Scottish Fiscal Commission

Scotland's Economic and Fiscal Forecasts – Summary

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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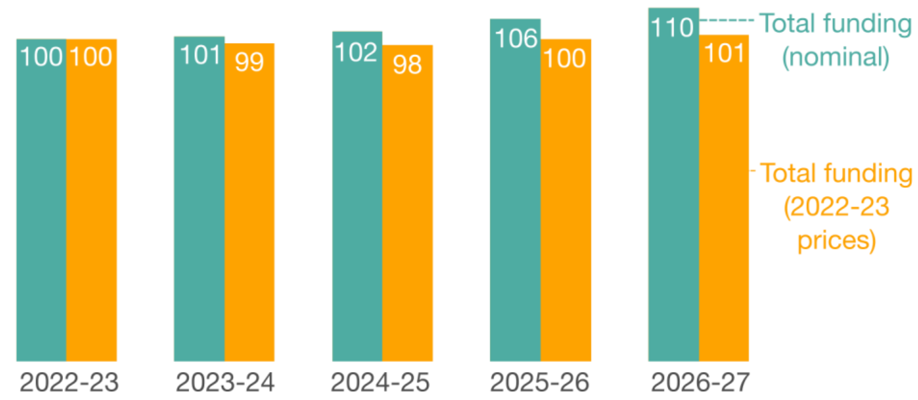
Fiscal Overview

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.

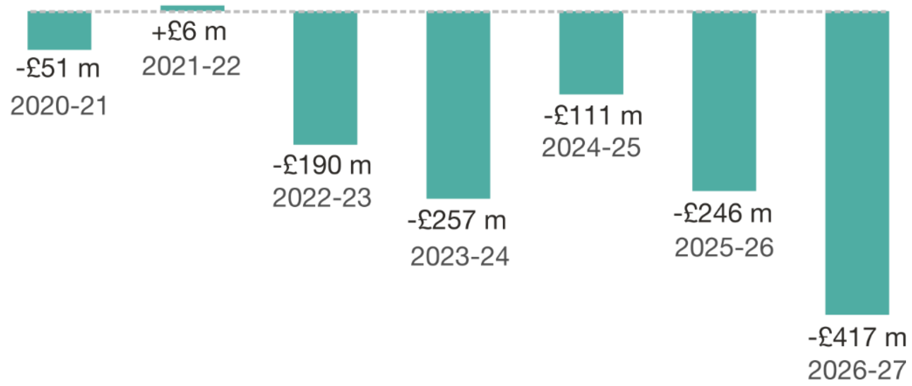
Expected Scottish Budgets flat after inflation



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

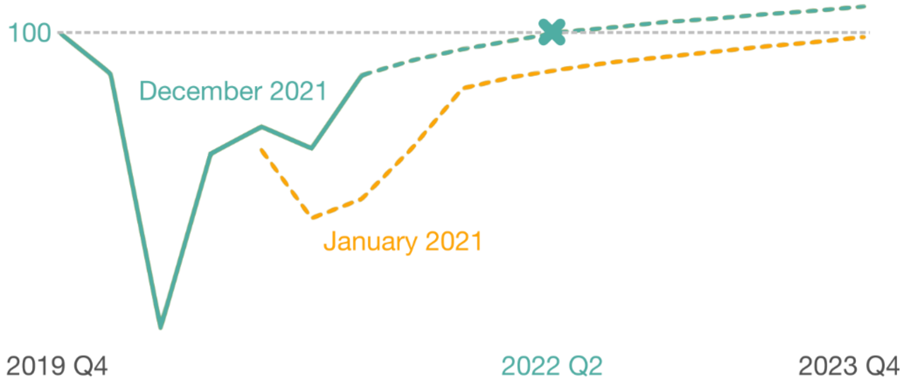


Economy

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.

