates a decrease in paid employment since last April. There is also a fall in workforce jobs for Scotland and the UK.[36] We expect the unemployment rate to peak at 7.6 per cent in 2021 Q2 once the furlough schemes end. As Figure 3.2 shows, we revised down our forecasts of employment growth in 2020 and 2021 to account for the effects of COVID-19 on the labour market.

3.9 Average nominal earnings have been relatively resilient to COVID-19, according to PAYE RTI data available up to October 2020, and are on course to grow in 2020 although at a slower rate than we expected last February. Our forecasts of average nominal earnings growth have been revised down in subsequent years, mainly reflecting lower productivity growth, lower public sector pay growth and higher unemployment compared to our previous forecast. With inflation currently very low, and lower than expected at the time of our previous forecast, real average earnings growth forecasts for 2020 and 2021 have been revised up.[37]

3.10 Another important development since our previous forecast is that the UK and EU have reached a free trade agreement which came into effect at the end of the transition period on 1 January 2021. Our recent forecasts already incorporated the long-run effects of Brexit on the Scottish economy and, because the deal was within the range of our previously expected outcomes, we continue to use the same assumptions for this forecast.

3.11 A feature of COVID-19 and Brexit is that some sectors are disproportionately more affected than others, mostly with non-overlapping effects from the two events: consumer-facing services have been the most exposed to the pandemic while export-focused businesses will be most affected by Brexit. Sectors such as non-food retail, accommodation and food, arts and recreation have been the hardest hit during the pandemic. Accommodation and food services saw by far the largest effect; activity fell by 82.3 per cent in April 2020 compared to April 2019, and in October it was still 43.5 per cent below its February level. Accommodation and food as well as arts and recreation also have significantly higher shares of workforce on furlough relative to other sectors.[38] We looked at GDP data covering the early-2020 lockdown to gain an indication of the possible shock to these and other sectors from the lockdown introduced at the start of 2021, and to build our forecast of GDP growth for 2021 Q1. Regarding Brexit, exporters of agricultural, fishing and meat products are particularly affected by the new UK-EU border arrangements. Although most food and plant products can still be traded freely, some are now facing EU export bans. Other exporters, most notably of fresh fish and seafood, are severely disrupted by new customs controls and border

[36] ONS (2020) JOBS05: Workforce jobs by region and industry – December 2020 (link)

[37] As shown in Figure 3.2, in 2020, average real earnings growth of 2.4 per cent is 0.1 percentage points below average nominal earnings growth of 2.5 per cent. This reflects growth in the Consumption Expenditure Deflator (CED) of 0.1 per cent in 2020, which is based on households-only CED from Scotland's Quarterly National Accounts up to 2020 Q2 and OBR forecasts of UK CED thereafter.

[38] Scottish Government (2020) BICS weighted Scotland estimates: data to wave 20 (link)

delays. All these sectors make up small proportions of Scottish GDP, but there are parts of Scotland such as rural and coastal communities for which they are vital.

3.12 Our latest GDP forecasts, when compared to the OBR's forecasts for the UK published last November, meet the criteria for a Scotland-specific economic shock to be triggered. The fiscal framework provides additional borrowing and Scotland Reserve powers for Scotland in the event of a Scotland-specific economic shock.[39] The criteria for a shock to occur are that: annual GDP growth in Scotland, on a four quarters on four quarters basis (4Q-on-4Q), is below 1.0 per cent; and 4Q-on-4Q growth in Scotland is 1.0 percentage point or more below the UK. Based on what we observed in 2020, we believe the outlook for Scottish GDP and UK GDP are broadly similar and most of the difference between our forecasts for Scotland and the OBR's UK forecasts is likely to be accounted for by the fact that the two forecasts were based on different announcements about what health measures would be in place in early 2021. The OBR's November 2020 forecasts did not account for the lockdown which began in January 2021. The Scotland-specific economic shock may not be present once the OBR updates its forecasts in March 2021, or once outturn data are available. Chapter 2 discusses the implications of the shock being triggered and what this means for additional flexibility in the Scottish Budget.

3.13 Our economy forecasts were finalised on 7 January 2021, so no new data or information received after this date were incorporated into the forecasts. These forecasts have been produced using the Commission's new in-house macroeconomic forecasting model and historical database. The development of an in-house macroeconomic model was recommended by the 2019 OECD review.[40] We will publish more information about the model in an occasional paper later in the year.[41]

[39] The agreement between the Scottish Government and the United Kingdom government on the Scottish Government's fiscal framework (link)

[40] OECD (2019) OECD Review of the Scottish Fiscal Commission (link)

[41] The new model is built in non-proprietary software and is fully owned by the Commission. The forecast methodology is fundamentally unchanged from the previous model.

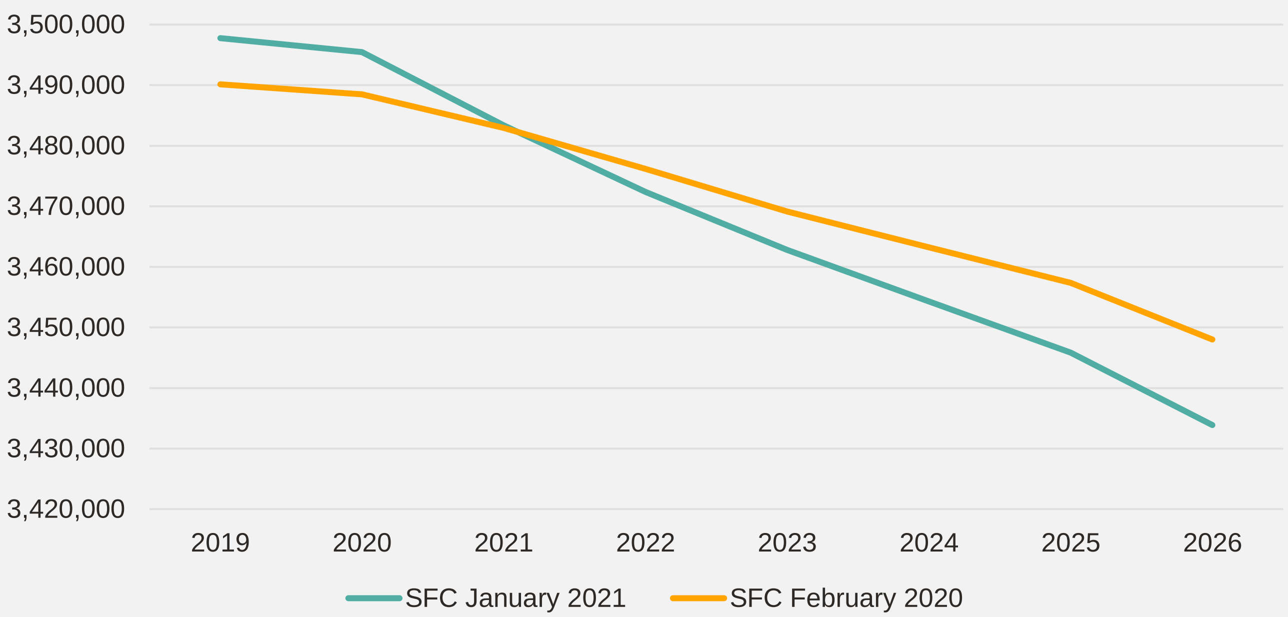
Box 3.1: Population projections

In previous forecasts our Scottish population projections were based on the ONS population projection variants, which are produced for the nations of the UK every two years. The most recent were published in late 2019 so the COVID-19 pandemic is not reflected in the projections. In our February 2020 forecast, we used the ONS 50 per cent net EU migration to allow for the UK leaving the EU, leading to a reduction in the level of migration.

For this forecast we have developed bespoke population projections which account for COVID-19. We now use a mortality assumption – the low life-expectancy assumption – adjusted for COVID-related excess deaths in 2020 and 2021. For migration, we assume zero net international migration from mid-2020 to mid-2021 to reflect the effects of the pandemic. Between mid-2021 and mid-2022 we assume net migration of around 2,100 individuals, rising to a long-term net migration of around 4,100 individuals which is the level consistent with the ONS zero per cent net EU migration scenario. In line with the continued decline in the number of births in Scotland, we have also reduced our fertility assumption.

Using our updated assumptions we anticipate that the population of Scotland aged between 16 and 64 will be smaller by around 14,000 individuals than we expected in our February 2020 forecast, mostly because of anticipated changes in net migration rather than the impact of extra deaths during the COVID-19 pandemic.

Figure 3.3: Population of Scotland in 16 to 64 age group



Source: Scottish Fiscal Commission, ONS (2019) 50% future EU migration variant – Scotland summary (link).

Main judgements

Figure 3.4: Economy forecast main judgements

Issue	February 2020	January 2021
1. Spare capacity	0.1 per cent in 2018 and 0.8 per cent in 2019	Significant spare capacity in economy at start of forecast period, -8.6 per cent of trend GDP
2. Trend productivity	From growth of 0.6 per cent in 2020 to growth of 1.3 per cent in 2024	From zero growth in 2020 to growth of 1.2 per cent in 2024 and 1.6 per cent in 2025. Level in 2025 Q1 is around 2 per cent lower compared to February 2020
3. Long-run unemployment rate	4.0 per cent in all years	From 5.5 per cent in 2020 Q2 gradually moving to 4.4 per cent in 2023 Q1
4. Nominal average annual earnings	Growth increasing from 3.0 per cent in 2020 to 3.3 per cent in 2024, broadly aligning with productivity	Using Real Time Information earnings for 2020 Q3. Growth increasing from 2.5 per cent in 2020 to 3.0 per cent in 2024 and 3.3 per cent in 2025
5. Population projections	ONS 2018-based 50 per cent net EU migration	Bespoke projections adjusted for COVID-19. For migration, we assume zero net international migration in the year to mid-2021, transitioning to zero per cent net EU migration from mid-2022
6. Forecasts of the UK	Short term based on forecasts published by the National Institute of Economic and Social Research (NIESR) in November 2019, long-run view maintained in line with the OBR UK March 2019 forecasts	Based on OBR UK November 2020 forecast
7. Brexit	Our Brexit assumptions were that: • the UK leaves the EU on 31 January 2020 • this is followed by a transition period until December 2020 • 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	Broadly unchanged – smooth transition to new relationship with EU on 1 January based on an free trade agreement Productivity, trade and migration are all slowed in line with February 2020 forecast
8. Oil & gas	Neutral impact of UK Continental Shelf activity on onshore economy over the forecast	No change
9. Savings ratio	Broadly flat, picking up in the later years of the forecast	High savings ratio in 2020 and first half of 2021, gradually declines over forecast period
10. Second round effects	The Commission is not including second round economy effects from any Budget policies	No change

Source: Scottish Fiscal Commission

Developments in the Scottish economy

Brexit

3.14 On 24 December 2020, the UK and EU agreed a post-Brexit trade and security deal, which contains provisions about their relations from 1 January 2021.[42] The deal was approved by the UK Parliament on 30 December. EU ambassadors have also backed the agreement, with formal ratification from the EU Parliament expected in March 2021. While there will be changes such as new custom procedures and border checks, the main implication of the deal is that there will be no taxes on goods (tariffs) or limits on the amount (quotas) that can be traded between the UK and the EU.

3.15 Over the longer term, the deal is within the range of possible Brexit outcomes captured by our previous broad-brush assumptions. We have retained the same Brexit judgements we used in our recent forecasts, based on a smooth transition to a new free trade agreement with the EU on 1 January 2021. These assumptions are also broadly in line with those used by the OBR in its November 2020 forecast for the UK. The deal eliminates the immediate uncertainty around the outcome of the negotiations which has affected our recent forecasts, but there remains significant uncertainty about the long-run effects of Brexit on the Scottish economy.

3.16 We capture the effects of Brexit through three main channels:

- Productivity – we forecast slow growth in productivity, in part because of Brexit
- Trade – using OBR assumptions, we forecast slower growth in Scottish international trade from the end of the transition period
- Migration – our population projections from mid-2022 onwards are consistent with the ONS zero per cent net EU migration variant, as described in Box 3.1

3.17 During January 2021 there have been significant border problems affecting fisheries exports, trade between Northern Ireland and Great Britain, and other trade. We expect many of these problems to be short lived, but the inevitable fact that Brexit increases border frictions is why we forecast slower growth in international trade.

GDP and expenditure components

3.18 Household consumption declined significantly in the second quarter of 2020, as the economy was placed into lockdown to control the pandemic, before partially bouncing back in Q3. Our forecast is that, with the second lockdown introduced at the start of this year, household consumption will fall again in 2021 Q1, although not as sharply as in 2020 Q2. We expect household consumption to increase quickly in the final part of 2021 as restrictions are gradually eased, but we don't expect it to return to 2019 Q4 levels until the second half of 2023.

3.19 The household savings ratio spiked in 2020 Q2 as the economy was put into lockdown and household consumption fell dramatically, and is likely to peak again in 2021 Q1 although at a lower level. We forecast the savings ratio to drop back to its pre-COVID level by 2022 Q1 as the economy

[42] Agreement reached between the United Kingdom of Great Britain and Northern Ireland and the European Union (link)

recovers and consumption rebounds. This is a cautious assumption and we could have assumed savings to fall below the pre-COVID level initially.

3.20 Business investment also dropped substantially in the second quarter of 2020. Compared to our February 2020 forecast where we anticipated a return to annual growth in 2020, business investment now looks on course to fall by around 27 per cent. We expect growth to pick up from 2021 onwards, making a small positive contribution to GDP growth over the forecast period.

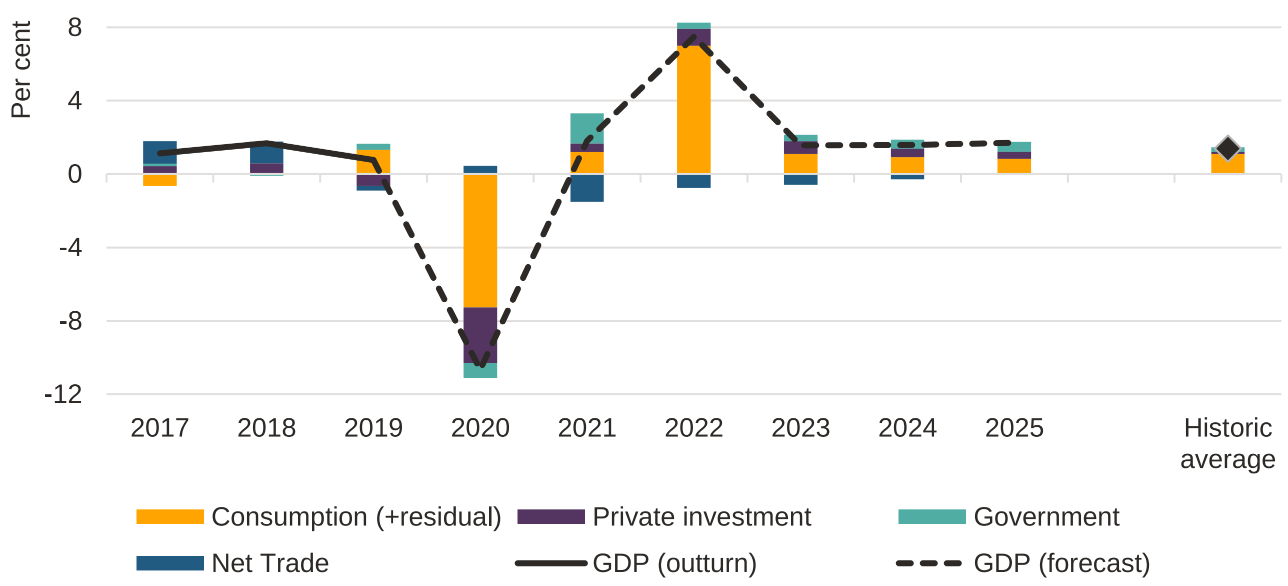
3.21 Scotland's exports and imports both decreased in 2020, reflecting the slowdown in global trade caused by COVID-19 restrictions. Thereafter, with the end of the Brexit transition period, Scottish international trade growth is expected to slow but, with broadly symmetric effects on exports and imports. Some sectors are likely to be affected more than others, but on balance, we expect the contribution from net trade to be broadly neutral over the forecast period.

3.22 In 2020, Government consumption expenditure in constant prices is set to fall in line with output from the education and health sectors, which is estimated using activity measures and was affected by schools closing and non-essential NHS treatments being paused during the early-2020 lockdown. This is different from Government consumption expenditure in current prices which has increased in 2020 in response to COVID-19.

3.23 In 2021 and subsequent years, our forecast of Scottish Government expenditure is mainly driven by the Scottish Government's plans set out in the Scottish Budget 2021-22 and in the Medium Term Financial Strategy. For UK Government and local authority spending in Scotland we use OBR forecasts from November 2020. Further details on Scottish Government funding elements are provided in Chapter 2.

3.24 The contributions of each of the components to growth in GDP are shown in Figure 3.5.

Figure 3.5: Contributions by component of expenditure to growth in GDP



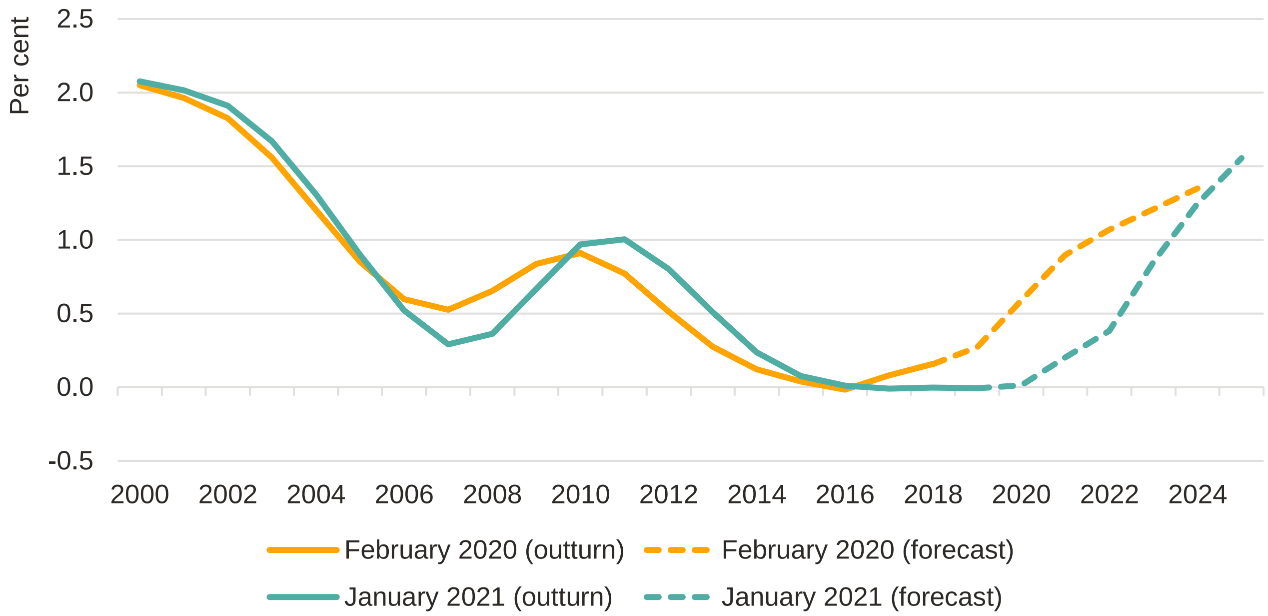
Source: Scottish Fiscal Commission, Scottish Government (2020) Gross Domestic Product (GDP) Quarterly National Accounts: 2020 Quarter 2 (link).
Historical average is based on growth from 1998 to 2009.

Long-run outlook

Productivity

3.25 Since our February 2020 forecast, we have revised down our pre-COVID estimates of trend productivity growth in the period 2016 to 2019, reflecting the latest outturn data. In addition, our forecasts of productivity have been revised down in light of the COVID-19 crisis. We expect productivity to be 2.3 per cent lower in 2025 Q1 than we forecast in February 2020. This COVID-19 productivity scarring figure is similar to the OBR's estimate for the UK published in its November 2020 forecast.

Figure 3.6: Trend productivity growth, outturn and forecast



Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2020) Scotland's Economic and Fiscal Forecasts – February 2020 (link).

Trend GDP

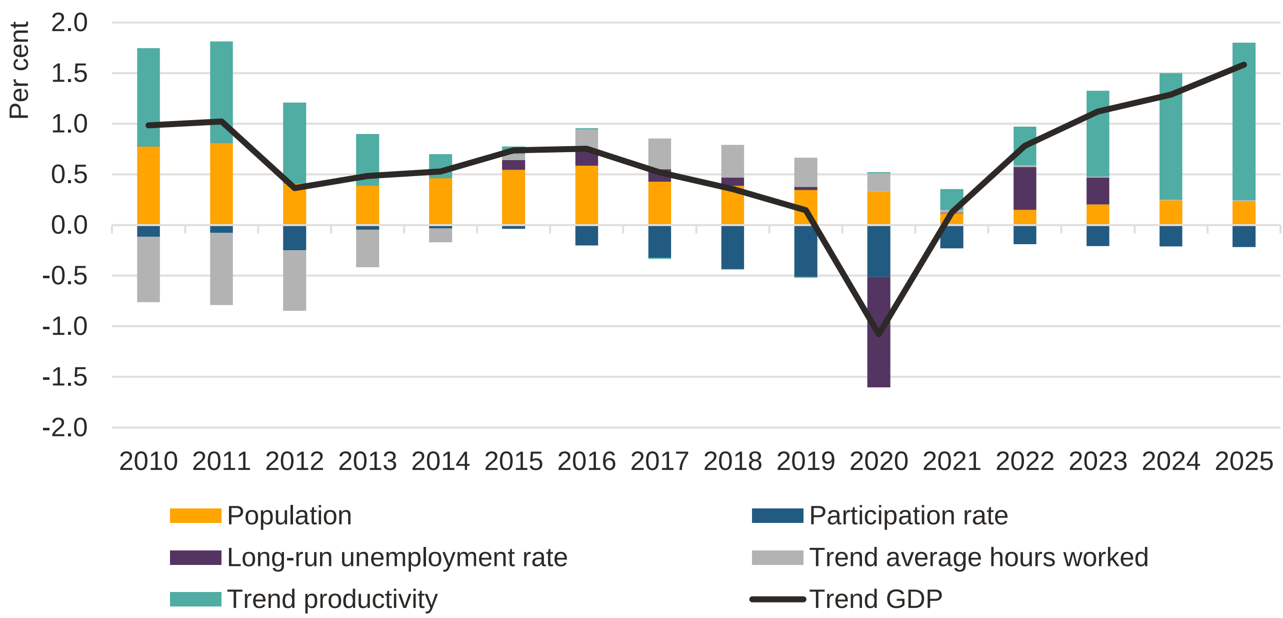
3.26 Although the outlook for trend GDP is dominated by our productivity assumption, as illustrated in Figures 3.7 and 3.8, the shock to trend GDP in 2020 of -1.1 per cent arises primarily because of our judgement concerning the long-run unemployment rate, also known as NAIRU (Non-Accelerating Inflation Rate of Unemployment). We assume the NAIRU has increased from 4.0 to 5.5 per cent in 2020. This increase reflects the fact that the pandemic put large portions of the economy under extreme pressure, especially in labour-intensive sectors which tend to absorb unemployment after recessions, decreasing the opportunity to re-enter work for those losing their job. As labour reallocation takes place, our long-run unemployment rate gradually decreases from 5.5 to 4.4 per cent at the start of 2023. This is in line with the OBR's judgement and leaves the NAIRU 0.4 per cent higher in the long run because of the scarring effects of the pandemic.

3.27 As discussed in Box 3.1, we have adjusted our population projections for COVID-19. These new population projections lower trend GDP relative to the projections we used in February 2020 by 0.5 per cent in 2025 Q1.

3.28 Our participation rate forecasts from February were also downgraded to account for the increase in economic inactivity we are likely to see because of the pandemic, particularly among those aged 16 to 24. We expect young people's labour market prospects to be more adversely affected by COVID-19. Young people are typically at risk in times of downturn, partly because they are more junior and inexperienced, but also because they are more likely to be employed in sectors that make use of flexible employment, a factor that is particularly pertinent in those sectors most exposed to the COVID-19 crisis. Periods of unemployment for younger people can have negative long-term effects on their future employability, so even when the economy revives their employment outcomes do not. We forecast an increase in economic inactivity among the 16 to 24 year olds which, along with outturn data and model updates, reduces trend GDP by 0.9 per cent in 2025 Q1.

