Scottish Fiscal Commission

Scotland's Economic and Fiscal Forecasts

December 2021

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Foreword

The Scottish Fiscal Commission is the independent fiscal institution for Scotland. Our statutory duty is to provide independent and official forecasts of Scottish GDP, devolved tax revenues and devolved social security spending to inform the Scottish Budget. We also continue to comment on the level of funding available to the Scottish Government and assess its borrowing plans.

Our forecasts represent the collective view of the four Commissioners of the Scottish Fiscal Commission who take full responsibility for them. We are very grateful to the staff of the Commission for their ongoing hard work and dedication in producing these forecasts.

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 as well as the Scottish Commission on Social Security for their constructive challenge of our judgements and for ensuring that we considered all the available evidence.

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9 December 2021

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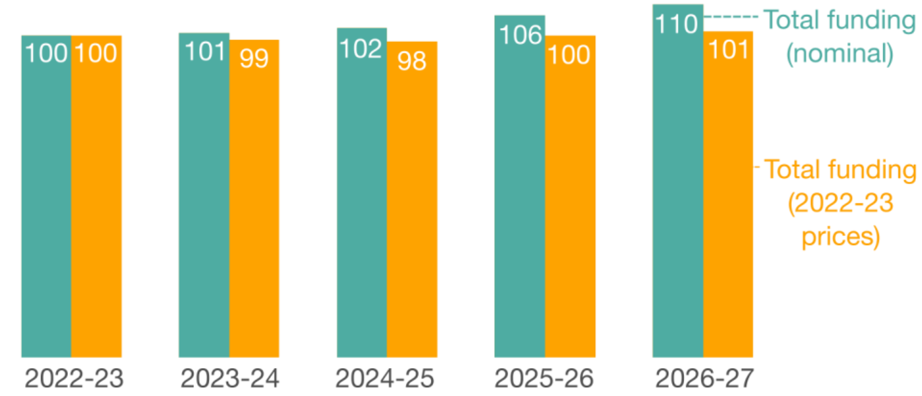
Fiscal Overview

We expect the Scottish Budget to increase by 10 per cent in cash terms between 2022-23 and 2026-27. After adjusting for inflation, this increase is 1 per cent.

Resource funding is expected to increase and capital funding to fall, as a result of changes in funding from the UK Government.

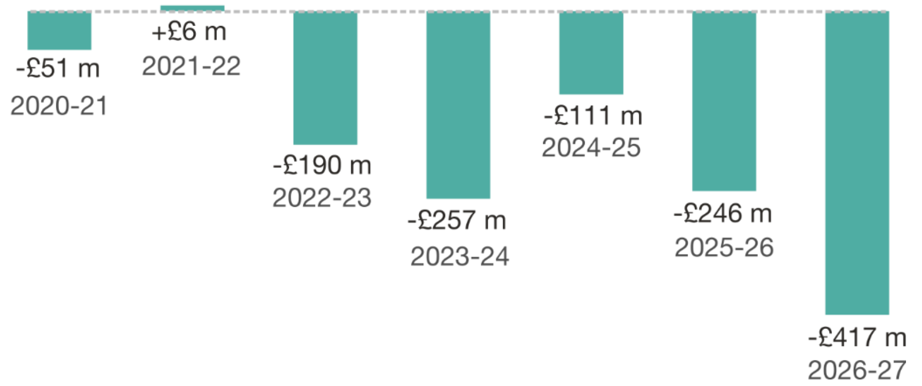
Expected Scottish Budgets flat after inflation



Scottish income tax revenues growing more slowly than the income tax Block Grant Adjustment means a negative net position and funding shortfall of £190 million in 2022-23.

This funding shortfall is expected to continue, reaching £417 million by 2026-27.

Income tax funding shortfalls forecast

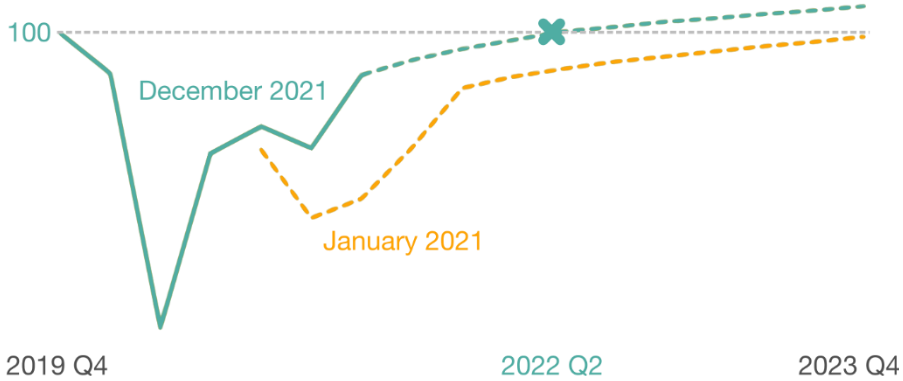


Economy

Since January, the outlook for the economy has improved, with GDP set to return to pre-pandemic levels by 2022 Q2.

This is because restrictions were lifted faster than anticipated and the economy adapted faster to restrictions than expected.

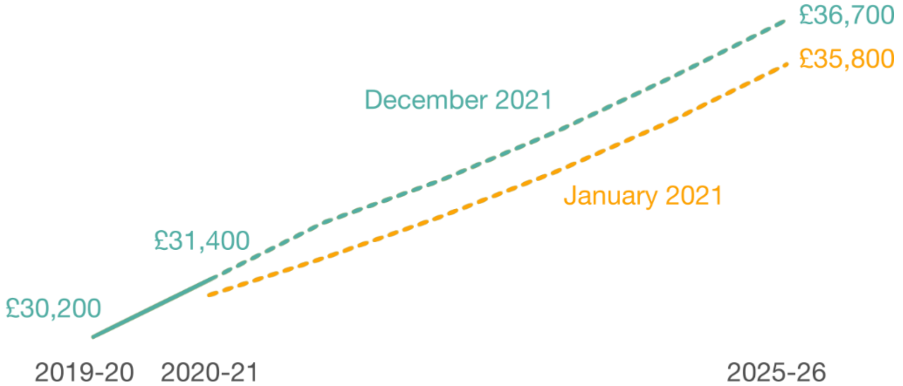
Return to pre-pandemic GDP revised since last Budget



Our December 2021 forecast for nominal average earnings is higher than in January 2021.

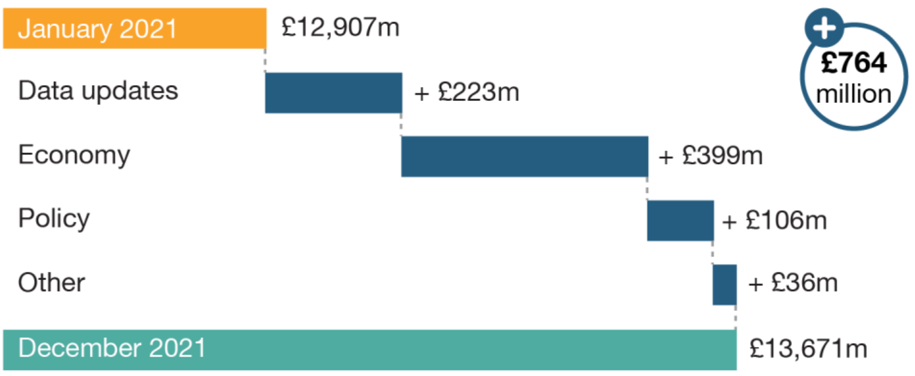
As well as higher inflation, this reflects wage pressures because of labour shortages in particular industries and increases in the minimum wage.

Higher earnings forecast partly driven by inflation



Tax

Income tax forecast for 2022-23 increased since January



Our income tax forecast for 2022-23 has increased by £764 million compared to January 2021 driven by more resilient economic performance.

Freezing the higher rate threshold raises an additional £106 million in revenues in 2022-23.

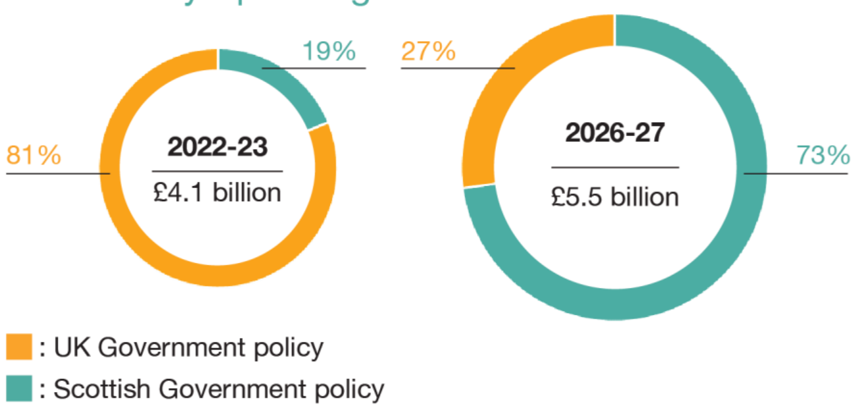
House price forecast revised up in line with income

We expect higher house prices in Scotland than in our previous forecast resulting from increased housing market activity since January 2021, as well as rising inflation feeding through to earnings.

As a result we have revised up our residential LBTT and ADS forecasts.

Social Security

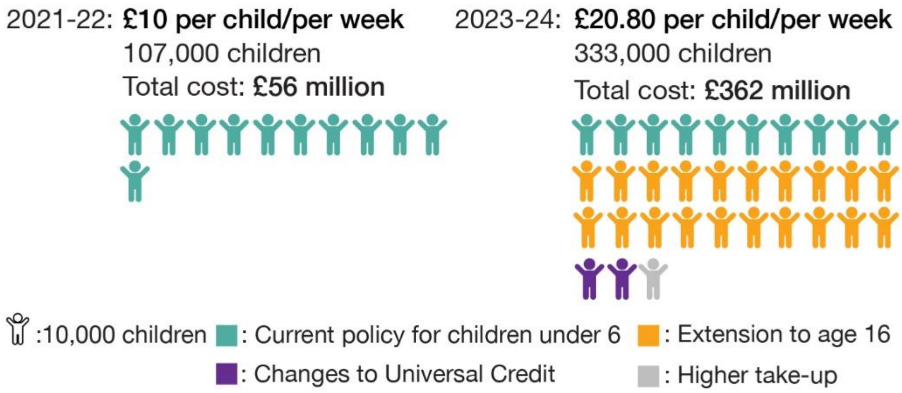
Social Security Spending



Over time Social Security Scotland will administer more payments directly following the introduction of Adult Disability Payment and Child Disability Payment.

Spending on Scottish Government payments also increases as payment rates rise and the Scottish Child Payment extends to children under 16.

Number of children receiving Scottish Child Payment



The number of children receiving Scottish Child Payment will peak in 2023 after the payment extends to children under 16.

We expect changes to Universal Credit will increase the number of eligible children and doubling the payment will encourage more people to apply.

Budget funding, £ million	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
Resource and capital (latest position)	49,637	48,353	48,739	49,414	51,293	52,989
Economy, % growth						
Gross Domestic Product	10.4	2.2	1.2	1.3	1.4	1.4
Consumer Price Index	3.3	3.7	2.3	2.0	2.0	2.0
Nominal Average Earnings	3.8	2.6	3.0	3.2	3.3	3.4
Employment	1.3	1.0	0.1	-0.1	-0.2	-0.2
Tax, £ million						
Income Tax	13,002	13,671	14,313	15,056	15,790	16,445
Non-Domestic Rates	2,083	2,809	3,233	3,167	3,231	3,519
LBTT	720	749	796	839	881	924
Scottish Landfill Tax	123	101	83	85	70	18
Policy announcements						
Freeze 2022-23 higher rate income tax threshold		106	106	111	117	124
2022-23 NDR Retail, hospitality and leisure relief		-56	0	0	0	0
Set NDR poundage to 49.8p in 2022-23		-40	-43	-42	-41	-44
Social Security, £ million						
All devolved social security assistance	3,679	4,065	4,657	4,966	5,230	5,511
Policy announcements						
Adult Disability Payment		38	233	358	458	567
Scottish Child Payment rise to £20		103	184	183	185	186
Other policy announcements	28	37	22	22	22	22

Summary

Introduction

1 Our latest forecasts accompany the Scottish Government's fiscal event presenting both the 2022-23 Scottish Budget and the Medium-Term Financial Strategy to the Scottish Parliament. This Budget is being presented in a context where the resource budget is forecast to face pressure from increasingly negative funding positions for devolved taxes and social security. At the same time the capital budget is falling over the next five years. We focus first on the Scottish Government's plans for 2022-23 before considering the outlook for the economy and Scottish public finances over the next five years.

2 The COVID-19 pandemic continues to affect society, the economy, and the Scottish Budget, but to a lesser extent than we expected when we produced our forecasts for the previous Scottish Budget in January 2021. The success of the vaccination programme has weakened the links between case numbers, hospitalisations and deaths, and the public health response has shifted. In addition many businesses have found ways of adapting to new ways of working. The economic recovery has been faster and smoother than we expected. We anticipate that from April 2022 and into the longer term COVID-19 will become endemic and begin to be managed through guidance and voluntary measures. Our forecasts were finalised before the emergence of the Omicron variant. Current information on the severity and likely implications for restrictions of Omicron is limited, but broadly we think it remains reasonable to assume the effects of Omicron fit within our central assumptions.

3 In our recent reports we have focused on the immediate funding challenges facing the Scottish Government in managing the COVID-19 pandemic. These challenges have not disappeared, but are less pronounced than last winter when the Government was balancing variable spending pressures arising from public health restrictions against an uncertain funding position dependent on UK Government policy.

4 Our focus now is shifting to the fiscal outlook for the next five years. In this report we set out our latest independent forecasts of the Scottish economy, tax, and social security spending as well as the Scottish Budget position.

2022-23 Scottish Budget

5 The Scottish Government has introduced three new tax policies in the 2022-23 Scottish Budget. The income tax higher rate threshold in Scotland is to be frozen at £43,662 in 2022-23 rather than rising in line with inflation, so more income will be taxed at the higher rate of 41 per cent, raising an expected £106 million of additional revenue in 2022-23. The increase is largely offset by two Non-Domestic Rates policies which set the poundage below inflation and extend the retail hospitality and leisure relief at 50 per cent for the first three months of 2022-23, together reducing revenues by £96 million.

6 We expect devolved Scottish taxes to raise £17.3 billion of revenue in 2022-23, a significant upwards revision of £777 million since our January 2021 forecasts. Stronger than expected economic activity combined with higher inflation has led us to revise up our forecasts of nominal household incomes, house prices and GDP, some of the main determinants of our tax forecasts.

The improved economic outlook was also in part due to public health restrictions being lifted more quickly than we anticipated in January.

7 Although our forecast of Scottish income tax revenues has increased since January, we expect revenues in 2022-23 to be £190 million less than the income tax Block Grant Adjustment (BGA) – the amount subtracted from the Scottish Budget to account for the devolution of income tax. We discuss the causes and consequences of this reduction in the budget further below.

8 The Scottish Government is forecast to spend £4.1 billion on social security in 2022-23 including new spending plans announced in the Budget. The Scottish Child Payment will double from £10 to £20 per child per week from April 2022.[1] Our forecast allows for the possibility that the higher payment rate encourages more applications. Low Income Winter Heating Assistance launches in winter 2022 replacing Cold Weather Payments and is forecast to cost £21 million in 2022-23. Our forecasts also include the launch of the largest social security payment, Adult Disability Payment, which will replace Personal Independence Payment.

Figure 1: Additional spending on the Scottish Child Payment

£ million	2022-23	2023-24	2024-25	2025-26	2026-27
SCP increased to £20	103	184	183	185	186

Source: Scottish Fiscal Commission

9 Overall the Scottish Budget in 2022-23 is 2.6 per cent lower than in 2021-22, after accounting for inflation the reduction is 5.2 per cent. The 2021-22 Budget included specific funding for COVID-19. From 2022-23 onwards there are no specific COVID-19 funding lines and any funding previously in this category which has continued is now part of general funding. This reduction is primarily because of the removal of COVID-19 funding and lower capital funding.

10 In developing its Budget the Scottish Government has assumed that it will receive extra income of £620 million for the resource budget in 2022-23 from a number of sources, some of which are still a matter of negotiation between the Scottish and UK Governments. We have reservations about the likelihood and amount of income available from some of these sources, but, considering the possibility of resource underspends materialising in the current financial year, we consider that, on balance across all the sources together, the Scottish Government assumptions are reasonable.

11 We discuss our concerns about some of the assumptions and the associated risks in the **Fiscal Overview chapter**. The Scottish Government has outlined the potential sources of income and the expected sum they might generate in Annex A of the Budget, and we expect it to explain further how these various sources develop over the coming financial year.[2]

The five-year outlook

Economy

12 We continue to expect a strong economic recovery in 2021-22, with Scottish GDP growing by 10.4 per cent which implies a return to pre-pandemic levels of economic activity by the second quarter of 2022.

[1] The April 2023 inflation increase in the payment rate is brought forward to the same time as the payment is extended to older children, which we expect to be in December 2022 with a payment rate of £20.80.
[2] Scottish Government (2021) Scottish Budget 2022-23 (link)

Figure 2: Scottish GDP growth comparing December 2021 and January 2021 SFC forecasts

Per cent	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
GDP							
January 2021	-12.4	7.5	5.1	1.5	1.7	1.7	
December 2021	-10.3	10.4	2.2	1.2	1.3	1.4	1.4

Source: Scottish Fiscal Commission

13 We assume that with the success of vaccines in weakening the link between case numbers, hospitalisations and deaths, domestic restrictions remain minimal with limited measures in place until April 2022. These assumptions were finalised before the emergence of the Omicron variant. Current information on the severity and likely implications for restrictions of Omicron is limited, but broadly we think it remains reasonable to assume the effects of Omicron fit within our central COVID-19 judgements. More severe effects from Omicron and the emergence of further variants of COVID-19 which are resistant to existing vaccines remain a downside risk to our forecast.

14 Throughout 2020-21 and 2021-22 the labour market has been more resilient than many economic forecasters and commentators, including the Commission, expected. We now expect the unemployment rate to peak at only 4.9 per cent, a significant downward revision from our January 2021 forecast which peaked at 7.6 per cent. Following strong growth in 2021-22, we expect nominal earnings growth to moderate in 2022-23 at 2.6 per cent. Inflationary pressures have intensified since the summer, driven in part by high energy prices. Our central view of inflation, in line with the OBR and similar to that of the Bank of England, sees annual CPI inflation peaking at 4.4 per cent in 2022 Q2 and gradually returning to target in the second half of 2024 as supply chain issues ease, global demand rebalances and energy prices fall back. There are however significant risks to the outlook for inflation. If inflation remains higher for longer, this will have significant implications for the Scottish economy and households.

15 Higher inflation, combined with recent tax rises including the new Health and Social Care Levy, will erode real disposable incomes and household consumption. With inflation outpacing nominal earnings growth in 2022-23, we expect real earnings to fall by 0.8 per cent next year. Low-income households could be disproportionately affected, for example because they spend more of their money on essentials including energy.

16 In spite of the pace of the recovery, there is some evidence that the Scottish economy has been lagging behind the UK. Compared to pre-pandemic levels, GDP, employment and earnings have recovered more slowly than in the UK. In part, this can be explained by a divergent sectoral and regional recovery, with areas like finance growing strongly in London. However, some issues pre-date COVID-19: declining North Sea oil and gas activity continues to act as a dampener, and Scotland's demographics are reducing labour market participation relative to the UK. We expect slower growth in earnings and employment in Scotland to continue over the next few years. This has important implications for tax revenues and the Scottish budget.

Contribution of tax to the Scottish Budget

17 The net position for a tax is the difference between the BGA and revenues: a positive net position means revenues are greater than the BGA so making a positive contribution to the budget while a negative net position means revenues are less than the BGA therefore reducing the budget. Over the next five years we expect the net position for Land and Buildings Transaction Tax (LBTT) to be positive, Scottish Landfill Tax (SLfT) has a positive net position until 2025-26. But the income tax

position is forecast to be negative and this is the dominant factor. With the exception of 2024-25, the overall net position for tax is negative for the next five years, as shown in Figure 3.

Figure 3: Tax net positions

£ million	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
Income Tax	148	-51	6	-190	-257	-111	-246	-417
LBTT	64	121	101	86	108	122	128	122
SLfT	20	20	34	18	1	9	1	-60
Total taxes	233	89	140	-86	-148	20	-117	-355

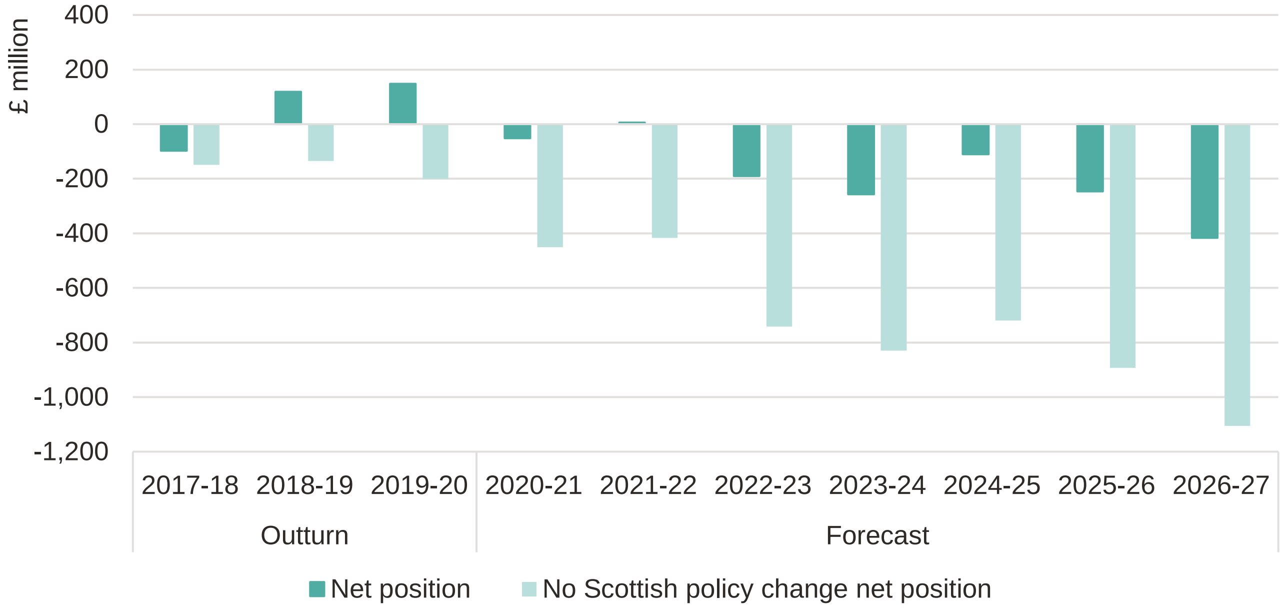
Source: Scottish Fiscal Commission, Scottish Government.
Shaded cells denote outturn.

18 Scottish income tax revenues in 2022-23 are expected to be £190 million less than the income tax Block Grant Adjustment (BGA) – the amount subtracted from the Scottish Budget to account for the devolution of income tax. We expect this shortfall to increase over the next five years, in spite of taxpayers earning over £27,850 paying higher levels of income tax in Scotland than in the rest of the UK.[3]

19 The net position is affected by two main factors: income tax policy differences and relative economic performance, including distributional differences. Since the 2016-17 initial deduction year for the income tax BGA, Scottish employment and earnings have grown more slowly than in the rest of the UK, even after accounting for differences in population growth. All else remaining equal, this would lead to a large negative income tax net position. Successive changes in income tax rates and bands in Scotland to raise additional income tax revenue have so far largely offset these negative economic effects on the income tax net position. Figure 4 shows the income tax net position and an illustrative calculation of what the income tax net position would have been without changes in Scottish income tax policy raising additional revenues. We estimate that in 2022-23, without cumulative Scottish income tax policy changes introduced since 2017-18, the net position would have been -£742 million. This does not factor in changes in UK Government income tax policy, which would have also contributed to the net position via their effect on the BGA.

[3] £27,850 is an illustrative calculation base on 2022-23 income tax rates and bands in Scotland compared to England and Northern Ireland. Individual tax circumstances may vary.

Figure 4: Income tax net position and illustrative position excluding Scottish policy change



Source: Scottish Fiscal Commission

20 From 2022-23, total earnings and employment are expected to continue to grow more slowly in Scotland than in the rest of the UK, and these economic factors are increasingly outweighing the additional income tax revenues from policy changes.

21 The relatively slower earnings and employment growth in Scotland compared to the UK arises from several underlying factors contributing to the emerging negative income tax net position. These include:

- Scotland's changing demographics and a faster growing share of the population among older age groups
- Falling labour market participation of younger age groups
- Slow growth in Scottish average earnings, particularly in North East Scotland relating to oil and gas activity
- More rapid growth in earnings in the UK, driven in part by strong growth in financial services in the UK

22 To move the net position back towards zero or positive values, there would need to be a period of relatively faster growth in income tax revenues per capita in Scotland to catch up with the BGA. Growth could be driven by further policies to raise additional income tax revenues from Scottish taxpayers, or by relatively faster economic growth in Scotland.

23 In addition to the effect on the resource budget of this downward pressure from tax revenues, it is important to note the consequences of increased spending on social security for the Scottish Budget.

Rising social security spending

24 The Scottish Government has introduced significant reforms of devolved social security. Existing payments administered by DWP on behalf of the Scottish Government are being replaced by new Scottish payments administered by Social Security Scotland. As well as reforming the administration

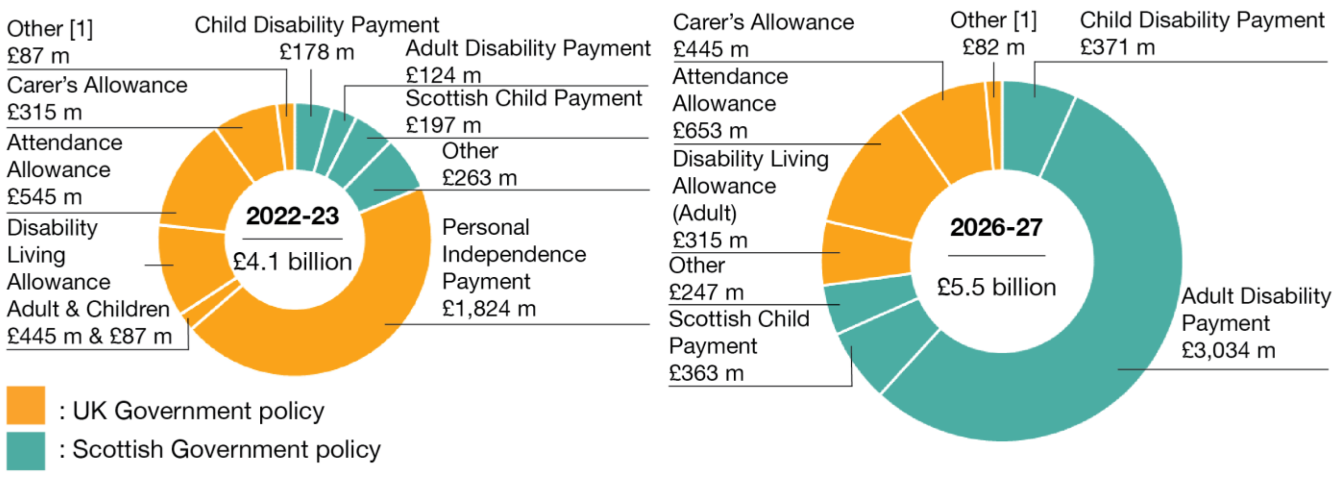
of these payments with an ambition to improve take-up of payments, the Scottish Government has, for many payments, expanded the number of people eligible and increased payment amounts. The largest payment, Adult Disability Payment, launches in 2022. The Scottish Government has also introduced new uniquely Scottish payments, most notably the Scottish Child Payment (SCP) which has been increased in this Budget.

25 We forecast devolved social security spending to increase from £4.1 billion in 2022-23 to £5.5 billion in 2026-27. Overall, our forecast of spending in 2025-26 has increased by £1.0 billion since January 2021. This increase primarily occurs because the Scottish Government plans to launch new payments which are more generous or received by more people. In addition, most payments are uprated by inflation and the higher inflation forecast therefore increases spending. By 2025-26, our forecast is £190 million higher than in January 2021 because of higher inflation.

26 Together these plans see more devolved social security transferring to be based on Scottish Government policy. In 2022-23, most social security spending, over £3 billion, will continue to be administered by the Department for Work and Pensions (DWP) on behalf of the Scottish Government.

27 By 2026-27, Social Security Scotland will administer more payments directly. Spending is also increasing as payment rates increase and the SCP is rolled out to all children aged under 16. As shown in Figure 5, our current forecasts estimate that 73 per cent of spending in 2026-27 will be administered by Social Security Scotland and be based on Scottish Government policy. We expect this percentage to increase in our future forecasts as we have not yet incorporated any changes in spending arising from the Scottish Government's replacement payments for Carer's Allowance, Attendance Allowance, Industrial Injuries Scheme, and Winter Fuel Payments which the Scottish Government aims to launch by the end of 2025. Any changes to these payments which further increase spending will also need to be met from the wider Scottish Budget.

Figure 5: Social security spending in 2022-23 and 2026-27



Source: Scottish Fiscal Commission
Scottish Government policy includes Best Start Foods, the three payments of Best Start Grant, Carer's Allowance Supplement, Child Winter Heating Assistance, Low Income Winter Heating Assistance, Funeral Support Payment, Discretionary Housing Payments, Fair Start Scotland, Self-Isolation Support Grant and Scottish Welfare Fund.
This figure does not include Winter Fuel Payment as it has not yet been devolved.
[1] "Other" includes Industrial Injures Disablement Scheme and Severe Disablement Allowance

28 Adult Disability Payment will become the largest component of social security, replacing Personal Independence Payment. People qualify for ADP on the basis of a disability or health condition, and their eligibility is not affected by their income or employment status. This means spending on ADP is

not related to economic performance, and instead is primarily related to demographics. Older people are more likely to receive ADP and therefore a combination of an aging population and increases in the state pension age mean we expect the number of people receiving ADP to increase over the next five years. Changes the Scottish Government is making to devolved social security have long-term spending implications, as once people are deemed to be eligible, they can continue to receive a payment for many years.

29 For the largest payments, the Scottish Government receives Block Grant Adjustment (BGA) funding from the UK Government based on spending on the original DWP payments. Spending above the BGAs for social security must be met from the wider Scottish Budget. The Scottish Government has introduced new payments that do not receive any funding from the UK Government and the costs must be met entirely from the Scottish Budget. Combining completely new payments and payments with BGA funding, we expect that by 2026-27 spending on the Scottish Government's social security benefits will be £760 million more than the corresponding funding received, reducing the funding available for other parts of the Scottish Budget.

Figure 6: Social security net position and new payments

£ million	2022-23	2023-24	2024-25	2025-26	2026-27
Social security net position [1]	-38	-176	-253	-255	-252
Social security new payments [2]	-322	-493	-496	-503	-512
Total	-361	-669	-749	-758	-764

Source: Scottish Fiscal Commission
[1] This includes Adult Disability Payment (covered by the Personal Independence Payment BGA), Child Disability Payment (covered by the Disability Living Allowance BGA along with DLA Adult spending), Attendance Allowance, Carer's Allowance, Industrial Injuries Disablement Scheme, Low Income Winter Heating Assistance (covered by the Cold Weather Payment BGA), and Severe Disablement Allowance.
[2] New payments includes: Carer's Allowance Supplement, Scottish Child Payment, Child Winter Heating Assistance, Best Start Grant Early Learning Payment and Best Start Grant School Age Payment. We also include spending on bedroom tax mitigation through Discretionary Housing Payments.

Fiscal Overview

30 Overall we expect the Scottish Budget in cash terms to increase by 10 per cent between 2022-23 and 2026-27, largely because of increases in UK Government funding. Behind this headline increase are several different elements. Increased resource funding is partially offset by a shrinking capital budget and anticipated shortfalls between tax revenues and Block Grant Adjustments (BGA). The Scottish Government also plans social security spending above the corresponding BGA funding. This creates pressures over the next five years and the Scottish Government will need to balance its spending plans against the available budget.

31 After taking account of inflation the overall increase in the Scottish Budget over the next five years is expected to be 1 per cent, with the first three years of funding being flat before increasing in the subsequent two years. The UK Government's recent Spending Review set out the funding the Scottish Government should expect for the next three financial years, and the Scottish Government has made assumptions about expected growth in the Block Grant beyond that period. We consider these assumptions reasonable.

Resource outlook

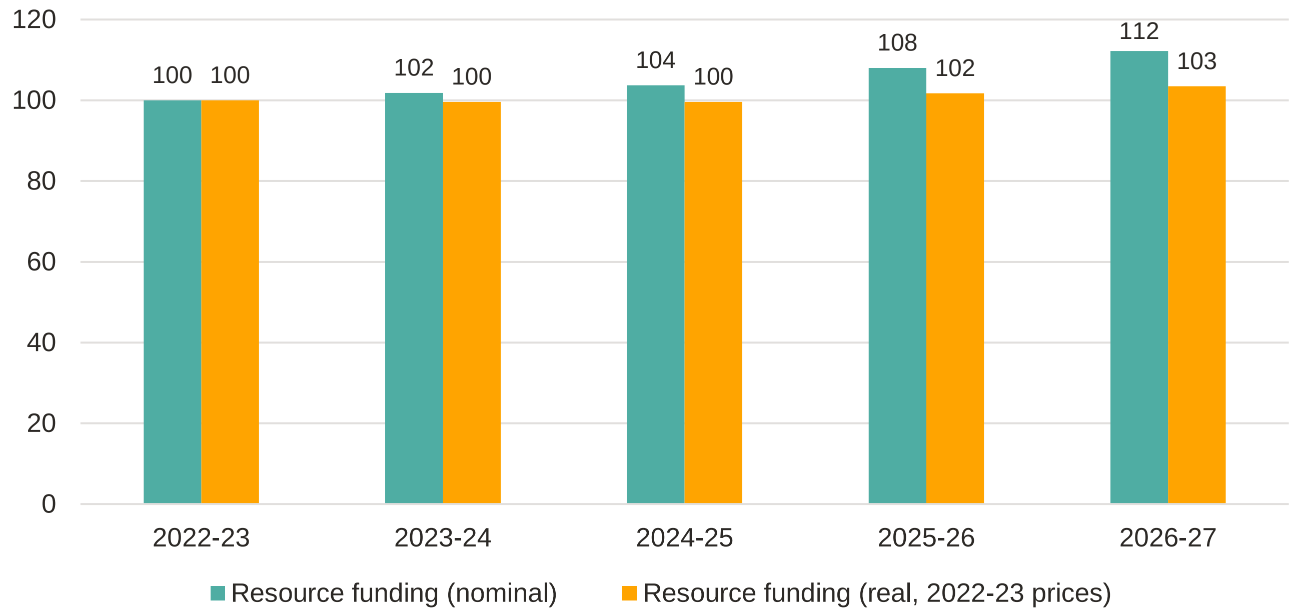
32 Resource funding makes up most of the Scottish Budget and is for spending on current costs such as public sector wages, spending on goods and services, grants and subsidies, and social security spending. For the period covered by the UK Government's Spending Review, 2022-23 to 2024-25,

resource funding increases in nominal terms but remains flat after adjusting for inflation. Thereafter it is assumed UK Government funding increases again.

33 Scottish tax revenues are forecast to increase by 20 per cent between 2022-23 and 2026-27, but the net effect on the budget is forecast to be negative in every year with the exception of 2024-25. Negative Block Grant Adjustments (BGA) reflect tax revenues in the rest of the UK, and these are forecast to outweigh the positive contribution from Scottish tax revenues. This difference is primarily driven by income tax because of lower earnings growth and lower labour market participation rates in Scotland.

34 The overall effect is that the resource budget increases by 12 per cent in nominal terms between 2022-23 and 2026-27, and by 3 per cent after adjusting for inflation.

Figure 7: Medium term outlook for resource funding, indexed to 2022-23



Source: Scottish Fiscal Commission, Scottish Government
Figures in 2022-23 prices calculated using year-on-year growth GDP deflators from Table 1.7 of the OBR's supplementary economy tables. Figures rebased so 2022-23 = 100. Office for Budget Responsibility (2021) Economic and fiscal outlook – October 2021 – supplementary economy tables (link)

35 The Scottish Government will need to balance its spending plans against the resource budget available. The resource management tools available to the Scottish Government give it a limited ability to transfer funding between financial years but cannot be used to manage longer term divergences in funding and spending plans.

Resource management tools

36 The Scottish Government is required to maintain a broadly balanced budget, matching its spending to available funding each year. As the Scottish Government cannot overspend its budget, outturn spending must come in below the allocated budget and this results in underspends, as a normal outcome of budget management. The Scottish Government can use the Scotland Reserve to transfer unspent funds from one financial year to the next. Following the devolution of tax and social security powers, the Scottish Government also has resource borrowing powers which can be used to manage forecast errors.

37 The Scottish Budget is set in advance of each financial year, based on forecasts of revenue and spending. For LBTT, SLfT and social security any differences between our forecasts and outturn

data are managed in-year. For income tax both our forecast of Scottish income tax revenue and the BGA based on OBR forecasts are fixed from when the Scottish Budget is set until outturn data become available. The outturns for revenue and the BGA only become known two years later and differences between forecasts and outturns give rise to a reconciliation in the subsequent budget.

38 In January 2021 the forecast 2021-22 BGA was £475 million lower than our forecast of Scottish income tax revenues. We cautioned that this difference could not be explained by economic or tax policy differences and seemed to reflect the considerable uncertainty surrounding COVID-19 and the fast-paced change of the COVID-19 outlook at the time. Since January 2021, both our and the OBR's forecasts have been revised up following stronger than expected earnings growth in 2021. However, the OBR forecasts have been revised up by significantly more than our forecasts, leading to a reduction in the net position. Our latest forecasts are for Scottish tax revenues to be just £6 million greater than the BGA in 2021-22, and we therefore expect a negative £469 million reconciliation to be applied in 2024-25. The actual reconciliation in 2024-25 will depend on the outturns which will be reported in 2023.

