Scottish Fiscal Commission

Scotland's Economic and Fiscal Forecasts

May 2022

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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 the Scottish economy, devolved taxes and devolved social security spending. Our forecasts represent the collective view of the Scottish Fiscal Commission, comprising the three Commissioners. We take full responsibility for the judgements that underpin them.

In our previous forecasts published in December 2021, we were focussed on the potential effects of the Omicron variant of COVID-19 and the risks this posed. Global events have continued to move quickly with the Russian invasion of Ukraine and the cost of living crisis closer to home, which have also led to significant and rapid changes in the economy and the data on which we base our forecasts. The deadline for new data to be included in our forecasts was 11 May 2022. This cut-off inevitably means we can't include some of the most recent data to be published, but we believe our forecasts remain reasonable and robust.

Our forecasts have been used to inform the Scottish Government's Medium Term Financial Strategy 2022 and Resource Spending Review 2022, also published today. Our protocol for engagement with the Scottish Government guides our interaction with the Government during the forecasting process.

We would like to thank the staff of the Commission as well as officials from the Scottish Government, Revenue Scotland, Social Security Scotland, DWP, HM Treasury, HMRC and the OBR for their support in creating this report.

After two full terms of service over eight years, Dame Susan Rice will be stepping down as the Chair of the Commission at the end of June. Her fellow Commissioners and staff would like to thank her for her leading role in making the Commission the successful organisation it is today.

Dame Susan Rice DBE

Professor Francis Breedon

Professor David Ulph

31 May 2022

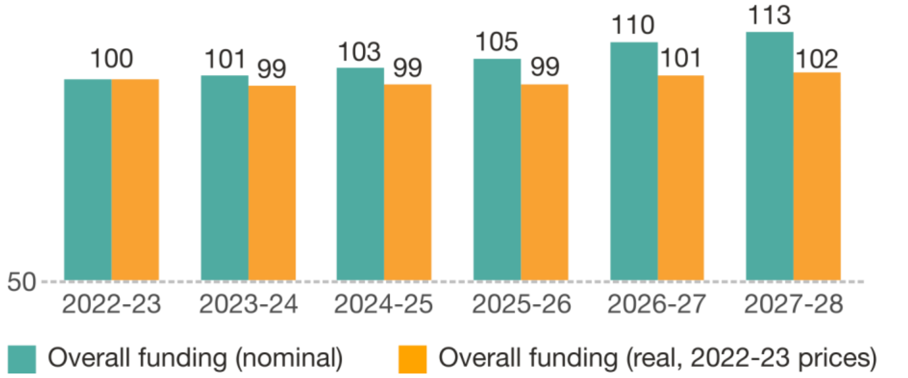
Contents

Fiscal Overview

The Scottish Government will see its overall funding levels increase through and beyond the Spending Review period.

However, inflation will erode this growth. Real terms funding will remain slightly below that of 2022-23 for most of the Spending Review period, increasing only modestly in its last year.

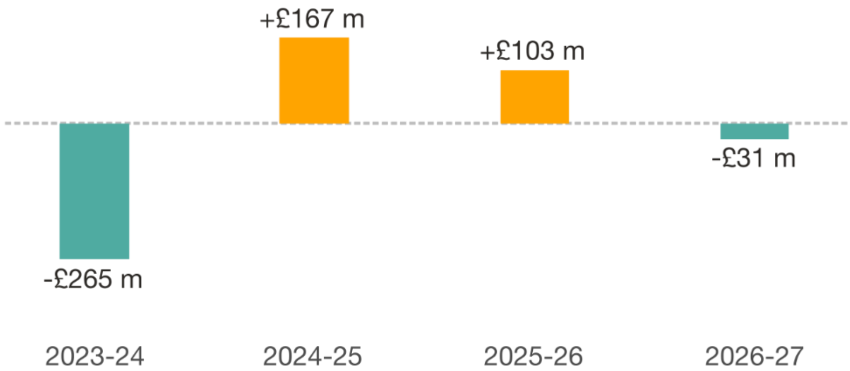
Medium term outlook for overall funding (2022-23 = 100)



Income tax is still expected to reduce the size of the Budget, but only in the first year of the Spending Review.

From 2024-25 the UK Government intends to reduce the basic rate of income tax to 19 per cent. The income tax BGA will reduce accordingly, thus supporting net Scottish income tax funding.

Indicative tax net positions



Economy

With inflationary pressures intensifying further since December 2021, we now expect annual CPI inflation to peak at 8.7 per cent in 2022 Q4.

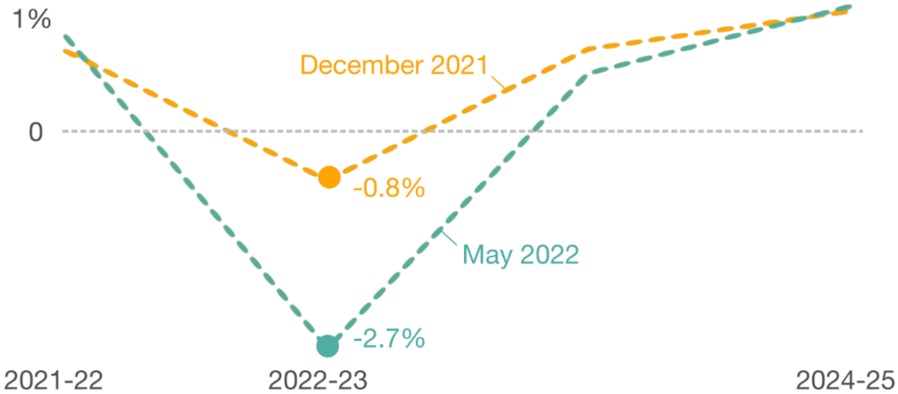
Rising global energy prices, exacerbated by the conflict in Ukraine, have driven large increases in the Ofgem energy price cap in April and October 2022.

Inflation forecast raised significantly

We forecast real average earnings to decrease by 2.7 per cent in 2022-23.

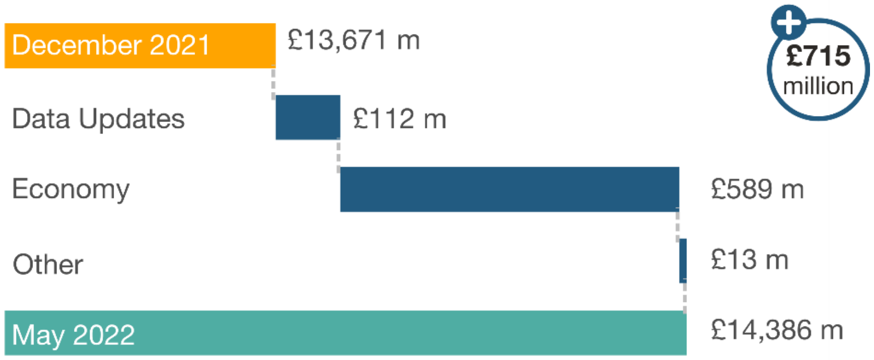
This is because we do not expect nominal earnings to keep pace with rising inflation. Low income households are expected to be disproportionately affected.

Real earnings decreasing because of higher inflation



Tax

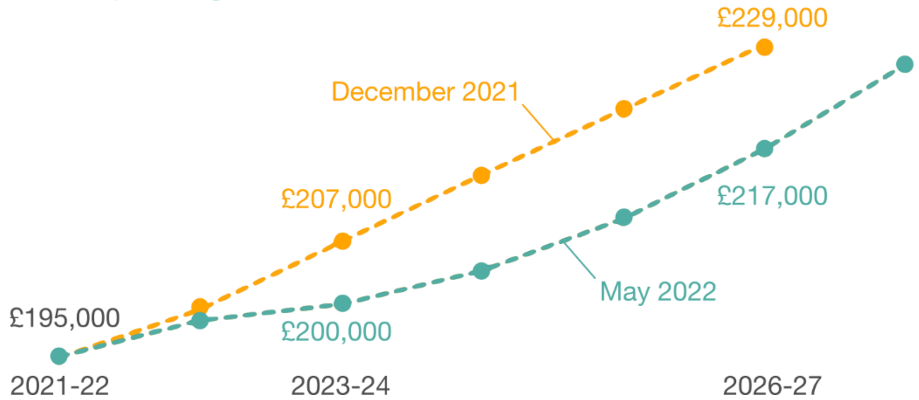
Income tax changes since December 2021 forecast



The increase in our income tax forecast for 2022-23 has largely been driven by changes in the economy.

Growth in nominal earnings and employment have increased the forecast for tax revenues.

House price growth forecast revised down

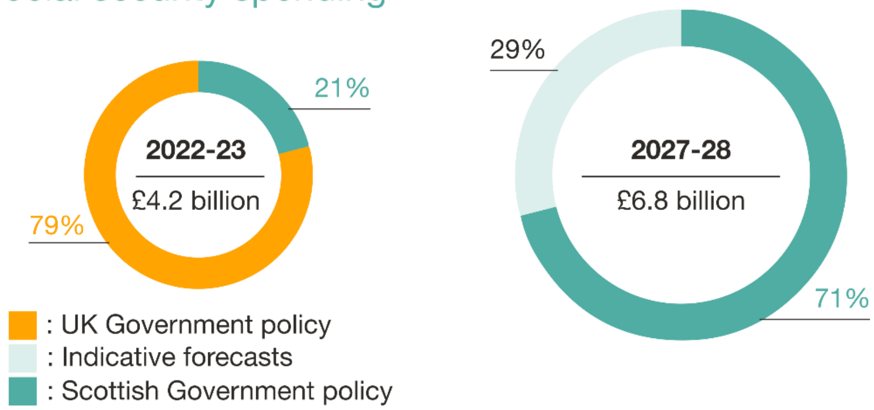


House prices will continue to rise but not as quickly as previously forecast.

The rising cost of living and rising interest rates will put pressure on how much households can afford to spend on moving home.

Social Security

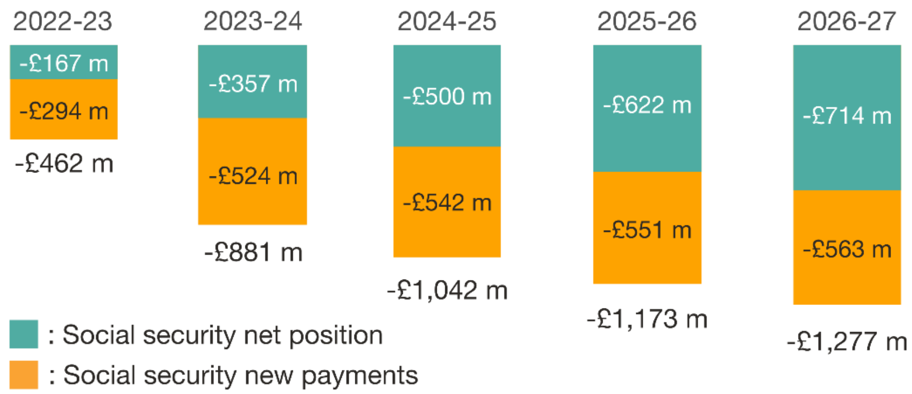
Social security spending



Security spending increases from £4.2 billion in 2022-23 to £6.8 billion in 2027-28.

The Scottish Government plans to replace payments devolved but administered by DWP with Scottish payments by the end of 2025. While the Scottish Government develops the plans for these payments, we present the spending as indicative.

Social security funding pressures forecast



Scottish Government receives funding for the payments devolved from the UK Government. Spending above this funding must be met from its wider Budget.

Scottish Government spending above the funding received is forecast to increase from £0.5 to £1.3 billion.

Budget funding, £ million	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Resource and capital budget (nominal)	49,072	49,646	50,687	51,719	53,829	55,390
Resource and capital budget (2022-23 prices)	49,072	48,477	48,593	48,632	49,624	50,061
Economy, % growth						
Gross Domestic Product	2.1	1.1	1.0	1.0	1.0	1.0
Consumer Price Index	8.0	2.4	1.7	2.0	2.0	2.0
Real Average Earnings	-2.7	0.4	1.2	1.1	1.2	1.3
Employment	1.5	-0.2	-0.2	-0.2	-0.3	-0.3
Tax, £ million						
Income Tax	14,386	15,143	15,954	16,754	17,484	18,298
Non-Domestic Rates	2,770	3,333	3,276	3,323	3,651	3,601
LBTT	797	821	849	886	932	987
Scottish Landfill Tax	121	95	94	75	16	17
Social Security, £ million						
All devolved social security assistance	4,173	5,072	5,725	6,108	6,490	6,847
Policy announcements						
Indicative forecasts of additional spending	-	13	249	309	344	359
Scottish Child Payment rise to £25	18	60	61	62	62	63
Other policy announcements	6	40	31	34	36	39

Summary

Introduction

1 Our latest forecasts accompany the Scottish Government's fiscal event presenting both the Medium-Term Financial Strategy (MTFS) and Resource Spending Review (RSR) to the Scottish Parliament. This is the first time the Scottish Government has conducted a multi-year spending review since 2011. The RSR covers the four financial years starting in 2023-24, a period when the Scottish Government's resource funding is broadly flat after allowing for inflation. Although the final year of the RSR, 2026-27, has funding 11 per cent higher than 2022-23 before adjusting for inflation, it is 3 per cent higher in real terms. Spending on social security will account for an increasing share of the resource Budget, rising from around 10 per cent of the resource budget in 2022-23 to 14 per cent in 2026-27. At the same time the capital budget is expected to fall, both before and after inflation, over the next four years.

2 As we discuss throughout this summary, the recent sharp rise in inflation has had a significant effect on our forecasts and on the Scottish fiscal outlook. High inflation means falling real incomes for households in Scotland and will also put pressure on the Scottish budget via rising social security payments which are linked to inflation. On the other hand, higher nominal earnings growth has led us to revise our income tax forecasts upwards.

3 We first focus on the economic outlook before turning to the Scottish Government's funding outlook and spending plans.

The economic outlook and uncertainty

4 The Scottish and UK economies were emerging from the pandemic with already rising inflation, driven by global energy and traded goods prices, when Russia's invasion of Ukraine delivered another significant global inflation shock. At the same time Coronavirus (COVID-19) developments in China are contributing to a worsening in supply chain disruptions and deterioration in the global economic outlook. Together, these factors are contributing to rising inflation and slowing growth, though it is not possible to disentangle each effect individually. After Scottish GDP growth of 2.1 per cent this year, sustained by the rebound from the COVID-19 shock, we expect growth to slow to 1.1 per cent in 2023-24, slightly lower than we forecast in December 2021.

5 Overall, economic uncertainty has risen in the last few months. While GDP growth is lower than we previously forecast, in our forecasts we do not expect Scotland to enter a recession. However, the risk of a recession in Scotland and the UK is materially higher now than at the time of our previous forecasts.

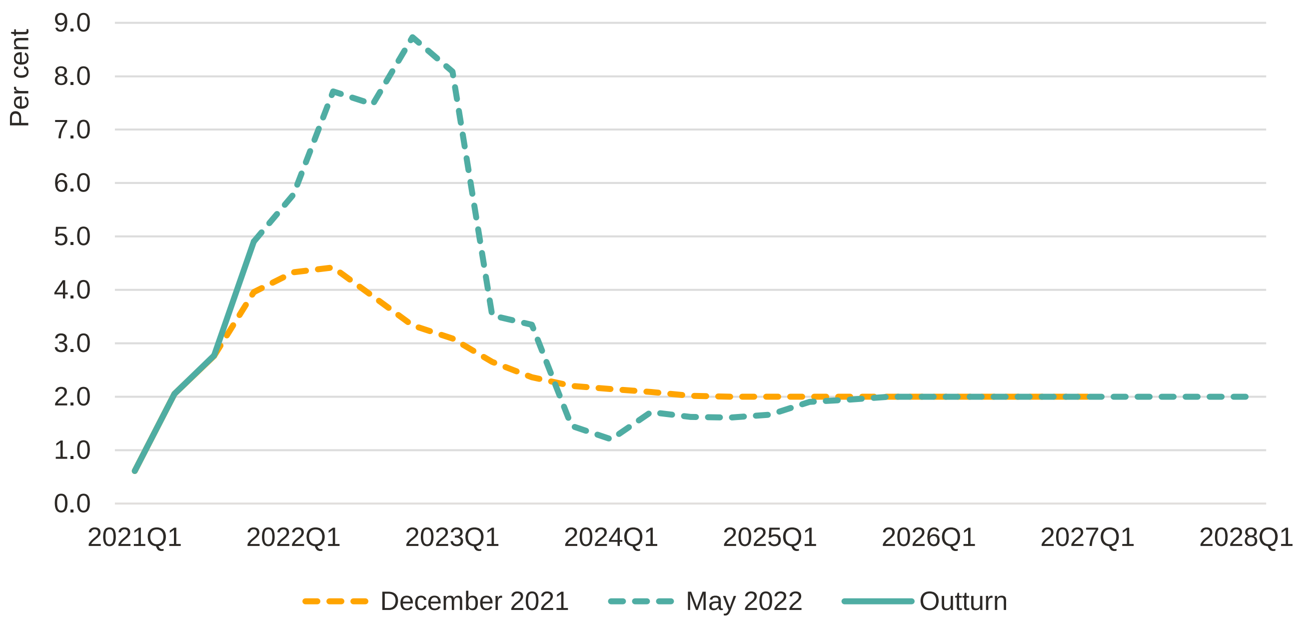
Figure 1: Headline economy forecasts, growth rates

Per cent	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
GDP							
December 2021	10.4	2.2	1.2	1.3	1.4	1.4	-
May 2022	11.6	2.1	1.1	1.0	1.0	1.0	1.0
Consumer Price Index							
December 2021	3.3	3.7	2.3	2.0	2.0	2.0	-
May 2022	4.0	8.0	2.4	1.7	2.0	2.0	2.0
Average real earnings							
December 2021	0.6	-0.8	0.7	1.1	1.3	1.4	-
May 2022	0.8	-2.7	0.4	1.2	1.1	1.2	1.3

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

6 With inflationary pressures intensifying further since December 2021, we now expect annual Consumer Price Index (CPI) inflation to peak at 8.7 per cent in 2022 Q4, as shown in Figure 2. This is mainly driven by the large increases in the Ofgem energy price cap in April and October, which is an effect of rising global energy prices in the wake of the pandemic, which are further exacerbated by the conflict in Ukraine.

Figure 2: Consumer Price Index inflation, year-on-year growth



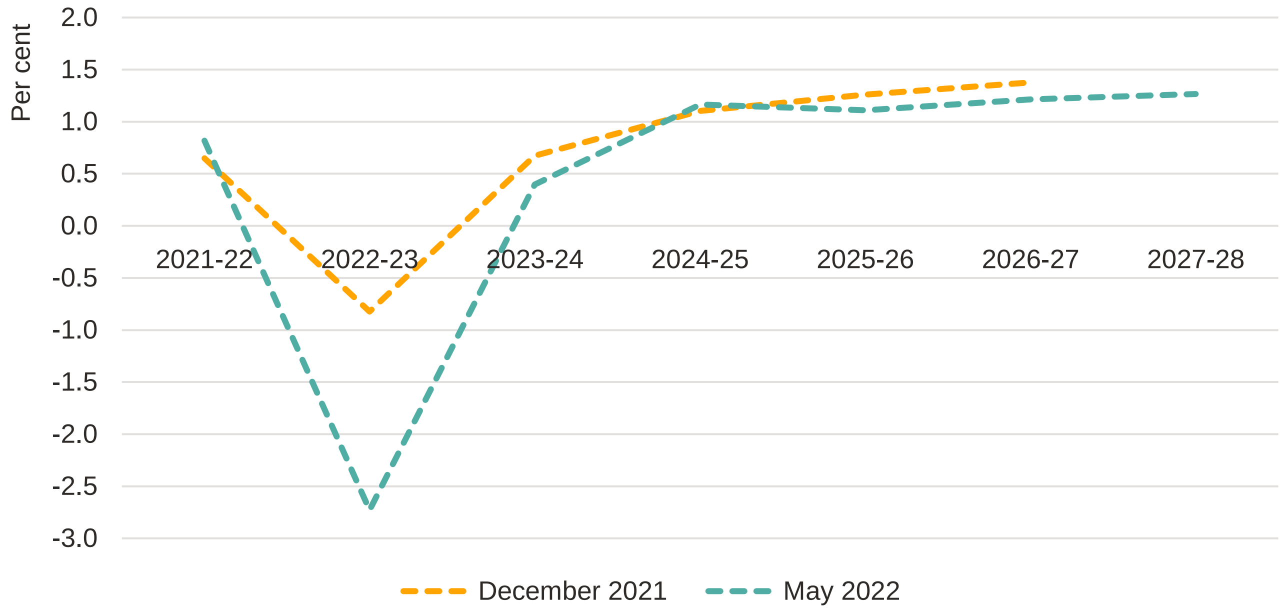
Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – December 2021 (link), OBR (2022) Economic and Fiscal Outlook – March 2022 (link), OBR (2021) Economic and Fiscal Outlook – October 2021 (link).
The year-on-year CPI inflation peak in 2022 Q4 of 8.7 per cent is different from the year-on-year peak for 2022-23 which is 8.0 per cent.

7 Domestic price pressures from the labour market have also picked up. Unemployment has continued to fall despite the end of furlough and is now at historic lows, adding to recruitment difficulties. Reflecting higher inflation and wage pressures from an increasingly tight labour market,

we expect nominal average earnings to grow by 4.1 per cent in 2022-23, moderating in later years as inflation falls back and labour market conditions normalise.

8 We do not expect average earnings growth to match inflation levels in the next year. Consequently, as shown in Figure 3, many households are expected to see a fall in their real earnings next year. This has significant implications for households, especially for lower income households who spend more of their money on essentials and cannot cut back on savings or discretionary spending to cover rising costs. This is discussed in further detail in Chapter 3.

Figure 3: Real average earnings growth



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

9 Our forecast of inflation is aligned with the Office for Budget Responsibility (OBR) March 2022 UK inflation forecast and is similar to that of the Bank of England from its May 2022 Monetary Policy Report.[1] After peaking in 2022 Q4, we expect inflation to gradually return to the 2 per cent target as energy prices stabilise, global supply bottlenecks ease, and the squeeze on real incomes and demand limits domestically generated inflation. There are significant risks around the outlook for inflation, with consequences for the wider economic outlook.

- Inflation could be higher if global inflationary pressures intensify further because of the conflict in Ukraine and the COVID-19 lockdowns in China. Similarly, supply chain disruptions could increase and hold back investment and production by more than anticipated. This could potentially result in an extended period of high inflation and subdued growth.

- There is also a risk that higher inflation becomes entrenched and more persistent domestically leading to a wage-price spiral in the UK. This would require a much larger interest rate response from the Bank of England in order to re-anchor inflation expectations, with significant implications for the economy.

- Alternatively, external inflationary pressure could fall more quickly than we expect, reducing inflation and the squeeze on real incomes.

[1] Office for Budget Responsibility (2022) Economic and Fiscal Outlook – March 2022 (link)
Bank of England (2022) Monetary Policy Report – May 2022 (link)

10 High inflation is a risk for economic growth because it erodes households' real incomes, firms' profit margins, and consumer and business confidence. We carefully considered a range of forecasts, including that by the Bank of England, and concluded that they all agree on the underlying drivers but, as happens with forecasting, take a different view as to their effects on the economy. We therefore recognise that stagnant growth or a recession are a downside risk to the forecast.

11 After we closed our forecasts to new data on 11 May, Office for National Statistics (ONS) inflation data published on 18 May showed inflation continuing to rise sharply, with CPI inflation at 9 per cent over the year to April 2022. This underlines the significant uncertainty around the outlook for inflation and the economy. While the current monthly inflation data continue to be volatile, we believe our outlook for inflation remains reasonable.

12 Broadly in line with the assumptions we made in our December 2021 forecasts, all COVID-19 legal restrictions in Scotland ended on 21 March 2022. COVID-19 is now being managed like a standard virus, with only voluntary guidance in place. The economy has also returned to close to pre-recession levels of activity. COVID-19 is still present in Scotland leading to hospitalisations and deaths. The Scottish Government's COVID-19 threat level is now at medium.[2] In our central forecast, we expect deaths and serious illness from COVID-19 in Scotland to remain low and stable, with no legal restrictions being reintroduced. There remains a risk that a new variant of COVID-19 emerges that is resistant to current vaccines, which could lead to new public health restrictions. Should new public health restrictions which affect economic activity be necessary, then the economic and fiscal outlook over the forecast is likely to be more negative than we currently expect.

13 We continue to see Scotland's total earnings growth lagging behind the UK's. We expect this trend to persist over the next few years, with important implications for tax revenues and the Scottish Budget. As we discussed in our December 2021 forecast report, Scotland's slower total earnings growth relative to the UK can be explained by a combination of longer-term structural factors and divergent sectoral and regional performance. We explore some of these issues further in Chapter 3.

Tax revenues

14 Rising inflation will have contributed to higher tax revenues as higher nominal growth in the economy and fixed tax thresholds will help income tax and Land and Buildings Transaction Tax (LBTT) to create more revenue. However, nominal earnings and house prices are not expected to keep pace with inflation so the contribution of higher prices to tax revenues might be less than expected. In addition where Scottish and UK revenues are similarly affected, this is unlikely to improve the Scottish Budget position which depends on the relative performance of tax revenues.

15 The tax net position is the difference between the tax revenue devolved to Scotland and the Block Grant Adjustments (BGA). The BGA is the amount deducted from the Block Grant to account for tax foregone by the UK Government. Our forecasts of income tax, LBTT and Scottish Landfill Tax (SLfT) are compared to the BGAs which are based on OBR forecasts of corresponding UK Government tax revenues.[3] Figure 4 shows the net contribution of tax to the Scottish Budget. We expect tax to contribute negatively to the Budget in 2023-24 before becoming positive in 2024-25.

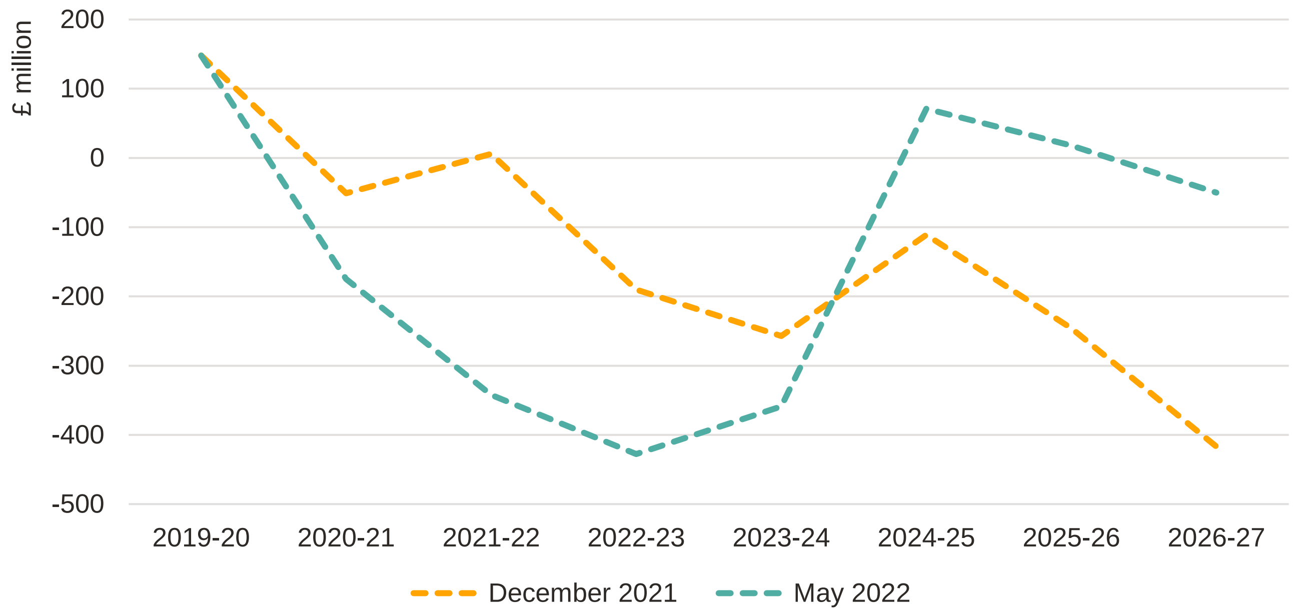
16 Income tax accounts for the most significant changes to the net position. The COVID-19 pandemic introduced significant uncertainty to forecasting, and both we and the OBR initially made large downward revisions to our forecasts of income tax compared to pre-pandemic. We do not yet have

[2] Scottish Government (2022) Coronavirus in Scotland (link) accessed 26 May 2022
[3] Non-Domestic Rates are included differently in the Scottish Budget. Further information can be found in Chapter 4

income tax outturn data for 2020-21, but the available data such as RTI suggest income tax revenues in both Scotland and the UK have performed better during the pandemic than expected, particularly in 2021-22.[4] We and the OBR have been revising up our more recent income tax forecasts since the start of the pandemic. However, the available data suggest income tax revenues have been growing relatively more strongly in the UK than in Scotland in 2020-21 and 2021-22. This has significant implications for both the income tax net position and income tax reconciliations.

17 Figure 4 shows the implied net position from December 2021 and our latest May 2022 forecasts. Following strong UK data in 2020-21 and 2021-22 and accompanying BGA revisions, the net position has moved in a negative direction from 2020-21 to 2023-24.

Figure 4: The implied income tax net position



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

18 From 2023-24 we now assume the higher rate threshold remains frozen as part of our forecast baseline, which is more in line with recent policy changes in Scotland. This adds around £129 million to our forecast in 2023-24, rising to £503 million by the end of the forecast. Compared to an assumption of inflation uprating of the higher rate threshold, an individual higher rate taxpayer pays up to an extra £653 in income tax in 2023-24, rising to £1,317 in 2026-27. We discuss this change in judgement in detail in **Chapter 4**.

19 The UK Government has announced a cut in the basic rate of income tax to 19 per cent from 2024-25. This reduces forecast income tax revenues in the UK, which reduces the size of the income tax BGA, and therefore shifts the net position in a more positive direction.

Reconciliations

20 The Scottish Budget is set in advance of each financial year, based on forecasts of revenues and spending. Reconciliations are funding adjustments once outturn data are available which are a product of our and OBR forecast errors for income tax. Smaller adjustments apply for OBR forecast errors of fully devolved tax and social security payment BGAs, and are either managed in-year or in the following financial year. As one of the largest components of the Budget, income tax funding is

[4] RTI refers to Pay As You Earn Real Time Information – timely information on earnings and employment based on PAYE data published by ONS and HMRC (link)

fixed for the financial year. The income tax outturn data are available around 16 months after the end of the financial year so the 2022-23 income tax reconciliation will be applied to the 2025-26 Scottish Budget.

21 The Scottish Government's funding outlook includes forecast negative reconciliations until 2025-26, as shown in Figure 5. Reconciliations in future years will depend on forecasts used to inform future Budgets.

22 The larger upwards revisions in OBR forecasts of UK income tax revenues compared to our forecast of Scottish income tax revenues have led to expected negative income tax reconciliations over the next three years. These put additional pressure on the Scottish Government's funding position.

Figure 5: Outturn and indicative estimates of income tax reconciliations

Collection year	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23
Applies to Budget for	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Reconciliation (£ million)	-204	-309	-34	-221	-817	-238

Source: Scottish Fiscal Commission, Scottish Government, SIT outturn from HMRC annual reports (link).
Shaded cells refer to outturn available at time of publication.

23 Forecasts currently indicate a very large and negative reconciliation for 2021-22 of -£817 million to be applied to the 2024-25 Scottish Budget. Figure 6 shows how forecasts of Scottish income tax revenues and the BGA have changed since the Budget for 2021-22 was set based on our January 2021 forecasts.

Figure 6: Scottish income tax revenue forecast and BGA for 2021-22

£ million	Budget setting	Latest	Total Change
Scottish income tax revenues	12,263	13,342	1,078
BGA	-11,788	-13,684	-1,896
Net position	475	-342	-817

Source: Scottish Fiscal Commission, Scottish Government.

24 Our Budget setting forecasts of Scottish income tax revenues in January 2021 were significantly larger 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, and the outlook changed 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".[5] We warned that because of timing differences, the income tax net position was somewhat artificial. The true net position was likely to be lower, and would result in a negative reconciliation in 2024-25.

25 By including near complete RTI data for 2021-22 in our forecast, we have revised up our estimate of 2021-22 income tax revenues by £1,078 million compared to our budget setting forecast. However, the OBR has also revised its forecasts for 2021-22, increasing the BGA by £1,896 million. Overall, this has shifted the estimated net position from +£475 million to -£342 million, with an anticipated

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

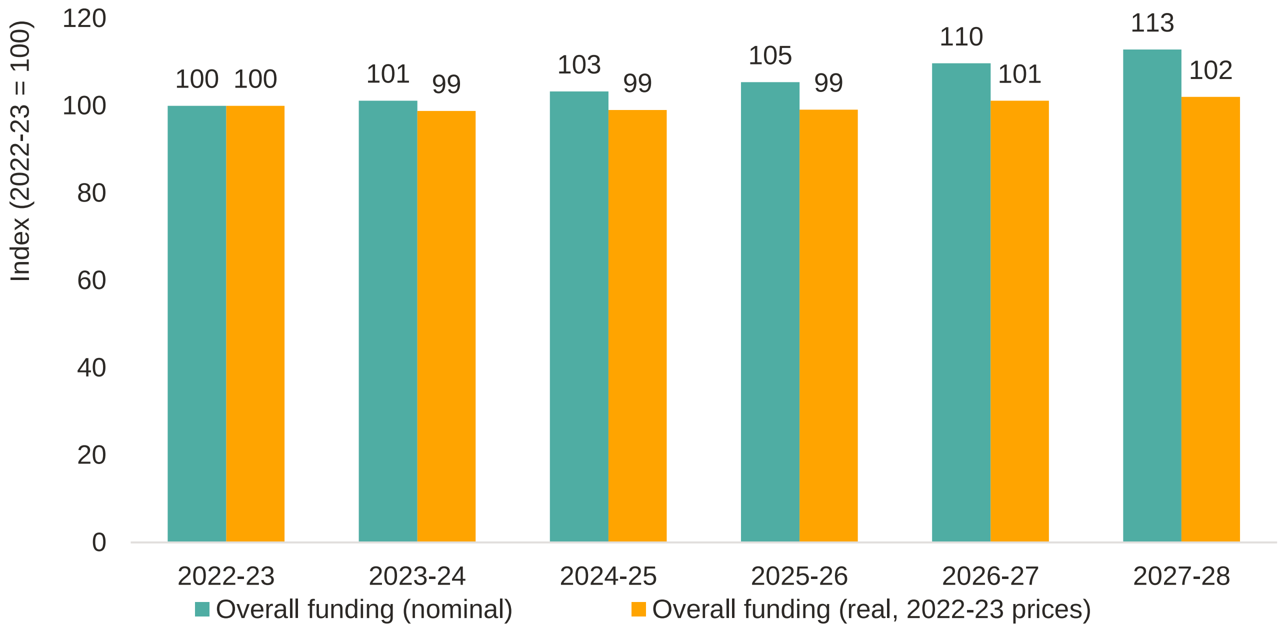
reconciliation of -£817 million to be applied in 2024-25. The reconciliation will be confirmed once outturn data for 2021-22 are published in summer 2023.