3.29 Average weekly hours worked in the economy also plummeted in 2020 Q2 as large parts of the economy were shut down. This was more of a temporary effect of the restrictions and so our trend average hours worked forecasts are not significantly revised down, with trend GDP around 0.1 per cent smaller in 2025 Q1 as a result.

Figure 3.7: Trend GDP growth and contribution of components, 2010 to 2025



Source: Scottish Fiscal Commission

Figure 3.8: Trend GDP growth and contribution of components, 2018 to 2025

Per cent	Trend GDP Growth	16+ population	16+ participation rate	Long-run unemployment rate	Trend average hours worked	Trend Productivity
2018	0.4	0.4	-0.4	0.1	0.3	0.0
2019	0.1	0.3	-0.5	0.0	0.3	0.0
2020	-1.1	0.3	-0.5	-1.1	0.2	0.0
2021	0.1	0.1	-0.2	0.0	0.0	0.2
2022	0.8	0.1	-0.2	0.4	0.0	0.4
2023	1.1	0.2	-0.2	0.3	0.0	0.8
2024	1.3	0.2	-0.2	0.0	0.0	1.2
2025	1.6	0.2	-0.2	0.0	0.0	1.6

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

Spare capacity in the economy

3.30 Although we have reduced our estimate of trend GDP, actual GDP fell by far more in 2020. This leaves capacity for actual GDP to increase rapidly until it meets our new estimate of trend GDP. As the output gap closes, GDP growth will slow down. Because of the downward revision to trend GDP, the economy will be smaller over the longer term than it would have been without the COVID-19 shock.

3.31 We forecast GDP to recover to its pre-COVID level by the start of 2024, at which point GDP also reaches its new trend. In 2025 Q1, with the output gap closed, our GDP forecast is 4.1 per cent below our February 2020 forecast.

Labour market

Employment

3.32 Measuring what's going on in the labour market is difficult in the current circumstances, because alternative data sources give differing pictures of the conditions facing workers since the outbreak of the pandemic. The ONS Labour Force Survey (LFS) shows 14,000 fewer people in employment in Scotland between Jan-Mar and Jul-Sep 2020, compared to nearly 70,000 fewer payrolled employees according to PAYE Real Time Information (RTI).[43] There were also 70,000 fewer workforce jobs in Scotland in September compared to March 2020.[44]

3.33 Analysis from the ONS suggests that the difference is largely explained by those temporarily away from work who regard themselves as employed, but are not currently being paid.[45] In the current climate, we expect administrative data from PAYE RTI to be more reliable than individuals' self-reported data from LFS, as it is based on administrative records rather than dependent on people's perceptions of their employment status. Other advantages of PAYE RTI are its timeliness and links with income tax RTI data. There is also analysis arguing that the fall in RTI employees is because of a decrease in population, as migrant workers left the UK during the pandemic, and that the LFS overestimates the employment level because it continues to gross up survey responses to the pre-pandemic population.[46] In response to these comments, the ONS released a statement advising caution in using levels and changes in levels from the LFS, which will also be included as a caveat in its LFS publication.[47]

3.34 Our outturn employment figures for 2020 Q2 and Q3 are based on PAYE RTI rather than LFS, and are consistent with an unemployment rate of 6.2 per cent in Q2 and 6.8 per cent in Q3 compared to around 4.5 per cent reported in the LFS.[48] This means that from 2020 Q2 our view of employment and unemployment differs from LFS estimates, but we expect this divergence to be temporary – the two sources should re-align as workers' employment status becomes clearer or as data used in survey estimation are fully updated.

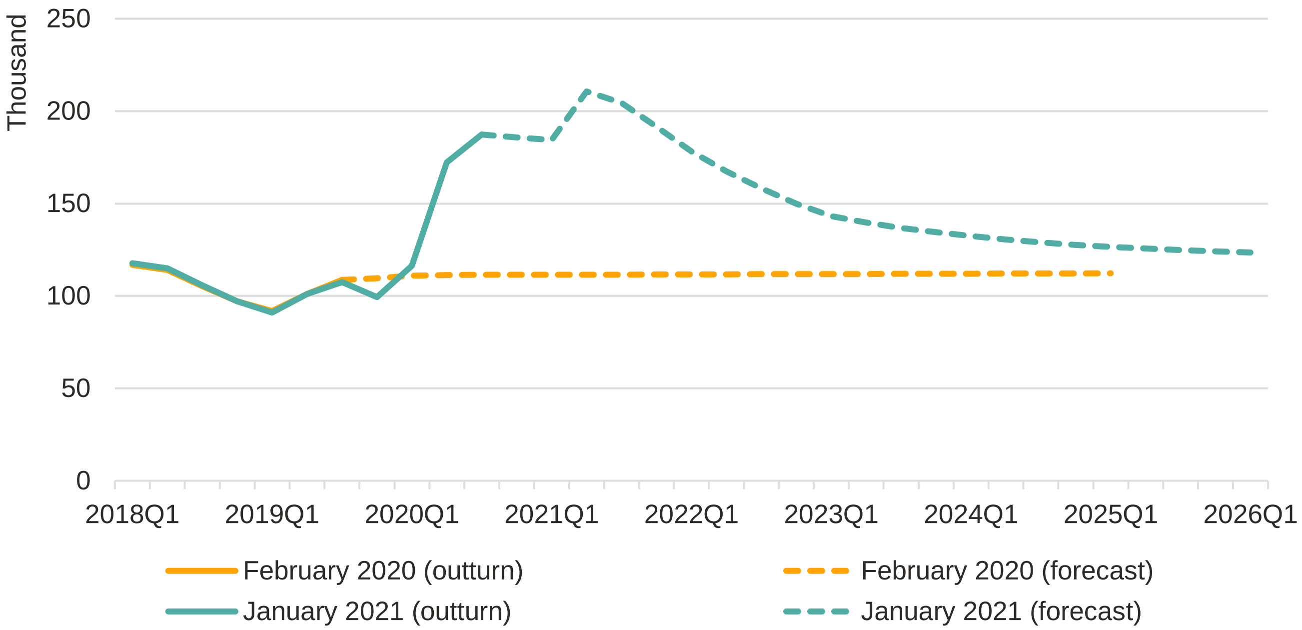
[43] ONS (2020) HI11 Regional labour market: Headline indicators for Scotland – December 2020 (link), ONS (2020) Earnings and employment from Pay As You Earn Real Time Information, UK: December 2020 (link).
[44] ONS (2020) JOBS05: Workforce jobs by region and industry – December 2020 (link)
[45] ONS (2020) Comparison of labour market data sources (link)
[46] Michael O'Connor and Jonathan Portes (2020) Estimating the UK population during the pandemic (link)
[47] ONS (2020)The impact of COVID-19 on the UK labour market estimates and population flows (link)
[48] RTI does not contain the self-employed. We use the per cent decrease in paid employment indicated by RTI as proxy for the per cent reduction in total employment.

3.35 With furloughing now extended to April 2021, we forecast unemployment to be stable in 2020 Q4 and 2021 Q1 before increasing to 7.6 per cent in 2021 Q2 when the job retention schemes end, which is similar to the peak in UK unemployment predicted by the OBR. From then onwards, unemployment is expected to decline as the economy recovers.

3.36 As discussed above, we forecast long-run unemployment to be higher than in our February forecast, reflecting the structural changes to the economy that have taken place over the course of the pandemic.

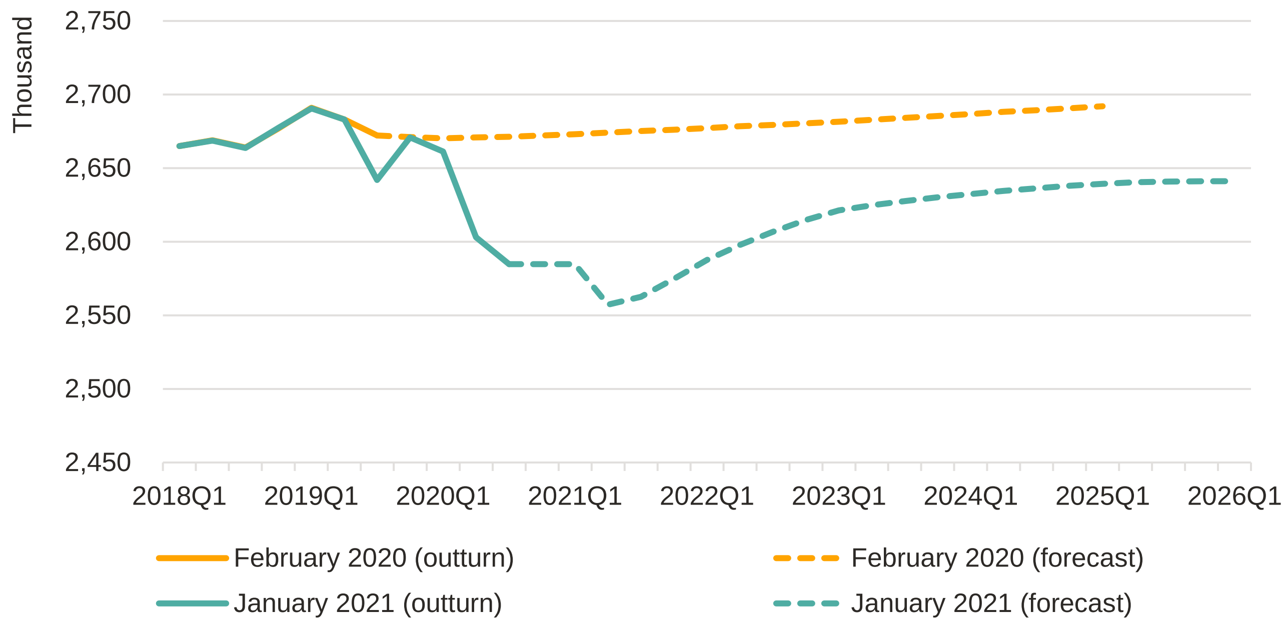
3.37 In level terms, our employment forecasts are revised down from February 2020. This is because of higher forecasts of unemployment and inactivity, as shown in Figures 3.9 to 3.11.

Figure 3.9: Unemployment level, outturn and forecast



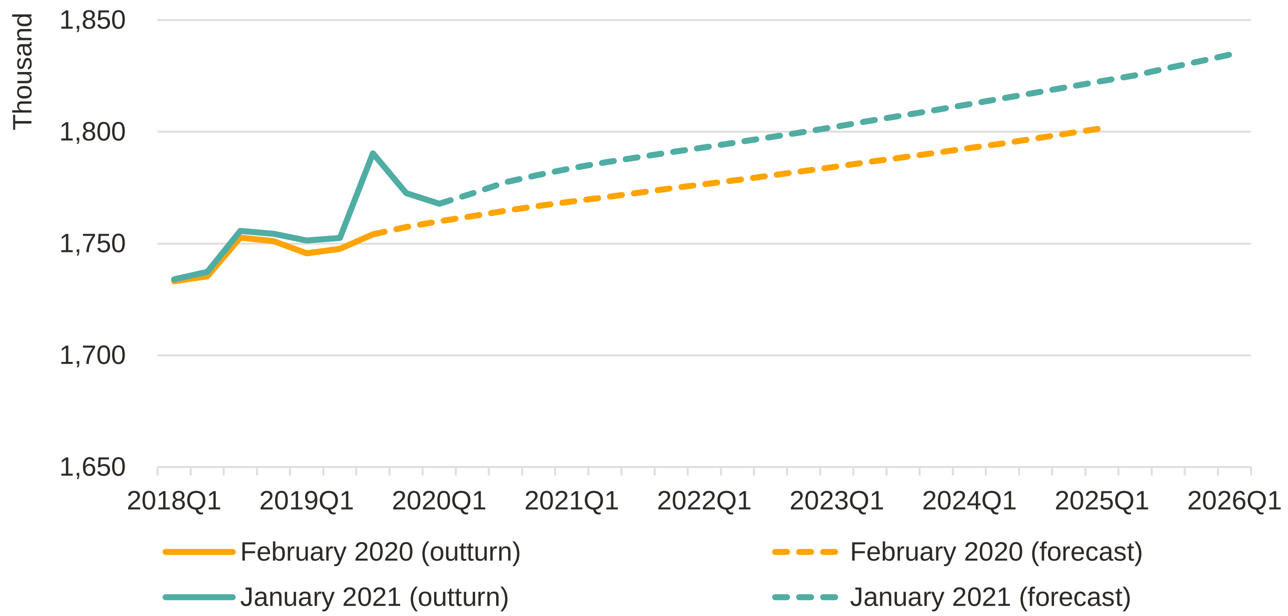
Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2020) Scotland's Economic and Fiscal Forecasts – February 2020 (link), ONS (2020) HI11 Regional labour market: Headline indicators for Scotland (link), ONS (2020) Earnings and employment from Pay As You Earn Real Time Information, UK: December 2020 (link).
Outturn unemployment data are based on the Labour Force Survey up to 2020 Q1, and on PAYE RTI for 2020 Q2 and Q3.

Figure 3.10: Employment level, outturn and forecast



Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2020) Scotland's Economic and Fiscal Forecasts – February 2020 (link), ONS (2020) HI11 Regional labour market: Headline indicators for Scotland (link), ONS (2020) Earnings and employment from Pay As You Earn Real Time Information, UK: December 2020 (link).
Outturn employment data are based on the Labour Force Survey up to 2020 Q1, and on PAYE RTI for 2020 Q2 and Q3.

Figure 3.11: Inactivity level, outturn and forecast



Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2020) Scotland's Economic and Fiscal Forecasts – February 2020 (link), ONS (2020) HI11 Regional labour market: Headline indicators for Scotland (link).

Earnings

3.38 Our forecast of nominal average earnings growth has been revised down in light of COVID-19 compared to February 2020, but is higher than we may have expected given the pandemic and furloughing. The available evidence – in particular PAYE RTI mean pay data – shows that, after a shock in the second quarter of 2020, average earnings have bounced back in the third quarter, so we see a relatively resilient picture emerging for earnings in 2020. Last February, we said we are placing increasing weight on the RTI publication in forming our earnings judgement; we adopt the same approach in this forecast, aligning our view of average earnings in 2020 Q3 to RTI data. Figure 3.12 compares our January 2021 and February 2020 forecasts.

3.39 We forecast nominal average earnings growth of 2.5 per cent in 2020 and 2.6 per cent in 2021, both revised down from February 2020. With inflation currently very low, and lower than expected at the time of our previous forecast, real average earnings growth forecasts for 2020 and 2021 are revised up since February.

3.40 Our forecast of nominal average earnings growth remains weak compared to its pre-2008 (pre-Global Financial Crisis) average value of around 4 per cent. We believe pay growth will remain moderate in the longer term because of factors such as continued low productivity growth, lower public sector pay growth, high unemployment, and pressures from the pandemic on companies' cashflows. Real earnings growth is also still low, except in 2020 when it is more in line with its pre-2008 average value of around 2 per cent thanks to very low inflation.

Figure 3.12: Nominal and real average earnings growth

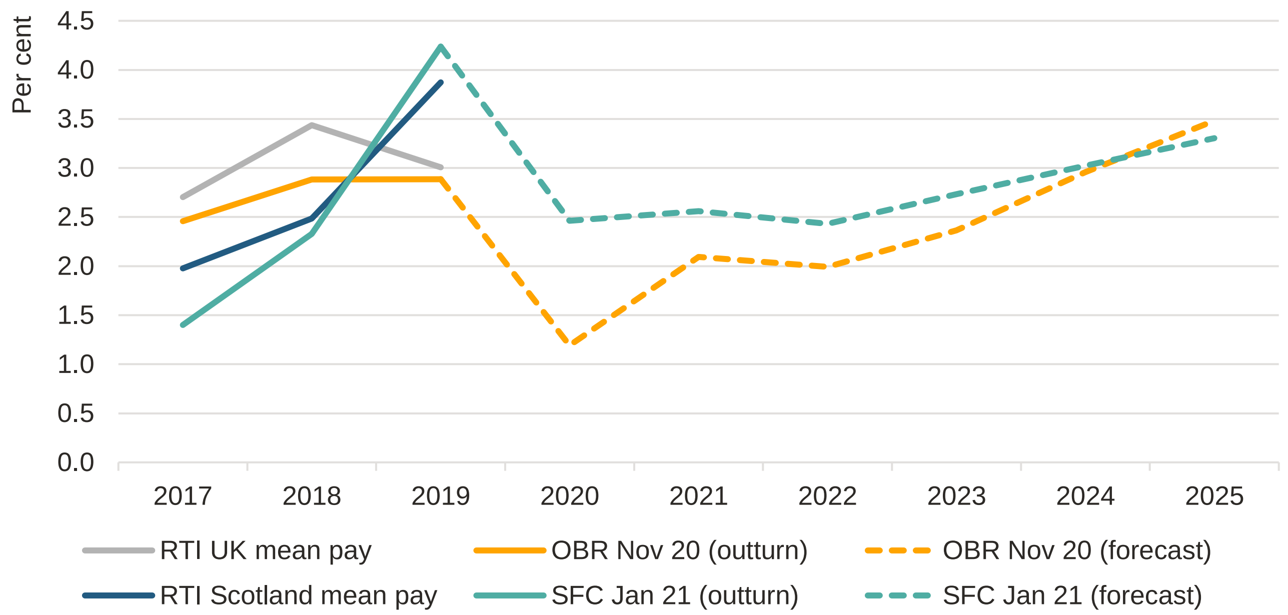
Per cent	Forecast	2019	2020	2021	2022	2023	2024	2025
Nominal	February 2020	2.8	3.0	3.1	3.2	3.3	3.3	
	January 2021	4.2	2.5	2.6	2.4	2.7	3.0	3.3
Real	February 2020	1.0	1.1	1.0	1.2	1.2	1.2	
	January 2021	2.6	2.4	1.7	0.8	0.9	1.1	1.3

Source: Scottish Fiscal Commission

Shaded cells refer to outturn available at time of publication.

3.41 Figures 3.13 and 3.14 illustrate how our latest nominal average earnings forecast compares to the OBR's for the UK. Our growth forecasts are above those for the UK in most years, but from 2021 onwards by 0.5 percentage points or less.

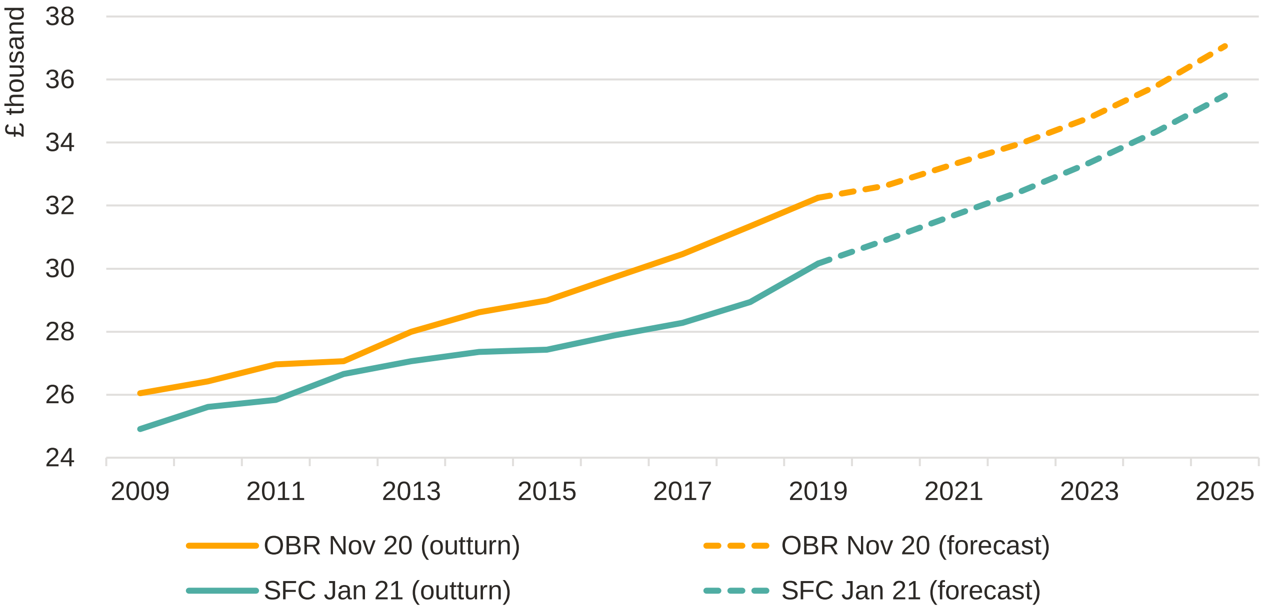
Figure 3.13: Nominal average earnings growth, Scotland and UK



Source: Scottish Fiscal Commission, OBR (2020) Economic and fiscal outlook – November 2020 (link), ONS (2020) Earnings and employment from Pay As You Earn Real Time Information, UK: December 2020 (link).

3.42 Looking at earnings forecasts in levels, we see Scotland's earnings are lower than UK earnings and, although there is an initial catching-up which continued from 2019, the gap remains during the forecast period. There is no clear evidence to suggest we should expect any further convergence with UK earnings over the forecast period. To the extent that the difference is driven by structural factors, such as a loss of high-value employment in the oil and gas sector following the oil price crisis of 2015 and 2016, then it is reasonable to expect it to be maintained for a long period. Moreover, the latest RTI mean pay data show that, after a strong relative performance of Scottish earnings in 2019, earnings growth in Scotland has been lagging behind the UK over the course of 2020.

Figure 3.14: Nominal average earnings level, Scotland and UK



Source: Scottish Fiscal Commission, OBR (2020) Economic and fiscal outlook – November 2020 (link).

Chapter 4
Tax

Overview

4.1 In this chapter we present our tax forecasts and discuss the effect they have on the 2021-22 Scottish Budget. Our tax forecasts are summarised in Figure 4.1, with a summary of the changes from the previous February 2020 forecast in Figure 4.2. In addition to our main forecasts, we also provide illustrative forecasts for the Scottish share of Air Passenger Duty and Scottish VAT Assignment. Details of these forecasts can be found at the end of this Chapter.

Figure 4.1: Summary of tax forecasts

£ million	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Income tax	11,850	12,263	12,907	13,481	14,080	14,718
Non-domestic Rates	1,848	2,680	2,930	3,224	3,231	3,216
Land and Buildings Transaction Tax	517	586	629	664	701	740
Of which: Residential	360	408	446	474	502	533
Non-residential	157	178	184	190	199	207
Scottish Landfill Tax	95	88	86	72	74	61
Total	14,310	15,617	16,553	17,441	18,085	18,735

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

Figure 4.2: Summary of changes to our tax forecasts since February 2020

£ million	2020-21	2021-22	2022-23	2023-24	2024-25
Income tax	-516	-634	-540	-578	-642
Non-domestic Rates	-901	-332	-415	-199	-360
Land and Buildings Transaction Tax	-125	-80	-63	-56	-48
Of which: Residential	-72	-43	-24	-16	-8
Non-residential	-52	-37	-39	-40	-40
Scottish Landfill Tax	-21	-21	-8	-7	8
Total	-1,562	-1,068	-1,025	-840	-1,042

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

4.2 The forecast for total tax revenue reflects our expectation that the Scottish economy will gradually recover from the COVID-19 pandemic. Income tax remains the largest source of devolved tax revenue and the most significant influence on Scotland's net tax position. We expect that the share of income tax in overall devolved tax revenue will decrease from 83 per cent in 2020-21 to 78 per cent over the forecast horizon.

4.3 Figure 4.3 sets out the expected financial effect of the main tax policy changes announced in the Scottish Budget. The only announcements are for Non-domestic Rates (NDR) and include reducing the poundage to 2019-20 levels, thereby freezing rates, all else being equal, due to the expiration of the 1.6 per cent universal relief and extending the retail, hospitality, leisure and aviation (RHL) relief for three months as well as changes to the Business Growth Accelerator (BGAc). We expect these to reduce tax revenue by £251 million in 2021-22. Further details of these policy changes can be found in Annex A.