39 The Scottish Government has limited tools to manage this reconciliation, and has stated it plans to use resource borrowing to manage income tax reconciliations. The Scottish Government will be able to borrow £300 million to manage the reconciliation, effectively passing the repayment forward to future years. The remaining £169 million of the expected £469 million reconciliation will reduce funding in 2024-25. The Scotland Reserve is the other tool available to the Scottish Government, which in principle could prepare for a negative reconciliation by deliberate underspends to build up the Reserve. However, the Reserve has an overall size limit and an annual drawdown limit and, given the existing need for the Scottish Government to use the Reserve to manage underspends, the scope for it to help prepare for negative reconciliations is very limited.

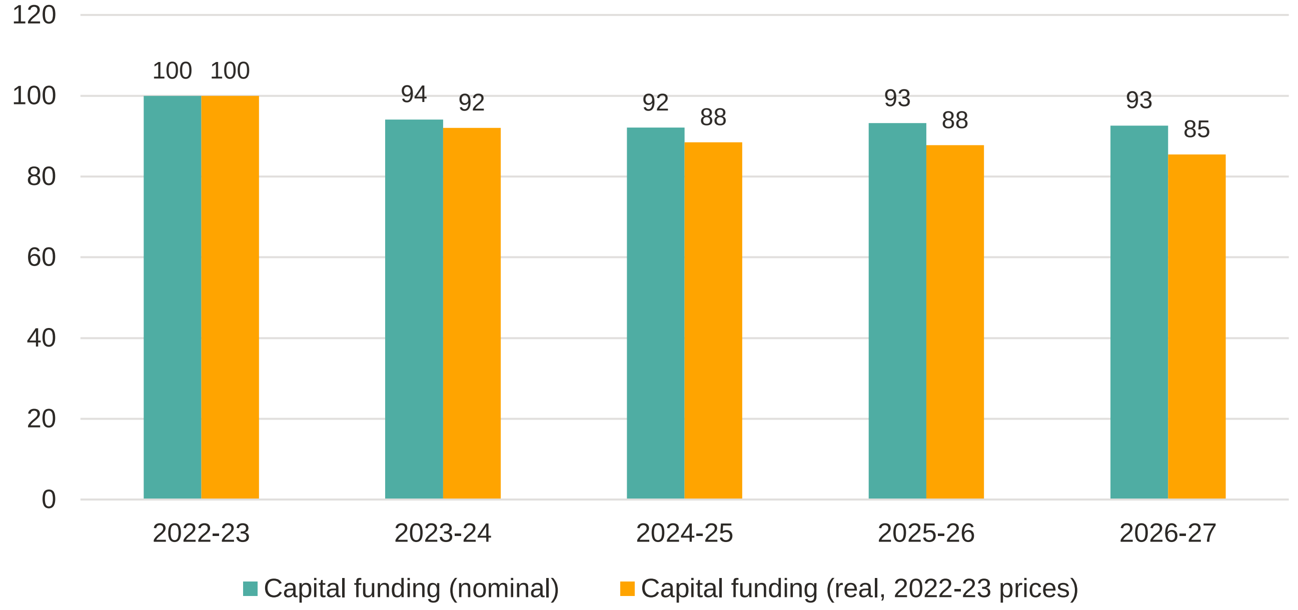
40 Currently the Scottish Government has enhanced borrowing powers and greater flexibility to use the Scotland Reserve because our January 2021 forecasts triggered a "Scotland-specific economic shock". These flexibilities expire after 2023-24 and are therefore not available to the Scottish Government to manage the large income tax reconciliation expected in 2024-25. As a result, the Scottish Government would need to consider adjustments to spending to manage the reconciliations. With the Scottish budget steadily increasing in size (both through inflation and real increases) this situation is likely to become increasingly common while the limits remain fixed.

Capital funding

41 Capital funding accounts for 13 per cent of the Scottish Budget. It is used for long-term investment such as hospitals, roads, and research and development. Financial transactions are a subsection of capital funding and can be used to make loans to, or equity investments in, private sector entities.

42 Over the next five years we expect capital funding to fall in both cash and inflation adjusted terms, primarily because of reduced UK Government funding. The Scottish Government is moving closer to reaching its capital borrowing limit of £3 billion, with a self-imposed rule to ensure a contingency of £300 million remains available in 2026-27. To stay within these limits, borrowing is planned to reduce over the next five years, further reducing capital funding.

Figure 8: Medium term outlook for capital funding, indexed to 2022-23



Source: Scottish Fiscal Commission, Scottish Government
Figures in 2022-23 prices calculated using year-on-year growth GDP deflators from Table 1.7 of the OBR's supplementary economy tables. Figures rebased so 2022-23 = 100. Office for Budget Responsibility (2021) Economic and fiscal outlook – October 2021 – supplementary economy tables (link)

43 The Scottish Government plans to borrow the annual maximum of £450 million in 2022-23. However, in the past, where underspends have arisen during the year, it has typically reduced planned borrowing in-year to ensure there is not a large underspend which reaches the Scotland Reserve limit. We therefore consider the Scottish Government's planned borrowing reasonable, but note both the likelihood that borrowing will turn out to be less than planned in each year, and that over the next five years it is likely the Scottish Government will be close to the overall borrowing limit.

Chapter 1 Introduction

What is in this report?

1.1 This report presents the independent economic and fiscal forecasts of the Scottish Fiscal Commission. It is published alongside the 2022-23 Scottish Budget on 9 December 2021. We provide five-year forecasts covering the 2022-23 Budget year and the following years up to and including 2026-27. We have also revised our in-year forecasts for 2021-22.

1.2 Throughout the report we set out the main assumptions and judgements made in reaching our forecasts. In addition, we compare our latest December 2021 forecasts to those we published in January 2021 for the 2021-22 Scottish Budget. We also published forecasts in August 2021 following a recommendation from the Finance and Constitution Committee.[4] While we sometimes refer to these August forecasts in this report, detailed comparisons between them and the forecasts set out in this report can be found in supplementary tables published on our website.[5]

1.3 In this introduction we explain the 10 week process we have followed in the creation of our forecasts and then how the different elements of our forecasts relate to the Scottish Government's Budget and associated publications. Because the COVID-19 pandemic continues to have effects on the economy, tax revenues and social security spending, we also set out here the COVID-19 assumptions that underpin the approach we take to all these elements of our forecasts. The report contains the following chapters:

Summary	Our economic and fiscal forecasts, the fiscal overview and the highlights from this round of forecasts.
Fiscal Overview	Discusses the main fiscal changes since our last forecasts. This includes UK Government funding and tax revenues. We also assess the Scottish Government's planned borrowing and use of the Scotland Reserve.
Economy	Our five-year forecasts for the Scottish economy.
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 new policies will cost or raise, and explanations of how the Commission has arrived at those estimates.
Annex B: Policy Recostings	Our revised estimates of policies previously costed. Recostings may be needed because of new data or revisions to assumptions and judgements.
Annex C: Materiality	Our approach to handling policies which have a very small fiscal effect.
Annex D: Medium term funding outlook	Resource and capital funding projections five-year forecasts.

1.4 Additional information such as comparisons to our previous forecasts, OBR forecasts and sensitivity analysis are in supplementary tables, available on our website. If the information you are looking for is not in this report or the supplementary tables, please contact us at info@fiscalcommission.scot.

[4] Finance and Constitution Committee (2021) Report on Scottish Government Budget 2021-22 (link)
[5] Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – December 2021 (link)

The process behind creating these forecasts

1.5 On 21 September 2021, we received 11 weeks' notice from the Cabinet Secretary for Finance and the Economy of the publication of a Scottish Budget and Medium Term Financial Strategy on 9 December 2021. Throughout this period, our interaction with the Scottish Government has been guided by our Protocol for engagement.[6]

1.6 Since the formal notification, the Commission has had several rounds of meetings to discuss our forecasts. Attendees have included the Scottish Government, Revenue Scotland and Social Security Scotland. In accordance with the Protocol, details of timings and attendees are published on our website.[7]

1.7 We developed a new process with HM Treasury to ensure we had access to relevant information following the UK Government's Autumn Budget and Spending Review. Our Statement of Data Needs published in September 2020 recommended we work with HM Treasury to define a process "for timely sharing of relevant information and analysis when there is a UK Government policy change that directly affects the Commission's tax and social security forecasts."[8] In producing these forecasts we had discussions on UK Government policy changes announced at the Autumn Budget with analysts in HM Treasury, HMRC and DWP. We plan to formalise these arrangements in a Memorandum of Understanding.

1.8 To finalise our forecasts for publication, our cut-off date for incorporating new data and information into the forecasts was 18 November 2021. We were given pre-release access to information before that date on the Self-Isolation Support Grant and Scottish Landfill Tax (SLfT) which was published after 18 November. These data helped inform our social security forecasts and SLfT forecasts. No other new data or information available after 18 November were included in our forecasts.

1.9 Headline dates are:

21 September	Cabinet Secretary for Finance and the Economy wrote to advise that the Scottish Government intended to publish its Budget 2022-23 and Medium Term Financial Strategy on 9 December 2021.
18 November	Deadline for inclusion of new data in the forecasts.
23 November	Closure of economy forecasts.
25 November	Deadline for the Scottish Government to provide the Commission with any final policy measures to be included in the forecasts.
30 November	The Commission presented the Scottish Government with final forecasts.
6 December	The Commission's near-final report was shared with the Scottish Government.
7 December	Call between Dame Susan Rice, Chair of the Commission and the Cabinet Secretary for Finance and the Economy.
8 December	A pre-release version of the Commission's report was shared with the Cabinet Secretary for Finance and the Economy, the Cabinet Secretary for Social Justice, Housing and Local Government and the Minister for Social Security and Local Government.
9 December	Scotland's Economic and Fiscal Forecasts – December 2021 published.

[6] Protocol for engagement between the Scottish Fiscal Commission and the Scottish Government Version 4.1 – October 2021 (link)
[7] Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – December 2021 (link)
[8] Scottish Fiscal Commission (2020) Statement of Data Needs – September 2020 (link)

How the Scottish Government uses our forecasts

1.10 On 9 December 2021 the Scottish Government published three documents informed, in part, by our forecasts. The 2022-23 Scottish Budget, Medium Term Financial Strategy (MTFS) and a Resource Spending Review Framework.

1.11 The 2022-23 Scottish Budget sets out the Scottish Government's spending plans for the next financial year. Those spending plans are based on the funding available to the Scottish Government for the 2022-23 financial year which we set out in Chapter 2 of this report, including the tax revenue contribution. Our social security forecasts in Chapter 5 are also used directly in the Budget to allocate spending.

1.12 The Medium Term Financial Strategy (MTFS) sets out five-year forecasts of the Scottish Government's funding position, based on our forecasts of tax revenues and social security spending, the recent UK Government Spending Review, and assumptions about future funding and borrowing. We discuss these funding plans in Chapter 2 and in Annex D.

1.13 The Scottish Government has also published its Resource Spending Review Framework, setting out broad spending projections for the next five years. With the exception of our forecasts of social security spending, the Scottish Government has produced the forecasts for all other spending areas. This forms the basis of the next Resource Spending Review which will take place in May 2022 alongside the MTFS and a revised capital spending review.

1.14 Box 1.1 explains future spending commitments that are not included in our forecasts, and therefore are not represented in the MTFS and Resource Spending Review Framework.

Box 1.1: Future financial commitments missing from our forecasts

As the official producer of forecasts for the Scottish Budget and Medium Term Financial Strategy, our forecasts reflect Scottish Government policy at the time they are produced, including all new tax and social security policies announced in the 2022-23 Scottish Budget. There are however areas where the Scottish Government has stated its intention to introduce policy changes in the future, but where the details of those changes are still being decided and therefore there is insufficient information for us to include these policies in our forecasts at this point in time.

When considering our five-year forecasts of social security spending in particular, there are a number of policies still to be implemented in the future, which suggest our current forecasts underestimate social security spending from 2023-24 to 2026-27.

- New payments launching in the future: the Scottish Government plans to replace Attendance Allowance, Carer's Allowance and Industrial Injuries Disablement Scheme. Spending on the existing payments administered by DWP on behalf of the Scottish Government is included in our five-year forecasts. Given that the other new payments launched by the Scottish Government are expected to have higher spending levels than those they replace, spending on the replacement Scottish payments may be higher in the future than our forecasts suggest.

- Winter Fuel Payments (WFP): when devolved, the Scottish Government plan to replace WFP with Pension Age Winter Heating Assistance in winter 2024. We expect the 2024-25 Scottish

Budget to include provision for Pension Age Winter Heating Assistance along with funding through a new Block Grant Adjustment. Our current forecasts do not include WFP or the replacement payment, but an illustrative forecast of WFP spending is included at the end of Chapter 5.

- Employability: our current forecasts are for Fair Start Scotland to close to new entrants at the end of March 2023. Spending therefore reduces over the forecast horizon and reaches zero in 2025-26. The Resource Spending Review in May 2022 will consider spending plans beyond 2022-23 and we expect detail on future employability programmes to be available then.

COVID-19

1.15 Our January 2021 forecasts were produced during the second lockdown and early on in the vaccine roll-out. At that time we expected it would take until the final quarter of 2021 before domestic restrictions would be lifted with restrictions easing during the second and third quarters. Since then there have been positive developments with the vaccine roll-out weakening the link between cases, hospitalisations and deaths. Restrictions lifted slightly faster than we expected, with all legal requirements for businesses to close or to apply physical distancing being revoked before the end of the third quarter of 2021. While some rules remain, such as the requirement for people to wear face coverings in certain settings, for hospitality to collect customers' contact details, and for some events to use the COVID status app, the removal of the most stringent restrictions has contributed to improvements in the economic outlook since our January 2021 forecast, as discussed in Chapter 3.

1.16 Overall, we expect cases to remain elevated over the winter. However, the high levels of vaccination and previous infection are expected to limit further hospitalisations and deaths, therefore reducing the risk of further legal restrictions being introduced. Figure 1.1 sets out the assumptions on the progression of the pandemic which inform our economic and fiscal forecasts.

Figure 1.1: Central COVID-19 assumptions

	Assumption
1. Case numbers, hospitalisations and deaths	Since the start of the pandemic in March 2020 there have been several waves of rising case numbers, hospitalisations and deaths, with periods of low numbers in between. Rising case numbers since summer 2021 have been associated with much lower hospitalisations and deaths following widespread vaccination of the population. We assume that hospitalisations and deaths continue but they remain well below the peak levels seen in 2020 and in 2021 Q1. Over this winter, the limited restrictions in place combined with higher levels of social contact are likely to contribute to somewhat elevated COVID-19 case levels with the potential for further peaks. From April 2022 and into the longer term, we assume COVID-19 will become endemic, continuing at a low baseline level again with the possibility of some periods of higher cases. There will continue to be COVID related hospitalisations and deaths but most of the time these will be at relatively low levels.
2. Vaccinations and treatments	The vaccination programme is a major contributor to the high immunity levels that have weakened the link between cases, hospitalisations and deaths since

	summer 2021. A booster programme designed to offset waning protection from the original two doses is being rolled out to people who had their full course of vaccination more than 6 months ago. At the time of publication over 90 per cent of the Scottish population over age 12 had received their first dose, over 82 per cent have received their second dose and over 39 per cent have received a booster dose.[9] We assume that vaccines continue to be effective against any new variants of the virus in preventing serious illness, though possibly not as effective against infection and infectivity. We also assume that any significant waning of the vaccines' effectiveness over time in individuals is countered by booster vaccinations. We assume that some form of annual booster vaccination programme will be in place in future years if needed. We assume that treatments for COVID continue to be developed and tested. It seems reasonable to assume that some effective treatments become available. For example, the recent approval (and NHS purchase) of anti-viral treatment for use at home by the patients most at risk promises to further reduce the link between cases and deaths this winter and in the future.[10]
3. National and regional restrictions	With the success of vaccines, domestic restrictions remain minimal with limited measures such as mandatory face coverings and vaccine passports for some activities in place until April 2022. These restrictions may dampen the demand for some face-to-face activities. There are some indications that the population is also continuing to make behavioural changes in the absence of formal restrictions and that average contacts per person are lower than pre-pandemic levels.[11] We therefore assume that there will be no significant further local or national closures or lockdowns in the period until April 2022. Any additional mandatory restrictions are more likely to build upon or extend existing measures. After April 2022, we anticipate COVID-19 will begin to be managed through guidance and voluntary measures. These may be more extensive than pre-pandemic measures including the use of voluntary isolation and face coverings if symptomatic. There may be some limited restrictions on international travel.
4. Job protection schemes and business support	The main Coronavirus Job Retention Scheme (CJRS) was wound down in September 2021. Smaller and more targeted job support schemes were introduced but these are of a fundamentally smaller scale and will have less of an effect on the labour market. The ending of the CJRS in effect limits the scope for the Scottish Government to introduce mandatory restrictions that close or seriously reduce opening hours of business premises. The existing business support schemes have largely been phased out. The Self-isolation Support Grant is assumed to end in October 2022.
5. International outlook	The virus will continue to be prevalent in other countries around the world for some time, particularly in those countries with low vaccination rates. This will continue to affect supply chains and foreign tourism, both inbound and outbound, with the long-term effects continuing after 2021.

[9] Public Health Scotland COVID-19 Daily Dashboard accessed 06 December 2021 (link)
[10] UK Government (2021) UK government secures ground-breaking COVID-19 antivirals (link)
[11] Jarvis, C. et al., (2021) CoMix study – Social contact survey in the UK Week 87 (link) and OBR analysis of pre-pandemic average contacts OBR (2021) Economic and Fiscal Outlook – October 2021 (link)

Risks to our COVID 19 assumptions

1.17 Our central forecasts are based on broad-brush assumptions about the outlook for the pandemic. Although these do not cover every aspect of the pandemic, our forecasts are based on minimal restrictions applying in Scotland and the rest of the UK. It is clear from what we can see in parts of Europe that a smooth exit from the pandemic is not a certainty. Our forecasts are based on the assumption that the vaccination programme continues to result in a weakened link between cases, hospitalisations and deaths and therefore public health restrictions remain minimal.

1.18 We consider our forecasts to reflect the central and most likely future state of the pandemic. Given the current situation in Europe and with the emergence of the Omicron variant of COVID-19, we think it is unlikely that the outlook will be more positive than we expect, and there are risks that the outlook could be more negative. Should new public health restrictions which affect economic activity be necessary, then the economic and fiscal outlook over the next year is likely to be more negative than we currently expect. At the same time we would expect significant public health restrictions across the UK to be accompanied by increased public spending, with UK Government spending decisions resulting in funding for the Scottish Government. The current UK Government policy, and associated funding position, is based on businesses and economic activity continuing to operate with minimal restrictions. Therefore, any decision by Scottish Ministers to impose tighter public health restrictions than in England that require assistance to businesses or individuals could pose difficulties for the Scottish Budget.

1.19 We consider the risks are most likely to become a reality should it emerge that the new Omicron variant of COVID-19, or another variant, is resistant to existing vaccines and leads to rapidly rising cases, hospitalisations and deaths, so short term restrictions would need to be re-imposed to safeguard the capacity of the NHS.

Chapter 2
Fiscal Overview

Introduction

2.1 Our latest forecasts accompany the Scottish Government's fiscal event presenting both the 2022-23 Scottish Budget and the Medium-Term Financial Strategy to the Scottish Parliament. This Budget is being presented in a context where resource funding is increasing but the resource budget is forecast to face downward pressure from increasingly negative funding positions for devolved taxes and social security. At the same time the capital budget is falling over the next five years.

2.2 In our recent reports we have focused on the immediate funding challenges facing the Scottish Government in managing the COVID-19 pandemic. These challenges have not disappeared, but are less pronounced than last winter when the Government was balancing variable spending pressures arising from public health restrictions, against an uncertain funding position dependent on UK Government policy. The 2021-22 Budget included specific funding for COVID-19, but from 2022-23 onwards there are no specific COVID-19 funding lines and any funding previously in this category which has continued is now part of general funding. Overall the Scottish Budget in 2022-23 is 2.6 per cent lower than in 2021-22, and after accounting for inflation the reduction is 5.2 per cent. This reduction is primarily because of reduced COVID-19 funding and falling capital funding from the UK Government.

2.3 A description of the different sources of Scottish Government funding can be found in our Funding for the Scottish Budget paper.[12]

2.4 Our focus now is shifting to the fiscal outlook for the next five years. We look first at the Scottish Government's plans for 2022-23 before considering the outlook for over the next five years and the Government's plans for borrowing and use of the Scotland Reserve. We turn first to resource funding before discussing capital funding.

Resource

Resource funding

2.5 Resource funding makes up most of the Scottish Budget and is for spending on current costs such as public sector wages, goods and services, grants and subsidies, and social security spending.

2.6 Figure 2.1 sets out resource funding for the 2022-23 Scottish Budget, compared to the latest positions for 2020-21 and 2021-22. The COVID-19 pandemic resulted in significant increases in UK Government funding, which in turn generated COVID-19 Barnett funding for the Scottish Budget. This additional funding was most significant in the 2020-21 Budget when public health restrictions were tightest. COVID-19 funding still formed an explicit part of the 2021-22 Budget but from 2022-23 onwards there is no separate COVID-19 funding and any funding previously in this category which

[12] Scottish Fiscal Commission (2021) Funding for the Scottish Budget (link)

has continued is now part of the general Block Grant. Overall resource funding has decreased each year from 2020-21 to 2022-23, driven by decreased funding for COVID-19.

2.7 In nominal terms resource funding is falling is 2.9 per cent between 2021-22 and 2022-23. After adjusting for inflation this reduction is 5.4 per cent.

Figure 2.1: Resource funding

£ million	2020-21	2021-22	2022-23
Barnett-determined Block Grant	29,776	30,916	34,322
Non-Barnett funding [1]	618	756	704
COVID-19 funding	8,600	4,924	0
SFC tax forecasts [2]	12,989	13,107	14,521
Tax and non-tax BGAs [3]	-12,825	-12,529	-14,639
Social security BGAs [4]	3,185	3,313	3,587
Final reconciliations [5]	-177	-319	-15
Resource borrowing	207	319	15
Resource reserve drawdown	171	402	0
Other [6]	160	271	742
NDR distributable amount	1,868	2,090	2,766
Total resource funding	44,572	43,250	42,002

Source: Scottish Fiscal Commission, based on Scottish Government information.

Figures may not sum because of rounding. The accompanying footnotes provide details for 2022-23 funding. Information for other years can be found in our previous publications.

[1] Non-Barnett funding includes: £80 million of Network Rail funding, £584 million of EU replacement farm funding, £14 million of EU replacement fisheries funding and £26 million Bew review funding.

[2] 2022-23 includes forecasts for income tax (£13,671), Land and Buildings Transaction Tax (£749 million) and Scottish Landfill Tax (£101 million).

[3] 2022-23 includes BGAs for income tax (-£13,861 million), Land and Buildings Transaction Tax (-£664 million), Scottish Landfill Tax (-£82 million), fines forfeitures and fixed penalties (-£28 million) and proceeds of crime (-£4 million).

[4] 2022-23 includes BGAs for Attendance Allowance (£545 million), Personal Independence Payment (£1,933 million), Disability Living Allowance (£687 million), Carer's Allowance (£323 million), Industrial Injuries Disablement Scheme (£79 million), Severe Disablement Allowance (£6 million) and Cold Weather Payments (£14 million).

[5] 2022-23 includes final reconciliations for 2019-20 income tax (-£34 million), 2020-21 Land and Buildings Transaction Tax (-£6 million), Scottish Landfill Tax (£0 million), 2020-21 fines forfeitures and fixed penalties (£4 million), 2019-20 Carer's Allowance (£1 million) 2019-20 Attendance Allowance (-£9 million), 2019-20 Personal Independence Payment (£30 million), Disability Living Allowance (£2 million), Industrial Injuries Disablement Scheme (-£2 million), Severe Disablement Allowance (£0 million).

[6] Other funding in 2022-23 includes revenue from fines forfeitures and fixed penalties (£25 million), Queen's and Lord Treasurer's Remembrancer (£5 million), migrant surcharge (£92 million) and assumed other income sources (£620 million).

Scottish Government assumptions on other funding

2.8 The Scottish Government has set its budget based on an assumption that it will receive extra income of £620 million for the resource budget in 2022-23. Annex A of the Budget identifies four potential sources of this income, all of which have a range of possible levels of income and associated risk of the source of income emerging.[13] The four sources of income are: additional UK Government funding at supplementary estimates, additional UK Government funding at a spring UK fiscal event, agreement between the UK and Scottish Governments on funding transfers for a spillovers dispute relating to income tax, and income from the Crown Estate offshore wind leasing.

2.9 In the two previous budgets the Scottish Government has made assumptions about additional funding from the UK Government. In the 2020-21 Budget the Scottish Government assumed £142 million of additional resource funding and £326 million of capital would arise at the UK Budget in March 2020. This assumption was made as the recently elected UK Government had several manifesto commitments which would increase spending. In the 2021-22 Budget the Scottish Government assumed £500 million of additional COVID-19 funding would result from the UK Budget in March 2021.

2.10 The Scottish Government is now assuming some additional positive consequentials will arise at either the UK Supplementary Estimates, which update the 2021-22 fiscal position, or a spring fiscal event ahead of the next financial year. The recent UK Government Spending Review set out spending plans for the next three years. Although there may be some new policy announcements at either Supplementary Estimates or the spring fiscal event which result in additional funding, the probability of this happening is lower than in previous years and we would caution against placing too much weight on this as a source of income.

2.11 The Scottish Government is also assuming its dispute with the UK Government over spillovers relating to the income tax personal allowance is resolved in 2022-23 and results in a transfer of funding from the UK Government to the Scottish Government. The Scottish Fiscal Commission is not involved in the dispute or in estimating the scale of the spillover. We note that this dispute has been on-going since 2017 and has not yet been resolved. Given that the fiscal framework negotiations are due to start next year, there is a risk of this dispute being caught up in the wider negotiations so the income may not materialise in the next financial year.

2.12 The fourth potential source of income arises from the Crown Estate. The Crown Estate was devolved as part of the Scotland Act 2016. The Crown Estate is currently running a programme leasing options for developing windfarms in Scottish waters.[14] This programme is expected to develop significant income which will materialise in the Scottish Budget over several years. We note the uncertainty about the potential scale of income, and the commercial sensitivity associated with the estimates of income.

2.13 The Scottish Government has set their budget on the assumption there are no resource underspends from the current financial year paid into the Scotland Reserve and then drawn down in 2022-23. We note that given the requirement on the Scottish Government to balance the Budget, it cannot overspend and must therefore underspend each year so it is likely there will be some additions to the Scotland Reserve which would be available to the Scottish Government.

2.14 There are commercial and political sensitivities associated with some of the figures as well as significant uncertainties about each. The Scottish Government has not assigned individual figures to the different income sources. We have set out above the risks we see with each of the sources, and have noted the possibility of resource underspends in the current financial year.

2.15 Taken together across all the sources of income and given the possible scale of each we judge the Scottish Government assumption that it will be able to access an additional £620 million in 2022-23

[13] Scottish Government (2021) Scottish Budget 2022-23 (link)
[14] Crown Estate Scotland – Scotwind (link)

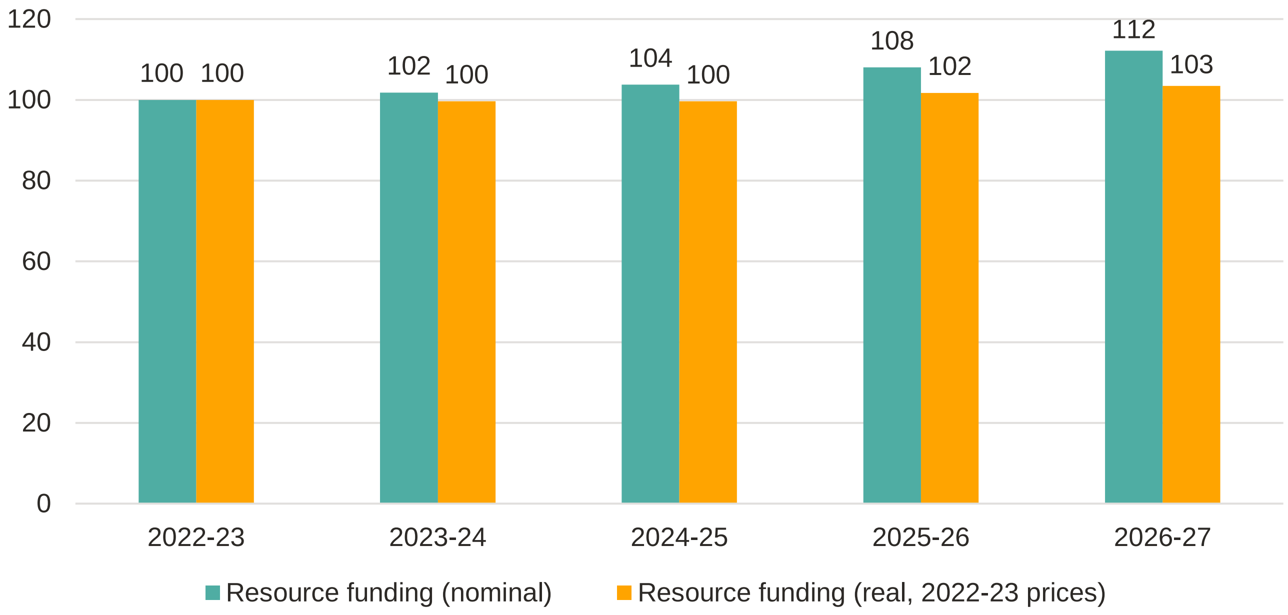
to be reasonable. We expect the Scottish Government to explain transparently how these income sources develop over the coming financial year and we will report on any changes in our future publications. We would also expect the Government to be aware that there is a risk that it may not be able to access at least part of the assumed £620 million package in 2022-23 and be willing to respond to any shortfall over the course of the financial year.

Resource five-year outlook

2.16 The UK Government published a Spending Review alongside its Autumn Budget in October 2021, setting out three-year spending plans and therefore components of funding for the Scottish Budget from 2022-23 to 2024-25.[15] Using this information, our latest forecasts of tax revenues, and Scottish Government assumptions for future years, it is possible to highlight medium term trends in resource funding. A more detailed description of the data used can be found in **Annex D**.

2.17 Figure 2.2 sets out the medium-term outlook for resource funding, in real and nominal terms, indexed to 2022-23 prices.

Figure 2.2: Medium term outlook for resource funding, indexed to 2022-23



Source: Scottish Fiscal Commission, based on Scottish Government information.
Figures in 2022-23 prices calculated using year-on-year growth GDP deflators from Table 1.7 of the OBR's supplementary economy tables. Figures rebased so 2022-23 = 100. Office for Budget Responsibility (2021) Economic and fiscal outlook – October 2021 – supplementary economy tables (link)

2.18 Resource funding increases in nominal terms across the five-year horizon. After adjusting for inflation, resource funding remains flat for the period covered by the UK Government's Spending Review (2022-23 to 2024-25) before gradually increasing in later years. Resource funding is made up of several components and we now consider each in turn.

Block Grant funding

2.19 Block Grant funding is the largest component of funding for the Scottish Budget and comes from the UK Government. Block Grant funding includes any Barnett funding, non-Barnett funding and COVID-19 funding set out in **Figure 2.1**.

[15] UK Government (2021) Autumn Budget and Spending Review 2021 (link)

2.20 The UK Government's Spending Review resulted in Block Grant funding for 2023-24 and 2024-25, which is flat in real terms, similar to the overall position of resource funding set out in Figure 2.2. For 2025-26 and 2026-27, the Scottish Government has assumed nominal growth of around 4 per cent, based on the OBR's projections of UK Government resource spending.[16] This reflects a real terms increase of around 2 per cent and pushes up the overall resource funding position in 2025-26 and 2026-27.

Funding related to tax and social security

2.21 Our forecasts of tax revenues and social security spending are used to set the Scottish Budget. Corresponding Block Grant Adjustments (BGAs) reduce or supplement the Scottish Budget, to reflect tax revenues or social security spending in the rest of the UK.

2.22 We compare our forecasts of tax revenues and social security spending to their corresponding BGAs, to calculate a net position. The net position for a tax is the difference between the BGA and revenues, a positive net position means revenues are greater than the BGA so making a positive contribution to the budget while a negative net position means revenues are less than the BGA therefore reducing the budget.[17]

Figure 2.3: Tax net position

£ million	2022-23	2023-24	2024-25	2025-26	2026-27
Tax net position	-86	-148	20	-117	-355

Source: Scottish Fiscal Commission
Includes the net position for income tax, Land and Buildings Transaction Tax and Scottish Landfill Tax.

2.23 We expect the net position for both Land and Buildings Transaction Tax (LBTT) and Scottish Landfill Tax (SLfT) to generally be positive over the next five years.[18] But the income tax position is negative and this is the dominant factor. With the exception of 2024-25, the overall net position for tax is negative for the next five years, as shown in Figure 2.3. We provide a detailed explanation of the tax net position in **Chapter 4** of this report, while this chapter will focus on its effects on the Scottish Budget. Funding for the 2022-23 Scottish Budget includes this -£86 million net position, reducing the amount available for the Scottish Government to spend.

2.24 Social security BGAs are included in funding for the Scottish Budget, while our forecasts set the budget for spending. Figure 2.4 compares available funding to spending by considering social security payments with BGAs and new payments.

2.25 For payments with BGAs, we compare funding to spending to calculate a net position. A negative figure reflects spending on Scottish payments being higher than the corresponding BGAs. It is worth noting that our forecasts do not yet incorporate any changes in spending arising from the Scottish Government's planned replacements for Carer's Allowance, Attendance Allowance, Industrial Injuries Scheme, and Winter Fuel Payments. In **Chapter 5** we discuss in further detail reasons why we consider the latest forecast of the social security net position to be an underestimate.

2.26 In addition, the Scottish Government has introduced new payments that do not receive any funding from the UK Government.[19] The costs of the new payments must be met entirely from the Scottish

[16] Office for Budget Responsibility (2021) Economic and Fiscal Outlook – October 2021 (link)
[17] Taxes with BGAs are income tax, Land and Buildings Transaction Tax and Scottish Landfill Tax.
[18] The only negative net position is SLfT in 2026-27, with -£60 million.
[19] New payments include Carer's Allowance Supplement, Scottish Child Payment, Child Winter Heating Assistance, and Best Start Grant Early Learning Payment and School Age Payment. We also include spending on bedroom tax mitigation through Discretionary Housing Payments.

Budget. We expect spending on these payments to increase in the future as new payments are launched and existing payment are amended or uprated. Spending on new payments can therefore be added to the net position for social security payments with BGAs to illustrate how much greater spending on social security will be than the funding received.

Figure 2.4: Social security net position and new payments

£ million	2022-23	2023-24	2024-25	2025-26	2026-27
Social security net position [1]	-38	-176	-253	-255	-252
Social security new payments [2]	-322	-493	-496	-503	-512
Total	-361	-669	-749	-758	-764

Source: Scottish Fiscal Commission

[1] This includes Adult Disability Payment (covered by the Personal Independence Payment BGA), Child Disability Payment (covered by the Disability Living Allowance BGA along with DLA Adult spending), Attendance Allowance, Carer's Allowance, Industrial Injuries Disablement Scheme, Low Income Winter Heating Assistance (covered by the Cold Weather Payment BGA), and Severe Disablement Allowance.

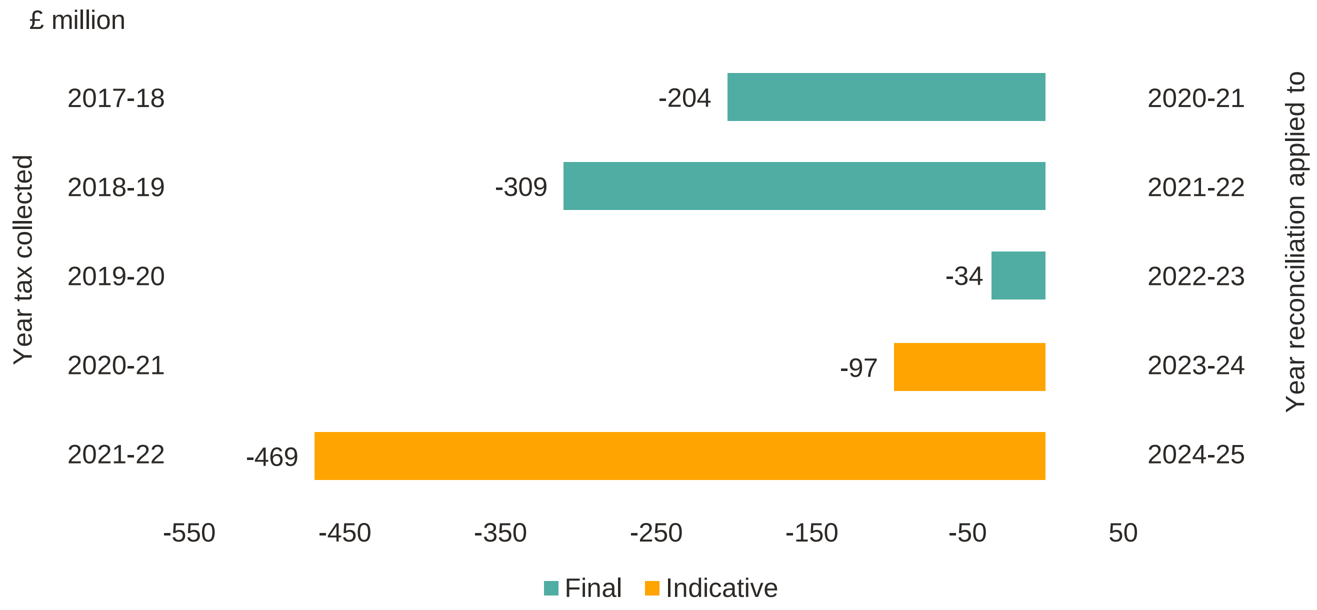
[2] New payments includes: Carer's Allowance Supplement, Scottish Child Payment, Child Winter Heating Assistance, Best Start Grant Early Learning Payment and Best Start Grant School Age Payment. We also include spending on bedroom tax mitigation through Discretionary Housing Payments.