The five-year funding outlook

26 The Scottish Government has set its RSR plans for the next four years, 2023-24 to 2026-27, based on a forecast funding position. We include an additional year of funding for 2027-28 based on our own projections including our five-year tax and social security forecasts. The funding position depends on UK Government funding, tax revenues, borrowing and reserve plans and Scottish Government assumptions about other funding sources. We consider the Scottish Government's assumptions broadly reasonable, but note the risk that funding differs from the current plans. Should funding be less than currently projected then the Scottish Government will need to adjust its spending plans in each year in the Budget.

27 The relatively small increases in total funding (resource and capital) have presented a challenge for Scottish Government in setting its spending plans, despite the Scottish Government assuming funding will increase above the UK Government Spending Review settlement. After adjusting for inflation the Scottish Government's total funding for the next three years is expected to be 1 per cent lower than in 2022-23. It increases by 2 per cent in 2026-27 bringing it to 1 per cent higher than the current financial year. We discuss the consequence of the Scottish Government's funding position and its growing social security commitments in the spending outlook section below.

Figure 7: Total Scottish Government funding (resource and capital)



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 March 2022 supplementary economy tables (link). Figures rebased so 2022-23 = 100.
Funding in 2022-23 has been updated for the latest information including changes in UK Government funding, changes to Scottish Government Reserve drawdown plans and revised fully devolved tax forecasts. This differs from the Scottish Government's presentation of 2022-23 funding which is presented at the same level as the 2022-23 Scottish Budget as introduced in December 2021. The growth rates for funding presented here therefore differ from those presented by the Scottish Government.
Scottish Fiscal Commission assumptions are used for 2027-28. Please refer to Annex D for more details.

28 Resource funding makes up most of the Scottish Budget and is for current spending on the delivery of public services such as NHS Scotland, other public sector wages, goods and services and social

security spending. Capital funding accounts for 13 per cent of the Scottish Budget in 2022-23. It is used for long-term investment such as hospitals, roads and research and development. Capital funding is decreasing for the next three years. We focus on resource funding in the rest of this summary, detail on capital funding can be found in Chapter 2.

29 The relatively flat level of resource funding is because of several factors. Firstly, the UK Government's Spending Review in October 2021[6] set out the Scottish Government's funding from the UK Government up to 2024-25, and funding falls over this period after adjusting for inflation. Scottish tax revenues have a negative impact on the Scottish Budget in 2023-24 because these revenues are expected to grow more slowly than in the rest of the UK. In 2024-25, a very large negative reconciliation of -£817 million is expected because of changes to forecasts for 2021-22 income tax revenues. The pressure is alleviated slightly in 2025-26 as the tax net position is positive and the reconciliations are smaller. Figure 8 summarises the Scottish Government's resource funding position. Further detail can be found in Chapter 2.

Figure 8: Summary of the Scottish Government's resource funding position

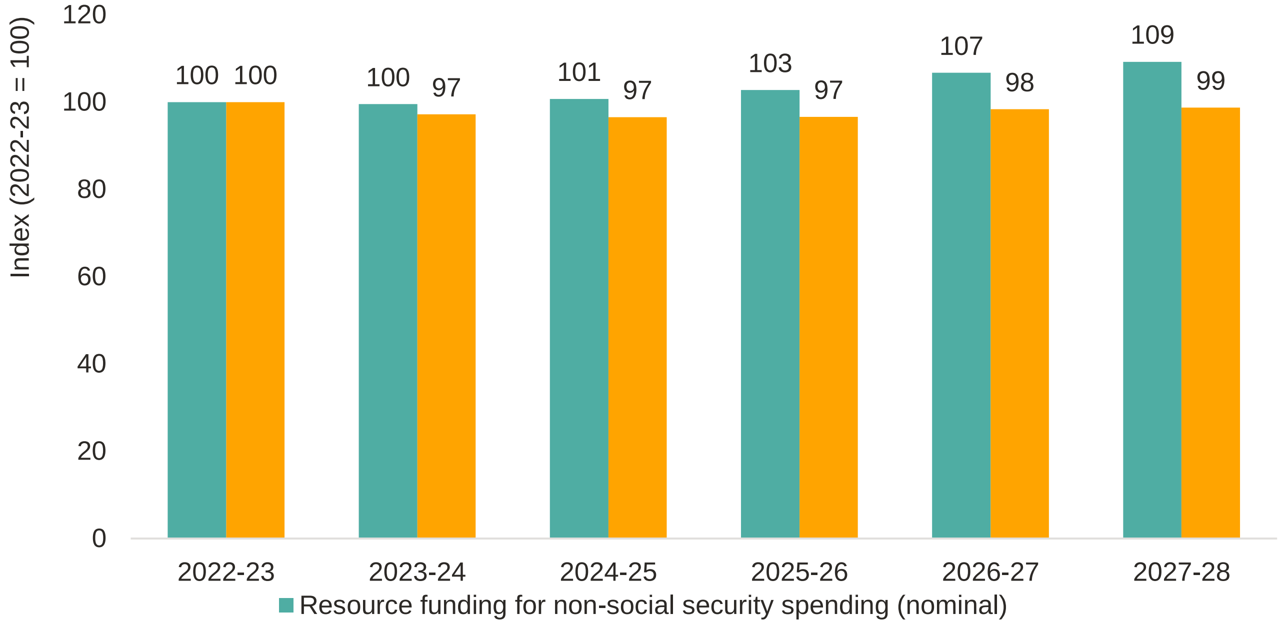
£ million	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
UK Government funding [1]	39,019	39,956	41,232	42,466	44,118	45,512
Other funding [2]	3,238	3,463	3,307	3,036	3,324	3,294
Tax net position	-51	-265	167	103	-31	-54
Final reconciliations [3]	-15	-221	-817	-238	-	-
Resource borrowing	15	110	300	119	-	-
Resource reserve drawdown	400	279	250	113	87	87
Total resource funding available	42,607	43,321	44,439	45,600	47,498	48,839
Social security spending	4,173	5,072	5,725	6,108	6,490	6,847
Total resource funding for all other portfolios	38,434	38,249	38,715	39,492	41,008	41,992

Source: Scottish Fiscal Commission, Scottish Government.
Figures may not sum because of rounding.
[1] UK Government funding includes Block Grant (Barnett and non-Barnett), social security Block Grant Adjustments (BGAs) and non-tax BGAs.
[2] Other funding includes the NDR distributable amount and 'other' funding sources such as income from the Immigration Health Surcharge. It also removes the cost of capital and resource borrowing repayments from available funding.
[3] Final reconciliations in 2022-23 include income tax, and final reconciliations for the BGAs for LBTT, SLfT, social security and Fines, Forfeitures and Fixed Penalties. From 2023-24 onwards final reconciliations are for income tax only and based on forecasts.
Scottish Fiscal Commission assumptions are used for 2027-28. Please refer to Annex D for more details

30 The funding position for areas other than social security is constrained by both the relatively flat level of total funding, and the growing social security allocation. In 2022-23 social security spending accounts for around 10 per cent of the overall resource budget; by 2026-27 we expect it to account for around 14 per cent. In real terms this means the available resources for the non-social security budget are falling for the first three years of the RSR.

[6] HM Treasury (2021) Autumn Budget and Spending Review 2021 (link)

Figure 9: Resource funding for non-social security spending in 2022-23 prices



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 March 2022 supplementary economy tables (link). Figures rebased so 2022-23 = 100.
Scottish Fiscal Commission assumptions are used for 2027-28. Please refer to Annex D for more details.

31 As part of its forecast funding, the Scottish Government has made a number of assumptions about other income sources to balance against the relatively low funding level and consequent potentially negative impact on its ability to spend.

32 From 2025-26 onwards future UK Government funding is projected based on OBR forecasts of resource spending. The Scottish Government has assumed additional funding from the UK Government above the Spending Review plans. It assumes additional Barnett consequentials of £250 million in 2023-24 rising to £591 million of assumed Barnett consequentials in 2026-27.

33 Income from the sale of offshore wind leases is no longer included in the 2022-23 Budget; instead the Scottish Government plans to use the £660 million of revenue in 2023-24 and 2024-25.

34 The Scotland Reserve can be used to transfer unspent or unallocated funds from one financial year to the next. Underspends tend to occur as part of managing a balanced budget because the Scottish Government cannot overspend. The Scottish Government's funding plans for each year assume that a level of underspend from the previous year will be transferred through the Scotland Reserve. In 2023-24 and 2024-25 it is assumed that £279 million and £250 million will be available to be drawn down respectively. This drops to £113 million and £87 million in the later years of the RSR.

35 The Scottish Government can borrow to manage the negative effects on the budget of forecast error. Negative income tax reconciliations are forecast to reduce the Scottish Budget in the next three financial years and the Scottish Government plans to borrow to partly offset these.

36 The Scottish Government's funding position is not fixed, even in the current financial year changes can arise from the UK Government altering its spending plans, changes to tax forecasts and changes to the Scottish Government's borrowing and reserve plans. The RSR therefore needs to be set based on a projection of future funding. We do however note that the Scottish Government will need to alter its future spending plans as the funding position becomes clearer for each year.

The five-year spending outlook

Overall position

37 The RSR sets out the Scottish Government's spending plans over the four years from 2023-24. The spending allocations have been set at a time when inflation will erode the purchasing power of the Government, and there will be pressure for public sector wages to increase with inflation.

38 The Scottish Government plans to increase spending on health and social security. We show the amount available to be spent on other areas in Figure 10. Before adjusting for inflation, the remaining funding is lower for the first three years of the RSR than in 2022-23. Only in 2026-27 is funding for other areas expected to increase above the current level. Once adjusted for inflation, funding for other areas falls more substantially for the first three years of the RSR and is 8 per cent below 2022-23 levels by 2025-26. In 2026-27 funding is expected to be 5 per cent below 2022-23 levels in real terms. This reduction in real funding for other areas has consequences for how the Scottish Government has allocated funding to different portfolios.

Figure 10: Summary of the Scottish Government's funding position

£ million	2022-23	2023-24	2024-25	2025-26	2026-27
Total resource funding available [1]	42,607	43,321	44,439	45,600	47,498
Social security spending [2]	4,173	5,072	5,725	6,108	6,490
Health and social care spending	17,106	17,550	17,995	18,536	19,029
Total resource funding for all other portfolios	21,328	20,699	20,719	20,956	21,979

Source: Scottish Fiscal Commission and Scottish Government.

Figures may not sum because of rounding.

[1] Funding in 2022-23 has been updated for the latest information including changes in UK Government funding, changes to Scottish Government Reserve drawdown plans and revised fully devolved tax forecasts. This differs from the Scottish Government's presentation of 2022-23 funding which is presented at the same level as the 2022-23 Scottish Budget as introduced in December 2021.

[2] Social Security spending is based on our forecasts and not directly traceable to a specific spending allocation in the Resource Spending Review.

39 In 2023-24 and 2024-25 spending on all other areas is expected to fall in real terms. In 2025-26 only the Net Zero, Energy and Transport portfolio is expected to increase, with spending 0.8 per cent above 2022-23 levels in real terms. In 2026-27, the last year of the RSR when funding growth is highest, spending on the Education and Skills portfolio and Finance and Economy portfolio also increase. The Deputy First Minister and Covid Recovery portfolio has a large increase in funding in 2026-27 to cover the next Scottish Parliament elections. All other portfolios will see real terms reductions in spending in every year of the RSR.

Figure 11: Scottish Government's spending allocations in 2022-23 prices

£ million	2022-23	2023-24	2024-25	2025-26	2026-27
Constitution, External Affairs and Culture	100	95	87	86	84
Crown Office and Procurator Fiscal Service	100	98	96	94	92
Deputy First Minister and Covid Recovery	100	98	96	94	157
Education and Skills	100	98	96	95	109
Finance and Economy	100	96	95	94	102
Health and Social Care	100	100	101	102	103
Justice and Veterans	100	98	96	98	96
Net Zero, Energy and Transport	100	97	98	101	115
Rural Affairs and Islands	100	97	96	94	93
Social Justice and Housing	100	117	128	134	139
Local Government	100	98	96	94	93
Scottish Parliament and Audit Scotland	100	98	96	94	92
Total	100	101	102	102	104

Source: Scottish Fiscal Commission, based on Scottish Government information.
Figures may not sum because of rounding.
Figures in 2022-23 prices calculated using year-on-year growth GDP deflators from Table 1.7 of the OBR's March 2022 supplementary economy tables (link). Figures rebased so 2022-23 = 100.
Scottish Government spending plans for 2022-23 are at the same funding level as when the 2022-23 Scottish Budget was introduced in December 2021. This differs from the Scottish Government's presentation which excludes non-recurring spending from the 2022-23 baseline. The growth rates for allocations presented here therefore differ from those presented by the Scottish Government. The spending level in 2022-23 informing the growth rates presented in this figure is different to our estimated funding presented in other figures as it reflects spending plans from December 2021.

Social security

40 The Scottish Government has introduced significant reforms to delivering social security in Scotland. Existing payments administered by the Department for Work and Pensions (DWP) on behalf of the Scottish Government are being replaced by new payments administered by Social Security Scotland. In previous publications we highlighted how our forecasts did not include changes which the Scottish Government planned to make beyond the next financial year, where crucial details on the new payments were still to be decided.

41 To support the RSR we have included indicative forecasts of the additional spending arising from the Scottish Government's policy commitments over the RSR. These include the introduction of Scottish Carer's Assistance, Pension Age Disability Payment, Pension Age Winter Heating Assistance and Employment Injuries Assistance.[7] We also include an estimate for spending on services to replace the current Fair Start Scotland employability service. The inclusion of these indicative forecasts has increased spending by £344 million in 2026-27.

42 Our forecasts now include the additional spending arising from the Scottish Government's plans to replace the devolved previously UK-wide payments with Scottish payments. The spending forecasts included in the RSR reflect these plans and the additional spending arising from the Scottish

[7] Scottish Carer's Assistance replaces Carer's Allowance and the Carer's Allowance Supplement; Pension Age Disability Payment replaces Attendance Allowance; Employee Injuries Assistance replaces Industrial Injuries Disablement Scheme; Pension Age Winter Heating Assistance replaces Winter Fuel Payments; and Scottish Adult DLA replaces Adult Disability Living Allowance.

Government's different approach to social security as set out in the social security charter.[8] It does not reflect any further changes the Scottish Government may make to the payments, such as changes to the qualifying criteria for payments or payment amounts.

43 Social security is funded differently to other parts of the Scottish Budget. The Scottish Government receives BGAs from the UK government for taking on the payment of devolved benefits but these are based on the UK payments they replace and do not include the effect of Scottish Government reforms. Any spending above the funding received through the BGAs must be met by the Scottish Government from its wider Budget. The net position, the difference between our forecasts of devolved social security payments and the BGAs, is forecast to be increasingly negative. The Scottish Government has also introduced new payments which are only available in Scotland, and these must be entirely funded from the Budget. The difference between the funding received through the BGAs and our forecast for social security payments receiving these, plus the spending on new unique Scottish payments represents the amount the Scottish Government must fund from the wider Scottish Budget.

44 The difference between social security funding and spending is forecast to increase each year, rising from £462 million in 2022-23 to £1.3 billion in 2026-27. The social security BGAs are included in UK Government funding in Figure 10. The widening difference between social security funding and spending because of reforms being made to social security has implications for spending on other portfolios. The increase in social security spending is balanced by reductions in other spending areas. Overall social security is increasing from around 10 per cent of the resource budget in 2022-23 to 14 per cent in 2026-27.

Figure 12: Social Security net position and new payments

£ million	2022-23	2023-24	2024-25	2025-26	2026-27
Social security net position	-167	-357	-500	-622	-714
Social security new payments	-294	-524	-542	-551	-563
Total	-462	-881	-1,042	-1,173	-1,277

Source: Scottish Fiscal Commission
Figures may not sum because of rounding.
Social security net position include Adult Disability Payment (covered by the Personal Independence BGA), Child Disability Payment and Scottish Disability Living Allowance (covered by the Disability Living Allowance BGA), Pension Age Disability Payment (covered by the Attendance Allowance BGA), Scottish Carer's Assistance (covered by the Carer's Allowance BGA), Employment Injuries Assistance (covered by the Industrial Injuries Disablement Scheme BGA), Low Income Winter Heating Assistance (covered by the Cold Weather Payment BGA), Pension Age Winter Heating Assistance (covered by the Winter Fuel Payment BGA) and Severe Disablement Allowance.
Social security new payments include 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 and benefit cap mitigation through Discretionary Housing Payments.
In this report we have presented Carer's Allowance Supplement together with Scottish Carer's Assistance and Carer's Additional Person Payment as part of the net position comparison against the Carer's Allowance BGA.

[8] Social Security Scotland (2022) Our Charter (link)

Chapter 1 Introduction

What is in this report?

1.1 In this report, published on 31 May 2022, we present our latest official five-year economic and fiscal forecasts. We create our forecasts independently, representing the collective judgements of our Commissioners. Our forecasts have been used to inform the Scottish Government's Medium-Term Financial Strategy (MTFS) 2022 and Resource Spending Review (RSR) 2022. We show how our latest May 2022 forecasts have changed compared to those we published in December 2021, which informed the 2022-23 Scottish Budget, the MTFS 2021 and the RSR Framework also published in December 2021.

1.2 We have also published a Fiscal Update which details changes to last and this year's Scottish Budgets, 2021-22 and 2022-23, since our December 2021 publication.[9]

1.3 In this introduction we explain the 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 MTFS and RSR. We also discuss how Coronavirus (COVID-19) has affected our outlook.

1.4 The report contains the following chapters:

Summary	Our economic and fiscal forecasts, the fiscal overview and the highlights from this round of forecasts.
Chapter 2: Fiscal Overview	The main fiscal changes since our last forecasts. This includes UK Government funding and tax revenues. We assess the Scottish Government's planned borrowing and use of the Scotland Reserve.
Chapter 3: Economy	Our forecasts for the Scottish economy, including the underlying judgements.
Chapter 4: Tax	Our forecasts of devolved tax revenue.
Chapter 5: 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 required because of new outturn data or revisions to assumptions and judgements.
Annex C: Materiality	Our approach to handling policies which have a very small fiscal effect.
Annex D: Fiscal Overview Technical Details	Our 2027-28 funding assumptions and explanation of differences between the Scottish Fiscal Commission and Scottish Government presentation of funding sources.

1.5 Our supplementary tables, available to download from our website, contain some additional information such as comparisons to our previous forecasts, OBR forecasts and sensitivity analysis.[10] If there is any information you are looking for that is not in this report or the supplementary tables, please get in touch with us at info@fiscalcommission.scot.

[9] Scottish Fiscal Commission (2021) Fiscal Update – December 2021 (link)
[10] Scottish Fiscal Commission (2022) Scotland's Economic and Fiscal Forecasts – May 2022 (link)

The process behind creating these forecasts

1.6 On 14 March 2022, we received notice from the Cabinet Secretary for Finance and the Economy of the publication of a MTFS and RSR on 31 May 2022. Throughout this period, our interaction with the Scottish Government has been guided by our Protocol for engagement.[11]

1.7 Since the formal notification, the Commission has had two rounds of meetings to discuss our forecasts. Attendees 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.[12]

1.8 To finalise our forecasts for publication, our cut-off date for incorporating new data and information into the forecasts was 11 May 2022. No data or information available after 11 May were included in our forecasts.

1.9 Headline dates are:

14 March	Cabinet Secretary for Finance and the Economy wrote to advise that the Scottish Government intended to publish its Medium Term Financial Strategy and Resource Spending Review on 31 May 2022.
11 May	Deadline for inclusion of new data in the forecasts.
11 May	Closure of economy forecasts.
13 May	Deadline for the Scottish Government to provide the Commission with any final policy measures to be included in the forecasts.
18 May	The Commission presented the Scottish Government with final forecasts.
26 May	The Commission's near-final report was shared with the Scottish Government.
30 May	Call between Dame Susan Rice, Chair of the Commission and the Cabinet Secretary for Finance and the Economy.
30 May	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.
31 May	Scotland's Economic and Fiscal Forecasts – May 2022 published.

How the Scottish Government uses our forecasts

1.10 On 31 May 2022 the Scottish Government published the MTFS and the RSR which are informed, in part, by our forecasts. The MTFS sets out five-year forecasts of the Scottish Government's funding position, based on our forecasts of tax revenues, social security spending and assumptions about future funding and borrowing. We discuss these funding plans in Chapter 2. Our tax and social security forecasts are detailed in Chapter 4 and Chapter 5 respectively.

[11] Protocol for engagement between the Scottish Fiscal Commission and the Scottish Government Version 4.1 – October 2021 (link)
[12] Scottish Fiscal Commission (2022) Scotland's Economic and Fiscal Forecasts – December 2021 (link)

1.11 The Scottish Government has also published its RSR, setting out multi-year spending plans from 2023-24 to 2026-2027. The Scottish Government has produced spending envelopes which include our forecasts of social security spending. We provide brief commentary on Scottish Government spending plans in Chapter 2.

COVID-19

1.12 Broadly in line with the assumptions we made in our December 2021 forecasts, all COVID-19 legal restrictions in Scotland came to an end on 21 March 2022. COVID-19 is now being managed like a normal virus, with only voluntary guidance in place. The economy has returned to close to pre-recession levels of activity. COVID-19 is still present in Scotland leading to hospitalisations and deaths, with the Scottish Government's COVID-19 threat level now at medium.

1.13 In our central forecast, we expect COVID-19 levels in Scotland to remain low and stable, with no legal restrictions being reintroduced.

1.14 The effects of the pandemic on society and the economy will be long lasting. Some industries have been reshaped, more people are likely to work from home or adopt hybrid working than before the pandemic. For people who experienced unemployment because of the pandemic there are likely to be scarring effects on their future productivity and earnings. We are not making any explicit adjustments to our forecasts to account for COVID-19 or its legacy effects as these are now implicitly present in our forecast baseline.

1.15 In our Chapter 2 funding tables, we remove the distinction between COVID-19 and non-COVID-19 Barnett consequentials as there is no COVID-19 related funding in our five-year forward look.

Risks to our COVID-19 assumptions

1.16 Our forecasts are based on the assumption that legal public health restrictions are not reintroduced. We believe this assumption is central, however, there are downside risks to this outlook.

1.17 There is a risk that a new variant of COVID-19 emerges that is resistant to current vaccines, which could lead to new public health restrictions or for the public to respond by reducing their activity and contacts with other people. Should new public health restrictions be necessary, then the economic and fiscal outlook over the forecast 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 without legal 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.

Chapter 2
Fiscal Overview

Introduction

2.1 Our latest forecasts accompany the Scottish Government's Medium-Term Financial Strategy (MTFS) and Resource Spending Review (RSR). The RSR covers four years from 2023-24 to 2026-27. In this chapter we compare the funding position in the RSR period to 2022-23. We include an additional year of funding for 2027-28 based on our own projections including our 5 year tax and social security forecasts.

2.2 Although the focus of this chapter is on the medium-term horizon, we also report on the 'other income' assumptions that the Scottish Government made for the 2022-23 Scottish Budget, and how these affect funding in future years. We discuss changes to the 2022-23 Scottish Budget in detail in our supplementary Fiscal Update publication.[13]

2.3 There have been relatively small increases in total funding (resource and capital) across the RSR period. As shown in **Figure 7**, after adjusting for inflation the Scottish Government's total funding for the next three years is expected to be 1 per cent lower than in 2022-23. It then increases in 2026-27, bringing it to 1 per cent higher than the current financial year.

2.4 We provide a detailed explanation of how the Scottish Budget is funded in our Funding for the Scottish Budget paper.[14] In this chapter we provide an update on the different funding sources rather than re-explaining the concepts. For further detail, we refer the reader to that paper.

Resource funding

Five-year outlook

2.5 The UK Government published a Spending Review alongside its Autumn Budget in October 2021, setting out three-year spending plans including the Scottish Government's Block Grant up to 2024-25.[15] The latest estimates of UK Government funding from the Spending Review combined with the recent Spring Statement set out UK Government funding.[16] We combine our latest forecasts of tax revenues, Scottish Government plans for borrowing, the Scotland Reserve and its assumptions on funding in future years with UK Government funding from the Spending Review and the Spring Statement to estimate Scotland's resource funding over the next five years. The Scottish Government have used this level of funding to allocate spending in the RSR.

2.6 Figure 2.1 shows the five-year outlook of resource funding. For consistency we have followed our presentation of the funding position from previous reports. **Annex D** explains how to reconcile our

[13] Scottish Fiscal Commission (2022) Fiscal Update – May 2022 (link)
[14] Scottish Fiscal Commission (2021) Funding for the Scottish Budget (link)
[15] UK Government (2021) Autumn Budget and Spending Review 2021 (link)
[16] UK Government (2022) Spring Statement 2022 Government (link)

table with the new funding tables seen in the Scottish Government's publications.[17] Since 2027-28 is beyond the period covered by the Scottish Government's RSR, we have made some assumptions to project funding for that year, described in in Annex D.

Figure 2.1: Five-year resource funding position

£ million	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
UK Spending Review baseline (Barnett) [1]	34,322	34,943	35,577	36,643	37,742	38,875
Barnett consequentials	406	250	400	316	591	591
Non-Barnett funding	704	715	715	715	715	715
SFC tax forecasts [2]	14,589	16,058	16,897	17,716	18,433	19,303
Tax and non-tax BGAs	-14,639	-16,357	-16,763	-17,645	-18,497	-19,424
Social security BGAs [3]	3,587	4,082	4,574	4,825	5,103	5,397
Final reconciliations [4]	-15	-221	-817	-238	-	-
Resource borrowing	15	110	300	119	-	-
Resource reserve drawdown	400	279	250	113	87	87
Other [5]	632	483	419	26	30	30
NDR distributable amount [6]	2,766	3,190	3,134	3,323	3,651	3,601
Total resource funding	42,767	43,531	44,685	45,913	47,855	49,175
Minus: resource borrowing costs	-77	-110	-124	-169	-191	-149
Minus: capital borrowing costs	-83	-100	-122	-144	-166	-188
Total resource funding for discretionary spend	42,607	43,321	44,439	45,600	47,498	48,838

Source: Scottish Fiscal Commission, Scottish Government.
Figures may not sum because of rounding.
[1] For consistency with Scottish Government publications, the baselines for 2023-24 and 2024-25 include consequentials from the UK Spring Statement 2022 (less than £1 million in each year).
[2] For 2022-23, the SFC tax forecasts have increased by £68 million (£48 million from LBTT and £21 million from SLfT), but income tax revenues were fixed at the December 2021 forecast when the Budget was set. Changes to the income tax forecast for 2022-23 are shown in Chapter 4 but these do not change the funding position for 2022-23.
[3] From 2024-25 the Social Security BGA includes estimated specific funding for the Scottish benefit that will replace Winter Fuel Payments. This amount has not yet been agreed with the UK Government.
[4] Indicative Income Tax reconciliations based on the latest forecasts of both the OBR and the SFC.
[5] More detail on the 'other income' for 2022-23 can be found on the accompanying Fiscal Update document. The method to reconcile these amounts with those presented by the Scottish Government in their Resource Spending Review can be found in Figure D.1 in Annex D.
[6] NDR distributable amounts in 2022-23, 2023-24 and 2024-25 are Scottish Government policy. For later years it is our forecast of the NDR contributable amount.

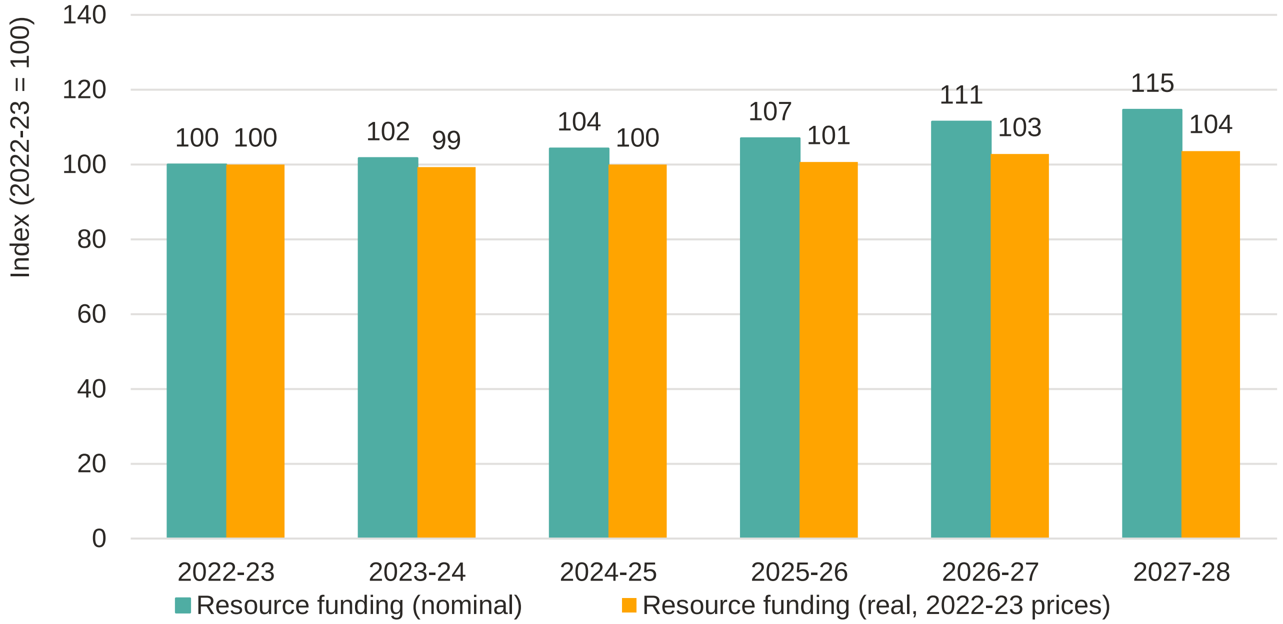
2.7 We expect resource funding to grow steadily in nominal terms throughout the forecast horizon. The pace will be modest initially, with growth of 2 per cent in the first year of the RSR as shown in Figure 2.2. Nominal funding grows faster in future years because of a less negative tax position, and assumed higher funding from the UK Government.

2.8 Inflation will dampen the growth in resource funding. Both the Scottish Government Budget documents and the UK Government Spring Statement have used the GDP deflator to show funding

[17] Scottish Government (2022) Medium Term Financial Strategy (link), Scottish Government (2022) Resource Spending Review (link).

in real terms, so, for consistency, we do the same. Box 2.1 explains what this deflator is and some of its potential weaknesses.

Figure 2.2: Medium-term outlook for resource funding (indexed)



Source: Scottish Fiscal Commission, based on Scottish Government information.
Figures in 2022-23 prices calculated using GDP deflators from Table 1.7 of the OBR's supplementary economy tables. Figures rebased so 2022-23 = 100.
Funding in 2022-23 has been updated for the latest information including changes in UK Government funding, changes to Scottish Government Reserve drawdown plans and revised fully devolved tax forecasts. This differs from the Scottish Government's presentation of 2022-23 funding which is presented at the same level as the 2022-23 Scottish Budget as introduced in December 2021. The growth rates for funding presented here therefore differ from those presented by the Scottish Government.
Several assumptions are made for 2027-28. Please refer to the Annex D for more details.

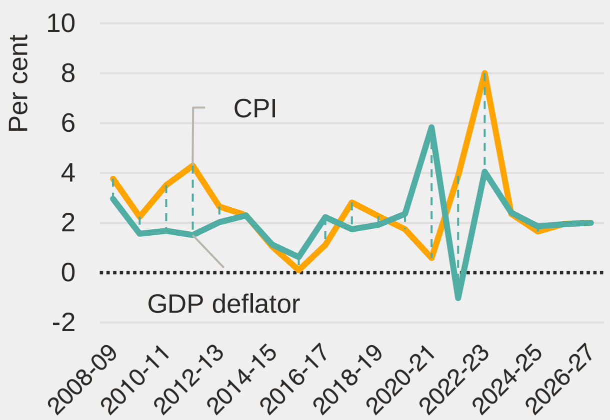
2.9 In real terms the Scottish Government will have the same amount of resource funding available at the mid-point of the RSR as it has in 2022-23. By the end of the RSR, we expect the funding levels in real terms to be only 3 per cent higher than they are in the current financial year.

Box 2.1: Differences between the GDP deflator and CPI

There are many different measures of inflation. The most common is the Consumer Price Index (CPI). The Office of National Statistics (ONS) use this measure to track the changes in price of a standard basket of goods bought by households in the UK.

CPI is designed to capture changes in consumer prices. It is not generally suitable to analyse the real spending power of governments. This is because governments do not purchase the same goods and services as consumers. The GDP deflator is a more general indicator of price changes in the economy, and is usually used to measure public spending over time. The ONS calculates it by pooling together many inflation indices and we include it in our economy forecasts.

Figure 2.3: Evolution of GDP Deflator and CPI



Source: OBR (2022) – Economic and Fiscal Outlook – March 2022 (link)

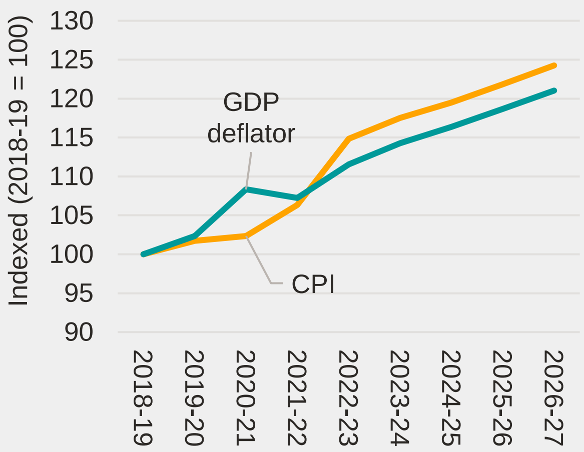
Normally, both indices move closely together. However, as shown in Figure 2.3, at the start of the COVID-19 pandemic they started to diverge. CPI remained low during the first lockdowns in 2020-21, but the GDP deflator shot up. This was because of a large rise in the government consumption deflator. Measured real government output fell during lockdowns because of school closures and postponed health treatments while nominal government expenditure increased.

As restrictions relaxed, the GDP deflator decreased sharply, suggesting that there had been deflation. From 2022-23, even though the forecast of CPI is at an all-time high, the GDP deflator does not capture the same degree of price rises. Higher import prices have a more significant effect on CPI than on the GDP deflator, an important difference in the current situation.