Figure 4.3: Summary of Budget 2021-22 tax policy changes

£ million	2021-22	2022-23	2023-24	2024-25	2025-26
Setting the 2021-22 poundage at 49.0p	-63	-64	-69	-68	-67
Changing the eligibility criteria for the BGAc relief	-2	-3	-5	-5	-5
100 per cent relief for RHL and aviation for three months	-185				
Total	-251	-67	-74	-73	-71

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

Box 4.1: Updates to our tax forecasting approaches

We set out our approach to forecasting taxes in our September 2017 paper.[49] While our methodology remains consistent with what has been previously set out, there have been a number of changes to aspects of our forecasting methodology for our January 2021 forecasts.

Income Tax: We have chosen to align our forecast to better reflect HMRC's Real Time Information (RTI) data. For 2019-20 we match our forecast to the RTI tax data, whereas for 2020-21 we extrapolate the growth rate based on the data available. We made this change because of the uncertainty from COVID-19, and the improved consistency of the RTI tax data with PAYE data. Previously, we based our forecast on the most recently available outturn year for PAYE data, which in this case would be 2018-19. The effect of aligning to RTI data decreases our income tax forecast by £340 million in 2021-22.

NDR: We revised the adjustment made to reconcile the difference between appeals losses reported in the revaluation appeals data and the losses reported in local authorities' returns (which also include running roll appeals). We have also altered the calculation of growth in the tax base in our forecast, in light of the most recent outturn data. The combined effect of these changes lowers NDR income by £1 million in 2021-22.

Land and Buildings Transaction Tax (LBTT): We have updated our residential house price model to align it better with our economy forecast. Our near term forecast is still based on the statistical ARIMA model described in our 2017 paper. Our medium term projection is now based on our disposable income forecast, combined with Commissioners' judgements on the prospective average house price to income ratio. This raises our medium term house price growth forecast from 2 per cent to 3 per cent in this forecast.

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

COVID-19

4.4 Our economy forecasts play a key role in setting our tax forecasts so all of our tax forecasts use the broad-brush assumptions about the future impact of COVID-19 set out in **Figure 1.1** in Chapter 1. Direct effects include policy changes in response to the pandemic, like the retail, hospitality and leisure relief for Non-domestic Rates, as well as other factors like outturn data from 2020-21.

Tax forecasts and the Scottish Budget

4.5 Our tax forecasts are just one component of the Scottish Budget which is based on a combination of funding from the UK Government, Scottish tax revenues, and Scottish Government borrowing and cash management decisions. All of these components can vary during the financial year.

4.6 Tax BGAs represent the hypothetical amounts that would have been raised in Scotland if the taxes had not been devolved. They are based on revenues in Scotland the year before devolution, adjusted in line with forecasts of changes in revenue per head in the rest of the UK. The BGAs are calculated by the UK and Scottish Governments based on OBR forecasts of the corresponding UK Government tax and projected population growth in each country.[50]

4.7 The Scottish Budget is set in advance of each financial year, based on forecasts of the BGA and our tax forecasts.[51] Over time, information on revenues and spending becomes available and the forecasts are updated or aligned with these data. The Scottish Government's funding is then altered in response to the outturn data and revised forecasts. Changes to LBTT and SLfT are applied in-year, while the income tax net position is fixed for the 2021-22 financial year based on the forecast set out here and will not be reconciled with outturn data until the 2024-25 Budget.

4.8 NDR is managed through a separate process. There is no corresponding block grant adjustment, instead the Scottish Government receives funding through the Block Grant if the UK Government increases spending on business rates in England. The introduction of relief for retail, hospitality and leisure properties, and aviation, as part of the COVID-19 response led to NDR revenues falling by £904 million in 2020-21.[52] The Scottish Government funded this reduction from the additional block grant funding following the introduction of a similar policy in England.

4.9 Alongside these forecasts, we have published a Fiscal Update that provides a detailed breakdown of how the 2020-21 Scottish Budget has changed since the Budget was introduced in February 2020, including the effect of revised tax forecasts. This section will summarise the changes affecting the 2020-21 Budget, before setting out the implication for the 2021-22 Budget.

Tax forecast changes affecting the 2020-21 Budget

4.10 In total our tax revenue forecasts for 2020-21 have been revised down by around £1.6 billion, or 10 per cent, from £15.8 billion to £14.3 billion.

4.11 LBTT and SLfT are fully devolved taxes. Changes to our forecasts and Block Grant Adjustments for these taxes will be applied to the 2020-21 Scottish Budget in the Spring Budget Revision. Our forecast of revenues from LBTT and SLfT combined have fallen by £145 million since February. This is broadly in line with the reduction in corresponding revenues received by the UK Government and

[50] Scottish Fiscal Commission (2021) Explainers (link)
[51] For this budget the BGAs are classed as provisional, and the Scottish Government have the option of changing the BGAs at the time of the UK budget.
[52] Local authorities' mid-year estimates indicate that £927 million was claimed in RHL relief, but we estimate that the automatic application of this relief led to £23 million less being claimed in other reliefs, giving a net reduction of £904 million.

is therefore more or less matched by a reduced Block Grant Adjustment. The direction of the net budgetary change has been positive for LBTT and negative for SLfT. The net combined effect of changes to our and the OBR's forecasts is an increase of £21 million to the Scottish Budget, and the Scottish Government must manage these changes in year.

Figure 4.4: Summary of Budget 2020-21 tax forecast changes

£ million	Change in forecast	Change in BGA	Net effect on Budget
LBTT	-125	166	41
SLfT	-21	0	-20
Total	-145	166	21

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

4.12 The £41 million positive net position for LBTT is partly because of the property tax cuts until 1 April 2021 in response to COVID-19. In Scotland the nil rate band was raised to £250,000, while it rose to £500,000 in England and Northern Ireland. Because these policy changes reduce the BGA by more than our forecast, the net effect is to increase the Scottish Budget.

4.13 Income tax funding for 2020-21 is fixed, based on the forecasts used to set the budget in February 2020 and the provisional BGAs from the OBR's March 2019 forecasts. Funding will remain fixed until outturn data are available in summer 2022, and a reconciliation will be applied in the 2023-24 Budget. Chapter 2 sets out our latest view of the income tax reconciliations.

4.14 NDR revenues are managed through the NDR rating account, also known as the NDR pool. Local authorities collect NDR revenues which are pooled nationally, and subsequently redistributed to local authorities. The contribution of NDR to the Scottish Budget does not change during the financial year, Box 4.2 discusses how the Scottish Government manage differences in NDR revenues in future years.

Tax forecast changes affecting the 2021-22 Budget

4.15 In total our tax revenue forecasts for 2021-22 have been revised down by around £1.1 billion, or 6 per cent, from £16.7 billion to £15.6 billion since we published our last forecasts in February 2020. At the same time the forecast BGAs have also been revised reflecting broadly similar drops in tax revenue forecasts in Scotland and the rest of the UK.

Changes in the net position of our tax forecasts

4.16 Comparing the BGAs with our revenue forecasts can illustrate how much more or less funding the Scottish Government will have available, now that the tax is devolved. In current circumstances, any comparison should be made with caution as the BGAs are based on the OBR's November 2020 economy and fiscal assumptions while our forecasts consider more up to date information. At the UK Budget in March the OBR will update their forecasts, and the Scottish Government can decide whether to use the updated BGAs or to continue with the Budget set on the current BGAs.

4.17 A variety of different factors affect the net position including policy, assumptions, and modelling approaches. We can compare the forecast net 2021-22 position of the taxes between our February 2020 forecast and our latest forecast.

4.18 Figure 4.5 below highlights the evolution of our net position of our tax forecasts.

Figure 4.5: Change in net position of taxes for 2021-22

£ million		Income tax	LBTT	SLfT
February 2020	BGA	-12,742	-597	-85
	Scottish revenue	12,897	666	110
	Difference	155	69	25
January 2021	BGA	-11,788	-515	-95
	Scottish revenue	12,263	586	88
	Difference	475	71	-7
Change	BGA	954	82	-10
	Scottish revenue	-634	-80	-21
	Difference	320	2	-32

Source: Scottish Fiscal Commission, Scottish Government.

4.19 As a result of similar changes in our forecasts of the combined revenue and the BGAs for LBTT and SLfT, the changes to the net position for these taxes are relatively small. For income tax the net position for 2021-22 has increased from £155 million to £475 million, a significant increase in the expected funding available in the Scottish Budget for 2021-22.[53] Chapter 2 discusses some of the implications of the increase to the income tax net position for the Scottish Budget. The section below sets out some of the analytical reasons that caused the net position to increase.

Increase in the income tax net position

4.20 As shown in Table 4.5 the 2021-22 income tax net position has increased markedly since our February 2020 forecasts were published, from £155 million to £475 million. This is because our forecast growth of Scottish income tax revenue in 2021-22 is higher than the forecast growth in the BGA based in the OBR's forecasts. We are forecasting growth in income tax revenues in 2021-22 of 3.5 per cent, compared to growth in the BGA of 1.0 per cent. We believe the higher relative growth rate of Scottish income tax revenues largely arises because of the significant uncertainty around COVID-19 and its effects on the data and judgements used in our income tax modelling. The timing of the Scottish and OBR UK forecasts and the pace of change between the two forecasts being produced has also had a significant effect. COVID-19 is an exceptional event and we do not expect a divergence between our and the OBR's forecasts that cannot be directly related to underlying economic factors or policy change to happen in other years. Here we explain why this has occurred, and the implications for the Budget are discussed in Chapter 2.

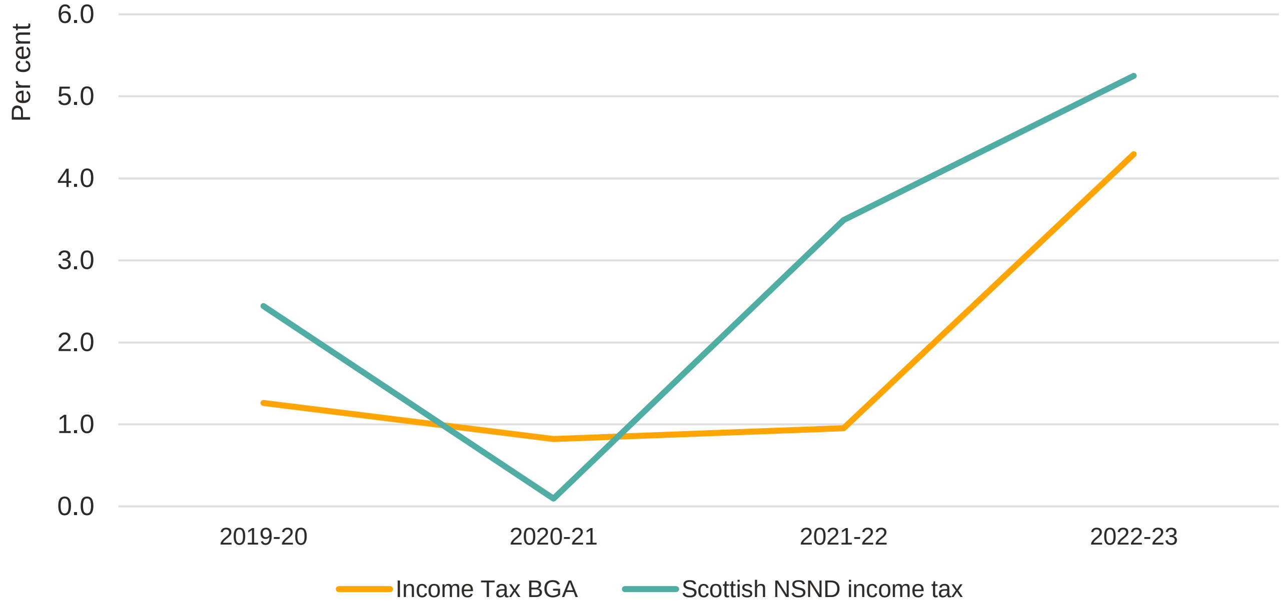
4.21 When looking at the underlying economic growth driving the income tax forecasts, there is some divergence between our income tax and GDP forecasts for Scotland and the OBR's forecasts for the UK. Our forecast for GDP growth in the financial year 2021-22 is 7.5 per cent, compared to the OBR's forecast of UK GDP growth of 10.4 per cent. While, our GDP forecast for Scotland is lower than the OBR's for the UK, our Scottish income tax forecasts are higher than the OBR's for the UK. In the paragraphs below we explain how the £475 million net position has arisen, and the apparent mismatch in our forecasts of income tax and GDP relative to the OBR. To do this we consider the forecasts from 2018-19 onwards.

[53] The change in the 2021-22 net position between February 2020 and January 2021 is one way to think of the increase in the net position. An alternative methodology is to measure the difference between the 2020-21 and 2021-22 net position. Both methods arrive at similar results.

4.22 In 2018-19, the outturn for Scottish income tax revenues was £11.6 billion, £119 million more than the income tax BGA. Figure 4.6 shows our latest forecasts for the growth rate of income tax revenue in subsequent years together with the growth rates of the income tax BGA, based on the OBR's November 2020 forecasts.

4.23 We use Real Time Information (RTI) data from HMRC to estimate growth in income tax revenues in 2019-20 and 2020-21. In 2019-20 our forecast Scottish income tax revenues growth was slightly higher than the BGA, and in 2020-21 our forecast was slightly lower than the BGA, as shown in Figure 4.6. This could be partly because of policy divergence between Scotland and the rest of the UK – particularly with the higher rate threshold differences. Our latest estimate of the net position for 2020-21 is £173 million, compared with the £119 million outturn in 2018-19.

Figure 4.6: Annual growth in Scottish NSND income tax and BGA



Source: Scottish Fiscal Commission, Scottish Government.

4.24 Figure 4.6 shows a much larger divergence in the forecasts for 2021-22: our income tax forecast growth rate of 3.5 per cent is much larger than the forecast growth in the BGA of 1.0 per cent, and it's this difference which mainly accounts for the forecast net position growing to £475 million in 2021-22. This forecast difference is a net addition to the 2021-22 Scottish Budget.

4.25 The 3.5 per cent growth rate in Scottish NSND income tax revenue is consistent with our economy forecast for 2021-22: we are forecasting GDP growth for 2021-22 of 7.5 per cent as the economy recovers from the pandemic.

4.26 The large income tax net position forecast for 2021-22 results from a divergence between our forecasts and the OBR's November 2020 economy forecasts. Figure 4.7 shows the main component of that divergence: different views of the outlook for total earnings growth in Scotland. Our forecast of total earnings growth is 1.8 per cent while the OBR forecasts 0.0 per cent growth, and we also forecast that earnings growth is more tax rich than in the OBR forecast, so the gap between the growth rates of our tax forecast and the BGA is 2.6 per cent.

Figure 4.7: SFC and OBR forecasts of growth in total earnings, Scottish NSND income tax revenues and the income tax BGA in 2021-22

Per cent growth	Total earnings [1]	Income tax revenues and BGA
SFC Scotland	1.8	3.5
OBR UK	0.0	1.0
Difference	1.7	2.5

Source: Scottish Fiscal Commission, Office for Budget Responsibility (2020) Economic and fiscal outlook – November 2020 (link).
Figures may not sum because of rounding.
[1] Refers to wages and salaries.

4.27 There is no single or simple explanation as to why it exists. We think there are a number of factors which could explain this divergence.

- This is a period of exceptional uncertainty. The scale of the economic shock is unprecedented. Economic data cannot fully capture the effect of the pandemic on the economy, and there is significant uncertainty even for the period for which we have some outturn data. With the boundaries of uncertainty much wider and a greater reliance on judgement than usual, it is not unexpected that there is greater divergence between SFC and OBR forecasts.

- SFC and OBR forecasts were made at different points in time and therefore based on different information. In particular, since the OBR's November forecasts were published, the furlough scheme has been extended by one month, the UK and Scotland entered a new lockdown, and we've also received additional RTI income tax data for Scotland.

- The furlough scheme means that the effect of the pandemic on GDP is very different to the effect on the labour market and earnings. While GDP fell sharply in 2020, employment and earnings fell to a much lesser extent as the Government supported people in work. This means that we wouldn't necessarily expect the forecast GDP effect to be fully mirrored in the labour market and income tax revenues while the furlough scheme remains in place, and perhaps for some time after. It may be that there are differences in how GDP growth translates into earnings growth in the two forecasts, so that the difference in GDP forecasts translates into a larger difference in earnings and income tax forecasts.

- There is also uncertainty about those in self-employment, particularly those on the Self Employment Income Support Scheme, and others who pay income tax through self-assessment (SA). For those paying PAYE tax, we have relatively up to date RTI data so we have a reasonably good idea what has happened to their earnings and income tax liabilities over the last year. Self-assessment data have a longer lag than PAYE data and so we know less about this group. For the UK, the OBR can look at cash data on SA payments which may offer some limited insight, but this is not available for Scotland. Different trends in SA revenues may be another source of divergence between ours and the OBR's forecast.

- It is now widely recognised that the economic effects of COVID-19 have affected different income groups differently. The lower-paid are more likely to have suffered significant income losses than the higher-paid; and since the higher-paid contribute more to income tax revenue, the relationship between earnings growth and tax revenue growth is likely to have changed in the pandemic and to change again as the economy recovers. This is another possible source of divergence between the two forecasts.

- Labour market data is a source of some uncertainty while the furlough schemes are in place. The headline measure of the labour market – the LFS – is potentially currently overestimating the number of people in employment, as has been widely noted.54 We have based our employment modelling on RTI data, whereas the OBR may have placed different weights on different labour market indicators. The RTI data show a greater fall in employment in 2020-21 than is shown in the LFS data. Although in total we expect Scottish employment to fall by a similar relative amount as in the UK, the RTI data show more of this fall occurring in 2020-21, whereas LFS data is relatively flat for 2020-21. The OBR forecasts show more of a fall in employment occurring in 2021-22. We believe issues with measuring the labour market in different sources, the judgements placed on this, and the difference in timing of the labour market shock between the two forecasts may be the source of some of the forecast divergence in Scottish and UK income tax revenues.

Non-Domestic Rates

4.28 NDR revenues are managed through the NDR rating account, also known as the NDR pool. Local authorities collect NDR revenues and these are pooled nationally and subsequently redistributed to local authorities. We forecast the amount of revenue collected, the contributable amount, and this is used by the Scottish Government to set the distributable amount. The Scottish Government also consider the balance of the pool, which accounts for any forecast errors in previous years.[55] The distributable amount is set in the Budget and remains unchanged during the financial year, this means the Scottish Government do not need to manage any NDR forecast error during the year.[56] Box 4.2 explains how the Scottish Government have set the distributable amount for 2021-22.

4.29 The Scottish Government has announced a policy to extend the relief for retail, hospitality, leisure and aviation into 2021-22. Details on this policy can be found in the NDR section. The Scottish Government may choose to revisit this relief following the UK Budget, with the final policy design taking into account the UK Government's own position on any RHL relief and related Barnett consequential payments to the Scottish Government. If the Scottish Government changes details of the policy, the policy cost may be higher than we have estimated, and if the distributable amount of NDR isn't changed, the NDR pool balance would be lower at the end of 2021-22 than shown in Box 4.2.

[54] ONS (2020) Comparison of labour market data sources (link)
[55] Although our forecasts of the contributable amount are used by the Scottish Government to set the distributable amount, for the position of the pool in any given year is based on local authorities estimates of the NDR they will collect produced at the start of the financial year.
[56] The distributable amount was reduced in March 2020 following the Scottish Government announcement to introduce NDR relief for retail, hospitality and leisure for 2020-21.

Box 4.2 Calculation of the Distributable Amount in 2021-22

The Commission forecasts the 'contributable amount' of NDR, the revenue collected by local authorities and pooled nationally, for subsequent redistribution as the 'distributable amount' to local authorities as part of the local government finance settlement.

Our forecast is used by the Scottish Government to inform the decision about how much can be distributed to local authorities in the year ahead.[57] Government can choose to distribute more or less than the forecast contributable amount in any given year so long as the total amount collected is eventually distributed back to local authorities. The calculation of the distributable amount by Government takes account of three factors:

- the estimated closing balance of the account from the previous financial year
- estimated prior year adjustments to be carried over from the year before
- the amount forecast to be raised in the year ahead

This year, the distributable amount set by Government leads to a projected balance of -£75 million on the account at the end of 2021-22, as shown in Figure 4.8. The Scottish Government plans to bring the account back into balance by 2022-23.

Figure 4.8: Illustrative projected balance of the Non-Domestic Rating Account

£ million	2018-19	2019-20	2020-21	2021-22
Provisional contributable amount (A)	2,883	2,890	1,916	2,680
Net effect of prior year adjustments (B)	-82	-36	-129	-68
Distributable amount (C)	2,636	2,853	1,868	2,631
Annual balance (D) (A + B – C)	165	1	-80	-20
Cumulative balance (E) (E from previous year + D)	24	25	-56	-75

Source: Scottish Fiscal Commission, Scottish Government.
Figures may not sum because of rounding.
Shaded cells refer to outturn at the time of publication.
The projected balance is provisional because at time of publication, we do not have the audited NDR income figures for 2019-20; it is based on the provisional outturn figures provided on the Notified returns. The presentation differs slightly to that in the published audit of the NDR rating account, mainly because of the presentation of line B – 'net effect of prior year adjustments'.

In practice the audited balance of the pool will be determined by several factors. These include not only our forecast accuracy, but also the difference between the start of year estimates provided by local authorities to the Government after the start of the financial year in April (the provisional contributable amount in Figure 4.8) and the final audited NDR income returns for the financial year. The difference is termed the prior year adjustment. 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

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

financial year. This means that 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.

Income tax

Forecast

Figure 4.9: Forecast revenue for non-savings non-dividend income tax

£ million	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
	11,556	11,838	11,850	12,263	12,907	13,481	14,080	14,718

Source: Scottish Fiscal Commission, HMRC (2020) Scottish Income Tax Outturn Statistics (link).
Shaded cells refer to outturn available at time of publication.

Background

4.30 Income tax is partially devolved. The UK Government is responsible for setting the personal allowance, defining the income tax base and setting or changing income tax reliefs. Non-savings and non-dividend (NSND) income tax rates and bands are controlled and determined by the Scottish Parliament. Her Majesty's Revenue and Customs (HMRC) is responsible for the collection and management of Scottish Income tax.

4.31 NSND income tax is paid on all income other than from savings and dividends so the main sources of NSND income are employment income, pension income, income from property and profits for the self-employed.

Changes since February 2020

4.32 Changes to our forecast since February 2020 are shown in Figure 4.10. Our forecast has increased slightly for 2018-19 and 2019-20, but has decreased by over £500 million annually from 2020-21 onwards. This is primarily as a result of the COVID-19 pandemic.

Figure 4.10: Change in NSND income tax revenue since February 2020

£ million	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
February 2020	11,378	11,677	12,365	12,897	13,447	14,059	14,722
2018-19 outturn data	168	233	207	181	152	122	91
Economy earnings	31	247	32	-125	-282	-417	-480
Economy employment	-5	-93	-380	-458	-280	-195	-156
UK historic policy	0	-40	-70	25	61	85	88
CPI outturn and forecast	0	0	0	136	207	259	300
HMRC TMI [1]	-13	-7	-35	-59	-57	-68	-94
NHS £500 bonus	0	0	48	0	0	0	0
Other [2]	-2	-43	9	5	17	10	0
2019-20 RTI adjustment	0	-134	-136	-141	-148	-155	-162
2020-21 RTI adjustment	0	0	-191	-199	-209	-219	-228
January 2021	11,556	11,838	11,850	12,263	12,907	13,481	14,080
Change since February 2020	178	161	-516	-634	-540	-578	-642

Source: Scottish Fiscal Commission, HMRC (2020) Scottish Income Tax Outturn Statistics (link).
Shaded cells refer to outturn available at time of publication.
Figures may not sum because of rounding.
[1] HMRC Tax-Motivated Incorporations
[2] Other includes State Pension updates, revisions to SA settlements, policy recostings, HMRC Gift Aid, 2019-20 debt write off and small model developments. The largest factor in the £43 million Other figure in 2019-20 is a - £19 million revision to the SA settlement adjustment.