Income tax reconciliations

2.27 The Scottish Budget is set in advance of each financial year, based on forecasts of revenue and spending. As one of the largest components of the Budget, income tax funding is fixed for the financial year. Once outturn information on income tax revenues becomes available, funding is aligned with outturn with an adjustment called a reconciliation, which is applied to the following year's Scottish Budget. The outturn data for income tax are only available after the deadline for Self-Assessed income tax returns and payments, around 16 months after the end of the financial year.

2.28 Reconciliations are funding adjustments which are a product of our and OBR forecast errors. The 2019-20 income tax outturn resulted in a final reconciliation of -£34 million, which has been applied to the 2022-23 Scottish Budget. Based on the latest forecasts, we are expecting negative reconciliations in 2023-24 and 2024-25.

Figure 2.5: Indicative and final income tax reconciliations



Source: Scottish Fiscal Commission

2.29 In January 2021, we highlighted the reconciliation risk arising from income tax funding in 2021-22.[20] At the time the 2021-22 Budget was set, we could not attribute the £475 million income tax net position to economic or tax policy differences, which would suggest revenues in Scotland would be that much higher than the income tax BGA. We concluded the relatively high net position arose because of timing differences in our and the OBR's forecasts, the significant uncertainty around COVID-19, and how both of these factors affected the data and judgements used in our and the OBR's income tax modelling.

2.30 Since January 2021, both ours and the OBR's forecasts have been revised up significantly following stronger than expected earnings growth in 2021. However, the OBR forecast has been revised up by significantly more. As shown in Figure 2.6, the income tax net position in 2021-22 is now expected to be £6 million, suggesting a reconciliation of -£469 million will be applied to the 2024-25 Scottish Budget, removing the additional funding the Scottish Government received in 2021-22. The actual reconciliation in 2024-25 will depend on the outturns reported in 2023.

Figure 2.6: Changes to 2021-22 income tax net position

£ million	SFC forecast	BGA	Net position
January 2021	12,263	-11,788	475
December 2021	13,002	-12,996	6
Difference	739	-1,208	-469

Source: Scottish Fiscal Commission, based on Scottish Government information.

2.31 The fiscal framework does not envisage situations where our forecasts and the BGA are made on different bases. Any subsequent reconciliations need to be managed within the Scottish Budget. The Scottish Government has limited tools for this, and has stated it plans to use resource borrowing to manage income tax reconciliations. The Scottish Government will be able to borrow £300 million to manage the reconciliation, so only £169 million of the expected £469 million reconciliation will reduce funding in 2024-25. The rest of the reconciliation can be repaid in future

[20] Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – January 2021 (link)

years via resource borrowing. The Scotland Reserve is the other tool available to the Scottish Government, which in principle could prepare for a negative reconciliation by deliberate underspends to build up the Reserve. However, the Reserve has an overall limit and an annual drawdown limit and given the existing need for the Scottish Government to use the Reserve to achieve a balanced budget each year, the scope for it to help prepare for negative reconciliations is very limited.

2.32 Currently the Scottish Government has enhanced borrowing powers and greater flexibility to use the Scotland Reserve because our January 2021 forecasts triggered a "Scotland-specific economic shock". These flexibilities expire after 2023-24 and are therefore not available to the Scottish Government to manage the large income tax reconciliation expected in 2024-25. As a result, one-off spending cuts may be required.

Resource reserve

2.33 The Scottish Government is required to maintain a broadly balanced budget, matching its spending to available funding each year. As the Scottish Government cannot overspend its budget, outturn spending must come in below the allocated budget and this results in underspends, as a normal outcome of budget management. The Scottish Government can use the Scotland Reserve to transfer unspent funds from one financial year to the next. The Scotland Reserve was introduced in 2017-18 as a mechanism to allow the Scottish Government to save any underspends or surplus tax revenues, build up funds and draw them down in future years.

2.34 The Scotland Reserve has a total limit of £700 million, which includes resource and capital funds. There are no restrictions on how the reserve is split between resource and capital or on 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 is triggered, as it was by our economy forecast in January 2021, the drawdown limit is waived for three years. The balance of the resource reserve, based on Scottish Government plans, is shown in Figure 2.7. The Scottish Government is planning to use the relaxed drawdown rules to draw down the resource reserve in full in 2021-22 and has no planned drawdown in 2022-23.

Figure 2.7: Balance of the resource reserve

£ million	2020-21	2021-22	2022-23
Opening balance	217	402	0
Drawdowns	-171	-402	0
Additions	356	0	
Closing balance	402	0	0

Source: Scottish Fiscal Commission, based on Scottish Government information.
Figures may not sum to totals because of rounding. Shaded cells refer to provisional outturn available at time of publication.

2.35 The average underspend, or addition to the Scotland Reserve, is £370 million each year, as shown in Figure 2.8. The Scottish Government must therefore reduce the balance of the Scotland Reserve on average to below £330 million before the end of each year to ensure there is space for underspends to be paid in without breaching the overall £700 million limit. As the Scottish Government is required to leave space in the Reserve to add any underspends each year, this limits the utility of the Reserve to build up funds to manage other risks, for example negative reconciliations.

Figure 2.8: Historic resource and capital additions to the Scotland Reserve

£ million	2017-18	2018-19	2019-20	2020-21	Average
Total additions (resource and capital)	464	339	256	421	370

Source: Scottish Fiscal Commission, based on Scottish Government information.
Shaded cells refer to outturn available at time of publication. Capital and resource additions are displayed separately in Figure 2.7 and Figure 2.13.

2.36 The limits of the Scotland Reserve are fixed in cash terms while the size of the Scottish Budget increases each year. The capacity of the Scotland Reserve as a tool to manage underspends is therefore reducing in real terms over time. In 2017-18, when the Scotland Reserve was created, the £700 million overall limit accounted for the equivalent of 2.1 per cent of the Scottish Budget, and in 2022-23 this reduces to 1.5 per cent. The annual drawdown limits, which will apply again from 2024-25 onwards, also now account for a smaller proportion of funding, as shown in Figure 2.9.

Figure 2.9: Limits of the Scotland Reserve as a percentage of Budget

Per cent	2017-18	2022-23
Overall limit	2.1	1.5
Resource drawdown limit	0.8	0.6
Capital drawdown limit	2.5	1.6

Source: Scottish Fiscal Commission
Percentages are calculated based on their corresponding budgets (that is, resource drawdown limit is relative to total resource funding, and capital drawdown limit is relative to total capital funding).
Resource calculations exclude the NDR distributable amount as this is managed through the Non-Domestic Rating account.

Resource borrowing

2.37 The Scottish Government can access resource borrowing powers when tax and social security forecast errors have occurred. Under normal circumstances, borrowing is limited to £300 million per year and £1,750 million in total, up to the balance of forecast errors. As a Scotland-specific economic shock was triggered in 2021-22, the annual borrowing limit has been increased to £600 million for 2021-22 to 2023-24 inclusive. Resource borrowing is 'unlocked' when forecast errors occur, up to the annual and overall limits. The Scottish Government plans to borrow to manage income tax reconciliations.[21] Figure 2.10 sets out historic and planned borrowing, with future years based on estimated income tax reconciliations. Borrowing is shown only up to 2024-25 as future reconciliations will depend on income tax for the coming and future financial years.

Figure 2.10: Historic and planned resource borrowing

£ million	2020-21	2021-22	2022-23	2023-24	2024-25
Borrowing – central scenario	207	319	15	97	300
Total debt	207	505	448	438	621

Source: Scottish Fiscal Commission, based on Scottish Government information.
Shaded cells refer to outturn available at time of publication.
The reconciliations applied to 2021-22 and 2022-23 are final while 2023-24 and 2024-25 are indicative, based on the latest forecasts. We currently estimate a reconciliation of -£469 million in 2024-25 but borrowing is limited to £300 million.

[21] Scottish Government (2021) Medium Term Financial Strategy (link)

2.38 In January 2021 we presented an analysis of income tax reconciliations.[22] We highlighted the risk that resource borrowing powers are unlikely to be sufficient to manage income tax reconciliations in full. Our analysis suggested in around 3 in 10 years the £300 million limit will be exceeded and in around 1 in 10 years the limit of £600 million will be exceeded. This looks likely to occur in 2024-25, where the £300 million resource borrowing is not sufficient to cover the expected -£469 million reconciliation.

2.39 Debt from resource borrowing as shown in Figure 2.10 is well below the £1,750 million cap. Because of the short repayment period and limits on how much can be borrowed each year, it is not possible for the Scottish Government to reach the £1,750 million cap without both another Scotland-specific economic shock and significant forecast errors occurring.

Resource Assessment

2.40 The Scottish Government's resource budget is expected to increase by 12 per cent between 2022-23 and 2026-27, largely because of increases in UK Government funding. Behind this headline increase are several different elements. Increased resource funding from the UK Government is partially offset by anticipated shortfalls between tax revenues and Block Grant Adjustments (BGA). The Scottish Government also plans social security spending above the corresponding BGA funding. This creates pressures over the next five years and the Scottish Government will need to balance its spending plans against the resource budget available.

2.41 The resource management tools available to the Scottish Government can be used to transfer funding between financial years but cannot be used to manage longer term divergences in funding and spending plans. Resource borrowing can only be used to manage forecast errors and forecast differences in funding in future years cannot be managed through borrowing. The Scotland Reserve limits allow the Scottish Government to manage the Budget between consecutive financial years, but are not sufficient to balance spending across longer time horizons.

2.42 In January 2021 we highlighted the risk that in 2021-22 the income tax net position, the difference between forecast Scottish revenues and the BGA, was artificially high and would likely result in a negative reconciliation in 2024-25. This has translated into a forecast negative reconciliation of -£469 million. The Scottish Government has limited tools to manage the expected reconciliation, as it is larger than the £300 million borrowing limit and the limits of the Scotland Reserve would not have been sufficient for this funding to be saved in 2021-22 then removed in 2024-25, as the resource drawdown limit in 2024-25 will be £250 million. In addition the Scottish Government uses the Scotland Reserve to manage underspends from elsewhere in the resource budget.

2.43 The Scottish Government's policy is to use resource borrowing to manage income tax reconciliations.[23] With the current estimate of future reconciliations, the debt stock is expected to reach £621 million, well below the overall £1,750 million limit, and we consider the borrowing plans to be reasonable.

2.44 In previous reports we highlighted the significant uncertainty around COVID-19 funding, including the potential for large underspends because of additional funding added or removed late in the financial year. The Scottish Government has kept the balance of the Scotland Reserve low, in both 2020-21 and 2021-22, to allow space to manage any underspends.

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[22] Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts (link)
[23] Scottish Government (2021) Scotland's Fiscal Outlook: The Scottish Government's Medium-Term Financial Strategy – January 2021 (link)

Capital

Capital funding

2.45 Capital funding accounts for 13 per cent of the Scottish Budget. It is used for long-term investment such as hospitals, roads, and research and development. Financial transactions are a subsection of capital funding and can be used to make loans to, or equity investments in, private sector entities.

2.46 In this section we first set out the detailed capital funding position for the year ahead, 2022-23, compared to previous years for reference. We then move on to consider the medium-term outlook for capital funding, which is expected to fall in both cash and inflation adjusted terms. We discuss different components of capital funding to explain these trends.

Figure 2.11: Capital funding

£ million		2020-21	2021-22	2022-23
Capital (excluding financial transactions)	Barnett-determined Block Grant	4,886	5,007	4,469
	Non-Barnett funding [1]		188	643
	COVID-19 funding	0	326	0
	Capital borrowing	200	400	450
	Capital reserve drawdown	80	4	118
	Other [2]	-60	0	144
Financial transactions	Barnett-determined Block Grant	611	208	466
	COVID-19 funding	0	57	0
	Financial transaction reserve drawdown	0	197	61
	Other	-25	0	0
Total		5,692	6,387	6,351

Source: Scottish Fiscal Commission, based on Scottish Government information.
Figures may not sum because of rounding. The accompanying footnotes provide details for 2022-23 funding. Information for other years can be found in our previous publications.
[1] Non-Barnett funding in 2022-23 includes £643 million Network Rail funding. This was previously included in the Barnett-determined Block Grant funding line.
[2] Other funding in 2022-23 includes £100 million of City Deal funding and £44 million from the Fossil Fuel Levy.

2.47 In nominal terms capital funding is falling by 0.6 per cent between 2021-22 and 2022-23. After adjusting for inflation this reduction is 3.2 per cent. Capital funding in 2022-23 is lower than in the current financial year, because of a reduction in UK Government capital funding partially offset by an increase in financial transaction Barnett funding.

2.48 The UK Government's recent Spending Review set out three-year funding for the Scottish Budget from 2022-23 to 2024-25.[24] Based on the UK Government's plans, and Scottish Government assumptions for the following two years, we can set out capital funding over five years.

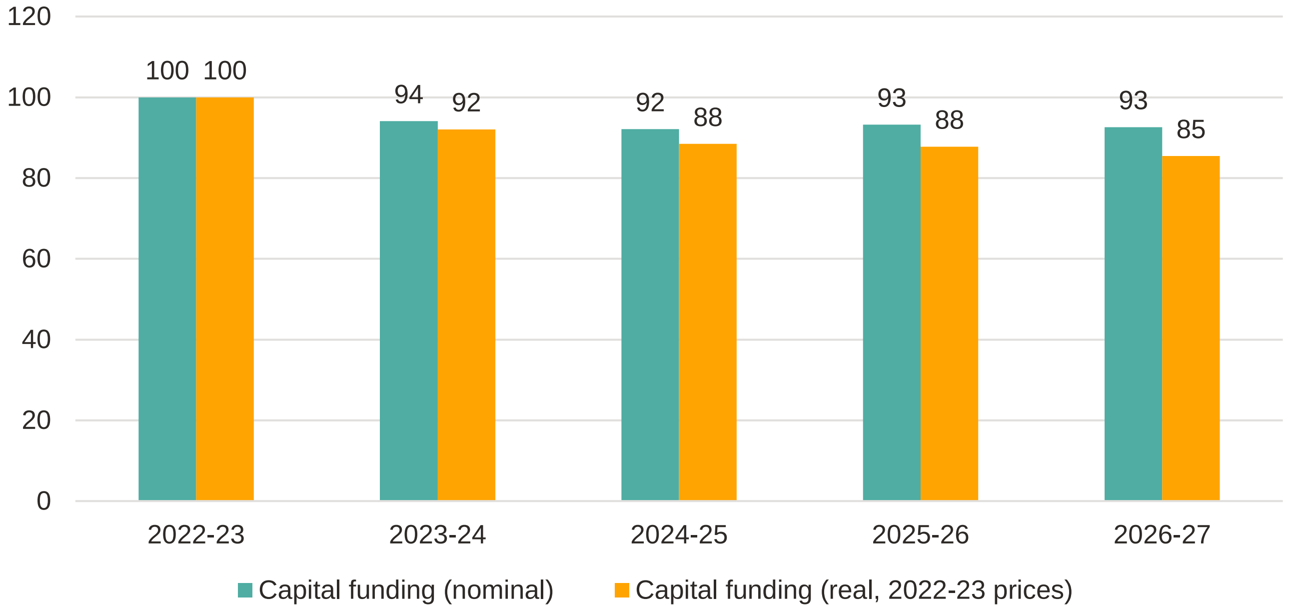
2.49 Over the next five years we expect capital funding to fall in both cash and inflation adjusted terms, primarily because of reduced UK Government funding. The Scottish Government is moving closer to

[24] UK Government (2021) Autumn Budget and Spending Review 2021 (link)

reaching its capital borrowing limit of £3 billion, with a self-imposed rule to ensure a contingency of £300 million remains available in 2026-27. To stay within these limits, borrowing is planned to reduce over the next five years, further reducing capital funding.

2.50 Figure 2.12 sets out our the medium-term outlook for capital funding in cash terms and adjusted for inflation. Annex D provides detailed information on the sources of this information, any assumptions made and how we produced this trend.

Figure 2.12: Medium term outlook for capital funding, indexed to 2022-23



Source: Scottish Fiscal Commission, based on Scottish Government information.
Figures in 2022-23 prices calculated using year-on-year growth GDP deflators from Table 1.7 of the OBR's supplementary economy tables. Figures rebased so 2022-23 = 100. Office for Budget Responsibility (2021) Economic and fiscal outlook – October 2021 – supplementary economy tables (link)

Block Grant funding

2.51 Block Grant funding is also the largest component of funding for the capital part of Scottish Budget and comes from the UK Government. Block Grant funding includes Barnett, non-Barnett and COVID-19 funding set out in Figure 2.11.

2.52 Over the period of the UK Government Spending Review (2023-24 and 2024-25) Block Grant funding is expected to reduce in real terms, reflecting a decrease first in financial transactions then capital funding. The Scottish Government assumes capital Block Grant funding (excluding financial transactions) will grow by 5 per cent in 2025-26 and 4 per cent in 2026-27, in line with the OBR's October 2021 projections of UK public sector gross investment for capital.[25] These assumptions for the later years slow the decline in real terms block grant funding in 2024-25 and increase real terms Block Grant funding marginally for 2025-26. These trends in Block Grant funding are reflected in Figure 2.12, with a quick initial decline slowing in the later years.

[25] The resource and capital projections are for Departmental Expenditure Limit (DEL) spending and can be found in Table 3.14: Total managed expenditure of its October 2021 Economic and Fiscal Outlook publication. Office for Budget Responsibility (2021) Economic and Fiscal Outlook – October 2021 (link)

Capital reserve

2.53 The capital part of the Scotland Reserve covers both capital and financial transactions and can be used to carry underspends between years and to 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 it is removed. Our January 2021 forecast triggered this shock, which means the drawdown limit is removed from 2021-22 to 2023-24 inclusive. The Reserve is subject to an overall £700 million limit for both resource and capital.

Figure 2.13: Balance of the capital and financial transaction reserve

£ million		2020-21	2021-22	2022-23
Capital	Opening balance	80	4	118
	Drawdowns	-80	-4	-118
	Additions [1]	4	118	
	Closing balance	4	118	0
Financial transactions	Opening balance	136	197	61
	Drawdowns	0	-197	-61
	Additions [1]	61	61	
	Closing balance	197	61	0

Source: Scottish Fiscal Commission, based on Scottish Government information.
Figures may not sum to totals because of rounding. Shaded cells refer to provisional outturn available at time of publication.
[1] The additions to the reserve in 2021-22 are not based on forecast underspend. These are balancing figures to allow the planned 2022-23 drawdowns.

2.54 The Scottish Government used the relaxed rules to draw down £197 million of financial transactions from the Reserve in 2021-22. The Scottish Government plans to draw down the capital and financial transaction reserves in full in 2021-22 and 2022-23.

2.55 As the overall limit of the Scotland Reserve is not split between capital and resource, reducing the capital balance of the Reserve allows more space for resource underspends to be carried between years.

Capital borrowing

2.56 The Scottish Government can borrow for capital spending up to a maximum £450 million each year with a total limit of £3 billion. The Scottish Government's policy is to borrow between £250 million and £450 million each year over the period of the National Infrastructure Mission (up to 2025-26 inclusive), with a contingency reserve of £300 million remaining in 2026-27.[26]

2.57 The Scottish Government provided their central borrowing scenario up to 2025-26, which meets their policy requirement to leave a £300 million contingency reserve in 2026-27. We have not included any planned borrowing for 2026-27 to illustrate the debt position at the end of the Scottish Government's plans. Borrowing in 2026-27 could be up to £340 million without exceeding the £3 billion limit.

[26] Scottish Government (2021) Scotland's Fiscal Outlook: The Scottish Government's Medium-Term Financial Strategy – January 2021 (link)

Figure 2.14: Capital borrowing central scenario

£ million	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
Borrowing – central scenario	200	400	450	300	250	250	0
Total debt	1,744	2,061	2,418	2,604	2,722	2,825	2,660

Source: Scottish Fiscal Commission, based on Scottish Government information.
Shaded cells refer to outturn available at time of publication.

2.58 The Scottish Government is planning to borrow £400 million in 2021-22. The Government's planned borrowing is included in the latest estimate of the 2021-22 Scottish Budget position and has been reduced by £50 million since the Budget was set in January 2021. The actual borrowing is likely to be confirmed at the end of the financial year. In the past, where underspends have arisen during the year, the Government has typically reduced planned borrowing in-year to ensure there is not a large underspend which breaches the Scotland Reserve limit. Borrowing can be reduced to either manage capital underspends, or remove capital funding from the Scotland Reserve, creating more space for resource funding.

2.59 Capital borrowing of £450 million has been included in each Scottish Budget since it was introduced in 2017-18, while outturn borrowing is typically lower.

Figure 2.15: Capital borrowing in Budget compared to outturn

£ million	2017-18	2018-19	2019-20	2020-21	2021-22
Capital borrowing in the Budget	450	450	450	450	450
Outturn borrowing or adjusted plans	450	250	405	200	400

Source: Scottish Fiscal Commission, based on Scottish Government information.
Shaded cells refer to outturn available at time of publication.

Capital Assessment

2.60 Over the course of 2020-21 and 2021-22, the Scottish Government has used capital borrowing and the capital reserve as tools to reduce underspends and maintain a balanced Budget.

2.61 The Scotland Reserve is primarily used to carry underspends between financial years. As the total limit of the reserve is not split between 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 has reduced the capital and financial transactions balance of the reserve in 2020-21, which brought the balance low enough to allow £420 million of resource and capital underspends to be carried into 2021-22. The Scottish Government is planning to draw down the Reserve in full in 2021-22, which will allow space for underspends arising from any Budget volatility this year.

2.62 The Scottish Government borrowed £200 million in 2020-21, taking total debt to £1.7 billion. Borrowing plans for 2021-22 are currently £400 million, but this may be reduced before the end of 2021-22, based on evidence from previous years.

2.63 Over the next five years we expect capital funding to fall in both cash and inflation adjusted terms, primarily because of reduced UK Government funding. As capital borrowing is moving closer to reaching the £3 billion limit, borrowing is planned to reduce over the next five years, further reducing capital funding.

2.64 We assess the Scottish Government's borrowing plans to be reasonable, but note the likelihood borrowing will turn out to be lower than planned each year, and capital debt moving closer to the limit over the next five years. We also note these borrowing plans have been made within the context of expected reductions to Block Grant funding in future years and the slowing of planned borrowing will further reduce capital funding over the forecast period.

Chapter 3 Economy

Forecast summary

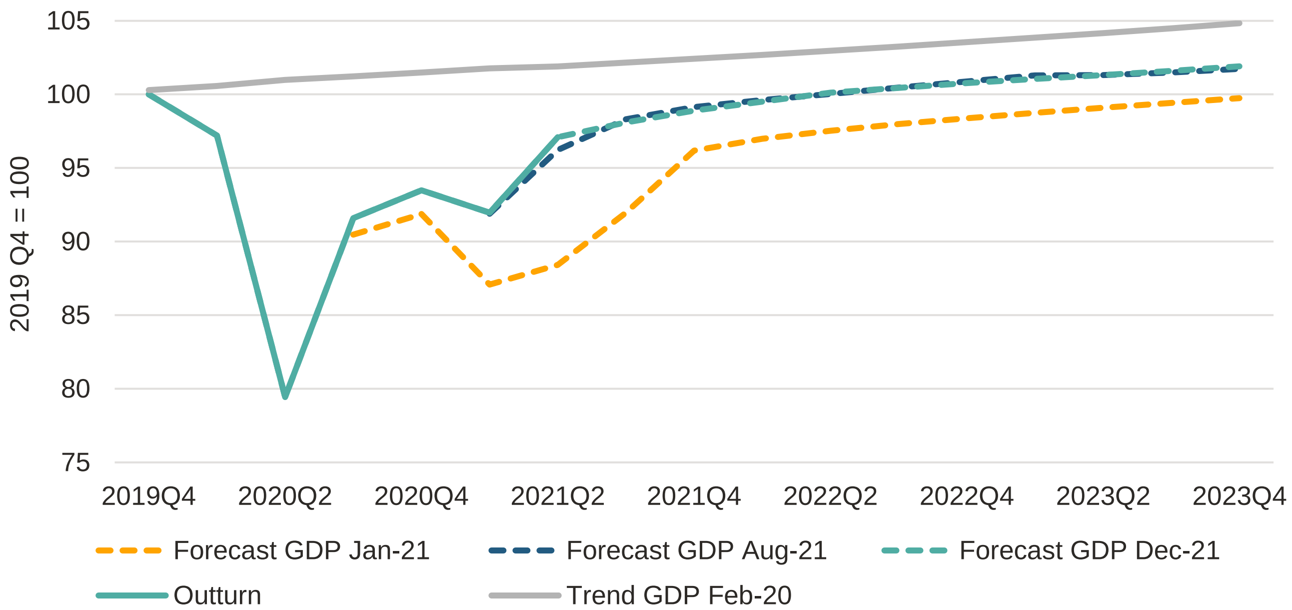
3.1 We continue to expect a strong economic recovery in 2021-22, with Scottish GDP growing by 10.4 per cent, which implies a return to pre-pandemic levels of economic activity by the second quarter of 2022. Figure 3.1 shows our latest December 2021 GDP forecast is largely unchanged since our previous forecast published in August 2021. We assume that long-run GDP in 2025 Q1 will be 2 per cent lower than our pre-pandemic February 2020 forecast, down from the 3 per cent expected in January 2021 and unchanged from August 2021.

3.2 Throughout 2020-21 and 2021-22, the labour market has been more resilient than many economic forecasters and commentators, like the Commission, expected. We now expect the unemployment rate to peak at only 4.9 per cent, a significant downward revision from our January 2021 forecast which peaked at 7.6 per cent.

3.3 Inflationary pressures have intensified since the summer, driven in part by high energy prices, global supply chain disruptions and shortages, and we now expect CPI inflation to peak at 4.4 per cent in 2022 Q2. Partly reflecting inflation, nominal pay growth is expected to be relatively strong in 2021-22, at 3.8 per cent. We expect nominal earnings growth to moderate in 2022-23 at 2.6 per cent. Higher inflation, combined with recent tax rises, means that many households will see their real average earnings fall by 0.8 per cent in 2022-23.

3.4 In spite of the pace of the recovery in Scotland, there is some evidence that the Scottish economy has been lagging behind the rest of the UK. Compared to pre-pandemic levels, Scottish GDP, employment and earnings have recovered more slowly than in the UK.

Figure 3.1: Trend and forecast Scottish GDP



Source: Scottish Fiscal Commission, Scottish Government (2021) GDP QNA: 2021 Quarter 2 (April to June) (link).

3.5 [Chapter 1](#) provides a discussion of our central COVID-19 assumptions. We assume that with the success of vaccines in weakening the link between case numbers, hospitalisations and deaths, domestic restrictions remain minimal with limited measures in place until April 2022. These assumptions were finalised before the emergence of the Omicron variant. Current information on the severity and likely implications for restrictions of Omicron is limited, but broadly we think it remains reasonable to assume the effects of Omicron fit within our central COVID-19 judgements. More severe effects from Omicron and the emergence of further variants of COVID-19 which are resistant to existing vaccines remain a downside risk to our forecast.

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	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
GDP							
January 2021	-12.4	7.5	5.1	1.5	1.7	1.7	
December 2021	-10.3	10.4	2.2	1.2	1.3	1.4	1.4
Consumer Price Index inflation							
January 2021	0.6	1.4	1.6	1.8	1.9	2.0	
December 2021	0.6	3.3	3.7	2.3	2.0	2.0	2.0
Average nominal earnings							
January 2021	2.1	2.5	2.6	2.8	3.1	3.3	
December 2021	3.8	3.8	2.6	3.0	3.2	3.3	3.4
Average real earnings							
January 2021	2.5	1.2	0.9	0.9	1.1	1.3	
December 2021	3.8	0.6	-0.8	0.7	1.1	1.3	1.4
Employment							
January 2021	-2.8	-0.7	1.5	0.7	0.3	0.1	
December 2021	-3.8	1.3	1.0	0.1	-0.1	-0.2	-0.2
Unemployment rate							
January 2021	6.6	7.1	5.6	4.9	4.6	4.5	
December 2021	4.5	4.6	4.5	4.3	4.2	4.2	4.2

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – January 2021 (link).
Shaded cells refer to outturn available at time of publication. Nominal earnings are adjusted for inflation using the Consumer Expenditure Deflator.

3.7 The outlook for inflation has changed significantly since January 2021, and this affects our forecasts of earnings and household incomes. In January 2021, we forecast inflation to remain low and below the 2 per cent target. Our current inflation forecast, aligned with the OBR's October 2021 UK inflation forecast, is revised up as inflationary pressures have intensified over the year.[27] In particular, wholesale gas prices have risen sharply, pushed to historic highs by strong global

[27] OBR (2021) Economic and Fiscal Outlook – October 2021 (link)

demand, depleted European gas reserves after last year's cold winter, and a below-average renewable energy output.

3.8 In its November 2021 Monetary Policy report, the Bank of England predicts a temporary surge in inflation, with higher energy prices driving up firms' costs and consumer prices. This surge will eventually put downward pressure on demand by weighing on households' real incomes and spending, which in turn will limit inflation.[28] Our central view of inflation, in line with the OBR's and similar to that of the Bank, sees annual CPI inflation peaking at 4.4 per cent in 2022 Q2 and gradually returning to target by the second half of 2024 as supply chain issues ease, global demand rebalances, and energy prices fall back. There are however significant risks to the outlook for inflation and interest rates. If inflation remains higher for longer, this could lead to a larger interest rate response from the Bank of England and have significant implications for the Scottish economy and households, including limiting credit and reducing house prices.

3.9 Despite high inflation and relatively strong earnings growth, we currently do not see any evidence of a wage-price spiral, with pay settlements remaining modest at 2.0 to 3.5 per cent. There are several reasons to believe this may continue to be the case. First, there is evidence that the domestic labour market may not be as tight as current labour shortages suggest. Economic participation is still below potential, and recruitment difficulties and record-high vacancies are largely because of a post-lockdown adjustment across sectors.[29] Second, longer-term inflation expectations which feed into wage and price setting have remained well anchored.[30] Third, businesses already facing high energy and other input costs may resist wage increases that keep up with inflation.

3.10 Higher inflation, combined with recent tax rises including the new Health and Social Care Levy, will erode real disposable incomes and household consumption. With inflation outpacing nominal earnings growth in 2022-23, we expect real earnings to fall by 0.8 per cent next year. Low-income households could be disproportionately affected, for example because they spend more of their money on essentials including energy.[31]

3.11 There is emerging evidence that the recovery from the COVID-19 shock in Scotland has been slightly lagging behind the UK. Figure 3.3 shows the shape of GDP and labour market recovery across different sectors in Scotland relative to the UK. Scotland's Pay As You Earn (PAYE) mean pay growth between February 2020 and September 2021 is around 1.3 percentage points lower than that of the UK, with the highly-paid finance and insurance sector largely driving this gap. The largest relative fall in Scottish sectoral GDP is in mining and quarrying, reflecting both the importance and the longer-term decline of oil and gas support services in Scotland. These features have important implications for our forecasts of the Scottish economy and tax revenues. We further explore aspects of Scotland's labour market performance relative to the UK in Boxes **3.1** and **3.2**.

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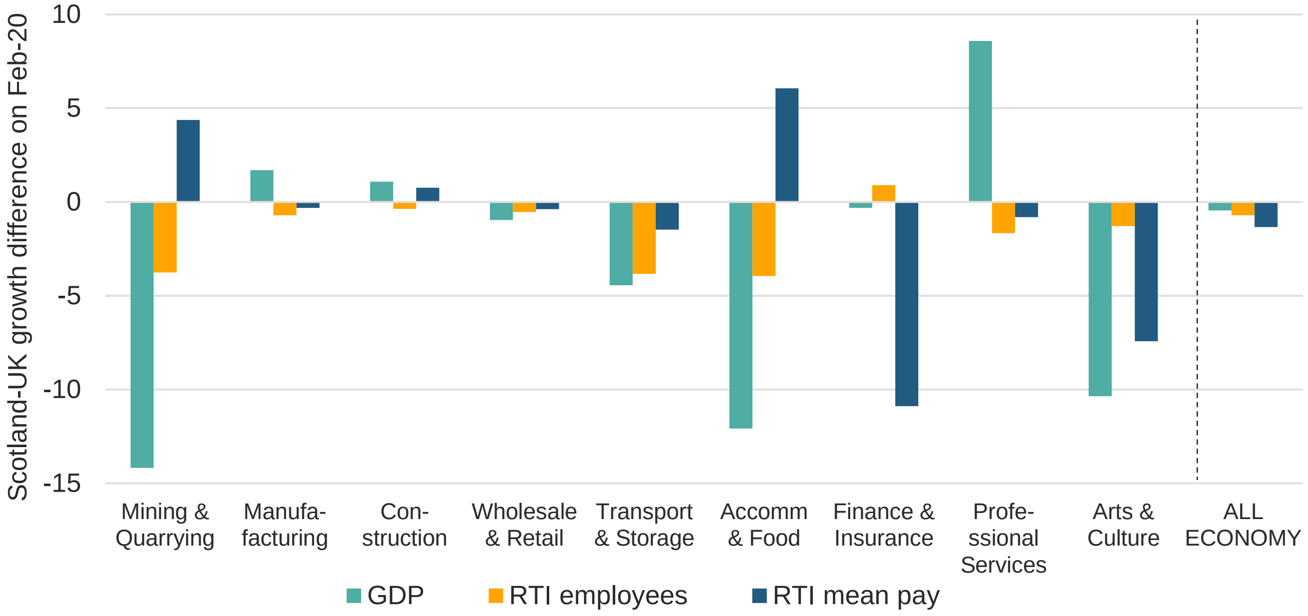
[28] Bank of England (2021) Monetary Policy Report – November 2021 (link)
[29] Resolution Foundation (2021) Two-and-a-half cheers for the UK's post-furlough labour market (link), ONS (2021) X02: Labour Force Survey Flows estimates – November 2021 (link).
[30] Bank of England (2021) Monetary Policy Report - November 2021 (link)
[31] Institute for Fiscal Studies (2021) The cost of living crisis – who is hit by recent price increases? (link)

Figure 3.3: Percentage point difference, relative to the UK, in Scotland's growth in GDP, PAYE employees, PAYE mean pay since pre-pandemic February 2020 levels[32]



Source: Scottish Fiscal Commission, Scottish Government (2021) GDP Monthly Estimate: September 2021 (link), ONS (2021) Monthly gross domestic product by gross value added (link), ONS (2021) Earnings and employment from Pay As You Earn Real Time Information, seasonally adjusted – November 2021 (link).
For reasons of space, the figure covers a selection of sectors. GDP and PAYE mean pay figures are as of September 2021, PAYE employee figures are as of October 2021.

3.12 To aid comparisons of our headline GDP forecasts in financial and calendar year terms, Figures 3.4 and 3.5 show our latest and previous forecasts of GDP growth on both annual bases.

Figure 3.4: SFC latest and previous forecasts, GDP growth rates in financial years

Per cent	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
January 2021	7.5	5.1	1.5	1.7	1.7	
August 2021	10.5	2.4	1.0	1.2	1.6	1.7
December 2021	10.4	2.2	1.2	1.3	1.4	1.4

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – August 2021 (link), Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – January 2021 (link).

Figure 3.5: SFC latest and previous forecasts, GDP growth rates in calendar years

Per cent	2021	2022	2023	2024	2025	2026
January 2021	1.8	7.5	1.6	1.6	1.7	
August 2021	6.7	4.0	1.2	1.0	1.6	1.7
December 2021	6.7	3.8	1.3	1.3	1.4	1.4

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – August 2021 (link), Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – January 2021 (link).

[32] GDP comparisons between Scotland and the UK as a whole, or other countries, should be treated with caution due to the increased levels of uncertainty at this time. The ONS has discussed these challenges and identified that there are two different estimates of where the UK economy is relative to its pre-pandemic levels depending on the quarterly or monthly statistics. ONS (2021) Measuring monthly and quarterly UK gross domestic product during the coronavirus (COVID-19) pandemic (link)

3.13 Figure 3.6 shows how our December 2021 forecast of GDP growth in calendar years compares to a range of other available forecasts for Scotland and the UK.

Figure 3.6: Forecast comparison, GDP growth rates in calendar years

Per cent	2021	2022	2023	2024	2025	2026
Scotland						
SFC December 2021	6.7	3.8	1.3	1.3	1.4	1.4
FAI September 2021	6.5	4.8				
UK						
OBR October 2021	6.5	6.0	2.1	1.3	1.6	1.7
NIESR November 2021	6.9	4.7	1.7	1.3	1.4	1.3
BoE November 2021	7.0	5.0	1.5	1.0		
HMT average of forecasters Nov 2021	7.0	5.0				

Source: Scottish Fiscal Commission, Fraser of Allander Institute (2021) FAI Economic Commentary, 2021 Q3 (link), OBR (2021) Economic and Fiscal Outlook – October 2021 (link), NIESR (2021) UK Economic Outlook Autumn 2021 (link), Bank of England (2021) Monetary Policy Report – November 2021 (link), HM Treasury (2021) Forecasts for the UK economy: November 2021 (link).

3.14 Our economy forecasts were finalised on 18 November 2021. No new data or information received after this date were incorporated into the forecasts.