This means that, relative to their respective 2018-19 levels, there is now a sustained gap between CPI and GDP deflator indices. Any cash value we adjust with the GDP deflator in the next five years will suggest that prices have grown by 3 per cent less than the CPI would have grown them by.

Although governments do not purchase the same kind of goods and services as consumers, high consumer inflation affects some of their largest structural costs. One example is staff pay, as CPI is often used to negotiate pay rises. This means that where we compare real and nominal funding in future years we may not be showing the fully reduced purchasing power of future funding.

Figure 2.4: GDP deflator and CPI evolution (indexed)



Source: OBR (2022) – Economic and Fiscal Outlook – March 2022 (link)

Assumed future Barnett consequentials

2.10 The UK Government set a Block Grant baseline (Barnett and non-Barnett) for the Scottish Government until 2024-25 in the Spending Review in October 2021.[18] Since then the UK Government has made changes to Scottish Government funding in the 2022 Spring Statement and other updates to 2021-22 and 2022-23 funding.[19] As in previous fiscal events, the Scottish Government has made assumptions about additional funding from the UK Government in the future.

2.11 Assumed consequentials range from £250 million in 2023-24 to £591 million in 2026-27. Within the UK Government Spending Review period the Scottish Government have based this assumption on annual changes since 2010 in Block Grant funding. During this period there were also a Spending Reviews and consequentials above the set baselines. Typically, the further away from a Spending Review, the greater the divergence from the baselines as the UK Government's economic and fiscal circumstances change. The UK Government also budgeted 'Reserves' at the 2021 Spending Review, which was funding committed to be spent but unallocated as a buffer for uncertainty. If the UK Government was to spend 20 to 40 per cent of the Reserve in devolved areas, such as health or education, then this would generate the Scottish Government's assumed consequentials.

2.12 For subsequent years the Scottish Government have estimated additional consequentials based on OBR's March 2022 forecasts of resource spending.[20]

Tax net positions

2.13 Tax net positions are the difference between the tax revenue devolved to Scotland and the Block Grant Adjustments (BGAs), which are the amounts deducted from the Block Grant to account for tax foregone by the UK Government. We compare our forecasts of income tax, Land and Buildings Transaction Tax (LBTT) and Scottish Landfill Tax (SLfT) to the BGAs which are based on OBR forecasts of corresponding UK Government tax revenues.[21]

2.14 We expect the net position for devolved taxes to be significantly negative in the first year of the RSR (2023-24), as shown in Figure 2.5. Although the net position for LBTT and SLfT is mostly positive throughout the forecast period, the larger negative income tax net position brings the overall position down in the first two years. We expect the overall net position to turn positive in 2024-25 and 2025-26 as the UK Government has committed to introducing a 19 pence basic rate of income tax. The reduction in the income tax rate reduces UK Government income tax revenues, therefore reducing the income tax BGA. The net position returns to negative in 2026-27, but is forecast to have a close to neutral effect on funding.

2.15 We have not included a revised net position for 2022-23 based on our latest forecasts and those of the OBR in March 2022. This is because the net position for income tax, which has the largest impact on funding, was fixed when the 2022-23 Budget was set. The movements in the net position shown by the most recent forecasts for this financial year only give an indication of how future funding levels are likely to be affected through reconciliations.

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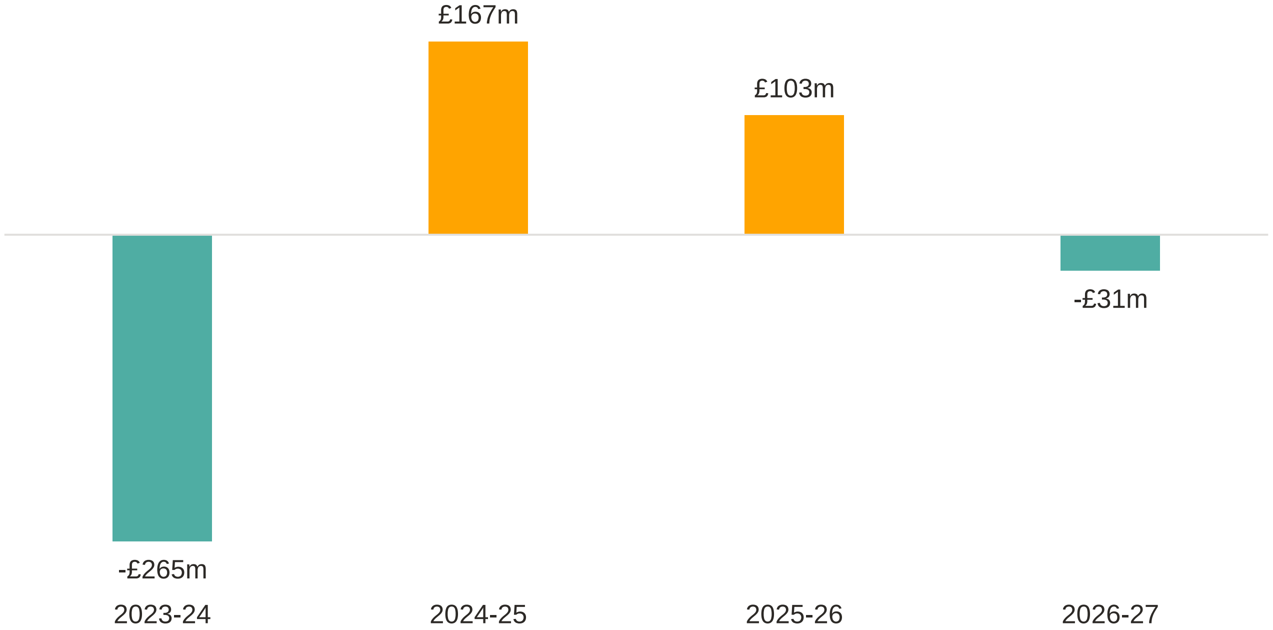
[18] HM Treasury (2021) Autumn Budget and Spending Review 2021 (link)
[19] Changes to Scottish Government funding from the UK Government's Supplementary Estimates and Main Estimates in 2022 are detailed in our Fiscal Update published separately. Scottish Fiscal Commission (2022) Fiscal Update – May 2022 (link)
[20] Office for Budget Responsibility (2022). March 2022 Economic and Fiscal Outlook – Table 3.16 (link) Projection based on Public Sector Current Expenditure (PSCE) in Resource DEL.
[21] Non-Domestic Rates are included differently in the Scottish Budget. Further information can be found in **Chapter 4**.

Figure 2.5: Indicative tax net positions



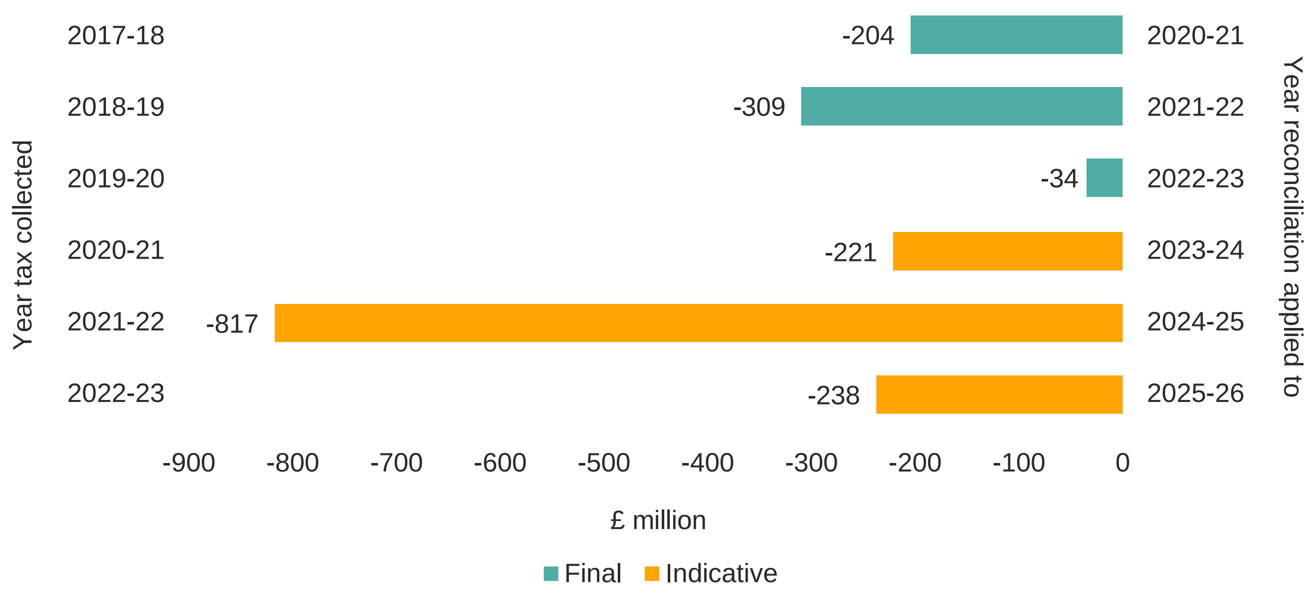
Source: Scottish Fiscal Commission.
Tax net position includes Income Tax, Land and Buildings Transaction Tax (LBTT) and Scottish Landfill Tax (SLfT).
The net position uses our latest May 2022 forecasts for revenues and the Block Grant Adjustments based on the OBR's March 2022 forecasts.

Reconciliations and resource borrowing

2.16 The Scottish Budget is set in advance of each financial year, based on forecasts of revenues and spending. Reconciliations are funding adjustments once outturn data are available which are a product of our and OBR's forecast errors for income tax. Smaller adjustments apply for fully devolved taxes and social security payment BGAs and are either managed in-year or in the financial year following the publication of outturn data. As one of the largest components of the Budget, income tax funding is fixed for the financial year. Income tax outturn data are available around 16 months after the end of the financial year so, for example, the 2022-23 income tax reconciliation will be applied to the 2025-26 Scottish Budget.

2.17 In December 2021 we expected a negative income tax reconciliation of -£469 million to be applied to 2024-25. There have been no new tax outturn data since our last report. However, based on both our May 2022 forecasts and those from the OBR in March, we now expect reconciliations to be much larger, reducing available funding in future years. The income tax reconciliation in 2024-25 is currently forecast to be -£817 million, as shown in Figure 2.6.

Figure 2.6: Indicative and final income tax reconciliations

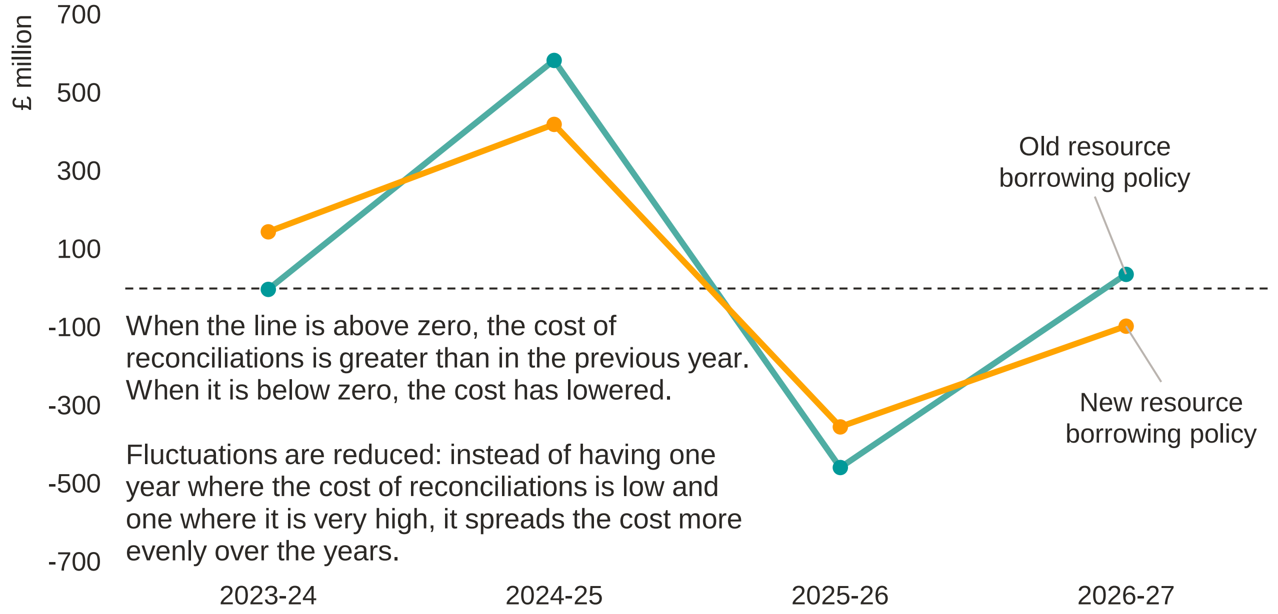


Source: Scottish Fiscal Commission

2.18 The Scottish Government can use resource borrowing powers to manage reconciliations and forecast error. Borrowing is limited to £300 million per year. Our January 2021 forecasts met the conditions for a Scotland-specific economic shock, so resource borrowing powers increased to £600 million until 2023-24. In 2024-25 the limit returns to £300 million. The Scotland Reserve is used primarily to achieve a balanced budget and manage underspends and is not suitable to manage very large negative reconciliations.

2.19 Faced with reconciliations that exceed the borrowing limits, the Scottish Government have changed their resource borrowing approach. We compare the yearly cost of reconciliations under the new approach with the old one in Figure 2.7. Previously the Scottish Government borrowed to match any negative reconciliations in full and spread all of their cost over time. Since borrowing alone can no longer manage the reconciliation, the Scottish Government's current plan smooths the changes in the cost of reconciliations between years. The cost of reconciliation comprises the expense of servicing past financed reconciliations (repayment of principal and interest) and the balance of any new reconciliation unmet by borrowing. By summing together final reconciliations, borrowing and the costs of borrowing, the Scottish Government is making this total amount more consistent between years, though it does not completely prevent variation caused by large reconciliations.

Figure 2.7: Yearly variations in the cost of reconciliations



Source: Scottish Fiscal Commission, Scottish Government.
Indicative Income Tax reconciliations based on the latest forecasts of both the OBR and the SFC.

Scotland Reserve

2.20 The Scottish Government is required to maintain a broadly balanced budget, matching its spending to available funding each year. Given the requirement to not run a deficit, managing the budget tends to produce underspends. The Scottish Government can use the Scotland Reserve to transfer unspent funds from one financial year to the next.

2.21 The Scotland Reserve has a total limit of £700 million, including resource and capital funds. 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 in January 2021, the drawdown limit is waived for three years.

2.22 Figure 2.8 shows the balance of the resource reserve, based on the latest Scottish Government plans. The Scottish Government will update the 2021-22 reserve balance in the provisional outturn statement in June.

Figure 2.8: Balance of the resource Scotland Reserve

£ million	2020-21	2021-22	2022-23
Opening balance	217	405	400
Drawdowns	-170	-405	-400
Additions	358	400	-
Closing balance	405	400	-

Source: Scottish Government
Figures may not sum because of rounding. Shaded cells refer to final outturn.

2.23 When the 2022-23 Scottish Budget was set in December 2021, the Scottish Government expected no additions to the Reserve in 2021-22 and therefore assumed no draw down from the Reserve in 2022-23.

2.24 In January 2022 the Cabinet Secretary for the Economy and Finance announced an additional £120 million would be allocated to the Local Government portfolio in 2022-23.[22] This additional funding was to come from consequentials deferred through the Scotland Reserve.

2.25 The Scottish Government currently plans to add £400 million to the Reserve from 2021-22 funding, and to draw down this amount in full. This will cover current funding commitments and results in additional funding in 2022-23. Part of this drawdown could offset part of the 'other income' assumption in 2022-23, go to other spending areas or remain in the Reserve for future years.

2.26 As shown in **Figure 2.1**, the Scottish Government plans drawdowns of £279 million in 2023-24 and £250 million in 2024-2025, £113 million in 2025-26 and £87 million in 2026-27. This choice reflects the pressures on the Scottish Budget in the first years of the RSR period. It also signals that underspends of £279 million and £250 million may be needed in 2022-23 and 2023-24.

'Other' for future years

2.27 Our 'other' line typically includes elements that come from two sources:

- The UK Government outside of the Block Grant settlement – such as the Scottish share of the Immigration Health Surcharge.
- Directly from Scottish sources – such as the proceeds from the Queen's and Lord Treasurer's Remembrancer (QLTR).

2.28 The Scottish Government changed its presentation of funding for the May 2022 MTFS and RSR. The 'other' line now encompasses any funding source that is not part of the Block Grant settlement from the UK Government or devolved tax revenue (after net BGAs).

2.29 For consistency, we have continued to present the funding position in the same way as in our previous reports. In **Annex D** we detail how both definitions of 'other income' can be reconciled.

2.30 As shown in Annex D, one of the elements we include within our definition of 'other' is the profiling of the ScotWind proceeds. The Scottish Government plans to draw down £660 million in the first two years of the RSR period.

2.31 Since December 2021 the Scottish Government's 'other income' has also included assumed compensation arising from the expected resolution of a dispute with the UK Government. The Scottish Government view the 2015 UK Government's policy to raise the personal allowance above inflation as having a spillover effect on Scottish income tax revenues. [23] The two governments are negotiating over the size of the spillover. The dispute remains unresolved, but has progressed since December 2021.

2.32 The nature of the spillover has changed for future years. Changes in UK Government tax policy now maintains the personal allowance at its 2021 level from April 2022 to April 2026. This freeze combined with the current high level of inflation mean the potential spillover payments may need to go in the opposite direction in the future, with the Scottish Government compensating the UK Government. Although the scale of any payments to the UK Government is uncertain, the Scottish

[22] Scottish Government (2022) News: funding boost for local councils (link)
[23] UK Government (2015) Income Tax: personal allowance indexation (link)

Government has included provision for a negative effect on the budget within their classification of 'other'.[24]

2022-23 'Other'

2.33 In December 2021 the Scottish Government assumed £620 million of 'other income' as part of the funding available for the 2022-23 Scottish Budget. This was a risk-assessed amount made up of deferrable consequentials from the 2021 Supplementary Estimates and the 2022 Spring Statement, assumed compensation from the resolution of the dispute with HM Treasury on income tax spill over, and from the auction of ScotWind leases.

2.34 Despite some uncertainty about each individual source taken together we assessed the Scottish Government's assumption to be reasonable, but committed to report further on any changes as these sources developed.[25] So far, £236 million have materialised through £110 million of consequentials and £126 million through a new source: deferred voluntary NDR payments. We expect further changes throughout the financial year.

2.35 Since December 2021 2021 the Scottish Government have received £110 million in consequentials, £44 million from the UK Government's Spring Statement and £66 million from Main Estimates in May. More consequentials have been announced, but these are required to support the Scottish Government's announcement of council tax rebates funded via local government, which were not part of the 2022-23 as introduced in December 2021.[26]

2.36 The third component was an expected payment from HM Treasury for the income tax spillover. The Scottish Government expect to resolve this dispute for past financial years during the 2022-23 financial year and so this will contribute to the £620 million of 'other income'.

2.37 The Scottish Government expected proceeds from the auction of leases under the ScotWind project to make a small contribution to 'other income' in 2022-23 as these would be profiled over a few years.[27] ScotWind proceeds have been profiled over 2023-24 and 2024-25 and no longer contributes to the assumed 'other income' in 2022-23.

2.38 Although not originally part of the 'other income' assumption, the Scottish Government have re-profiled into 2022-23 £126 million of voluntary donations by some ratepayers to refund the NDR relief automatically awarded in 2020-21. This is the portion of donations received directly into the Scottish Consolidated Fund in 2021-22. This funding will help offset shortfalls in any of the components of the £620 million of 'other income' assumption.

2.39 Thus far, £236 million from original and new sources has materialised to cover the £620 million assumption. We expect the outcome from the spillover dispute to contribute to meeting the outstanding £384 million. We noted in our December 2021 publication that additions to the reserve were likely to be available for drawdown when assessing the 2022-23 'other income' assumption. The Scottish Government has indicated plans to draw down £400 million from the reserve of which only £120 million are already committed to spending not initially budgeted, so there are resources available in the Scotland Reserve to help cover the outstanding £384 million. We will continue to monitor and report on how the Scottish Government's funding evolves over 2022-23.

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[24] The Scottish Government have assumed negative contributions to future budgets from the spillover dispute: -£77 million in 2023-24, -£133 million in 2024-25, -£154 million in 2025-26 and -£152 million in 2026-27. The scale of the spillover relating to previous years has not been disclosed by the Scottish Government.
[25] Scottish Fiscal Commission (2021) Scottish Economic and Fiscal Forecasts – December 2021 (link)
[26] Scottish Government (2022) Scottish Budget Bill passed (link)
[27] Crown Estate (2022) Awards, lead applicants, project partners, area, capacity and foundations (link)

Spending

2.40 The Scottish Government have set their RSR plans for the next four years, 2023-24 to 2026-27, based on a forecast funding position. The spending allocations have been set at a time when inflation will erode the purchasing power of the Scottish Government, and there will be pressure for public sector wages to increase with inflation.

2.41 The Scottish Government plans to increase spending for health and social security. We show the available funding, and spend in health and social care social security, and all other portfolios in Figure 2.9. The total resource funding available for other portfolios decreases in real terms in the first three years of the RSR. In 2026-27 funding is assumed to increase in both real and nominal terms. The increase in health spending reflects increases in funding being received from the UK Government and the Scottish Government's commitment to pass any additional health funding from the UK Government to the health portfolio.

Figure 2.9: Summary of the Scottish Government's spending allocations

£ million	2022-23	2023-24	2024-25	2025-26	2026-27
Total resource funding available [1]	42,607	43,321	44,439	45,600	47,498
Social security spending [2]	4,173	5,072	5,725	6,108	6,490
Health and social care spending	17,106	17,550	17,995	18,536	19,029
Total resource funding for all other portfolios	21,328	20,699	20,719	20,956	21,979

Source: Scottish Fiscal Commission, Scottish Government.
Figures may not sum because of rounding.
[1] Funding in 2022-23 has been updated for the latest information including changes in UK Government funding, changes to Scottish Government Reserve drawdown plans and revised fully devolved tax forecasts. This differs from the Scottish Government's presentation of 2022-23 funding which is presented at the same level as the 2022-23 Scottish Budget as introduced in December 2021.
[2] Social Security spending is based on our forecasts and not directly traceable to a specific spending allocation in the Resource Spending Review.

2.42 The Scottish Government have introduced significant reforms of devolved social security. Existing payments administered by DWP on behalf of the Scottish Government are being replaced by new payments administered by Social Security Scotland. In the process of taking over the administration of these benefits the Scottish Government have made significant reforms. As we show in Chapter 5 we expect spending to be higher than on the UK wide payments they replace.

2.43 The Scottish Government receive BGAs from the UK government for taking on the payment of devolved benefits but these are based on the UK payments they replace and do not include the effect of Scottish Government reforms. The net position, which is the difference between our forecasts of devolved social security payments and the BGAs, is forecast to be increasingly negative. In addition, the Scottish Government have introduced new payments which are only available in Scotland, and spending on these must be entirely funded from the Scottish Budget. The total spending on social security is forecast to increase each year, rising from £462 million in 2022-23 to £1,277 million in 2026-27.[28] This increase is balanced by real terms reductions in other spending areas. Overall social security is increasing from around 10 per cent of the resource budget in 2022-23 to 14 per cent in 2026-27.

[28] Please refer to Figure 5.14 for more details.

Resource Assessment

2.44 The Scottish Government has set its RSR for the next four years based on assumed income. The first two years of the RSR are challenging because of the income tax position. Scottish income tax revenues have grown more slowly than in the rest of the UK. This has led to income tax negatively affecting the Budget in 2023-24 and we expect negative income tax reconciliations resulting from forecast error. The Scottish Government have made assumptions about funding above the level set at the UK Spending Review, including additional consequentials and underspends from previous years available through the Scotland Reserve. Additions to the reserve in recent years would suggest this is a reasonable assumption but decisions on spending may need to be made in-year to ensure sufficient funds for current and future years.

2.45 The Scottish Government have changed their approach to presenting funding plans. They now combine borrowing and reserve drawdown plans with multiple other sources, some of which are based on assumed additional income which will arise because of UK Government changes or negotiations with the UK Government. This change in approach makes it more difficult to assess the reasonableness of the Scottish Government's borrowing plans, and to monitor how funding evolves over time. Annex D sets out how the Scottish Government's definition of 'other income' differs from the presentation in our funding tables. We consider the Scottish Government's assumptions broadly reasonable, but note the risk that funding may differ from the current plans. If funding is less than currently projected then the Scottish Government will need to adjust its spending plans in each Budget.

2.46 The Scottish Government plans to draw down most of the income from the sale of ScotWind in the first two financial years of the RSR, which is understandable given the funding challenges in these years. If funding from other sources turn out to be higher than currently expected, we would encourage the Scottish Government to reconsider how they profile these funds over time, although we understand that the first two years of the RSR will be challenging.

2.47 In December 2021, the Scottish Government included an assumed £620 million of 'other income' in the 2022-23 Scottish Budget. While the information we have received so far is broadly in line with its initial expectations, we note the continued uncertainty over some of the other income sources. We note again that the review of the fiscal framework is due to begin this year and it is possible that negotiations will also cover the income tax spillover. We expect the outcome from the spill over dispute to contribute to meeting the outstanding amount of £384 million which the Scottish Government expect in 'other income' in 2022-23. This may delay conclusion of the dispute beyond this financial year. We will continue to track the 2022-23 funding position and report on how the sources of income develop during the rest of the financial year.

2.48 Normally, our commentary on Scottish Government spending covers only social security as we are responsible for producing the forecasts the Scottish Government uses. However, in 2023 we will be publishing a Fiscal Sustainability Report which will project spending in all devolved areas. Currently the Scottish Government's Budget documents focus on spending by portfolio area. However, portfolios change over time to reflect different ministerial responsibilities. This makes tracking spending over time difficult.

2.49 The Organisation for Economic Cooperation and Development (OECD) developed the Classification of Functions of Government (COFOG). It is used to reflect spending in a consistent way by identifying spending under set definitions. We would like the Scottish Government to publish its Budget later this year with information on how spending is split by COFOG as well as by portfolio.

This would provide a baseline level of spending for us to use in our Fiscal Sustainability Report, and provide a benchmark for comparisons of the Scottish Budget in future years.

Capital funding

Five-year outlook

2.50 Capital funding is smaller than resource funding, accounting for around 13 per cent of the total 2022-23 Scottish Budget. It is split into two parts: capital and financial transactions (FTs). Capital (excluding FTs) is used for long-term investment such as hospitals, roads and research and development. FTs are used to make loans to, or buy equity in, private sector entities, where this will help to attain stated policy goals. FTs can be allocated on a gross or a net basis. Gross allocations require the repayment of most of the FT funding to the UK Government. Allocations on a net basis means the Scottish Government is able to recycle any repayments into further awards of FTs.

2.51 Figure 2.10 shows the five-year outlook of capital funding. Annex D explains the assumptions we have made for funding in 2027-28.

Figure 2.10: Five-year capital funding position

£ million	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Capital (excluding Financial Transactions)						
UK Spending Review baseline (Barnett)	4,469	4,757	4,690	4,937	5,148	5,369
Barnett consequentials	12	-	-	-	-	-
Non-Barnett funding [1]	718	632	632	632	632	632
Capital borrowing	250	250	250	250	250	250
Capital reserve drawdown	144	-	-	-	-	-
Other [2]	344	300	300	300	300	300
Total capital funding (excl. FTs)	5,937	5,939	5,872	6,119	6,330	6,551
Financial Transactions						
UK Spending Review baseline (Barnett)	466	186	176	-	-	-
Barnett consequentials	-	-	-	-	-	-
FT reserve drawdown	61	-	-	-	-	-
Other [3]	-	200	200	-	-	-
Total Financial Transactions	527	386	376	-	-	-
Total capital funding	6,464	6,325	6,248	6,119	6,330	6,551

Source: Scottish Fiscal commission, Scottish Government.

Figures may not add up because of rounding.

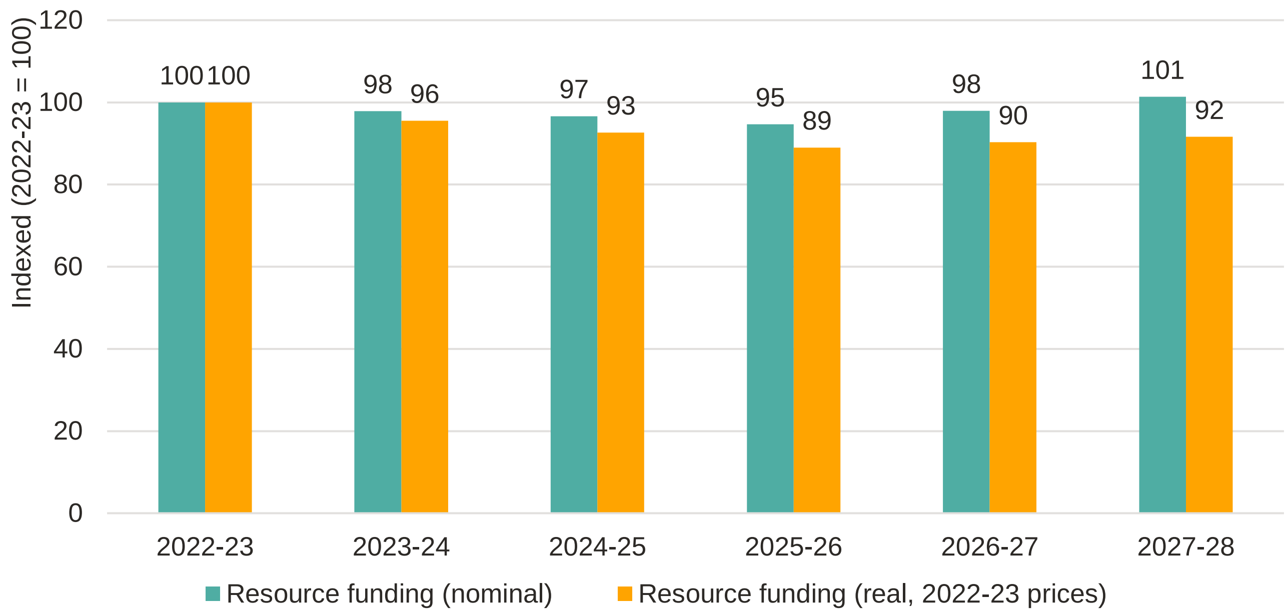
[1] The flat-lined £632 million are an assumed continuation of Network Rail capital funding.

[2] The flat-lined £300 million includes £100 million of assumed City Deals and £200 million of assumed other capital funding which is expected to come from reserve drawdowns, consequentials or underspends. In the event that these are not enough, the Scottish Government may increase their capital borrowing plans to cover the assumption.

[3] The 'Other' amount for financial transactions relates to corrective payments to compensate for under allocation of historic consequentials.

2.52 We expect capital funding to decrease in nominal terms over the next three years, reaching its lowest level in 2025-26 at 95 per cent of the level of 2022-23 funding, as shown in Figure 2.11. From 2026-27 onwards capital funding is assumed to increase again. By the end of the forecast horizon we expect the Scottish Government to have only 1 per cent more capital funding available in nominal terms than it does in 2022-23. Adjusting for inflation, capital funding shows larger reductions. By 2027-28 funding is 8 per cent lower in real terms than in 2022-23.

Figure 2.11: Medium-term outlook for capital funding (indexed)



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

Scotland Reserve

2.53 The Scottish Government drew down the Scotland Reserve balances in full to support spending in 2021-22. A total drawdown of £205 million is planned in 2022-23. We show the balance of the capital and FTs reserves, based on Scottish Government plans, in Figure 2.12.

Figure 2.12: Balance of the capital Scotland Reserve

£ million	2020-21	2021-22	2022-23
Capital (excluding FTs)			
Opening balance	80	7	144
Drawdowns	-80	-7	-144
Additions	7	144	-
Closing balance	7	144	-
Financial Transactions			
Opening balance	136	197	61
Drawdowns	0	-197	-61
Additions	61	61	-
Closing balance	197	61	-

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

2.54 In December 2021 the Scottish Government planned to draw down the full reserve balance in 2022-23. This means that the 2022-23 Budget was set with an assumption that a total of £179 million would be funded from reserve drawdowns (£118 million from the capital reserve and £61 million from the FTs reserve). At the Spring Budget Revision the Scottish Government increased its 2021-22 addition to the capital reserve by £26 million, making it £144 million.[29]

2.55 The total £205 million capital and FT additions in 2021-22, together with the resource additions shown in Figure 2.8 (£400 million) take the planned overall reserve closing balance to £605 million. This is only £95 million below the maximum balance of £700 million. Provisional outturn data will be published in June 2022 showing actual additions to the reserve, but there is limited capacity for more underspends to be added.

Capital borrowing

2.56 The Scottish Government can borrow for capital spending up to a maximum £450 million each year, with a total cap of £3 billion on the debt stock.

2.57 Until recently, the Scottish Government's policy was to borrow between £250 million and £450 million each year over the National Infrastructure Mission (NIM), which covered up to 2025-26 inclusive, with a contingency reserve of £300 million remaining in 2026-27.[30]

2.58 The capital borrowing plans have now been revised. From now on, the Government plans to borrow £250 million each year, with loan durations of 15 years. In managing total capital funding, the Government plans for the sum of capital borrowing, Scotland Reserve drawdowns, redeployments in-year and other capital funding to be £450 million each year. Borrowing can be increased or decreased depending on the level of the other sources of funding. The Scottish Government also plan to adjust the loan duration depending on the level of debt it has and the cost of borrowing. For now, all borrowing is assumed to be on a 15 year duration. From 2024-25 onwards the Scotland Reserve drawdown limit will be £100 million, therefore of the £200 million only up to half can potentially come from the Scotland Reserve. We will monitor how other sources of funding emerge each year and how the Scottish Government's capital borrowing plans change in future.

2.59 Figure 2.13 shows the change in capital borrowing plans from the previous policy to the new policy for the years we cover in our report.

Figure 2.13: Change in borrowing plans

£ million	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Borrowing plans under old plans	450	350	350	300	-	-
Repayment term (years)	20	20	20	15	-	-
Percentage of debt cap (per cent)	72	80	87	92	87	82
Borrowing plans under new plans	250	250	250	250	250	250
Repayment term (years)	15	15	15	15	15	15
Percentage of debt cap (per cent)	65	70	74	78	81	84

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

[29] Scottish Government (2022) Spring Budget Revision 2021 to 2022 (link)
[30] Scottish Government (2021) Scotland's Fiscal Outlook: The Scottish Government's Medium-Term Financial Strategy – January 2021 (link)

Other financial transactions funding

2.60 Figure 2.10 shows how the Scottish Government expects £200 million of 'other' financial transactions (FTs) funding in 2023-24 and 2024-25. These are corrective payments from HM Treasury to compensate for an under-allocation of FT funding from the UK Government in previous years.