2018-19 Outturn Data

4.33 The income tax outturn data published by HMRC in September 2020 showed Scottish NSND income tax revenues were £11,556 million in 2018-19, £178 million above our February 2020 forecast.[58] After accounting for other modelling changes in 2018-19, aligning to the latest outturn data increases our forecast by £181 million in 2021-22. Our October 2020 Forecast Evaluation Report sets out more detailed analysis of the 2018-19 outturn data.[59]

Economy forecast

4.34 We incorporate the latest economy forecast as set out in **Chapter 3** of this publication. As a result of the COVID-19 pandemic, the reduction in employment and earnings has reduced our forecast of NSND income tax revenue.

4.35 The COVID-19 pandemic, public health restrictions and associated economic downturn have not affected all households and groups evenly, with those on lower earnings tending to see a greater fall in income.[60] As shown in Figure 4.10, the shock to employment has been greater than the shock to

[58] HMRC (2020) Scottish Income Tax Outturn Statistics (link)
[59] Scottish Fiscal Commission (2020) Income Tax Evaluation (link)
[60] Resolution Foundation (2020) The effects of the coronavirus crisis on workers (link)

earnings, with those who have remained in employment seeing their earnings hold up reasonably well. The furlough schemes have played a critical role for many employees who were furloughed.

4.36 As lower earning groups have lower effective tax rates than those with higher incomes, the effect of falling incomes focussed on lower income groups on total income tax revenues is less than if the effect on incomes was spread more evenly. We capture this effect in part by aligning our forecast for 2020-21 to the RTI tax revenue data, this is discussed in more detail in the next section.

Other Data updates

4.37 To create our forecast we use estimates from HMRC of Tax-Motivated Incorporations (TMI). The data from the November 2020 Spending Review has been used to update our forecast. These updates have resulted in a small downward revision to our forecast.

4.38 In the absence of a policy change, the starter and basic rate bands, and the higher rate threshold increases by the September CPI inflation measure. The top rate of tax threshold remains fixed at £150,000.

4.39 For 2021-22 policy thresholds, the September 2020 CPI estimate of 0.5 per cent is significantly below the 1.9 per cent we estimated in our February 2020 forecast. This has resulted in lower tax thresholds, which has pushed more taxpayers into higher tax brackets. In combination with the revised OBR CPI forecast for future years, this has increased our income tax forecast by £300 million in 2024-25.

NHS £500 bonus

4.40 On 30 November 2020 the Scottish Government announced that a payment of £500 will be made as soon as is practicable to all NHS and social care workers employed since 17 March 2020.[61] Part-time staff are due to receive a portion of this payment. As the Scottish Government receives revenue from all Non-Savings Non-Dividends income tax in Scotland, then they will receive part of this bonus back. Using information provided to us by the Government, we have estimated that the income tax forecast will increase by £48 million in 2020-21.

Updates to previous policy costings

4.41 Updated costings of policies from previous Scottish Budgets can be found in Annex B and the accompanying policy measures database. As we now have 2018-19 outturn data, the effect of the 2018-19 income tax policy is in our forecast baseline. We no longer provide a separate costing of this policy.

Model Development

Real Time Information (RTI) tax information

4.42 HMRC publish both RTI earnings and RTI tax data up to and including 2019-20.[62] We receive additional in-year RTI tax data from HMRC that is currently unpublished, but is expected to be included in the Scottish Income Tax Outturn statistics in Summer 2021. Our economy forecasts have always considered the RTI earnings data in relation to assumptions on average earnings.

4.43 In previous years we didn't find there was a strong correlation between the 2016-17 and 2017-18 RTI tax data and the eventual Scottish income tax outturn data, and so we didn't directly use RTI tax

[61] Scottish Government (2020) - £500 bonus for health and social care staff (link)
[62] HMRC (2020) Scottish Income Tax Outturn Statistics (link)

data in our income tax forecast. While early RTI tax data appeared to only have a weak correlation with the eventual Scottish income tax data, the 2018-19 data has increased our confidence in the RTI data as a guide to overall Scottish income tax. Added to the increased value of higher frequency data in a fast changing situation like the COVID-19 pandemic, this has led us to put greater weight on RTI as a source of information.

4.44 Figure 4.11 shows the comparison between RTI tax data, HMRC Scottish income tax outturn data and HMRC Pay as You Earn (PAYE) outturn collection data.

Figure 4.11: RTI tax information in comparison to outturn

£ million	2016-17	2017-18	2018-19	2019-20	2020-21 [1]
Overall outturn	10,719	10,916	11,556		
Growth rate (per cent)		1.8	5.9		
Estimated PAYE and RTI					
Outturn collection by PAYE	9,768	9,897	10,470		
Growth rate (per cent)		1.3	5.8		
RTI Scotland	9,985	10,221	10,828	11,116	11,058
Growth rate (per cent)		2.4	5.9	2.7	-0.5
Comparison between PAYE outturn and RTI					
Difference in growth rate		1.0	0.1		

Source: Scottish Fiscal Commission, HMRC (2020) Scottish Income Tax Outturn Statistics (link).
[1] SFC analysis of in-year RTI tax information from HMRC.

4.45 The 2018-19 Outturn collection by PAYE and the RTI Scotland growth rate are very closely aligned at 5.8 per cent and 5.9 per cent. This is in comparison to 2017-18 where the difference was around 1.0 percentage points.

4.46 We have chosen to align our forecast to match RTI growth rates for 2019-20 and 2020-21, overwriting the existing forecast growth rates. Figure 4.12 highlights the disaggregated effects this has on our forecast.

Figure 4.12: RTI forecast effect

£ million	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Pre-RTI forecast growth rates (per cent)	3.8	1.1	3.9	5.2	4.4	4.4	4.5
RTI growth rates (per cent)	2.7	-0.5					
Difference	-1.2	-1.6					
2019-20 RTI adjustment	-134	-136	-141	-148	-155	-162	-169
2020-21 RTI adjustment		-191	-199	-209	-219	-228	-239
Total RTI adjustment	-134	-327	-340	-358	-374	-390	-408

Source: Scottish Fiscal Commission.

4.47 Both 2019-20 and 2020-21 RTI growth rates are below our pre-RTI forecast growth rates. To bring our forecast in line with RTI, we apply two downward adjustments for each year of RTI data. In total this reduces our forecast by £340 million in 2021-22. There are a number of caveats associated in applying the RTI tax data in this manner:

- The RTI tax data is a snapshot from the HMRC PAYE administration system, and does not represent the final tax position of individuals, particularly those who also or only file an SA tax return. In addition to RTI tax not fully reflecting final tax liabilities for a year, it also only reflects the tax regime each individual is liable for – such as Scottish, Welsh or English - when the data is compiled. Some individuals may become, or cease to be, a Scottish taxpayer due to address changes by the time their liability is determined after the end of the tax year.

- RTI provides us with data on PAYE only. We are assuming that the Self-Employment liabilities will broadly match the RTI PAYE tax data. Data from previous years shows this is sensible. However, COVID-19 and the varying job support schemes may introduce greater divergence between PAYE and Self-Assessment (SA), but at present we don't have much data on this. Over the next year we will be looking to better understand the Self-Employment liabilities portion of our forecast.

4.48 Our 2020-21 in-year RTI estimate of -0.5 per cent is particularly uncertain. At the time of our forecast, we have RTI tax data available up to October 2020. Given the ever evolving economic situation with COVID-19, it is challenging to estimate what will happen in the remaining months of the tax year.

Forecast uncertainty

4.49 The sensitivity of our income tax forecast to the alternative economy scenarios considered in **Chapter 3** can be found in Figure S4.7 in our Supplementary Tables. We also assess how taxpayers' behavioural responses to income tax policy would change if we made different assumptions about their behaviour. This analysis can be found in Supplementary Table S4.8.

COVID-19

4.50 The income tax forecast has been affected by the economic and social restrictions imposed to control COVID-19. There have been policy responses which affect income tax made by both the UK and Scottish Government including the job protection schemes, and the NHS £500 bonus. We have made assumptions and judgements about the impact of COVID-19 based on our central COVID-19 scenario. Further information on our main COVID-19 assumptions can be found in **Figure 1.1**.

4.51 The employment and earnings forecasts described in **Chapter 3** are key inputs into the income tax forecasts. Our economy forecasts for both these components have been affected by COVID-19 so bringing these inputs into the income tax forecast, along with the RTI information for 2020-21, helps us capture the effect of the pandemic on income tax.

UK Government policy

4.52 Another source of uncertainty is the response to UK Government policy decisions. The 2021-22 Scottish Budget has taken place before the UK Budget, so we do not yet know if there will be any changes to income tax policy for the rest of the UK.

4.53 Our current assumption is that there will not be an increase in the gap between the income tax systems in Scotland and the rest of the UK. If the gap between the tax system in Scotland and the rest of the UK increases, the behavioural response to this is a risk to Scottish income tax revenue.

Non-Domestic Rates

Forecast

Figure 4.13: Forecast revenue for Non-Domestic Rates

£ million	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
	2,761	1,848	2,680	2,930	3,224	3,231	3,216

Source: Scottish Fiscal Commission, Scottish Government (2020) Non-domestic rates income statistics (link).
Shaded cells refer to provisional outturn available at time of publication.

4.54 Non-Domestic Rates (NDR), also known as business rates, are payable by the occupiers of non-domestic properties. In 2021-22, the tax is forecast to raise £2,680 million.

Changes since February 2020

Figure 4.14: Change in Non-Domestic Rates revenue since February 2020

£ million	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
February 2020	2,806	2,749	3,012	3,345	3,423	3,590
Data updates	-44	-34	-79	-114	-132	-136
Methodology updates		13	-1	-8	-17	-17
Policy change		-880	-2	-226	24	-134
January 2021 pre-measures	2,761	1,848	2,931	2,997	3,298	3,304
Budget policy change			-251	-67	-74	-73
January 2021 post-measures	2,761	1,848	2,680	2,930	3,224	3,231
Change since February 2020	-44	-901	-332	-415	-199	-360

Source: Scottish Fiscal Commission, Scottish Government (2020) Non-domestic rates income statistics (link).
Shaded cells refer to provisional outturn available at time of publication.
Figures may not sum because of rounding.

Policy changes introduced before the 2021-22 Budget

4.55 The biggest change to our pre-measures forecast for 2020-21 was the introduction of two new reliefs aimed at mitigating the effect of the COVID-19 pandemic on businesses:

- A universal 1.6 per cent relief applied to all properties
- A 100 per cent relief for properties in the retail, hospitality and leisure (RHL) sectors and aviation

4.56 These policies were announced in March 2020 and we estimated that they would reduce NDR revenue by £875 million in 2020-21.[63]

4.57 At the same time as costing the COVID-19 policies, we updated our forecast to take account of changes made at Stage 3 of the Non-Domestic Rates (Scotland) Bill. We were unable to include

[63] Scottish Fiscal Commission (2020) Supplementary Costings: Non-Domestic Rates Measures – March 2020 (link)

these in our February 2020 forecast as Stage 3 concluded after our forecasts were closed. This lowers our forecast by £18 million in both 2022-23 and 2023-24, and by £252 million in 2024-25.

4.58 A number of other policies have been amended during the financial year and these affect NDR revenue across the forecast horizon:

- Mainstream independent schools become ineligible for charity relief from 1 April 2021, and not 1 September 2020 as previously scheduled. This reduces the forecast for 2020-21 by £4 million.

- The next revaluation cycle is delayed by one year and begins on 1 April 2023. The cyclical effect of revaluation typically means that revenues are higher in the early years and lower in later years of the cycle than they would have been in the absence of revaluation. Shifting these effects one year later reduces revenues by £112 million in 2022-23 and increases them in later years.

4.59 The start dates of two policies that are tied to the revaluation date have also been adjusted and reduce the forecast by a total of £90 million in 2022-23. These changes are:

- Devolution of empty property relief to local authorities happens 1 April 2023

- Entering of commercial activities in parks onto the valuation roll starts on 1 April 2023

4.60 We also assume Transitional relief continues until the start of the next revaluation.

Data updates

4.61 We have included a large number of data updates in our model since February 2020. The most significant of these are described below.

4.62 We have updated the forecast with the latest returns from local authorities. The notified returns for 2019-20 were £44 million lower than our February 2020 forecast, and reduce our forecast in each subsequent year by between £24 and £34 million. The mid-year estimates for 2020-21 reflect the effect of COVID-19 restrictions and indicate that the RHL relief reduced revenue by around £904 million, higher than our estimate of £824 million.[64] Overall the mid-year estimates lower our forecast by £90 million in 2020-21, and by £20 to £40 million in subsequent years.

4.63 Data on revaluation appeals for 2019-20 and 2020-21 have led us to revise our NDR income forecast for 2020-21 upwards. Losses in 2019-20 were higher than expected and since we don't expect that total losses for this revaluation cycle as a whole will be higher, we have lowered our forecast of losses in future years. Losses in the first half of 2020-21 came through more slowly than expected, because of the significant reduction in the number of appeals hearings since the start of the pandemic. Combining this with the Scottish Government's decision to delay one of the deadlines for disposal of appeals by one year, we lowered our forecast for losses in 2020-21 further. We now expect these to be realised in 2021-22 and 2022-23. Overall, lower losses increase our forecast by £101 million in 2020-21 compared to our February forecast.

[64] The mid-year estimates indicate that £927 million was claimed in RHL relief, but we estimate that the automatic application of this relief led to £23 million less being claimed in other reliefs, giving a net reduction of £904 million.

4.64 The latest ONS inflation data and the most recent OBR inflation forecast reflect the effects of COVID-19 and reduce our forecast by £35 million in 2021-22 and by between £44 and £78 million in subsequent years.

Methodology updates

4.65 We revised the adjustment made to reconcile the difference between appeals losses reported in the revaluation appeals data and the losses reported in local authorities' returns (which also include running roll appeals). This increases the forecast by around £13 million in 2020-21 and by between £1 million and £5 million in later years.

4.66 The calculation used to forecast growth in the tax base because now includes only the most recent data. This lowers the forecast by £6 million in 2021-22 and by between £12 and £23 million in later years.

Scottish Government Policy

4.67 Our forecast includes three new policy measures introduced as part of the 2021-22 Scottish Budget: setting the poundage at 49.0p, a change in the eligibility criteria for the Business Growth Accelerator Relief (BGAc) and a three-month extension to the 100 per cent relief and properties in the retail, hospitality and leisure (RHL) sectors and aviation. The cost of these policies is shown in Figure 4.15 and further details of the costing methodology can be found in Annex A.

Figure 4.15: Cost of policies introduced in the 2021-22 Budget

£ million	2021-22	2022-23	2023-24	2024-25	2025-26
Setting the 2021-22 poundage at 49.0p	-63	-64	-69	-68	-67
Changing the eligibility criteria for the BGAc relief	-2	-3	-5	-5	-5
100 per cent relief for RHL and aviation for three months	-185				
Total	-251	-67	-74	-73	-71

Source: Scottish Fiscal Commission.

4.68 The costing of the RHL relief is based on two main assumptions which are subject to change. First, we assume that the relief will not be subject to the state-aid cap. The Scottish Government has confirmed it intends to offer this relief without a cap applied under the terms of the UK-EU Trade and Cooperation Agreement.[65] We note this position may be reconsidered in light of legal advice or revisited following the UK Budget. If the cap was applied, we estimate that the cost of the relief would be around £22 million lower.

4.69 The second assumption concerns those retailers who have committed to repaying the relief they received in 2020-21. In light of these public commitments which, in practical terms, will require these ratepayers to make a donation to the Scottish Government equivalent to the amount of rates relief received in 2020-21, our costing assumes that they will not claim the relief in 2021-22. If the state-aid cap was applied to the relief, this assumption would have made little difference to the

[65] UK Government (2020) EU-UK Trade and Cooperation Agreement (link)

costing. Without the state-aid cap applied, if these retailers did choose to claim the relief, the cost of the policy would increase to £231 million.

4.70 It is possible that the Scottish Government might revisit this relief following the UK Budget and that other details of the relief could be changed at this point. If it was decided to extend the relief for a longer period, this would raise the cost significantly.

Forecast uncertainty

4.71 The COVID-19 pandemic has significantly increased the uncertainly around our forecast. Since the beginning of the pandemic, over 40,000 Material Change of Circumstance (MCC) appeals have been lodged with assessors. MCC appeals allow ratepayers to appeal their valuation if there has been a change in circumstances as defined in statute.

4.72 It is not unusual for large portions of the tax base to be under appeal, for example, following the 2017 revaluation around 70 per cent of total rateable value was appealed. We can use data from previous revaluations to determine the likely extent and timing of losses from revaluation appeals. However, we have no relevant data on which to base any assumptions about the likely outcome of MCC appeals, nor the precise time period during which any losses are likely to be realised. It is expected that these appeals will be resolved during the period covered by our forecasts so this is a significant downside risk to our forecast.

Land and Buildings Transaction Tax

Forecast

Figure 4.16: Forecast revenue for Land and Buildings Transaction Tax

£ million	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Residential LBTT (excluding ADS)	287	251	299	325	347	372	398
Additional Dwelling Supplement	120	108	108	120	127	131	134
Non-residential LBTT	190	157	178	184	190	199	207
Total LBTT	597	517	586	629	664	701	740

Source: Scottish Fiscal Commission, Revenue Scotland (2020) Annual Report and Accounts 2019/20 – Devolved Taxes Accounts (link).
Figures may not sum because of rounding. Shaded cells refer to outturn available at time of publication.

4.73 LBTT is payable on transactions of residential and non-residential properties and land. Additional Dwelling Supplement (ADS) is an LBTT supplement on purchases of additional residential properties, such as second homes or buy-to-let properties.

Residential LBTT

Figure 4.17: Forecast revenue for total residential LBTT

£ million	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
	407	360	408	446	474	502	533

Source: Scottish Fiscal Commission, Revenue Scotland (2020) Annual Report and Accounts 2019/20 – Devolved Taxes Accounts (link).
Figures may not sum because of rounding. Shaded cells refer to outturn available at time of publication.

Change since February 2020

Figure 4.18: Change in total residential LBTT forecast since February 2020

£ million	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
February 2020	422	432	450	470	490	511
Prices		4	-2	-2	4	13
Transactions		-59	-8	-9	-10	-11
Data updates	-14	22	-10	-10	-10	-11
COVID-19 policies		-39	-22	-3	0	
January 2021	407	360	408	446	474	502
Change since February 2020	-14	-72	-43	-24	-16	-8

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2020) Scotland's Economic and Fiscal Forecasts - February 2020 (link), Revenue Scotland (2020) Annual Report and Accounts 2019/20 – Devolved Taxes Accounts (link).
Shaded cells refer to outturn available at time of publication. Figures may not sum because of rounding.
More detailed tables with Residential LBTT (excluding ADS) and ADS changes can be found in Supplementary Tables S4.11 and S4.12.

4.74 In 2020, the Scottish Government introduced a number of policies in response to the pandemic. Because they were based on our February 2020 forecasts, the costings published alongside these policies did not account for the effects of COVID-19.[66] The updated costings which account for the effects of COVID-19 can be found in Annex B.

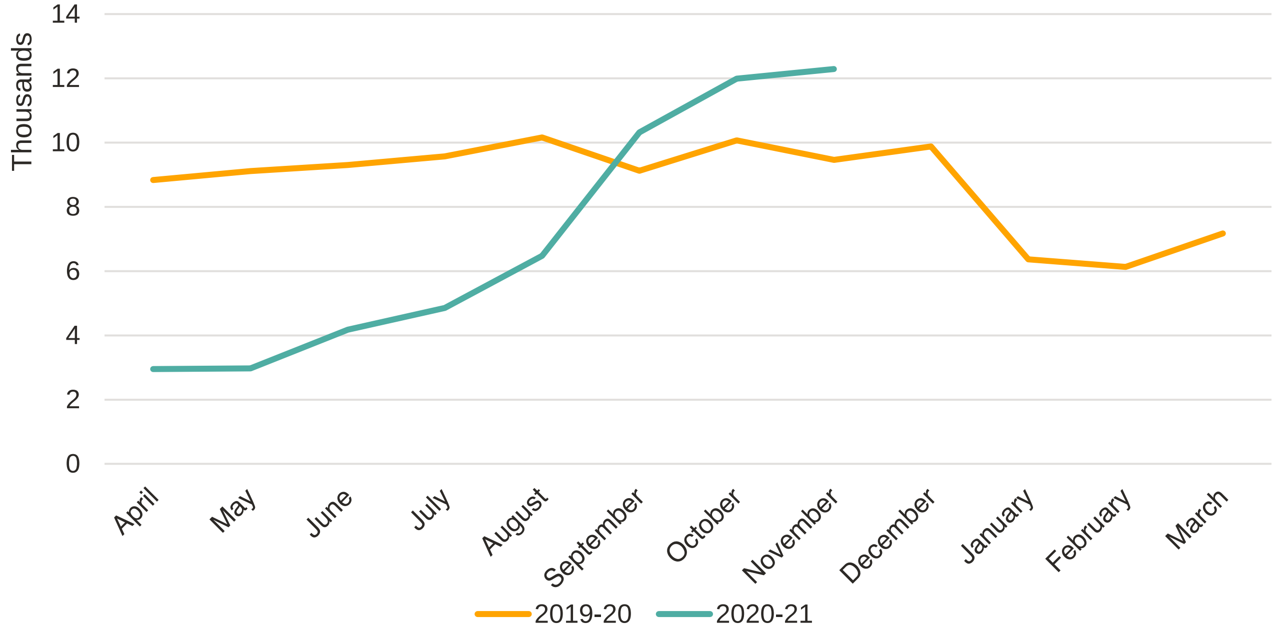
4.75 Data from Revenue Scotland show that since June 2020 there has been a higher proportion of transactions in the top two bands of LBTT than in previous years. Adjusting our forecast for this change in the distribution increases it by £22 million, partially offsetting the fall in transactions and COVID-19 policies. We believe this is because of both the rise in the LBTT nil rate band and the increased activity in the property market after the end of the lockdown in June 2020, and don't expect this change in the distribution to carry on beyond 2020-21.

4.76 Figure 4.12 shows how monthly residential LBTT transactions in 2020-21 have compared to 2019-20. During the lockdown between April and June, residential property transactions fell by 63 per cent compared to the same period in 2019. Since that lockdown ended, there has been a recovery in transactions, with total residential transactions 21 per cent higher than 2019 from September onwards. This recovery from the low levels seen earlier in the year is for three reasons:

- a return to the normal level of residential transactions as the strictest of COVID-19 lockdowns were lifted in the summer
- delayed transactions from earlier in the year pushing up transactions in the summer
- the Scottish Government's policy to raise the LBTT nil rate band from £145,000 to £250,000 until the end of March 2021

4.77 Overall, because we expect this higher level of transactions in the second half of 2020-21 will offset the effects of the lockdown, we expect residential LBTT transactions to be 9 per cent below 2019-20. Because current lockdown rules do not restrict the housing market, we do not expect the pandemic to significantly affect transactions in 2021-22.

Figure 4.19: Monthly residential LBTT transactions, 2019-20 and 2020-21



Source: Scottish Fiscal Commission, Revenue Scotland (2020) November 2020 LBTT Statistics (link).

66 Scottish Fiscal Commission (2020) – Supplementary Costings – Coronavirus (Scotland)(No. 2) Bill – May 2020 (link), Scottish Fiscal Commission (2020) – Supplementary Costing – Increased starting threshold for residential LBTT – July 2020 (link).

4.78 We have updated our house price forecasting model so it links to our household incomes forecast from 2022-23 onwards. This means our medium-term LBTT forecasts will better reflect changes in the wider economy. Moving to this model raises our forecast towards the end of the forecast horizon, with an increase of £13 million in LBTT revenues in 2024-25.

Non-residential LBTT

Figure 4.20: Forecast revenue for non-residential LBTT

£ million	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
	190	157	178	184	190	199	207

Source: Scottish Fiscal Commission, Revenue Scotland (2020) Annual Report and Accounts 2019/20 – Devolved Taxes Accounts (link).
Shaded cells refer to outturn available at time of publication.