Main judgements

Figure 3.7: Economy forecast main judgements

Issue	January 2021	December 2021
1. Spare capacity	Significant spare capacity in economy at start of forecast period, -9.9 per cent of trend GDP in 2020-21	Spare capacity was -10.7 per cent of trend GDP in 2020-21, gradually returning to zero
2. Trend productivity	Level in 2025 Q1 is 2.2 per cent lower than in our February 2020 forecast	Growth revised up from 0.2 per cent to 0.6 per cent in 2021-22 and from 0.5 per cent to 1.1 per cent in 2022-23 Level in 2025 Q1 is 0.9 per cent lower than in our February 2020 forecast
3. Long-run unemployment rate	From 5.5 per cent in 2020 Q2 gradually moving to 4.4 per cent in 2023 Q1	4.2 per cent over the forecast period
4. Nominal average annual earnings	Using Real Time Information earnings for 2020 Q3. Growth increasing from 2.5 per cent in 2021-22 to 3.3 per cent in 2025-26	Growth revised up from 2.5 per cent to 3.8 per cent in 2021-22, partly reflecting higher inflation and compositional effects. Growth increasing from 2.6 per cent in 2022-23 to 3.4 per cent in 2026-27
5. Population projections	Bespoke projections adjusted for COVID-19. For migration, we assume zero net international migration in the year to mid-2021, transitioning to the 'zero per cent net EU migration' scenario in later years	Projections of population and migration in the year to June 2020 updated for mid-2020 outturn estimates No change to migration assumptions
6. Forecasts of the UK	Based on OBR UK November 2020 forecast	Based on OBR UK October 2021 forecast
7. Oil and gas	Neutral impact of UK Continental Shelf activity on onshore economy over the forecast	North Sea oil and gas activity contributes to slower recovery in GDP, employment and earnings in Scotland than in the UK compared to pre-pandemic levels
8. Savings ratio	High savings ratio in 2020-21, declining gradually over forecast period	Savings ratio of almost 20 per cent in 2020-21, falling in 2021-22 to nearly reach its long-run average of 8 per cent
9. Second round effects	No material effect of any Scottish Government policy changes on economic growth	No change

Source: Scottish Fiscal Commission

GDP and expenditure components

3.15 The outlook for overall GDP is similar to our August 2021 forecast with a return to pre-pandemic levels in the second quarter of 2022, but the composition of the GDP forecast has changed, with a shift in consumption from households to government. The fiscal easing announced in the October 2021 UK Budget feeds through to higher government spending in Scotland, broadly offsetting the reduced contribution from household expenditure to GDP growth over the next year.

3.16 Financial support provided to the economy while it adapted to public health restrictions meant that government spending increased significantly over 2020-21. Meanwhile, government output declined in 2020-21 because of school closures and non-essential health treatments being postponed, but is expected to bounce back in 2021-22, with education almost back to normal and the National Health Service (NHS) working through waiting lists. The health service is under increased pressure with NHS waiting lists increasing from around 80,000 in 2019 Q4 to approximately 400,000 in 2021 Q2 as efforts were focussed on the response to COVID-19.[33]

3.17 Our forecast for household disposable income has decreased because of a lower pass-through from inflation to private wages, and also because of higher taxes including the new Health and Social Care Levy. The reduction in our forecast of household income puts pressure on the savings ratio which was already near its long-run average of 8 per cent at the start of the forecast. A flatter profile for household income means that household consumption is 4 per cent lower by the end of the forecast period than in our August 2021 forecast.

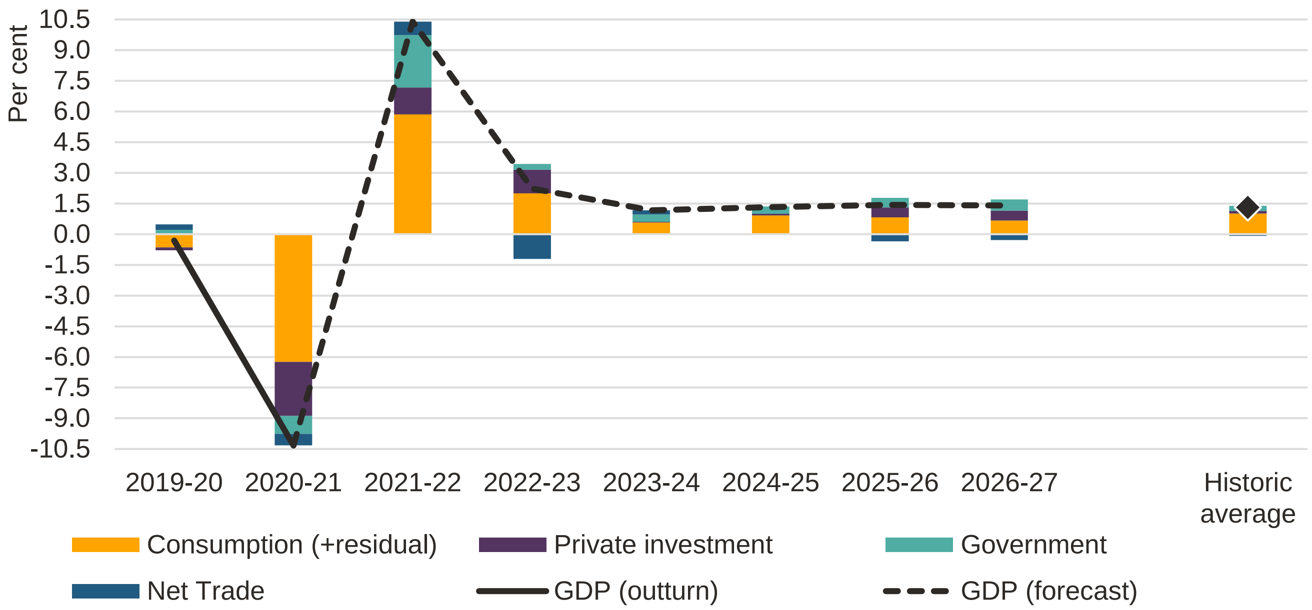
3.18 Outturn data for business investment have been revised up, pushing up our forecast. Over the forecast period, the time-limited capital allowance super-deduction announced in the UK Budget in March 2021 is expected to bring forward business investment until the deduction ends in April 2023.[34] After this, business investment is predicted to fall temporarily before returning to growth. While the outlook for aggregate business investment is positive in the short term, there are differing prospects for business investment according to firm size and level of debt after the pandemic, with smaller firms more likely to be in debt and less likely to invest.[35]

3.19 In the coming years we expect net trade to have a broadly neutral effect on GDP growth. This is because the recovery in exports due to the resurgence of global demand is balanced by the import-intensive nature of the increase in business investment and household consumption.

3.20 The contributions of each of the components to growth in GDP are shown in Figure 3.8.

[33] Public Health Scotland (2021) All releases of NHS waiting times – stage of treatment (link)
[34] Measure which enables expenditure on qualifying new plant and machinery to temporarily benefit from a 130 per cent capital allowance.
[35] Bank of England (2021) Financial Stability in Focus: The corporate sector and UK financial stability – October 2021 (link)

Figure 3.8: Contributions by component of expenditure to growth in GDP



Source: Scottish Fiscal Commission, Scottish Government (2021) GDP Quarterly National Accounts: 2021 Quarter 2 (April to June) (link).
Historical average is based on growth from 1999-00 to 2019-20. Private investment includes business and housing investment.

Long-run outlook

3.21 The long-run outlook for the economy is mixed. The size of the labour force is set to decline, with existing trends such as low population growth and declining labour market participation exacerbated by the pandemic. Meanwhile, the outlook for unemployment is more positive than we forecast in January and August 2021, with evidence from labour market statistics that the furlough scheme has been effective at preventing the loss of many viable jobs. There is also reason to be optimistic about the capacity for future productivity growth, with the pandemic potentially accelerating the adoption of new technologies and business practices.[36]

3.22 Scotland's natural rate of population change, defined as births minus deaths, is below zero and the labour force has grown since the early 2000s only because of positive net migration. Brexit and the pandemic have reduced international migration and prompted us to lower our migration assumption. These trends put downward pressure on the potential size of the labour force.

3.23 Exacerbating these population trends, the labour market participation rate is also falling because of declining economic activity rates for men since the 2008 global financial crisis and a marked fall in labour market participation by young people since the mid-2000s. The COVID-19 crisis had a disproportionate impact on the youngest participants in the labour market who were typically employed in the industries most affected by the lockdowns, so we assume that the pandemic scars the labour market participation of those aged 16 to 24. This assumption lowers trend GDP in 2025 Q1 by 0.7 per cent relative to our pre-pandemic February 2020 forecast. Box 3.1 discusses trends in labour market participation in more detail.

[36] Centre for Economic Performance (2021) The business response to COVID-19 one year on: findings from the second wave of the CEP-CBI survey on technology adoption (link)

Box 3.1: Labour market participation

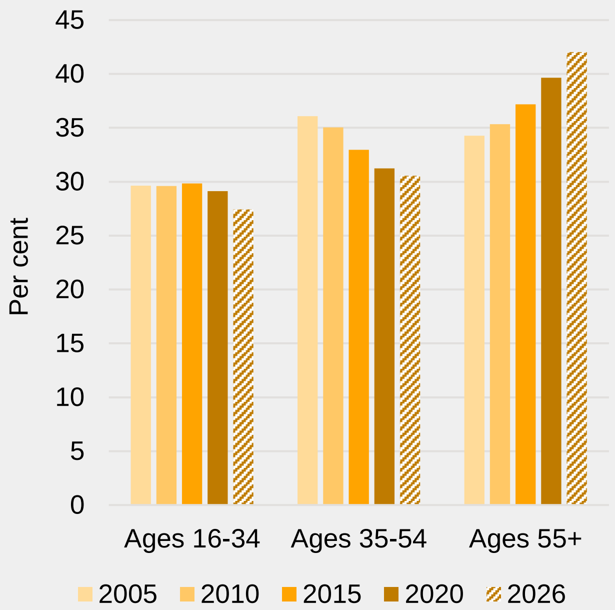
Scotland's labour market participation rate has been declining relative to the UK because of a mixture of demographic changes and changes in labour market participation in different age groups, and the decline is likely to be persistent.

As shown in Figure 3.9, the proportion of Scotland's population aged over 55 is increasing because of lower migration, historic decline in the birth rate, and improved life expectancy. As older age groups have much lower labour market participation rates, this puts downward pressure on the whole economy participation rate.

There have also been significant changes in the labour market participation of different age groups as shown in Figure 3.10. Economic activity rates are increasing in the 55+ age group. This trend has been driven in part by the staggered increase in state pension age to 66 for men and women by October 2020.[37] Since 2016, however, there has been a marked slowdown in the growth of participation rates of those aged 65+ as the participation rate uplift from the increasing pension age diminishes.

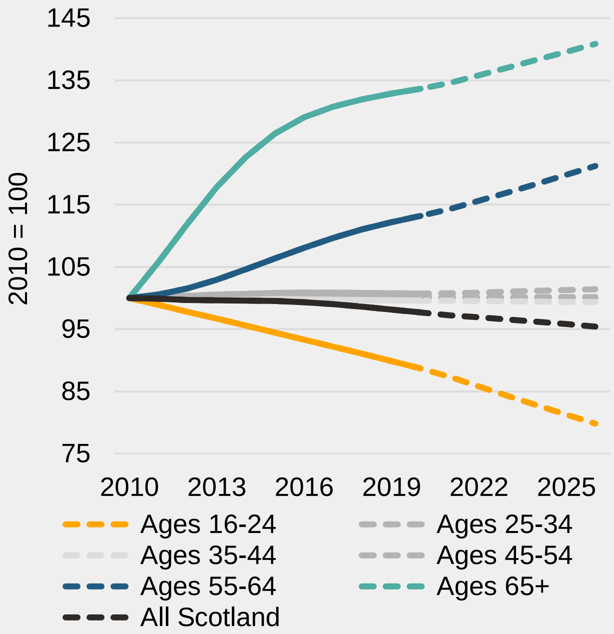
Labour market participation of those aged 16-24 has been declining since the mid-2000s reflecting growing enrolment in tertiary education.

Figure 3.9: 16+ population composition



Source: Scottish Fiscal Commission

Figure 3.10: 16+ trend participation rates



Source: Scottish Fiscal Commission

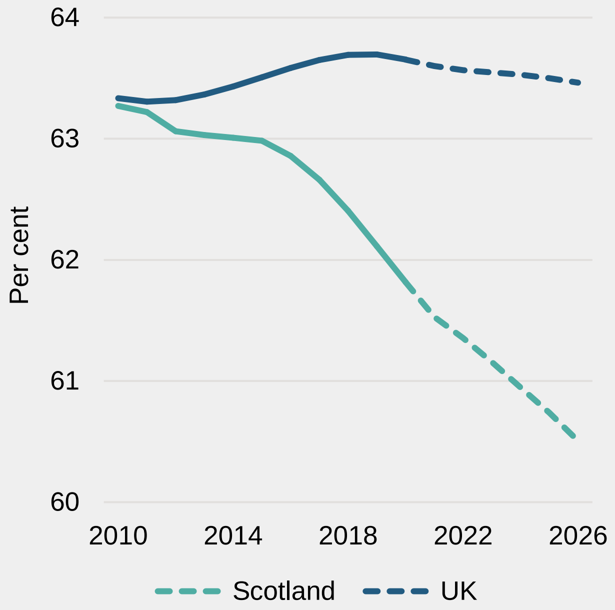
Taking these trends together, Scotland's whole economy participation rate has been falling over the last decade, particularly since 2016. In addition, the increasing population share and participation rates of those aged 55+ means that older age groups account for a growing share of the labour force.

Falling labour market participation coupled with a slowdown in population growth means that we expect a decline in the size of Scotland's labour force over the forecast period and falling employment by 2024.

[37] Legislation.gov.uk (2011) Pensions Act 2011 (link)

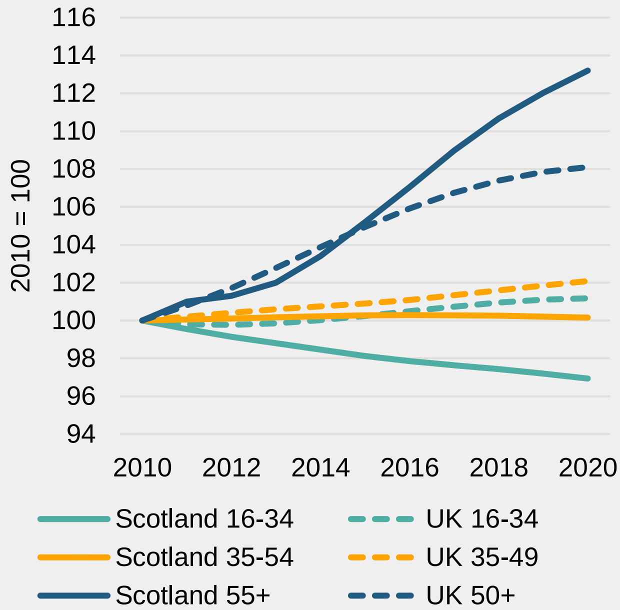
Differences in Scotland's population, demographics and labour market trends mean participation trends in Scotland and the UK have diverged in recent years, and the gap is set to widen over the forecast period. This has important implications for our forecasts of the economy and also Scottish tax revenues.

Figure 3.11: 16+ economic activity rates



Source: Scottish Fiscal Commission, OBR (2021) Economic And Fiscal Outlook – October 2021 (link).

Figure 3.12: Economic activity rates by age



Source: Scottish Fiscal Commission

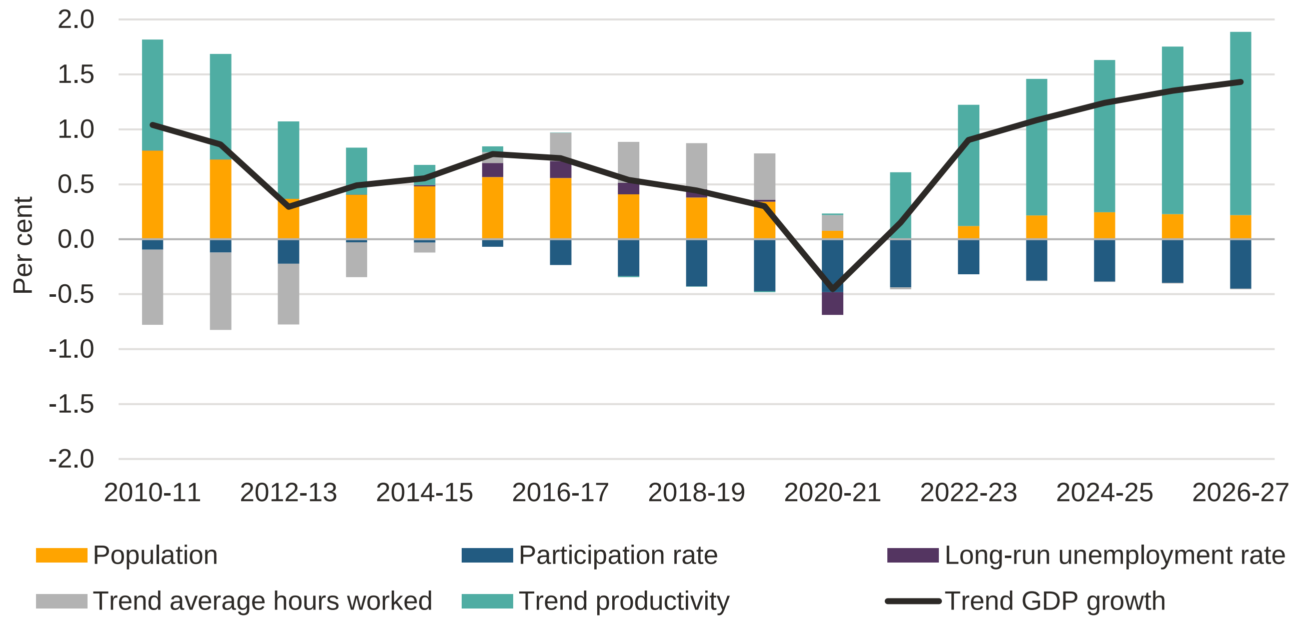
3.24 We have reduced our estimate of the long-run unemployment rate, also known as NAIRU (Non-Accelerating Inflation Rate of Unemployment), from 4.4 per cent in our January and August 2021 forecasts to 4.2 per cent, in light of robust labour market conditions and the prospect of a lower peak in unemployment after the end of furlough. This leaves the NAIRU 0.2 percentage points higher than in our February 2020 forecast.

3.25 As in August 2021, we expect faster trend productivity growth in the near term than we had assumed in January, reflecting the speed of economic recovery following the 2021 reopening and the technological and operational advancements made during the pandemic. As a result, we expect the level of productivity in 2025 Q1 to be 0.9 per cent lower than our February 2020 forecast, compared to 2.2 per cent which we estimated in January 2021.

3.26 Overall, our estimate of COVID-related scarring to long-run GDP is unchanged from our August 2021 forecast, at 2 per cent in 2025 Q1. This is the same as the OBR's October 2021 estimate and within the range of scarring assumptions from other UK forecasters.

3.27 Growth in trend GDP is driven by productivity gains in the coming years, with productivity making up the vast majority of trend GDP growth at the end of the forecast, as shown in Figures 3.13 and 3.14.

Figure 3.13: Trend GDP growth and contribution of components, 2010-11 to 2026-27



Source: Scottish Fiscal Commission

Figure 3.14: Trend GDP growth and contribution of components, 2019-20 to 2026-27

Per cent	Trend GDP growth	16+ population	16+ participation rate	Long-run unemployment rate	Trend average hours worked	Trend productivity
2019-20	0.3	0.3	-0.5	0.0	0.4	0.0
2020-21	-0.5	0.1	-0.5	-0.2	0.1	0.0
2021-22	0.2	0.0	-0.4	0.0	0.0	0.6
2022-23	0.9	0.1	-0.3	0.0	0.0	1.1
2023-24	1.1	0.2	-0.4	0.0	0.0	1.2
2024-25	1.2	0.2	-0.4	0.0	0.0	1.4
2025-26	1.4	0.2	-0.4	0.0	0.0	1.5
2026-27	1.4	0.2	-0.5	0.0	0.0	1.7

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

Labour market

3.28 Throughout the pandemic, unemployment has been lower than might have been expected, primarily because of the success of job support schemes such as the Coronavirus Job Retention Scheme (CJRS). In part, it is also because the fall in employment over the last year has been reflected more in rising inactivity and less in unemployment, as restrictions made it difficult to search for work and businesses withdrew opportunities as a result of the uncertainty of the pandemic.

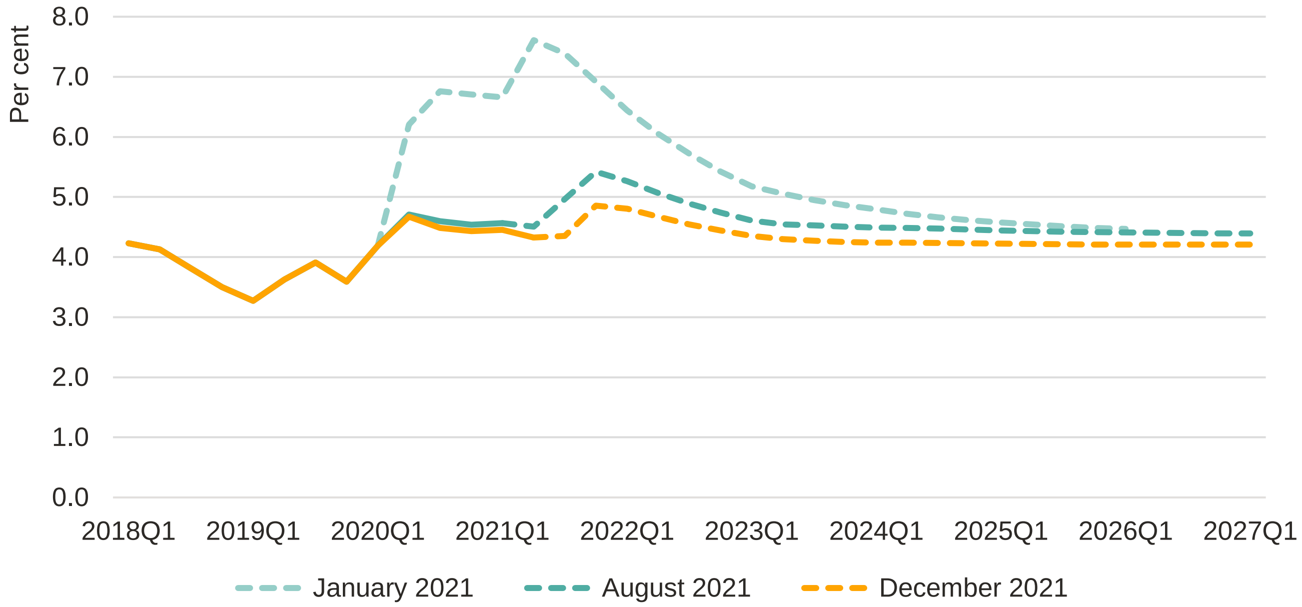
3.29 When the CJRS closed on 30 September 2021, there were 80,300 employees still furloughed in Scotland, or 3 per cent of the eligible workforce which is a similar rate to that of the UK.[38] Early indications for October are that the labour market has remained resilient: payrolled employee

[38] HMRC (2021) Coronavirus Job Retention Scheme statistics: 4 November 2021 (link)

numbers have fully recovered to pre-pandemic levels, although the October figures may include people made redundant in September who are serving notice periods; the claimant count rate has been stable; and business survey evidence on the status of furloughed workers following the end of CJRS suggests that most remained in work.[39]

3.30 We now forecast the unemployment rate will peak at 4.9 per cent in 2021 Q4. This is down from 5.4 per cent in our August 2021 forecast, and considerably lower than our January 2021 unemployment forecast which peaked at 7.6 per cent. We expect some post-furlough job losses because of business closures, reduced demand, and labour market frictions. The increase in unemployment in 2021 Q4 also reflects people who had stopped looking for work re-joining the labour market. The near-term outlook for unemployment remains uncertain and will become clearer as more data on the post-furlough state of the labour market become available.

Figure 3.15: Unemployment rate, outturn and forecast



Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – August 2021 (link), Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – January 2021 (link).

3.31 A source of uncertainty about the future path of unemployment is the persistence of current frictions in the labour market. As we discussed in our August 2021 forecast publication, high levels of vacancies have been in contrast with wide use of the furlough scheme and unemployment being above pre-COVID levels. If there is mismatch between furloughed or unemployed workers and the occupations with excess vacancies, then unemployment may increase.

3.32 Vacancies have picked up further since August and there are ongoing hiring difficulties in specific sectors, notably distribution, hospitality, and construction.[40] Businesses attribute recruitment pressures to a combination of factors: high demand for workers following the rapid reopening of the economy; fewer EU migrants; an ageing workforce, so more people are leaving jobs than can be replaced in the short term; and workers switching to jobs that offered better working conditions, more flexibility or greater security.[41] Some bottlenecks and mismatches in the labour market are likely to

[39] ONS (2021) Earnings and employment from Pay As You Earn Real Time Information, seasonally adjusted – November 2021 (link), ONS (2021) HI11 Regional labour market: Headline indicators for Scotland – November 2021 (link), Scottish Government (2021) BICS weighted Scotland estimates: data to wave 42 (link).
[40] ONS (2021) VACS01: Vacancies and unemployment – November 2021 (link), ONS (2021) Online job advert estimates (link).
[41] Bank of England (2021) Agents' summary of business conditions – 2021 Q3 (link)

be temporary and will wane with the end of furlough and the economy continuing to normalise. Frictions associated with reduced immigration and shortages of certain types of skills may take longer to unwind and lead to pay increases for workers whose skills are in high demand.

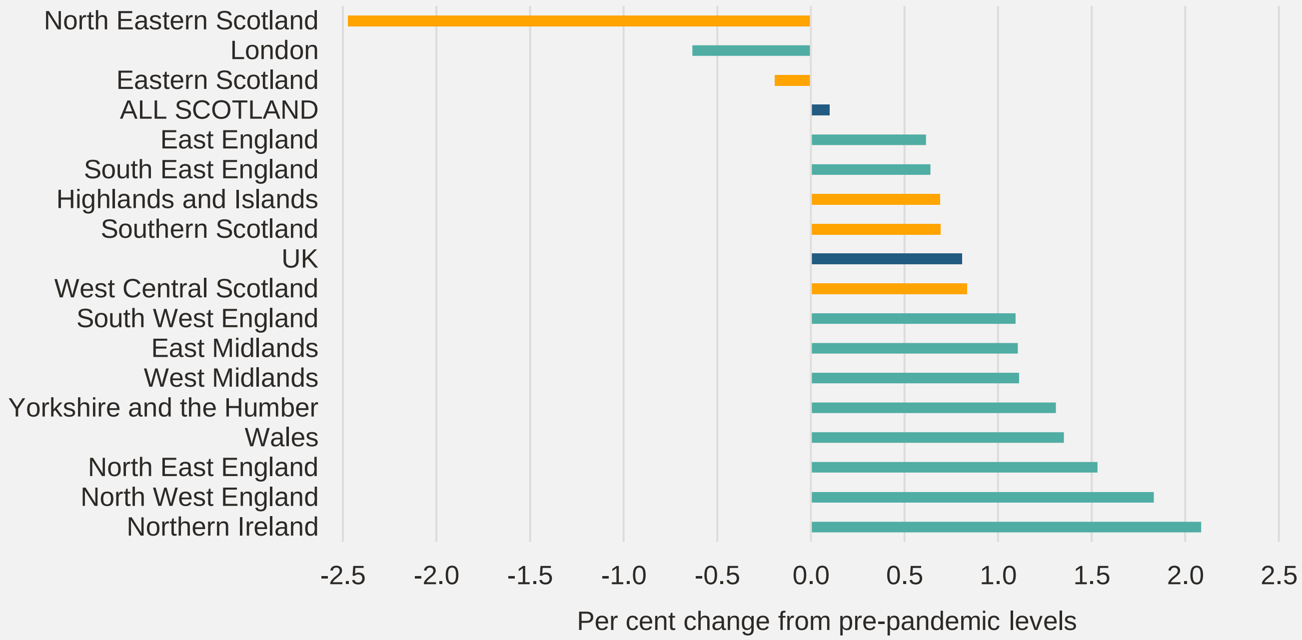
3.33 The COVID-19 economic crisis has affected the labour market across the UK but the initial shock and subsequent recovery have been uneven across different regions, as discussed in detail in Box 3.2.

Box 3.2: Regional labour market data during the pandemic

Analysis of HMRC Real Time Information (RTI) shows Scotland lagging behind the UK on PAYE employment and pay growth during the pandemic although, on pay, the gap is partly driven by strong earnings growth in London. In Scotland, pandemic-related effects are adding to existing long-term factors, such as the oil and gas sector being on a downward trajectory and contributing to weakness in the North East. There are also adverse long-term demographic trends in Scotland, which we discuss in depth in Box 3.1. In this Box, we first look at payrolled employees then move on to earnings.

As shown in Figure 3.16, PAYE employee numbers are back to pre-pandemic levels in most parts of the UK (such as Northern Ireland and North West England) but still lagging behind in others (most notably North East Scotland and London). At NUTS2 level, four of the five regions covering Scotland are below the UK average.[42]

Figure 3.16: Change in PAYE employees between February 2020 and October 2021



Source: Scottish Fiscal Commission, ONS (2021) Earnings and employment from Pay As You Earn Real Time Information, seasonally adjusted – November 2021 (link).
Scotland at NUTS2 level (orange), rest of UK at NUTS1 level (teal), Scotland at NUTS1 level and UK average (blue).

Adzuna online job advert estimates, available at NUTS1 level, suggest a similar geographical variation in labour market recovery.[43] There are various factors that may explain these regional differences.

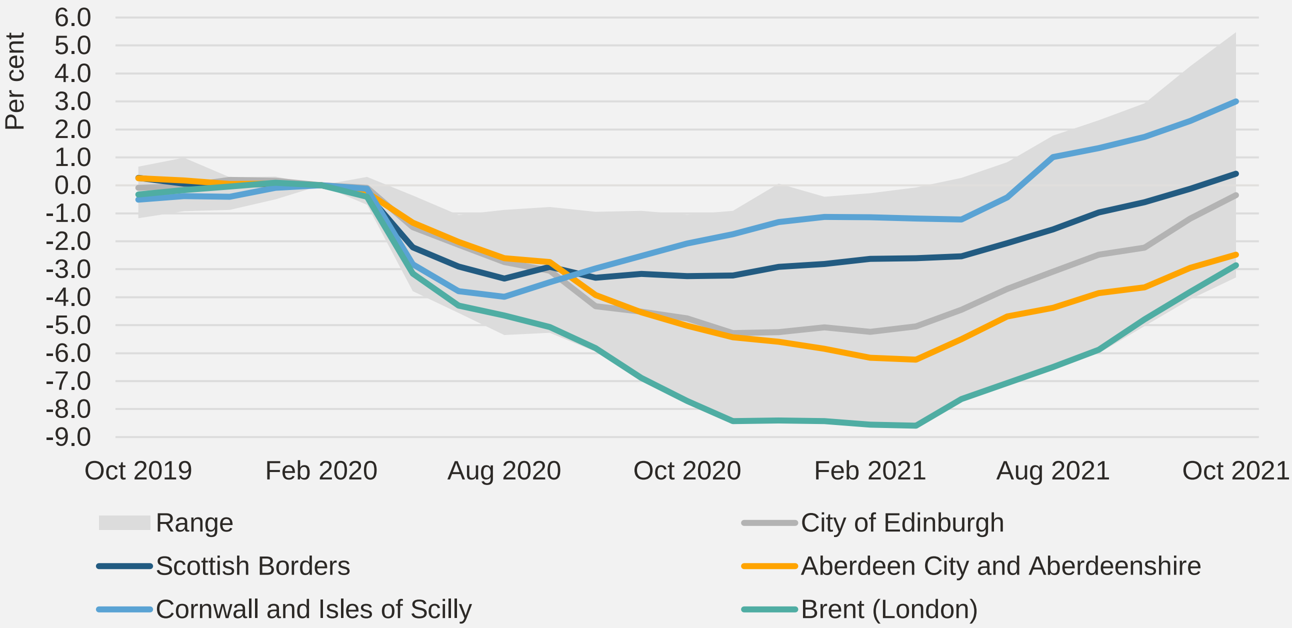
[42] The Nomenclature of Territorial Units for Statistics (NUTS) is a hierarchical classification of geographical areas used for statistical purposes. There are three levels: level 1 (major), level 2 (basic) and level 3 (small).
[43] Office for National Statistics (2021) Online job advert estimates (link)

The local industrial mix is one possible explanation. North East Scotland is particularly reliant on mining and quarrying activities (part of the oil and gas supply chain), where output and PAYE employment are still significantly below February 2020 levels.[44] Oil prices have increased as global economies reopened and worldwide oil demand picked up, but this has yet to fully feed through to a labour market recovery in North East Scotland.

In addition, Scotland and London are top destinations in the UK for international tourism. With foreign travel still subdued, this is one possible reason why other Scottish regions, as well as London, have relatively weak PAYE employment growth.[45]

At NUTS3 level, PAYE data in Figure 3.17 indicate that employee numbers in coastal or rural areas such as Cornwall and the Scottish Borders have been among the fastest to bounce back, especially during the summer thanks to the boost from domestic tourism. Meanwhile high-wage, urban areas such as London, Aberdeen City and the City of Edinburgh have been among the least likely to experience a jobs recovery.[46] One reason for slower employee growth in cities is that people are visiting city centres less than before the pandemic. Weekday visits are relatively subdued, suggesting that cities are mostly being hit by lower levels of commuter footfall, while weekend leisure trips have largely recovered.[47]

Figure 3.17: Change in PAYE employees since February 2020, selection of rural and urban areas in Scotland and England



Source: Scottish Fiscal Commission, ONS (2021) Earnings and employment from Pay As You Earn Real Time Information, seasonally adjusted – November 2021 (link).

As shown in Figure 3.18, when it comes to PAYE mean pay growth relative to pre-pandemic levels, the Scottish regions are slightly more spread across the distribution but all are below the UK average. London emerges as an outlier, with mean pay growth outpacing that of all other regions. This reflects both compositional effects, to the extent that lower-paid jobs lost during the pandemic have been slower

[44] Scottish Government (2021) GDP Monthly Estimate: September 2021 (link)
[45] VisitScotland (2021) Impact of COVID-19 on our Scottish tourism industry (link), VisitBritain (2021) 2022 tourism forecast (link)
[46] Resolution Foundation (2021) Levelling up and down Britain (link)
[47] Centre for Cities (2021) High streets recovery tracker (link)

to come back in cities, and strong PAYE mean pay growth in the financial services sector which is central to the London economy.

When looking at total pay growth since the start of the pandemic as illustrated in Figure 3.19, the Scottish regions are clustered towards the bottom half of the distribution with North East Scotland significantly underperforming the rest of the UK, largely mirroring the pattern in Figure 3.16.

Figure 3.18: Per cent change in mean pay between February 2020 and September 2021

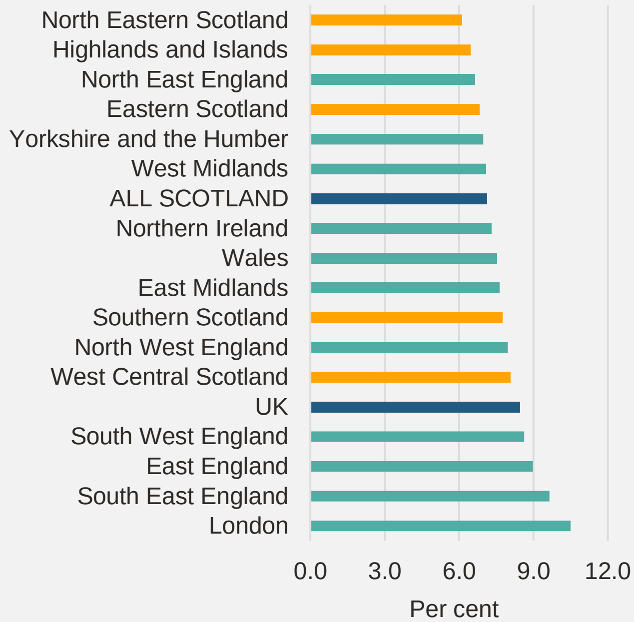
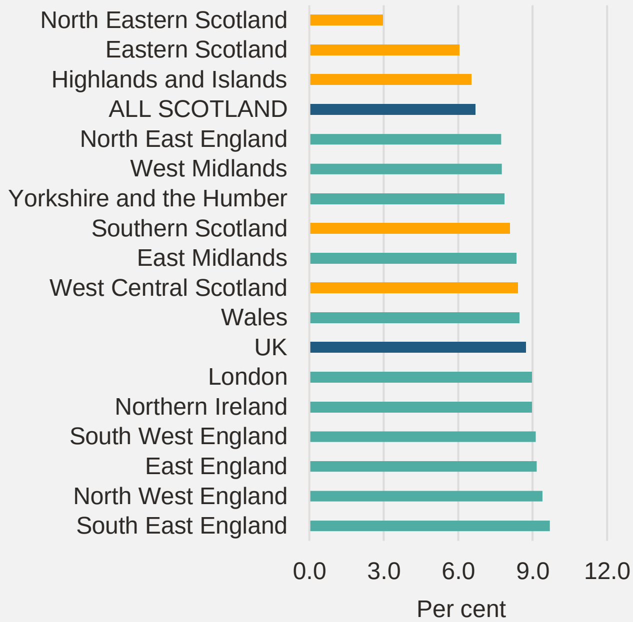


Figure 3.19: Per cent change in total pay between February 2020 and September 2021



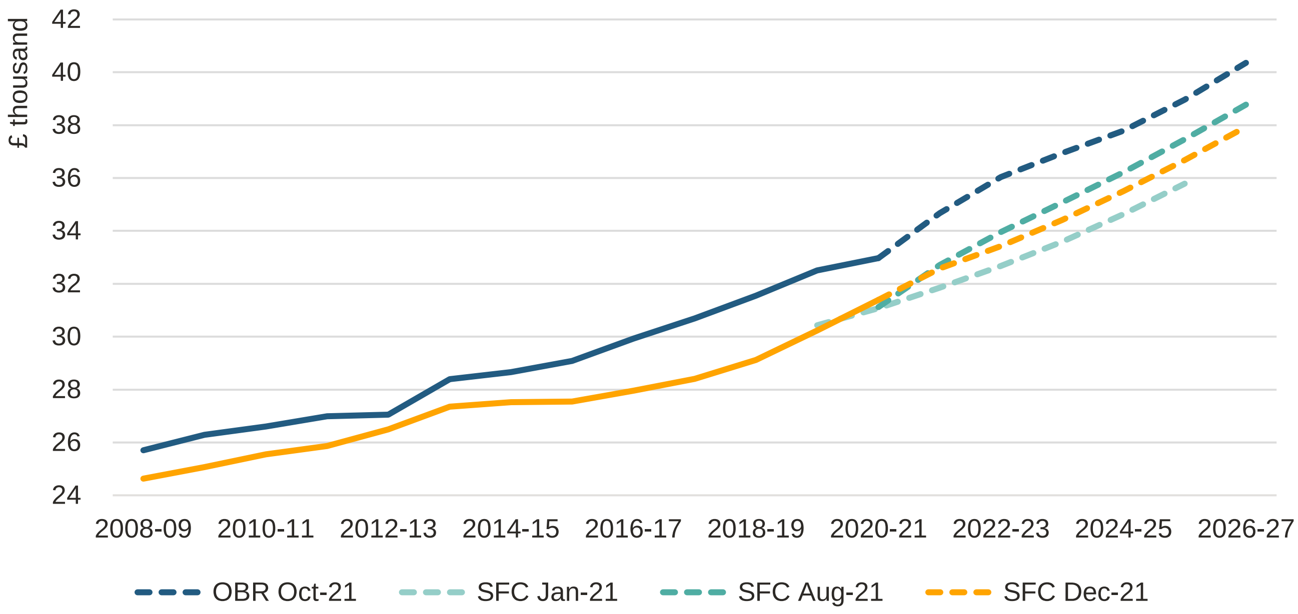
Source: Scottish Fiscal Commission, ONS (2021) Earnings and employment from Pay As You Earn Real Time Information, seasonally adjusted – November 2021 (link).