Capital Assessment

2.61 We previously noted how the Scottish Government's capital borrowing plans risked hitting the borrowing cap, therefore constraining future borrowing. As shown in Figure 2.13, under the previous approach the Scottish Government would have been close to the debt cap (92 per cent) by 2025-26. Borrowing in 2026-27 of £389 million would have meant reaching the borrowing cap.

2.62 The new borrowing approach will allow the Scottish Government to continue to borrow at a more consistent level for a longer period. Our analysis suggest that borrowing £250 million annually and repaying over 15 years would reach the limit of the cap by 2040-41, nearly 15 years later than the previous plans.

2.63 The current UK Spending Review covers the period until 2024-25, so any capital or other funding plans beyond that year are based on assumptions. Therefore, there is much more uncertainty about the expected Block Grant settlement for capital beyond 2024-25.

2.64 The Scottish Government now aim to have £450 million available between capital borrowing, capital Reserve drawdowns, underspends and unanticipated consequentials, with borrowing as an option to reach £450 million if required, As we explained, at the baseline borrowing plans of £250 million per year the new approach is more sustainable than previous plans. However, we note the risk that if the four latter components together tend to generate less funding than expected, and capital borrowing needs to be increased as a result, the new plans will be less sustainable. The £200 million annually of assumed income coming from those other sources should be risk-assessed and reviewed each year. We will monitor how other sources of funding emerge each year and how the Scottish Government's capital borrowing plans change in future.

2.65 Overall, we conclude that the Scottish Government capital borrowing plans for the five years covered by our report are reasonable.

Chapter 3 Economy

Forecast summary

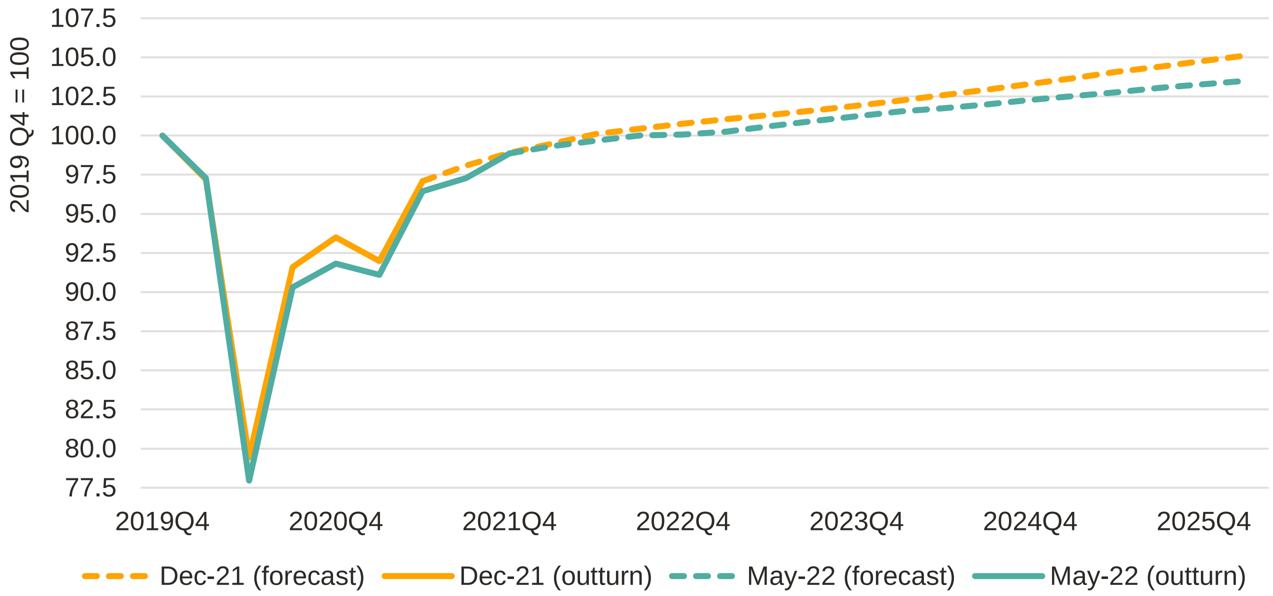
3.1 The Scottish and UK economies were emerging from the Coronavirus (COVID-19) pandemic with already rising inflation, driven by global energy and traded goods prices, when Russia's invasion of Ukraine delivered another significant global inflation shock. At the same time, COVID-19 developments in China are contributing to a worsening in supply chain disruptions and deterioration in the global economic outlook. After Scottish Gross Domestic Product (GDP) growth of 2.1 per cent this year, sustained by the rebound from the COVID-19 shock, we expect growth to slow to 1.1 per cent in 2023-24, slightly lower than we forecast in December 2021. Figure 3.1 shows our latest May 2022 GDP forecast alongside our previous forecast.

3.2 With inflationary pressures intensifying further since December 2021, we now expect annual CPI inflation to peak at 8.7 per cent in 2022 Q4. This is mainly driven by the large increase in the Ofgem energy price cap in April and October, which is an effect of rising global energy prices in the wake of the pandemic, with the conflict in Ukraine further exacerbating energy price rises.

3.3 Domestic price pressures from the labour market have also picked up. Unemployment has continued to fall despite the end of furlough and is now at historic lows, adding to recruitment difficulties. Reflecting higher inflation and wage pressures from an increasingly tight labour market, we expect nominal average earnings to grow strongly in 2022-23, by 4.1 per cent, moderating in later years as inflation falls back and labour market conditions normalise.

3.4 Rising inflation, combined with recent tax rises, means that many households will see their real incomes fall sharply this year. Overall, consumption growth will slow because of the real income squeeze but remain positive, partly supported by savings accumulated during the pandemic.

Figure 3.1: Scottish GDP, outturn and forecast



Source: Scottish Fiscal Commission, Scottish Government (2022) GDP Quarterly National accounts (QNA): 2021 Quarter 4 (October to December) (link), Scottish Government (2021) GDP QNA: 2021 Quarter 2 (April to June) (link).

3.5 We continue to see Scotland's total earnings growth lagging behind the UK's. We expect this trend to persist over the next few years, with important implications for tax revenues and the Scottish Budget. As we discussed in our December 2021 forecast report, Scotland's slower total earnings growth relative to the UK can be explained by divergent sectoral and regional performance, with areas such as finance growing strongly in London, and longer-term structural factors such as declining North Sea oil and gas activity and a shrinking labour force in Scotland. We explore some of these issues further in **Box 3.1** and the section on **UK Continental Shelf oil and gas activity**.

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	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
GDP							
December 2021	10.4	2.2	1.2	1.3	1.4	1.4	-
May 2022	11.6	2.1	1.1	1.0	1.0	1.0	1.0
Consumer Price Index							
December 2021	3.3	3.7	2.3	2.0	2.0	2.0	-
May 2022	4.0	8.0	2.4	1.7	2.0	2.0	2.0
Average nominal earnings							
December 2021	3.8	2.6	3.0	3.2	3.3	3.4	-
May 2022	4.4	4.1	2.9	2.9	3.1	3.2	3.3
Average real earnings							
December 2021	0.6	-0.8	0.7	1.1	1.3	1.4	-
May 2022	0.8	-2.7	0.4	1.2	1.1	1.2	1.3
Employment							
December 2021	1.3	1.0	0.1	-0.1	-0.2	-0.2	-
May 2022	1.6	1.5	-0.2	-0.2	-0.2	-0.3	-0.3
Unemployment rate							
December 2021	4.6	4.5	4.3	4.2	4.2	4.2	-
May 2022	4.0	3.9	4.0	4.0	4.0	4.1	4.1

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – December 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 Our economy forecasts were finalised on 11 May 2022. No new data or information received after this date were incorporated into the forecasts.

3.8 We continue to monitor our Scottish Uncertainty Index, published for the first time in our August 2021 forecast report.[31] The updated indicator, up to 2022 Q1, can be found in the economy supplementary tables accompanying this report. The period covered by the indicator does not yet fully cover the conflict in Ukraine. Even still, it shows a small rise in uncertainty at the start of 2022.

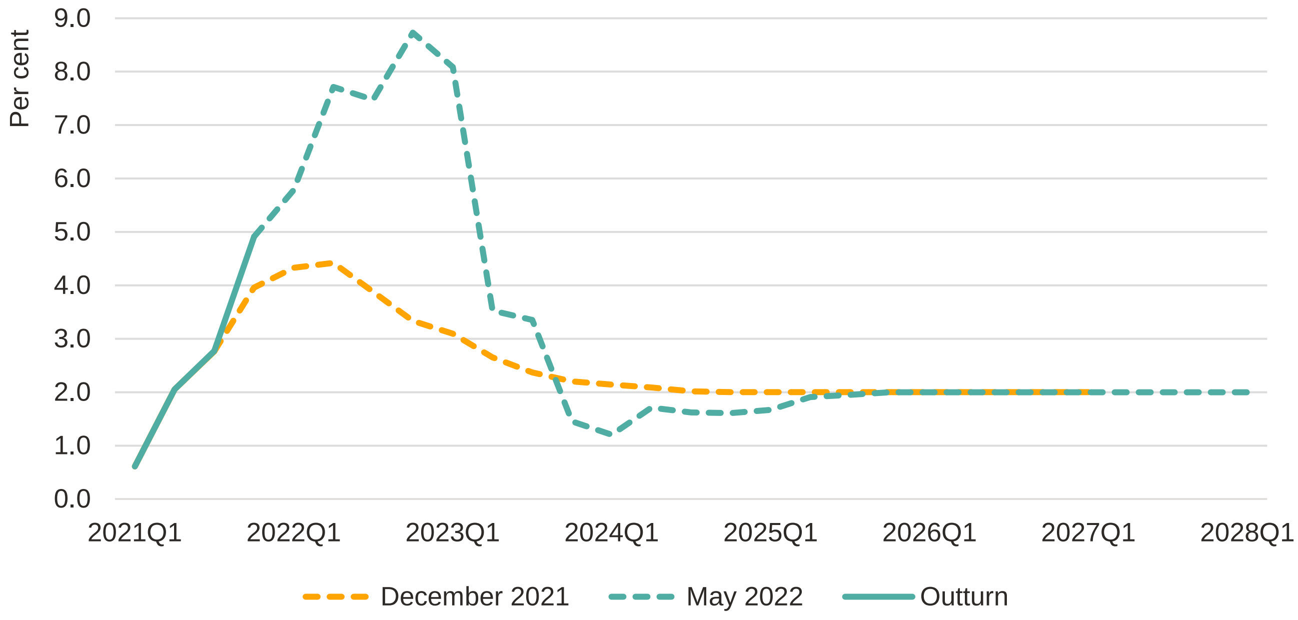
[31] Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – August 2021 (link)

Forecast risks

Risks to our inflation assumptions

3.9 Our forecast of inflation is aligned with the Office for Budget Responsibility (OBR) March 2022 UK inflation forecast and is similar to that of the Bank of England from its May 2022 Monetary Policy Report. After peaking in 2022 Q4, we expect inflation to gradually return to the 2 per cent target as energy prices stabilise, global supply bottlenecks ease, and the squeeze on real incomes and demand limits domestically generated inflation.

Figure 3.3: Consumer Price Index inflation, year-on-year growth



Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – December 2021 (link), OBR (2022) Economic and Fiscal Outlook – March 2022 (link), OBR (2021) Economic and Fiscal Outlook – October 2021 (link).
The year-on-year CPI inflation peak in 2022 Q4 of 8.7 per cent is different from the year-on-year peak for 2022-23 which is 8.0 per cent.

3.10 There are significant risks around the outlook for inflation, with consequences for the wider economic outlook.

- Inflation could be higher if global inflationary pressures intensify further because of the conflict in Ukraine and the COVID-19 lockdowns in China. Similarly, supply chain disruptions could increase and hold back investment and production by more than anticipated. This could potentially result in a period of high inflation and subdued growth.

- There is also a risk that higher inflation becomes entrenched and more persistent domestically leading to a wage-price spiral in the UK. This would require a much larger interest rate response from the Bank of England in order to re-anchor inflation expectations, with significant implications for the economy.

- Alternatively, external inflationary pressures could fall more quickly than we expect, reducing inflation and the squeeze on real incomes.

- In all these cases, output could be lower and unemployment could be higher than our central forecast, leaving the economy below trend in the medium term.

3.11 High inflation is a risk for economic growth because it erodes households' real incomes, firms' profit margins, and consumer and business confidence. We carefully considered a range of forecasts, including that by the Bank of England, and concluded that they all agree on the underlying drivers but, as happens with forecasting, take a different view as to their effects on the economy. We therefore recognise that stagnant growth or a recession are a downside risk to the forecast.

3.12 The risks around the inflation forecasts can also have significant implications for our fiscal forecasts. For example, higher levels of inflation would mean higher uprating of benefits and higher social security spending on these benefits. On the other hand, higher inflation can be positive for tax revenues in nominal terms, if rising inflation leads to higher nominal earnings, house prices, or other factors that influence our tax forecasts.

3.13 After we closed our forecasts to new data on 11 May 2022, ONS inflation data published on 18 May showed inflation continuing to rise sharply, with CPI inflation at 9 per cent over the year to April 2022. This underlines the significant uncertainty around the outlook for inflation and the economy. While the current monthly inflation data continues to be volatile, we believe our outlook for inflation remains reasonable.

Box 3.1: Rising inflation and cost of living

CPI inflation in the year to April 2022 reached 9 per cent, a 40-year high, driven by sharp rises in energy bills and the highest food price inflation in a decade. This will mean a significant fall in real incomes for many Scottish households, but lower income households are likely to be particularly severely affected.

Low-income households will tend to struggle more with rising prices as they spend more of their money on essentials including energy and food, and cannot just cut back on savings or discretionary spending to cover rising costs.

In addition, the prices of those essential items that form a greater proportion of spending for low income households are rising fast. Estimates of inflation by income groups from the Institute for Fiscal Studies and the Resolution Foundation show the bottom ten per cent earners are facing even higher inflation than the headline CPI, above 10 per cent, compared to below-average rates for the top ten per cent earners.[32]

While costs are rising, the latest HMRC PAYE mean pay data by income groups for the UK, show that the bottom ten per cent earners saw pay growth of only 0.1 per cent between February and March 2022, compared to 2.3 per cent for the top one per cent earners.[33] While some Scottish payments will see large increases, most benefits will only rise by 3.1 per cent in April 2022, based on the September 2021 CPI rate. From April 2023, payments will be uprated by the September 2022 CPI rate. In our current forecast, this would be a 7.5 per cent increase.

The package of additional measures announced by the Chancellor of the Exchequer on 26 May 2022 may help alleviate the pressures on lower income households.[34]

It is possible that the pressure higher prices are putting on household finances could drive higher take-up of both devolved social security payments and the underlying reserved qualifying benefits like Universal Credit. While we currently forecast slightly higher take-up of devolved payments in the future, any further increases will result in higher social security spending.

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[32] Institute for Fiscal Studies (2022) Inflation hits 9% with poorest households facing even higher rates (link), Resolution Foundation (2022) Cap off (link).
[33] Institute for Fiscal Studies (2022) Latest pay data confirms rise in earnings inequality (link)
[34] Institute for Fiscal Studies (2022) IFS response to government cost of living support package (link)

Risks to our COVID-19 assumptions

3.14 Chapter 1 provides a discussion of our central COVID-19 assumptions. Our central assumption is that COVID-19 levels in Scotland remain low and stable, with no legal restrictions being reintroduced, but there are downside risks to this outlook. There is a risk that a new variant of COVID-19 emerges that is resistant to current vaccines, which could lead to new public health restrictions or for the public to respond by reducing their activity and contacts with other people. Should new public health restrictions which affect economic activity be necessary, then the economic and fiscal outlook over the forecast is likely to be more negative than we currently expect.

Forecast comparisons

3.15 Figure 3.4 shows how our May 2022 forecast of GDP growth in calendar years compares to a range of other available forecasts for Scotland and the UK.

Figure 3.4: Forecast comparison, GDP growth rates in calendar years

Per cent	2021	2022	2023	2024	2025	2026	2027
Scotland: SFC May 2022	7.4	4.0	1.0	1.1	1.0	0.9	1.0
Scotland: FAI March 2022	7.4	3.5	1.5	-	-	-	-
UK: OBR March 2022	7.4	3.8	1.8	2.1	1.8	1.7	-
UK: NIESR May 2022	7.4	3.5	0.8	0.9	1.1	1.5	-
UK: BoE May 2022	7.4	3.75	-0.25	0.25	-	-	-
UK: HMT average of forecasters May 2022	7.4	3.9	1.3	-	-	-	-

Source: Scottish Fiscal Commission, Fraser of Allander Institute (2022) FAI Economic Commentary, 2022 Q1 (link), OBR (2022) Economic and Fiscal Outlook – March 2022 (link), NIESR (2022) UK Economic Outlook – May 2022 (link), Bank of England (2022) Monetary Policy Report – May 2022 (link), HM Treasury (2022) Forecasts for the UK economy: May 2022 (link).

3.16 To aid comparisons of our headline GDP forecasts in financial and calendar year terms, Figures 3.5 and 3.6 show our latest and previous forecasts of GDP growth on both annual bases.

Figure 3.5: 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	2027-28
December 2021	10.4	2.2	1.2	1.3	1.4	1.4	-
May 2022	11.6	2.1	1.1	1.0	1.0	1.0	1.0

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

Figure 3.6: SFC latest and previous forecasts, GDP growth rates in calendar years

Per cent	2021	2022	2023	2024	2025	2026	2027
December 2021	6.7	3.8	1.3	1.3	1.4	1.4	-
May 2022	7.4	4.0	1.0	1.1	1.0	0.9	1.0

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

Main judgements

Figure 3.7: Economy forecast main judgements

Issue	December 2021	May 2022
1. Spare capacity	Spare capacity was -10.7 per cent of trend GDP in 2020-21, gradually returning to zero	Spare capacity is slightly positive in the initial years of the forecast before gradually returning to zero
2. Trend productivity	Growth of 0.6 per cent in 2021-22 and 1.1 per cent in 2022-23, increasing to 1.7 per cent in 2026-27	Growth revised down over the forecast period as our estimate of trend productivity growth continues to be broadly flat and below expectations. Long-term growth similar to OBR's forecast for the UK
3. Long-run unemployment rate	4.2 per cent over the forecast period	4.1 per cent over the forecast period
4. Nominal average annual earnings	Growth of 3.8 per cent in 2021-22, boosted by compositional effects. Growth increasing from 2.6 per cent in 2022-23 to 3.4 per cent in 2026-27	Growth revised up in 2022-23 reflecting higher inflation and wage pressures from a tight labour market, and revised down in the longer term because of lower productivity growth
5. Population projections	Projections of population and migration in the year to June 2020 aligned with mid-2020 outturn estimates Scottish population aged 16 to 64 falls every year from 2020-21 onwards	Migration increased in 2021-22, including 3,000 Ukrainian displaced people in line with Scottish Government's public commitment under the 'super-sponsor' scheme. Migration kept in line with the '0 per cent net EU' scenario for 2022-23 onwards Scottish population aged 16 to 64 still falling from 2020-21 onwards
6. Forecasts of the UK	Based on OBR UK October 2021 forecast	Based on OBR UK March 2022 forecast
7. Oil and gas	North Sea oil and gas activity contributes to slower recovery in GDP, employment and earnings in Scotland than in the UK	Broadly unchanged
8. Savings ratio	Savings ratio spiked to almost 20 per cent in 2020-21, falling in 2021-22 to nearly reach its long-run average of 8 per cent	Savings ratio falls temporarily below its long-run average, as savings support consumption growth while real incomes fall
9. Second round effects	No material effect of any Scottish Government policy changes on economic growth	No change

Source: Scottish Fiscal Commission

Developments in the Scottish economy

UK Continental Shelf oil and gas activity

3.17 The oil and gas sector affects the onshore Scottish economy via demand generated by UK Continental Shelf (UKCS) activity in the onshore oil and gas supply chain, particularly via capital and operational expenditure. The UKCS is a mature basin which entered a phase of 'managed decline' in 2019. Coupled with growing uncertainty and volatility in oil prices, the industry has experienced reduced confidence and profitability.

3.18 Over the last few years, this has constrained activity and investment, with consequences for a wide range of sectors in the Scottish economy. The decline of North Sea oil and gas activity is one factor explaining slower employment and earnings growth in Scotland relative to the UK since 2016-17, and a driver of the underlying negative net position for income tax.

3.19 Over the longer term, our judgement is that declining oil and gas activity will act as a dampener, contributing to Scotland's lagging economic performance compared to the rest of the UK.

3.20 In our central forecast, we assume no effect from higher global energy prices and the energy security implications of the conflict in Ukraine on UKCS activity. In the short term, these factors could lead to modest boosts in North Sea production, investment and employment. However, this is unlikely to fundamentally shift the longer-term outlook for oil and gas production in Scotland.

Capital expenditure and employment

3.21 Since 2014, the focus of the oil and gas industry has been on cost efficiency gains to support total basin production, driven by improvements in existing facilities and infrastructure. New investment has been on a downward trajectory, and well construction activity is now at record-low levels as shown in Figures 3.8 and 3.9.

Figure 3.8: Drilling activity in the UKCS, exploration and appraisal

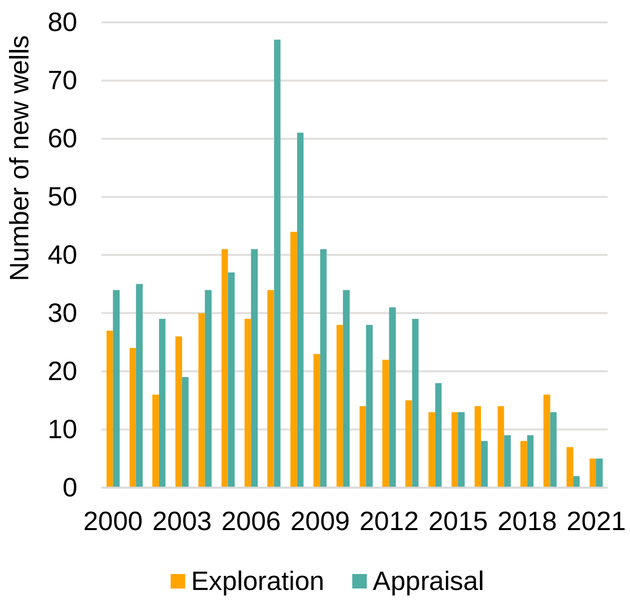
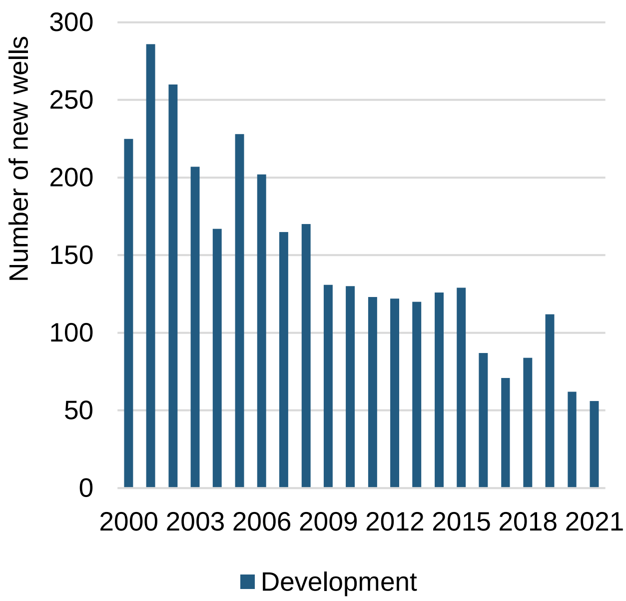


Figure 3.9: Drilling activity in the UKCS, development



Source: North Sea Transition Authority (2022) Well data – January 2022 (link)

3.22 Falling activity levels have been driven by continued capital discipline and reduced investor risk, as declining opportunities for extraction have made the UKCS less attractive and resulted in commitment only to the most valuable investment projects.

3.23 The effect of reduced activity and expenditure has also been felt in the labour market within oil and gas related sectors. Figure 3.10 shows that Oil and Gas UK (OGUK) – now Offshore Energies UK – estimates that the UK offshore oil and gas industry supported a total of 195,900 jobs in the UK during 2021 (including direct, indirect, and induced employment) and that 36 per cent of these, or 70,500 jobs, were located in Scotland. This represents a decrease in total oil and gas employment in Scotland and the UK by more than half compared to 2013 levels.

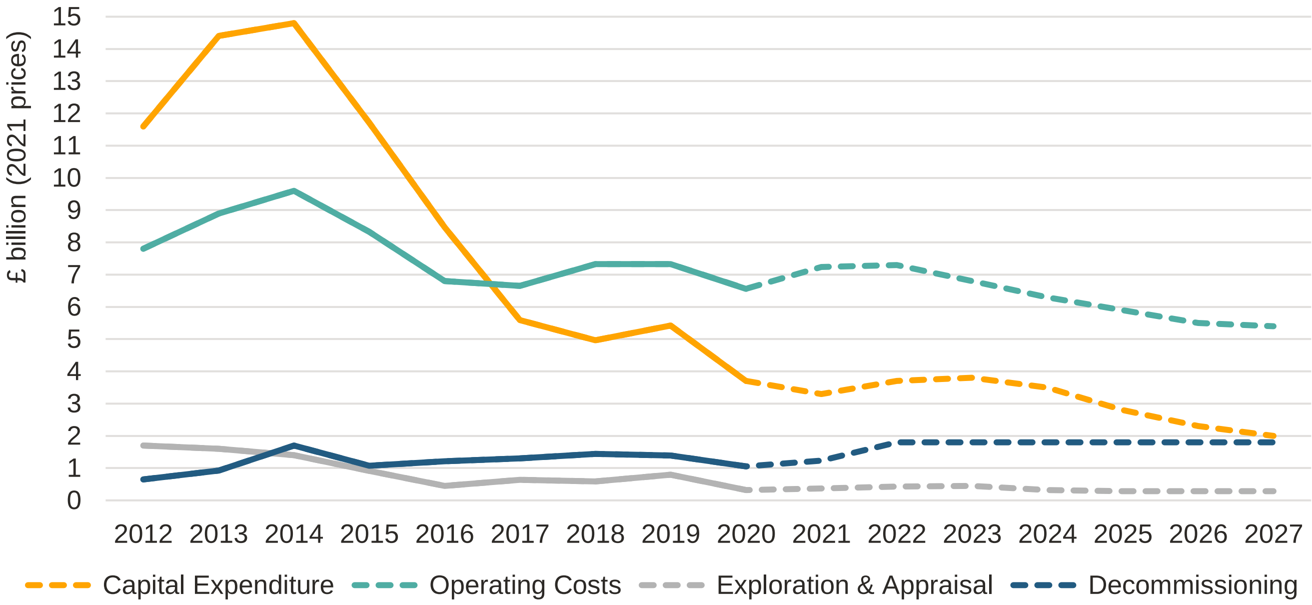
Figure 3.10: Employment supported by the offshore oil and gas industry, number of individuals

Period	2013	2013	2020	2020	2021 (OGUK forecast)	2021 (OGUK forecast)
Geography	UK	Scotland	UK	Scotland	UK	Scotland
Direct	36,600	13,900	25,700	9,300	26,900	9,700
Indirect	198,100	75,300	91,700	33,000	91,500	32,900
Induced	206,200	78,400	61,100	22,000	77,500	27,900
Total	440,900	167,600	178,500	64,300	195,900	70,500

Source: Oil and Gas UK (2021) Workforce Insight Report 2021 (link), Oil and Gas UK (2017) Workforce Report 2017(link).
Based on OGUK, Scotland's employment is derived as 38 per cent of UK figures in 2013 and 36 per cent of UK figures in 2020 and 2021.
Direct jobs are core activities directly associated with the production of oil and gas. Indirect jobs refer to workers employed in supply chain industries, who supply goods and services in support of oil and gas production. Induced jobs are those supported by income from the oil and gas sector spent in the wider economy.

3.24 Capital and operational expenditure is projected by the Oil and Gas Authority (OGA) – now North Sea Transition Authority – to fall further, potentially leading to more job losses, indicating that the oil and gas sector has not yet reached a new steady state. The latest OGA projections in Figure 3.11, which pre-date the conflict in Ukraine, show that the long-term downward trend in capital expenditure is expected to continue.

Figure 3.11: Oil and Gas Authority projections of UKCS expenditure, by category



Source: North Sea Transition Authority (2022) Projections of UK oil and gas production and expenditure – February 2022 (link)
Solid lines denote outturn.

Future prospects

3.25 Since the start of the conflict in Ukraine, the already-elevated global gas and oil prices have been very volatile, and after the invasion reached their highest levels in more than a decade. Oil price fluctuations mainly affect profits arising from UKCS production, and these profits only affect the Scottish economy if remitted to and spent in Scotland. Higher oil prices can help raise investors' confidence, but high prices would need to be sustained to affect longer-term investment decisions. Along with the maturity of the basin, we do not expect an improvement in the long run prospects for Scottish onshore oil and gas activities from higher short-term oil and gas prices.

3.26 The conflict also prompted a push for greater energy independence. The British energy security strategy published in April includes a commitment to launch a new licensing round for net zero compatible oil and gas projects this autumn and sets out plans to accelerate the transition to renewables and low carbon energy sources.[35]

3.27 This can open up new oil and gas investment in the North Sea but we do not expect it will reverse the long-run structural decline of the oil and gas industry. Any new production can take three to five years to come on stream and, because of the basin maturity, will not match the high levels of extraction seen in the past. The energy transition can create opportunities for some oil and gas workers to move into green sectors such as offshore wind, but it is unlikely that these new energy sectors will fully replace oil and gas as a source of high-paid jobs and income tax revenues.

3.28 Our view is that the structural decline in oil and gas activity will continue in future years, driving the long-term gap in employment and earnings growth between Scotland and the UK and affecting the income tax net position.

GDP and expenditure components

3.29 The medium-term outlook for overall GDP growth is weaker compared to our December 2021 forecast, partly reflecting a lower contribution from household consumption in a context of rising inflation and higher interest rates as well as a weaker global economic outlook.

3.30 Household consumption has continued to grow despite the spread of Omicron COVID-19 variant and is set to have passed its pre-pandemic level in 2022 Q1. We forecast that rising inflation, together with higher taxes from April 2022 including the new Health and Social Care Levy, will reduce real household disposable income by 2.9 per cent in 2022-23, the biggest fall since Scottish records began. We predict that consumption growth will slow but remain positive, with the savings ratio dropping temporarily below its long-run average. As well as savings being run down, the lower savings ratio captures other types of household response to higher inflation such as taking on debt.

3.31 Government spending increased significantly over the past two years in line with financial support provided to the economy while it adapted to pandemic-related restrictions. Meanwhile, government output declined in 2020-21 because of school closures and non-essential health treatments being postponed. Government output bounced back in 2021-22 with education returning to normal, the National Health Service (NHS) working through waiting lists, and testing and vaccination activity rising in response to the Omicron variant. From 2022-23 onwards, our forecasts of government consumption and investment growth are consistent with the Scottish Government's latest spending plans.

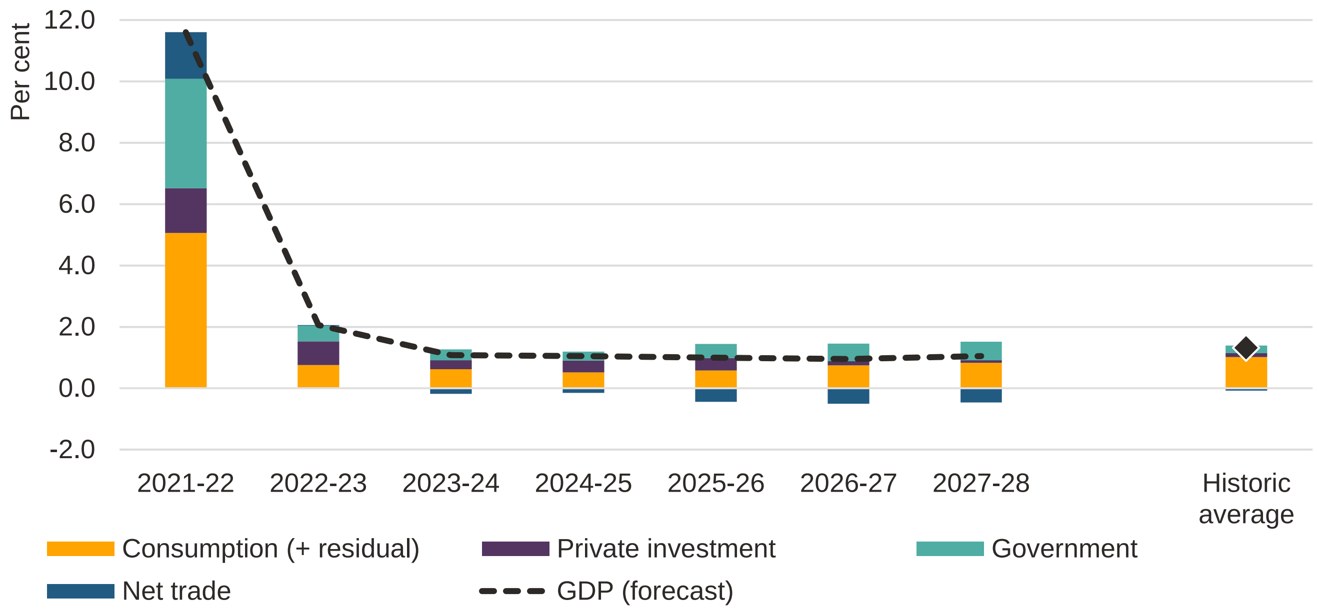
[35] British energy security strategy (link)

3.32 Business investment has been weak because of the high levels of uncertainty throughout the COVID-19 pandemic, and in the final quarter of 2021 it was still 11 per cent below its pre-pandemic level. We expect business investment to pick up in 2022-23 because of the capital allowance super-deduction announced in the UK Budget in March 2021.[36] Based on UK survey evidence, and in line with OBR, we now assume that less capital spending is being brought forward by the super-deduction than we anticipated in December 2021, as supply bottlenecks are holding back investment. This, however, affects the timing rather than the overall amount of business investment taking place over the medium term, which is broadly similar to our December 2021 forecast.

3.33 The contribution from net trade in 2022-23 was negative in December 2021 but is now broadly neutral, as weaker domestic demand and higher import prices lead to lower import growth. In the coming years, we expect net trade to detract slightly from GDP growth.

3.34 Figure 3.12 shows the contributions of each of the components to growth in GDP.

Figure 3.12: Contributions by component of expenditure to growth in GDP



Source: Scottish Fiscal Commission, Scottish Government (2022) GDP Quarterly National Accounts (QNA): 2021 Quarter 4 (October to December) (link).
Historical average is based on growth from 1999-00 to 2019-20. Private investment includes business and housing investment.