Change since February 2020

Figure 4.21: Change in non-residential LBTT forecast since February 2020

£ million	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
February 2020	191	209	216	222	230	238
Prices		3	-9	-11	-12	-12
Transactions		-45	-18	-16	-16	-16
Data updates	-1	-10	-11	-11	-12	-12
January 2021	190	157	178	184	190	199
Change since February 2020	-1	-52	-37	-39	-40	-40

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2020) Scotland's Economic and Fiscal Forecasts - February 2020 (link), Revenue Scotland (2020) Annual Report and Accounts 2019/20 – Devolved Taxes Accounts (link).
Figures may not sum because of rounding. Shaded cells refer to outturn available at time of publication.

4.79 Compared to February 2020, we are forecasting lower non-residential prices and transactions across the forecast horizon. We expect that the difficulties faced by the non-residential property sector will continue after the pandemic, with lower prices and fewer transactions taking place in all years than we had forecast in February.

Forecast Uncertainty

4.80 We assume that any lockdowns in 2021 will not include restrictions on the property market. If the Government does introduce restrictions on property transactions, this means that LBTT revenues will be lower than forecast.

4.81 We have costed the rise in the residential nil rate band the Government introduced in response to COVID-19 in line with our standard assumptions, set out in our December 2018 report.[67] If the pandemic changes taxpayer behaviour, the actual effect of policies could be significantly different to our estimates.

4.82 Non-residential LBTT revenues have historically been more volatile than residential LBTT revenues. Although we have seen a similar recovery to residential LBTT, this volatility makes non-residential LBTT much more uncertain over the short-term.

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

Scottish Landfill Tax

Forecast

Figure 4.22: Forecast revenue for Scottish Landfill Tax

£ million	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
	119	95	88	86	72	74	61

Source: Scottish Fiscal Commission. Revenue Scotland (2020) Annual Report and Accounts 2019/20 – Devolved Taxes Accounts (link).
Shaded cells refer to final outturn available at the time of publication.
SLfT revenue is net of repayments, excludes penalties & interest and also excludes revenue losses.

4.83 We expect SLfT to raise £88 million in 2021-22. As in previous forecasts we anticipate that SLfT revenues will fall over time as incineration capacity and recycling rates in Scotland increase.

Change since February 2020

Figure 4.23: Change in SLfT forecast since February 2020

£ million	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
February 2020	124	116	110	94	79	66
Data updates	-3	-18	-19	-5	-4	-3
BMW ban	0	0	0	0	0	14
Other	-2	-3	-3	-3	-3	-3
January 2021	119	95	88	86	72	74
Change since February 2020	-5	-21	-21	-8	-7	8

Source: Scottish Fiscal Commission, Revenue Scotland (2020) Annual Report and Accounts 2019/20 – Devolved Taxes Accounts (link).
Figures may not sum because of rounding. Shaded cells refer to final outturn available at the time of publication.
SLfT revenue is net of repayments, excludes penalties & interest and also excludes revenue losses.

4.84 The main reason for the change in our SLfT forecast since February 2020 is updated data and revised economy forecasts, both of which have been affected by COVID-19. These reduce the forecast by £19 million in 2021-22. Other updates to our model have led to a further £3 million reduction in the forecast.

4.85 The timings of the biodegradable municipal waste (BMW) ban and new incineration capacity becoming operational would normally have the largest effects on our forecast as more waste is diverted away from landfill sites. The Scottish Government announced that full enforcement of the BMW ban will be delayed until 31 December 2025. We had previously assumed the start of the ban would be January 2025. The delay to the introduction of the ban increases SLfT revenues by £14 million in 2024-25 because BMW will continue to be landfilled. We have made no changes since February 2020 to the expected dates on which new incineration capacity comes online.

Forecast uncertainty

4.86 New incineration capacity and the timing of the BMW ban are the major sources of forecast uncertainty. We will continue to monitor new information on development of waste infrastructure in

Scotland and progress towards the ban on BMW and factor any interventions by the Scottish Government into our future forecasts.

Illustrative forecasts

Scottish share of UK Air Passenger Duty

Figure 4.24: Forecast revenue for the Scottish share of UK Air Passenger Duty

£ million	2019-20 [1]	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
	273	100	145	206	262	275	290

Source: Scottish Fiscal Commission
[1] Figure in shaded cell not classed as outturn data. It is an estimate of the Scottish share of APD revenues.

4.87 Air Departure Tax is a tax paid on eligible passengers on flights departing from UK airports. It was due to replace UK Air Passenger Duty (APD) in Scotland from April 2018. The introduction of Air Departure Tax has been deferred until the state-aid issue raised in relation to the Highlands and Islands exemption has been resolved.[68] We produce an illustrative forecast of the Scottish share of UK APD. Detail on our approach to forecasting the Scottish share of APD can be found in our December 2018 publication.[69]

4.88 The forecast has been revised downwards since February 2020 because of the significant fall in air passenger numbers following the outbreak of COVID-19. Inclusion of data on Scottish air passenger numbers in the first half of 2020-21 and OBR UK GDP and inflation forecasts from November 2020, combined with the Commission's forecast judgements, reduce the forecast by £165 million in 2021-22. More detail can be found in Supplementary Table S4.20.

VAT Assignment

Figure 4.25: Forecast of Scottish VAT Assignment

£ million	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
	5,581	5,418	4,843	5,246	5,893	6,141	6,349	6,594

Source: Scottish Fiscal Commission, HM Treasury, HMRC and Scottish Government.
Shaded cells refer to outturn available at time of publication. Outturn in this context refers to a provisional estimate of the Scottish share of VAT, applied to outturn UK VAT receipts.

4.89 The Scotland Act 2016 states that half of VAT raised in Scotland will be assigned to the Scottish Government.[70] The UK and Scottish Governments initially agreed to implement VAT assignment from 2019-20, but this has now been delayed until the Fiscal Framework Review.

4.90 We will continue to produce illustrative forecasts of VAT assignment to help users understand the potential change. We published a paper on our approach to creating forecasts of assigned VAT in September 2018.[71]

4.91 Our forecast for 2021-22 has been revised down by £641 million compared to our February 2020 forecast. This is mainly because of the revision to our economic forecasts in the wake of the COVID-19 pandemic. More information can be found in Supplementary Table S4.21.

[68] Scottish Government (2020) Programme for Government 2020-21 (link)
[69] Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 (link)
[70] Scotland Act 2016 Part 2 Section 16 (link). The Scotland Act 2016 legislated to assign 10 pence of the standard rate and 2.5 pence of the reduced rate to the Scottish Budget. This represents half of the current VAT rates.
[71] Scottish Fiscal Commission (2018) Approach to forecasting VAT assignment (link)

Chapter 5
Social security

Overview

5.1 In this chapter, we provide forecasts of devolved social security spending to inform the 2021-22 Scottish Budget. We expect devolved social security spending in Scotland to be £3.6 billion in 2021-22, excluding administrative costs which are budgeted for separately by the Scottish Government. Figure 5.1 shows a summary of our social security spending forecasts. As well as the payments included in the Scottish Government's Social Security portfolio, our legislative scope also requires that we produce forecasts for other devolved social security payments including Best Start Foods, Discretionary Housing Payments and Fair Start Scotland.[72,73]

Figure 5.1: Summary of social security spending forecasts

£ million	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Scottish Government Social Security portfolio spending	374	3,379	3,492	3,694	3,916	4,031	4,155
Fair Work, Communities and Health portfolio spending							
Best Start Foods [1]	6	12	12	10	9	9	8
Discretionary Housing Payments	65	83	82	83	84	85	86
Fair Start Scotland [2]	16	21	27	22	11	4	0
Total social security spending	460	3,495	3,614	3,810	4,020	4,129	4,249

Source: Scottish Fiscal Commission, Social Security Scotland (2020) Annual Report and Accounts for the year to 31 March 2020 (link), Scottish Government (2020) Discretionary Housing Payments in Scotland: 1 April 2019 to 31 March 2020 (link), Scottish Government (2020) Fair Start Scotland: annual report – year 2 (link).
Figures may not sum because of rounding. Shaded cells refer to outturn available at time of publication.
[1] Best Start Foods for 2019-20 and 2020-21 includes spending on the UK Government Healthy Start Vouchers Scheme.
[2] Spending for 2019-20 also includes £0.04 million on Work First Scotland.

5.2 We estimate spending will continue to increase over the next five years, reaching £4.2 billion by 2025-26, as more people receive social security support each year and payment amounts increase with inflation, also referred to as uprating. Our forecasts include the current devolved benefits such as the Personal Independence Payment, but they do not account for changes in spending arising from the Scottish replacement payments launched beyond the next financial year such as the introduction of Adult Disability Payment. We discuss this in Box 5.1.

[72] Scottish Fiscal Commission Act 2016 (link)
[73] Fair Start Scotland is in the Finance, Economy and Fair Work portfolio. Discretionary Housing Payments are in the Communities and Local Government portfolio. Best Start Foods is in the Health and Sport portfolio and will be transferred to the Social Security and Older People portfolio later in 2021-22.

Figure 5.2: Change in total social security spending forecasts since February 2020

£ million	2020-21	2021-22	2022-23	2023-24	2024-25
February 2020	3,435	3,578	3,704	3,857	3,959
January 2021	3,495	3,614	3,810	4,020	4,129
Change since February 2020	60	36	106	164	170

Source: Scottish Fiscal Commission

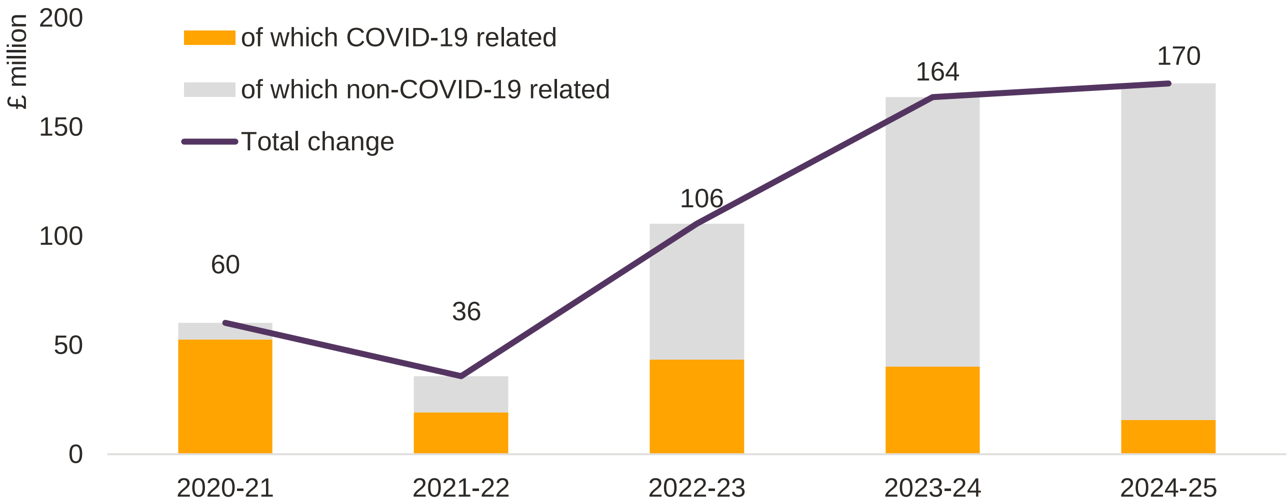
5.3 Our forecasts have increased since February 2020. For 2020-21, this is mostly because of the Scottish Government's response to COVID-19. For later years of the forecast, the increase arises because we have updated our forecasts to take account of the most recent data from DWP, but largely because of modelling changes, particularly for disability payments as we have continued to develop our models since we produced our first forecasts in February 2020.

COVID-19

5.4 Social security spending is demand-led in the sense that it is assumed that all eligible people who apply for support will receive payment. It is difficult to predict demand-led spending even in 'normal' times and now we have the additional challenge that COVID-19 is having significant economic and social effects. COVID-19 has undoubtedly increased the number of people eligible for working-age social security support as unemployment has increased and those who are in work may find their income has reduced as result of the restrictions. An increase in eligibility will increase spending only if people apply for devolved payments to which they have become entitled. COVID-19 may have led to increased awareness of the assistance available and reduced some of the perceived stigma around social security support.

5.5 There are other changes that we attribute to COVID-19 that reduce social security spending. Inflation is currently very low, and lower than we expected in our February 2020 forecasts, which decreases payment rates in all future years and reduces spending. We also expect the number of COVID-19 related deaths in the pension age population will reduce spending on assistance for older people such as Attendance Allowance. Another factor which has reduced spending in 2020-21 is fewer people registering for Personal Independence Payment while COVID-19 restrictions were in place. There is judgement involved in deciding which changes are COVID-19 related and we describe this in more detail later in the chapter.

Figure 5.3: Change in spending forecast because of COVID-19 since February 2020



Source: Scottish Fiscal Commission

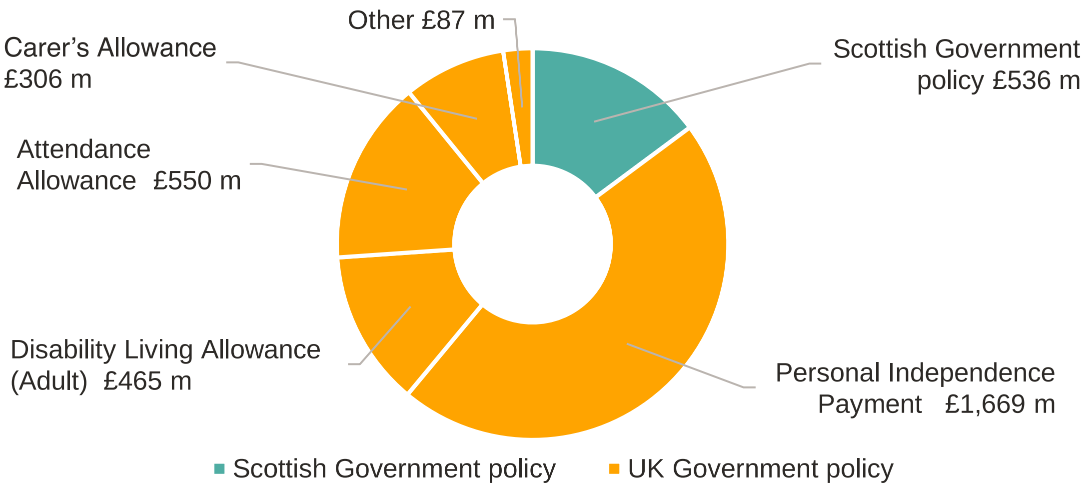
Forecasts

5.6 In this section we provide more detail on our spending forecasts, along with our forecast of how many people we expect to be supported (the caseload). We also show the changes in our spending forecasts since our previous published forecasts in February 2020.

Spending forecasts

5.7 For 2021-22 most social security spending, over £3 billion, will be administered by DWP under agency agreements with the Scottish Government. Personal Independence Payment is the most significant payment with an expected spend of £1.7 billion. Figure 5.4 presents social security spending in 2021-22.

Figure 5.4: Social security spending in 2021-22



Source: Scottish Fiscal Commission
Child Disability Payment is included as being costed on Scottish Government policy, however this includes spending on the UK Government Disability Living Allowance (Child) in 2021-22.

5.8 In Figure 5.4 we also show the basis on which we have produced our forecasts, with the payments being administered by DWP based on UK Government policy and the other payments based on Scottish Government policy. Showing our Disability Living Allowance (Adult) and Personal Independence Payment forecasts as being produced based on UK Government policy is a simplification. We also allow for two important Scottish Government policy decisions:

- The managed migration of working-age Disability Living Allowance recipients to Personal Independence Payment stopped in Scotland from 1 April 2020 whereas it continues under UK Government policy that applies in England and Wales.[74]
- Under UK Government policy that applies in England and Wales, children getting Disability Living Allowance Child are asked to apply for Personal Independence Payment six months out from their 16th birthday. Under new Scottish Government policy, young people in Scotland will

[74] Any existing working-age Disability Living Allowance recipients who report a change of circumstances or reach the end of their award will continue to be migrated to Personal Independence Payment until Adult Disability Payment opens for applications.

continue to get Disability Living Allowance, as long as they remain eligible, up to the age of 18.[75]

Box 5.1: Our approach to producing social security forecasts

Payments already launched or launching in 2021-22

A number of social security payments have already been launched by the Scottish Government and we produce forecasts based on Scottish Government policy. At the time of publication:

- Social Security Scotland is making payments for Best Start Grant, Best Start Foods, Carer's Allowance Supplement, Child Winter Heating Assistance and Funeral Support Payment.[76] The Scottish Child Payment will start on 15 February 2021 and Child Disability Payment will fully launch in autumn 2021.[77,78]
- The Scottish Welfare Fund, Discretionary Housing Payments and the Self-Isolation Support Grant are administered by local authorities. Our forecasts for these only show Scottish Government spending.
- Fair Start Scotland is delivered by external providers contracted by the Scottish Government.

Payments launching after 2021-22

The Scottish Government plans to launch a number of new payments after 2021-22 to replace existing UK Government benefits such as Attendance Allowance and Carer's Allowance.[78] Currently we do not have sufficient detail of the policy and operational changes that the Scottish Government wants to introduce so we do not forecast spending on the new payments. Our forecasts are based on existing UK Government policy. When the Scottish Government announces their policy intent, we will incorporate these changes into future published forecasts.

The next payment the Scottish Government plans to launch is the Adult Disability Payment which will be rolled out nationally in summer 2022. The Scottish Government is still developing the details of Adult Disability Payment and is currently consulting on draft regulations.[79] In this case, we have made a judgement to delay production of a forecast for Adult Disability Payment until policy details are firmer and details of how the payment will be delivered are clearer. Instead we forecast spending for working age disability assistance based on current UK Government policy as embodied in the two benefits – Personal Independence Payment and Disability Living Allowance. The Scottish Government plans to launch a pilot in spring 2022, but we expect spending on the pilot in 2021-22 to be below our materiality threshold for small measures of £5 million. Further information on our materiality policy can be found in Annex C.

It is important to note that our forecasts of spending from 2022-23 onwards do not account for these new payments. Once they are included, we expect spending to increase given Ministerial

---

75 Scottish Government (2020) 16 year olds will no longer need to apply for PIP in Scotland (link)
76 Social Security Scotland is also making payments for Young Carer Grant and Job Start Payment. We do not produce forecasts for Young Carer Grant because we estimate spending is immaterial, please see Annex C, and Job Start Payment is not part of our legislative scope.
77 Scottish Government (2020) Applications to open early for Scottish Child Payment (link)
78 Scottish Government (2020) Child Disability Payment to be introduced next summer (link). Work is continuing with the UK Government to establish timelines for Scottish Carer's Assistance, the other disability related benefits and winter benefits.
79 Scottish Government (2020) Adult disability payment: consultation (link)

announcements and policy position papers published to date. We expect the new payments to have more accessible application routes, more support for applicants and be more widely promoted.

5.9 In Figure 5.5 we provide: outturn spending for 2019-20 where available and the benefit was devolved at this time; our estimate of spending for the current financial year (2020-21); and a five year forecast for each benefit and payment.

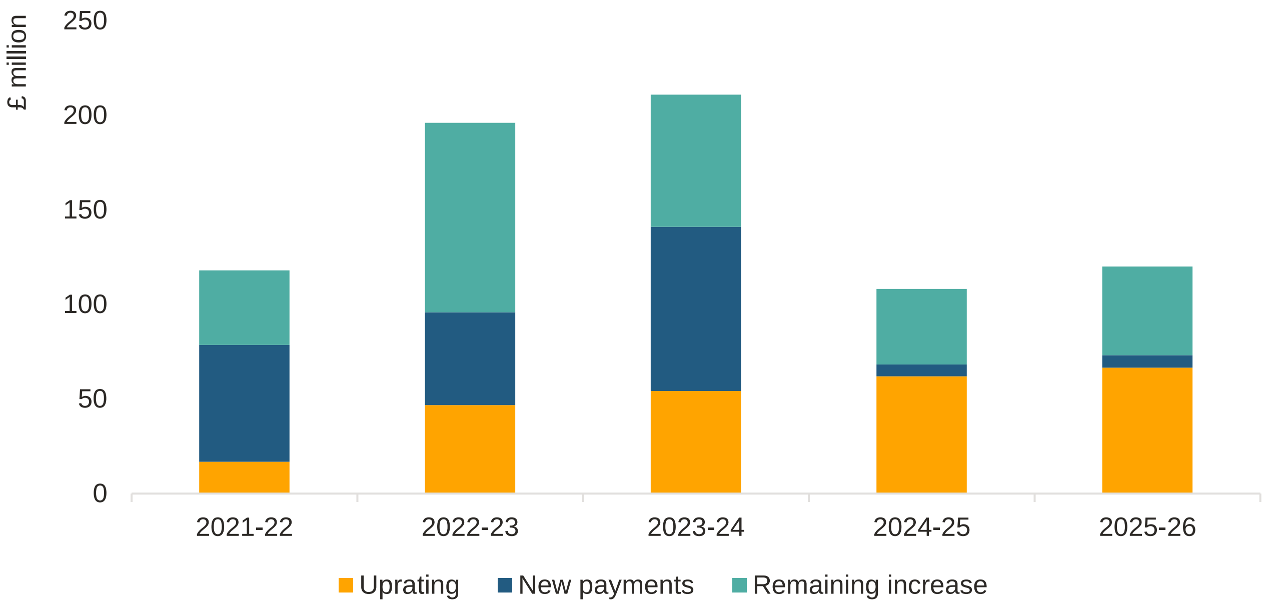
Figure 5.5: Social security spending forecasts

£ million	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Administered by Social Security Scotland:							
Best Start Foods [1]	6	12	12	10	9	9	8
Best Start Grant	21	20	19	18	17	17	17
Carer's Allowance Supplement	37	59	42	44	46	49	51
Child Disability Payment [2]		208	231	269	302	325	348
Child Winter Heating Assistance		3	3	4	4	4	4
Funeral Support Payment	4	12	11	11	12	12	12
Scottish Child Payment		9	68	105	184	183	182
Administered by DWP:							
Attendance Allowance		534	550	568	583	599	618
Carer's Allowance	279	299	306	322	342	359	376
Disability Living Allowance (Adult)		509	465	426	391	357	325
Industrial Injuries Disablement Scheme		82	80	79	78	77	76
Personal Independence Payment		1,574	1,669	1,807	1,916	2,008	2,105
Severe Disablement Allowance		8	7	6	5	5	4
Administered by local authorities and other bodies:							
Discretionary Housing Payments	65	83	82	83	84	85	86
Fair Start Scotland [3]	16	21	27	22	11	4	0
Self-Isolation Support Grant		5	6				
Scottish Welfare Fund	33	58	36	36	36	36	36
Total spending	460	3,495	3,614	3,810	4,020	4,129	4,249

Source: Scottish Fiscal Commission, Social Security Scotland (2020) Annual Report and Accounts for the year to 31 March 2020 (link), Scottish Government (2020) Use of Discretionary Housing Payments: financial year 2019 to 2020 (link), Scottish Government (2020) Fair Start Scotland: annual report – year 2 (link).
Figures may not sum because of rounding. Shaded cells refer to outturn available at time of publication.
Some benefits do not have costs in 2019-20 as they were not devolved or had not launched at this time.
[1] Best Start Foods for 2020-21 includes spending on the UK Government Healthy Start Scheme.
[2] Child Disability Payment includes spending on the UK Government Disability Living Allowance (Child) until all children are receiving the new payment.
[3] Spending for 2019-20 also includes £0.04 million on Work First Scotland

5.10 Social security spending increases over time because we expect more people to receive support, also referred to as the caseload, and most payment amounts to increase each year with inflation, referred to as uprating. In Figure 5.6 we show how much of the growth in social security spending is related to uprating.

Figure 5.6: Growth in social security spending



Source: Scottish Fiscal Commission
New payments includes the year-on-year increase in spending because of the roll-out of Child Disability Payment and the Scottish Child Payment.

5.11 We expect the growth in social security spending in later years to be more significant than shown in Figure 5.6 as the Scottish Government launches Adult Disability Payment, Pension Age Disability Payment and also replaces Carer's Allowance and the Industrial Injuries Disablement Scheme. We provide more detail on this in Box 5.1.