Earnings

3.34 Figure 3.20 shows how our forecast of nominal average earnings has evolved since January 2021 and how it compares to the OBR's October 2021 forecast for the UK. In August 2021, we increased our forecast significantly from January 2021, in line with higher inflation. Our new forecast is lower than in August because, with inflation being driven primarily by global energy prices rather than domestic factors, we now assume a lower degree of pass-through to nominal earnings. This means less upward pressure on nominal earnings, and more downward pressure on real earnings, than we had assumed in August. Despite the downward revisions from August, our December 2021 forecast is still higher than in January. As well as higher inflation, this reflects factors such as National Living Wage and Minimum Wage increases and wage pressures because of labour shortages in particular industries.

3.35 The gap between Scottish and UK earnings grew larger from 2015-16, possibly because of a loss of highly-paid employment in the oil and gas sector in Scotland following the oil price crisis of 2015 and 2016. Based on our forecast and the OBR's, this gap is expected to be broadly maintained over the forecast period.

Figure 3.20: Nominal average earnings level, Scotland and UK



Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – August 2021 (link), Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – January 2021 (link), OBR (2021) Economic and Fiscal Outlook – October 2021 (link).

3.36 Figure 3.21 shows our recent forecasts of growth in nominal average earnings and the OBR's forecast for the UK. Our latest forecast is higher than our January 2021 forecast in most years, but not as high as we predicted in August 2021. Compared to the OBR, our December 2021 forecast is lower at the start of the period by around 1.4 percentage points in both 2021-22 and 2022-23, similar to the gap shown by RTI PAYE mean pay data. This is followed by two years in which Scottish average earnings growth is above the UK, consistent with the level forecasts in Figure 3.20. By 2025-26, average earnings growth rates in the two economies are more similar.

Figure 3.21: Nominal average earnings growth, Scotland and UK

Per cent	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
SFC January 2021	2.1	2.5	2.6	2.8	3.1	3.3	
SFC August 2021	2.7	5.1	3.8	3.3	3.2	3.4	3.5
SFC December 2021	3.8	3.8	2.6	3.0	3.2	3.3	3.4
OBR October 2021	1.4	5.2	4.0	2.5	2.3	3.1	3.6

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – August 2021 (link), Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – January 2021 (link), OBR (2021) Economic and Fiscal Outlook – October 2021 (link).
Shaded cells refer to outturn available at time of publication.

Chapter 4
Tax

Overview

4.1 In this chapter we present our tax forecasts and discuss the effect they have on the 2022-23 Scottish Budget. Our tax forecasts use the broad-brush assumptions about the effect of COVID-19 set out in Chapter 1. Our tax forecasts are summarised in Figure 4.1 and we show the changes from our January 2021 forecast in Figure 4.2.[48]

Figure 4.1: Summary of tax forecasts

£ million	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
Income tax	13,002	13,671	14,313	15,056	15,790	16,445
Non-Domestic Rates	2,083	2,809	3,233	3,167	3,231	3,519
Land and Buildings Transaction Tax	720	749	796	839	881	924
Of which: Residential	506	523	561	596	628	661
Non-residential	215	226	235	243	253	262
Scottish Landfill Tax	123	101	83	85	70	18
Total	15,929	17,330	18,426	19,148	19,972	20,906

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

Figure 4.2: Summary of changes to our tax forecasts since January 2021

£ million	2021-22	2022-23	2023-24	2024-25	2025-26
Income tax	739	764	832	976	1,072
Non-Domestic Rates	-597	-121	9	-63	14
Land and Buildings Transaction Tax	134	120	132	138	141
Of which: Residential	98	77	87	93	96
Non-residential	36	43	44	45	46
Scottish Landfill Tax	35	14	11	11	9
Total	312	777	984	1,062	1,237

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

4.2 We expect devolved Scottish taxes to raise £17.3 billion of revenue in 2022-23, a significant upwards revision of £777 million since our January 2021 forecasts. Following the COVID-19 induced recession in 2020-21, the Scottish economy has recovered faster than expected in 2021-22. We are now anticipating less long-term damage to the Scottish economy from COVID-19 compared to our

[48] For Non-domestic rates we compare to our supplementary costing published in March 2021: Scottish Fiscal Commission (2021) Supplementary Costings – Non-Domestic Rates Measures and Self-Isolation Support Grant – March 2021 (link)

January 2021 forecasts. Since the summer, inflation has also been rising, and this is expected to continue into 2022-23. Stronger than expected economic activity combined with higher inflation has led us to revise up our forecasts of nominal household incomes, house prices and GDP, some of the main determinants of our tax forecasts.

4.3 Rising inflation can lead to fiscal drag. With certain taxes, rising inflation can have an accelerating effect on the growth of tax revenues when tax thresholds are fixed or rising by less than inflation, leading to growth in tax revenues above growth in the tax base. We discuss this effect in **Box 4.1**. This helps to explain some of the rapid growth in tax revenues in the current high inflation environment.

4.4 The extensions to the Retail, Hospitality and Leisure (RHL) relief for Non-Domestic Rates (NDR) introduced in March 2021 and in this Budget have meant our forecast of total NDR revenue in 2021-22 and 2022-23 has been revised down significantly since January 2021. Stripping out these policy changes, the movement in our NDR forecast is far smaller.

4.5 We have produced cost estimates of three tax policy changes that have been introduced in the 2022-23 Scottish Budget. These are shown in Figure 4.3. The higher rate threshold in Scotland is to be frozen at £43,662 in 2022-23 rather than rising in line with inflation, so more income will be taxed at the higher rate of 41 per cent, raising an estimated £106 million of additional revenue in 2022-23. The increase is partly offset by NDR policies to set the poundage below an inflationary increase and extend the RHL relief at 50 per cent for the first three months of 2022-23.

Figure 4.3: Summary of Budget 2022-23 tax policy changes

£ million	2022-23	2023-24	2024-25	2025-26	2026-27
Income Tax					
Freeze 2022-23 higher rate threshold	106	106	111	117	124
Non Domestic Rates					
Set poundage to 49.8p in 2022-23	-40	-43	-42	-41	-44
50 per cent RHL relief in first three months of 2022-23	-56				
Total tax policy changes	9	63	70	76	80

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

4.6 In addition to our main forecasts, we also provide illustrative forecasts for the Scottish share of Air Passenger Duty, Aggregates Levy and Scottish VAT Assignment. Details of these forecasts can be found at the **end of this chapter**.

4.7 Alongside this report, we have published a Fiscal Update that provides a detailed breakdown of how the 2021-22 Scottish Budget has changed since it was introduced in January 2021, including the effect of revised tax forecasts and LBTT and SLfT outturn data.[49]

[49] Scottish Fiscal Commission (2021) Fiscal Update – December 2021 (link)

Box 4.1: Fiscal drag

Fiscal drag is a feature of many taxes where inflation leads to revenues increasing at a faster rate than growth in the underlying tax base. This can occur when there is a progressive structure of tax rates and thresholds where higher incomes or transactions attract higher tax rates. Where tax thresholds rise in line with inflation in the tax base, inflationary increases in the tax base don't lead to changes in real post-tax income.

Fiscal drag occurs when thresholds rise by less than inflation, either because inflation was unexpectedly high, or because government policy limited the increase in thresholds. When inflation is greater than increases in tax thresholds, taxpayers will find themselves paying taxes at higher rates than they would otherwise have done. The overall effect is that more income or transactions are shifted into higher tax bands, and more tax is paid in total.

Fiscal drag can have an accelerating effect on growth in tax revenues over and above growth in the tax base. As a hypothetical example, if nominal incomes grow by 2 per cent driven by price inflation, but in a progressive tax system tax thresholds remain frozen, fiscal drag could lead to tax revenues growing by say 4 per cent.

As a real example of the way fiscal drag increases tax revenues, consider residential LBTT. All five bands of residential LBTT have been fixed since LBTT was introduced in 2015-16.[50]

If house prices were to rise at 2 per cent per year while tax thresholds remained fixed, LBTT revenues would rise by £245 million over our forecast horizon. If tax thresholds instead rose in line with inflation, and assuming that inflation is 2 per cent each year, LBTT revenues would rise by £138 million. The difference between these two scenarios is the effect of fiscal drag, causing more property transactions to rise into higher tax bands because the thresholds are frozen.

Tax forecasts and the Scottish Budget

4.8 For income tax, Land and Building Transaction Tax (LBTT) and Scottish Landfill Tax (SLfT), our tax forecasts must be considered alongside the associated Block Grant Adjustments (BGAs) to understand the net effect on the funding for the Scottish Budget. Non-Domestic Rates (NDR) has a separate process to other taxes. A detailed explanation of how funding is calculated can be found in our recent occasional paper, Funding for the Scottish Budget.[51]

4.9 The net position shows how much funding the Scottish Government is receiving from Scottish tax revenues compared to the BGAs. Figure 4.4 shows the net position for income tax, LBTT and SLfT.

[50] Excluding a temporary policy change in 2020-21 in response to the COVID-19 pandemic.
[51] Scottish Fiscal Commission (2021) Funding for the Scottish Budget (link)

Figure 4.4: Tax net positions

£ million	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
Income Tax								
BGA	-11,685	-11,989	-12,996	-13,861	-14,571	-15,167	-16,036	-16,862
Scottish revenue	11,833	11,938	13,002	13,671	14,313	15,056	15,790	16,445
Net Position	148	-51	6	-190	-257	-111	-246	-417
LBTT								
BGA	-533	-397	-620	-664	-688	-717	-753	-802
Scottish revenue	597	517	720	749	796	839	881	924
Net Position	64	121	101	86	108	122	128	122
SLfT								
BGA	-99	-87	-90	-82	-82	-77	-69	-78
Scottish revenue	119	107	123	101	83	85	70	18
Net Position	20	20	34	18	1	9	1	-60
Total taxes								
Net position	233	89	140	-86	-148	20	-117	-355

Source: Scottish Fiscal Commission, Scottish Government.
Shaded BGA and Scottish revenue values show outturn
Negative figures for the net position represent a negative funding effect on the Scottish Budget, where the BGA reduces funding by more than the tax revenue. Figures may not sum because of rounding.

4.10 The LBTT and SLfT forecast net positions remain positive in 2022-23, with Scottish tax revenues exceeding the BGA. However, the income tax net position is now expected to be negative in 2022-23. The overall tax net position is expected to be -£86 million in 2022-23, falling from a positive position of £140 million in 2021-22. The income tax net position, and the overall tax net position, are then expected to remain negative over most of the forecast horizon, except in 2024-25. We now turn to factors behind the negative income tax net position.

The negative income tax net funding position

4.11 Figure 4.5 shows outturn (shaded cells) and forecasts (unshaded cells) of Scottish income tax revenue, the income tax BGA and the income tax net position.

Figure 4.5: Income tax revenue, BGA and net position

£ million	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Income tax revenue	10,916	11,556	11,833	11,938	13,002	13,671	14,313	15,056
BGA	-11,013	-11,437	-11,685	-11,989	-12,996	-13,861	-14,571	-15,167
Net position	-97	119	148	-51	6	-190	-257	-111

Source: Scottish Fiscal Commission, Scottish Government.
Shaded cells refer to outturn available at time of publication. Figures may not sum because of rounding.

4.12 The income tax net position has varied between being positive and negative since income tax was devolved in 2017-18. For the 2022-23 Budget, the net position is expected to be negative, at -£190 million. This means £190 million less funding available for the Scottish Budget than if income tax revenues had kept up with the income tax BGA.

4.13 The net position is affected by two main factors: income tax policy differences and relative economic performance, including distributional differences. Since the 2016-17 initial deduction year for the income tax BGA, Scottish employment and earnings have grown more slowly than in the rest of the UK, even after accounting for differences in population growth.[52] All else remaining equal, this would lead to a large negative income tax net position. Successive changes in income tax rates and bands in Scotland to raise additional income tax revenue from taxpayers has so far largely offset these negative economic effects on the income tax net position. From 2022-23, we expect Scottish total earnings growth to continue to lag behind the UK, particularly driven by slower employment growth, and these economic factors are increasingly outweighing the additional income tax revenues from policy changes.

4.14 The magnitude of the net position can be persistent. From a negative net position of -£190 million in 2022-23, if Scottish income tax revenue per capita grows at the same rate as in the rest of the UK, then the net position would remain at approximately -£190 million in 2023-24. To move the net position back towards zero or positive values, there would need to be a period of relatively faster growth in income tax revenues per capita in Scotland to effectively catch-up with the BGA. Growth could be driven by further policies to raise additional income tax revenues from Scottish taxpayers, or by relatively faster economic growth in Scotland. Our latest forecasts and those from the OBR imply the net position will remain negative over the forecast horizon.

4.15 Because of the importance of this discussion to the Scottish Budget, we intend to publish more detailed analysis in 2022 looking at the factors contributing to the net position in Scotland. The discussion below sets out some initial analysis.

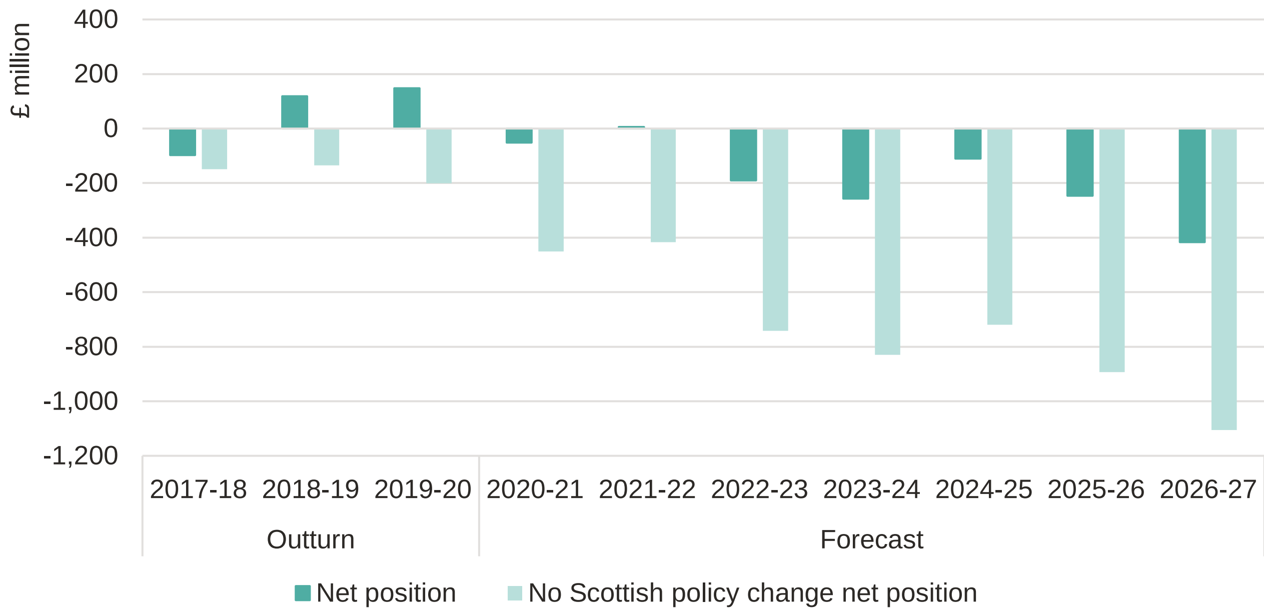
Scottish and UK income tax policy change

4.16 Since 2017-18, the Scottish Government has introduced policies to raise additional income tax revenues – by increasing tax rates and by limiting increases in tax thresholds. These policies will move the net position in a positive direction.

4.17 Figure 4.6 shows the net position as currently estimated, and also an illustrative net position stripping out all Scottish income tax policy changes since 2017-18 using Scottish Fiscal Commission policy costing estimates. Our policy costings compare changes in Scottish Government income tax policy to an assumed no-policy change counterfactual baselined to the 2016-17 initial deduction year. They do not take account of UK Government policy changes.

[52] Until 2019-20 the income tax BGA was based on income tax revenue growth in England, Wales and Northern Ireland. From 2020-21 the income tax BGA is based on income tax revenue growth in England and Northern Ireland only. For brevity, we simply refer to the rest of the UK, or rUK, when discussing the income tax BGA, irrespective of the year discussed.

Figure 4.6: Income tax net position and illustrative position excluding Scottish policy change



Source: Scottish Fiscal Commission

4.18 Figure 4.6 shows that in the absence of Scottish policy changes to raise additional income tax revenue, the net position would have been negative in every year since 2017-18, and 2022-23 is a continuation of this trend.

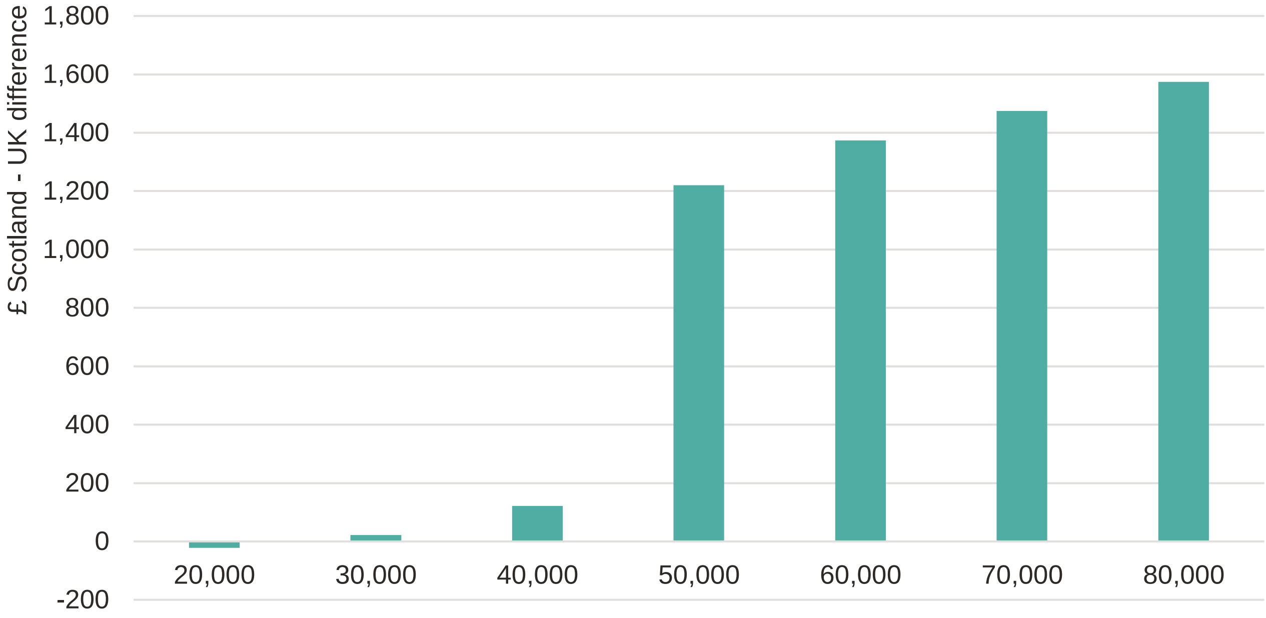
4.19 Changes in UK income tax policies have also affected the net position, because of their effect on the income tax BGA. From 2017-18 to 2021-22, the UK Government has largely introduced income tax policies which reduce income tax revenues, such as above inflation increases in the higher rate threshold. These policies to reduce income tax revenues in the rest of the UK have had a positive effect on the Scottish income tax net position by reducing the income tax BGA.

4.20 The Scottish and UK Governments have both made income tax policy announcements for 2022-23. Looking at 2023-24 and beyond, it's uncertain how policy might change though in its March 2021 Budget the UK Government announced a freezing of the personal allowance and UK higher rate threshold until 2025-26. In isolation, this will raise additional revenues in the UK, increase the BGA and reduce the net position. In contrast, the Scottish Government has only set income tax policy for 2022-23. For later years we assume ongoing inflation increases in the higher rate threshold, which further reduce Scottish income tax revenues relative to the UK in Figure 4.6, though the Scottish Government may make different policy choices in practice.

4.21 Focussing on 2022-23, Figure 4.7 illustrates the difference between income tax liabilities in Scotland and the rest of the UK for a given income level. At lower income levels, Scottish taxpayers pay slightly less tax because of the 19 per cent starter rate. For incomes above £27,850, taxpayers pay more income tax in Scotland than they would in the rest of the UK.[53] For incomes above £50,000, this difference grows to over £1,000 per year.

[53] £27,850 is an illustrative calculation based on 2022-23 income tax rates and bands in Scotland compared to England and Northern Ireland. Individual tax circumstances may vary.

Figure 4.7: Illustrative difference in income tax liabilities between individual Scottish and rUK taxpayer, 2022-23



Source: Scottish Fiscal Commission

4.22 Overall, Scottish taxpayers are paying more in income tax than they would under UK Government income tax policies. The Scottish Parliament Information Centre (SPICe) estimated that in 2021-22 the total divergence between Scottish and UK Government income tax policy will have added around £535 million to Scottish income tax, compared to a scenario where Scotland had followed UK Government income tax policies.[54]

4.23 This suggests that, in the absence of Scottish and UK Government income tax policy divergence, the net position in 2021-22 might have been closer to -£529 million, rather than the latest estimate of £6 million.

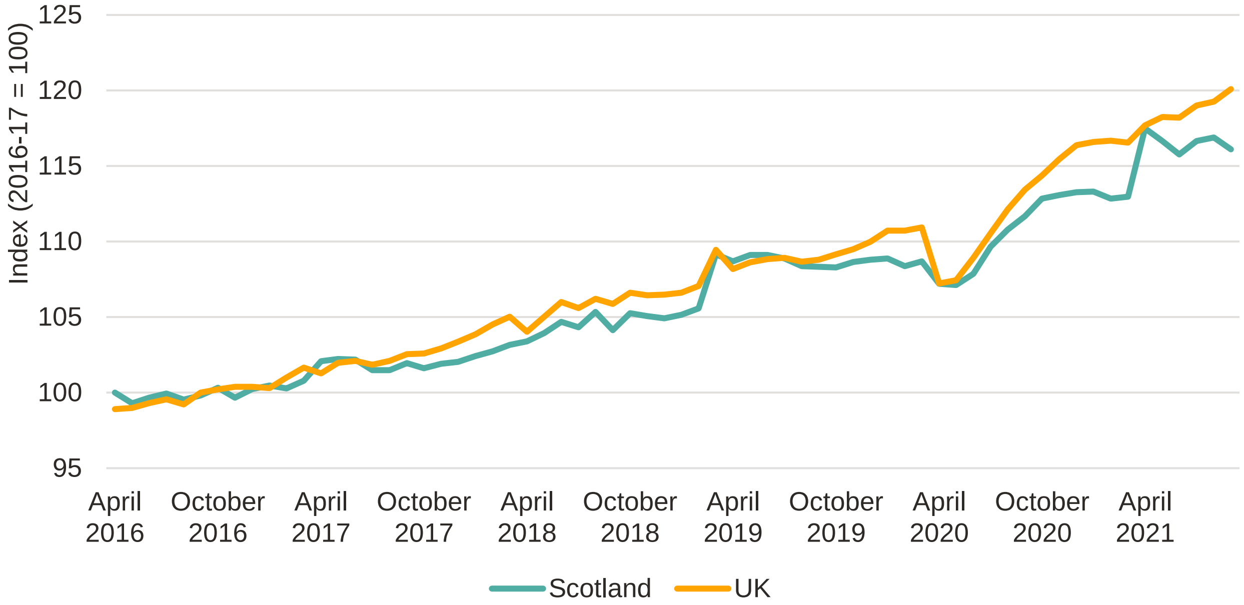
Scottish and UK economic performance

4.24 After stripping out policy divergence, this illustrative underlying net position of -£529 million in 2021-22 reflects the effect of differential economic performance between Scotland and the rest of the UK since 2016-17.

4.25 Looking first at earnings growth, Figure 4.8 shows cumulative growth in average pay in Scotland and the UK since 2016-17, the initial deduction year for the income tax BGA. Scottish growth has typically been slower than in the UK, and by September 2021 Scottish average pay has grown by 16.1 per cent since 2016-17, compared to 20.1 per cent in the UK. This will have contributed significantly to the underlying negative net income tax position since 2017-18. Box 3.2 in Chapter 3 discusses some of the factors behind slower pay growth in Scotland.

[54] Scottish Parliament Information Centre (2021) Income tax in Scotland: using the powers (link)

Figure 4.8: Growth in Scottish and UK average pay from HMRC RTI data



Source: Scottish Fiscal Commission, ONS (2021) Earnings and employment from Pay As You Earn Real Time Information, UK: November 2021 (link)

4.26 Slower average earnings growth in Scotland, when compared to the OBR's forecasts for the UK, is expected to persist in 2021-22 and 2022-23, having a further negative effect on the income tax net position.

4.27 As well as differences in growth in average incomes, it is possible there have also been differences in growth at different points in the income distribution between Scotland and the UK. While evidence is so far limited, faster growth at the top end of the income distribution in the UK could also be contributing to faster overall income tax revenue growth in the UK compared to Scotland. **Box 3.2** in Chapter 3 shows particularly slow pay growth in North East Scotland. This is likely to be driven by slowing North Sea oil and gas activity in recent years. The oil and gas industry has historically had very high pay rates and made a big contribution to income tax revenues. Even a small reduction in pay and employment in this sector could have a large effect on Scottish income tax revenues. Conversely, in the rest of the UK pay tends to be highest in and around London, and as Box 3.2 shows pay growth has also been strong in London, which is likely to have contributed to higher overall income tax growth in the UK.

4.28 We've also seen labour market participation and employment growing more slowly in Scotland than in the UK. This is partly explained by slower total population growth in Scotland, which is controlled for in the calculation of the BGA. However, even accounting for slower total population growth, labour market participation and employment in Scotland has been growing more slowly than in the UK. Figure 4.9 shows growth in the number of payrolled employees per head of total population in Scotland and the UK since 2016-17. The number of employees per head of total population in the UK has grown by 2.3 per cent since 2016-17, compared to only 0.6 per cent in Scotland. This will also have contributed to a declining income tax net position.

4.29 The participation rate in Scotland has been falling compared to the UK and we expect this trend to continue over the forecast horizon. The diverging Scottish and UK labour market participation rates discussed in **Box 3.1** in Chapter 3 are driven by demographic changes as well as changes in labour market participation rates of different age groups. Between 2016-17 and 2026-27, we expect the Scottish participation rate to decline by around 0.2 percentage points per year relative to the rate in the UK. As an illustrative calculation, all else equal, this could reduce the income tax net position by around £50 million per year.

Figure 4.9: Growth in payrolled employees per person from HMRC RTI data, UK and Scotland

Source: Scottish Fiscal Commission, ONS (2021) Earnings and employment from Pay As You Earn Real Time Information, UK: November 2021 (link).

4.30 Overall, it appears that a number of trends where Scotland is diverging from the rest of the UK are contributing to a negative income tax position:

- Scotland's changing demographics and a faster growing share of the population among older age groups
- The labour market participation of younger age groups
- Slow growth in Scottish average earnings, particularly in North East Scotland relating to oil and gas activity
- More rapid growth in earnings in the UK, driven in part by strong growth in financial services in the UK.

Income tax reconciliations and changes in the net position since January 2021

4.31 When the Scottish Budget is set, funding from income tax for the financial year is based on forecasts and does not change during the year. Only when outturn information on income tax revenues becomes available is funding brought in line with outturn and a reconciliation applied to the following Scottish Budget. Following the publication of income tax outturn data for 2019-20 in July 2021, a reconciliation of -£34 million will be applied to the Scottish Budget for 2022-23, as was discussed in our August 2021 Supplementary Forecast Evaluation Report.[55,56]

[55] HMRC (2021) Scottish Income Tax Outturn: 2019 to 2020 (link)

[56] Scottish Fiscal Commission (2021) Supplementary Forecast Evaluation Report – August 2021 (link)

4.32 We can derive illustrative estimates of future income tax reconciliations by comparing our latest forecasts to the latest forecast BGAs. Outturn and illustrative estimates of income tax reconciliations are shown in Figure 4.10.

Figure 4.10: Outturn and illustrative estimates of income tax reconciliations

Collection year	2017-18	2018-19	2019-20	2020-21	2021-22
Applies to Budget for	2020-21	2021-22	2022-23	2023-24	2024-25
Reconciliation (£ million)	-204	-309	-34	-97	-469

Source: Scottish Fiscal Commission
Shaded cells refer to outturn available at time of publication. The -£34 million reconciliation related to the 2019-20 collection year is provisional.

4.33 Since we published our last budget setting forecasts in January 2021, our forecasts of income tax revenues and also forecasts of the income tax BGA have changed significantly. This has had a significant effect on the estimated net position for 2021-22 leading to our reconciliation estimate of -£469 million to be applied in the 2024-25 Budget.

4.34 In our January 2021 Scotland's Economic and Fiscal Forecasts publication we warned that there was a significant divergence between our Scottish income tax forecasts and forecasts of the income tax BGA that could not be explained by either a divergence in policy or differential economic performance.[57] Figure 4.11 shows the January 2021 Budget setting Scottish income tax forecasts and BGA for 2021-22 compared to the latest available forecasts.

Figure 4.11: Scottish income tax revenue forecast and BGA for 2021-22

£ million	Budget setting	Latest	Total Change
SIT	12,263	13,002	739
BGA	-11,788	-12,996	-1,208
Net position	475	6	-469

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

4.35 Figure 4.11 shows our forecasts of Scottish income tax revenues in January 2021 were significantly more positive than the BGA based on the November 2020 OBR forecasts. In late 2020 and early 2021 COVID-19 policies were changing rapidly in the UK and Scotland, so the outlook could change significantly over the course of a few weeks. At the time we said the divergence was 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.".[58]

4.36 The divergence in our forecasts led to what we believed to be an artificially high estimate of the net funding position for 2021-22 of £475 million. This was significantly higher than the net funding position in previous years and from earlier forecasts, and we expected there could be significant revisions once updated forecasts were available.

4.37 Figure 4.11 also shows our latest December 2021 Scottish income tax forecast compared to the latest BGA based on the OBRs October 2021 forecast. Both have been revised up significantly

[57] Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts January 2021 (link)
[58] Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts January 2021 (link)

following the unexpectedly strong growth in the economy, earnings and inflation in both the UK and Scotland over 2021. While our Scottish income tax revenue forecast has been revised up by £739 million, the BGA has been revised up by a much greater £1,208 million. These forecast revisions have led to a revision to the income tax net position for 2021-22 to £6 million.

4.38 While significant uncertainty remains, the outlook for COVID-19 is more stable than in January 2021. We believe our forecasts and forecast of the BGA are now more comparable and £6 million should be significantly closer to the outturn net position which will be published in summer 2023. A net position of £6 million for 2021-22 would imply an income tax reconciliation of -£469 million will be applied to the 2024-25 budget.

Non-Domestic Rates

4.39 NDR operates from a separate account, called the Non-Domestic Rating Account or NDR pool. NDR is ring-fenced, remaining separate from the rest of the Scottish Budget, and all revenues collected are ultimately paid back to local authorities. The balance of the Non-Domestic Rating Account depends on both the contributable amount and the distributable amount as well as changes from previous years. Full details on how NDR funding works can be found in our recent occasional paper, Funding for the Scottish Budget.[59]

4.40 We forecast the contributable amount of NDR, the revenue collected by local authorities and pooled nationally. This is then redistributed as the distributable amount to local authorities as part of the local government finance settlement.

4.41 Our forecast is used by the Scottish Government to inform the decision about how much will be distributed to local authorities in the year ahead. 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 takes account of three factors:

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

4.42 The distributable amount is set in the Budget and remains unchanged during the financial year. This means that the Scottish Government do not need to manage any NDR forecast error during the year. The distributable amount for 2022-23 is set at £2,766 million.

4.43 Figure 4.12 shows our updated estimate of the pool balance based on the latest information. The distributable amount set leads to a projected balance of -£128 million at the end of 2022-23, as shown in Figure 4.12.

4.44 The Scottish Government plans to bring the account back into balance by 2024-25. The cumulative balance peaks at -£192 million in 2021-22, and then is then reduced between 2022-23 and 2024-25. From 2025-26 onwards, the Government plans to match the distributable amount to our forecast of the contributable amount. Figure 4.12 shows the plan for the Non-Domestic Rating account over our forecast horizon.

[59] Scottish Fiscal Commission (2021) Funding for the Scottish Budget (link)

Figure 4.12: Illustrative projected balance of the Non-Domestic Rating Account

£ million	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
Provisional contributable amount (A)	2,890	1,916	2,062	2,809	3,233	3,167	3,231	3,519
Net effect of prior year adjustments (B)	-36	-137	-100	21	0	0	0	0
Distributable amount (C)	2,853	1,868	2,090	2,766	3,169	3,103	3,231	3,519
Annual balance (D) (A + B – C)	1	-89	-128	64	64	64	0	0
Cumulative balance (E) (Previous year E + D)	25	-64	-192	-128	-64	0	0	0

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 2020-21; 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'.

4.45 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 4.12) 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 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 in their start-of-year estimates.

Income tax

Figure 4.13: Forecast revenue for non-savings non-dividend income tax

£ million	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
	11,833	11,938	13,002	13,671	14,313	15,056	15,790	16,445

Source: Scottish Fiscal Commission, HMRC (2021) Scottish Income Tax Outturn Statistics: 2019 to 2020 (link)
Shaded cells refer to provisional outturn available at time of publication.

4.46 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. Power to set the rates and bands that apply to the non-savings and non-dividend (NSND) income of Scottish taxpayers rests with the Scottish Parliament. Her Majesty's Revenue and Customs (HMRC) is responsible for administering Scottish income tax on behalf of the Scottish Government. 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.

4.47 A discussion of the effect of income tax on the Scottish Budget including the net position and reconciliations is provided in the tax summary section at the start of this chapter.

Changes since January 2021

Figure 4.14 Change in NSND income tax revenue since January 2021

£ million	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
January 2021	11,838	11,850	12,263	12,907	13,481	14,080	14,718
Economy Employment		48	216	170	108	66	33
Economy Earnings			315	311	352	366	357
CPI effect on thresholds			0	-82	-189	-235	-249
RTI		167	220	230	240	251	263
UK Policy			-28	12	175	339	442
Other	-6	-127	16	16	40	78	109
Forecast pre-measures	11,833	11,938	13,002	13,564	14,207	14,945	15,673
Policy Costing				106	106	111	117
Forecast post-measures	11,833	11,938	13,002	13,671	14,313	15,056	15,790
Change since January 2021	-6	88	739	764	832	976	1,072

Source: Scottish Fiscal Commission, HMRC (2021) Scottish Income Tax Outturn Statistics: 2019 to 2020 (link)
Shaded cells refer to provisional outturn available at time of publication. Figures may not sum because of rounding.

4.48 Changes to our forecast since January 2021 are shown in Figure 4.14. Our forecasts have been revised upwards from 2020-21 to 2025-26 by around £4.5 billion in total. Around £1.7 billion of this arises from increases in earnings and the changes in the earnings forecast are discussed in greater detail in the economy chapter. The re-opening of the economy and return to work for many has resulted in a rise in people in employment which accounts for a further £0.6 billion of the change.

4.49 We align our forecast to HMRC Real Time Information (RTI) data on income tax collected via the PAYE system which represented about 86 per cent of UK income tax receipts in 2020-21.[60] This forecast includes RTI data up to September 2021, which is halfway through the tax year 2021-22. Our modelling of RTI shows stronger growth than we expected in our January forecast. This has resulted in changes of £1.4 billion over the total forecast. The changes in earnings, employment and RTI account for 83 per cent of the total change in the forecast for 2021-22 to 2025-26.

4.50 CPI inflation has been rising in the UK and this is forecast to continue. We capture the effect of rising inflation in our economy forecasts. In addition, income tax thresholds are linked to CPI inflation. When inflation is higher, tax thresholds rise more rapidly which, all else equal, reduces income tax revenues.

UK Government policy

4.51 The UK government announced in March 2021 that the UK-wide Personal Allowance would be frozen from 2022-23 to 2025-26. The personal allowance change increases both the number of tax payers and also the amount of income on which people pay income tax, raising additional revenue in Scotland.

4.52 The UK government announced in September 2021 an increase of 1.25 per cent in National Insurance Contributions taking effect in 2022-23. From 2023-24 onwards a new Health and Social Care levy will be introduced of 1.25 per cent and National Insurance contributions will revert to their 2021-22 level. At the same time the UK government announced an increase of 1.25 per cent in Dividend Savings tax.