Long-run outlook

3.35 Longer term, Scotland faces fundamental challenges in raising its trend GDP growth. Trend GDP is based on the size of the labour force, the capacity of the economy to allocate labour, and advances in technology, working practices and human and physical capital that drive productivity growth.

3.36 As we discussed in Box 3.1 of our December 2021 forecast report, we expect a decline in the size of Scotland's labour force over the forecast period.[37] This is because of a falling labour market participation rate coupled with slowing adult population growth.

[36] Measure which enables expenditure on qualifying new plant and machinery to temporarily benefit from a 130 per cent capital allowance.
[37] Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – December 2021 (link)

3.37 The economic activity rate is falling mainly because the population is aging, which puts downward pressure on the average participation rate. This has been compounded by a marked slowdown in the growth of the participation rate of those aged 65 and above, as the uplift from increasing state pension age diminishes, and a decline in the participation rate of those aged 16 to 24 reflecting growing enrolment in tertiary education. The pandemic has exacerbated the declining trend in the participation rate, with more people in both Scotland and the UK becoming inactive because of early retirement, long-term sickness, or being in full-time education, although the rising cost of living might encourage some people back into the workforce.[38]

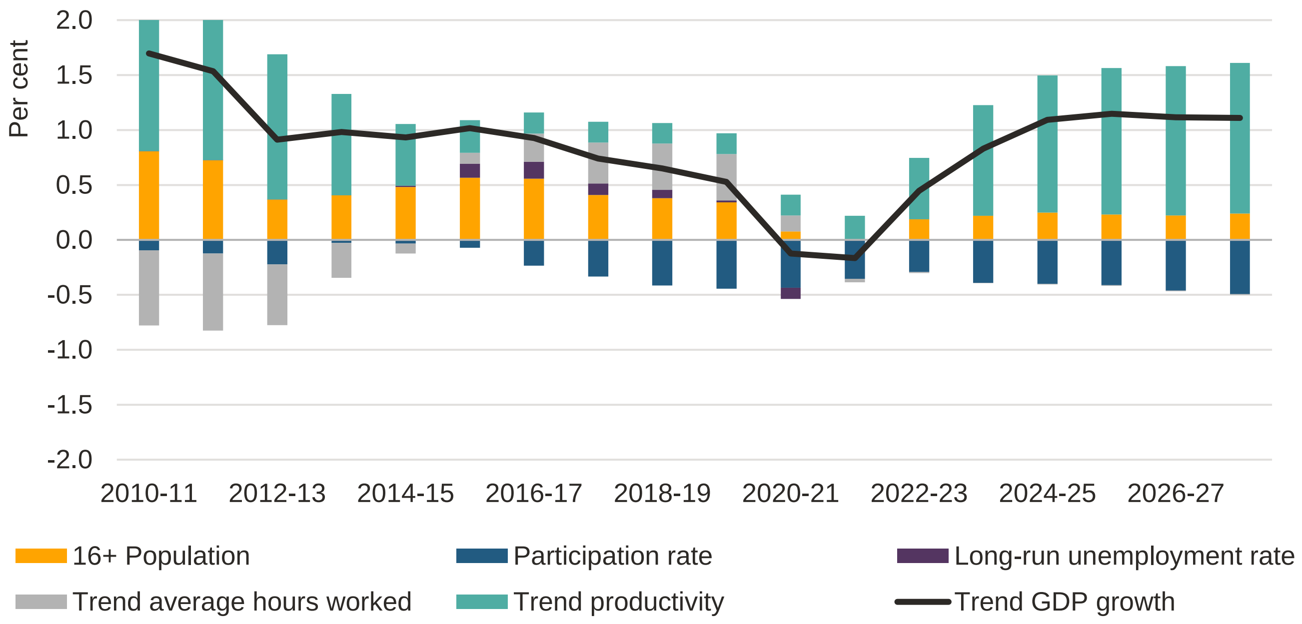
3.38 Looking at the employment capacity of the economy, we have lowered the long-run rate of unemployment from 4.2 per cent to 4.1 per cent. This is mainly because the unemployment rate has remained low despite the end of the furlough scheme.

3.39 Productivity growth has stalled in Scotland since 2015. Challenges to productivity growth in Scotland include the decline of the North Sea oil and gas sector, regional disparities with productivity in Edinburgh 35 per cent higher than Glasgow, and low business investment. Upside factors include strong finance and energy sectors, one of the most educated workforces in the OECD, and an internationally competitive research and development spend.[39]

3.40 We expect productivity growth to pick up over the medium term, reaching 1.0 per cent in 2023-24 on its way to a steady state growth of 1.4 per cent by 2026-27, similar to that of the OBR's forecast for the UK.

3.41 With the long-run employment rate and average weekly hours worked stable, productivity is the main driver of growth of the economy in the medium to long term, as shown in Figures 3.13 and 3.14.

Figure 3.13: Trend GDP growth and contribution of components, 2010-11 to 2027-28



Source: Scottish Fiscal Commission

[38] Fraser of Allander Institute (2022) Trends in Economic Activity (link), Resolution Foundation (2022) The Living Standards Outlook 2022 (link).
[39] The Productivity Institute (2021) Scotland Productivity Forum (link)

Figure 3.14: Trend GDP growth and contribution of components, 2020-21 to 2027-28

Year (growth in per cent)	Trend GDP growth	16+ population	16+ participation rate	Long-run unemployment rate	Trend average hours worked	Trend productivity
2020-21	-0.1	0.1	-0.4	-0.1	0.1	0.2
2021-22	-0.2	0.0	-0.4	0.0	0.0	0.2
2022-23	0.4	0.2	-0.3	0.0	0.0	0.6
2023-24	0.8	0.2	-0.4	0.0	0.0	1.0
2024-25	1.1	0.2	-0.4	0.0	0.0	1.2
2025-26	1.1	0.2	-0.4	0.0	0.0	1.3
2026-27	1.1	0.2	-0.5	0.0	0.0	1.4
2027-28	1.1	0.2	-0.5	0.0	0.0	1.4

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

3.42 Figure 3.15 shows that, comparing our forecasts to the OBR's, Scotland has lower population growth and a steeper decline in the labour force participation rate than the UK, resulting in lower GDP growth over the longer term.

3.43 As we discussed in our December 2021 forecast report in Box 3.1, 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.[40] This has important implications for our forecasts of the economy and also for Scottish tax revenues.

Figure 3.15: SFC and OBR trend GDP growth and contribution of components in 2026-27

Forecast (growth in per cent)	Trend GDP growth	16+ population	16+ participation rate	Long-run unemployment rate	Trend average hours worked	Trend productivity
SFC May-22	1.1	0.2	-0.5	0.0	0.0	1.4
OBR Mar-22	1.8	0.5	-0.1	0.0	0.0	1.3
Gap	-0.6	-0.3	-0.4	0.0	0.0	0.0

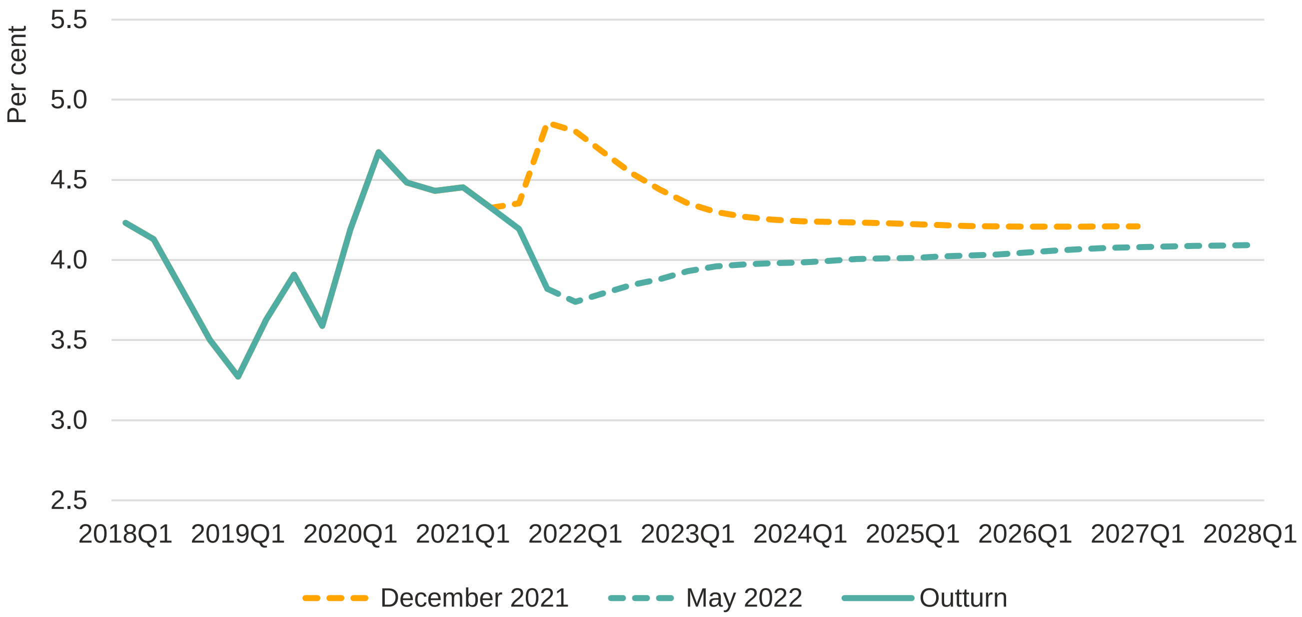
Source: Scottish Fiscal Commission, OBR (2022) Economic and Fiscal Outlook – March 2022 (link).
Figures may not sum because of rounding. Potential output growth is approximately equal to the sum of the growth rates of population, employment rate, average hours and productivity.

Labour market

3.44 The unemployment rate proved resilient to the end of the furlough scheme on 30 September 2021 and the predicted rise in the final quarter of 2021 did not materialise. The unemployment rate fell to a near-record low of 3.8 per cent in 2021 Q4, 1.0 percentage points lower (or 29,000 fewer people) than we forecast in December 2021. We expect the unemployment rate to fall further in the first quarter of 2022 before rising towards its long-run rate of 4.1 per cent over the forecast period.

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

Figure 3.16: Unemployment rate, outturn and forecast



Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – December 2021 (link), ONS (2022) HI11 Regional labour market: Headline indicators for Scotland – April 2022 (link).

3.45 Total employment remains below its pre-COVID level over the forecast horizon as a result of lower self-employment and lower labour market participation. Some of the reduction in self-employment is because of self-employed workers reclassifying into payroll jobs, partly in response to IR35 legislation changes.[41] This is likely to have boosted the number of payrolled employees, which has increased steadily over the last year and is now above its pre-pandemic level.

3.46 Longer term, we expect a decline in the size of Scotland's labour force over the forecast period and falling employment from 2023 onwards, because of a declining labour market participation rate coupled with slowing adult population growth.

Earnings

3.47 Nominal average earnings growth has strengthened further since December 2021 in line with an increasingly tight labour market, driven by a combination of record-high vacancies in the wake of the pandemic and a shrinking labour force. A significant rise in voluntary job-to-job moves, as workers gained confidence after the economic reopening, has added to employer concerns over staff recruitment and retention, putting upward pressure on starter salaries and pay settlements.[42]

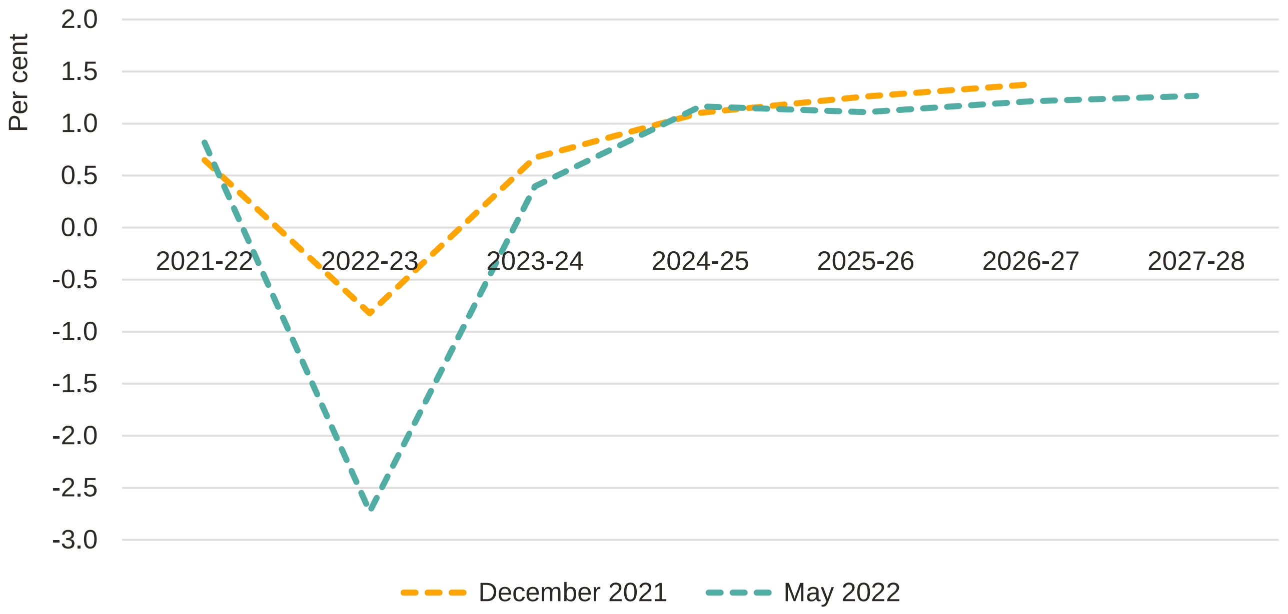
3.48 Reflecting tighter labour market conditions and rising inflation, we now expect nominal earnings to grow by 4.1 per cent in 2022-23, 1.5 percentage points faster than we forecast in December 2021. Nominal earnings growth falls back to 3.3 per cent by 2027-28, consistent with productivity growth and lower inflation.

3.49 Despite strong pay growth this year, nominal earnings are not expected to keep pace with rising inflation, much of which is externally generated. This means real earnings are set to fall sharply in 2022-23, before recovering to growth of 1.3 per cent by the end of the forecast as inflation eases.

[41] Resolution Foundation (2022) Labour Market Outlook Q1 2022 (link)

[42] NatWest Group (2022) Royal Bank of Scotland Report on Jobs – March 2022 (link), Bank of England (2022) Agents' summary of business conditions – 2022 Q1 (link).

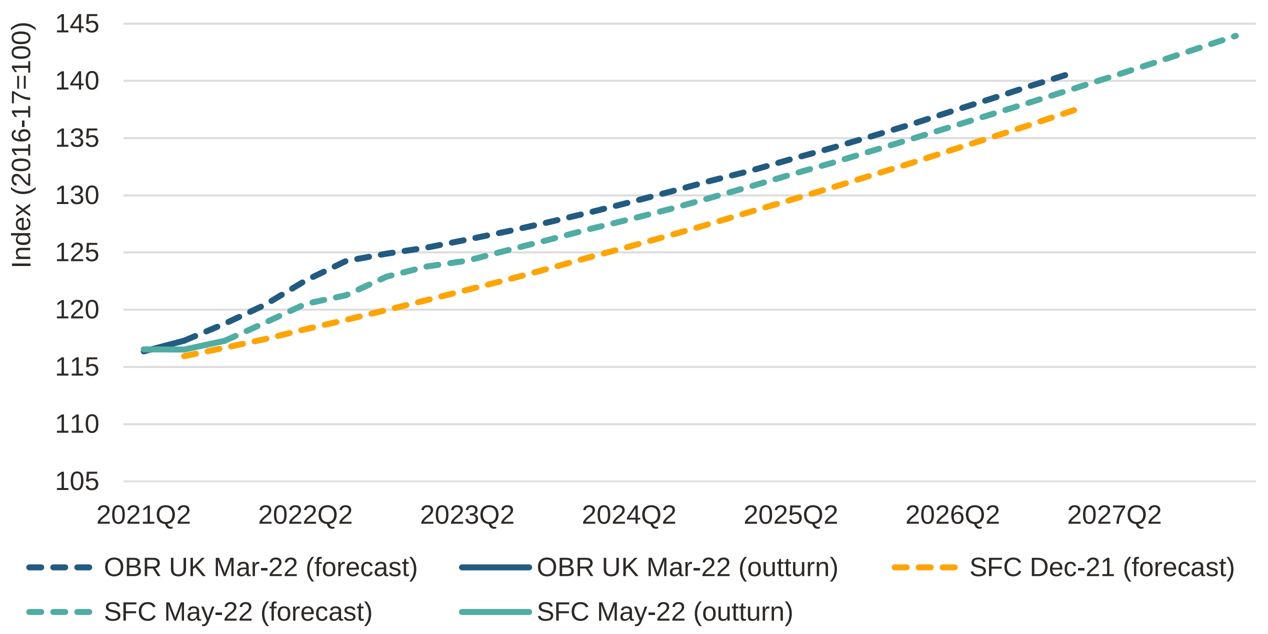
Figure 3.17: Real average earnings growth



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

3.50 Figure 3.18 shows cumulative growth in nominal average earnings in Scotland and the UK since 2016-17, a main driver of relative income tax revenue growth, including our forecast and the OBR's for the UK. As we discussed in our December 2021 forecast report, Scotland's growth has typically been slower than in the UK, contributing to the underlying negative income tax net position.[43] As shown in Figure 3.18, we expect this gap to persist over the forecast horizon.

Figure 3.18: Cumulative growth in nominal average earnings since 2016-17, Scotland and UK



Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – December 2021 (link), OBR (2022) Economic and Fiscal Outlook – March 2022 (link).

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

3.51 Box 3.2 explores regional and sectoral variation in HMRC Real Time Information (RTI) mean pay data and discusses the main factors behind slower average earnings growth in Scotland, both since 2016-17 and over the last two years.

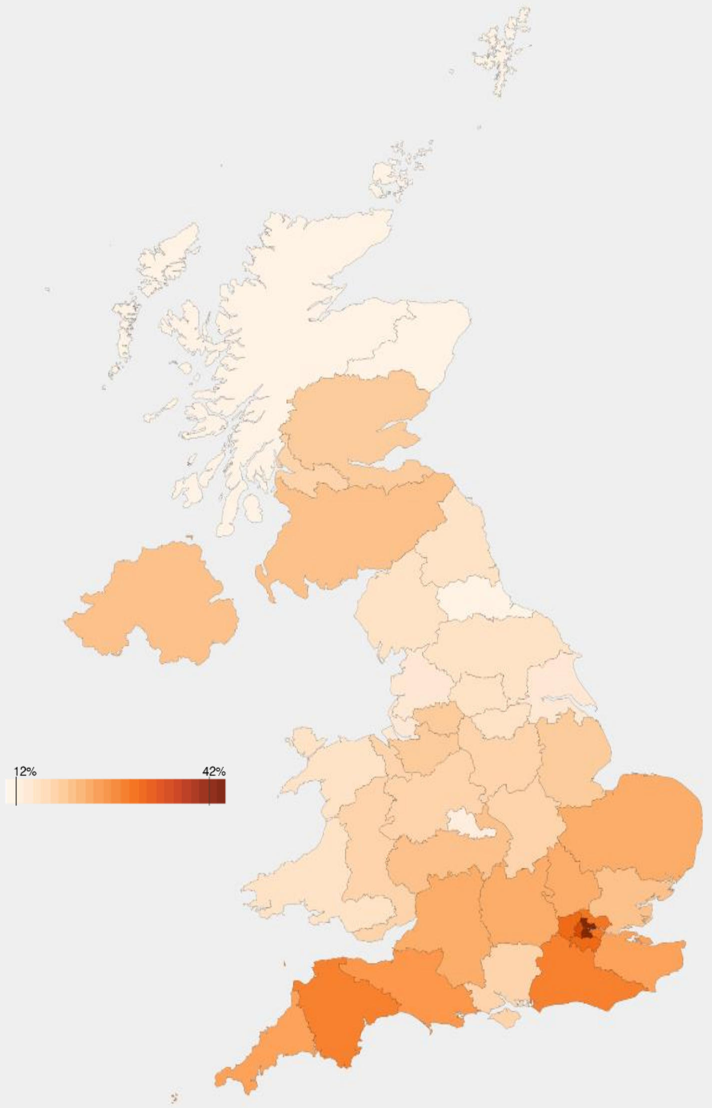
Box 3.2: Regional and sectoral RTI mean pay data

Between 2016-17 and 2019-20, we saw Scottish nominal mean pay growing more slowly than in the UK. Since the start of the pandemic, this gap has widened further, and by more than we had anticipated.

The RTI regional analysis in Figure 3.19 shows that Scotland's slower mean pay growth since 2016-17 can be explained by the relative underperformance of the North East of Scotland combined with significantly higher pay growth in London.

Scotland's mean pay growth since 2016-17 (21 per cent) is similar to that of other UK regions such as the North East of England and Wales, but lags behind that of the UK as a whole (26 per cent) with the gap being driven by strong earnings growth in London (34 per cent). In addition, mean pay in the North East of Scotland, its highest-wage region in level terms, has grown by only 16 per cent since 2016-17.

Figure 3.19: Growth in RTI mean pay since 2016-17 by region of the UK



Source: Scottish Fiscal Commission, ONS (2022) Earnings and employment from Pay As You Earn Real Time Information, seasonally adjusted – May 2022 (link).

Figures 3.20 and 3.21 highlight the main drivers of the widening in the Scotland-UK gap in mean pay growth since the start of the pandemic.

One factor behind London's over-performance since the start of the pandemic is significantly stronger earnings growth in the highly-paid financial services sector. This has been boosted by strong bonus pay growth, especially for high earners in the sector.[44]

By contrast, earnings growth in the mining and quarrying sector (part of the oil and gas supply chain) has been relatively weak in Scotland over the last six years and since the start of the pandemic. This acts as a drag on Scotland's pay growth given the importance of oil and gas related activities to the Scottish economy.

Figure 3.20: Growth in RTI mean pay since 2016-17

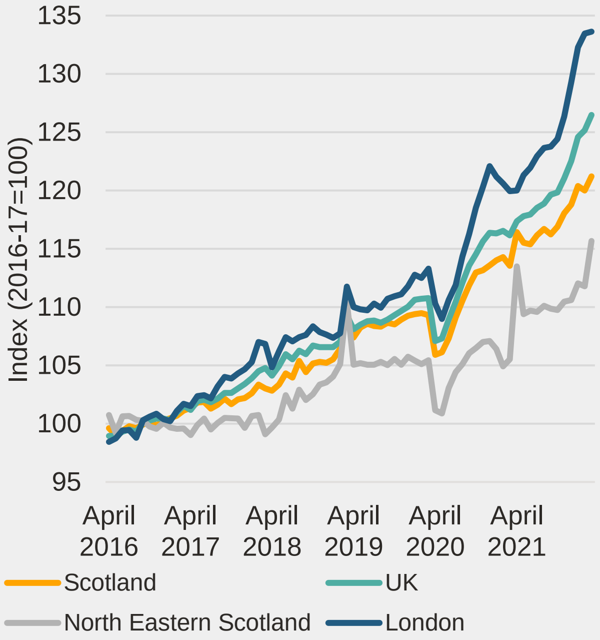
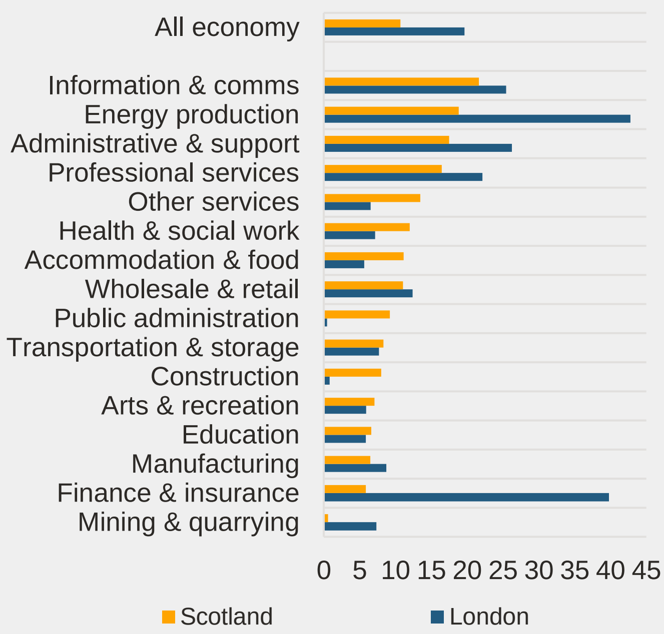


Figure 3.21: Per cent change in RTI mean pay between 2019 Q4 and 2022 Q1



Source: Scottish Fiscal Commission, ONS (2022) Earnings and employment from Pay As You Earn Real Time Information, seasonally adjusted – May 2022 (link).
In Figure 3.21, sectors are ordered based on Scotland's mean pay growth from highest to lowest. The sectoral breakdown in the RTI data is based on the UK Standard Industrial Classification code for each PAYE enterprise.

[44] Institute for Fiscal Studies (2022) Return of bumper pay growth in finance fuels new rise in earnings inequality (link)

Chapter 4
Tax

Overview

4.1 In this chapter we present our tax forecasts and discuss the effect they have on the Scottish Budget. We summarise our tax forecasts in Figure 4.1, and show changes from December 2021 in Figure 4.2.

Figure 4.1: Summary of tax forecasts

£ million	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Income tax	13,342	14,386	15,143	15,954	16,754	17,484	18,298
Non-Domestic Rates	1,966	2,770	3,333	3,276	3,323	3,651	3,601
Land and Buildings Transaction Tax	799	797	821	849	886	932	987
Of which: Residential	549	528	541	560	588	624	669
Non-residential	251	269	280	289	298	308	319
Scottish Landfill Tax	128	121	95	94	75	16	17
Total	16,235	18,073	19,391	20,173	21,038	22,084	22,904

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

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

£ million	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
Income tax	340	715	829	898	965	1,039
Non-Domestic Rates	-117	-40	100	109	92	132
Land and Buildings Transaction Tax	79	48	25	10	5	9
Of which: Residential	43	5	-20	-36	-41	-37
Non-residential	36	43	45	45	46	46
Scottish Landfill Tax	4	21	12	9	5	-1
Total	306	743	965	1,026	1,066	1,178

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

4.2 We expect devolved Scottish taxes to raise £18.1 billion of revenue in 2022-23, an upward revision of £743 million since our December 2021 forecasts. We have seen higher inflation since the winter, mostly driven by the increase in the Ofgem energy price cap and higher global energy prices following the conflict in Ukraine. This has led us to revise up our forecasts of nominal household incomes, one of the main determinants in our tax forecasts.

4.3 We have changed our baseline assumptions for the income tax higher rate threshold and now assume it will remain fixed across the forecast horizon. This change increases our income tax forecasts by £1,243 million across the forecast horizon and has the largest effect in later years. We provide further discussion on this assumption change in the income tax section of this chapter.

4.4 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, leading to growth in tax revenues above growth in the tax base. We discussed this effect in our December 2021 Scotland's Economic and Fiscal Forecasts publication.[45]

Tax forecasts and the funding outlook

4.5 For income tax, Land and Building Transaction Tax (LBTT) and Scottish Landfill Tax (SLfT), we must consider our tax forecasts 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. We explain how funding is calculated in our occasional paper, Funding for the Scottish Budget.[46]

4.6 The net position shows how much funding the Scottish Government is receiving from Scottish tax revenues compared to the BGAs. Figure 4.3 shows the net position for income tax, LBTT and SLfT.

Figure 4.3: 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	12,293	13,684	14,813	15,502	15,883	16,737	17,534
Scottish revenue	11,833	12,118	13,342	14,386	15,143	15,954	16,754	17,484
Net Position	148	-175	-342	-428	-359	71	18	-50
LBTT								
BGA	533	397	651	716	741	772	807	854
Scottish revenue	597	517	799	797	821	849	886	932
Net Position	64	120	148	81	80	77	79	78
SLfT								
BGA	99	87	86	81	81	75	69	76
Scottish revenue	119	107	128	121	95	94	75	16
Net Position	20	20	41	41	14	19	6	-59
Total taxes								
Net position	233	-35	-153	-306	-265	167	103	-31

Source: Scottish Fiscal Commission, Scottish Government.
Shaded BGA and Scottish revenue values show outturn. Figures may not sum because of rounding.
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 raises.

4.7 The LBTT net position remains positive in all years of the forecast, with Scottish tax revenues exceeding the BGA. The SLfT net position is positive up to 2025-26. We have forecast SLfT revenues to be much lower from 2026-27 because the Scottish Government plans to implement the

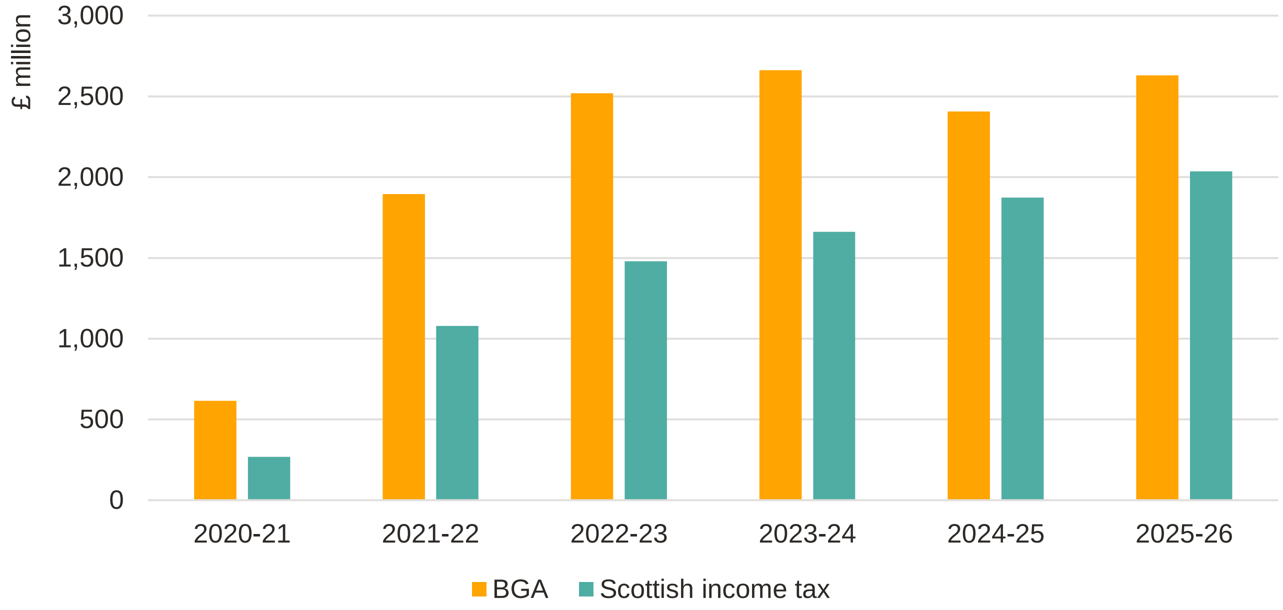
[45] Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – December 2021, Box 4.1 (link)
[46] Scottish Fiscal Commission (2021) Funding for the Scottish Budget (link)

ban on landfilling biodegradable municipal waste (BMW) by December 2025. This means there is a negative net position for SLfT from 2026-27.

The income tax net position and reconciliations

4.8 The Coronavirus (COVID-19) pandemic introduced significant uncertainty to forecasting. We and the OBR initially made significant downward revisions to our forecasts compared to pre-pandemic. We do not have income tax outturn data for 2020-21, but the available RTI data suggest income tax revenues in both Scotland and the UK have performed better during the pandemic than we had initially thought, particularly in 2021-22.[47] Figure 4.4 shows revisions in the income tax BGAs and our Scottish income tax forecasts since our first pandemic-based forecasts in November 2020 and January 2021, respectively. We and the OBR have been revising up our income tax forecasts since the start of the pandemic. However, the available data suggest income tax revenues have been growing relatively more strongly in the UK as a whole than in Scotland in 2020-21 and 2021-22. This has significant implications for the income tax net position and reconciliations.

Figure 4.4: Income tax BGA and SFC income tax forecast revisions over the pandemic period



Source: Scottish Fiscal Commission, Scottish Government.
The figure shows revisions to the income tax BGA comparing the OBR's March 2022 forecast to its November 2020 forecast. Scottish income tax forecast revisions compare our latest May 2022 forecast to our January 2021 forecast.

4.9 The income tax net position compares the amount gained by the Scottish Budget from income tax revenues to the amount deducted from the Scottish Budget by the income tax BGA. 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.

4.10 Figure 4.5 shows confirmed income tax reconciliations for the collection years where we have outturn data available. It also shows indicative estimates for collection years where outturn data are not yet available. We can derive indicative estimates of future income tax reconciliations by comparing our latest forecasts to the latest BGA forecasts.

[47] HM Revenue and Customs and Office for National Statistics(2022) Earnings and employment from Pay As You Earn Real Time Information, non-seasonally adjusted (link)

Figure 4.5: Outturn and indicative estimates of income tax reconciliations

Collection year	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23
Applies to Budget for	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Reconciliation (£ million)	-204	-309	-34	-221	-817	-238

Source: Scottish Fiscal Commission, Scottish Government, HMRC (2021) Annual Reports and Accounts (link).
Shaded cells refer to outturn available at time of publication.

4.11 In line with the available data, OBR has revised up its forecasts of UK income tax revenues by more than our forecasts of Scottish income tax revenues. This has led to expected negative income tax reconciliations over the next three years.

The reconciliation for 2021-22

4.12 Forecasts currently indicate a very large negative reconciliation for 2021-22 of -£817 million which will be applied to the 2024-25 Scottish Budget. Figure 4.6 shows how forecasts of Scottish income tax revenues and the BGA have changed since the 2021-22 Scottish Budget was set based on our January 2021 forecasts.

Figure 4.6: Scottish income tax (SIT) revenue forecast and BGA for 2021-22

£ million	Budget setting	Latest	Total Change
SIT	12,263	13,342	1,078
BGA	-11,788	-13,684	-1,896
Net position	475	-342	-817

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

4.13 Figure 4.6 shows our forecasts of Scottish income tax revenues in January 2021 were significantly larger 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, and the outlook changed 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.".[48]

4.14 In our December 2021 forecast, we warned that because of timing differences, the high income tax net position was somewhat artificial and the true net position was likely to be lower resulting in a large negative reconciliation in the future.

4.15 By including near complete RTI data for 2021-22 in our forecast, we have revised up our estimate of 2021-22 income tax revenues by £1,078 million compared to our budget setting forecast published in January 2021. However, the OBR has also revised its forecasts for 2021-22, increasing the BGA by £1,896 million. Overall, this has shifted the estimated net position from +£475 million to -£342 million, with an anticipated reconciliation of -£817 million to be applied in 2024-25. The reconciliation will be confirmed once HMRC publish outturn data for 2021-22 in summer 2023.