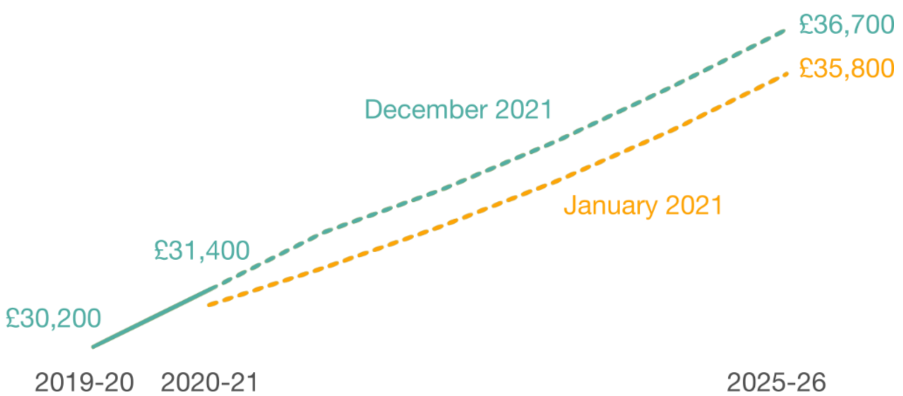
Return to pre-pandemic GDP revised since last Budget



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

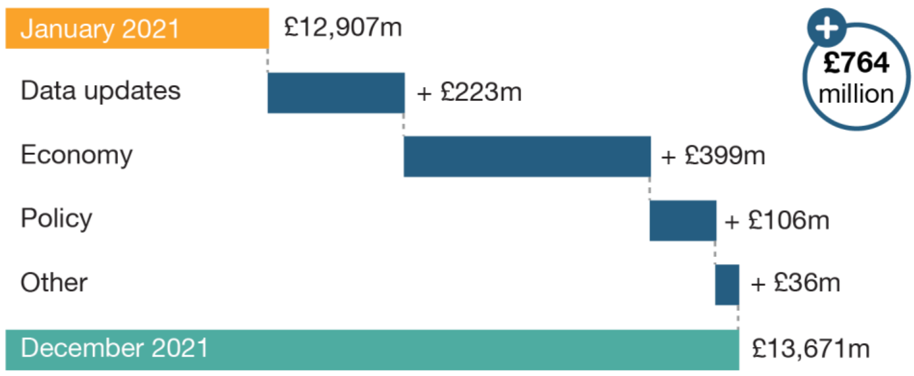
As well as higher inflation, this reflects wage pressures because of labour shortages in particular industries and increases in the minimum wage.

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.

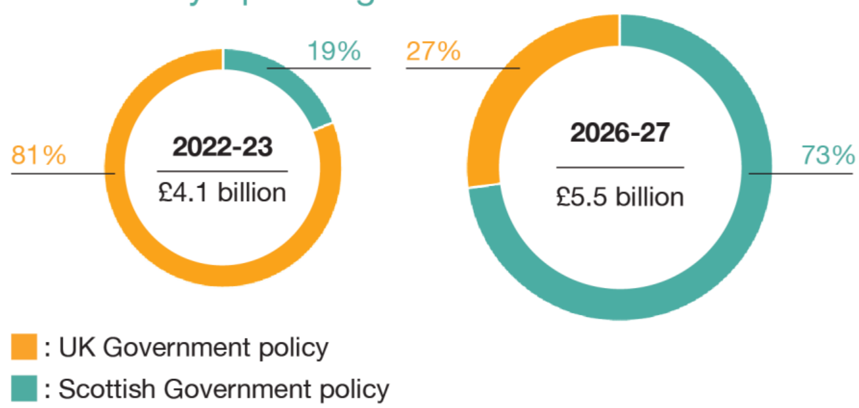
House price forecast revised up in line with income