4.53 Due to the effect of the pandemic and furlough on the labour market, average wage growth during the uprating period used for the triple lock increased markedly to 8.3 per cent – which is an anomaly. Therefore the pension triple lock has been suspended for 2022-23, and the state pension will be adjusted by either inflation or 2.5 per cent whichever was the higher. From April 2022, the state pension will increase in line with CPI inflation of 3.1 per cent in the 12 months to September 2021.

4.54 Taken together these measures lead to small revisions in income tax for 2021-22 and 2022-23, but more substantial increases in the later years of the forecast.

Scottish Government policy

4.55 The Scottish government has proposed freezing the 2022-23 higher rate threshold at the 2021-22 level of £43,662, and we assume that from 2023-24 the threshold will rise in line with inflation. We forecast that this will raise income tax revenues by £106 million in 2022-23, rising to £117 million by 2025-26. Further information on the policy costing can be found in **Annex A**.

Comparison to OBR forecast

4.56 The Figures in this section compare our latest forecasts to the OBR's. Figures 4.15 and 4.16 show how the economy determinants used in our forecast compare to the OBR's. We want to make these tables as useful as possible and will continue to develop them for future reports, and we welcome any feedback on them.

[60] HMRC tax receipts and National Insurance contributions for the UK (link)

Figure 4.15: Forecast drivers comparison between OBR and SFC

Per cent change	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Income tax revenue						
OBR [1]	3.1	8.8	7.1	5.6	4.5	6.2
SFC [2]	0.9	8.9	5.1	4.7	5.2	4.9
Employment						
OBR	-1.7	-0.1	1.3	1.0	0.5	0.4
SFC	-3.8	1.3	1.0	0.1	-0.1	-0.2
Average nominal earnings						
OBR	1.4	5.2	4.0	2.5	2.3	3.1
SFC	3.8	3.8	2.6	3.0	3.2	3.3
Total nominal earnings [3]						
OBR	1.4	5.5	4.8	3.0	2.4	3.2
SFC	0.8	5.7	3.6	3.1	3.1	3.1

Source: Scottish Fiscal Commission, OBR (2021) Economic and Fiscal Outlook – October 2021 (link).
[1] UK NSND excluding SIT and WRIT
[2] Scottish NSND income tax
[3] For OBR row, this refers to OBR's Wages and Salaries series.

Figure 4.16: Forecast drivers comparison between OBR and SFC (cumulative growth paths)

Index 2019-20 = 100	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Income tax revenue							
OBR [1]	100	103	112	120	127	133	141
SFC [2]	100	101	110	116	121	127	133
Employment							
OBR	100	98	98	100	101	101	101
SFC	100	96	97	98	98	98	98
Average nominal earnings							
OBR	100	101	107	111	114	116	120
SFC	100	104	108	111	114	117	121
Total nominal earnings [3]							
OBR	100	101	107	112	115	118	122
SFC	100	101	106	110	114	117	121

Source: Scottish Fiscal Commission, OBR (2021) Economic and Fiscal Outlook – October 2021 (link).
[1] UK NSND excluding SIT and WRIT
[2] Scottish NSND income tax
[3] For OBR row, this refers to OBR's Wages and Salaries series.

4.57 The tables above show that we expect that income tax revenues in Scotland will grow less than the rest of the UK over the forecast period. From the latest outturn year 2019-20, we align our income tax forecast to income tax RTI data for 2020-21 and 2021-22. RTI tax data show Scottish income tax revenues growing more slowly than in the UK, particularly in 2020-21.

4.58 From 2022-23 our economy forecasts drive our income tax forecasts. We forecast both Scottish earnings and employment growth to be significantly lower than the OBR's forecast for the UK in 2022-23, leading to the gap between Scottish and UK tax revenues further widening in 2022-23.

4.59 From 2023-24 onwards, Scottish total nominal earnings growth is expected to be more comparable to UK total nominal earnings growth. However, employment growth remains much lower in Scotland than in the UK, becoming negative in 2024-25 and this has a further significant effect on the forecasts of total revenues.

4.60 Figure 4.17 shows how ours and the OBR's forecasts have changed since the previous budget setting forecasts.

Figure 4.17 Change between SFC Scottish and OBR rUK income tax forecast

	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
OBR – rUK NSND forecast (£ million) [1]							
December 2020	160,897	162,368	164,067	171,272	179,043	188,083	197,069
October 2021	162,917	167,913	182,767	195,743	206,662	216,029	229,356
Difference	2,020	5,545	18,700	24,471	27,620	27,946	32,287
Of which (as per cent of forecast):							
Modelling and Outturn alignment		2.9	3.2	3.2	3.3	3.3	3.4
Forecast and other changes		0.4	6.9	8.5	9.6	7.6	8.6
UK policy changes		0.1	1.3	2.6	2.6	3.9	4.5
SFC – Scottish income tax revenues (£ million)							
January 2021	11,838	11,850	12,263	12,907	13,481	14,080	14,718
December 2021	11,833	11,938	13,002	13,671	14,313	15,056	15,790
Difference	-6	88	739	764	832	976	1,072
Of which (as per cent of forecast):							
Modelling and Outturn alignment		1.2	1.8	1.7	1.8	1.7	1.7
Forecast and other changes		-0.4	4.3	3.4	3.6	4.4	4.8
Scottish policy changes		0.0	0.0	0.8	0.8	0.8	0.8

Source: Scottish Fiscal Commission, OBR (2020) Economic and Fiscal Outlook November 2020 (link), HMRC (2021) Scottish Income Tax Outturn Statistics: 2019 to 2020 (link), OBR (2021) Economic and fiscal outlook October 2021 (link).
Shaded cells refer to outturn available at time of publication.
[1] UK NSND excluding SIT and WRIT.

4.61 Both ours and the OBR's forecasts have been revised significantly since our previous budget setting forecasts. Focussing on 2021-22, OBR forecast have been revised up by relatively more, driven by outturn data, changes in their underlying economy forecast and also policy changes.

Non-Domestic Rates

Forecast

Figure 4.18: Forecast revenue for Non-Domestic Rates

£ million	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
	2,753	1,816	2,083	2,809	3,233	3,167	3,231	3,519

Source: Scottish Fiscal Commission, Scottish Government (2021) Non-domestic rates income statistics (link).
Shaded cells refer to outturn available at time of publication.

4.62 Non-Domestic Rates (NDR), also known as business rates, are payable by the occupiers of non-domestic properties, or the owner if the property is vacant. For 2022-23, the tax is forecast to raise £2,809 million.

Changes since January 2021

Figure 4.19: Change in Non-Domestic Rates revenue since January 2021

£ million	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
January 2021	2,761	1,848	2,680	2,930	3,224	3,231	3,216
Modelling changes			-3	4	4	-84	-12
Data updates	-9	-32	-75	-74	-71	-72	-70
CPI forecast			0	46	118	135	137
March 2021 policy costings [1]			-518				
December 2021 pre-measures	2,753	1,816	2,083	2,906	3,276	3,209	3,272
Budget policy changes				-96	-43	-42	-41
December 2021 post-measures	2,753	1,816	2,083	2,809	3,233	3,167	3,231
Change since January 2021	-9	-32	-597	-121	9	-63	14

Source: Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – January 2021 (link), Scottish Government (2021) Non-domestic rates income statistics (link), Scottish Fiscal Commission (2021) Supplementary Costings – Non-Domestic Rates Measures and Self-Isolation Support Grant – March 2021 (link).
Shaded cells refer to outturn available at time of publication. Figures may not sum because of rounding.
[1] This includes an extension of the 2021-22 retail, hospitality, leisure and aviation relief by 9 months, and a one year delay to the start date for mainstream independent schools to no longer be eligible for charitable relief.

Data updates

4.63 We have included a number of data updates in our model. The most important of these are:

- councils' audited returns for 2019-20, replacing the notified returns
- councils' notified returns for 2020-21, replacing the mid-year estimates
- councils' mid-year estimates for 2021-22
- rateable values of non-domestic properties from the valuation roll, as at 1 April 2021,
- revaluation appeals data up to quarter one 2021-22

4.64 We discussed the changes driven by the 2019-20 audited returns, 2020-21 notified returns, the valuation roll on 1 April 2021, and the revaluation appeals data in the August 2021 forecast report.[61] Together, these updates lower the 2022-23 forecast by £68 million, and an average of £58 million in years beyond that.

4.65 The mid-year estimates (MYEs) for 2021-22 have reduced our forecast by £43 million in 2021-22, an average of £31 million after that. We have adjusted the MYEs for the small business bonus scheme (SBBS) and empty property relief (EPR), because we do not expect the MYEs for these reliefs to be a reliable indicator of their final values.

4.66 For EPR we have adjusted the MYE upwards in line with the average difference between it and outturn over the past four years. For SBBS relief we have adjusted some councils' estimates upwards, to avoid underestimating the reapplications for the relief in 2021-22.[62] We have accounted for the MYE of the 2021-22 retail, hospitality, leisure and aviation (RHLA) relief in our recosting of the policy, explained in detail below.

4.67 We have adjusted the figure for retentions from the Business Rates Incentivisation Scheme based on the latest information from the Scottish Government which increases the forecast for 2021-22 by £5 million and 2022-23 by £7 million.

CPI forecast

4.68 Because inflation is forecast to be higher in 2022-23 than we had expected in January, our forecast of the NDR poundage is higher than our January forecast from 2023-24 onwards. This raises our baseline forecast of NDR revenues by an average of £109 million.

Modelling changes

4.69 On 22 September 2021 the Scottish Government launched a consultation on proposed changes to how appeals to NDR revaluation cycles are processed. The current system requires appeals to be lodged within 6 months of the revaluation date, with appeals heard by valuation appeals committees. The proposed system is to be based on a two-stage appeals process, first through a proposal to the assessor, and then through an appeal to a first-tier tribunal. The new system is designed with the aim that more appeals will be processed within the first three years after a revaluation cycle, and is set to come into place on 1 January 2023.[63]

4.70 Overall, we expect these changes to speed up the appeals process. We have updated our model to account for these changes in the appeals system. We expect that 90 per cent of appeals will now be processed within the first three years, compared to an assumption of 61 per cent in our previous forecasts. Figure 4.20 shows a simplified comparison of the old and new appeals systems, and the cumulative percentage of appeals processed by the end of year.

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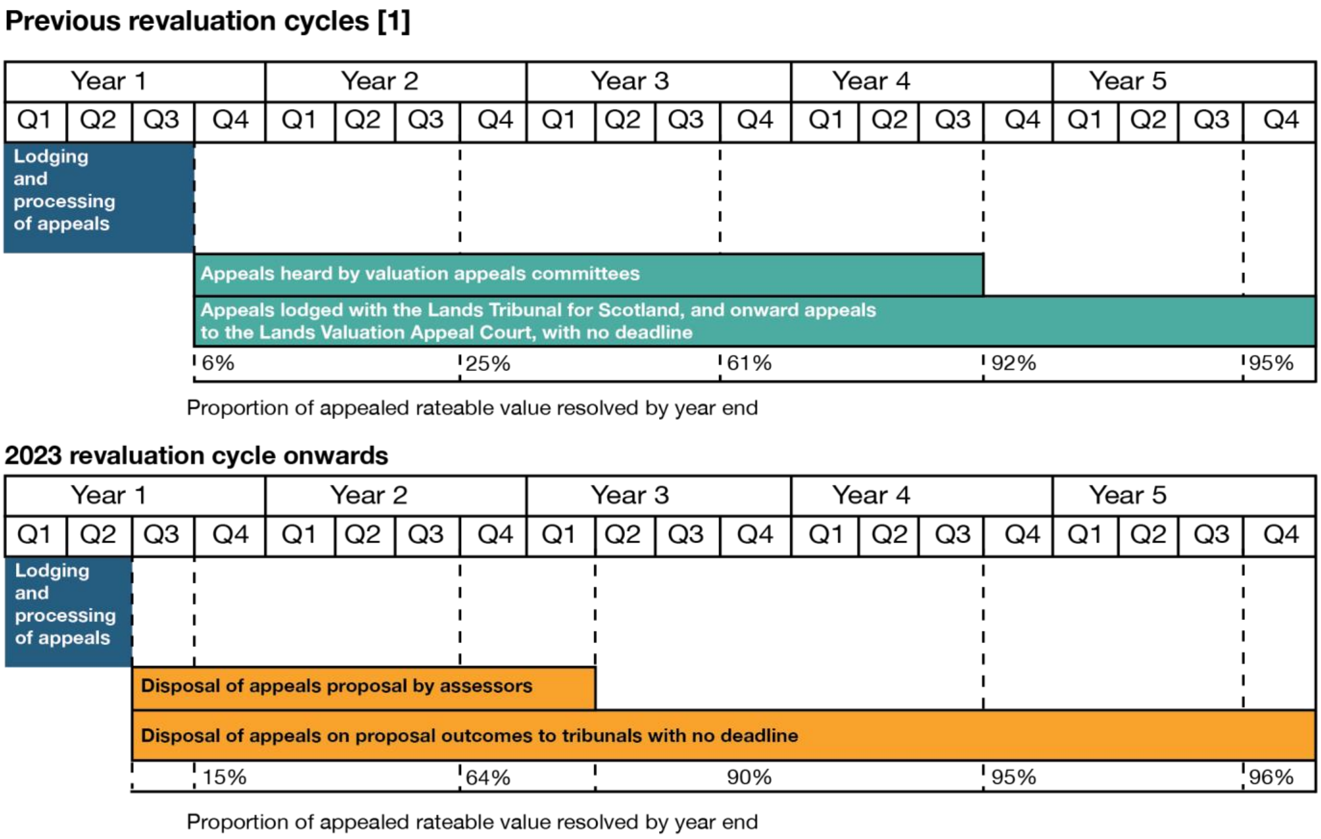
[61] Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – August 2021 (link)
[62] Scottish Government (2021) Non-Domestic Rates Relief Statistics 2021 (link)
[63] Scottish Government (2021) Non-domestic rates - procedures in proposals and valuation notices etc.: consultation (link)

Figure 4.20: Proposed updates to revaluation appeals process



Source: Scottish Fiscal Commission

[1] Hearing of appeals was extended to the end of year 5 for the 2017 revaluation cycle because of the COVID-19 pandemic, we have not included this to simplify Figure 4.20.

4.71 We have not changed our assumption that there will be a 4 per cent reduction in total rateable value from appeals, in line with the average from previous revaluation cycles. That means that the move to a shorter appeals process shifts revenue between years, but does not affect total NDR revenue in our model.

4.72 Similarly, we have not changed our assumption that some appeals will be processed by tribunals, which will continue after the end of the appeals process. For the 2017 revaluation, we forecast that appeals will continue to be processed into 2025-26. We assume a similar profile for future revaluation cycles, though this does not directly affect our forecast of the next five years.

4.73 Other modifications to our forecast are accounting for the lower notified figure in 2020-21 for write-offs and bad debts, and refining accounting for more reliefs in our forecast of claims of reliefs backdated to previous years. We discussed these changes in detail in our August 2021 forecast. Together, these changes increase the forecast by £4 million in 2022-23, and by an average of £9 million for the rest of the forecast.

Policy recosting

4.74 In March 2021, the Scottish Government extended the 100 per cent RHLA relief until 31 March 2022. For 2021-22, the relief was granted following application by ratepayers, rather than being automatically extended as in 2020-21.

4.75 Data from both the 2021 billing snapshot and the 2021-22 MYEs have shown that applications for the RHLA relief in 2021-22 have been lower than we previously expected in our August forecast. We had forecast claims of £752 million for the full year, while councils' 2021-22 MYEs expect £662 million to be claimed.

4.76 We now estimate that £712 million of RHLA relief will be claimed in 2021-22. We believe that there will be more claims of the relief between the latest data release and the end of 2021-22, but that total RHLA claims will be lower than our previous forecast as indicated by the MYE.

4.77 After adjusting this costing for the extension of the relief to the full year and accounting for recent data, our forecast of NDR revenues in 2021-22 is £511 million lower than in our January forecast, but £40 million higher than in our August 2021 forecast.

Budget 2022-23 Policy Changes

4.78 Our forecast includes two new policies introduced in the 2022-23 Scottish Budget: setting the 2022-23 poundage at 49.8p, and a 50 per cent retail, hospitality and leisure (RHL) relief in the first three months of 2022-23, capped at £27,500 for each ratepayer claiming it. The cost of these policies is shown in Figure 4.21, and further details of the costing methodology can be found in Annex A.

Figure 4.21: Cost of policies introduced in the 2022-23 Budget

£ million	2022-23	2023-24	2024-25	2025-26	2026-27
Setting the 2022-23 poundage at 49.8p	-40	-43	-42	-41	-44
2022-23 retail, hospitality and leisure relief	-56				
Total	-96	-43	-42	-41	-44

Source: Scottish Fiscal Commission

4.79 The costing of the 2022-23 RHL relief is in line with our recosting of the relief in 2021-22. However, because of the reduced value of the relief compared to previous years, it may be that fewer claims are received for this relief. This is the main source of uncertainty around the policy costings for this Budget.

Forecast uncertainty

4.80 The RHL relief leads to uncertainty in our forecast for 2021-22 and 2022-23. Because applications to the relief for 2021-22 are still being submitted and processed, we do not yet know how many properties in total will claim the relief. Errors in our assumption of application numbers could lead to significant errors, but we do not currently have information to assess whether NDR revenues are likely to be above or below our present forecast.

4.81 Changes to our assumption around revaluation appeals from the 2023 cycle onwards are also highly uncertain. We do not have any data on how the changes to the appeals system will affect the processing of appeals. Although we believe that the broad change in our forecast of appeals processing will be correct, even relatively small errors in the forecast would lead to shifts of revenue between years.

Land and Buildings Transaction Tax

Forecast

Figure 4.22: Forecast revenue for Land and Buildings Transaction Tax

£ million	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
Residential	375	506	523	561	596	628	661
Non-residential	143	215	226	235	243	253	262
Total LBTT	517	720	749	796	839	881	924

Source: Scottish Fiscal Commission, Revenue Scotland (2021) Annual Report and Accounts 2020-21 – Devolved Taxes Accounts (link).
Figures may not sum because of rounding. Shaded cells refer to outturn at time of publication.
LBTT revenue is net of repayments, excludes penalties and interest and also excludes revenue losses.

4.82 Land and Buildings Transaction Tax (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 and included in our residential LBTT forecast.

Residential LBTT

Figure 4.23: Forecast revenue for residential LBTT

£ million	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
Residential LBTT (excluding ADS)	260	380	390	420	451	480	510
Additional Dwelling Supplement	115	125	133	141	145	148	152
Total residential LBTT	375	506	523	561	596	628	661

Source: Scottish Fiscal Commission, Revenue Scotland (2021) Annual Report and Accounts 2020-21 – Devolved Taxes Accounts (link).
Figures may not sum because of rounding. Shaded cells refer to outturn at time of publication.
LBTT revenue is net of repayments, excludes penalties and interest and also excludes revenue losses.

Changes since January 2021

Figure 4.24: Change in total residential LBTT forecast since January 2021

£ million	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
January 2021	360	408	446	474	502	533
Prices		27	34	44	51	55
Transactions		21	3	0	-2	-4
Data updates	15	48	40	43	46	49
Other		1	1	0	-2	-4
December 2021	375	506	523	561	596	628
Changes since January 2021	15	98	77	87	93	96

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – January 2021 (link), Revenue Scotland (2021) Annual Report and Accounts 2020-21 – Devolved Taxes Accounts (link).
Figures may not sum because of rounding. Shaded cells refer to outturn at time of publication.
LBTT revenue is net of repayments, excludes penalties and interest and also excludes revenue losses. Tables showing the change in Residential LBTT (excluding ADS) and ADS can be found in Supplementary Tables S4.11 and S4.12.

4.83 In January 2021, we noted that Revenue Scotland data had shown more transactions in the top two bands of LBTT than in previous years.[64] Data from Revenue Scotland and Registers of Scotland since then show that this effect was larger than we predicted and has continued into 2021-22. There has been a significant increase in the average purchase price leading to a higher share of transactions in the top two bands of LBTT.[65] This has included a doubling in the average quarterly number of purchases of houses valued at £1 million or more, accounting for 13 per cent of Residential LBTT in the first half of the financial year.

4.84 A number of factors have driven recent changes in the housing market. These include the timing and nature of lockdowns, the release of pent-up savings, fewer properties coming onto the market compared to buyer demand, the effects of the 2020-21 temporary nil rate band rise policy, and changes in preferences over the type and location of residential properties being purchased. We do not know the exact contribution of each of these effects, but recent data from Revenue Scotland suggest that this change in the housing market has continued during the first half of 2021-22.

4.85 We are forecasting that the high demand for properties will ease slightly in 2021-22, with slower price growth as the housing market eases. From 2022-23, our price forecast is primarily driven by our outlook for household disposable incomes. Upward revisions in our economy forecast since January 2021 has led to corresponding upward revisions in our house price forecast and a £29 million increase in the forecast of Residential LBTT (excluding ADS) in 2022-23.

4.86 The largest upwards revision to the Residential LBTT forecast has come from the inclusion of data for LBTT receipts for the end of 2020-21 and the first half of 2021-22. These reflect both the higher average house prices and the increased share of transactions falling into the top two tax bands. We have aligned our forecast to the 2021-22 LBTT data to September, effectively "locking in" recent housing market activity. This means that data updates have led to a £38 million upward revision in Residential LBTT (excluding ADS) in 2022-23.

[64] Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – January 2021 (link).
[65] Registers of Scotland (2021) Monthly house price statistics – September 2021 (link).

4.87 In line with the latest prices and transactions forecast, we have revised up our ADS forecast. Higher prices cause a £4 million upward revision in 2022-23 and a greater number of transactions a £2 million one. Data updates lead to a £2 million increase in the forecast.

Non-residential LBTT

Figure 4.25: Forecast revenue for non-residential LBTT

£ million	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
	143	215	226	235	243	253	262

Source: Scottish Fiscal Commission, Revenue Scotland (2021) Annual Report and Accounts 2020-21 – Devolved Taxes Accounts (link).
Shaded cells refer to outturn available at time of publication.
LBTT revenue is net of repayments, excludes penalties and interest and also excludes revenue losses.

Changes since January 2021

Figure 4.26: Change in non-residential LBTT forecast since January 2021

£ million	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
January 2021	157	178	184	190	199	207
Prices	0	6	11	12	12	12
Transactions	0	11	11	11	10	10
Data updates	-15	18	19	19	20	21
Model updates	1	1	2	2	2	2
December 2021	143	215	226	235	243	253
Change since January 2021	-14	36	43	44	45	46

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – January 2021 (link), Revenue Scotland (2021) Annual Report and Accounts 2020-21 – Devolved Taxes Accounts (link).
Figures may not sum because of rounding. Shaded cells refer to outturn available at time of publication.
LBTT revenue is net of repayments, excludes penalties and interest and also excludes revenue losses.

4.88 The non-residential market during 2021-22 has recovered faster than we expected in January and the broad base of upward revisions to our forecast reflects that. Our economic outlook has been revised upwards since January and our forecasts for average prices and transactions mirror that faster pace of recovery. This has led to a £22 million increase in our forecast for 2022-23. Our forecast from 2022-23 onwards is now similar to our pre-pandemic forecast made in February 2020.

4.89 Following a worse than expected year for non-residential LBTT in 2020-21, receipts in the first half of 2021-22 have been at their highest since its introduction in 2015. These recent data have led us to revise our forecasts up by £18 million in 2021-22 and £19 million in 2022-23. Commercial property transactions (including both conveyances and leases) during 2021-22 have been comparable to pre-pandemic years with the share of very high value transactions also comparable to the average of the past three years-to-date.

Forecast uncertainty

4.90 Average house price growth in 2020-21 was more rapid than we have seen in recent years. There is uncertainty over whether this represents a permanent rise in average house prices, or simply a shorter-term spike driven by changes in the housing market because of the pandemic. An unanticipated deterioration in the labour market or larger than expected interest rate response from the Bank of England (as discussed in **Chapter 3**) are two other notable sources of risk to house prices. A further source of uncertainty stems from the increasing influence of a small number of high-value transactions on the tax take, making even small swings at the top of the market significant for the LBTT forecast.

4.91 The commercial property market is recovering faster than we expected in January 2021. Non-residential LBTT is highly volatile and although we have revised our forecasts up, questions still remain about the durability of the current recovery. There are also continued questions about the extent to which there may or may not be a switch in demand away from commercial premises. Future tax revenue is also heavily influenced by how many very large transactions take place during a given financial year. This means that 1 per cent of transactions account for 28 per cent of non-residential LBTT, making the variability of only very few transactions significant for the annual tax take.

Scottish Landfill Tax

Forecast

Figure 4.27: Forecast revenue for Scottish Landfill Tax

£ million	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
	107	123	101	83	85	70	18

Source: Scottish Fiscal Commission, Revenue Scotland (2021) Annual Report and Accounts 2020-21 – Devolved Taxes Accounts (link).
Shaded cells refer to provisional outturn available at the time of publication.
SLfT revenue is net of repayments, excludes penalties and interest and also excludes revenue losses.

4.92 We expect Scottish Landfill Tax (SLfT) to raise £101 million in 2022-23. As in previous forecasts, we anticipate that SLfT revenue will fall over time as incineration capacity and recycling rates in Scotland increase.

Changes since January 2021

Figure 4.28: Change in SLfT forecast since January 2021

£ million	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
January 2021	95	88	86	72	74	61
Data updates	11	35	16	14	14	11
Incineration capacity	0	0	-2	-3	-3	-2
December 2021	107	123	101	83	85	70
Change since January 2021	11	35	14	11	11	9

Source: Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – January 2021 (link), Revenue Scotland (2021) Annual Report and Accounts 2020-21 – Devolved Taxes Accounts (link).
Figures may not sum because of rounding. Shaded cells refer to provisional outturn available at the time of publication.
SLfT revenue is net of repayments, excludes penalties and interest and also excludes revenue losses.

4.93 The main revisions to our forecast come from more waste being sent to landfill over the second half of 2020-21 and the first half of 2021-22 than we expected in January. We have revised our forecast for 2021-22 up by £23 million and for 2022-23 by £12 million as a result. The remainder of the upward forecast revisions come from incorporating our latest economy forecasts, increasing expected SLfT by £3 million in 2022-23.

4.94 In previous forecasts, the timings of both the Biodegradable Municipal Waste (BMW) ban and new incineration capacity becoming operational have had important effects on our forecast, as more waste is diverted away from landfill. We have made a £2 million downward revision in 2022-23 because the Grangemouth incinerator will operate at a higher capacity than previously anticipated.

Forecast uncertainty

4.95 The timing of new incineration capacity and the BMW ban are the main sources of forecast uncertainty. Our estimate of the amount of BMW covered by the ban is also uncertain and will change as more information becomes available. We continue to monitor information on the development of waste infrastructure and progress towards the ban and we will factor any changes into our future forecasts.

Illustrative forecasts

Scottish share of UK Air Passenger Duty

Figure 4.29: Forecast revenue for the Scottish share of UK Air Passenger Duty

£ million	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
	25	86	162	262	346	362	380

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

4.96 UK Air Passenger Duty (APD) is a tax paid on eligible passengers on flights departing from UK airports. Air Departure Tax (ADT) was due to replace APD in Scotland from April 2018. The introduction of ADT has been deferred to allow issues raised in relation to the Highlands and Islands exemption to be resolved. 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 occasional paper, 'How we forecast devolved taxes'.[66]

4.97 The forecast has been revised downwards since January 2021 because the fall in air passenger numbers during the pandemic has been larger than we expected. Inclusion of the latest data (along with modelling updates) reduces our forecast by £44 million in 2022-23. The UK Government changed APD policy in its October 2021 Autumn Budget and Spending Review, reducing rates on domestic flights and introducing a new Band C for journeys of 5,500 miles or more from London, both as of 1 April 2023.[67] More detail can be found in Supplementary Table S4.26.

VAT Assignment

Figure 4.30: Forecast revenue for Scottish VAT Assignment

£ million	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
	5,383	4,816	5,542	6,143	6,388	6,636	6,854	7,073

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.

4.98 The Scotland Act 2016 stated that half of VAT raised in Scotland will be assigned to the Scottish Government.[68] The UK and Scottish Governments initially agreed to implement VAT assignment from 2019-20 but this has been delayed and a revised date for implementation has not been set.

4.99 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.[69] Our forecast for 2022-23 has been revised up by £250 million compared to our January 2021 forecast. This is mainly because of the upward revision to our economy forecasts,

[66] Scottish Fiscal Commission (2021) How we forecast devolved taxes (link)
[67] HM Treasury (2021) Autumn Budget and Spending Review 2021 – Policy Costings (link)
[68] 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 represented half of the VAT rates at that time. Changes to VAT rates during the COVID pandemic mean this is no longer the case. HMRC (2020) VAT: reduced rate for hospitality, holiday accommodation and attractions (link). However, as our forecast is illustrative we continue to apply the 50 per cent approach.
[69] Scottish Fiscal Commission (2018) Approach to forecasting VAT assignment (link)

caused by the faster recovery from the COVID-19 pandemic than we expected in January. More information can be found in Supplementary Table S4.28.

Scottish share of UK Aggregates Levy

Figure 4.31: Forecast revenue for Scottish share of UK Aggregates Levy

£ million	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
	57	58	59	60	61	62	63

Source: Scottish Fiscal Commission
Figure in shaded cell not classed as outturn data. It is an estimate of the Scottish share of UK Aggregates Levy revenues.

4.100 The UK Aggregates Levy is a tax which applies to the commercial exploitation of crushed rock, sand and gravel. The Scotland Act (2016) gives the Scottish Parliament powers over the Aggregates Levy, but devolution was delayed initially because of an ongoing court case and subsequently by the UK review of the levy.[70]

4.101 HMRC data up to 2020-21 show that activity in the aggregates industry has been below its 2019-20 level, and we expect that this will continue in future years. We assume that the market will grow in line with its average annual growth rate since 2015, which means that the Aggregates Levy will not return to its 2019-20 level until 2024-25.

[70] Scotland Act 2016 Part 2 Section 18 (link)

Chapter 5
Social security

Overview

5.1 In this chapter, we provide forecasts of devolved social security spending and focus on changes since the 2021-22 Scottish Budget was published in January 2021. We now forecast devolved social security spending to increase from £4.1 billion in 2022-23 to £5.5 billion in 2026-27. This forecast excludes administrative costs which are budgeted for separately by the Scottish Government.

5.2 Figure 5.1 shows a £981 million increase in our forecast of spending in 2025-26 since January 2021. This increase occurs because the Scottish Government are introducing new payments with more people receiving social security support each year and because inflation increases payment amounts each year.[71] Revisions to our inflation forecast increase our spending forecast by £190 million by 2025-26.

Figure 5.1: Change in total social security spending forecasts since January 2021

£ million	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
January 2021	3,495	3,614	3,810	4,020	4,129	4,249	
December 2021 [1]	3,535	3,679	4,065	4,657	4,966	5,230	5,511
Change since January 2021	39	66	256	637	837	981	

Source: Scottish Fiscal Commission, Social Security Scotland, Scottish Government.
Shaded cells refer to outturn available at time of publication. Figures may not sum because of rounding.
[1] Social security spending forecasts are split into two Scottish Government portfolios. The Social Justice, Housing and Local Government portfolio includes all social security payments that were previously captured within the Social Security and Older People portfolio, plus Discretionary Housing Payments and Best Start Foods. The Finance and Economy portfolio includes Fair Start Scotland and Self-Isolation Support Grant.

5.3 Since January we have produced estimates of spending on the Scottish Government's new Adult Disability Payment (ADP), including its effect on Carer's Allowance (CA) and Carer's Allowance Supplement (CAS) spending. ADP is scheduled to launch in 2022 and forecast spending on the payment is expected to reach £3 billion by 2026-27, £527 million more than spending on the payment replaced, Personal Independence Payment, with an additional £40 million on CA and CAS. A detailed explanation on how we forecast ADP was covered in our August 2021 forecast.[72]

5.4 The 2022-23 Scottish Budget includes provision for a number of new social security policies, including plans to increase the Scottish Child Payment (SCP) to £20 per week from April 2022. We estimate that this will increase annual spending on SCP by £186 million by 2026-27. The new Low Income Winter Heating Assistance is scheduled to launch in winter 2022-23, with spending of £21 million in 2022-23. Our forecasts do not account for any additional spending associated with new payments launched beyond 2022-23, such as the replacements for Attendance Allowance and CA, as the details of how the payments will be delivered are not confirmed.

[71] These figures do not include Winter Fuel Payment spending. Spending on Cold Weather Payment is excluded from the 2020-21 figure but our forecast for 2026-27 includes spending on Low Income Winter Heating Assistance which replaces Cold Weather Payments.
[72] Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – August 2021 (link)

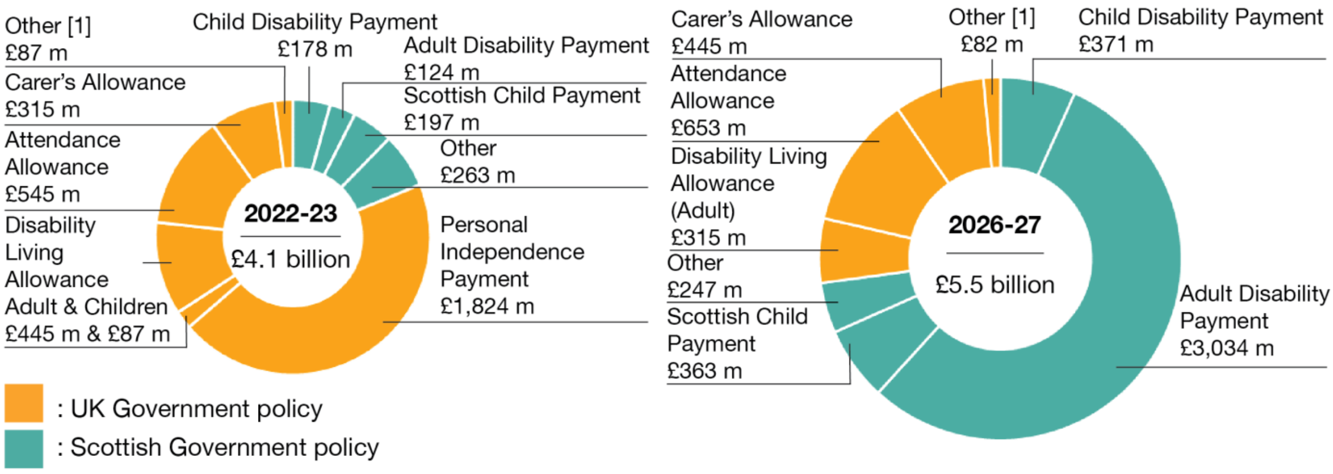
Forecasts

5.5 In this section, we provide more detail on our spending forecasts and our forecast of how many people we expect to receive payments, which we refer to as the caseload. We also show the changes in spending since our January 2021 forecasts.

Spending forecasts

5.6 Most social security spending in the Scottish Budget, over £3 billion, will continue to be administered by the Department for Work and Pensions (DWP) under agency agreements with the Scottish Government in 2022-23.[73] Personal Independence Payment (PIP) is still the most significant payment with an expected spend of £1.9 billion in 2022-23. A small proportion of spending will start to be administered by Social Security Scotland in 2022-23 when ADP launches, and this proportion will increase over time. Spending on Low Income Winter Heating Assistance (LIWHA) is now included in our forecasts for the first time and will be based on Scottish Government policy from the point of devolution in 2022-23.

Figure 5.2: Social security spending in 2022-23 and 2026-27



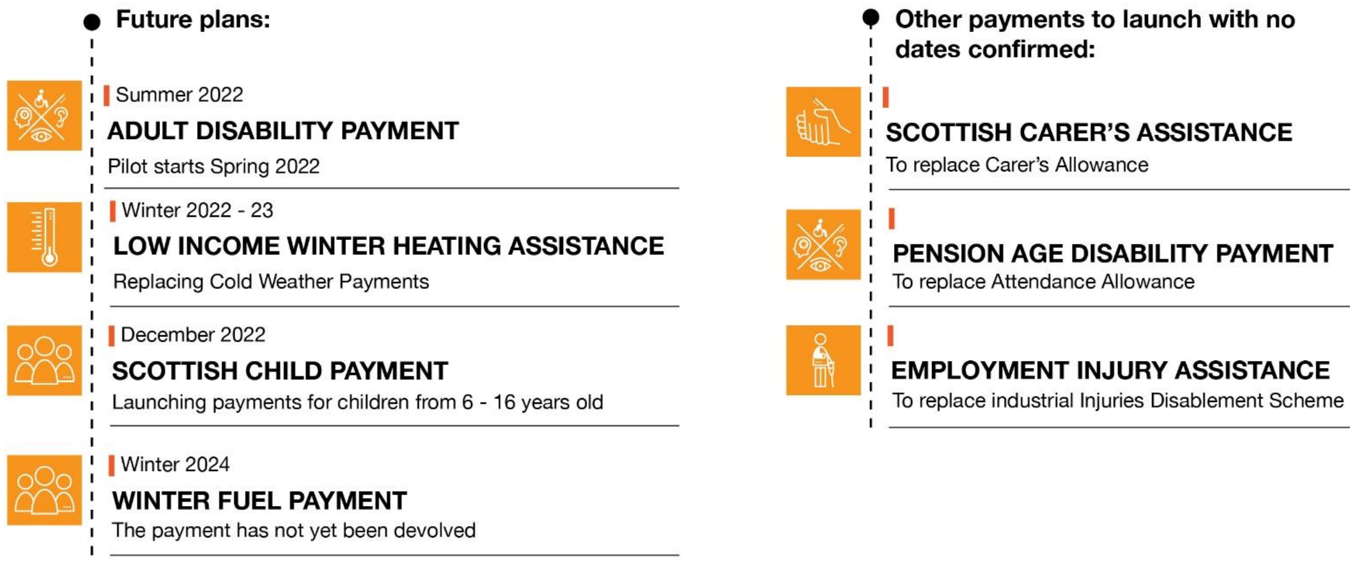
Source: Scottish Fiscal Commission
Scottish Government policy includes Best Start Foods, the three payments of Best Start Grant, Carer's Allowance Supplement, Child Winter Heating Assistance, Low Income Winter Heating Assistance, Funeral Support Payment, Discretionary Housing Payments, Fair Start Scotland, Self-Isolation Support Grant and Scottish Welfare Fund.
This figure does not include Winter Fuel Payment as it has not yet been devolved.
[1] "Other" Includes Industrial Injures Disablement Scheme and Severe Disablement Allowance.