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

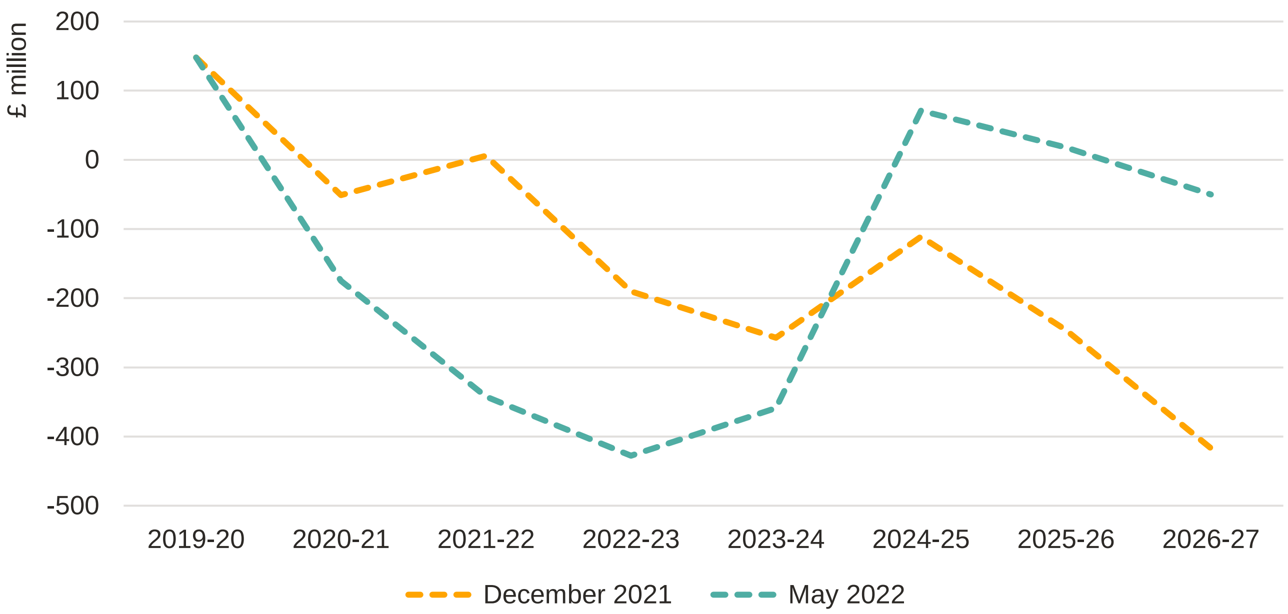
4.16 In summary, the large reconciliation is the result of two factors:

- The artificially high net position when the 2021-22 was set because of forecast timing differences and COVID-19 uncertainty.
- The unexpected very strong relative growth in UK income tax revenues in 2021-22.

The income tax net position

4.17 Figure 4.7 shows the implied net position in our December 2021 and May 2022 forecasts. Following strong UK data in 2020-21 and 2021-22 and accompanying BGA revisions, the net position has moved in a negative direction from 2020-21 to 2023-24.

Figure 4.7: The implied income tax net position



Source: Scottish Fiscal Commission

4.18 Baseline policy adjustments and announced policy changes also have a significant effect on the profile of the net position. From 2023-24 we now assume the higher rate threshold in Scotland remains frozen as part of our forecast baseline. The freeze raises additional income tax revenues in Scotland and shifts the net position in a positive direction in 2023-24 and beyond. We explain this change in detail in the income tax section.

4.19 The UK Government has announced a cut in the basic rate of income tax to 19 per cent in the UK. This reduces forecast income tax revenues in the UK, which reduces the size of the income tax BGA, and therefore also shifts the net position in a more positive direction.

4.20 As in December 2021, if we were to strip out the effect of changes in Scottish and UK rates and thresholds, the underlying income tax net position would be continuing to head in a negative direction for Scotland. However, the cumulative effect of policy divergences is to return the net position to near zero in 2024-25 onwards. We intend to publish further analysis later this year showing how divergent economic performance and different policy changes have all contributed to the latest forecast income tax net position.

Non-Domestic Rates

4.21 Non-Domestic Rates (NDR) operate from a separate account, called the Non-Domestic Rating Account or NDR pool. NDR revenue 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. We provide full details on how NDR funding works in our occasional paper, Funding for the Scottish Budget.[49]

4.22 We forecast the contributable amount of NDR, which is 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.

4.23 The Scottish Government use our forecast to inform the decision about how much will be distributed to local authorities in the year ahead. The Scottish 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
- the estimated adjustments to be carried over from the year before
- the amount forecast to be raised in the year ahead

4.24 The distributable amount for 2022-23 was set at £2,766 million in December 2021. This will remain fixed until the 2023-24 Scottish Budget and means that the Scottish Government do not need to manage any NDR forecast error during the year. Figure 4.8 shows our estimate of the NDR pool balance based on the latest information.

4.25 The Scottish Government plans to bring the account back into balance by 2024-25. The cumulative balance peaks at -£285 million at the end of 2022-23, and is then reduced to £0 million by 2024-25. From 2025-26 onwards, the Government plans to match the distributable amount to our forecast of the contributable amount.

4.26 Local authorities initially notified the Scottish Government that their total Provisional Contributable Amount for 2021-22 was going to be £2,062 million. However, this total was reduced in-year by £8 million following an agreed downward calculation of the amount contributed by one local authority.[50] This produced the current figure of £2,054 million.

[49] Scottish Fiscal Commission (2021) Funding for the Scottish Budget (link)
[50] This recalculation was because of a revaluation appeal resulting in a decrease of in-year income and an increase in refunds of overpaid rates.(link)

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

£ million	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Provisional contributable amount (A)	2,054	2,770	3,333	3,276	3,323	3,651	3,601
Net effect of prior year adjustments (B)	-104	-88	0	0	0	0	0
Distributable amount (C)	2,090	2,766	3,190	3,134	3,323	3,651	3,601
Annual balance (D) (A + B – C)	-140	-85	142	142	0	0	0
Cumulative balance (E) (Previous year E + current year D)	-200	-285	-142	0	0	0	0

Source: Scottish Fiscal Commission, Scottish Government.
Shaded cells refer to outturn at the time of publication. Figures may not sum because of rounding.
The provisional contributable amount for 2021-22 has been adjusted to incorporate late data updates from 2020-21.
The projected balance is provisional because at time of publication, we do not have the audited NDR income figures for 2020-21. Projected balance 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'.

4.27 The audited balance of the pool will be determined by our forecast accuracy. It will also be determined by the difference between the start of year estimates provided by local authorities to the Government in April and the final audited NDR income returns for the financial year. Figure 4.8 shows the start of year estimates as the provisional contributable amounts. The difference is termed the prior year adjustment.

4.28 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 if local authorities report a high level of collection in their start-of-year estimates, then the balance of the pool could be positive despite our projection of a negative balance.

Income tax

Forecast

4.29 We have revised our income tax forecast up significantly compared to December 2021. We forecast an average increase in revenues of £889 million from 2022-23 onwards, which is driven mainly by improvements in the outlook for the economy and an adjustment in our baseline assumptions on the higher rate threshold.

Figure 4.9: 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	2027-28
Revenue	11,833	12,118	13,342	14,386	15,143	15,954	16,754	17,484	18,298

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

Changes since December 2021

Figure 4.10: Change in NSND income tax revenue since December 2021

£ million	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
December 2021	11,938	13,002	13,671	14,313	15,056	15,790	16,445
Baseline change	-	-	0	129	246	364	503
Economy	16	155	589	507	435	384	317
RTI	-76	-12	86	90	95	99	103
Model change	60	105	26	68	71	75	79
SA settlement	180	90	-	-	-	-	-
UK policy	-	1	13	35	51	43	36
May 2022	12,118	13,342	14,386	15,143	15,954	16,754	17,484
Change since December 2021	180	340	715	829	898	965	1,039

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

4.30 We have revised up our forecasts for economy earnings and employment since our December 2021 forecast. This leads to increases in revenues in all years of the forecast. The increase in revenues is highest in 2022-23 where our estimate of the growth in nominal total earnings is revised up the most from our December 2021 forecast. The size of the revision declines in later years, as the growth in earnings returns to pre-pandemic rates. Employment growth is around 1.5 per cent in 2021-22 to 2022-23 and this increases liabilities although the effect becomes lower in later years as employment gradually declines.

4.31 We do not receive outturn data on self-assessment (SA) tax revenue until it is published by HMRC.[51] Normally, we assume that tax paid via self-assessment grows in line with PAYE, for which we

[51] HM Revenue and Customs (2021) Scottish Income Tax Outturn Statistics: 2019 to 2020 (link)

receive monthly RTI data from HMRC.[52] However, we expect self-assessment tax revenue to have grown more quickly in 2020-21 and 2021-22 than the RTI data predict for PAYE.

4.32 HMRC data on whole of UK self-assessment payments show strong growth in 2021-22. In addition, we know that a large amount of Self Employment Income Support Scheme payments were made in 2020-21 and 2021-22, which would have supported incomes in these years.[53] We also know the OBR revised up its forecasts of UK income tax liabilities in 2020-21 and 2021-22 driven by an expectation of higher growth in self-assessment revenues.[54] Overall, we have added £180 million to our income tax revenue forecast in 2020-21 and £90 million in 2021-22 to reflect higher expected income tax self-assessment revenues in these years.

UK Government policy

4.33 A change to National Insurance (NI) was introduced at the UK Spring Statement. The primary threshold and lower profit limit will be aligned with the income tax primary threshold from July 2022. This change will reduce NI contributions paid by Scottish taxpayers but has no impact on the income tax forecast.

4.34 The OBR March 2022 forecast notes indirect impacts from broader Spring Statement measures which increase Scottish income tax revenues by between £35 million and £51 million in the later years of the forecast.

Change to our higher rate threshold baseline assumption

4.35 We now assume that the higher rate threshold will remain fixed at its current value of £43,662, rather than rising in line with inflation. This section explains the background to this change in judgement, and shows the effect on our forecast.

4.36 The Scottish Government typically sets income tax policy one year ahead. To forecast income tax revenues more than one year ahead, we need to make assumptions about future tax rates and thresholds. We call this our forecast policy baseline. When the Government sets income tax policy, we compare the Government's policy to our baseline, and show the effect of any differences between our assumptions and the set policy, which we refer to as a policy costing.

4.37 We described the general process of forming our forecast baselines in our 2019 occasional paper Approach to policy costings.[55] For Scottish income tax, there is no legislative basis describing how thresholds should change over time, and so we based our assumptions on our understanding of the Government's policy intentions and historic precedent. As Scottish income tax was only devolved in 2017-18, the historic precedent was largely based on the behaviour of UK income tax policy prior to devolution.

4.38 It would be unhelpful and inappropriate to change our forecast baseline assumptions regularly, as this would introduce volatility into our forecasts and create uncertainty about our views on the direction of policy. However, we do need to ensure our forecast baseline remains appropriate. Now that we have provided forecasts alongside five successive Scottish Budgets, we feel it is an appropriate time to revisit our assumption about the Scottish higher rate threshold.

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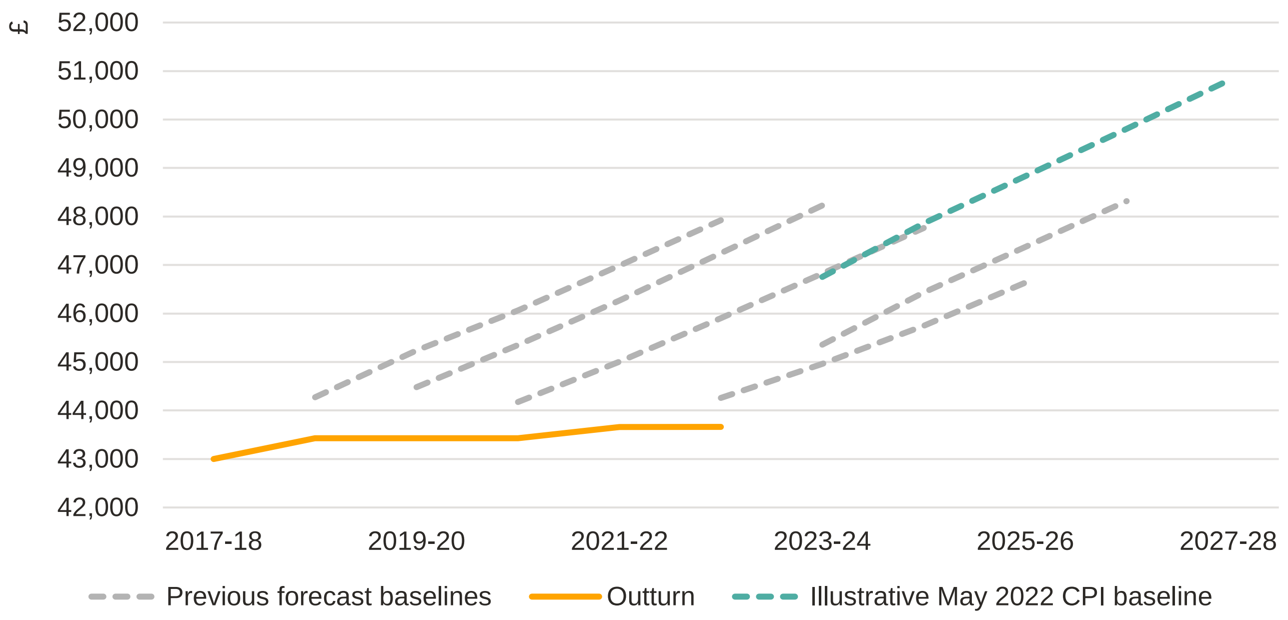
[52] HM Revenue and Customs (2022) Earnings and employment from Pay As You Earn Real Time Information, non-seasonally adjusted (link)
[53] HM Revenue and Customs (2021) Self-Employment Income Support Scheme statistics: December 2021 (link)
[54] Office for Budget Responsibility (2022) Devolved tax and spending forecasts (link)
[55] Scottish Fiscal Commission (2019) Approach to Policy Costings (link)

4.39 Since our first forecast in December 2017 we have assumed the higher rate threshold in Scotland would rise in line with inflation. This was primarily based on pre-devolution UK practice, as well as an interpretation of the Scottish national Party (SNP) 2016 and 2021 election manifesto commitments to increase the higher rate threshold by a maximum of inflation.[56] Figure 4.11 shows how the higher rate threshold has changed relative to our forecast baseline assumptions at each Budget forecast.

Figure 4.11: SFC higher rate threshold baseline assumptions and outturn



Source: Scottish Fiscal Commission

4.40 The higher rate threshold in Scotland has mostly been frozen since 2017-18, with only two small increases in 2018-19 and 2021-22. This is significantly below our forecast baseline assumptions. Our forecasts of Scottish income tax revenues would have been higher if we had correctly anticipated how the higher rate threshold would change.

4.41 Given the experience of our last five budget forecasts, our judgement now is that keeping the higher rate threshold fixed in cash terms in our forecast baseline is a more realistic assumption. In addition, inflation is currently high and expected to remain so over at least the next year. We show in Figure 4.11 that inflation uprating of the higher rate threshold would suggest a large and probably unrealistic increase.

4.42 The Scottish Government will continue to set the higher rate threshold each year, and it can be set to any value chosen. By shifting our forecast baseline, we have only changed the value against which we measure future policy changes. This should have no material effect on how the Scottish Government chooses to set policy in the future. We have discussed our new judgement with the Scottish Government, who agree that a frozen higher rate threshold is a more reasonable baseline assumption for our forecasts[57].

4.43 The UK Government has frozen the UK higher rate threshold until 2024-25. While not a driving factor in our judgement, assuming a frozen higher rate threshold in Scotland makes our forecasts more comparable to the BGA.

4.44 By assuming a frozen higher rate threshold, our forecasts imply there will be more higher rate taxpayers and higher income tax revenues than if we'd assumed the higher rate threshold continued

[56] Scottish National Party (2021) Scotland's Future (link)
[57] Scottish Government (2022) Medium Term Financial Strategy (link)

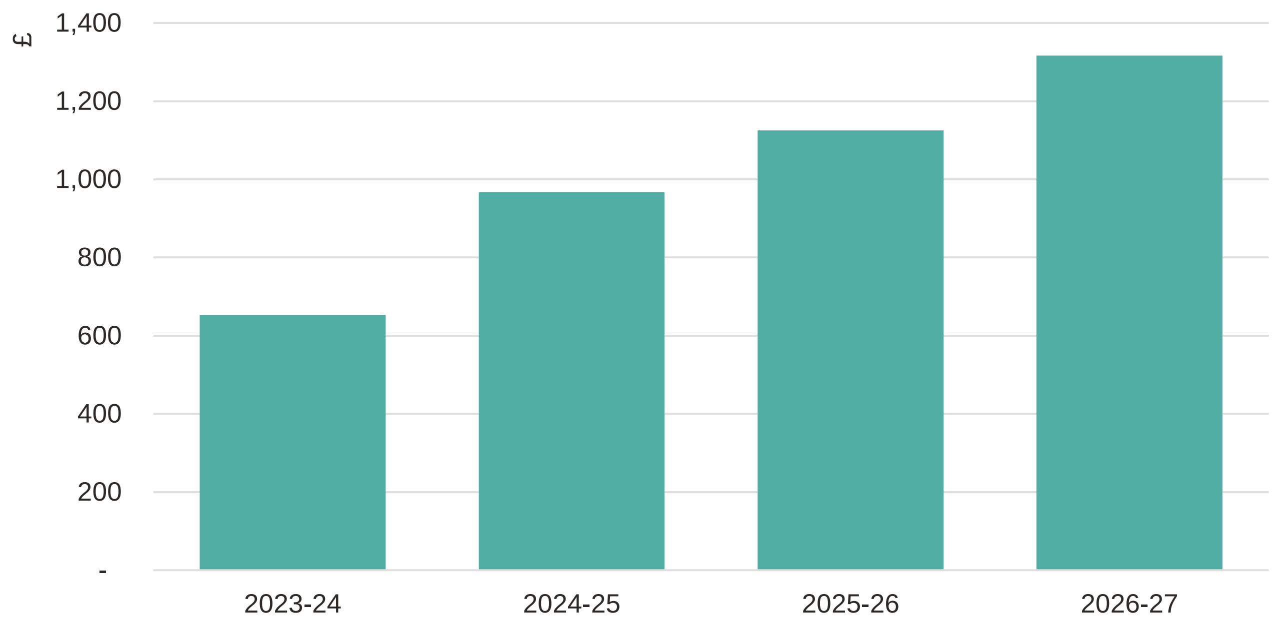
to rise in line with inflation. As we show in our forecast changes table, this adds £129 million to our forecast in 2023-24 rising to £503 million by the end of the forecast.

4.45 The change in our higher rate threshold will mean that a greater proportion of Scottish tax-payers will pay income tax at the higher rate. We estimate that the proportion of higher rate taxpayers will increase from 11.8 per cent of total tax payers in 2022-23, to 17.0 per cent by 2027-28. This would mean around 232,000 more tax-payers in 2027-28 than if we maintained an assumption of inflation uprating

Effect on assumed individual income tax liabilities

4.46 Our baseline assumption has no material effect on tax policy or the tax paid by individuals – it is up to the Government to set tax policy. However, following our change of judgement, we do now assume some taxpayers pay more income tax in the future than they would have done in our previous forecasts. We show this effect in Figure 4.12.

Figure 4.12: Baseline effect on the tax liabilities of a person earning £60,000 per year



Source: Scottish Fiscal Commission

4.47 In Figure 4.12 we show the effect on tax liabilities of our change in assumptions for an individual earning £60,000 per year. Our new baseline assumption that the higher rate threshold is unchanged means that the individual would be liable for £653 more income tax in 2023-24 than under the assumption that the higher rate threshold rises with inflation. The difference in liability increases to £1,317 by 2026-27.

Comparison to OBR

4.48 In this section we compare our latest forecasts to the OBR's. We show in Figures 4.13 and 4.14 how the economic determinants used in our forecast compare to the OBR's.

Figure 4.13: Forecast drivers comparison between OBR and SFC (growth rates)

Per cent change	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Income tax revenue						
OBR [1]	4.0	9.8	9.6	3.9	4.6	5.0
SFC [2]	2.4	10.1	7.8	5.3	5.4	5.0
Employment						
OBR	-1.7	0.5	0.8	0.6	0.5	0.4
SFC	-3.7	1.6	1.5	-0.2	-0.2	-0.2
Average nominal earnings						
OBR	2.6	6.1	5.1	2.4	2.7	3.0
SFC	4.0	4.4	4.1	2.9	2.9	3.1
Total nominal earnings [3]						
OBR	2.6	7.5	6.0	2.7	3.0	3.1
SFC	1.0	6.7	5.7	2.7	2.7	2.9

Source: Scottish Fiscal Commission, OBR (link).
Shaded cells refer to outturn available at time of publication.
[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.

4.49 Figure 4.13 shows income tax revenue in the UK growing more than in Scotland between 2020-21 and 2022-23. RTI data on PAYE income tax is a factor for forecasts in this period and this data show more growth in the rest of the UK (rUK) than in Scotland. From 2023-24 the forecast Scottish revenue grows more than the rUK because of the change in our baseline assumption and the reduction in the basic rate of income tax announced in the UK Spring Statement. We expect differences in assumptions between independent forecasters and as the UK government and Scottish Government set policy in future years we will observe the impact of those policy decisions.

Figure 4.14: Forecast drivers comparison between OBR and SFC (cumulative growth paths)

Index 2019-20 = 100	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Income tax revenue						
OBR [1]	104	114	125	130	136	143
SFC [2]	102	113	122	128	135	142
Employment						
OBR	98	99	100	100	101	101
SFC	96	98	99	99	99	99
Average nominal earnings						
OBR	103	109	114	117	120	124
SFC	104	109	113	116	120	123
Total nominal earnings [3]						
OBR	103	110	117	120	124	127
SFC	101	108	114	117	120	124

Source: Scottish Fiscal Commission, OBR (link).
[1] UK Non-Savings and Non-Dividends (NSND) excluding Scottish Income Tax (SIT) and Welsh Rates of Income Tax (WRIT)
[2] Scottish NSND income tax
[3] For OBR row, this refers to OBR's Wages and Salaries series.

4.50 Figure 4.14 shows how the levels of income tax revenue, and the economic factors that drive income tax growth, change over the forecast period. The figures are indexed to the level of UK income tax revenue and Scottish income tax revenue in 2019-20 and provide a comparison between the performances of the two economies. There is only a small divergence between our forecast and the OBR in the level of income tax revenue by 2025-26 but Scottish employment and nominal earnings remain slightly below rest of UK levels. This would normally mean lower income tax revenues, but our new baseline assumption that the higher rate threshold will be frozen until the end of the forecast increases our forecast of income tax revenues.

4.51 A further factor is the downward revision in the rUK basic rate of income tax from 2024-25 onwards as a result of the planned decrease in the basic rate of income tax to 19 per cent announced in the Spring Statement. This results in downward pressure on the forecast of UK income tax in those years.

Figure 4.15: Change between SFC Scottish and OBR rUK income tax forecast

£ million	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
OBR – rUK NSND forecast (£ million) [1]							
October 2021	162,917	167,913	182,767	195,743	206,662	216,029	229,356
March 2022	162,917	172,183	192,472	209,288	219,961	226,178	239,348
Difference	-	4,269	9,705	13,545	13,299	10,149	9,991
Of which (as per cent of forecast):							
Modelling and outturn alignment	-	0.1	0.2	0.2	0.2	0.3	0.2
Forecast and other changes	-	2.4	4.8	6.2	5.7	6.5	6.2
UK policy changes	-	0.0	0.0	0.0	0.1	-2.3	-2.3
SFC – Scottish income tax revenues (£ million)							
December 2021	11,833	11,938	13,002	13,671	14,313	15,056	15,790
May 2022	11,833	12,118	13,342	14,386	15,143	15,954	16,754
Difference	-	180	340	715	829	898	965
Of which (as per cent of forecast):							
Modelling and outturn alignment	-	0.9	0.6	0.6	1.5	2.3	2.9
Forecast and other changes	-	0.6	2.0	4.6	4.3	3.7	3.2

Source: Scottish Fiscal Commission, HMRC (2021) Scottish Income Tax Outturn Statistics: 2019 to 2020 (link), OBR (2021) Economic and Fiscal Outlook October 2021 (link), OBR (2022) Economic and Fiscal Outlook March 2022 link)
Shaded cells refer to outturn available at time of publication. Figures may not sum because of rounding.
[1] UK NSND excluding SIT and WRIT.

4.52 Figure 4.15 shows how our forecasts and the OBR's forecasts have changed since previous forecasts. "Forecast and other changes" covers changes in the economy and these account for the greater proportion of changes in both forecasts. Our change in baseline assumption affects our "Modelling and Outturn alignment" change from 2023-24 onwards. The revision in rUK basic rate of income appears in "UK policy changes" for the OBR forecast and is important from 2024-25 onwards. We expect income tax performance to be similar by the end of the forecast period, but there are slight differences in the underlying causes.

4.53 Both forecasts have been produced during unusual periods. The events of the last two years have had wide impacts and uncertainty persists into the future with conflict in Ukraine and the evolving relationship of the UK and European Union after the UK's exit from the EU. The impacts on economies and therefore on people's jobs and standard of living will likely continue to be large and uncertain.

Non-Domestic Rates

Forecast

4.54 Non-Domestic Rates (NDR), also known as business rates, are paid by the occupiers of non-domestic properties. For 2022-23, the tax is forecast to raise £2,770 million.

Figure 4.16: Forecast revenue for Non-Domestic Rates

£ million	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
NDR	1,816	1,966	2,770	3,333	3,276	3,323	3,651	3,601

Source: Scottish Fiscal Commission, Scottish Government (2022), Non-domestic rates income statistics (link).
Shaded cells refer to outturn available at time of publication.

Changes since December 2021

Figure 4.17: Change in Non-Domestic Rates revenue since December 2021

£ million	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
December 2021	2,083	2,809	3,233	3,167	3,231	3,519
Assumption changes	13	-179	3	-35	-107	-27
Methodology changes	-130	139	-6	7	74	28
Data updates	1	1	-7	-5	-4	-5
Inflation forecast	0	-1	110	141	129	136
May 2022	1,966	2,770	3,333	3,276	3,323	3,651
Changes since December 2021	-117	-40	100	109	92	132

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – December 2021 (link), Scottish Government (2022), Non-domestic rates income statistics (link).
Shaded cells refer to outturn available at time of publication. Figures may not sum because of rounding.

Assumption and Methodology changes

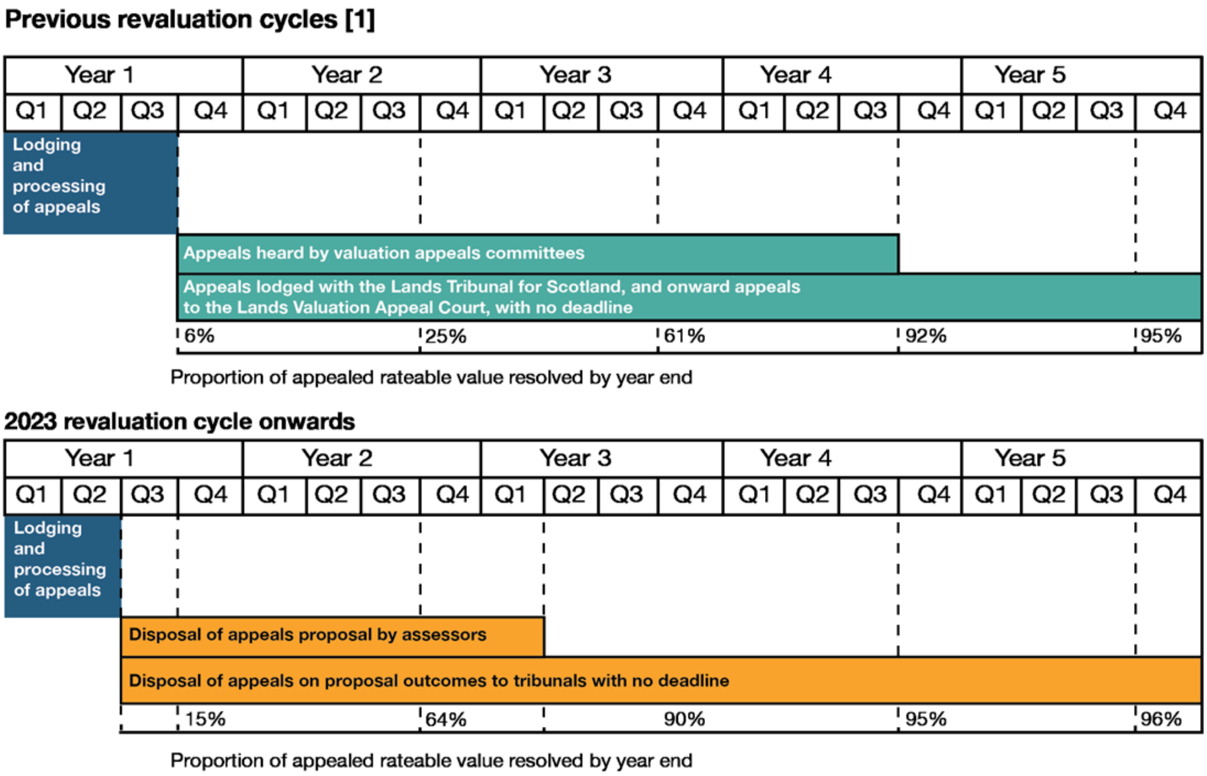
4.55 We changed our December 2021 assumption that 5 per cent of rateable value on the initial 2017 valuation roll will ultimately be lost to appeals in the 2017 appeals cycle. We now assume this will be a loss of 6 per cent. Over the past year, rateable value lost has already reached 5 per cent. We expect further rateable value to be lost before the conclusion of the 2017 cycle, based on losses in previous appeals cycles. The effect of this change will be a decrease of £95 million in 2022-23 forecast revenue, and a decrease of £87 million in 2023-24 forecast revenue. This change is included with other assumption changes in Figure 4.17.

4.56 We changed our assumption that 4 per cent of rateable value will be lost to appeals during the 2023 and 2026 appeals cycles. We now assume a loss of 5 per cent because appeals losses have increased over previous cycles.

4.57 On 22 September 2021 the Scottish Government launched a consultation on proposed changes to how appeals to NDR revaluation cycles are processed.[58] The Scottish Government collated results from this consultation for analysis.[59] The new system is set to come into place on 1 January 2023.

4.58 The current system requires revaluation appeals to be lodged within six months of receipt of the valuation notice or by 30 September on the year of revaluation, whichever is later. Appeals are heard by valuation appeals committees. The new system will be based on two stages. In the first stage a proposal will be considered by the assessor, and then in the second stage an appeal can be made the Local Taxation Chamber of the Scottish Tribunals. The new system is designed to ensure that revaluation appeals are considered more promptly in a revaluation cycle. Figure 4.18 compares the old and new appeals systems.

Figure 4.18: Simplified Schematic Overview of Revaluation Appeals Profile Update



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 4.18.
This does not necessarily reflect the proposals set out in the consultation on reforming the non-domestic rates system including proposals, the draft valuation roll, or content of valuation notices.

Data and inflation updates

4.59 We include a number of data updates in our model. The most important are:

- rateable values of non-domestic properties from the valuation roll, as at 1 April 2022
- revaluation appeals data up to quarter three 2021-22
- councils' audited returns data for 2020-21, replacing notified returns
- councils' notified returns for 2021-22, replacing the mid-year estimates

[58] Scottish Government (2021) Non-domestic rates - procedures in proposals and valuation notices etc: consultation (link)
[59] Scottish Government (2022) Reforming the non-domestic rates system: consultation analysis (link)

- councils' mid-year estimates for 2022-23, replacing the provisional contributable amounts

4.60 Increased inflation forecasts since December 2021 increase projected NDR revenue. Inflation is discussed in detail in Chapter 3.

Policy changes and recosting

4.61 No new NDR policies have been announced since December 2021. There have been no major changes to policy costings since the December 2021 forecast. Policy recostings are shown in Annex B. Recosted policies include Retail, Hospitality and Leisure relief (RHL) and Empty Property Relief devolution (EPR).

4.62 The Valuation Timetable (Scotland) Amendment Order 2022[60] was laid before the Scottish Parliament on 22 April 2022. None of the amendments in the order affect our modelling.

Forecast uncertainty

4.63 Our assumptions around revaluation appeals from the 2023 cycle onwards are uncertain and may change once the data on the new appeals cycle becomes available. We do not have any data to suggest how the changes to the appeals system will affect the lodging or processing of appeals.

4.64 The assessment of all rateable value across the NDR tax base is carried out by Scottish Assessors and is undertaken with reference to a single date to ensure fairness. This 'tone date' for revaluation of properties for the 2023 valuation roll was 1 April 2022. Once a new valuation roll is available, changes to rateable values at revaluation may lead to changes in forecast NDR revenue. Our forecast assumes that total rateable value is effectively stable, because there is limited current evidence on likely changes in rateable values across the tax base.

4.65 The poundage is the percentage of rateable value that non-domestic properties pay in rates. We assume that Scottish Government will set the poundage to achieve revenue neutrality in NDR income over the next revaluation cycle, so that the larger the NDR tax base after revaluation, the lower the poundage will be in 2023-24. We have assumed that valuation and poundage combined will be revenue neutral in our model.

4.66 One of the factors we use to model projected poundage is CPI inflation, with increases in inflation contributing to increases in poundage. As 2023-24 is a revaluation year, the actual poundage will be influenced by expected changes in the NDR tax base as a result of the revaluation. Although we have used a projected poundage based on CPI in our model, we do not expect poundage will necessarily rise with inflation in this year in practice.

4.67 Figure 4.19 compares our projected poundage based on CPI inflation forecasts against actual poundage set by the Scottish Government in previous budgets. Poundage has rarely increased exactly in line with inflation, either in revaluation years or otherwise. Despite this we have used a projected poundage partially based on CPI inflation in our model, which may introduce uncertainty.

4.68 In summary, future NDR forecasts may change because of uncertainty from the appeals cycle, revaluation and possible changes to poundage. After a new valuation roll is available and appeals data is received, this uncertainty should diminish.

[60] Scottish Government (2022) The Valuation Timetable (Scotland) Amendment Order 2022 (link)

Figure 4.19: Projected poundage and actual poundage in past years

Poundage (pence)	2018-19	2019-20	2020-21	2021-22	2022-23
Projected poundage	47.9	49.5	49.8	50.0	50.5
Actual poundage	48.0	49.0	49.8	49.0	49.8

Source: Scottish Fiscal Commission

Land and Buildings Transaction Tax

Forecast

4.69 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 we include it in our residential LBTT forecast. Our overall forecast remains broadly similar to December 2021.