5.12 The Scottish Child Payment will start being paid in February 2021 and will be rolled out to all children under 16 by the end of 2022 so we see spending increasing significantly for this payment over the forecast period.

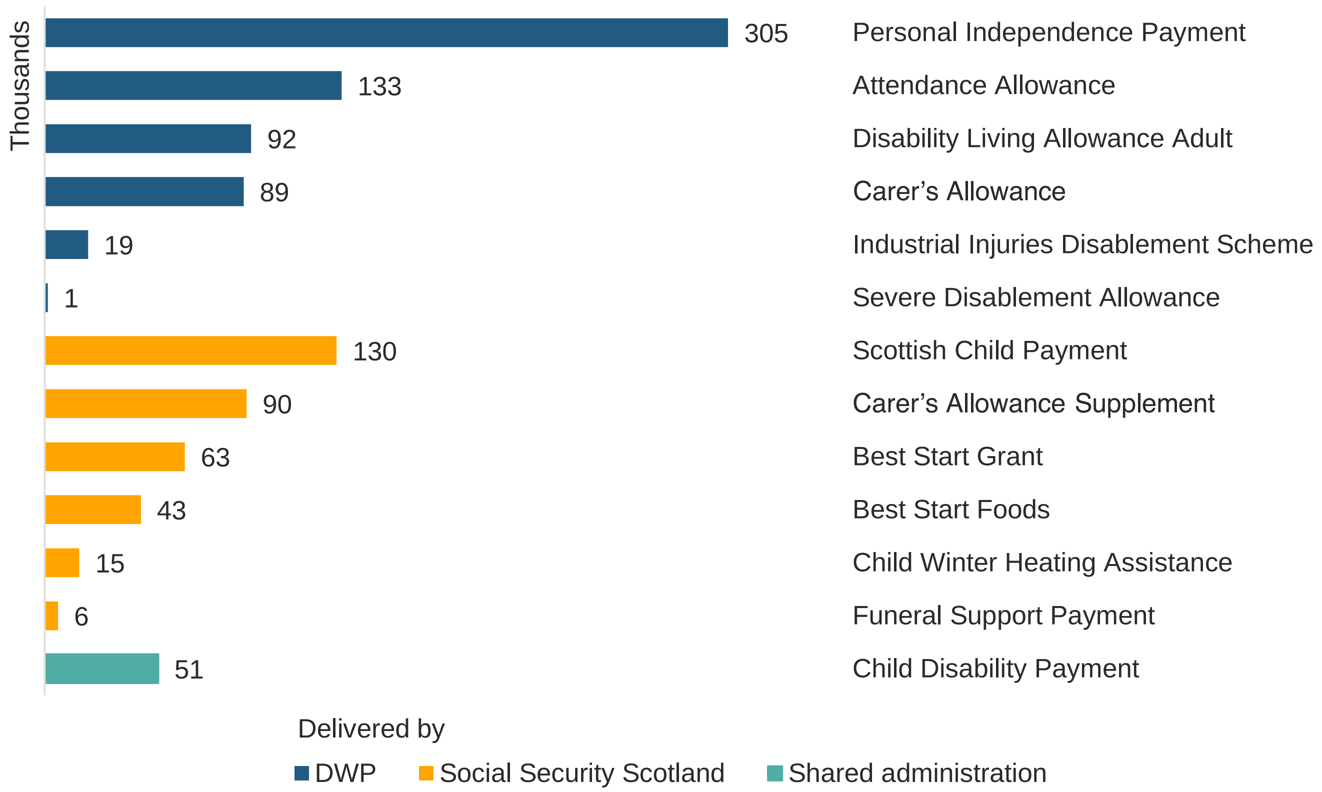
Caseload forecasts

5.13 We expect the caseloads for most existing benefits to increase over time. This assumption is largely data driven, based on the increases in the caseloads in recent years. Some of this is caused by changes in the population of Scotland: for example we expect that an ageing population would increase caseloads for benefits to support the pension age group such as Attendance Allowance. The other factor is the proportion of the population that receives social security support. An increasing proportion of the child and working age population are in receipt of a disability benefit so even if the population remains relatively stable, we would expect caseloads to increase. These factors can offset each other, for example we expect the eligibility and take-up rates for low income benefits like Best Start Grant to be higher than before, but as the population of young children is shrinking this reduces the effect.

5.14 We expect the caseload for Disability Living Allowance (Adult), Industrial Injuries Disablement Scheme, Severe Disablement Allowance to fall over the next five years. Disability Living Allowance (Adult) and Severe Disablement Allowance are closed to new applicants and there are very few new applicants to the Industrial Injuries Disablement Scheme with several of the underlying benefits effectively closed to new applicants.

5.15 Figure 5.7 shows our forecast caseloads for 2021-22 for payments administered by DWP and Social Security Scotland. Our estimates for later years can be found in Supplementary Table S5.1. Note that people may receive more than one of these payments so it is not possible to sum these figures to give a total view of how many people are supported.

Figure 5.7: Social security caseload forecast for 2021-22



Source: Scottish Fiscal Commission
Child Disability Payment includes spending on the UK Government Disability Living Allowance (Child) until all children are receiving the new payment.
The total caseload for Severe Disablement Allowance in Scotland is not reported so we have estimated this using the reported expenditure and our average award assumption.

Changes since February 2020

Figure 5.8: Change in social security spending forecasts since February 2020

£ million	2020-21	2021-22	2022-23	2023-24	2024-25
February 2020	3,435	3,578	3,704	3,857	3,959
January 2021	3,495	3,614	3,810	4,020	4,129
Change since February 2020	60	36	106	164	170
Of which:					
Attendance Allowance	2	4	6	2	-2
Best Start Grant	2	2	1	0	-1
Carer's Allowance	7	-5	-15	-13	-16
Carer's Allowance Supplement	20	0	-1	-1	-1
Child Disability Payment [1]	-9	-19	-6	7	14
Child Winter Heating Assistance [2]	3	3	4	4	4
Disability Living Allowance (Adult)	7	-5	-13	-19	-23
Funeral Support Payment	2	1	1	1	1
Industrial Injuries Disablement Scheme	2	1	0	0	0
Personal Independence Payment	-9	20	93	140	167
Scottish Child Payment	-12	3	11	27	21
Scottish Welfare Fund	22				
Self-Isolation Support Grant	5	6			
Severe Disablement Allowance	0	0	0	0	0
Total Scottish Government Social Security portfolio	43	11	81	148	163
Best Start Foods [3]	3	4	3	2	1
Discretionary Housing Payments	11	6	5	4	2
Fair Start Scotland	3	14	17	11	4

Source: Scottish Fiscal Commission

Figures may not sum because of rounding.

[1] Child Disability Payment includes spending on the UK Government Disability Living Allowance (Child) until all recipients are transferred to the new payment.

[2] Child Winter Heating Assistance was previously part of our costing of Child Disability Payment so the total spending on this payment is shown as a change since our February 2020 forecast.

[3] Best Start Foods for 2020-21 includes spending on the UK Government Healthy Start Vouchers Scheme.

5.16 The most significant changes are for our Personal Independence Payment forecast. Figure 5.9 shows the main reasons our forecasts have changed since February 2020, split by data updates, modelling changes, assumption changes and policy changes.

Figure 5.9: Change in social security spending forecasts since February 2020

£ million	2020-21	2021-22	2022-23	2023-24	2024-25
February 2020	3,435	3,578	3,704	3,857	3,959
Data updates	72	84	98	107	112
Modelling changes	0	15	33	60	90
Assumptions – Inflation	0	-46	-68	-86	-96
Assumptions – Eligibility and take-up	9	19	31	49	41
Assumptions – Population	-4	-9	-11	-13	-16
Assumptions – Other	-64	-53	2	32	28
Policy changes – Scottish Government	43	13	9	6	1
Policy changes – UK Government	3	14	12	9	8
January 2021	3,495	3,614	3,810	4,020	4,129
Change since February 2020	60	36	106	164	170

Source: Scottish Fiscal Commission

Figures may not sum because of rounding.

Data updates

5.17 Overall, as we updated our forecasts for new data, spending has been revised upwards. This is driven by changes to our disability benefit forecasts as we have updated for the latest information from DWP on the caseload and the award amounts. There have been a significant number of data releases since our last publication in February 2020 and they have increased in-year spending for 2020-21. We then assume these trends continue in the future, which increases spending in all years of the forecast.

Modelling changes

5.18 We made several updates to our Personal Independence Payment model this summer. The main changes include improved modelling of the Disability Living Allowance (Child) recipients who then move to Personal Independence Payment and the number of people who leave the reassessed group (working age individuals who previously received Disability Living Allowance). These changes are material and increase our forecast by £100 million by 2024-25, compared to our February 2020 forecast.

5.19 Our Carer's Allowance forecast model is now linked to our forecasts of the qualifying disability benefits (Attendance Allowance, Disability Living Allowance and Personal Independence Payment). This brings consistency to our forecasts and is also more aligned with the OBR's approach.

Assumption changes

5.20 **Inflation:** Inflation is currently very low, and lower than we expected in our February 2020 forecasts which decreases payment rates in all future years and reduces spending.

5.21 **Eligibility and take-up:** Our assumptions for low income benefits have been updated to reflect our economy forecasts and data from Social Security Scotland on claims. Although overall we expect the effects of COVID-19 to increase eligibility, the effect is less than we expected in September 2020 when we updated our Scottish Child Payment forecast because of improvements in the economic outlook with the UK-wide job protection schemes extended to April 2021. For Discretionary Housing Payments we assume increased numbers of people qualifying for the bedroom tax mitigation payments.

5.22 We also revised down our pre-COVID eligibility assumptions which means the picture is not simply an increase across all benefits. For example, for Best Start Grant pre-COVID eligibility is considerably lower than we estimated in February 2020 and remains lower than forecast in February even after we account for COVID-19. This is offset with a higher estimated take-up rate. Our eligibility and take-up rate assumptions can be found in Supplementary Table S5.4 and S5.5.

5.23 **Population:** We have updated our population assumptions. Our population forecast applies for all the Commission's forecasts and more detail can be found in Box 3.1. Our child population is lower than in February 2020 so this decreases spending.

5.24 **Other assumptions:** The Personal Independence Payment forecast includes two assumptions related to COVID-19. The first is that the drop in new applications seen during the first lockdown period from March until June 2020, and an expected drop in applications during the lockdown in 2021 Q1, results in higher claim numbers over the following two financial years as these 'missing' claims are delayed rather than never being made. These drops in new applications reduce Personal Independence Payments spending whereas the UK Government's policy response to COVID-19 has increased Personal Independence Payments spending, as discussed in the next section.

5.25 The second assumption is that the COVID-19 crisis results in long-term health effects which increase the caseload. These effects relate to the recession, directly to COVID-19 and to lockdown effects and cover both mental and physical health effects. This assumption increases spending by up to £70 million a year.

5.26 We have moved all our forecasts to a National Accounts accounting basis which is consistent with the OBR's approach to forecast spending in England and Wales. In most cases this had no material effect on the forecasts, but it reduced our Carer's Allowance forecast by around £5 million each year and increased our Industrial Injuries Disablement Scheme by between £2 and £3 million each year.

Policy changes

5.27 There have been a number of Scottish Government policy changes, largely in response to the COVID-19 pandemic. We provide more details on these changes in the Scottish Government policy section.

5.28 The two main UK Government policy changes relate to Personal Independence Payment. These changes will also affect England and Wales spending so we expect the higher spending would to some extent be offset by increases in the BGA. The two changes are:

- **Minimum award length:** For those whose condition is unlikely to change, the UK Government has set a minimum award length of 18 months. This was announced and costed by HM Treasury at the UK Government's March 2020 budget.[80] The previous minimum award length was 9 months so this change increases spending as people are guaranteed payment for a longer period of time.
- **COVID-19 operational changes:** DWP has made a number of operational changes in response to COVID-19, for example they suspended face to face assessments and diverted

[80] HM Treasury (2020) Budget 2020: policy costings (link)

these to telephone assessments and other remote technology.[81] These operational changes have caused fluctuations in award success rates which temporarily increases spending.

5.29 The UK Government also announced that award reviews and reassessments were suspended from 24 March 2020 in response to the COVID-19 pandemic. This also increases spending, but we have not been able to isolate out the extent of this. This change is already showing in the caseload data from DWP that we have available up to end October 2020. The caseload is higher than we would have expected as fewer award reviews have taken place. This is included in our 'data updates' change. This change will affect other disability benefits but we only have caseload information available to May 2020 so it will not be showing in the data to the same extent.

COVID-19

5.30 The COVID-19 crisis has affected many components of our forecasts. Although there is no clean way to separate out COVID-19 effects we can identify the changes in our forecasts which can, in some way, be attributed to COVID-19. Figure 5.10 summarises the effect on our forecasts of changes which we consider to be related to COVID-19 including:

- outturn data for caseloads and inflation relating to the period since March 2020
- revised population projections relating to pension age adults
- adjustments for additional expected demand
- Scottish Government policy announcements or changes in delivery timescales in response to COVID-19

5.31 Changes we don't consider to be related to COVID-19 include modelling updates, data releases relating to periods before March 2020 and changes in our population projections relating to children and working-age adults. This is not a perfect split as the inflation changes will only be partially attributable to COVID-19 and our revised population projection changes affecting pension age adults also include assumed stalling in life expectancy improvements which is not related to COVID-19. Further details on our population projections can be found in Box 3.1.

Figure 5.10: Change in social security spending forecasts since February 2020 – COVID-19

£ million	2020-21	2021-22	2022-23	2023-24	2024-25
Change since February 2020	60	36	106	164	170
COVID-19 related changes	53	19	43	40	16
Other changes	8	17	62	124	154

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

5.32 The net effect of COVID-19 on our forecasts is not as significant as we may expect. Overall we expect COVID-19 to increase social security spending, largely because we assume eligibility and take up increases, but there are changes that reduce spending and reduce the overall effect:

- **Inflation:** The CPI inflation rate used to set the payment rates for 2021-22 is lower than we expected in February 2020. The CPI inflation forecast for later years is also lower than our

[81] DWP (2020) Personal Independence Payment: Official Statistics to October 2020 (link)

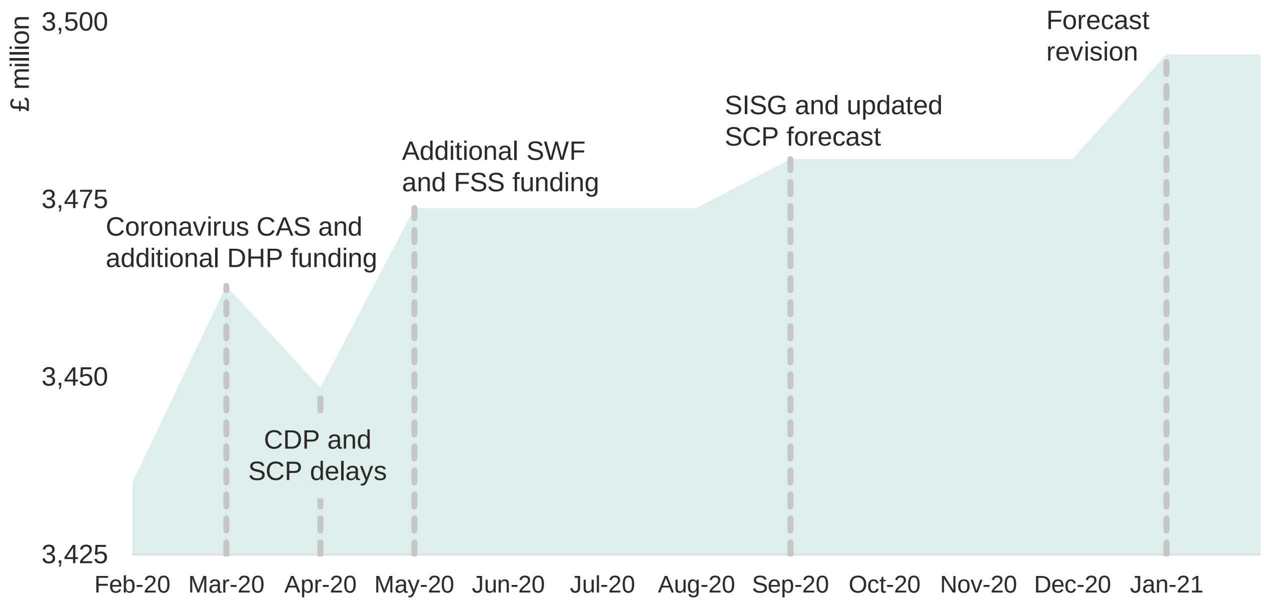
February 2020 forecast. Both of these changes reduce growth in payment rates and therefore spending.

- **Delays to new payments:** The Scottish Government has delayed the launch of the Scottish Child Payment and Child Disability Payment which decreases spending in the short term.

- **Pension age population:** Most of the people who have died of COVID-19 have been people aged 75 or over with underlying health conditions. It is likely that a significant proportion will have been receiving disability benefits such as Attendance Allowance, and we estimate spending will be lower as a result.

5.33 Our forecast of 2020-21 spending has been most affected by the social and economic effects of COVID-19. Figure 5.11 shows the changes in our forecasts of social security spending for 2020-21. We discuss the Scottish Government's policy response in further detail in the Scottish Government policy section. The Scottish Government has announced additional funding for the Scottish Welfare Fund (SWF), Fair Start Scotland (FSS) and Discretionary Housing Payments (DHPs) as well as two new payments: the one-off Coronavirus Carer's Allowance Supplement (CAS) and the Self-Isolation Support Grant (SISG). There have also been delays to the start dates for the Scottish Child Payment (SCP) and Child Disability Payment (CDP).

Figure 5.11: 2020-21 social security spending



Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2020) Supplementary Costing – Scottish Child Payment (link).

Comparison with Block Grant Adjustments

5.34 The largest social security benefits are funded through Block Grant Adjustments (BGAs), which will change directly in response to changes in spending in the rest of the UK on the corresponding benefits. This includes Personal Independence Payment, Disability Living Allowance, Attendance Allowance, Carer's Allowance, Industrial Injuries Disablement Scheme and Severe Disablement Allowance. Out of our total forecast of £3.6 billion of spending for 2021-22, over 90 per cent is spent on benefits funded through BGAs. The remaining social security payments were either devolved through normal Block Grant funding arrangements or are new payments which do not receive any funding from the UK Government; further information can be found in **Box 2.1**.

Figure 5.12: Comparison of social security spending forecast and BGAs forecast

£ million	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
BGAs	3,185	3,310	3,503	3,676	3,837	3,988
Spending on social security benefits with BGAs [1]	3,214	3,308	3,477	3,617	3,730	3,853
Difference (BGAs less spending)	-29	1	26	59	107	135

Source: Scottish Fiscal Commission, Scottish Government.

Figures may not sum because of rounding.

[1] We have included social security spending on Attendance Allowance, Carer's Allowance, Disability Living Allowance, Industrial Injuries Disablement Scheme, Personal Independence Payment and Severe Disablement Allowance as well as the costs for the new Child Disability Payment which will replace Disability Living Allowance (Child).

5.35 The differences shown in Figure 5.12 are calculated as the BGA less spending to show the effect on the Scottish Government's funding. The SFC spending forecast and the BGA forecast, based on the OBR's November 2020 forecasts, are calculated on different bases so comparisons should be interpreted with caution. A comparison between the forecasts of the BGA and spending for each benefit can be found in Supplementary Table S5.10. We consider the latest position for 2020-21 and 2021-22 in more detail in the following sections.

2020-21

5.36 For 2020-21 there has been an increase of £1 million in our social security forecasts and a £17 million reduction in the BGAs since the Scottish Budget was set in February which means there is an additional £18 million of spending that needs to be met from the Scottish Budget. This relatively small net change masks several larger changes, including an increase in the Disability Living Allowance BGA and a reduction in the Personal Independence Payment BGA reflecting fewer people moving from Disability Living Allowance to Personal Independence Payment in England and Wales than the OBR were forecasting at the time of the February 2020 Budget.

Figure 5.13 Comparison of social security spending and BGA forecasts for 2020-21

£ million	Change in BGA since February 2020	Change in SFC forecast since February 2020	Change in net position
Attendance Allowance	-5	-2	-6
Carer's Allowance	-14	-7	-21
Disability Living Allowance [1]	50	1	51
Industrial Injuries Disablement Scheme	-1	-2	-3
Personal Independence Payment	-46	9	-37
Severe Disablement Allowance	-1	0	-1
Total	-17	-1	-18

Source: Scottish Fiscal Commission, Scottish Government.

Negative figures represent an increased cost that has to be met from the Scottish Budget. For the BGA this is a reduction in funding, for our forecasts this is an increase in spending. Figures may not sum because of rounding.

[1] SFC forecast includes spending on Child Disability Payment, the Scottish Government's replacement for Disability Living Allowance (Child).

2021-22

5.37 For 2021-22, the BGAs and spending forecasts are closely aligned, likely because the support is administered by DWP and largely based on UK Government policy so spending in Scotland and the rest of the UK should be similar. The overall BGA is £1 million higher than our spending forecast.

Figure 5.14 Comparison of social security spending and BGA forecasts for 2021-22

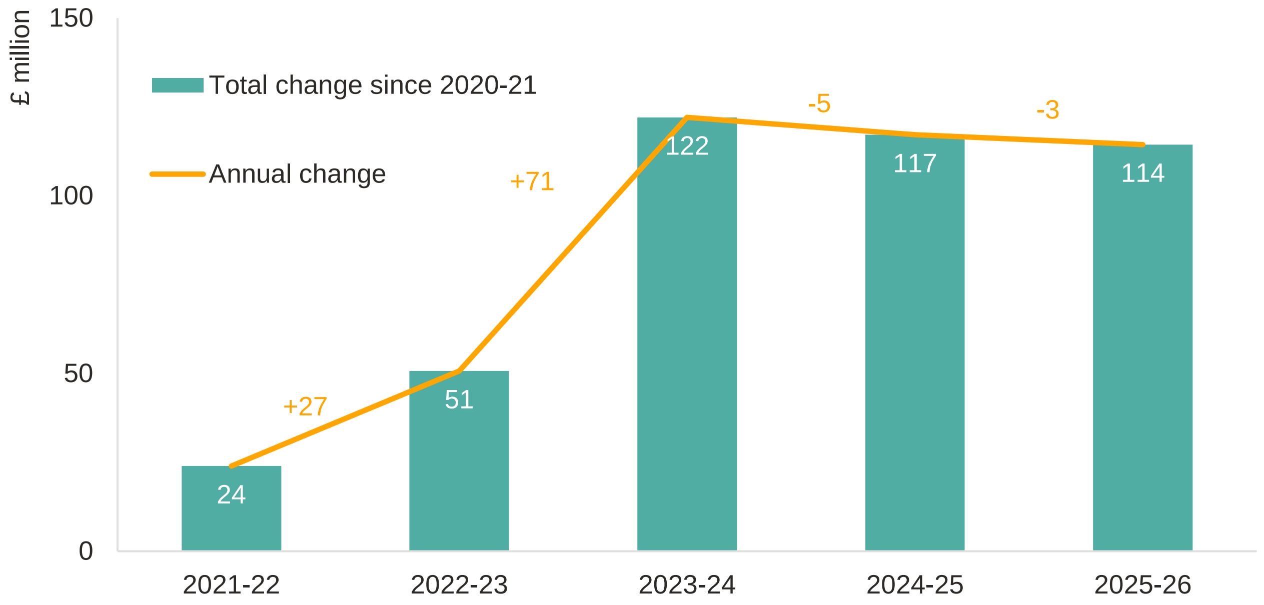
£ million	BGA	Spending	Net position (BGA minus spending)
Attendance Allowance	546	550	-3
Carer's Allowance	309	306	3
Disability Living Allowance [1]	685	696	-11
Industrial Injuries Disablement Scheme	81	80	1
Personal Independence Payment	1,682	1,669	12
Severe Disablement Allowance	7	7	1
Total	3,310	3,308	1

Source: Scottish Fiscal Commission, Scottish Government.
Figures may not sum because of rounding.
[1] SFC forecast includes spending on Child Disability Payment, the Scottish Government's replacement for Disability Living Allowance (Child).