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

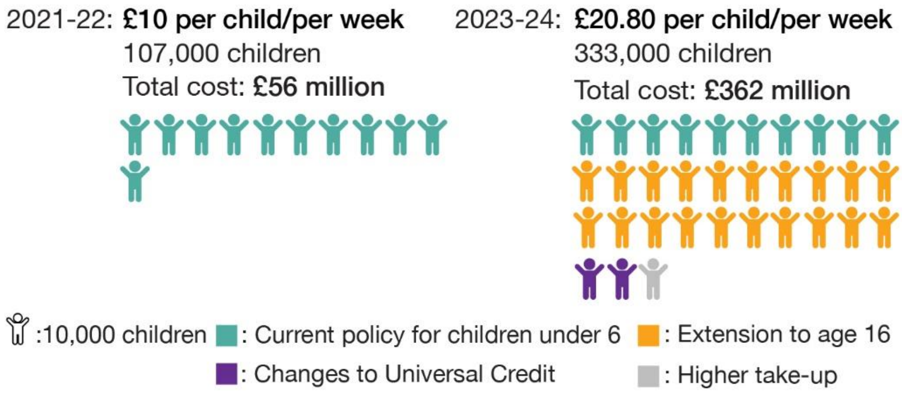
Social Security Spending



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

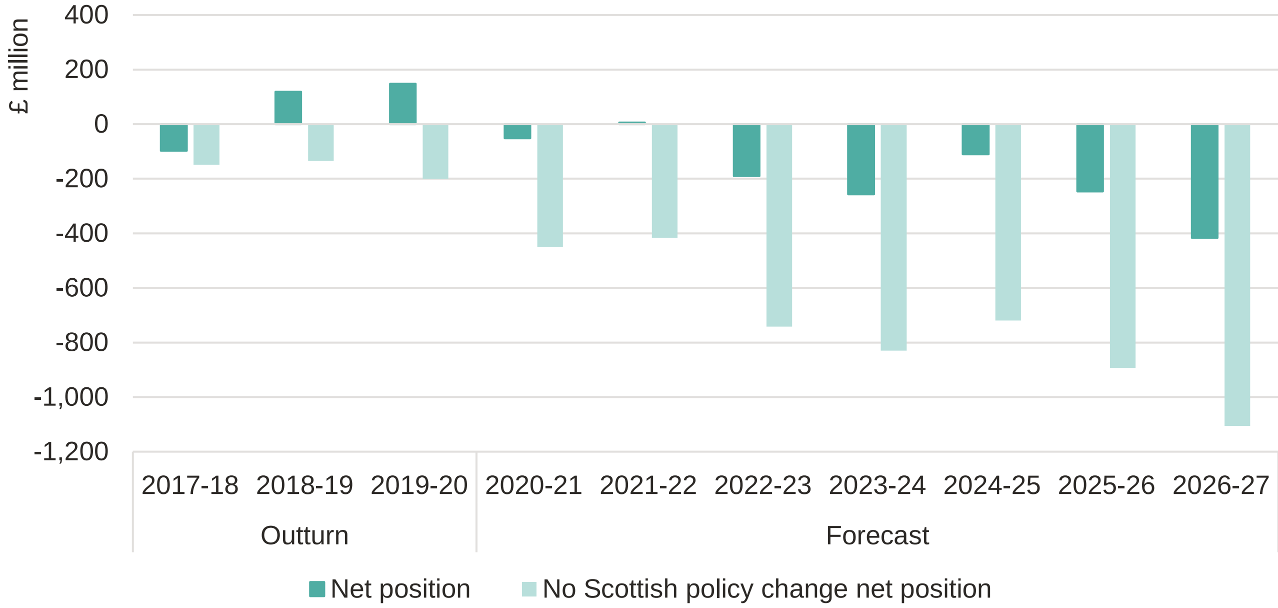
Source: Scottish Fiscal Commission, Scottish Government.
Shaded cells denote outturn.