5.7 By 2026-27, Social Security Scotland will administer more payments directly following the introduction of Adult Disability Payment (ADP), Child Disability Payment (CDP) and LIWHA. Spending is also increasing as payment rates rise and the Scottish Child Payment (SCP) is rolled out to all children aged under 16. As shown in Figure 5.2, our current forecasts estimate that 73 per cent of spending in 2026-27 will be administered by Social Security Scotland and be based on Scottish Government policy. This is based on the Scottish Government's confirmed plans to launch new payments. We expect this percentage to increase in our future forecasts as the Scottish Government aims to launch the replacement payments for AA, Carer's Allowance (CA) and

[73] DWP will make payments on behalf of the Scottish Government of devolved benefits subject to agency agreements to eligible customers resident in Scotland.

Industrial Injuries Disablement Scheme (IIDS) and for all clients to have transferred from DWP to Social Security Scotland by the end of 2025.

Figure 5.3 Timeline of Social Security payments



Source: Scottish Fiscal Commission

5.8 There are no current public commitments on launch dates for Scottish Carer's Assistance (which will replace CA and the Carer's Allowance Supplement), Pension Age Disability Payment (which will replace AA) or Employment-Injury Assistance (which will replace IIDS). When the Scottish Government announces details of these replacements for the remaining payments that are currently administered by DWP, we will incorporate the changes in our forecasts. Our forecast already reflect spending on the current payments.

5.9 A Scottish replacement for Winter Fuel Payments (WFP) is provisionally scheduled for winter 2024.[74] WFP is not yet devolved and as such does not feature in our headline forecasts. However, an illustrative forecast is provided at the end of this chapter.

5.10 Our forecasts also include the Fair Start Scotland employability service which has operated since 2018-19 under devolved powers which fall within our remit. This will close to new entrants at the end of 2022-23 and the Scottish Government has not yet announced whether it is to be replaced by a service or funding stream that would remain within our remit.

Box 5.1: Social security spending not covered by our forecasts

Our forecasts exclude two smaller payments administered by Social Security Scotland. Job Start Payment, which is paid under devolved Employment and Training Act powers, is outside our remit, and the Young Carer Grant is excluded from our forecasts on grounds of materiality. Further information on the Young Carer Grant can be found in Annex C.

The 'bridging payments' that councils are paying to low-income families ahead of the extension of Scottish Child Payment to older children are also outside our remit.

[74] Parliamentary Question reference S6W-03327 answered 22 October 2021 (link)

5.11 In Figure 5.4, we show outturn spending for 2020-21, our estimate of spending for the current financial year (2021-22) and a five-year forecast for each payment.

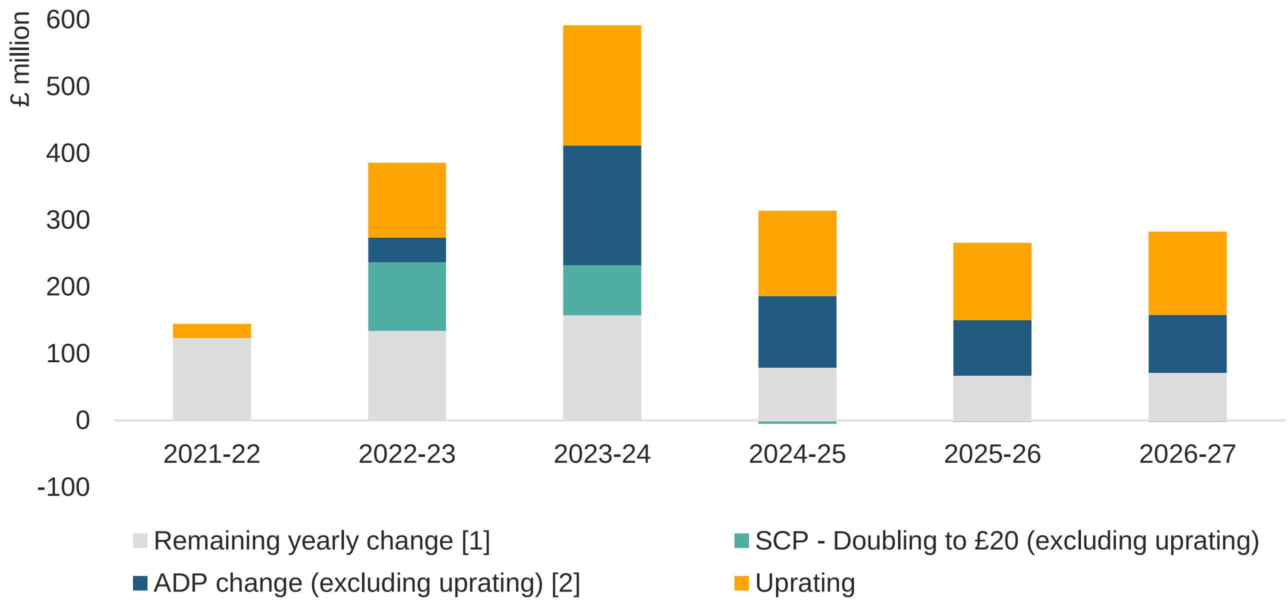
Figure 5.4: Social security spending forecasts

	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
Administered by Social Security Scotland:							
Adult Disability Payment [1]	1,626	1,734	1,948	2,322	2,588	2,806	3,034
Best Start Foods [2]	12	15	13	12	11	10	9
Best Start Grant	18	17	18	18	18	17	17
Carer's Allowance Supplement	59	60	42	46	50	55	58
Child Disability Payment [3]	208	226	265	305	330	350	371
Child Winter Heating Assistance	3	5	4	4	4	4	4
Funeral Support Payment	11	12	12	12	13	13	14
Scottish Child Payment	6	56	197	362	360	362	363
Low Income Winter Heating Assistance			21	21	21	21	22
Administered by DWP:							
Attendance Allowance	528	519	545	575	600	628	653
Carer's Allowance	296	301	315	348	380	412	445
Disability Living Allowance (Adult)	515	475	445	416	383	349	315
Industrial Injuries Disablement Scheme	83	81	81	81	80	79	78
Severe Disablement Allowance	7	7	6	6	5	5	4
Administered by local authorities and other bodies:							
Discretionary Housing Payments	81	78	79	81	82	83	87
Fair Start Scotland	21	27	24	13	5	0	
Self-Isolation Support Grant	4	32	15				
Scottish Welfare Fund	58	36	36	36	36	36	36
Total spending [4]	3,535	3,679	4,065	4,657	4,966	5,230	5,511

Source: Scottish Fiscal Commission, Social Security Scotland, Scottish Government.
Shaded cells refer to provisional outturn available at time of publication. Figures may not sum because of rounding.
[1] Adult Disability Payment includes spending on the UK Government Personal Independence Payment until all existing clients are receiving ADP. We assume that this transfer will be completed by the end of 2024-25.
[2] Best Start Foods for 2020-21 includes spending on UK Government Healthy Start Vouchers.
[3] Child Disability Payment includes spending on the UK Government Disability Living Allowance (Child) until all clients are receiving the new payment. We assume that this transfer will be completed by the end of 2022-23.
[4] Social security spending forecasts is split in two Scottish Government portfolios. Social Justice, Housing and Local Government portfolio includes all social security payments that were previously captured within the Social Security and Older People portfolio, plus Discretionary Housing Payments and Best Start Foods. Finance and Economy portfolio includes Fair Start Scotland and Self-Isolation Support Grant.

5.12 Social security spending increases over time because we expect more people to receive support, and most payment amounts are uprated each year with inflation. Most payment rates will increase by 3.1 per cent in April 2022 and we forecast a 3.9 per cent increase in April 2023.[75] In Figure 5.5, we show how much of the growth in social security spending each year is related to uprating.

Figure 5.5: Annual change in social security spending (year on year change)



Source: Scottish Fiscal Commission
[1] "Remaining yearly change" covers other elements such as the general caseload increases and other policy changes
[2] Includes additional effect on CA and CAS

5.13 SCP launched in February 2021 to children under six. The Scottish Government has committed to double the payment rate to £20 in April 2022 and to extend the payment to all eligible children under 16 in December 2022. These changes increase social security spending in 2022-23 and in 2023-24.

5.14 The introduction of ADP in 2022-23 will progressively increase social security spending. Our forecast reflects the transfer of clients from the DWP to Social Security Scotland. The additional spending on ADP increases overtime as more people have their application assessed or have their awards reviewed.

5.15 We expect the change in social security spending in later years to be higher than shown in Figure 5.5 once the Scottish Government launches other payments. We provide more details in Box 5.1 and in the section on illustrative forecasts.

Box 5.2: Social security caseload forecasts

The launch of LIWHA in winter 2022-23 will substantially increase the number of people receiving payments from Social Security Scotland. Eligible households will receive a payment regardless of the incidence of very cold weather. We expect that there will be an additional 406,000 people who receive this payment. Similarly, the caseload for SCP increases by over 200,000 children from late 2022 following the expansion to children aged under 16.

We expect the number of people receiving disability payments to increase over the forecast horizon. There are several other payments where we expect the caseload to remain broadly flat or fall gradually overtime. The caseload for payments to families with children, such as the Best Start Grant (BSG), are

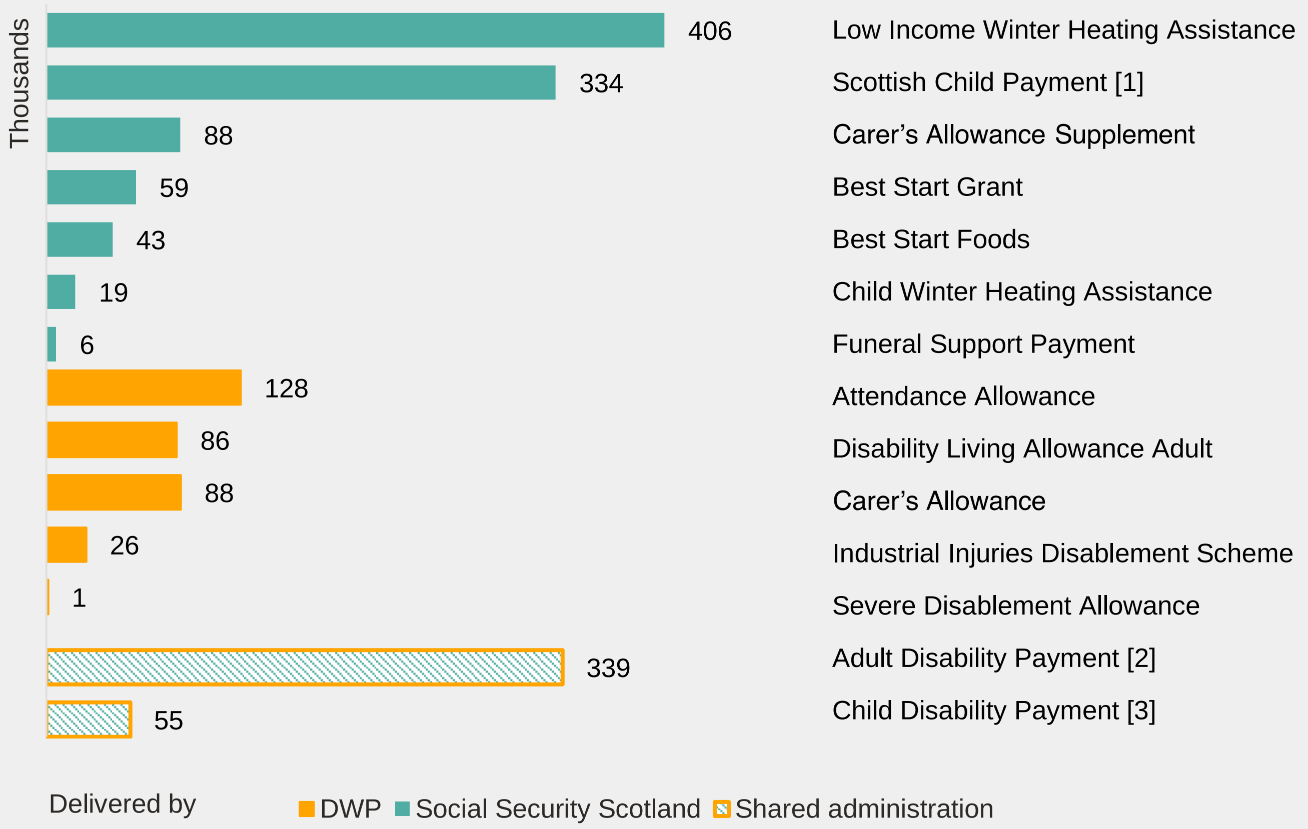
[75] Uprating for payment in 2022-23 is based on the Consumer Price Index (CPI) inflation rate in September 2021 published by the ONS.

affected by the size of the child population. We are forecasting that the number of births and the child population will fall over the next five years, so the caseload for the BSG falls each year.

We also expect an increase in the SCP caseload in the short-term due to UK Government changes to the Universal Credit taper rate and work allowances, and higher take-up in response to the much larger weekly payment for SCP. Over the medium term we still expect the caseload to fall from a peak in 2022-23 due to economic recovery and a falling population.

Our caseload forecast for each payment is shown in Figure 5.6. These estimates should be treated cautiously, as people may receive more than one of these payments. It is not possible to sum these figures to give a total of people supported. More information on caseload forecasts in subsequent years can be found in Supplementary Table S5.1 published on our website.

Figure 5.6: Social security caseload forecast for 2022-23



Source: Scottish Fiscal Commission

[1] Scottish Child Payment caseload is an average number of children benefitting over the whole financial year for children under 6, the children over 6 are averaged only over the period from December 2022 onwards when we assume the payment will be extended to the 6 to 16 age group.

[2] Adult Disability Payment includes clients on the UK Personal Independence Payment.

[3] Child Disability Payment includes clients on the UK Government Disability Living Allowance (Child).

Scottish Government policy

5.16 Since January 2021, the Scottish Government has announced several policy changes, some in response to the COVID-19 pandemic and others that were included in the SNP manifesto or announced in the 2022-23 Scottish Budget.

5.17 We have included the Scottish Government's new Adult Disability Payment (ADP) in our forecast. ADP is due to launch nationally in summer 2022 and will be delivered by Social Security Scotland. ADP will replace the UK Government payment, Personal Independence Payment (PIP). Our estimate shows that implementing the new payment will increase spending by £37 million in 2022-23, rising to £527 million by 2026-27. This additional spending will be above what would have been spent on PIP in the absence of ADP. Further detail can be found in **Box 5.3**.

5.18 In addition, we forecast that the introduction of ADP will result in more people qualifying for Carer's Allowance (CA) in Scotland. This will increase CA and Carer's Allowance Supplement (CAS) spending by £40 million by 2026-27.

5.19 The Scottish Government will increase the Scottish Child Payment (SCP) payment rate to £20 per week from April 2022. We estimate spending on the SCP will increase by over £180 million a year once the payment is fully extended to all children under 16. We assume take-up of SCP and Universal Credit is higher in response to the larger payment. More detail can be found in **Annex A**.

5.20 Low Income Winter Heating Assistance (LIWHA) is scheduled to launch in winter 2022-23 and will replace the Department for Work and Pensions (DWP) administered Cold Weather Payment (CWP). LIWHA will be a single £50 payment to all eligible households, replacing CWP which were £25 payments made based on weather conditions in local areas.[76] We forecast spending on LIWHA will be £21 million on average each year, £6 million a year greater than what would have been spent on CWP in an average winter. More detail can be found in **Annex A**.

5.21 Self-Isolation Support Grant has had several changes since January 2021. An expansion of eligibility to cover households with higher incomes was announced just after the January 2021 Budget, and then more recently in October 2021 eligibility was restricted so contacts who have been double-vaccinated only qualify if they test positive for COVID-19 and are therefore required to self-isolate.[77] Together these policy changes add around £6 million to spending in 2021-22 relative to the policy position in January. Following a request from the Scottish Government the forecast has been extended to add budget provision up to the end of October 2022, with £15 million spending in 2022-23. More detail can be found in **Annex A**.

5.22 The Scottish Government plan to make a double payment of CAS due to be paid in December 2021.[78] We estimate this will increase spending by £20 million in 2021-22.

5.23 The Child Winter Heating Assistance (CWHA) payment rate has been uprated by 5 per cent from £202 a year in winter 2021-22 to £212.10 a year for the remainder of the forecast period. This policy change increases our forecast by £0.2 million from 2022-23. An amendment to the CWHA regulations was introduced to retroactively extend entitlement to young people in receipt of the enhanced rate daily living component of PIP.[79] This results in an additional 2,300 young people becoming entitled to CWHA in 2022-23, increasing spending by £0.5 million.

5.24 The weekly payment amount for Best Start Foods increased in August 2021 from £4.25 to £4.50.[80] We estimate this increased spending by around £0.6 million per year. The income thresholds were

[76] Cold Weather Payments are £25 payments made to eligible people for each period in which the average temperature in their area is recorded as, or forecast to be, zero degrees Celsius or below over 7 consecutive days.
[77] Scottish Government (2021) More people supported to self-isolate (link), Scottish Government (2021) Scottish Welfare Fund Statutory Guidance Self-Isolation Support Grant Extract – 13 October 2021 (link)
[78] Scottish Government (2021) Double payment for unpaid carers (link)
[79] Scottish Government (2021) Child Winter Heating Assistance eligibility extended (link)
[80] Scottish Government (2021) Increase in payments to help boost family incomes (link)

also increased to match the National Living Wage in 2021-22 and will be increased again next year for the same reason, but we do not regard these changes as having a material effect on spending.

Figure 5.7: Scottish Government policy changes since January 2021

£ million	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
Adult Disability Payment [1]			38	233	358	458	567
Carer's Allowance Supplement [2]		20					
Child Winter Heating Assistance [3]		2	1	0	0	0	0
Low Income Winter Heating Assistance			21	21	21	21	22
Scottish Child Payment			103	184	183	185	186
Self-Isolation Support Grant [4]	1	6	15				
Other [5]	0	1	1	1	1	1	0
Total policy change	1	28	179	440	563	665	775

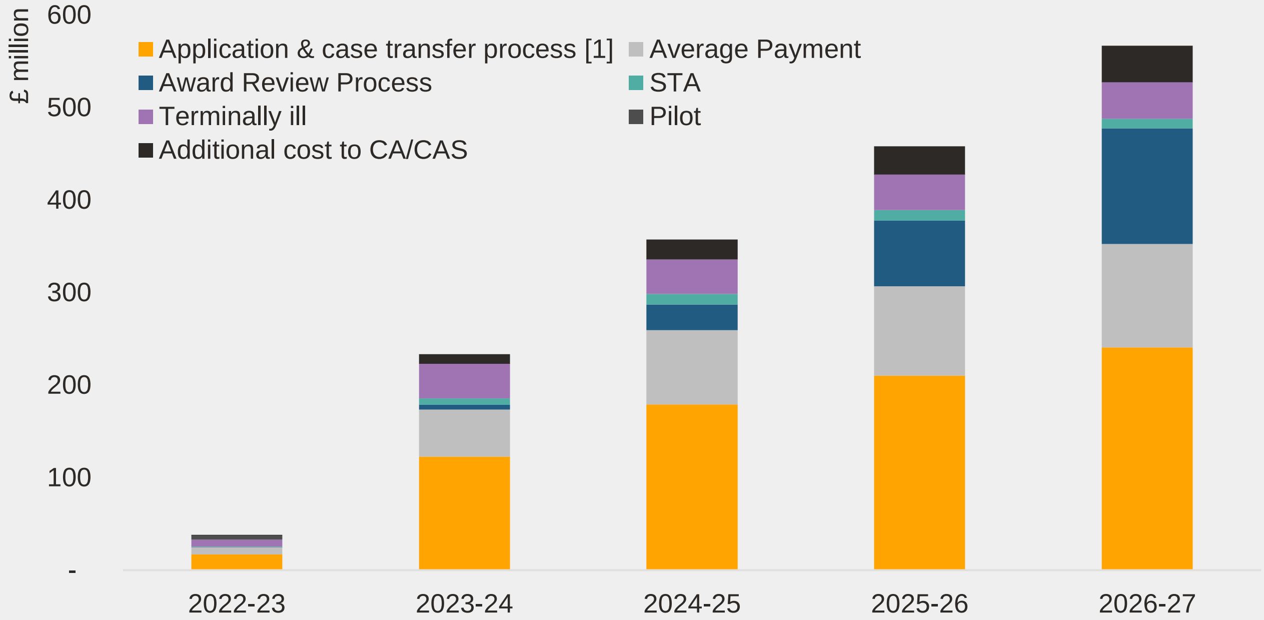
Source: Scottish Fiscal Commission, Scottish Government.
Figures may not sum because of rounding.
[1] This contains the direct additional cost of the new policy on ADP, and the additional cost to Carer's Allowance and Carer's Allowance Supplement because of the introduction of ADP.
[2] Carer's Allowance Supplement (Scotland) Bill was initially costed in June 2021. Scottish Fiscal Commission (2021) Supplementary Costing – Carer's Allowance Supplement (Scotland) Bill – June 2021(link).
[3] This contains the extension of CWHA eligibility to PIP and backdated payments for 2020-21 that will be paid in 2021-22; and the change in Scottish Government uprating policy for CWHA.
[4] This includes both the upward effect of expanding eligibility early in 2021 and the more recent downward effect of removing eligibility from double-vaccinated contacts who do not have a positive PCR test.
[5] "Other" covers changes to the funding arrangement for DHP and the increase in the Best Start Foods payment rate

Box 5.3: Adult Disability Payment

ADP will replace PIP launching nationally in Scotland from summer 2022. Whilst similar in legislation, there are some differences in the processes and support that will be available for ADP compared to PIP, as well as some changes in policy such as the introduction of Short Term Assistance and changes to the terminal illness definition. We expect these differences to result in an increase in the number of clients receiving payment and the average amount they receive.

We use as a baseline our PIP forecast, which is based on historic data on the caseload and average award payments. To estimate future spending on ADP, we consider the effects of the new ADP processes and procedures on caseload and spending and how these caseload and spending will differ from PIP in order to arrive at a total forecast for ADP. We consider the effects of the changes within several categories: new successful applications received, average payments received by clients, transfer of clients from the DWP to Social Security Scotland, award lengths, review processes, the new Short Term Assistance payments and changes to the definition of terminal illness.

Figure 5.8: ADP Policy decomposition



Source: Scottish Fiscal Commission.
[1] We assume that the case transfer will be completed by the end of 2024-25.

Further details on how we have forecast the additional ADP cost can be found in Annex A of our August 2021 publication.[81] Our overall approach to costing ADP is unchanged since August. However, in August, we assumed that the Scottish Government would run a pilot from spring 2022, which we did not include in our costing as the scale of the pilot was unclear and we assumed that it would not have a material effect on our forecast. Based on new information shared by the Scottish Government, we have now included the pilot in our costing of ADP. We assume the pilot will start in spring 2022, covering a gradually increasing number of Local Authorities. We forecast that the ADP pilot will increase spending by £4 million in 2022-23.

There is an additional cost to Carer's Allowance (CA) and Carer's Allowance Supplement (CAS) because of the introduction of ADP. We expect more people to be in receipt of disability payments under ADP compared to PIP, and in turn more people to be eligible and apply. Based on our forecast of ADP caseload, we estimate that CA and CAS spending will increase by £40 million by 2026-27.

As ADP is a new payment, there is little evidence on which to base our forecast. We have drawn on evidence from the introduction of other new payments, such as the transition from DLA Working Age to PIP and the introduction of other devolved Scottish Government payments. However, none of these are directly comparable to ADP and so our costing is based on a number of assumptions and judgements.

We attach a high degree of uncertainty to our estimate of additional spending on ADP. In August 2021, we conducted some sensitivity analysis assessing the effect of our most significant assumptions being 50 per cent higher or lower. If our main assumptions were all 50 per cent lower, then spending would be £242 million lower in 2026-27 than we expected in August. Conversely, if these were all 50 per cent higher, then spending would be £234 million higher in 2026-27 than we expected in August. We published a more detailed sensitivity analysis in our August forecast.[82]

[81] Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – August 2021 (link)
[82] Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – August 2021 (link)

Changes since January 2021

5.25 Since January 2021, our forecasts have been updated to include the latest outturn data available and to account for the introduction of new policies. Figure 5.9 shows the change in spending forecasts for each of the social security payments.

Figure 5.9: Change in social security spending forecasts since January 2021, by payment

£ million	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
January 2021	3,495	3,614	3,810	4,020	4,129	4,249
December 2021	3,535	3,679	4,065	4,657	4,966	5,230
Change since January 2021	39	66	256	637	837	981
Of which:						
Adult Disability Payment [1]	52	65	141	405	580	701
Attendance Allowance	-6	-30	-23	-8	1	9
Best Start Foods	0	3	3	3	3	2
Best Start Grant	-2	-2	0	0	0	1
Carer's Allowance	-3	-5	-7	6	21	36
Carer's Allowance Supplement	-1	18	-2	0	2	4
Child Disability Payment [2]	0	-5	-4	3	4	2
Child Winter Heating Assistance	0	2	1	0	0	0
Disability Living Allowance (Adult)	5	10	18	26	26	24
Discretionary Housing Payments	-2	-4	-4	-3	-3	-3
Fair Start Scotland	0	0	2	2	1	0
Funeral Support Payment	-1	1	1	1	1	1
Industrial Injuries Disablement Scheme	0	1	2	3	4	3
Low Income Winter Heating Assistance	0	0	21	21	21	21
Scottish Child Payment	-3	-12	92	178	177	179
Scottish Welfare Fund	0	0	0	0	0	0
Self-Isolation Support Grant	-1	26	15	0	0	0
Severe Disablement Allowance	0	0	0	0	0	0

Source: Scottish Fiscal Commission
Shaded cells refer to outturn available at time of publication. Figures may not sum because of rounding.
[1] Adult Disability Payment includes spending on the UK Government Personal Independence Payment until all existing clients are receiving ADP. We assume that this transfer will be completed by the end of 2024-25.
[2] Child Disability Payment includes spending on the UK Government Disability Living Allowance (Child) until all clients are receiving the new payment. We assume that this transfer will be completed by the end of 2022-23.

5.26 Figure 5.10 shows the main reasons our headline forecasts have changed since January 2021 split by data updates, modelling changes, assumption changes and policy changes. The most significant change is our costing of Adult Disability Payment (ADP), the replacement for Personal Independence Payment (PIP). This change in ADP spending, together with the doubling of Scottish Child Payment (SCP) and other policies, are presented in Figure 5.10 under 'Policy changes –

Scottish Government'. Detailed breakdowns for all payments are available in supplementary tables published on our website.

Figure 5.10: Change in social security spending forecasts since January 2021

£ million	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
January 2021	3,495	3,614	3,810	4,020	4,129	4,249
Data updates	47	83	89	96	101	105
Modelling changes	-7	-3	-5	-6	-5	-3
Inflation	0	0	60	151	180	190
Assumptions – Eligibility and take-up	-2	-10	-13	-21	-21	-19
Assumptions – Population	0	1	-2	-4	-4	-5
Assumptions – Other	2	-33	-55	-27	10	35
Policy changes – Scottish Government	1	28	179	440	563	665
Policy changes – UK Government	0	1	4	7	13	12
December 2021	3,535	3,679	4,065	4,657	4,966	5,230
Change since January 2021	39	66	256	637	837	981

Source: Scottish Fiscal Commission, Social Security Scotland, Scottish Government.
Shaded cells refer to provisional outturn available at time of publication. Figures may not sum because of rounding.

Data updates

5.27 Since our January publication, our models have been updated with a further year of data. The number of PIP recipients has been higher than we forecast in January 2021. For some payments, such as Attendance Allowance (AA) and Child Disability Payment (CDP), the data updates have reduced our forecast. Overall, across all the forecasts, data updates have increased our forecast by £83 million in 2022-23 and £105 million by 2025-26.

Modelling changes

5.28 Modelling changes covers several changes made in August to our baseline PIP model to better reflect the current PIP policies and captures the increasing number of people over State Pension Age.[83]

Inflation

5.29 Our inflation forecast is used to uprate the weekly payment rates for future years. Our January 2021 inflation forecast implied that payment rates would increase by 1.4 per cent in April 2022 and 1.6 per cent in April 2023. We have now revised up our inflation forecasts, meaning most payment rates will increase by 3.1 per cent in April 2022 and we forecast a 3.9 per cent increase in April 2023. A higher inflation forecast increases the payment rates and spending forecast from 2022-23 onwards. This increases spending by £60 million in 2022-23 and £190 million by 2025-26.

[83] Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – August 2021 (link)

Assumption changes

Eligibility and take-up

5.30 In our August forecast we made a significant reduction in our assumed proportion of children who are eligible for SCP.[84] While these reductions are now partly offset by UK Government changes to the Universal Credit (UC) taper rate and work allowances, our view of the proportion of eligible children remains lower than in January. Changes to our assumptions on the proportion of eligible children applying for and receiving the payment (take-up) resulting from the increase in the SCP to £20 are included in our estimate of the policy change and covered in detail in **Annex A**.

Population

5.31 We have updated our population forecast in line with the mid-2020 population and migration data published by National Records of Scotland and more recent monthly data on births and deaths. Compared to our January 2021 forecast, the total Scottish population is slightly lower and falls in every year of the forecast, by an average of 3,000 people per year, with falling births being the main driver of this downward trend.

Other assumptions

5.32 We have made a number of other key assumptions in our forecasts, most notably adjustments to account for external factors and policy changes that are not fully reflected in data. We incorporate these either by adjusting our models to better reflect our judgements or by including adjustments estimated using other models or information provided by the OBR.

5.33 We have made a number of changes to our estimates of PIP baseline spending to reflect changes made October 2021 Economic and Fiscal Outlook[85]. In January, we assumed the COVID-19 pandemic would result in long-term health effects which would increase the PIP caseload, and that the drop in applications seen during the lockdown periods would result in higher applications in future quarters. We have extended the length of time we expect it to take for those extra clients to join the caseload until April 2024. We have also incorporated a supply constraint assumption included in the OBR's forecasts to reflect that the demand for PIP assessments has outstripped the Department for Work and Pensions' (DWP) capacity for both current clients requiring a reassessment and new applicants. This result in clients staying in the caseload for longer and some receiving larger back payments. Finally, the estimates on the cost of the legal challenges against DWP have also been updated in our forecast. The combined effect of all changes decreases ADP spending by £30 million in 2022-23, and increases it by £14 million 2025-26.

5.34 For AA, we have revised down our assumptions on the number of successful applications. We assume that some of the drop in applications seen during the lockdowns will be delayed, but others will no longer apply. This reduced our AA forecast by £14 million in 2021-22, £8 million in 2022-23 and £4 million thereafter.

5.35 We have introduced a further COVID-19 excess death assumption in our Attendance Allowance forecast. We assume that most of the excess deaths within the AA caseload during the pandemic would otherwise have occurred at some point by 2026-27.

5.36 As in the ADP and AA model, our CDP forecast contains a new assumption on deferred demand. New successful applications onto DLA Child were lower than expected in 2020 and 2021, and we

[84] Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – August 2021 (link)
[85] OBR (2021) Economic and fiscal outlook – October 2021 (link)

assume that the majority of these clients will defer their applications to CDP during the forecast horizon.

Policy changes – Scottish Government

5.37 The launching of ADP in summer 2022, and the increase in the SCP payment rate to £20 per week from April 2022 are the two main policy changes introduced since January 2021.

5.38 There are other policy changes, such as the launching of LIWHA, changes to the SISG, or the extension to the CWHA regulations which have also been included in our forecasts. We provide more details on these changes in the **Scottish Government policy section**.

Policy changes – UK Government

5.39 After the 2021-22 Scottish Budget was delivered in January 2021, the UK Government extended the Coronavirus Job Retention Scheme and the £20 uplift to the weekly value of UC and Tax Credits until September 2021.[86] These changes affected eligibility for payments such as the Best Start Grant and SCP but we do not think there was a material effect on spending.

5.40 The UK Government announced in their October 2021 Autumn Budget a reduction of the Universal Credit (UC) taper rate from 63 per cent to 55 per cent and a £500 per year increase to work allowances. This is a notable change leading to more families receiving UC, and hence being eligible for devolved low-income benefits. We estimate a material increase in spending in SCP and Best Start Grant of an additional £13 million a year towards the end of the forecast period. We consider the effect of these changes on Best Start Foods, Discretionary Housing Payments, Funeral Support Payment and Self-Isolation Support Grant (SISG) to be below our materiality threshold.

5.41 The UK Government has expanded the qualifying criteria for the Special Rules for Terminal Illness so that people are eligible if they are reasonably expected to be in their final 12 months of life, rather than six months. This allows people to make fast tracked claims to a number of disability and incapacity benefits. This measure was initially announced in the Health and Disability Green Paper.[87] We estimate that this increases AA spending by £6 million in 2025-26 and the ADP baseline cost of Terminal Illness by £5 million by 2026-27. The increase in the ADP baseline is a small cost in comparison to our ADP Terminal Illness costing. By removing the time-limited definition altogether we expect the new criteria to capture a higher number of people with conditions, such as Motor-Neuron Disease, whose long-term prognosis is difficult for medical professionals to predict. This removal of the time limit accounts for most of the increased spending captured in our forecast because those with conditions that have a firmer prognosis are better captured by the current definition so the additional spending resulting from the 6 to 12 month change is comparatively lower. Also, under the existing 6 month criterion the average length of time a client stays on the special rules caseload is already longer than 6 months, so we think the additional cost will be lower for this group.

5.42 The UK Government announced in the Health and Disability Green Paper that it will no longer implement the 18 month minimum award length. This measure was in our January 2021 forecast and has now been removed, reducing our ADP baseline costing.

[86] HM Treasury (2021) Budget 2021 – What You Need to Know - (link)
[87] UK Government (2021) - Shaping future support: the health and disability green paper (link)

The effect of COVID on our forecast

5.43 Since March 2020, we have included changes caused by the COVID-19 pandemic into our forecasts. We have seen a decrease in the number of people applying for disability benefits and the introduction of additional payments to mitigate the effect of COVID on the most vulnerable.

5.44 Our social security forecasts are consistent with the COVID-19 assumptions set out in **Chapter 1**, with the virus assumed to be endemic over the medium-term forecast period from April 2022. We expect that from April 2022 the virus will begin to be managed through guidance and voluntary measures if there are no further contingency measures implemented. As our forecasts are used to set the social security budget, following a request from the Scottish Government, we have extended our SISG forecast until the end of October 2022 based in part on the recent introduction of the Coronavirus (Discretionary Compensation for Self-isolation) (Scotland) Bill.

5.45 While we no longer report the effect of COVID-19 in our forecasts, they do reflect the latest trends on eligibility or number of applications, as well as assumptions on the future effect of COVID-19 on the different payments. For example, we expect that most of the drop of applications to the disability benefits during the peak of the pandemic will be deferred to later in the forecast period.

Comparison with Block Grant Adjustments

5.46 The largest social security payments are funded through Block Grant Adjustments (BGAs).[88] The BGAs are additions to the Scottish Budget based on spending in Scotland before the payments were devolved, and updated to reflect social security spending in England and Wales. More information on BGAs can be found in our occasional paper, Funding for the Scottish Budget.[89]

5.47 The majority of social security spending in 2022-23 is funded through BGAs. We compare our forecasts of spending to the latest BGAs to calculate the difference between spending and funding for each payment. A negative figure means spending will be higher than corresponding funding, and the Scottish Government will need to meet the cost from the wider Scottish Budget.

5.48 For 2022-23, the overall BGA is £38 million lower than our spending estimate, but the difference varies by payment as shown in Figure 5.11. Our forecast of spending on DLA and CDP is higher than the BGA, reflecting the introduction of CDP and the halting of the migration from DLA to PIP which continued in England and Wales and therefore reduces DLA spending but increases PIP spending.

[88] This includes Adult Disability Payment (covered by the Personal Independence Payment BGA), Child Disability Payment (covered by the Disability Living Allowance BGA along with DLA Adult spending), Attendance Allowance, Carer's Allowance, Industrial Injuries Disablement Scheme, Low Income Winter Heating Assistance (covered by the Cold Weather Payment BGA), and Severe Disablement Allowance.
[89] Scottish Fiscal Commission (2021) Funding for the Scottish Budget (link)

Figure 5.11: Comparison to Block Grant Adjustments (BGA) 2022-23

£ million	BGA	Spending	Difference (BGA minus spending)
Adult Disability Payment [1]	1,933	1,948	-15
Attendance Allowance	545	545	0
Carer’s Allowance	323	315	8
Disability Living Allowance [2]	687	710	-23
Industrial Injuries Scheme	79	81	-1
Low Income Winter Heating Assistance	14	21	-7
Severe Disablement Allowance	6	6	0
Total	3,587	3,626	-38

Source: Scottish Fiscal Commission
[1] Spending includes Adult Disability Payment forecast
[2] Spending includes Child Disability Payment forecast

5.49 We can also compare our forecasts to the latest BGAs over the next five years to show the implied funding position. As shown in Figure 5.12 spending is currently forecast to be greater than BGA funding in every year of the forecast horizon, by over £250 million in each of the last three years. This funding gap partly reflects policy changes which raise spending only in Scotland. The additional costs will need to be managed from elsewhere in the Scottish Budget. This does not include spending on other payments which do not have a corresponding BGA and are funded through the Scottish Government’s general Block Grant, such as the Scottish Child Payment.