Payments without a Block Grant Adjustment

5.38 Other social security payments are funded through the Scottish Government's general block grant. More information on funding arrangements can be found in Box 2.1. There are no direct changes in funding from the UK Government to cover any increase in spending in these areas. The Scottish Government's policy changes in response to COVID-19 increased spending on these payments in 2020-21. Changes such as the Coronavirus Carer's Allowance Supplement and additional funding for Discretionary Housing Payments and the Scottish Welfare Fund do not carry on to 2021-22. In aggregate we do not see much change in spending from this year to next, even though 2021-22 is the first full year of spending on the Scottish Child Payment to children aged under six.

Figure 5.15: Growth in social security spending on payments without a BGA



Source: Scottish Fiscal Commission
Payments without a BGA include Best Start Foods, Best Start Grant, Carer's Allowance Supplement, Child Winter Heating Assistance, Discretionary Housing Payments, Fair Start Scotland, Funeral Support Payment, Scottish Child Payment, Self-Isolation Support Grant and Scottish Welfare Fund.

5.39 The largest increases are in 2022-23 and 2023-24 as we assume the Scottish Child Payment is rolled out to all children under 16. This adds £40 million to the forecast in 2022-23 and £120 million in 2023-24.

Scottish Government policy

Overview

5.40 The Scottish Government has announced several policy changes, mainly in response to the COVID-19 pandemic, since our February 2020 forecast. These include additional funding for existing social security assistance and two new payments: the one-off Coronavirus Carer's Allowance Supplement and the Self-Isolation Support Grant. These costs are partly offset by delays to the launches of Scottish Child Payment and Child Disability Payment.

Figure 5.16: Scottish Government policy changes since February 2020

£ million	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Additional funding						
Discretionary Housing Payments	6	-2	-2	-2	-2	-2
Fair Start Scotland	6	17	18	11	4	0
Scottish Welfare Fund	22					
New payments						
Coronavirus Carer's Allowance Supplement	19					
Self-Isolation Support Grant	5	6				
Start dates						
Child Disability Payment	-3	-8	-5	-4	-4	-4
Scottish Child Payment	-12					
Uprating						
Best Start Grant, Child Winter Heating Assistance and Funeral Support Payment		0	0	0	0	0
Scottish Child Payment		0	-1	-1	-1	-1
Total policy changes	44	13	11	4	-3	-7

Source: Scottish Fiscal Commission, Scottish Government.
Positive figures are increases in spending, negative figures are decreases in spending.
Figures may not sum because of rounding.
Removing Child Winter Heating Allowance from Child Disability Payment to its own benefit is not included as it is cost neutral.
Moving the extension of the upper age limit to our baseline Disability Living Allowance (Child) forecast rather than a Child Disability Payment cost has a net immaterial effect on spending so it is not included.

5.41 In **Annex A** we show the cost of policies announced in the 2021-22 Scottish Budget which includes the decision to uprate some payments for 2021-22. We also show the cost of the Self-Isolation Support Grant and the extension of Fair Start Scotland as we have not previously costed these policies.

Additional funding

5.42 The Discretionary Housing Payments forecast has increased by £6 million for 2020-21. An additional £5 million of funding was announced during the passage of the Coronavirus (Scotland) (No.2) Bill with a further £3 million announced in the Programme for Government, offset by a £2 million reduction as the additional funding that was planned for care-experienced young people has not been spent and is removed from all years of our forecast.[82]

5.43 In March 2020, the Scottish Government announced an additional £45 million for the Scottish Welfare Fund in 2020-21, of which £22 million was allocated immediately to local authorities and is included in our forecast.[83] Of the original £45 million, £3 million has been diverted to the extra Discretionary Housing Payment funding announced in the Programme for Government as noted in the previous paragraph. Local authorities have been given flexibility about how they use the

[82] Scottish Government (2020) Extra funding to support tenants (link), Scottish Government (2020) Protecting Scotland, Renewing Scotland: The Government's Programme for Scotland 2020-2021 (link).
[83] Scottish Government (2020) Funding for those who need it most (link)

remaining £20 million to best support people in their communities. We do not include this funding in our forecast but councils may spend some of it on the Scottish Welfare Fund or Discretionary Housing Payments.

5.44 A two-year extension of Fair Start Scotland was announced in July 2020.[84] This adds a total of £50 million to the forecast from 2021-22 onwards. We assume that this will involve another 29,000 participants, with the same success rates as in the original Fair Start Scotland. There was also a change in the way that service providers were paid in 2020-21, referred to as the 'Costs Plus' payments model, which increased spending by £6 million.

New payments

5.45 The Scottish Government announced a one-off Coronavirus Carer's Allowance Supplement as part of the Coronavirus (Scotland) (No.2) Bill. We estimated the cost of this additional payment to accompany the legislation at £19.2 million and we have revised it down slightly to £19.0 million.[85]

Self-Isolation Support Grant

5.46 In September 2020, the Scottish Government announced a new payment to support people on low incomes if asked to self-isolate.[86] The Self-Isolation Support Grant is a £500 payment and is delivered through the existing Scottish Welfare Fund, which is administered by local authorities. We provide more details on our Self-Isolation Support Grant forecast in Annex A.

Start dates

5.47 The Scottish Government has had to review their timeline for the launch of new social security payments as a result of the effect of COVID-19 on their operations and also their delivery partners such as DWP. The start date for both the Scottish Child Payment and Child Disability Payment have been pushed back and the financial effect of these decisions is shown in Figure 5.16.

5.48 To be able to produce our forecast for Child Disability Payment we need to make an assumption about the launch date and also when existing Disability Living Allowance recipients will transfer to Child Disability Payment, referred to as case transfer. We are assuming Child Disability Payment will launch fully in November 2021, with the case transfer starting at the same time and completing before the end of financial year 2022-23. These assumptions are highly uncertain and present a risk to our Child Disability Payment forecast.

5.49 Changing the Child Disability Payment start date has a long-term effect on the forecast as instead of having increased inflows from September 2020 until the end of the forecast period, we only have increased inflows from November 2021 onwards. This means that we have 15 months less of increased inflows, and our caseload is lower throughout the forecast period, compared to what we forecast in February.

Uprating

5.50 The Scottish Government has announced that the payment amounts for Best Start Grant, Child Winter Heating Assistance and Funeral Support Payment will be increased by 1.0 per cent for 2021-22 which is 0.5 per cent higher than the inflation-adjusted level of assistance. There is no

[84] Scottish Government (2020) £100 million for employment support and training (link)
[85] Scottish Fiscal Commission (2020) Supplementary Costings – Coronavirus (Scotland)(No. 2) Bill – May 2020 (link)
[86] Scottish Government (2020) New grant for those self-isolating (link)

statutory duty to uprate Best Start Grant and Child Winter Heating Assistance by inflation each year while there is for Funeral Support Payment. This is the first time that Best Start Grant and Child Winter Heating Assistance have been uprated. Overall this change has a minimal effect on spending and is shown in Figure 5.16.

5.51 In February 2020, we assumed the Scottish Government would uprate the Scottish Child Payment amount in 2021-22. Uprating for the Scottish Child Payment will not start until 2022-23 as set out in the Scottish Government's response to the Scottish Commission on Social Security's recommendations on uprating.[87] This reduces annual spending by around £1 million as shown in Figure 5.16.

Update on policy costings

5.52 In our February 2020 publication, we provided our initial policy costings of Child Disability Payment, the Scottish Government's replacement for Disability Living Allowance (Child) and the Scottish Child Payment.[88] We now provide a brief update on both costings.

Child Disability Payment

5.53 Our Child Disability Payment policy costing compares the increased costs of the new payment against a baseline forecast of Disability Living Allowance (Child) spending. In Figure 5.17 we provide our updated policy costing, the additional spending expected because of Child Disability Payment. We also show the additional spending we expect for Carer's Allowance as a result of the increased caseload for Child Disability Payment compared with Disability Living Allowance (Child).

Figure 5.17: Child Disability Payment policy costing

£ million	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Baseline forecast	208	228	257	282	299	315
Application process		1	7	11	14	16
Average award		1	3	6	8	10
Other costs [1]		0	2	3	5	6
Child Disability Payment forecast	208	231	269	302	325	348
Policy costing		3	12	20	26	33
Carer's Allowance spending [2]		0	2	4	6	8

Source: Scottish Fiscal Commission
Figures may not sum because of rounding.
[1] 'Other costs' include Short Term Assistance, terminal illness and award duration policy costs.
[2] Additional cost to Carer's Allowance because of the introduction of Child Disability Payment.

5.54 As well as the change in the start date that we have discussed earlier in this section and our regular data updates, there have been two other changes to our policy costing since February 2020. Firstly, the Scottish Government policy change to extend the age a young person can receive payment to 18 is now reflected in our baseline Disability Living Allowance (Child) forecast, rather than as a Child Disability Payment cost. Under new Scottish Government policy, young people will continue to

[87] Scottish Government (2020) Scottish Child Payment regulations : Response to report (link)
[88] Scottish Fiscal Commission (2020) Scotland's Economic and Fiscal Forecasts – February 2020 (link)

receive Disability Living Allowance, as long as they remain eligible, up to the age of 18.[89] This reduces the policy cost of Child Disability Payment, with the net effect being immaterial.

5.55 The second change is an increase in the average award forecast. In our February 2020 forecast, we assumed that the average award for Child Disability Payment would be consistent with our forecast of the average award for Disability Living Allowance (Child). Given more detailed policy information about how Social Security Scotland will make award decisions since our previously published forecast, we have decided to review this assumption.[90]

5.56 We now assume that the levels of award given to recipients by Social Security Scotland will be higher, on average, compared to DWP. In the absence of data, we have assumed that the average award for new Child Disability Payment recipients will be 10 per cent higher than for Disability Living Allowance (Child). Looking at the historical real average award for Disability Living Allowance (Child) for the last 10 years, we can see that it has been close to 10 per cent higher than it is now, so this assumption seems reasonable. This increases the Child Disability Payment policy costing.

5.57 We also note that in our February 2020 forecast, Child Winter Heating Assistance was shown as part of the Child Disability Payment costing whereas now it is a standalone payment.

Scottish Child Payment

5.58 We produced an updated forecast for the Scottish Child Payment in September 2020 to accompany the secondary legislation.[91] We have made further changes to our Scottish Child Payment forecast since then and these are summarised in Figure 5.18.

Figure 5.18: Change in Scottish Child Payment forecast spending since September 2020

£ million	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
September 2020	11	77	111	184	179	180
Assumption - Inflation				-1	-1	-1
Assumption - Eligibility	-1	-8	-8	-7	-3	-5
Assumption - Take-up	-1	0	3	8	8	8
Assumption - Population	0	0	0	0	0	0
January 2021	9	68	105	184	183	182
Change since September 2020	-3	-9	-5	1	4	3

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2020) Supplementary Costing – Scottish Child Payment (link). Figures may not sum because of rounding.

5.59 We have a lower eligibility assumption than in September, as the outlook for unemployment has improved relative to expectations in summer 2020, and new data and modelling suggest that the rise in the number of families with children who are claiming Universal Credit is relatively muted.

5.60 We have reduced our view of the take-up rate this year in light of the slower than anticipated build-up of applications through November and December. We have increased the assumed take-up rate for older children from 2022-23 in light of the upward revisions to our view of the take-up rates that have already been achieved for Best Start Grant in 2019-20.

[89] Scottish Government (2020) 16 year olds will no longer need to apply for PIP in Scotland (link)
[90] Scottish Government (2020) Social security: policy position papers: 2020 – October update (link)
[91] Scottish Fiscal Commission (2020) Supplementary Costing – Scottish Child Payment (link)

Forecast uncertainty

5.61 Most social security spending in 2021-22 will be on payments where policy is largely unchanged and we have existing data. Overall we consider our forecasts of social security spending to be more certain than our tax forecasts which are more volatile and will be affected to a greater extent by COVID-19 and the associated restrictions.

5.62 The COVID-19 crisis nevertheless adds uncertainty to our forecasts. Our central assumptions for COVID-19 are summarised in Figure 1.1. A materially different pathway of COVID-19 and restrictions would mean security spending could be significantly different from our forecasts.

5.63 For 2021-22, most social security spending is associated with benefits that will continue to be administered by DWP and have an associated Block Grant Adjustment. Overall, we would be expecting spending in Scotland to be moving in line with the Block Grant Adjustment as there is no obvious reason why it would not. There are significant risks to our forecasts for these benefits, largely as a result of COVID-19 as outlined in Box 5.3, but our expectation is that these would be offset by similar changes in spending in England and Wales.

Box 5.3: COVID-19 risks to spending

Long-term health effects: COVID-19 has direct health effects on those who contract the virus, and for some people these effects may be serious and long-term. This may increase demand for benefits related to ill-health and disability. In addition there may be indirect health effects arising because of the economic and social restrictions put in place to manage COVID-19. These effects will be on both mental and physical health, for example as a result of increased stress or anxiety, reduced physical activity and potentially having reduced or delayed access to healthcare. We expect this to increase demand for Personal Independence Payment and have assumed increased spending in all years of our forecast. If there are higher or lower numbers of additional claimants this will affect our forecasts.

Excess deaths: Our forecasts take account of the number of deaths above the five-year average, also referred to as excess deaths. Our central assumptions are set out in Figure 1.1. and we assume the second wave results in excess deaths throughout 2021 Q1. In 2021 Q2, excess deaths gradually return to the level seen from June to September 2020. Deaths directly affect our Funeral Support Payment forecasts with the number of excess deaths being reflected in higher levels of claims since March 2020. As many of those who have died are over the age of 65, the excess deaths have also reduced the number of people in receipt of Attendance Allowance and to a lesser extent, Industrial Injuries Disablement Scheme and Disability Living Allowance.

Future economic and social restrictions: Our forecasts assume some level of economic and social restrictions continue throughout 2021. If these restrictions are more stringent or last longer than we have assumed in Figure 1.1. then the effects on spending may be greater. If we take Personal Independence Payment as an example, we noted that during the lockdown in spring 2020 there were fewer applications for support which reduces spending. This was initially countered by fluctuations in award success rates as DWP made operational changes in response to the pandemic, although award rates do now seem to be returning to pre COVID-19 levels.[92]

[92] DWP (2020) Personal Independence Payment: Official Statistics to October 2020 (link)

5.64 Divergences between the income received from Block Grant Adjustments and the forecast spend are more likely to occur when the Scottish Government launches new payments. New payments may not have funding from the UK Government, as is the case with the Scottish Child Payment. Or the funding will be based on the UK equivalent benefit, as will be the case for the Child Disability Payment, but there may be differences in policy between the UK benefit and the new Scottish payment that could mean funding and spending diverge.

5.65 For 2021-22, we have determined that the most significant risk to the social security spending forecast is in the Scottish Child Payment and Child Disability Payment forecasts. As these are new payments we do not have historical data on which to base our forecast. New policies are always harder to forecast as it is inherently more difficult to predict how many people will be eligible and claim the payments. We discuss these risks further in the section on sensitivities.

5.66 We also noted in this year's Forecast Evaluation Report that forecast errors are relatively larger for the newer benefits where we have little or no data on which to base our forecasts.[93] This was borne out by our evaluation of our forecast performance for 2019-20 where spending was only 1 per cent above our forecast for the areas where we had data, but 9 per cent higher for the newer payments and services.

5.67 Over time more of our forecasts are based on data which reflects new Scottish Government policy rather than assumptions about how many people would be eligible and claim. For example we now have over a year's worth of data for Best Start Foods, Funeral Support Payment and the Best Start Grant. Although the effects of COVID-19 have increased the number of people eligible for the payments and increased spending, we receive regular information from Social Security Scotland on spending and have used these data to inform our forecasts.

5.68 There is a risk that spending is higher for the payments that are already being administered by Social Security Scotland. This is particularly true for Best Start Grant, Best Start Foods and Funeral Support Payment given the increase in Universal Credit applications we are seeing as a result of COVID-19. However, these three payments are relatively small in size with total spending of £42 million in 2021-22. If spending increases by 10 per cent, more than our forecast error for new payments in our recent forecast evaluation, this would be an additional £4 million of spend in 2021-22 which may be easier for the Scottish Government to manage in-year.

Sensitivities

5.69 The Commission is required to present a single set of forecasts for social security, but in reality these represent a central point within a broad range of possible outcomes. For spending on the Scottish Child Payment and Child Disability Payment we discuss here how much we might expect spending to vary if we altered some of our forecast assumptions. We consider the number of new awards to be the most difficult assumption as it is dependent on how many people apply as well as how many people are eligible, both of which can be hard to predict.

5.70 In the case of the Scottish Child Payment there is no equivalent payment which is being replaced and therefore no historical data on which to base our forecast. We have considered the experience and data from the Best Start Grant which is a one-off payment with similar eligibility, and Best Start Foods, which has narrower age and income criteria but a similar recurring payment structure. Social Security Scotland had received 63,000 applications for the Scottish Child Payment by mid-January. After an initial spike when applications were opened in November, the weekly number of

[93] Scottish Fiscal Commission (2020) Forecast Evaluation Report (link)

applications has fallen.[94] If applications continue at this lower level then take-up will fall below our forecast, but we anticipate that the number of applications will increase in the run-up to the mid-February start date as a result of further promotional activity from the Scottish Government.

5.71 In the case of the Child Disability Payment, which will replace Disability Living Allowance (Child), although the structure of the benefit is broadly unchanged the new payment will have different application routes and different approaches for determining and reviewing awards. The Scottish Government has set out its policy intent for Child Disability Payment but as this is the first disability assistance to be launched it is difficult to estimate how these new policies will increase spending. The increase in spending is dependent on the behaviour of those applying for support and the Social Security Scotland staff who will be making decisions.

5.72 We also present sensitivities for the average award value, only relevant for the Child Disability Payment, and the number of births expected in Scotland.

Figure 5.19 – Social security sensitivities: spending in 2021-22 if assumptions differ to forecast

£ million	New awards 10% higher than forecast	New awards 10% lower than forecast	Average awards 10% higher than forecast	Number of births 10% higher than forecast
Child Disability Payment [1]				
Change in spending	0.4	-0.4	1.1	
Scottish Child Payment [2]				
Change in spending	6.8	-6.8		1.1

Source: Scottish Fiscal Commission

[1] For Child Disability Payment, an increase in the number of births has a negligible effect on spending.

[2] For Scottish Child payment, a change in new awards is simply a change in the forecast caseload for 2021-22.

5.73 There is an equivalent UK Government benefit for Child Disability Payment, so the proportion of the caseload that is a new award is low. For the Scottish Child Payment, a 10 per cent variation on our forecast number of awards is a 10 per cent variation in the total caseload and is therefore a greater risk to the spending forecast. Additionally, Child Disability Payment will be introduced part-way through 2021-22, whereas Scottish Child Payment will be paid for the full year. Variations in our assumptions for Child Disability Payment pose much less risk to the 2021-22 Budget than variations in our assumptions for the Scottish Child Payment.

[94] Social Security Scotland (2021) Scottish Child Payment applications, 9 November 2020 – 17 January 2021 (link). When we closed our forecasts to new data on 7 January 2021, Social Security Scotland had received 56,000 applications.

Illustrative forecasts

5.74 We provide illustrative forecasts based on current UK Government policy for Cold Weather Payment and Winter Fuel Payment. Executive competence for these benefits has yet to be transferred to the Scottish Government and the expectation is that DWP will continue to make these payments to people in Scotland for winter 2021.

Figure 5.20: Illustrative spending for Cold Weather Payment and Winter Fuel Payment

£ million	2021-22	2022-23	2023-24	2024-25	2025-26
Cold Weather Payment	15	15	15	15	15
Winter Fuel Payment	169	172	175	180	184

Source: Scottish Fiscal Commission

5.75 Spending on Winter Fuel Payment increases over time because the pension age population in Scotland is forecast to increase.

5.76 Our forecast of Cold Weather Payment spending is based on a historic average of the spending in previous years. There is significant uncertainty on the level of spending because of the unpredictable nature of the weather. Therefore a simplistic approach has been taken to forecast expenditure, aligned with the funding arrangements in the fiscal framework.[95]

[95] The agreement between the Scottish Government and the United Kingdom government on the Scottish Government's fiscal framework (link)

Annex A
Policy costings

Introduction

A.1 This annex sets out the different steps and judgements taken to arrive at our costings of the Scottish Government's new policy proposals.

A.2 This section only provides costings for policy changes which we have not previously costed. Where we have previously provided a policy costing, any further changes will be captured in **Annex B** on policy recostings.

A.3 **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.

New policy costings

A.4 Figure A.1 provides a summary of new policy costings included in our forecasts. Negative figures represent lower tax revenue or higher social security spending and positive figures represent higher tax revenue or lower social security spending.

A.5 There have been three policy changes for Non-Domestic Rates which we cover in more detail later in the Annex. We also provide additional information on how we produced our costing for the new Self-Isolation Support Grant.

Fair Start Scotland

A.6 A two-year extension of Fair Start Scotland was announced in July 2020.[96] This adds a total of £50 million to the forecast from 2021-22 onwards. We assume that this will involve another 29,000 participants, with the same success rates as in the original Fair Start Scotland. There was also a change in the way that service providers were paid in 2020-21, referred to as the 'Costs Plus' payments model, which increased spending by £6 million.

Uprating

A.7 The Scottish Government has announced that the payment amounts for Best Start Grant, Child Winter Heating Assistance and Funeral Support Payment will be uprated by 1.0 per cent for 2021-22. Best Start Grant and Child Winter Heating Assistance were not previously uprated whereas Funeral Support Payment has been uprated by the CPI rate which was 0.5 per cent for 2021-22 uprating. This has a minimal effect on spending and is shown in Figure A.1.

[96] Scottish Government (2020) £100 million for employment support and training (link)

Figure A.1: Policy costings to accompany the Scottish Budget 2021-22

£ million	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Non-Domestic Rates						
Setting the 2021-22 poundage at 49.0p		-63	-64	-69	-68	-67
Changing the eligibility criteria for the BGAc relief		-2	-3	-5	-5	-5
100 per cent relief for RHL and aviation for the next three months		-185				
Social security						
Fair Start Scotland	-6	-17	-18	-11	-4	-0
Self-Isolation Support Grant	-5	-6				
Uprating		-0	-0	-0	-0	-0
Overall effect of new policy proposals	-11	-274	-86	-85	-78	-72

Source: Scottish Fiscal Commission

Figures may not sum because of rounding.

Non-Domestic Rates

Title of measure

Setting the poundage at 49.0 pence

Measure description

A.8 The Scottish Government has announced that the poundage (the basic rate of tax applied to a property's rateable value) for 2021-22 will be set at 49.0 pence. From 2022-23 onwards it is assumed that the poundage will revert to being uprated in line with the Consumer Prices Index (CPI).

The cost base

A.9 This measure affects the entire NDR tax base, so the cost base is our latest forecast of NDR income.

The costing

A.10 The costing is the difference in NDR revenue over our five-year forecast horizon in two scenarios:

- the Scottish Government's policy baseline, which was to uprate the poundage by CPI in 2021-22
- poundage of 49.0 pence in 2021-22

A.11 In both scenarios, OBR forecasts of Q3 CPI are used to estimate the poundage in subsequent years. Comparison between these two scenarios shows NDR income to be £63 million lower in 2021-22 as a result of this change. This reduction in revenue continues through each year of the forecast. Figure A.2 shows the final costing.

Figure A.2: Cost of setting the poundage at 49.0 pence in 2021-22

£ million	2021-22	2022-23	2023-24	2024-25	2025-26
	-63	-64	-69	-68	-67

Source: Scottish Fiscal Commission

Uncertainties about the costing

A.12 There is a low level of uncertainty attached to this costing as the poundage for 2021-22 has been confirmed by the Scottish Government.

Title of measure

Changing eligibility criteria for the BGAc relief

Measure description

A.13 A property that has had an increase in rateable value because of a change to the use of the property is not currently eligible to receive Business Growth Accelerator (BGAc) relief on that increase. From 1 April 2021, the Scottish Government will extend eligibility for the BGAc relief available on property improvements to include properties where there has been a change of use.

The cost base

A.14 This measure affects any property where there has been an increase in the rateable value as a result of a change in the use of the property.