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

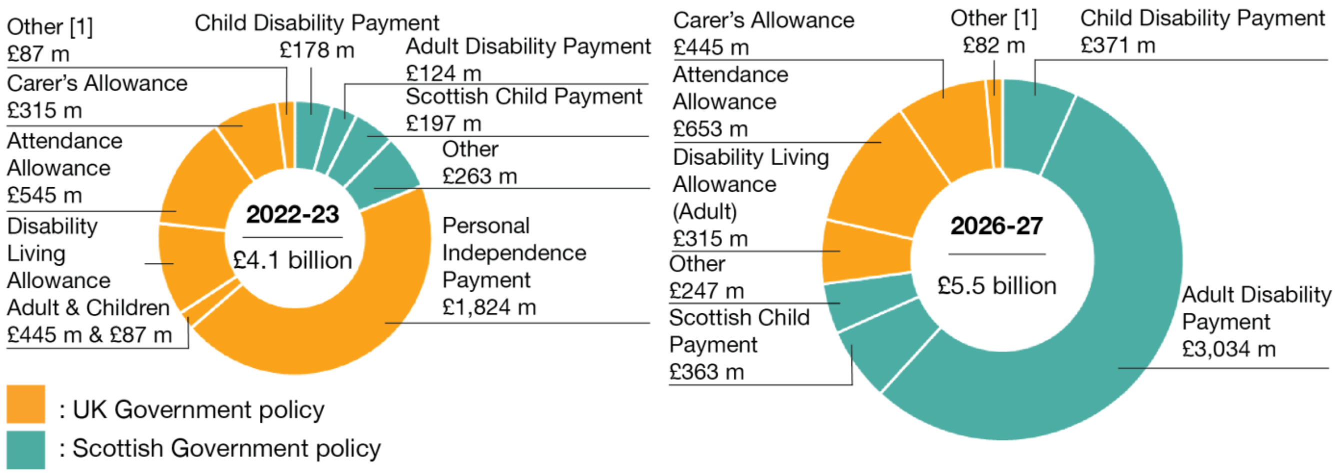
of these payments with an ambition to improve take-up of payments, the Scottish Government has, for many payments, expanded the number of people eligible and increased payment amounts. The largest payment, Adult Disability Payment, launches in 2022. The Scottish Government has also introduced new uniquely 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

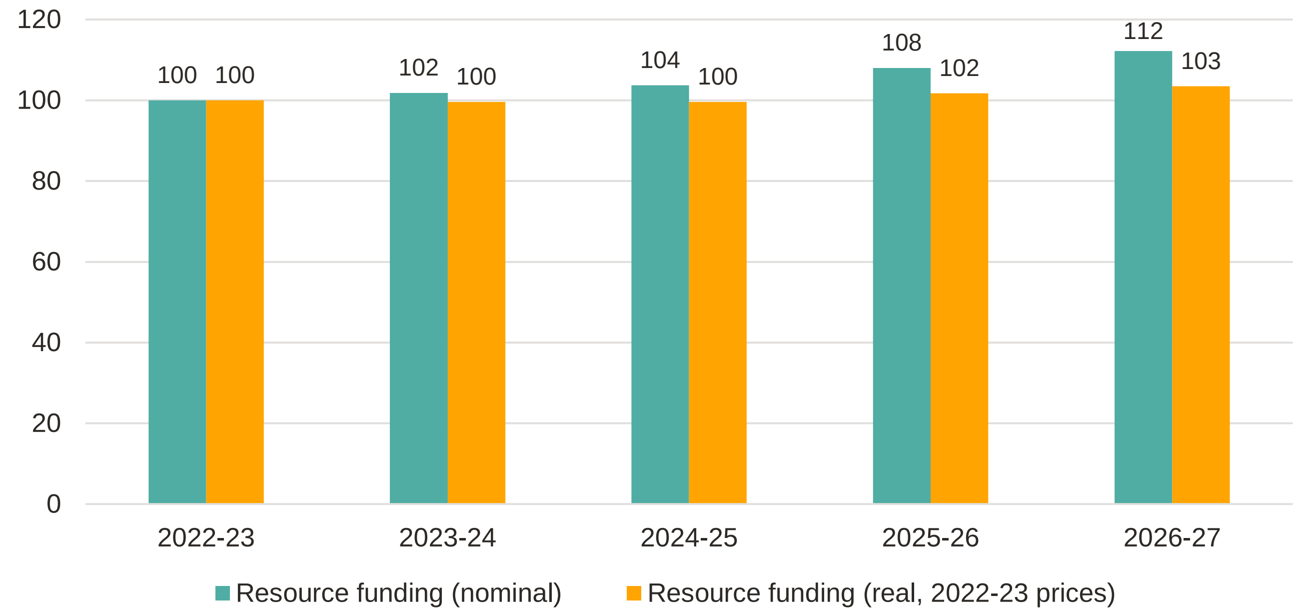
32 Resource funding makes up most of the Scottish Budget and is for spending on current costs such as public sector wages, spending on goods and services, grants and subsidies, and social security spending. For the period covered by the UK Government's Spending Review, 2022-23 to 2024-25,