Figure 4.20: Forecast revenue for Land and Buildings Transaction Tax

£ million	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Residential (including ADS)	549	528	541	560	588	624	669
Non-residential	251	269	280	289	298	308	319
Total	799	797	821	849	886	932	987

Source: Scottish Fiscal Commission, Revenue Scotland Monthly LBTT Statistics (Provisional) (link).
Shaded cells refer to outturn at time of publication. Figures may not sum because of rounding.
LBTT revenue is net of repayments, excludes penalties and interest and also excludes revenue losses.

Residential LBTT

4.70 More recent data have shown strong outturn performance in 2021-22 compared to our December 2021 forecast, revising up expected revenues across the forecast horizon. We have tried to assess whether this represented a real, sustainable change in the property market or delayed transactions from 2020-21 because of constraints on the market during the pandemic. Monthly Revenue Scotland outturn data show revenues exceed our forecast in almost every month, including towards the end of the year.[61] This suggests that there is a genuine uplift in the market rather than temporary effects of delayed purchases and this is something we will monitor in our future forecasts.

Figure 4.21: Change in total residential LBTT (including ADS) forecast since December 2021

£ million	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
December 2021	506	523	561	596	628	661
Model updates	0	-6	-22	-39	-56	-72
Data updates	33	29	32	34	36	38
Prices	0	0	-10	-10	2	22
Transactions	10	-18	-19	-21	-23	-25
May 2022	549	528	541	560	588	624
Changes since December 2021	43	5	-20	-36	-41	-37

Source: Scottish Fiscal Commission, Revenue Scotland Monthly LBTT Statistics (Provisional) (link).
Shaded cells refer to outturn at time of publication. Figures may not sum because of rounding.
LBTT revenue is net of ADS repayments, excludes penalties and interest and also excludes revenue losses.
Tables showing the change in residential LBTT (excluding ADS) and change in ADS can be found in our supplementary tables S4.11 and S4.12.

[61] Revenue Scotland Monthly LBTT Statistics (Provisional) (link)

4.71 From 2023-24 we have revised down our forecast compared to December 2021. Our model uses the historic average ratio between house prices and incomes to forecast LBTT revenues in the later years of the forecast. We have revised down this ratio from 6.6 to 6.2. We have made this judgment because of changes in macroeconomic conditions likely to affect this relationship, including higher cost of living and higher interest rates than in previous years. Figure 4.22 shows the effect of this change on our forecast since December 2021.

Figure 4.22: Effect of house price to income ratio revision on residential LBTT (excluding ADS)

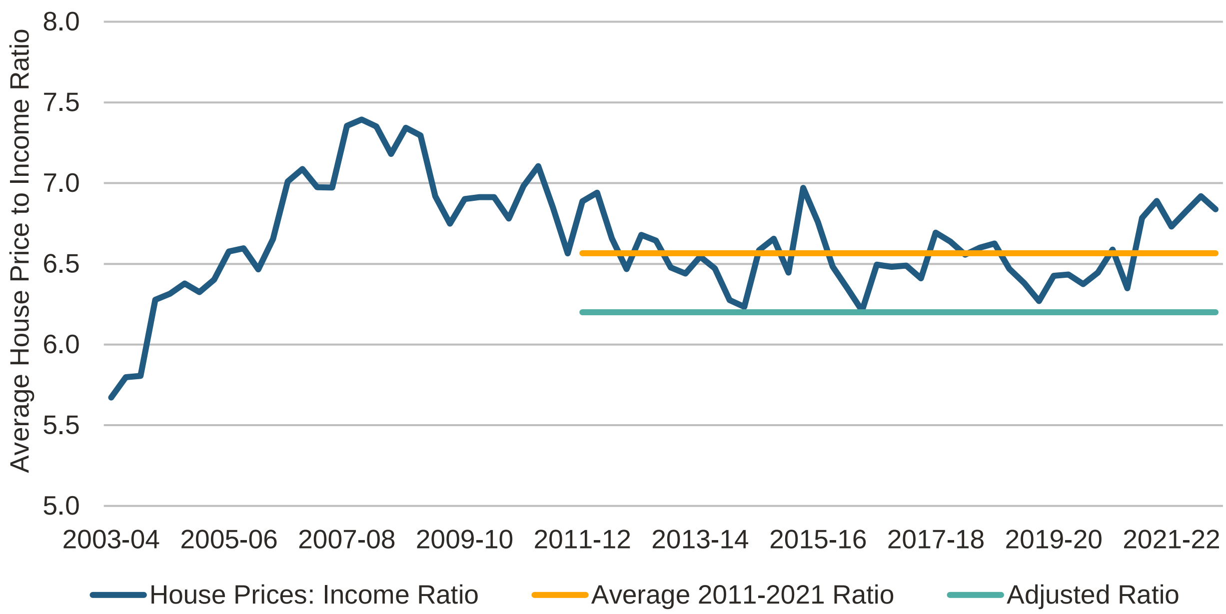
£ million	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Change	0	0	-11	-23	-36	-49	-62

Source: Scottish Fiscal Commission

4.72 Our model uses nominal personal disposable incomes to calculate the ratio and these are set to rise more slowly than yearly inflation. We predict that people will spend proportionately more of their incomes on living costs and less on savings. Higher inflation and interest rates could mean mortgage lenders will reduce the amount they are willing to lend for the same income. We provide more discussion on the economy in Chapter 3.

4.73 Figure 4.23 shows the effect of this judgment on the residential LBTT forecast. Note that although the forecast for house price growth is slowed under this judgment, there are no years of house price decline. House prices will rise every year, but more slowly than previously forecast.

Figure 4.23: Quarterly House Price to Income Ratio 2003-04 to 2021-22



Source: Scottish Fiscal Commission, Registers of Scotland Quarterly House Price Statistics (link).

Non-residential LBTT

4.74 We have revised our forecast for non-residential LBTT up by around £43 million in 2022-23 because of higher than expected revenues in 2021-22. We can see from monthly statistics published by Revenue Scotland that outturn revenues in 2021-22 are consistent across the year, suggesting that this represents a real change in the market rather than a temporary effect from economic restrictions in 2020-21.[62] This high level of outturn represents a source of uncertainty and we will monitor it for our future forecasts.

Figure 4.24: Change in non-residential LBTT forecast since December 2021

£ million	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
December 2021	215	226	235	243	253	262
Model updates	0	0	0	0	0	0
Data updates	36	38	39	41	42	43
Prices	0	5	6	6	6	6
Transactions	0	0	-1	-1	-3	-4
May 2022	251	269	280	289	298	308
Changes since December 2021	36	43	45	45	46	46

Source: Scottish Fiscal Commission, Revenue Scotland Monthly LBTT Statistics (Provisional) (link).
Shaded cells refer to outturn at time of publication. Figures may not sum because of rounding.
LBTT revenue is net of repayments, excludes penalties and interest and also excludes revenue losses.

Forecast uncertainty

4.75 There is more uncertainty in this forecast than in the December 2021 forecast. Changing macroeconomic conditions can have unforeseen effects on the housing market. . We base our judgement to change the house price to income ratio on our current understanding of rapidly changing circumstances. We will monitor this in our future forecasts.

4.76 Other risks to the accuracy of the forecast include further sudden economic shocks, the cost of living rapidly outpacing growth in nominal personal disposable incomes, and further interest rate rises restricting the availability of credit to mortgage applicants.

[62] Revenue Scotland Monthly LBTT Statistics (Provisional) (link)

Scottish Landfill Tax

Forecast

4.77 We expect Scottish Landfill Tax (SLfT) to raise £121 million in 2022-23. Revenue will fall after the introduction of new incineration capabilities over the forecast horizon. It will reduce further after the Biodegradable Municipal Waste (BMW) ban is implemented in 2025.

Figure 4.25: Forecast revenue for Scottish Landfill Tax

£ million	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Revenue	107	128	121	95	94	75	16	17

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.

Changes since December 2021

4.78 We have decided to change our base year from 2020-21 to 2021-22. We no longer view 2021-22 as an outlier year as outturn data for quarter 3 show that the trend of higher levels of waste sent to landfill has continued into the second half of the year.[63] This increases revenues between 2022-23 and 2025-26.

4.79 We forecast a further £9 million to be raised in 2022-23 as the Grangemouth incinerator start date has been pushed back to November 2022.

Figure 4.26: Change in SLfT forecast since December 2021

£ million	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
December 2021	123	101	83	85	70	18
Model changes	-1	11	15	12	9	-1
Determinants	0	1	-4	-3	-4	-1
Incineration	0	9	0	0	0	0
Outturn	5	0	0	0	0	0
May 2022	128	121	95	94	75	16
Change since December 2021	4	21	12	9	5	-1

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – December 2021 (link), Revenue Scotland (2021) Annual Report and Accounts 2020-21 – Devolved Taxes Accounts (link).
Figures may not sum because of rounding. SLfT revenue is net of repayments, excludes penalties and interest and also excludes revenue losses.

Forecast uncertainty

4.80 The timing of onset of higher incineration capacity and how BMW will be diverted from landfill are sources of forecast uncertainty. Our estimate of the amount of BMW sent to landfill is also uncertain and may improve as more data becomes available.

[63] Revenue Scotland (2022) Scottish Landfill Tax Statistics (link)

Illustrative forecasts

4.81 We produce illustrative forecasts for the Scottish share of UK Air Passenger Duty (APD), the Scottish share of UK Aggregates Levy, and VAT Assignment. We discuss these taxes in more detail in our December 2021 Scotland's Economic and Fiscal Forecasts publication.[64]

4.82 We provide detail on our approach to forecasting the Scottish share of APD and the Scottish share of Aggregates Levy in our occasional paper, 'How we forecast devolved taxes'.[65] We also published a paper on our approach to creating forecasts of assigned VAT in September 2018.[66]

Scottish share of UK Air Passenger Duty

Figure 4.27: 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	2027-28
Revenue	26	96	219	294	301	305	310	316

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

4.83 We have revised our forecast up to 2023-24 upwards since December 2021 because air passenger numbers have returned in higher numbers in 2022 than previously expected. Inclusion of the latest data and model updates increase our forecast by £56 million in 2022-23.

4.84 We have revised our forecast from 2024-25 downwards since December 2021. This is because of the reduction in APD for domestic flights from 2023-24 and modelling changes in how passenger numbers are forecast.

VAT Assignment

4.85 We have revised our forecast of VAT Assignment for 2022-23 downwards by £15 million compared to December 2021. This is mainly because of a downwards revision of 2019-20 outturn, aligning the figure with official statistics published by HMRC.[67]

Figure 4.28: Forecast revenue for Scottish VAT Assignment

£ million	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Revenue	5,220	4,695	5,511	6,090	6,378	6,579	6,759	6,972	7,229

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.

64 Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts December 2021 (link)
65 Scottish Fiscal Commission (2021) How we forecast devolved taxes (link)
66 Scottish Fiscal Commission (2018) Approach to Value Added Tax (link)
67 HM Revenue and Customs (2021) Scottish VAT Assignment statistics (link)

Scottish share of Aggregates Levy

4.86 HMRC data up to 2020-21 show that activity in the aggregates industry is below its 2019-20 level. We assume 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.

Figure 4.29: Forecast revenue for Scottish share of Aggregates Levy

£ million	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Revenue	57	58	59	60	60	61	62	63

Source: Scottish Fiscal Commission. Figure for 2020-21 is an estimate of the Scottish share of UK Aggregates Levy revenues

Chapter 5
Social security

Overview

5.1 In this chapter, we provide forecasts of devolved social security spending and present the changes since the 2022-23 Scottish Budget. We now forecast devolved social security spending to increase from £4.2 billion in 2022-23 to £6.8 billion in 2027-28.[68] Our forecasts cover spending on the payments to individuals and families, but not the associated administration costs, which are budgeted for separately by the Scottish Government.

5.2 Figure 5.1 shows that since December 2021 our forecast has increased by £41 million in 2021-22, and by £980 million in 2026-27.

5.3 A large proportion of the change is because we have included in our forecast the Scottish Government's social security policy commitments in the Resource Spending Review (RSR) and the devolution of Winter Fuel Payment. We are calling these inclusions indicative forecasts, and these increase spending by £344 million in 2026-27.

5.4 We have also included an adjustment in our Adult Disability Payment (ADP) model to incorporate the latest data and reflect clients who had previously received Disability Living Allowance (DLA) and successfully reapply to Personal Independence Payment (PIP). This adjustment adds £130 million to the forecast by 2026-27.

5.5 A higher inflation forecast for September 2022 increases spending from 2023-24 onwards across all the payments which are uprated. Increases in our inflation forecast raise our spending forecast by £213 million by 2026-27. The Scottish Government has announced policy changes that increase spending by £98 million in 2026-27. The main policy change is the increase of Scottish Child Payment to £25 per week. In addition, we have incorporated the latest data into our models, which results in an increased projected number of people receiving social security support.

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

£ million	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
December 2021	3,679	4,065	4,657	4,966	5,230	5,511
May 2022 [1]	3,720	4,173	5,072	5,725	6,108	6,490
Change since December 2021	41	108	414	758	878	980

Source: Scottish Fiscal Commission.
Figures may not sum because of rounding.
[1] Our forecasts cover most social security payments administered by Social Security Scotland and the DWP on behalf of the Scottish Government. The forecasts also cover the Scottish Welfare Fund, Self-Isolation Support Grant and Discretionary Housing Payments administered by local authorities as well as the Fair Start Scotland employability service.

5.6 In previous forecasts, we have only costed policies with clear plans on launch dates and sufficient details on the policy structure and delivery of payments. This year will be the first time the Scottish Government has conducted a multi-year Resource Spending Review (RSR) since the Commission

[68] Spending on Winter Fuel Payment (WFP) is excluded from spending in 2022-23, from 2024-25 we include spending on Pension Age Winter Heating Assistance which replaces Winter Fuel Payment.

was established in 2017. We have included indicative forecasts which include the additional spending associated with the Scottish Government's social security policy commitments. The Scottish Government agrees with this approach and is using our forecasts, including the indicative forecasts, in the RSR and Medium-Term Financial Strategy (MTFS).[69]

5.7 We will continue producing indicative forecasts for these payments until the Scottish Government announces its final policy approach for the new payments. Once detailed plans are available, we will publish estimates of spending in **Annex A** of our report, which covers policy costings. Policy costings reflect policy changes which can increase or decrease spending. The Commission will not produce indicative forecasts for additional policies in development in future publications.

5.8 For the first time, we have estimated spending on Scottish Carer's Assistance (SCA), Pension Age Disability Payment (PADP), Employment Injuries Assistance (EIA), Pension Age Winter Heating Assistance (PAWHA) and the Scottish Adult DLA.[70] We also include an estimate for spending on services to replace the current Fair Start Scotland employability service.

5.9 In addition to the indicative forecasts, the year-on-year increase in spending also arises from policy changes that the Scottish Government has already announced. These include the introduction of Adult Disability Payment (ADP), Child Disability Payment (CDP), Low Income Winter Heating Assistance (LIWHA) and the expansion and doubling of Scottish Child Payment (SCP). All these payments were included in our December 2021 forecasts. Since December there have been new policies announced which will increase spending on SCP, Best Start Grant (BSG) and Best Start Foods (BSF), and a commitment to mitigate Benefit Cap deductions through Discretionary Housing Payments (DHP).

5.10 At the end of this chapter, we discuss how social security spending will increasingly exceed the funding expected to be received from the UK Government. The Scottish Government receives funding through the Block Grant Adjustments (BGAs) for some payments and has also introduced new payments which must be funded entirely from the Scottish Budget. The combined effect is for spending to be £1 billion higher than the corresponding level of funding expected from the UK Government by 2024-25, increasing to £1.3 billion by 2026-27.

Forecasts

5.11 In this section, we provide details on our forecast of spending and of how many people we expect to receive payments. We refer to the latter as the caseload. We also show the changes in spending since our December 2021 forecasts.

5.12 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. 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.

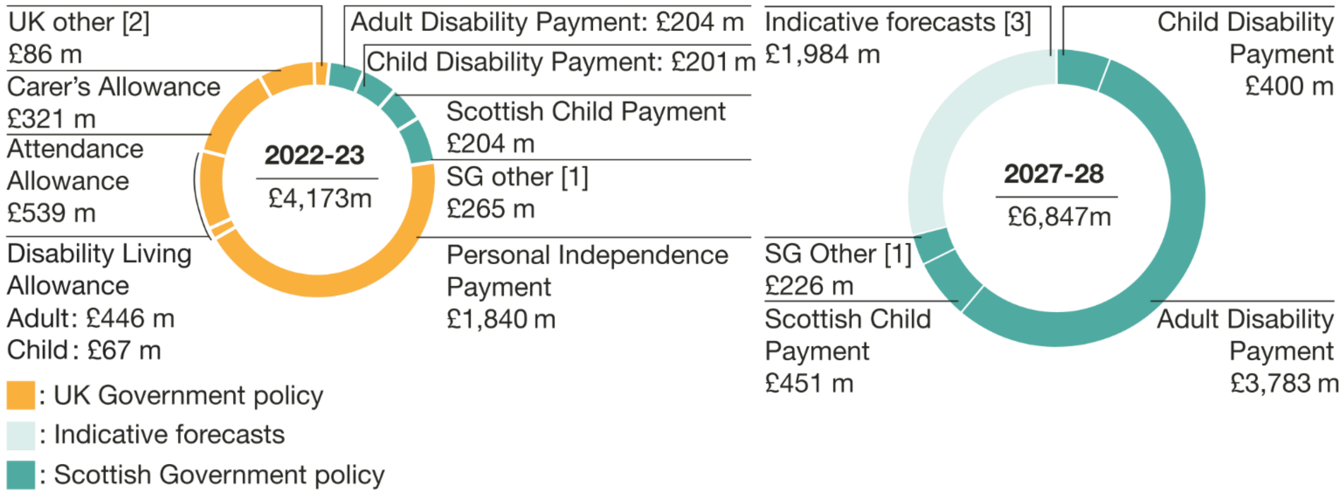
[69] Scottish Fiscal Commission (2022) Letter from Dame Susan Rice to the Social Justice and Social Security Committee – 11 March 2022 (link)
[70] We assumed that Scottish Carer's Assistance replaces Carer's Allowance and the Carer's Allowance Supplement; Pension Age Disability Payment replaces Attendance Allowance; Employee Injuries Assistance replaces Industrial Injuries Disablement Scheme; Pension Age Winter Heating Assistance replaces Winter Fuel Payments; and Scottish Adult DLA replaces Adult Disability Living Allowance. Final decisions on how the current payment will be replaced are not final so our current assumption may change.

Spending forecasts

5.13 In 2022-23 most social security spending in the Scottish Budget, £3.3 billion, will continue to be administered by the Department for Work and Pensions (DWP) under agency agreements with the Scottish Government.[71] By 2027-28, we expect that Social Security Scotland will administer all devolved payments except Severe Disablement Allowance (SDA), which will continue to be administered by DWP.[72]

5.14 Adult Disability Payment (ADP) opened for applications from people living in three pilot areas in March 2022.[73] Spending on ADP is forecast to increase from £204 million in 2022-23 to £3,783 million by 2027-28, while spending on PIP reduces as clients move to ADP. A similar effect applies to DLA for Children which is being replaced by Child Disability Payment (CDP).

Figure 5.2: Social security spending in 2022-23 and 2027-28



Source: Scottish Fiscal Commission

[1] Other includes Best Start Foods, 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 in 2022-23. It excludes spending on Carer's Allowance Supplement and Fair Start Scotland in 2027-28 as these are covered as part of the indicative forecasts

[2] Other includes Industrial Injuries Disablement Scheme and Severe Disablement Allowance in 2022-23, but only for Severe Disablement Allowance in 2027-28.

[3] Indicative forecasts includes spending on Scottish Carer's Assistance, Pension Age Disability Payment, Employment Injuries Assistance, Pension Age Winter Heating Assistance, the Scottish Adult DLA, and an estimate for spending on employability services to replace Fair Start Scotland.

5.15 The Scottish Government plans to transfer people receiving a UK Government disability or carers' payment to a Scottish payment by the end of 2025.[74,75] For the payments due to launch beyond the current year, there are no public announcements for when these will launch. We assume the new devolved payments will be progressively introduced by the end of 2025; and that Winter Fuel Payments (WFP) will be devolved and replaced by Pension Age Winter Heating Assistance in 2024-25.[76]

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[71] DWP will make payments on behalf of the Scottish Government for devolved benefits, subject to agency agreements, to eligible customers resident in Scotland. The agency agreement for SDA will remain affective until 31 March 2025, and can be extended if both parts agree on it (link).

[72] Scottish Government (2019) Severe Disablement Allowance: policy position paper (link).

[73] Scottish Government (2022) Adult Disability Payment pilot opens for new applications (link).

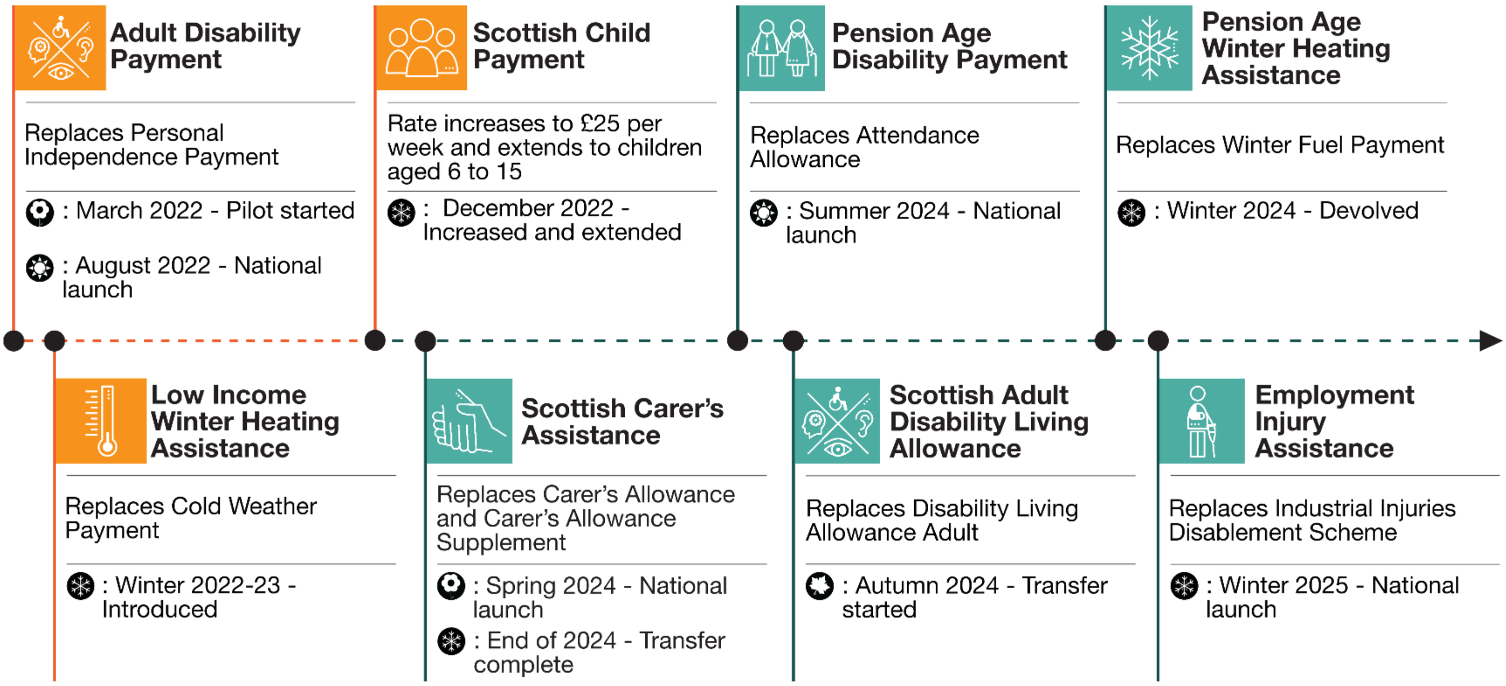
[74] Social Justice and Social Security Committee (2022) Case Transfer (link).

[75] This excludes people in receipt of SDA, who we assume continue receiving payment through agency agreements after 2025.

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

5.16 Figure 5.2 shows that £1,984 million of the £6,847 million social security spending forecast in 2027-28 is for the new payments which will launch in the future for which we do not have firm policy yet. As shown in Figure 5.3, we have assumed Carer's Allowance is the next payment to be replaced, in 2024. This will be followed by Attendance Allowance (AA), Disability Living Allowance (DLA) and Industrial Injuries Disablement Scheme (IIDS). Severe Disablement Allowance will continue to be administered by the DWP.

Figure 5.3 Timeline of social security payments



Source: Scottish Fiscal Commission
The important dates for the indicative replacement payment are illustrative and deemed reasonable assumptions by the Scottish Government.

5.17 In addition to the introduction of the replacement payments, we also expect the replacement of the current Fair Start Scotland employability service from 2023-24.

5.18 Figure 5.4 shows our estimate of spending for the previous and current financial year and a five-year forecast for each payment.

Figure 5.4: Social security spending forecasts

£ million	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Adult Disability Payment [1]	1,626	1,754	2,044	2,579	2,921	3,196	3,484	3,783
Best Start Foods [2]	12	14	12	18	18	18	18	18
Best Start Grant	18	15	20	18	18	18	18	18
Child Disability Payment [3]	208	228	268	315	344	366	387	400
Child Winter Heating Assistance	3	5	4	4	4	5	5	5
Discretionary Housing Payments	81	76	83	91	98	103	109	115
Employability Services [4]	21	26	22	25	25	25	25	25
Employment Injury Assistance [5]	83	80	80	83	84	83	83	83
Funeral Support Payment	11	11	12	13	13	14	14	15
Low Income Winter Heating Assistance	-	-	20	20	20	20	20	20
Pension Age Disability Payment [6]	528	521	539	591	642	691	728	764
Pension Age Winter Heating Assistance [7]	-	-	-	-	184	189	191	190
Scottish Adult Disability Living Allowance [8]	515	473	446	429	394	354	318	284
Scottish Child Payment	6	55	204	428	439	444	449	451
Scottish Carer's Assistance [9]	355	359	365	416	478	545	602	637
of which Carer's Allowance Supplement	59	59	44	50	55	59	62	66
Scottish Welfare Fund	58	36	36	36	36	36	36	36
Self-Isolation Support Grant	4	61	11	-	-	-	-	-
Severe Disablement Allowance	7	7	6	6	5	5	4	4
Total spending	3,535	3,720	4,173	5,072	5,725	6,108	6,490	6,847

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] Adult Disability Payment includes our estimate of the change in the baseline Personal Independence Payment and changes arising from the introduction of Adult Disability Payment policy.

[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 for Children until all recipients are transferred to the new payment.

[4] Employability Services is an indicative forecast and includes spending on Fair Start Scotland plus assumed funding for councils to provide similar services as part of Phase 3 of the No One Left Behind programme.

[5] Employment Injuries Assistance is an indicative forecast and includes our estimate of the change in the baseline Industrial Injuries Disablement Benefit and changes arising from the introduction of Employment Injuries Assistance policy.

[6] Pension Age Disability Payment is an indicative forecast and includes our estimate of the change in the baseline Attendance Allowance and changes arising from the introduction of Pension Age Disability Payment policy.

[7] Winter Fuel Payment will be devolved in winter 2024 and replaced by Pension Age Winter Heating Assistance

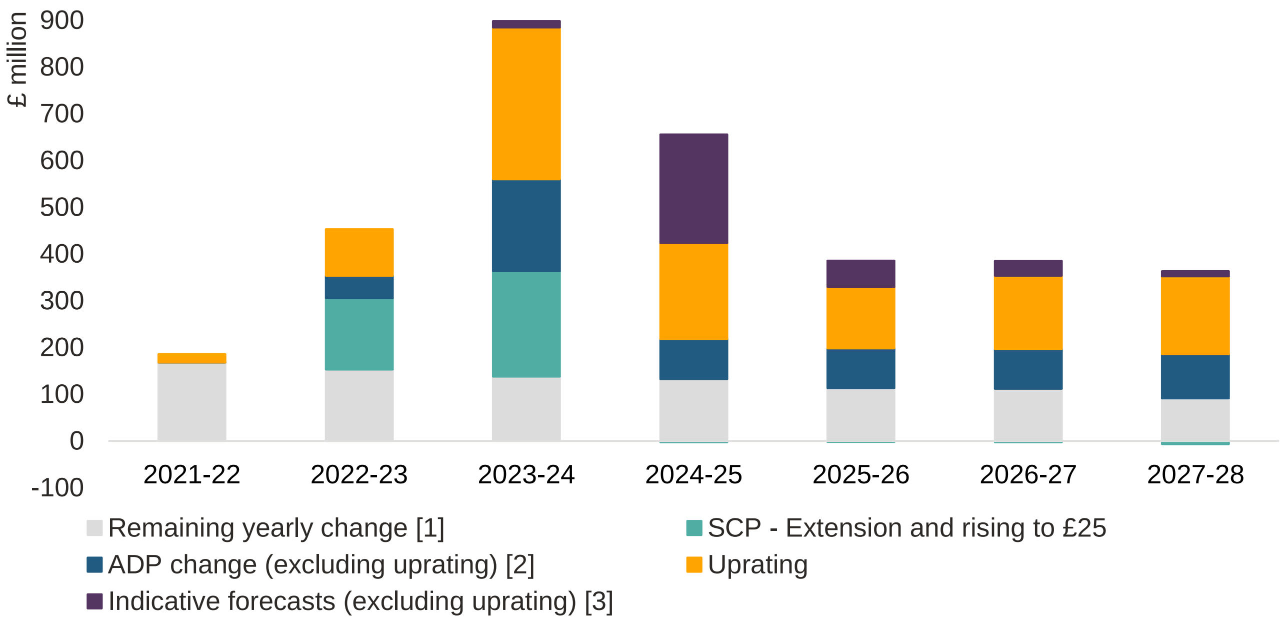
[8] Scottish Adult DLA is an indicative forecast and includes our estimate of the change in the baseline DLA Adult and changes arising from the introduction of Scottish Adult DLA policy.

[9] Scottish Carer's Assistance is an indicative forecast and includes our estimate of the change in the combined baseline of Carer's Allowance and Carer's Allowance Supplement and changes arising from the introduction of Scottish Carer's Assistance.

5.19 Spending on social security payments increases over time because we expect more people to receive support. Our caseload forecast increases because of the introduction of new policies, operational or delivery changes and the inclusion of more timely or relevant data in our models. Spending also increases as clients tend to receive higher payments over time. The payment rates increase either because there is a change in the percentage of people receiving a higher payment rate or because payments are uprated each year with inflation.

5.20 Figure 5.5 shows how much of the change in social security spending each year relates to uprating, to the SCP and ADP Scottish Government policy changes, and change in spend that arises from our indicative forecasts.

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 Carer's Allowance and Carer's Allowance Supplement

[3] Indicative forecasts (excluding uprating) includes the additional spend on the replacement payments

5.21 Uprating payments increases spending each year. In March 2022 the Scottish Government announced that some payments would be uprated above inflation in April 2022. We have also revised our inflation forecast and our spending forecasts are now based on a 7.5 per cent increase in April 2023.

5.22 SCP launched in February 2021, paying £10 per week to children under six. The weekly amount increased to £20 in April 2022 and the Scottish Government has committed to a further increase to £25 by the end of 2022, at the same time as the payment is extended to older children. These changes increase social security spending in 2022-23 and in 2023-24.

Box 5.1: Social security caseload forecasts

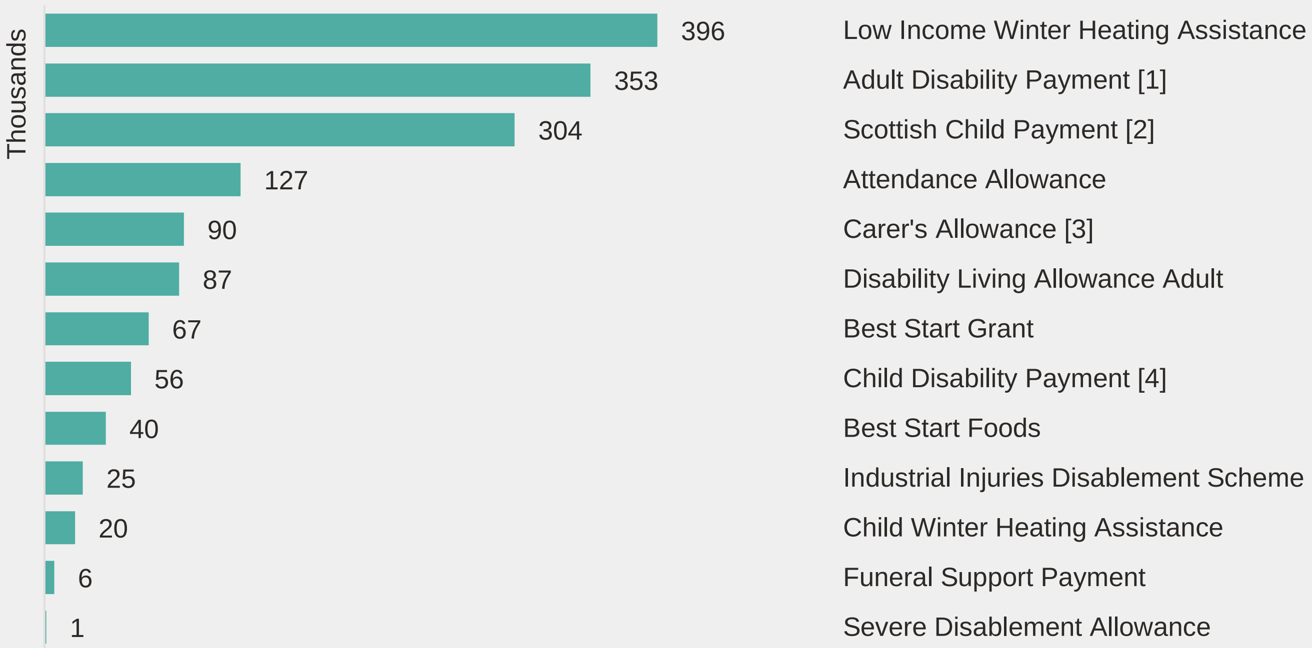
Several benefits contribute to the expected increase in caseloads over the forecast horizon.

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 weather. We expect that there will be almost 400,000 people who receive this payment in 2022-23. Similarly, the caseload for SCP is expected to increase by over 200,000 children following the expansion of the payment to children aged under 16 in late 2022.

We expect the number of people receiving ADP to increase by 33,000 clients by 2026-27, compared to our December 2021 forecast. Data updates have meant that there are more clients aging into the state pension age group, as well as fewer exits from this group, resulting in the caseload increasing by 20,000 clients by 2027-28. In addition, discussions with DWP have led us to understand that some clients were wrongly flagged on data published in the Stat Xplore online tool.[77] Our model used separate information on DLA reassessments, so these clients were not captured in previous forecasts, and including these people increases the caseload by around 18,000 clients by 2027-28. A combination of minor model developments, other data updates and refinement of off-model adjustments resulted in small decreases in the ADP caseload forecast.