The costing

A.15 The costing uses the valuation roll to identify properties where there has been an increase in rateable value that is likely to have been the result of a change of use. We compare snapshots of the valuation roll over time and compare the rateable values, as well as the property 'core' and 'description' fields of the entries. These two fields are used to describe the type of property so changes in these fields can help to identify where there might have been a change of use. We exclude cases where the core field indicates that there are no buildings present, for example fields marked 'ground', as premises without buildings are not eligible for BGAc relief.

A.16 We merge this list of properties with the latest billing system data to see which were already claiming other reliefs. There would be no net cost associated with extending the BGAc relief for these properties. Our final costing includes the cost of extending BGAc relief for those properties in the list which were not claiming the relief or, for those who claim less than 100 per cent relief, the cost of providing relief up to 100 per cent. Figure A.3 shows the final costing.

Figure A.3: Cost of changing eligibility for the BGAc relief

£ million	2021-22	2022-23	2023-24	2024-25	2025-26
	-2	-3	-5	-5	-5

Source: Scottish Fiscal Commission

Uncertainties about the costing

A.17 There is a high level of uncertainty attached to this costing as the method used to identify eligible properties on the valuation is only an approximation. This analysis was also conducted on historical snapshots of the valuation roll and billing system data, before the effects of the COVID-19 pandemic. While we have tried to account for the pandemic by scaling our estimate of the policy costing in line with our beliefs about the future costs of the BGAc relief more generally, it is important to note that BGAc is still a relatively new relief and there is a limited amount of historical data on which to base our judgement. Nevertheless the cost of the policy is small so this costing is not a significant risk to the forecast.

Title of measure

100 per cent relief for the retail, hospitality and leisure and the aviation sector for three months

Measure description

A.18 The current 100 per cent relief for properties in the retail, hospitality and leisure sectors and aviation sector expires on 31 March 2021. The Scottish Government has announced that these properties will receive 100 per cent relief for the first three months of 2021-22. Eligible ratepayers will need to apply for the relief in 2021-22, whereas it was automatically applied in 2020-21.

The cost base

A.19 The cost base is eligible properties in the aviation sector and the retail, leisure and hospitality sectors, excluding those that committed to donating an amount equivalent to the relief they received in 2020-21 to the Scottish Government.

The costing

A.20 We use data from the billing system to identify the properties that received the relief in 2020-21 and start from the assumption that the cost base in 2021-22 will be similar to that in 2020-21, with the exception of those supermarkets and other retailers that have committed to repaying the relief that they received in 2020-21. The relief was automatically applied in 2020-21 and a number of retailers that have not seen a reduction in trade as a result of the pandemic have committed to donating the amount of their 2020-21 relief to the Scottish Government. In light of these public commitments, we assume these retailers will not claim the relief in 2021-22 and exclude them from our calculation.

Figure A.4: Cost of extending the RHL and aviation relief by three months

£ million	2021-22
	-185

Source: Scottish Fiscal Commission

Uncertainties about the costing

A.21 There is a high level of uncertainty around this costing. The Scottish Government has confirmed it intends to offer the relief without a cap applied under the terms of the UK-EU Trade and Cooperation Agreement.[97] We note this may be reconsidered in light of legal advice or revisited following the UK Budget. If the cap of 325,000 Special Drawing Rights over any period of three fiscal years was applied we estimate the cost of the relief would be £22 million lower, at £163 million.

A.22 We assume that those retailers who committed to donating the amount received in 2020-21 will not claim it in 2021-22. If the cap described above applied, this assumption would make little difference to the costing. Without the cap, if these retailers did claim the relief in 2021-22, the cost of the policy would increase to £231 million.

A.23 We assume all other eligible ratepayers will claim the relief. They are already likely to be aware of the relief given that it was available in 2020-21 and the incentive to apply will be considerable. Should any ratepayers not claim relief, we would expect these to be concentrated among properties

[97] UK Government (2020) EU-UK Trade and Cooperation Agreement (link)

with low rateable values or those already receiving another relief covering a significant proportion of their NDR Bill and so not significantly affect the costing.

A.24 It is possible that the Scottish Government might revisit this relief following the UK Budget and that other details of the relief could be changed at this point. If it was decided to extend the relief for a longer period, this would raise the cost significantly.

Self-Isolation Support Grant

Title of Measure

Self-Isolation Support Grant introduced in October 2020

Measure Description

A.25 The Self-Isolation Support Grant (SISG) is a new payment of £500 for anyone receiving a qualifying benefit who is required to self-isolate because of COVID-19 and cannot work from home.[98] The new payment was introduced in October 2020 and the route for payment is through the Scottish Welfare Fund. From December 2020 the grant was extended to parents of children required to self-isolate and to those who would be deemed eligible for Universal Credit but are not receiving payment.

The cost base

A.26 The cost base is all individuals who are eligible and apply for the Self-Isolation Support Grant.

The costing

A.27 Spending on the SISG will depend on the number of COVID-19 cases and the number of people required to self-isolate. We assume the COVID-19 pandemic will continue throughout 2021 as described in Figure 1.1. There will still be cases of COVID-19, individuals required to self-isolate and therefore eligible for payment throughout this period. We assume the number of awards is highest in January, reduces slightly in February and March and then continues to fall during the rest of the year.

A.28 We use information on spending on the SISG in November relative to the number of cases seen in the same period to project spending for the period from December to March. We assume spending gradually reduces from April 2021 and that there is no spending beyond the 2021-22 financial year.

Figure A.5: Self-Isolation Support Grant

£ million	2020-21	2021-22
Self-Isolation Support Grant	5	6

Source: Scottish Fiscal Commission

Uncertainties about the costing

A.29 We attach a high degree of uncertainty to our SISG forecast, there are significant uncertainties about how the pandemic will evolve and therefore the numbers of people required to self-isolate. Our central assumption is that by 2021 Q4 a sufficient proportion of the population have been vaccinated to allow a significant easing of restrictions. The efficacy and duration of the vaccines is likely to affect the requirement to self-isolate. A slower vaccine roll-out or lower efficacy could lead to higher spending, and vice-versa.

[98] Scottish Government (2020) Self-Isolation Support Grants (link); Scottish Government (2020) More people can claim Self-Isolation Support Grant (link).

A.30 Activity by the Scottish Government could also affect future spending, for example if there was greater promotional activity by the Scottish Government or local authorities which increased take-up of the payment.

Annex B
Policy recostings

B.1 A policy recosting is a revised estimate of a policy that has been previously costed. There are two main reasons why we may recost previously announced or implemented policies:

- The outturn administrative data that includes the effects of the policy change is not yet available. For example, the 2019-20 income tax policy will not be present in the outturn data until summer 2021.
- We revise key judgments or assumptions relating to our previous policy costings – particularly in response to new evidence.

B.2 This Annex sets out the latest policy recostings and how they have changed from the previous costing. Negative figures represent lower tax revenue or higher social security spending and positive figures represent higher tax revenue or lower social security spending.

Figure B.1: Latest policy recostings

£ million	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Income Tax							
2019-20 policy	68	66	69	72	75	79	84
2020-21 policy		48	49	52	54	57	61
NDR							
Devolution of Empty Property Relief					88	91	93
Properties not in active occupation			15	16	16	16	17
Mainstream independent schools no longer eligible for charity relief			7	7	7	7	7
Commercial activity in currently exempt parks					2	2	2
Empty Property Relief reset period			3	3	3	3	3
Delaying the next revaluation by one year [1]				-115	44	119	64
Continuing transitional relief (offices - Aberdeen and Aberdeenshire only)			0	0			
Continuing transitional relief (hospitality)			-2	-1			
LBTT							
New tax band for non-residential leases		8	9	9	10	10	10
ADS repayment period extension		-4	-8	-3	-0		
Rise in residential LBTT nil rate band, of which		-34	-15	0	0		
Effect on residential LBTT		-41	-10				
Effect on ADS		6	-5	0	0		

Source: Scottish Fiscal Commission

[1] The delay to the next revaluation doesn't appear in Figure B.2 as it was announced in September 2020 in the Scottish Government's Program for Government (link).

Figure B.2: Change since February 2020

£ million	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Income Tax						
2019-20 policy	1.1	-3.7	-4.3	-4.7	-5.5	-5.9
2020-21 policy		-3.7	-4.7	-4.6	-5.4	-6.0
NDR						
Devolution of Empty Property Relief				-101.5	-14.6	-11.4
Properties not in active occupation			-2.4	-5.7	-5.6	-4.9
Mainstream independent schools no longer eligible for charity relief		-4.1	-0.2	-0.5	-0.5	-0.2
Commercial activity in currently exempt parks				-1.7	-0.1	0.0
Empty Property Relief reset period			-0.1	2.8		
Continuing transitional relief (offices - Aberdeen and Aberdeenshire)			0.0	0.0		
Continuing transitional (hospitality) relief			1.1	-1.3		
LBTT						
New tax band for non-residential leases		-2.3	-1.7	-1.8	-1.9	-1.9
ADS repayment period extension		-0.1	0.2	0.2	0.0	
Rise in residential LBTT nil rate band, of which:		-1.8	0.6	-0.1	0.0	
Effect on residential LBTT		-1.5	0.2			
Effect on ADS		-0.3	0.4	-0.1	0.0	

Source: Scottish Fiscal Commission

Annex C Materiality

Introduction

C.1 The tax revenues devolved to Scotland will amount to over £15.6 billion in 2021-22 increasing to £18.7 billion by 2025-26. Devolved social security spending equates to £3.6 billion in 2021-22, and reaches £4.2 billion by 2025-26. Some policies announced by the Scottish Government will have a very small effect relative to the size of the Scottish Budget.

C.2 The OECD review conducted in 2019 recommended that:

"As a new institution, the SFC has been under pressure to prove its capabilities in delivering its tax and benefit forecasts. As new areas were devolved, the SFC developed more detailed models for forecasting smaller tax and spending areas than peer IFIs might have done, given their relative fiscal immateriality. Now that it is more established, the SFC should dedicate greater resources to areas that are more important for the Scottish Budget." [99]

C.3 The Commission's approach to materiality was first introduced in our December 2018 Scotland's Economic and Fiscal Forecasts publication.[100] We have reviewed how our materiality policy should be applied in the context of this growing budget and have consulted with the Scottish Government and other stakeholders. We have decided to increase our materiality thresholds and this annex sets out our updated approach.

C.4 We also consider materiality in our approach to error corrections, published in our statement of compliance with the Code of Practice for Statistics.[101] We categorise errors based on materiality and then use this categorisation to help us decide on an appropriate response.

Materiality policy

Negligible policies

C.5 The Commission has set thresholds under which policies will be deemed to be negligible and therefore will not be costed. The threshold for negligible policies is **£2 million**. This is an increase from our previous threshold of £0.5 million.

Small policies

C.6 For policies with a low estimated cost, a decision will be made whether to cost the policy or not. The threshold for small policies is **£5 million**. This is an increase from our previous threshold of £2 million.

[99] OECD (2019) Independent Fiscal Institutions Review – Scottish Fiscal Commission (link)
[100] Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 (link)
[101] Scottish Fiscal Commission (2018) Statement of Voluntary Compliance with the Code of Practice for Statistics (link)

C.7 Our decision as to whether or not to cost a small policy is unchanged from December 2018 and 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 of taxpayers to a change in the tax or social security recipients to changes in social security

C.8 In addition we also consider the level of political and media interest in the cost of the policy. We will next review our materiality policy in two years' time, ahead of the 2023-24 Scottish Budget.

Materiality decisions for the Scottish Budget 2021-22

C.9 The Commission has decided not to cost the following policies for the 2021-22 Scottish Budget:

- The Scottish Government has announced there will be a pilot of Child Disability Payment that starts in summer 2021 in advance of the full launch in autumn 2021.[102] We estimate that the additional spending in the three pilot areas in advance of full launch is negligible and therefore have not included this in our forecast.
- There will also be a pilot for Adult Disability Payment that will start in spring 2022 so there may be some spending in financial year 2021-22.[103] This very much depends on when exactly the pilot launches, but we estimate the costs for financial year 2021-22 are under our threshold for small policies of £5 million. We have assumed the scale and duration of the pilot will be similar to the Child Disability Payment pilot in making this assessment, though arrangements for the pilot have not yet been publicly confirmed.
- The Scottish Government has published guidance for local authorities' decisions on whether to grant discretionary sports clubs relief from Non-Domestic Rates. The policy will commence on 1 April 2021. A costing of £3 million was included in the Barclay Review of Non-Domestic Rates. We estimate that this policy change will fall below our £5 million threshold for small policies.
- The Scottish Government has announced that from 1 April 2021, the rateable value threshold for Fresh Start relief from Non-Domestic Rates will be increased from £65,000 to £95,000. We estimate that the change will fall under our £2 million threshold.
- From 1 April 2021 to 31 March 2024 district heating networks installed on or after 1 April 2021 and that are powered by renewables, energy from waste or waste heat will receive 90 per cent relief, rather than 50 per cent. As the current estimate of the relief is £400,000, we estimate that this change will fall below our £2 million threshold for negligible policies.

[102] Scottish Government (2020) Child Disability Payment pilot areas announced (link)
[103] Scottish Government (2020) Child Disability Payment to be introduced next summer (link)

Assessing cumulative materiality

C.10 One of the criteria in deciding whether or not to cost small policies is to check if the cumulative policy changes would be above our materiality threshold.

C.11 In Figure C.1 we show where we have applied our materiality policy, introduced in December 2018:

Figure C.1: Policies not costed since December 2018

Policy	Description and reason not to cost	Timing of initial materiality decision
Social Security Administration and Tribunal Membership (Scotland) Bill	This is a series of administrative changes which we believe will have no material effect on benefit spending.	In advance of the bill being introduced in April 2020
Non-Domestic Rates – Reverse Vending Machine Relief	Reverse Vending Machines will be added to the valuation roll but will be eligible for 100 per cent relief. Hence, there is no effect on NDR income.	Scotland's Economic and Fiscal Forecasts February 2020
The Revenue Scotland Tax Powers Act 2014 (Amendment) Regulations 2020	This is an administrative change we believe will have no financial implications.	Scotland's Economic and Fiscal Forecasts February 2020
Young Carer's Grant	A one-off annual payment for young carers in Scotland aged 16, 17 or 18 who meet certain conditions, with an estimated cost of less than £1 million each year.	Scotland's Economic and Fiscal Forecasts December 2018

Source: Scottish Fiscal Commission

There have also been a large number of Scottish Statutory Instruments for social security which have no material impact on benefit spending as they relate to administrative changes or bring into force sections of the Social Security (Scotland) Act 2018.

C.12 We will also keep under review the policies we have previously not costed to ensure that none of these are now above the thresholds.

Annex D
Monte Carlo simulations of income tax reconciliations

Introduction

D.1. The reconciliation of our forecast of Scottish income tax (SIT) with the OBR's forecast of the income tax Block Grant Adjustment (BGA) can have a substantial effect on the Scottish Budget. While there have only so far been two income tax reconciliations we have had a greater number of forecasts by us and OBR of SIT and income tax BGAs respectively, so we have some understanding of the distribution of the errors in these forecasts.

D.2. Drawing on this information, we have carried out analysis to help improve understanding of the likely variation of reconciliations. This analysis is based on an approach called Monte Carlo simulations. We simulate a large number of forecasts of SIT and BGA which are then combined to generate a distribution of reconciliation figures.

D.3. The Scottish Government's borrowing powers are set out in the fiscal framework and amount to a total of £300 million for forecast errors in any fiscal year.[104] Extended borrowing powers of £600 million are available if a Scotland specific economic shock occurs. See Chapter 2 for further discussion. From our simulations we can make an estimate of how frequently a reconciliation of greater than £300 million might occur. We can also calculate how frequently reconciliations will exceed these limits.

Method

D.4. We make assumptions about the likely distributions of SIT and BGA errors, and use this to model the distribution of reconciliations. In our central case we assume that:

- SIT and BGA errors follow a normal distribution
- Based on OBR historic income tax forecast errors over the period 2010 to 2019, both SIT and BGA have an assumed average absolute forecast error of 5.7 per cent, which we take as the variance of the distribution in our central case
- There is positive correlation between SIT and BGA forecast errors – though there is limited evidence of how correlated SIT and BGA forecast errors might be in practice. We assume 50 per cent correlation in our central case
- SIT and BGA have an expected value of £12,000 million.

D.5. We simulate 100,000 SIT and BGA forecast errors based on these assumptions, and calculate the resulting reconciliations. We can then describe the distribution of reconciliations and how likely different values are to occur. We also investigate what happens if we vary the parameters of the simulation to represent different distributions of the forecast errors.

[104] The agreement between the Scottish Government and the United Kingdom government on the Scottish Government's fiscal framework (link)

D.6. Importantly, this approach does not help us to know what to expect about any single reconciliation. Instead, by making certain assumptions about the statistical properties of forecast errors, we can learn about the possible statistical properties of reconciliations over the longer term. However, even if forecast errors are typically low, and correlation in forecast errors is typically high, large income tax reconciliations could still occur from time to time.

Results

D.7. The results of our simulations are presented in Figure D.1. The table reports the likelihood of income tax reconciliations exceeding certain threshold values. In our central case of an average 5.7 per cent forecast error and 50 per cent correlation, we estimate that a negative reconciliation exceeding £300 million will occur 27 per cent of the time, or approximately three years in ten. A negative reconciliation exceeding £600 million will occur 12 per cent of the time, or approximately one year in ten. As the distribution of reconciliations is close to symmetrical the likelihoods of the positive reconciliations are very close to the likelihoods of negative reconciliations. We might expect that only 15 per cent of income tax reconciliations are less than £100 million, positive or negative.

Figure D.1: Selected results from simulated reconciliation distributions (likelihood of threshold being exceeded)

Forecast error (Per cent)	Correlation (Per cent)	Reconciliation (£ million)				
		Exceeds - 600	Exceeds - 300	Less than ± 100	Exceeds + 300	Exceeds + 600
Central Case						
5.7	50	12	27	15	27	11
Varying average absolute forecast error sensitivity						
3.7	50	3	18	24	17	3
7.7	50	19	33	11	33	19
Varying correlation sensitivity						
5.7	60	7	23	19	22	6
5.7	40	16	31	13	30	16
Varying both forecast and correlation sensitivity						
3.7	60	1	13	29	12	1
7.7	40	23	35	9	36	22

Source: Scottish Fiscal Commission
The results for reconciliations between -£100 million and -£300 million and between £100 million and £300 million are omitted.

D.8. We also carried out analysis to show how sensitive our results were to changes in the underlying assumptions. The larger the typical average absolute forecast error, the greater the variance of the distribution, and the larger we can expect reconciliations to be. We varied our assumed central forecast error of 5.7 per cent to 3.7 per cent and 7.7 per cent. Lower average absolute forecast errors would greatly reduce the probability of larger reconciliations, with nearly a quarter of all reconciliations being less than £100 million, and reconciliations exceeding £600 million would be very rare. On the other hand if average forecast errors are more like 7.7 per cent then reconciliations exceeding -£600 million would be common place, occurring nearly 20 per cent of the time.

D.9. Varying the correlation of SFC and OBR forecast errors also has an important effect on the forecast, though with the values we tested the scale of the effect is less than variation in the average absolute forecast error.

D.10. Finally, at the bottom of Figure D.1, we show the effect of combining variations in both the average absolute forecast error and correlation. With the most optimistic assumptions about forecast error at 3.7 per cent and correlation at 60 per cent, there is only a 1 per cent probability of reconciliations exceeding -£600 million, and only a 13 per cent probability of reconciliations exceeding -£300 million.

D.11. In this approach we treat each SIT and BGA forecast error as independent from previous forecast errors. However, we have previously discussed that negative and positive errors tend to be clustered over time. This is because income tax revenues come in longer cycles than a single year, but the lag in data means it takes time to catch up with a period of lower or higher revenues. In practice, if a series of negative reconciliations follow each other in a sequence, this may lead to more negative reconciliations occurring within any particular period of time, and vice versa for positive reconciliations. The probabilities described in the table above may only hold over longer periods of time.

Comparisons to analysis by the Scottish Government

D.12. As part of its January 2021 Medium Term Financial Strategy the Scottish Government has published similar analysis of the likelihood of different reconciliations occurring.[105] While our approach is similar, we have used a slightly different methodology and assumptions. Broadly, our results agree, and are well within the bounds of the uncertainty of such illustrative analysis.

D.13. Importantly, both pieces of analysis agree that income tax reconciliations are likely to exceed the Scottish Government's normal borrowing powers of £300 million on a somewhat regular basis, potentially as high as four times every ten years depending on the assumptions made. We do not consider the minor differences in our results to be of material importance.

Conclusions

D.14. The results of our simulations suggest that the normal £300 million borrowing powers of the Scottish Government could be exceeded between one and four times per decade, and negative reconciliations greater than £600 million could arise up to two times per decade.

[105] Scottish Government (2021) Scotland's Fiscal Outlook - The Scottish Government's Medium-Term Financial Strategy (link)

Additional Information

Abbreviations

ADP	Adult Disability Payment
ADS	Additional Dwelling Supplement
APD	Air Passengers Duty
ARIMA	Autoregressive Integrated Moving Average
BGA	Block Grant Adjustment
BGAc	Business Growth Accelerator
BMW	Biodegradable Municipal Waste
CA	Carer's Allowance
CAS	Carer's Allowance Supplement
CDP	Child Disability Payment
CPI	Consumer Price Index
COVID-19	Coronavirus
CWHA	Child Winter Heating Assistance
DHP	Discretionary Housing Payment
DLA	Disability Living Allowance
DWP	Department for Work and Pensions
EU	European Union
FSP	Funeral Support Payment
FSS	Fair Start Scotland
FTA	Free Trade Agreement
GDP	Gross Domestic Product
HMRC	Her Majesty's Revenue and Customs
HMT	Her Majesty's Treasury
IIDS	Industrial Injuries Disablement Scheme
IFI	Independent Fiscal Institution
LBTT	Land and Buildings Transaction Tax
LFS	Labour Force Survey
MCC	Material Change in Circumstance
MTFS	Medium Term Financial Strategy
NAIRU	Non-Accelerating Inflation Rate of Unemployment
NDR	Non-Domestic Rates
NIESR	National Institute of Economic and Social Research
NRS	National Records of Scotland
NSND	Non-Savings and Non-Dividends
OBR	Office for Budget Responsibility
OECD	Organisation for Economic Cooperation and Development
ONS	Office for National Statistics
PAYE	Pay As You Earn
PIP	Personal Independence Payment
QNAS	Quarterly National Accounts Scotland
RHL	Retail, hospitality, leisure and aviation relief
RTI	Real Time Information
SCP	Scottish Child Payment
SEFF	Scotland's Economic and Fiscal Forecasts
SFC	Scottish Fiscal Commission
SG	The Scottish Government
SISG	Self-Isolation Support Grant
SLfT	Scottish Landfill Tax
SPI	Survey of Personal Incomes
SWF	Scottish Welfare Fund
TMI	Tax Motivated Incorporations
UC	Universal Credit

VAT	Value Added Tax

A full glossary of terms is available on our website:

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

Professional Standards

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).[106]

The Commission also seeks to adhere to the highest possible standards for analysis. While we do not produce official statistics, we voluntarily comply as far 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.[107]

Correspondence and enquiries

We welcome comments from users about the content and format of our publications. If you have any feedback or general enquiries about this publication or the commission, please contact info@fiscalcommission.scot. Press enquiries should be sent to press@fiscalcommission.scot.

All charts and tables in this publication have also been made available in spreadsheet form on our website. For technical enquiries about the analysis and data presented in this paper please contact the responsible analyst:

Economy	Silvia Palombi	Silvia.palombi@fiscalcommission.scot
Income tax and public funding	Chris Dunlop	Chris.dunlop@fiscalcommission.scot
Fully Devolved Taxes	Rupert Seggins	Rupert.seggins@fiscalcommission.scot
Social security	Claire Mellor	Claire.mellor@fiscalcommission.scot

[106] OECD (2014) Recommendation on Principles for Independent Fiscal Institutions (link)
[107] Scottish Fiscal Commission (2018) Compliance with the Code of Practice for Official Statistics (link)

This publication is available at www.fiscalcommission.scot

ISBN: 978-1-911637-26-4

Published by the Scottish Fiscal Commission, January 2021