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.

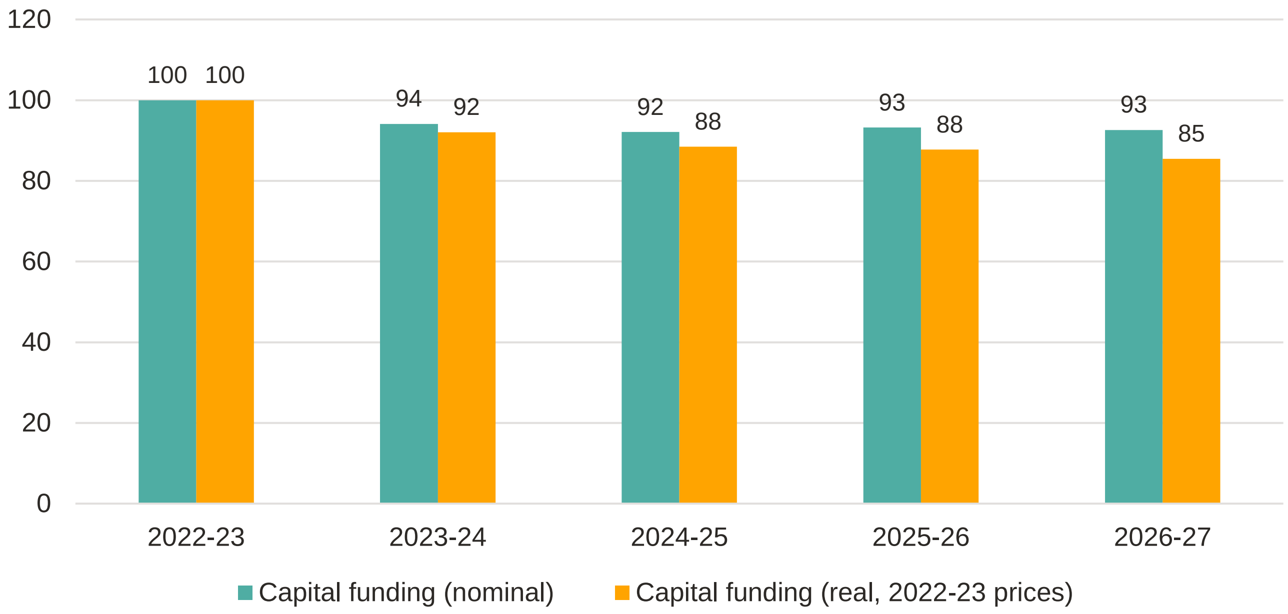
40 Currently the Scottish Government has enhanced borrowing powers and greater flexibility to use the Scotland Reserve because our January 2021 forecasts triggered a "Scotland-specific economic shock". These flexibilities expire after 2023-24 and are therefore not available to the Scottish Government 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.

Additional Information

Abbreviations

ADP	Adult Disability Payment
BGA	Block Grant Adjustment
COVID-19	Coronavirus
CPI	Consumer Price Index
DWP	Department for Work and Pensions
GDP	Gross Domestic Product
OBR	Office for Budget Responsibility
OECD	Organisation for Economic Cooperation and Development
PIP	Personal Independence Payment
SCP	Scottish Child Payment

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).[4]

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.[5]

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

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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