Figure 5.12: Comparison of social security spending forecast and BGAs

£ million	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
Block Grant Adjustments	3,207	3,313	3,587	3,898	4,134	4,395	4,670
Spending on social security payments with BGAs [1]	3,262	3,343	3,626	4,074	4,387	4,650	4,922
Difference (BGAs minus spending)	-55	-30	-38	-176	-253	-255	-252

Source: Scottish Fiscal Commission.
Shaded cells refer to outturn available at time of publication. Figures may not sum because of rounding.
[1] Includes social security spending on Attendance Allowance, Carer’s Allowance, Disability Living Allowance, Industrial Injuries Disablement Scheme, Low Income Winter Heating Assistance and Severe Disablement Allowance as well as the costs for the new Child Disability Payment and Adult Disability Payment which will replace Disability Living Allowance (Child) and Personal Independence Payments respectively.

5.50 The implied scale of the funding gap suggested by the latest comparison of our forecasts and the BGAs is likely to be an underestimate, primarily driven by difference between the Commission and the OBRs forecasts for PIP and ADP. Overall, we would expect spending on PIP and DLA Adult in Scotland to remain broadly consistent with the rest of the UK, before accounting for the policy changes introduced through ADP. We are forecasting spending on ADP to be over £500 million more than spending on PIP by 2026-27. This is larger than the £252 million gap between the BGAs and our forecasts in the same year.

5.51 We expect that the PIP baseline and DLA Adult spending will be broadly similar to the BGAs. This implies that either our PIP baseline and DLA Adult spending will be higher than we forecast or the BGAs will be lower than suggested by the OBR’s latest forecasts. Either way, we expect that the difference between the funding received and the actual spending will be closer to the additional spending on ADP above spending on PIP than the levels currently implied.

5.52 The funding position will become clearer over time and both our and the OBR's forecasts will be revised. It is also worth noting that our forecasts do not yet incorporate any changes in spending arising from the Scottish Government's replacement payments for Carer's Allowance, Attendance Allowance, Industrial Injuries Scheme, and Winter Fuel Payments.

5.53 Further discussion on the implications for the Scottish Budget of social security spending being higher than the funding received can be found in the **Fiscal Overview Chapter**. A comparison between the BGA and spending for each payment, and details of changes to recent BGAs can be found in Supplementary Tables S5.11, S5.12 and S5.13.

Payments without a Block Grant Adjustment

5.54 The Scottish Government has introduced new payments that do not receive any funding from the UK Government.[90] In addition, a number of smaller payments were devolved through the Block Grant.[91] There are no direct changes in funding from the UK Government to cover any increase in spending in these areas and the costs of the new payments must be met entirely from the Scottish Budget. We expect spending on these payments to increase significantly in the future as new payments are launched and existing payments are amended or uprated.

5.55 Spending on new payments introduced by the Scottish Government will reach £512 million by 2026-27 and, the largest costs are attributed to the Scottish Child Payment and Carer's Allowance Supplement. Further discussion on the implications for the Scottish Budget of social security spending being higher than the funding received can be found in the **Fiscal Overview Chapter.**

Forecast uncertainty

5.56 Our 2020-21 Forecast Evaluation Report set out that spending had been 3 per cent, or £100 million, higher than we forecasted in February 2020. Around half of this divergence can be attributed to the Scottish Government's introduction of policies to respond to the COVID-19 pandemic.[92]

5.57 Social security payment amounts will be higher in 2022-23 than we previously expected because of the higher inflation seen this year. We also expect higher inflation next year, which will apply to payments in 2023-24. As most payments are increased each year in line with inflation, a different inflationary outlook to our forecasts would affect forecast social security spending. Where spending is associated with a Block Grant Adjustment (BGA), higher inflation will increase payments in England and Wales, and therefore increase the available funding. For payments which don't have a BGA, higher spending driven by higher inflation will need to be met from the Scottish Budget.

5.58 Our latest forecasts include estimates of spending on the new Adult Disability Payments (ADP). New policies are always harder to forecast as it is more difficult to predict how many people will be eligible and receive the payments as there is very limited information on which to base our forecasts. In the past, reforms of major disability payments have cost more than initially expected. The Office of Budget Responsibility (OBR) has noted that the introduction of Disability Living Allowance in 1992

[90] These include Carer's Allowance Supplement, Scottish Child Payment, Child Winter Heating Assistance, Best Start Grant Early Learning Payment and Best Start Grant School Age Payment. We also include the bedroom tax mitigation element of Discretionary Housing Payments in this category.
[91] Best Start Foods, Best Start Grant Pregnancy and Baby Payment, Discretionary Housing Payments, Funeral Support Payment and Scottish Welfare Fund.
[92] Scottish Fiscal Commission (2021) Forecast Evaluation Report – July 2021 (link)

was intended to extend eligibility and although spending was expected to increase, it rose by considerably more than expected. The introduction of Personal Independence Payment (PIP) in 2013, which was expected to cut costs by 20 per cent by 2015-16, was costing 15 to 20 per cent more by 2017-18.[93] The OBR's Welfare Trends Report in 2019 concluded that "PIP, a reform intended to reduce spending has actually increased it".

5.59 The increase of the Scottish Child Payment (SCP) weekly rate to £20 and the changes to Universal Credit (UC) announced in the UK Budget increase the absolute and relative uncertainty around the SCP forecast. It is possible that these two changes could work together to drive higher eligibility and take-up than we have assumed in our forecast and policy costing, leading to significantly higher expenditure. It is also possible that spending could be significantly lower, for example if the higher income families newly eligible for UC tend not to claim it, or if a £20 payment does not lead to significantly different behaviour than a £10 payment.

5.60 Over time, the forecast uncertainty should decrease as we receive data and information on how many people receive the payments and how much they receive. However, we note that while the forecast risks will reduce, the risks to the budget may increase if spending proves to be higher than we forecast as the commitments being made now will have long-term spending implications.

Illustrative Forecasts

5.61 We provide illustrative forecasts based on current UK Government policy for Cold Weather Payment (CWP) and Winter Fuel Payment (WFP). Responsibility for CWP will transfer to the Scottish Government in 2022-23 and is included in our headline forecasts from 2022-23 onwards. WFP has yet to be transferred to the Scottish Government and therefore is not funded from within the Scottish Budget.

Figure 5.13: Illustrative spending for Cold Weather Payment and Winter Fuel Payment

£ million	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
Winter Fuel Payment	170	172	175	179	184	188	190
Cold Weather Payment [1]	23	16					

Source: Scottish Fiscal Commission, DWP (2021) Benefit Expenditure by country and region 1996-97 to 2020-21 (link)
Shaded cells refer to outturn available at time of publication.
[1] From 2022-23, Cold Weather Payment is replaced by Low Income Winter Heating Assistance and will be part of our Social Justice, Housing and Local Government portfolio forecast.

5.62 Our WFP spending forecast is £175 million in 2022-23. Spending on WFP increases over time because the population aged over State Pension age in Scotland is forecast to increase.

5.63 Outturn expenditure for CWP is £23 million in 2020-21. Based on averaging of historical spending, our forecast for CWP is £16 million in 2021-22. Spending on Low Income Winter Heating Assistance is included in our main forecasts from 2022-23.

[93] OBR (2019) Welfare Trends Report – January 2019 (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; which are policy changes that we have not previously costed.

A.2 Where we have previously provided a policy costing, any further changes will be captured as a policy recostings in Annex B. 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.3 Figure A.1 provides a summary of new policy costings included in our forecasts. Negative numbers represent lower tax revenue or higher social security spending and positive figures represent higher tax revenue or lower social security spending.

Figure A.1: Policy costings

£ million	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
Income Tax:						
Freeze 2022-23 Higher Rate threshold		106	106	111	117	124
Non-Domestic Rates:						
Set poundage to 49.8p in 2022-23		-40	-43	-42	-41	-44
2022-23 Retail, hospitality and leisure relief		-56				
Social Security:						
Scottish Child Payment		-103	-184	-183	-185	-186
Low Income Winter Heating Assistance		-21	-21	-21	-21	-22
Self-Isolation Support Grant	14	-15				
Overall effect of new costings	14	-129	-142	-135	-130	-127

Source: Scottish Fiscal Commission
Figures may not sum because of rounding.
In order to reflect the overall effect of policy changes included in the 2022-23 Scottish Budget this table uses negative figures represent lower tax revenue or higher social security spending, and positive figures represent higher tax revenue or lower social security spending. Elsewhere in the document higher social security spending is represented as a positive change, and lower social security spending as a negative change.

Income Tax

Title of measure

Higher rate threshold freeze in 2022-23

Measure description

A.4 The higher rate threshold for Scottish Non-Savings Non-Dividend (NSND) income tax will be frozen at £43,662 in 2022-23. All other bands will increase with CPI inflation both in 2022-23 and beyond, while the higher rate band is assumed to increase with CPI inflation from 2023-24 onwards.

A.5 Figure A.2 compares the higher rate thresholds for 2022-23 onwards following the implementation of the policy freeze announced in the 2022-23 Scottish Budget to our baseline assumption where no freeze was implemented. All other tax rates and bands used to produce our forecast can be found in Supplementary Table S4.1.

Figure A.2: Comparison of policy and baseline higher rate threshold assumptions

£	2022-23	2023-24	2024-25	2025-26	2026-27
Baseline	45,007	46,754	47,861	48,828	49,805
Policy	43,662	45,357	46,431	47,369	48,317
Difference	-1,345	-1,397	-1,430	-1,459	-1,488

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

The cost base

A.6 The cost base is all taxpayers in Scotland who earn more than £43,662. Our forecast of the number of taxpayers in Scotland can be found in Supplementary Table S4.3.

A.7 The freezing of the threshold will affect three different groups of taxpayers. We estimate that in 2022-23 there will be around 35,000 higher rate taxpayers, who we had previously expected to be intermediate rate taxpayers. These taxpayers will pay an extra 20 per cent on each pound earned, up to a maximum of £269 in their income tax liabilities.

A.8 The freeze in the higher rate threshold will also affect all existing higher and top rate taxpayers. We estimate that there are around 440,000 higher and top rate taxpayers who will see an increase in their income tax liabilities of £269. Since the higher rate threshold will be lower than the baseline in all future years these effects will persist into the future.

The costing

A.9 Table A.3 shows our costing for this policy. We expect that this policy would raise £106 million in 2022-23. Our costing factors the behavioural response to this policy change; we explain the calculation of behavioural effects in our occasional paper on forecasting income tax[94].

[94] How we forecast income tax (link)

Figure A.3: Costing of the higher rate threshold freeze in 2022-23

£ million	2022-23	2023-24	2024-25	2025-26	2026-27
Static costing	122	125	131	138	146
Behavioural response	-15	-18	-19	-20	-21
Post-behavioural costing	106	106	111	117	106

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

Uncertainties about the costing

A.10 The main uncertainty around the costing is the size of the behavioural responses. Other sources of uncertainty are the size of the tax base in Scotland and Scottish taxpayers' earnings growth. If the number of higher rate taxpayers or growth in earnings in Scotland are significantly different to our forecast, this will affect income tax revenue.

Non-Domestic Rates

Title of measure

Set poundage to 49.8p in 2022-23

Measure description

A.11 This measure sets the Non-Domestic Rates (NDR) poundage to 49.8p in 2022-23. From 2023-24 onwards, we assume that it will rise in line with Consumer Price Index (CPI) inflation. Figure A.4 shows how the policy poundage compares to our baseline assumption that it will rise with September 2021 outturn CPI.

Figure A.4: Comparison of baseline and policy NDR poundage assumptions

Pence	2022-23	2023-24	2024-25	2025-26	2026-27
Baseline	50.5	52.4	53.6	54.7	55.8
Policy	49.8	51.7	52.9	54.0	55.1
Difference	-0.7	-0.7	-0.7	-0.7	-0.7

The cost base

A.12 This measure affects the entire NDR tax base, so the cost base is our baseline forecast of NDR revenues from 2022-23 onwards.

The costing

A.13 The costing compares two scenarios, which are set out in Figure A.4. The two scenarios are:

- Our baseline assumption, that the poundage for 2022-23 will be raised in line with outturn September 2021 CPI inflation.
- The policy change, that poundage of 49.8p in 2022-23.

A.14 In both scenarios, the poundage is uprated with forecasts of CPI inflation in quarter three of the previous year from 2023-24 onwards. Comparison between the baseline and policy change estimate that revenues will be £40 million lower in 2022-23 compared to our baseline assumption. Figure A.5 shows the costing of the policy.

Figure A.5: Costing of setting the NDR poundage at 49.8 pence in 2022-23

£ million	2022-23	2023-24	2024-25	2025-26	2026-27
	-40	-43	-42	-41	-44

Source: Scottish Fiscal Commission

Uncertainties about the costing

A.15 There is a very low uncertainty around this costing, as the poundage for 2022-23 has been confirmed by the Scottish Government. We do not believe that there will be any behavioural responses to the policy change.

Title of measure

50 per cent relief to the retail, hospitality and leisure sectors for three months, capped at £27,500 per ratepayer

Measure description

A.16 The current 100 per cent relief to properties in the retail, hospitality, leisure and aviation sectors expires on 31 March 2022. The Scottish Government has announced that the retail, hospitality and leisure (RHL) sectors will receive 50 per cent relief for the first three months of 2022-23.

A.17 The total cash value of the relief is capped at £27,500 for each ratepayer. This is equivalent to an annual cap of £110,000 applied to the first quarter of 2022-23.

The cost base

A.18 The cost base is eligible properties in the RHL sectors, excluding those that committed to donating an amount equivalent to the relief they received in 2020-21 and 2021-22 to the Scottish Government.

The costing

A.19 We have used data from the NDR billing system snapshot (BSS) to identify properties that claimed the relief in 2020-21 and 2021-22. We assume that properties eligible for the relief in either of those years will continue to claim it in 2022-23, excluding aviation which is no longer eligible for the relief.

A.20 As with our costings of the 2021-22 relief, we assume that retailers who announced that they would repay the relief in 2020-21 will not claim it in 2022-23.

A.21 We have aligned this costing to our recosting of the 2021-22 relief. In line with the recent data from councils, we believe that the final level of claims of the RHL relief will be lower than the BSS data suggest, but do not know exactly which businesses will not claim the relief. We have adjusted this costing to reflect this using the 2021-22 mid-year estimate.

Figure A.6: Costing of 50 per cent RHL relief in quarter one of 2023-23, capped at £27,500

£ million	2022-23
	-56

Source: Scottish Fiscal Commission

Uncertainties about the costing

A.22 The main uncertainty around the costing is the number of claims of the relief. As discussed in Chapter 4, data on the number of claims of the relief in 2021-22 show that there have been fewer claims to date in 2021-22 than we previously expected. We assume that claims in 2022-23 will match those in 2021-22; but because of the decreased generosity of the relief, it may be that fewer properties decide to claim in 2022-23.

Social Security

Title of measure

Increase weekly Scottish Child Payment to £20 for each child

Measure description

A.23 The current weekly value of Scottish Child Payment (SCP) is £10 for each child. This measure increases Scottish Child Payment to £20 from April 2022. It also brings forward the increase that would normally occur in April 2023 to the same time as the payment is extended to older children, which we currently assume will be in December 2022. From April 2024 onwards the payment will continue to be uprated as normal.

A.24 Figure A.7 shows the forecast weekly value of the Scottish Child Payment under the existing (baseline) policy, in which it is uprated every April in line with CPI inflation, and under the new policy.

Figure A.7: Forecast inflation and weekly Scottish Child Payment amounts

	2022-23	2023-24	2024-25	2025-26	2026-27
Per cent					
CPI inflation [1]	3.1	3.9	2.4	2.0	2.0
£ per week					
Weekly amount – baseline policy	10.30	10.70	10.95	11.15	11.35
Weekly amount – new policy [2]	20.00	20.80	21.30	21.75	22.20

Source: Scottish Fiscal Commission

[1] Inflation figures are shown in the year that they would be used for uprating, for example the 2022-23 column shows the CPI inflation figure for September 2021, used to uprate the payment from April 2022.

[2] The highlighted rate for 2023-24 is expected to apply from December 2022, so also covers the final four months of 2022-23.

The cost base

A.25 The cost base is the number of children forecast to receive Scottish Child Payment, under our baseline assumptions on the proportion of children who are eligible and the take-up rate.

The costing

A.26 The initial static costing is based on the number of children forecast to receive Scottish Child Payment, multiplied by the increase in the payment amount relative to the baseline policy, in which the current value of £10 per week would be uprated in line with inflation every April. The weekly value under normal uprating would be only £10.30 in 2022-23, so the increase to £20 nearly doubles spending from April 2022 onwards.

A.27 We also make a behavioural adjustment to reflect that nearly doubling the payment amount may encourage more people to apply for support. We slightly increase our view of both the number of children eligible and the take-up rate.

A.28 The behavioural adjustment allows for three potential routes to higher spending. Firstly the take-up rate for Scottish Child Payment may increase among people who already receive a qualifying benefit (usually Universal Credit) but who haven't applied for the Scottish Child Payment. Secondly, some families who had previously not taken up their entitlement to Universal Credit may now do so in order to access the larger Scottish Child Payment. This would increase the number of children eligible for Scottish Child Payment. Thirdly, some families' labour market behaviour may change, for example not pursuing an increase in hours or pay which would result in losing eligibility for Universal Credit, and therefore also the larger Scottish Child Payment. This would also increase eligibility.

A.29 While we do not have a detailed model or firm evidence on how families will respond to the larger payment, we think it would be unrealistic to assume no behavioural response. Even a small response would have a material effect on spending. We have added 1 percentage point to our assumptions on the proportion of children who will be eligible for Scottish Child Payment, and 2 percentage points to our assumed take-up rates. Together these add around 5 per cent, or 15,000 children, to the forecast caseload, increasing spending by £17 million from 2023-24 onwards.

A.30 Figure A.8 shows the caseload forecast before and after this adjustment. Full details of our caseload forecasts, and eligibility and take-up assumptions are set out in supplementary tables S5.4, S5.5 and S5.6.

Figure A.8: Number of children forecast to receive Scottish Child Payment

Thousands [1]	2022-23	2023-24	2024-25	2025-26	2026-27
Baseline forecast	319	318	309	304	299
Behavioural adjustment	15	15	15	15	14
Final caseload	334	333	324	319	314

Source: Scottish Fiscal Commission
Figures may not sum due to rounding.
[1] The caseload is the average number of children receiving SCP at any point in time over the financial year, except in the figures for 2022-23. For 2022-23 the children over 6 are averaged only over the period from December 2022 onwards when we assume the payment will be extended to the 6 to 16 age group.

A.31 Figure A.9 shows the static costing and the final costing including the behavioural adjustment.

Figure A.9: Costing of the overall policy change to Scottish Child Payment

£ million	2022-23	2023-24	2024-25	2025-26	2026-27
Static costing	94	168	167	168	169
Behavioural response	9	17	17	17	17
Final costing	103	184	183	185	186

Source: Scottish Fiscal Commission
Figures may not sum due to rounding.

Uncertainties about the costing

A.32 There is significant uncertainty around the costing. A larger behavioural response could lead to higher spending. Our caseload forecast could be too low, for example if we have assumed too low a take-up rate among families with older children. On the other hand, the behavioural response could be smaller, for example if economic recovery is stronger than anticipated. Our caseload forecast could be too high, for example if the relatively higher income households who are now eligible for Universal Credit do not take up their new entitlements to Universal Credit or SCP.

A.33 We note that as the higher payment comes in the same year as SCP is extended to older children, and only months after a significant increase in the number of families eligible for Universal Credit, it may not be possible to isolate or identify the particular reasons for any rise in caseload that we may see over the next year.

A.34 The risks around inflation discussed in the **Summary** could also lead to a greater cost for the policy as higher inflation would mean bigger upratings of the larger weekly payment.

Title of measure

Introduction of Low Income Winter Heating Assistance

Measure description

A.36 Low Income Winter Heating Assistance (LIWHA) will replace Cold Weather Payment (CWP) in Scotland from winter 2022. The new payment will provide financial support to low income households to help with fuel costs during the winter when energy usage is higher.

A.37 Cold Weather Payment is yet to be devolved and is still administered by the Department for Work and Pensions. Currently a household can receive a payment if they are already receiving certain qualifying benefits.[95] Eligibility through working age benefits is restricted to those who have limited capability for work, care for a disabled child, or are out of work while caring for a child under five.

A.38 Eligible households receive £25 for every week from November through March when the temperature is, or is forecast to be, consistently below zero at their local weather station. The new LIWHA, administered by Social Security Scotland, will make a fixed annual payment of £50 to every eligible household, without any temperature test. The new payment will not change the eligibility criteria, so the number of eligible households will remain the same as for the current CWP.

The cost base

A.39 As the eligibility criteria for LIWHA are unchanged from CWP, and all eligible people receive a payment regardless of weather conditions, the cost base for the introduction of LIWHA is everyone in Scotland who is eligible for payment under CWP criteria.

A.40 To estimate the caseload, we use published historic data on the number of households eligible for CWP. We also analyse trends in the qualifying payments and make judgements on the likelihood of people meeting the criteria for receiving a payment under LIWHA.

The costing

A.41 We multiply the number of eligible recipients by the fixed payment amount of £50. We estimate that about 406,000 households will be eligible for payment in the launch year (2022-23), costing about £21 million. The cost rises to £22 million in 2026-27 as more people will receive the payment.

Figure A.10: Policy costing for the introduction of Low Income Winter Heating Assistance

£ million	2022-23	2023-24	2024-25	2025-26	2026-27
	21	21	21	21	22

Source: Scottish Fiscal Commission

Uncertainties about the costing

A.42 There is a low level of uncertainty attached to this costing since the payment amount is fixed at £50 throughout the forecast period and all eligible households will receive the payment. We do not think that there is material uncertainty around the forecast, unless the number of people receiving qualifying benefits increases significantly.

[95] Qualifying benefits include Pension Credit, Income Support or Income-based Jobseeker's Allowance, Income-related Employment and Support Allowance and Universal Credit.

Title of measure

Changes to Self-Isolation Support Grant

Measure description

A.43 On 13 October 2021, the Scottish Government revised the guidance issued to councils so that where someone who has been double-vaccinated is a contact of someone who has tested positive, they will not be able to claim Self-Isolation Support Grant unless they also test positive themselves.[96]

A.44 As the majority of the adult population are now double-vaccinated this significantly reduces the number of contacts who can successfully claim the grant.

A.45 As well as this change to eligibility, following a request from Scottish Government, the forecast has been extended to add budget provision up to the end of October 2022 in light of the recent introduction of the Coronavirus (Discretionary Compensation for Self-isolation) (Scotland) Bill.[97]

The cost base

A.46 The cost base is all individuals who are eligible through testing positive with COVID-19 or being a non-vaccinated contact of a positive case, and who meet the income conditions, and apply for the Self-Isolation Support Grant.

The costing

A.47 The costing for the 13 October change adjusts the ratio of awards to positive COVID-19 cases in line with the expected drop in eligibility. This is based on the prevalence of contacts amongst people asked to self-isolate and the proportion of the population who are double-vaccinated. This roughly halves the ratio of grants to positive cases, decreasing forecast spending in 2021-22 by £14 million.

A.48 The extension of the forecast through to the end of October 2022 adds £15 million to the forecast in 2022-23. For this extension we assume that the number of positive cases through to the end of October 2022 will on average be similar to recently observed levels.

Figure A.11: Costing of the changes to Self-Isolation Support Grant

£ million	2021-22	2022-23
Eligibility policy change	-14	
Extension to October 2022		15

Source: Scottish Fiscal Commission

Uncertainties about the costing

A.49 We attach a high degree of uncertainty to our forecast as there are significant uncertainties about how the pandemic will continue and therefore the numbers of people who will be required to self-isolate. Our central assumption is that the positive case rate seen since the easing of restrictions in Scotland will continue until the end of our forecast, however, if there are significant variations in the case rate this could make the cost significantly higher or lower.

[96] Scottish Government (2021) Coronavirus (COVID-19): Scottish Welfare Fund statutory guidance (link)
[97] Scottish Parliament (2021) Coronavirus (Discretionary Compensation for Self-isolation) (Scotland) Bill (link)

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 2020-21 income tax policy will not be present in the outturn data until summer 2022.
- We revise key judgements 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. These comparisons are against the costings in the August 2021 forecast unless otherwise specified. 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	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
Income Tax							
2020-21 higher rate policy	51	56	57	58	60	63	67
Non-Domestic Rates							
2021-22 Retail, Hospitality, Leisure and Aviation relief		-696					
Adult Disability Payment							
Adult Disability Payment			-38	-233	-358	-458	-567
Carer's Allowance Supplement							
Double payment in December 2021		-20					
Fair Start Scotland							
Two year extension		-18	-20	-13	-5	0	
Self-isolation Support Grant							
Extension to eligibility	-1	-20					

Source: Scottish Fiscal Commission

Figure B.2: Change since last costing

£ million	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
Income Tax							
2020-21 higher rate policy	0	-1	-2	-3	-4	-5	-6
Non-Domestic Rates							
2022-23 Retail, Hospitality, Leisure and Aviation relief		40					
Adult Disability Payment							
Adult Disability Payment			-3	3	5	4	1
Carer’s Allowance Supplement							
Double payment in December 2021		0.4					
Fair Start Scotland							
Two year extension		-0.4	-1.4	-1.3	-0.8	-0.0	
Self-isolation Support Grant							
Extension to eligibility		-12					

Source: Scottish Fiscal Commission

Annex C

Materiality

Introduction

C.1 The tax revenues devolved to Scotland will amount to £17.3 billion in 2022-23 increasing to £20.9 billion by 2026-27. Devolved social security spending equates to £4.1 billion in 2022-23, and reaches £5.5 billion by 2026-27. Some policies announced by the Scottish Government will have a very small effect relative to the size of the Scottish Budget.

C.2 In 2019, the OECD conducted a review of the Scottish Fiscal Commission (SFC) and 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."[98]

C.3 The Commission's approach to materiality was first introduced in our December 2018 Scotland's Economic and Fiscal Forecasts publication.[99] We reviewed our materiality policy and set out increased materiality thresholds in Annex C of our January 2021 Scotland's Economic and Fiscal Forecasts publication.[100] This Annex only discusses Scottish Government policy changes that fall below our materiality thresholds.

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**.

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**.

[98] OECD (2019) Independent Fiscal Institutions Review – Scottish Fiscal Commission (link)
[99] Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 (link)
[100] Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – January 2021 (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:

- a 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 ahead of the 2023-24 Scottish Budget.

Materiality decisions for December 2021

C.9 The Commission has decided not to cost the following policies for December 2021:

- The Scottish Government has extended Non-Domestic Rates Business Growth Accelerator relief to apply a 100 per cent relief to the increase in a property's rateable value from installing solar panels. We estimate that the values of this relief will be negligible, and have made no adjustment to our forecasts.
- From Winter 2021, the Scottish Government have extended the CWHA eligibility to include 16-18 year olds on the enhanced daily living component of Personal Independence Payment. We estimate that this will cost £1.6 million in 2021-22 as this includes retrospective payments for winter 2020, as well as payments for winter 2021. From winter 2022, the annual cost is less than £0.5 million. This is now included in our forecast but is below our materiality threshold so we have not included a separate costing in Annex A on this.
- The Scottish Government plans to increase the income thresholds for Best Start Foods from April 2022 in line with the rise in the National Living Wage. We estimate that the costs of this will be negligible and have made no adjustment to the forecast.
- In September, the Scottish Government laid regulations to ensure that people evacuated from Afghanistan under the UK Government's relocation and resettlement schemes could have immediate access to devolved social security assistance, subject to meeting other eligibility requirements.[102] We estimate that the costs associated with this measure will be negligible and have made no adjustment to our forecasts.
- The Scottish Government have decided to uprate CWHA by 5 per cent for 2022-23. We estimate that this will have an annual cost of £0.2 million. This is now included in our forecast but is below our materiality threshold so we have not included a separate costing in Annex A on this.

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.

[102] Scottish Government (2021) The Social Security (Residence Requirements)(Afghanistan)(Scotland) Regulations 2021 (link)

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
Non Domestic Rates – Local Authority Discretionary Sports Club Relief	A costing of £3 million was included in the Barclay Review of Non-Domestic Rates. We estimated that this policy change fell below our £5 million threshold for small policies.	Scotland's Economic and Fiscal Forecast January 2021
Non Domestic Rates – RV threshold for Fresh Start relief	The rateable value threshold for Fresh Start relief from non-domestic rates was increased from £65,000 to £95,000. We estimated that the change fell under our £2 million threshold.	Scotland's Economic and Fiscal Forecast January 2021
District Heating Networks relief	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. We estimated that this change fell below our £2 million threshold for negligible policies.	Scotland's Economic and Fiscal Forecast January 2021
Social Security Administration and Tribunal Membership (Scotland) Bill	This is a series of administrative changes for which we believe there will be no material implications on benefit spending.	In advance of the bill being introduced in April 2020
Non Domestic Rates – Reverse Vending Machine Relief	All Reverse Vending Machines will be eligible for 100 per cent relief and as such had 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 for which we believe there will be no financial implications.	Scotland's Economic and Fiscal Forecasts February 2020
Young Carer 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
Best Start Foods	Weekly value of Best Start Foods was increased to £4.50 and income thresholds were increased to match rise in National Living Wage	In advance of regulations being introduced in May 2021
Child Disability Payment – Pilot	The CDP pilot ran from the 26th of July 2021, in advance of the full launch on 22 November 2021. We estimated that the additional spending in the three pilot areas was negligible and therefore did not include this in our forecast.	Scotland's Economic and Fiscal Forecast January 2021

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

Medium term funding outlook

Introduction

D.1 In this Annex we set out a central scenario for resource and capital funding over the medium term, as shown in Figure D.1 and Figure D.2. The scenarios bring together information from a number of sources and are based on assumptions made by the Scottish Government. We explain the sources of information, the assumptions made, and how our analysis is carried out.

Figure D.1: Medium term resource funding position

£ million	2022-23	2023-24	2024-25	2025-26	2026-27
Barnett-determined Block Grant	34,322	34,942	35,576	36,963	38,371
Non-Barnett funding	704	715	715	715	715
SFC tax forecasts	14,521	15,193	15,980	16,741	17,387
Tax and non-tax BGAs	-14,639	-15,374	-15,994	-16,892	-17,775
Social security BGAs	3,587	3,898	4,134	4,395	4,670
Final reconciliations	-15	-97	-469	0	0
Resource borrowing	15	97	300	0	0
Resource reserve drawdown	0	0	0	0	0
Other	742	222	222	222	222
NDR distributable amount	2,766	3,169	3,103	3,231	3,519
Total resource funding	42,002	42,764	43,566	45,374	47,109

Source: Scottish Fiscal Commission, based on Scottish Government information.

Figure D.2: Medium term capital funding position

£ million		2022-23	2023-24	2024-25	2025-26	2026-27
Capital (excluding financial transactions)	Barnett-determined Block Grant	4,469	4,757	4,690	4,937	5,148
	Non-Barnett funding	643	632	632	632	632
	Capital borrowing	450	300	250	250	0
	Capital reserve drawdown	118	0	0	0	0
	Other	144	100	100	100	100
Financial transactions	Barnett-determined Block Grant	466	186	176	0	0
	Financial transaction reserve drawdown	61	0	0	0	0
	Other	0	0	0	0	0
Total	Total	6,351	5,975	5,848	5,919	5,880

Source: Scottish Fiscal Commission, based on Scottish Government information.

D.2 For ease of explanation, we categorise funding into three groups: Block Grant funding, funding related to devolved taxes and social security, and 'other', which includes, among other components, borrowing and use of the Scotland Reserve.

Block Grant funding

D.3 Despite increasing devolved tax revenues, the Block Grant remains the main source of funding of the Scottish Government. It is a transfer from the UK Government, and includes the Barnett and non-Barnett funding. In 2020-21 and 2021-22 the Block Grant also included COVID-19 funding. From 2022-23 there is no longer any funding allocated specifically for COVID-19, but the Block Grant will include funding in line with pandemic-related spending in the UK Government Spending Review.

D.4 The UK Government published a Spending Review alongside its Autumn Budget in October 2021, setting out three-year spending plans and Block Grant funding for the Scottish Budget from 2022-23 to 2024-25.[103] Barnett and non-Barnett funding in Figures D.1 and D.2 for these years come from this publication.

D.5 For 2025-26 and 2026-27 we use the Scottish Government's central funding scenario, which is based on a number of assumptions. Barnett funding is assumed to grow in line with the OBR's October 2021 projections of UK public sector current expenditure for resource and public sector gross investment for capital.[104] Barnett funding for financial transactions is assumed to drop to zero as less financial transactions are allocated by the UK Government and because of technical differences around how they are calculated. Non-Barnett funding is assumed to remain constant from the last year of the spending review.[105]

[103] UK Government (2021) Autumn Budget and Spending Review (link)
[104] The resource and capital projections are for Departmental Expenditure Limit (DEL) spending and can be found in Table 3.14: Total managed expenditure of its October 2021 Economic and Fiscal Outlook publication. Office for Budget Responsibility (2021) Economic and Fiscal Outlook – October 2021 (link)
[105] Resource non-Barnett funding includes EU replacement farm funding, EU replacement fisheries funding, Bew review and Network Rail funding. Capital non-Barnett funding includes Network Rail funding.

Funding related to devolved taxes and social security

D.6 Funding related to devolved taxes and social security includes: SFC tax forecasts, tax and non-tax BGAs, social security BGAs and final reconciliations.[106] We publish our five-year tax forecasts as part of this report. BGAs are agreed between the Scottish Government and HM Treasury and the latest estimates are based on the OBR's October 2021 forecasts.[107]

D.7 Funding for the Scottish Budget is set in advance of each financial year, based on forecasts of tax revenues and social security spending. As actual information on revenues or spending becomes available funding is updated or adjusted in line with outturn. These adjustments are called reconciliations. Final reconciliations are calculated once outturn information has been published and they are applied to subsequent Scottish Budgets. For 2022-23 the final reconciliation is based on outturn information and for future years, we use our latest estimates of final reconciliations.

Other funding

D.8 Other funding includes borrowing, the Scotland Reserve, Non-Domestic Rates (NDR) distributable amount and a number of smaller sources of funding.

D.9 The borrowing information included in Figures D.1 and D.2 reflects the Scottish Government's central scenarios for resource and capital. The Scotland Reserve drawdowns reflect Scottish Government plans for 2022-23 and then are assumed to be zero in remaining years. Each year there are additions made into the Reserve (not shown as part of the funding position) which can then be drawn down in future years so ultimately the reserve is only transferring funding between years rather than increasing available funding.

D.10 Other smaller sources of funding includes streams of revenue which may change between years. For each of our publications, we list the sources of funding included in this category. The Scottish Government has provided an assessment of funding from these sources over the five-year horizon which we have included in our outlook.[108]

D.11 The Scottish Government sets the NDR distributable amount each year, and provided us with the five-year central scenario for this which, among other considerations, accounts for our forecasts of how much revenue will be collected.

Analysis

D.12 In **Chapter 2** we present the five-year funding outlook for both resource and capital in cash terms and after account for future increases in prices. To adjust for inflation we converted the funding information in Figures D.1 and D.2 into 2022-23 prices using the GDP deflators published by the OBR.[109] To illustrate the trends between years, we indexed the total amounts using 2022-23 as our base year (base = 100).

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[106] BGAs for non-tax elements includes fines, forfeitures and fixed penalties and proceeds of crime.
[107] Office for Budget Responsibility (2021) Economic and fiscal outlook – October 2021 (link)
[108] For the five-year outlook, the following are included each year: £92 million migrant surcharge, £5 million Queen's and Lord Treasurer's Remembrancer, £25 million revenues from fines forfeitures and fixed penalties and proceeds of crime. In addition, the Scottish Government has included £620 million of other funding in 2022-23 of which £100 million is recurring each year from 2023-24 to 2025-26. We discuss this other funding in detail in Chapter 2.
[109] We use the year-on-year growth GDP deflators from Table 1.7 of the OBR's supplementary economy tables. We rebased these figures so the 2022-23 = 100. Office for Budget Responsibility (2021) Economic and fiscal outlook – October 2021 – supplementary economy tables (link)

Additional Information

Abbreviations

AA	Attendance Allowance
ADP	Adult Disability Payment
ADS	Additional Dwelling Supplement
ADT	Air Departure Tax
APD	Air Passengers Duty
BGA	Block Grant Adjustment
BoE	Bank of England
BMW	Biodegradable Municipal Waste
BSG	Best Start Grant
BSS	Billing System Snapshot
CA	Carer's Allowance
CAS	Carer's Allowance Supplement
CDP	Child Disability Payment
CJRS	Coronavirus Job Retention Scheme
CPI	Consumer Price Index
CWHA	Child Winter Heating Assistance
CWP	Cold Weather Payment
DHP	Discretionary Housing Payment
DLA	Disability Living Allowance
DWP	Department for Work and Pensions
EU	European Union
EPR	Empty Property Relief
FAI	Fraser Allander Institute
GDP	Gross Domestic Product
HMRC	Her Majesty's Revenue and Customs
HMT	Her Majesty's Treasury
IFI	International Financial Institutions
IIDS	Industrial Injuries Disablement Scheme
LBTT	Land and Buildings Transaction Tax
LIWHA	Low Income Winter Heating Assistance
MTFS	Medium Term Financial Strategy
MTE	Mid-year Estimate
NAIRU	Non Accelerating Inflation Rate of Unemployment
NDR	Non-Domestic Rates
NHS	National Health Service
NIESR	National Institute of Economic and Social Research
NSND	Non-Savings and Non-Dividends
OBR	Office for Budget Responsibility
OECD	Organisation for Economic Co-operation and Development
ONS	Office for National Statistics
PAYE	Pay As You Earn
PIP	Personal Independence Payment
QNA	Quarterly National Accounts
RHL	Retail, Hospitality and Leisure
RHLA	Retail, Hospitality, Leisure and Aviation
RTI	Real Time Information
RV	Rateable Value
SBBS	Small Business Bonus Scheme

SCP	Scottish Child Payment
SFC	Scottish Fiscal Commission
SG	The Scottish Government
SIT	Scottish Income Tax
SISG	Self-Isolation Support Grant
SLfT	Scottish Landfill Tax
SPICe	Scottish Parliament Information Centre
UC	Universal Credit
VAT	Value Added Tax
WFP	Winter Fuel Payment
WRIT	Welsh Rate of Income 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).[110]

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.[111]

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:

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

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