Figure 5.6 shows our caseload forecast for each payment. It is not possible to sum the caseload to give a total of people supported, as people may receive more than one of these payments. More information on caseload forecasts in subsequent years can be found in Supplementary Figure S.5.1.[78]

Figure 5.6: Social security caseload forecast for 2022-23



Source: Scottish Fiscal Commission
[1] Adult Disability Payment includes clients on the UK Government Personal Independence Payment.
[2] 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.
[3] Carer's Allowance includes clients on the UK Government Carer's Allowance and Carer's Allowance Supplement.
[4] Child Disability Payment includes clients on the UK Government Disability Living Allowance (Child).

[77] DWP Stat-Xplore (link)
[78] Scottish Fiscal Commission (2022) Scotland's Economic and Fiscal Forecasts – May 2022 (link)

Scottish Government policy

5.23 This section covers the effect of the Scottish Government policies on social security spending. We have separated the section in two parts:

- Policies that have been announced, where legislation has been introduced to Parliament, or we have enough detail to provide a detailed estimate of the effects on spending.
- Policies that are still in development, of which we have limited information; we refer to these as indicative forecasts. Our indicative forecasts are based on assumptions about when these new payments will launch as well as the design and delivery of the payments. These are uncertain and we have produced these to support the Resource Spending Review.

Policy announcements

5.24 Since December 2021, the Scottish Government has announced several policy changes.

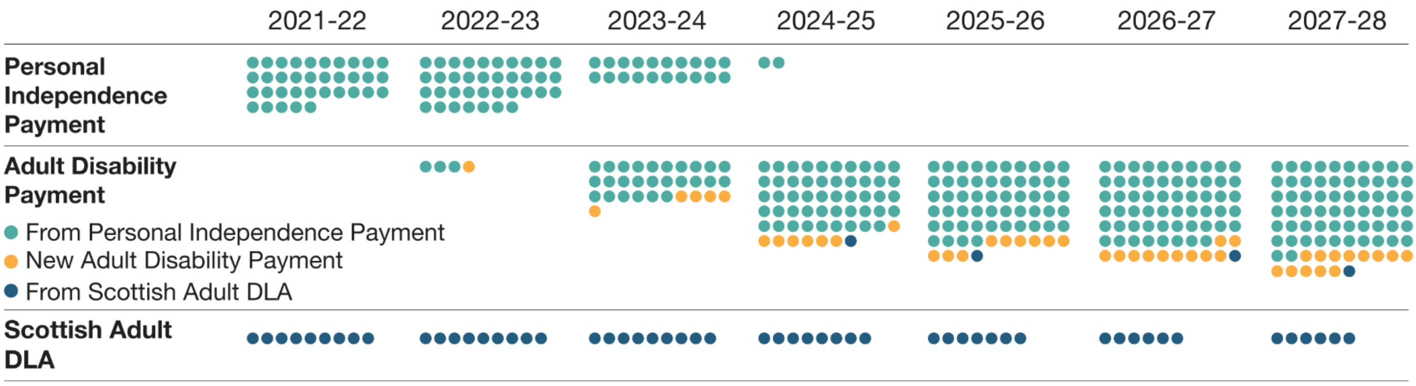
5.25 The weekly value of Scottish Child Payment will increase from £20 to £25 per child at the same time as the extension of the payment to older children by the end of 2022. At that point, the Scottish Government also plans to automate the payment of BSG Early Learning and School Age payments for families receiving SCP. The Scottish Government has also committed to removing the income threshold for Best Start Foods in 2023-24, increasing the number of people eligible for this payment. These measures were all announced in March 2022 as part of the Tackling Child Poverty Delivery Plan.[79]

5.26 This plan also included a commitment to mitigate Benefit Cap deductions through Discretionary Housing Payments. We estimate this will cost an additional £4 million in 2022-23, rising to £22 million by 2027-28.

5.27 From the national launch of Adult Disability Payment (ADP) in August 2022, clients receiving Disability Living Allowance (DLA) will transfer to ADP if they select for self-transfer, report a relevant change of circumstance or if they reach the end of their DLA award. We estimate a net increase in spending of £5 million by the end of the forecast period. The ADP spending increase is partially offset by reduced spending on DLA. The estimate reflects that the clients receiving Working Age DLA have an incentive to report a relevant change of circumstances or voluntarily request a transfer to ADP because of its higher expected payment, even when they may lose their current DLA award in the transfer process. Figure 5.7 illustrates the non-managed transfer from DLA to ADP, and transfer from PIP onto ADP, which will be conducted at the same time.

[79] Scottish Government (2022) Tackling Child Poverty Delivery Plan 2022-26 (link)

Figure 5.7: Illustrative transfer of spending from DLA Working Age and PIP onto ADP



Source: Scottish Fiscal Commission
Circles represent £50 million spend.

5.28 The Scottish Government has informed us that the process of transferring clients from PIP to ADP because of a change of circumstance or award review may take longer than if these had occurred under PIP. This is because clients will have longer to collect and provide information to support their change of circumstance application; or because Social Security Scotland delays the start of the review process. We have assumed that clients will continue receiving their PIP award for longer, with increases in payments backdated and over-payments not recovered. This increases ADP spending by £15 million in 2023-24. More detail can be found in Annex A.

5.29 From the end of April 2022, Coronavirus (COVID-19) testing centres have been closed and the requirement to isolate has been replaced by new ‘stay at home’ guidance. The Self-Isolation Support Grant (SISG) continues at a lower rate of £225 for people testing positive for COVID-19 from 1 May 2022. Our previous forecast assumed that SISG would continue at its previous rate of £500 until the end of October 2022. Our forecast treats both the reduction in the amount and the potential drop in take-up resulting from these changes as a policy change. The Scottish Government will review the need for the SISG at the end of June 2022, but we still assume that it remains in place in its new form until the end of October, when the Discretionary Compensation for Self-Isolation Act will cease to apply.[80]

5.30 On 16 March 2022, the Scottish Government announced the higher uprating of BSG, the fixed rates of Funeral Support Payments, Child Winter Heating Assistance, and Carer's Allowance Supplement.[81] These payment rates all increased by 6 per cent from April 2022.

5.31 The Scottish Government has confirmed that the extension of Child Winter Heating Assistance eligibility to some PIP recipients announced in September 2021 will also apply to Adult Disability Payment.

5.32 Changes to case transfer of disability benefits have small knock-on effects to spending on carer’s benefits.

5.33 We assume no material effect on spending from the relaxation of habitual residence requirements for Ukrainian refugees, and smaller changes to BSG and SCP eligibility in draft regulations, around kinship care and children receiving the first child rate of BSG. These are included in Annex C of our report.

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[80] The Scottish Parliament (2022) Coronavirus (Discretionary Compensation for Self-isolation)(Scotland) Bill (link)
[81] Scottish Government (2022) Increase in social security benefits (link)

Figure 5.8: Scottish Government announced policy changes since December 2021

£ million	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Increase of SCP to £25 per week	18	60	61	62	62	63
Automation of BSG	5	3	2	2	2	2
Remove BSF income thresholds	-	6	6	6	6	6
Benefit Cap mitigation	4	11	15	18	20	22
Natural case transfer, of which:	1	2	2	3	4	5
ADP	2	12	22	31	39	46
DLA	-1	-10	-20	-28	-35	-40
Processing of natural transfer	7	15	2	-	-	-
Changes to SISG	-14	-	-	-	-	-
Uprating policy	3	3	3	3	3	3
Eligibility for CWHA	0	0	0	0	0	0
Knock-on effect on SCA	1	1	0	0	0	-1
Total Scottish Government policy changes	25	100	92	95	98	101

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

Indicative forecasts

5.34 Our indicative forecasts have been produced to support the Scottish Government's multi-year Resource Spending Review (RSR). These include estimates of additional spending associated with the Scottish Government's social security policy commitments.

5.35 These are based on discussions with the Scottish Government in which our assumptions on the timings for launching the payments and the transfer of clients, as well as the principles of the policies in development were deemed reasonable, yet to be confirmed. We attach a high degree of uncertainty to these forecasts as the important policies details, for example on launch dates, are not firm. Where appropriate, we have assumed increases in successful new applications aligned with judgements used to estimate spending changes for similar policy changes. We will review the assumptions as more information becomes available and will publish detailed estimates of spending after the policies are announced.

5.36 We assume that Scottish Carer's Assistance (SCA) will replace Carer's Allowance (CA) and will maintain the extra support provided by Carer's Allowance Supplement (CAS). We assume this will be introduced at the start of 2024-25 after the PIP to ADP transfer is complete, and that all clients will have transferred to SCA by the end of 2024-25. We based our assumptions on the information from the consultation published in February 2022 and discussions with Scottish Government officials.[82] Specifically, we assume that Carer's Additional Person Payment (CAPP), which is a payment worth £10 per week to carers receiving Scottish Carer's Assistance and caring for more than one person who is receiving a disability payment, will be introduced when SCA is introduced. We have assumed that the five priorities for change set out in the consultation, which expand eligibility for SCA, will be introduced after the case transfer completes.

[82] Scottish Government (2022) Scottish Carer's Assistance: consultation (link)

5.37 We have also produced an indicative forecast for Pension Age Disability Payment (PADP), the replacement for Attendance Allowance (AA) in Scotland. We assume an increase in the number of successful applications when PADP launches and a higher level of applications thereafter. Our PADP forecast also reflects the change in the terminally ill definition for the disability payments.[83] The increase in the number of people receiving PADP has a knock-on effect on the number of people receiving SCA, as there will be a higher number of eligible people caring for a pensioner receiving an award for a disability payment.

5.38 Except for the clients receiving Severe Disablement Allowance (SDA), the Scottish Government plans to transfer everyone receiving a UK Government disability payment to a Scottish payment. We have discussed with the Scottish Government different options for a managed transfer of people receiving DLA. Of these options, we assume that people receiving DLA will be directly transferred without a reassessment into a new Scottish Adult DLA by the end of 2025. We assume DLA clients will continue receiving the same payment award in Scottish Adult DLA and an award review will not be required at the point of transfer. Under the current assumption, this policy would result in no additional spending.

5.39 While the Scottish Government has not announced plans for Employment Injury Assistance (EIA), the replacement of Industrial Injuries Disablement Scheme (IIDS), its officials believe that it is reasonable to assume that the ethos and principles from the already introduced disability payments will apply to EIA. We have assumed a 1 per cent increase in spending from 2025-26, rising to 4 per cent by 2027-28.

5.40 Our forecasts also include the Fair Start Scotland employability service, which has operated since 2018-19 under devolved powers falling within our remit. This service is scheduled to close to new participants from the end of 2022-23, but the Scottish Government plans to continue to fund similar support indirectly through funding to Local Authorities as part of the No One Left Behind programme. We do not have full details of how this will be implemented, but we have included an assumed £25 million overall annual spending for 2023-24 onwards, covering both the rundown of Fair Start Scotland and funding for replacement Employability Services.

5.41 We have now included Winter Fuel Payment in the headline forecast. We assume the same eligibility rules will apply when this is devolved in winter 2024 and replaced by Pension Age Winter Heating Assistance (PAWHA). When devolved, we expect the cost of PAWHA to be funded by the BGA.

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[83] Scottish Government Policy actions: Terminal illness (link)

Figure 5.9: Additional spending from indicative forecasts

£ million	2023-24	2024-25	2025-26	2026-27	2027-28
Scottish Carer's Assistance	-	24	54	75	78
Pension Age Disability Payment	-	18	39	50	59
Employment Injury Assistance	-	-	0	2	3
Employability Services	13	21	25	25	25
Pension Age Winter Heating Assistance	-	184	189	191	190
Knock-on effect on SCA	-	1	2	2	3
Total additional spending	13	249	309	344	359

Source: Scottish Fiscal Commission
Figures may not sum because of rounding.
Scottish Adult DLA is not included in Figure 5.9 because we do not expect it to result in additional spending.

Changes since December 2021

5.42 Since December 2021, we have updated our forecasts to include the latest outturn data, new policies announced by the Scottish Government, and indicative forecasts of additional spending on the Scottish Government's social security commitments. Figure 5.10 shows the change in spending forecasts for each of the social security payments.

Figure 5.10: Change in social security spending forecasts since December 2021, by payment

£ million	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
December 2021	3,679	4,065	4,657	4,966	5,230	5,511
May 2022	3,720	4,173	5,072	5,725	6,108	6,490
Change since December 2021, of which:	41	108	414	758	878	980
Adult Disability Payment [1]	20	95	257	333	390	450
Best Start Foods	-1	-1	6	7	7	8
Best Start Grant	-2	3	0	0	0	0
Child Disability Payment [2]	2	3	10	15	15	16
Child Winter Heating Assistance	0	0	0	0	0	0
Discretionary Housing Payments	-2	3	10	15	20	22
Employability Services [3]	-1	-1	12	20	25	25
Employment Injury Assistance [4]	-1	0	2	3	4	5
Funeral Support Payment	-1	0	1	1	1	1
Low Income Winter Heating Assistance	-	-1	-1	-1	-1	-1
Pension Age Winter Heating Assistance [5]	-	-	-	184	189	191
Pension Age Disability Payment [6]	2	-5	15	42	63	75
Scottish Adult Disability Living Allowance [7]	-1	2	13	12	5	2
Scottish Carer's Assistance [8]	-2	8	22	48	78	99
Scottish Child Payment	-1	7	66	79	82	86
Scottish Welfare Fund	-	-	-	-	-	-
Self-Isolation Support Grant	29	-4	-	-	-	-
Severe Disablement Allowance	0	0	0	0	0	0

Source: Scottish Fiscal Commission

Figures may not sum because of rounding.

[1] Adult Disability Payment includes our estimate of the change in the baseline Personal Independence Payment and changes arising from the introduction of Adult Disability Payment policy.

[2] Child Disability Payment includes spending on the UK Government Disability Living Allowance for Children until all recipients are transferred to the new payment.

[3] Employability Services is an indicative forecast and includes spending on Fair Start Scotland plus assumed funding for councils to provide similar services as part of Phase 3 of the No One Left Behind programme.

[4] Employment Injuries Assistance is an indicative forecast and includes our estimate of the change in the baseline Industrial Injuries Disablement Benefit and changes arising from the introduction of Employment Injuries Assistance policy.

[5] Winter Fuel Payment will be devolved in winter 2024 and replaced by Pension Age Winter Heating Assistance

[6] Pension Age Disability Payment is an indicative forecast and includes our estimate of the change in the baseline Attendance Allowance and changes arising from the introduction of Pension Age Disability Payment policy.

[7] Scottish Adult DLA is an indicative forecast and includes our estimate of the change in the baseline DLA Adult and changes arising from the introduction of Scottish Adult DLA policy.

[8] Scottish Carer's Assistance is an indicative forecast and includes our estimate of the change in the combined baseline of Carer’s Allowance and Carer’s Allowance Supplement and changes arising from the introduction of Scottish Carer's Assistance.

5.43 Figure 5.11 shows the main reasons our headline forecasts have changed since December 2021 split by data updates, modelling changes, assumption changes and policy changes.

5.44 Scottish Government policy changes accounts for around half of the increase in spending by 2026-27. These changes are largely because of the inclusion of the Scottish Government's policy commitments over the RSR reflected in our indicative forecasts, and the increase from £20 to £25 per week of the Scottish Child Payment.

5.45 Detailed breakdowns for all payments are available in Supplementary Figure S.5.18 – S.5.34 published on our website.[84]

Figure 5.11: Change in social security spending forecasts since December 2021

£ million	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
December 2021	3,679	4,065	4,657	4,966	5,230	5,511
Data updates	45	72	166	269	382	512
Modelling changes	0	46	65	40	-11	-92
Assumptions – Inflation	-	4	156	216	207	213
Assumptions – Eligibility and take-up	-5	-20	-10	-1	5	10
Assumptions – Population	0	1	2	3	4	4
Assumptions – Other	-2	-25	-78	-110	-113	-109
Policy changes – Scottish Government	0	25	113	341	404	442
Policy changes – UK Government	3	6	-	-	-	-
May 2022	3,720	4,173	5,072	5,725	6,108	6,490
Change since December 2021	41	108	414	758	878	980

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

Data updates and modelling changes

5.46 Since our December publication, our models have been updated, resulting in material changes to the number of people receiving the payments and, in some cases, the average payment amounts.

5.47 Data updates need to be considered together with other changes in the forecast. Some model developments and off-model adjustments (classified as Assumptions – Other in Figure 5.11) are introduced to better reflect changes in the data trends.

5.48 Our December 2021 forecast was based on an assumption there would be more new applications this year and in future years as a result of an increase in long-term health conditions and deferred demand because of the pandemic. The latest PIP data from DWP show a considerable increase in the number of people receiving PIP. The data update has increased our forecast but been offset by changes to our model and removing our assumption about higher new applications.

5.49 The latest data has also increased our ADP forecast since December because the number of people over state pension age in PIP has been considerably higher than we expected in December. Including the latest data has increased the number of clients over state pension age in our forecast by 18,000 people. The increase is because the number of working age clients in PIP aging into the

[84] Scottish Fiscal Commission (2022) Scotland's Economic and Fiscal Forecasts – May 2022 (link)

state pension age group has increased and the exits from this group decreases as this group no longer have award reviews, leading to a £100 million increase in ADP spending by 2026-27.

5.50 Analysis on the case transfer from DLA to PIP identified some inconsistencies in the various sources of data published by DWP. Our models used data on the number of people exiting DLA who are reassessed into PIP to inform the modelling of the ADP reassessed caseload. This approach was missing a group of clients who had received DLA in the past but accessed PIP after submitting a new application rather than after being directly reassessed into PIP. Including these in our forecast increases the monthly inflows and adds an additional £130 million to the forecast by 2026-27.

5.51 In our previous forecast, when forecasting the average payment in ADP, we allowed for some growth in the percentages of award combinations in the short-term. To reflect the stronger growth that we have seen in the last two years in the PIP average payment award, we allow the different award combinations to grow for a longer period. Our new approach increases the forecast by £57 million by 2026-27.

5.52 We have made two changes to our DLA Adult and Carer's Allowance forecast models which have reduced forecast spending. Combining DLA Working Age and Pension Age groups into a single forecast model has reduced spending by £10 million by 2026-27. As part of this model change we have aligned the exit rate for the DLA Working Age caseload to the latest data which show a lower exit rate than we assumed. As more people remain on the caseload, spending increases by £30 million by 2026-27.

5.53 We have reduced the proportion of children on DLA and CDP who are cared for by a person receiving Carer's Allowance (CA) as more people are receiving the carer's element in Universal Credit rather than CA. This change decreases our forecast by £16 million in 2026-27.

5.54 Since December the first data on the Child Disability Payment (CDP) was released by Social Security Scotland.[85] We have not included these data in our forecast as these are not consistent with the data published by DWP on DLA Child. We understand Social Security Scotland are looking to improve the data published, but there are a number of limitations because of how information is collected and processed. We will continue to discuss our data needs with Social Security Scotland and publish a detailed update in our Statement of Data Needs later in the year.

5.55 Based on DWP data on DLA Child we have changed our approach to modelling the Child Disability Payment (CDP). We previously used an incidence rate model to forecast the percentage of the population receiving the payment. We have now built a flows model which forecasts the caseload by estimating the number of children entering and exiting the caseload at each age. The flows model was introduced to better deal with structural changes such as the effects of COVID-19, as well as to incorporate the new CDP data more easily when these become available to us. As part of the remodelling, we have incorporated the extension of CDP to 18-year-olds into the core baseline model. These changes lower the forecast by £6 million by 2026-27.

Inflation

5.56 Most payments increase each year with inflation, known as uprating. Our inflation forecasts used for uprating have increased from 3.9 to 7.5 per cent in 2023-24 and from 2.4 to 3.4 per cent in 2024-25. Higher inflation has increased social security spending by £213 million in 2026-27. Further information on our inflation forecast can be found in **Chapter 3**.

[85] Social Security Scotland (2022) Child Disability Payment: high level statistics to 31 March 2022 (link)

Eligibility and take-up

5.57 Our forecasts of SCP, BSF and BSG are based on assumptions about the proportion of children who will be in families who are eligible for these payments through receipt of qualifying benefits, usually Universal Credit or Child Tax Credits. The eligibility assumptions are combined with an assumed take-up rate to give our caseload forecasts.

5.58 Since December 2021, we have slightly reduced our estimate of eligibility in the current year. Eligibility was reduced because:

- Universal Credit (UC) data and unemployment in late 2021 22 having been lower than expected.
- A lower estimate of the effect of UC taper and work allowance changes.
- The increase to the threshold for National Insurance from July 2022.

5.59 From these lower current levels, we now assume that eligibility will slightly increase in the medium term. This assumption is informed by:

- DWP forecasts of UC and Tax Credit caseloads.
- Micro-simulation modelling of eligibility under higher inflation.
- Our expectation that unemployment will increase from its current low level.

5.60 While eligibility appears to have been lower, Scottish Child Payment spending and caseload still appear to have been in line with our December forecast, so we have increased our estimate of the take-up rate.

5.61 We reduced our assumed take-up rate for BSG based on the latest data, but this effect is more than reversed by the assumed increase in take-up later this year once Early Learning and School Age payments are automated.

Population

5.62 Our population projections have only minimally changed since our December 2021 forecasts. We aligned our assumptions on birth rates and mortality from mid-2022 onwards to match the new projections published by National Records of Scotland (NRS) in January, and with higher net international migration for the year to mid-2022.[86] There are no material effects on our social security forecasts.

Policy changes – Scottish Government

5.63 The increase in the SCP payment to £25 per week from December 2022 is the main policy change announced since December 2021. There are other changes which have also been included in this forecasts, such as the automation of BSG, changes to the SISG, the non-managed transfer from DLA to ADP, and the commitment to mitigating the Benefit Cap.

[86] National Records of Scotland (2022) Projected Population of Scotland (2020-based) (link)

5.64 In addition, our indicative forecasts represent Scottish Government policy commitments over the next five years. We provide more details on these changes in the Scottish Government policy section.

5.65 There are also some smaller changes, which we have judged as being below our materiality threshold. These include changes to the eligibility criteria for Best Start Grant, or to ensure Ukrainian refugees can access benefits. These are discussed in Annex C.

Policy changes – UK Government

5.66 In its March 2022 forecasts, the Office of Budget Responsibility (OBR) adjusted its PIP forecast to account for operational delays to PIP award reviews by DWP.[87] We have updated our ADP baseline models with an additional off-model adjustment to reflect this change, which adds £6 million to the forecast in 2022-23.

Funding related to social security

5.67 Social security is one part of the Scottish Budget, and our forecasts set the budget for spending on social security payments.

5.68 Apart from health, social security is the only area where spending increases over the next five years. Social security is funded differently to other parts of the Scottish Budget, because the Scottish Government receives funding from the UK Government through Social Security Block Grant Adjustment (BGAs) for the payments devolved as part of the Scotland Act 2016. Any spending above the funding received through the BGAs must be met by the Scottish Government from its wider Budget. In addition, the Scottish Government has also introduced new payments, and spending on these must be entirely funded from the Budget. Broadly speaking, the Scottish Government's net funding position is the difference between the funding received through the BGAs and our forecast for social security payment with BGAs plus the spending on new unique Scottish payments.

Social security payments with a Block Grant Adjustment

5.69 For payments with BGAs, we compare the funding received through the BGAs with our forecast of spending to estimate the net position for these payments. A negative figure represents that forecast spending in Scotland is higher than the corresponding funding received from the UK Government.

5.70 Spending on social security payments with associated BGAs is forecast to be greater than their corresponding funding in every year of the forecast horizon, by over £700 million by 2026-27. The Scottish Government will need to manage this difference from elsewhere in the Scottish Budget.

[87] HM Treasury (2022) Spring Statement 2022: Policy Costings (link) Page 25 Operational measures to manage constraints within the Personal Independence Payment assessment services

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 [1]	3,207	3,320	3,602	4,082	4,574	4,825	5,103
Spending on social security payments with BGAs [2]	3,321	3,422	3,769	4,439	5,074	5,447	5,817
Net position (BGA less spending) , of which:	-114	-102	-167	-357	-500	-622	-714
Personal Independence Payment	-41	-28	-90	-280	-355	-396	-469
Disability Living Allowance	-1	0	-16	-12	-25	-43	-22
Attendance Allowance	-6	-6	-1	3	-17	-41	-56
Carer's Allowance	-64	-66	-47	-54	-86	-121	-143
Industrial Injuries Disablement Scheme	-1	-1	-1	-1	-1	-2	-5
Cold Weather Payment	-	-	-13	-13	-13	-13	-13
Winter Fuel Payment	-	-	-	-	-3	-5	-6
Severe Disablement Allowance	0	0	0	0	0	0	0

Source: Scottish Fiscal Commission, Scottish Government.
Shaded cells refer to outturn available at time of publication. Figures may not sum because of rounding.
[1] The latest BGA estimates are based on the OBR's March 2022 forecasts and the Scottish Government's estimate for the Winter Fuel Payment (WFP) BGA
[2] Our forecasts of social security spending reflect spending in Scotland on the current payments and additional spending arising from the Scottish Government's policy changes, including our indicative forecasts of future policy commitments.

Box 5.2: Social security payments and their BGAs

Some payments have been devolved or are in the process of being devolved from the UK Government to the Scottish Government. When payments are devolved, the Scottish Government receives funding to administer the payments through the BGAs. The BGAs notionally reflect the level of spending expected in Scotland in the absence of devolution.

The Scottish Government tends to rename these payments when executive competence is devolved. Figure 5.13 presents the Scottish Government payments and their equivalent BGAs.

Figure 5.13: Social security spending forecast and equivalent BGAs

Scottish Fiscal Commission forecasts	Equivalent BGA
Adult Disability Payment	Personal Independence Payment
Child Disability Payment	Disability Living Allowance
Scottish Adult Disability Living Allowance	Disability Living Allowance
Pension Age Disability Payment	Attendance Allowance
Scottish Carer's Assistance	Carer's Allowance
Employment Injuries Assistance	Industrial Injuries Disablement Scheme
Low-Income Winter Heating Assistance	Cold Weather Payment
Pension Age Winter Heating Assistance	Winter Fuel Payment [1]

Source: Scottish Fiscal Commission, Social Security Scotland, Scottish Government.
[1] Winter Fuel Payment BGA has been estimated by the Scottish Government and compared to our Pension Age Winter Heating Assistance forecast.

5.71 In our December 2021 publication, we cautioned that the scale of the funding gap implied by our forecasts was likely to be an underestimate, largely because of our ADP baseline forecast being significantly lower than the OBR's PIP forecast. We explained that this was likely to be because of forecasting differences rather than an actual difference in spending. Since December, we have made a series of modelling changes to adjust our baseline forecast reflecting an additional six months of data.

5.72 Our ADP baseline forecast has increased by almost £390 million in 2026-27 while the corresponding BGA estimate has only increased by £195 million for the same year. This means that the difference between the ADP baseline forecast and the BGA estimate has reduced by approximately £200 million to £90 million in 2026-27.

5.73 To better understand the ADP funding position, we compare the combined PIP and DLA BGAs to our forecasts of ADP, CDP and Scottish Adult DLA. Adult clients in England and Wales will eventually be moved from DLA to PIP. Together we forecast spending on ADP, CDP and Scottish Adult DLA to be £480 million higher than the BGA funding for these payments in 2026-27.

5.74 We forecast spending on ADP will be £584 million higher than on PIP in 2026-27. The difference between the combined PIP and DLA BGAs and the spending on ADP, CDP and Scottish Adult DLA is now more similar to the forecast of additional spending on ADP over what would have been spent on PIP in Scotland. The uncertainties around the ADP forecast mean the net position could be more negative than we currently estimate if our additional spend on ADP is accurate. This is because our estimate of spending on PIP still remains £90 million lower than the PIP BGA. In light of the latest forecast, this risk is not as great as it was in December 2021 when we highlighted that the discrepancy presented a likely underestimate of the net position.

5.75 Our forecasts now also include indicative estimates of additional spending on the replacement payments for Carer's Allowance, Attendance Allowance, Industrial Injuries Disablement Scheme, DLA Adult and Winter Fuel Payment. The introduction of the replacement payments further increases the funding gap. Spending on the replacement payments is forecast to be £209 million higher than the corresponding BGAs by 2026-27.[88] This contributes to the overall negative net position, representing social security spending which must be funded from the wider Scottish Budget. Detailed comparisons between our forecasts and the corresponding BGAs can be found in the Supplementary Tables published on our website.[89]

New payments

5.76 The Scottish Government has introduced several new social security payments which do not receive associated funding from the UK Government. Spending on these payments must be met entirely from the Scottish Budget.

5.77 Overall spending on the new payments is expected to increase from £294 million in 2022-23 to £563 million in 2026-27. The largest new payment is the Scottish Child Payment (SCP).

[88] This figure does not include DLA adult as it cannot be separated from DLA Child in the BGA
[89] Scottish Fiscal Commission (2022) Scotland's Economic and Fiscal Forecasts – May 2022 (link)

5.78 Since December 2021, forecast spending on new payments has increased because of:

- the rise in the SCP payment rate from £20 to £25
- the automation of BSG awards and the removal of income thresholds of BSF
- the commitment to mitigate Benefit Cap deductions through Discretionary Housing Payments
- the 6 per cent uprating to BSG, the fixed rate of FSP, CWHA and CAS 2021-22 payment rates
- higher inflation

5.79 In this report we have presented Carer's Allowance Supplement together with Scottish Carer's Assistance and Carer's Additional Person Payment as part of the net position comparison against the Carer's Allowance BGA.

5.80 Overall, we expect the Scottish Government to spend over £1 billion more on social security by 2024-25, compared to the funding received from the UK Government through the BGAs.

Figure 5.14: Social security net position and new payments

£ million	2022-23	2023-24	2024-25	2025-26	2026-27
Social security net position	-167	-357	-500	-622	-714
Social security new payments	-294	-524	-542	-551	-563
Total	-462	-881	-1,042	-1,173	-1,277

Source: Scottish Fiscal Commission
Figures may not sum because of rounding.
Social security net position includes Adult Disability Payment (covered by the Personal Independence BGA), Child Disability Payment and Scottish Disability Living Allowance (covered by the Disability Living Allowance BGA), Pension Age Disability Payment (covered by the Attendance Allowance BGA), Scottish Carer's Assistance (covered by the Carer's Allowance BGA), Employment Injuries Assistance (covered by the Industrial Injuries Disablement Scheme BGA), Low Income Winter Heating Assistance (covered by the Cold Weather Payment BGA), Pension Age Winter Heating Assistance (covered by the Winter Fuel Payment BGA) and Severe Disablement Allowance.
Social security new payments includes 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 and Benefit Cap mitigation through Discretionary Housing Payments.
In this report we have presented Carer's Allowance Supplement together with Scottish Carer's Assistance and Carer's Additional Person Payment as part of the net position comparison against the Carer's Allowance BGA.

Forecast uncertainty

5.81 There continue to be several areas of significant uncertainty for our spending forecast.

Effects of policies

5.82 The biggest uncertainties are still around the additional spending on the new Adult Disability Payment. As we set out in previous reports, the OBR has found that forecast errors for reforms to disability payments can be large. ADP is now being piloted but our estimate of over £700 million additional spending by 2027-28 is still largely based on subjective assumptions.

5.83 The Scottish Government has announced its intention to introduce indefinite awards for ADP. Clients who have the severe disabilities or conditions that are unlikely to change will not have any scheduled award reviews. Our initial estimate of additional spending was based on the Scottish Government's original award length plans, where clients whose condition was unlikely to change would get a ten-year award. Given that we only forecast spending over a five-year horizon, the introduction of indefinite awards does not have any effect on our forecast. This change is however a long-term risk to the additional spending on ADP, the effect of which will depend on how these would be awarded.

5.84 Our ADP forecast does not include any potential outcomes from the ADP review that is scheduled to begin later this year, or from the independent review commencing a year after ADP is rolled out. If the review indicates that further policy or eligibility rules should change then spending could differ from our forecast. One example of a potential policy change is the discussion around the twenty-metre rule for the mobility component of disability forecasts, which if it was removed, more people are likely to qualify for the mobility component and spending will increase.

5.85 There is a lot of uncertainty around the indicative forecasts for the payments that are still to be launched. We are assuming that they will all be launched and will have replaced the corresponding DWP benefits by the end of the current parliament, but if they are delivered later than we have assumed, then spending will be lower than forecast. It is also possible that when they launch there will be more communications activity which increases take-up of these payments above our current assumptions, or that the Scottish Government will make further policy decisions which make them more expensive.

5.86 In the shorter term, the expansion of Scottish Child Payment this year is still dependent on data from DWP, and spending will be lower if this is delayed beyond our current assumption of an early December 2022 launch. It is also possible that an earlier launch, a higher take-up rate, or worse economic conditions could lead to significantly higher spending.

5.87 Changes in UK Government policies can also affect Scottish social security spending, for example changes to Universal Credit can affect the number of people eligible for the Scottish Child Payment and other low income payments. Our forecasts do not account for policies announced by the UK Government after the 11 May 2022.

Inflation and labour market

5.88 The risks around the economy and inflation forecasts are discussed in more detail in Chapter 3. Our current forecasts are consistent with the OBR's March 2022 forecast, in which the inflation figures used for uprating of benefits are forecast to be 7.5 per cent for the 2023 uprating and 3.4 per cent for 2024.

5.89 If inflation instead follows the path set out in the Bank of England's May Monetary Policy Report, then uprating could be as high as 9.5 per cent for 2023 and 5.9 per cent in 2024, and spending on the uprated benefits could be over 4 per cent higher from 2024-25 onwards.[90]

5.90 The net budget position for social security would be protected from most of this effect, as the higher uprating would also apply to England and Wales, leading to similar increases in funding through the BGAs. However, higher inflation will still increase the total funding gap as it increases the uprating of benefits without UK funding, such as the Scottish Child Payment, or the additional spending on payments, such as Adult Disability Payment, which already exceed their BGA.[91]

5.91 It is also possible that the pressure higher prices are putting on households could indirectly lead to higher spending through higher take-up rates for both devolved social security payments, and the underlying reserved qualifying benefits such as Universal Credit.

5.92 As discussed in **Chapter 3**, we see a recession as a downside risk to the forecast. In the event of a recession the main impact on social security spending would be likely to be through higher eligibility for Scottish Child Payment as more families claim Universal Credit.

Forecast performance and evaluation

5.93 In our July 2021 Forecast Evaluation Report, we set out that Social Security spending in 2020-21 was around £100 million or 3 per cent higher than we had forecast at the time of the 2020-21 Scottish Budget, of which around half was directly attributable to the COVID-19 pandemic response.[92] We do not yet have full data for 2021-22, but our latest forecast suggests a similar scale of error, with the majority again related to the pandemic, mainly through much higher spending on the Self-Isolation Support Grant, and the policy decision to make a double payment of Carer's Allowance Supplement in December 2021. We will report fully on our forecast errors for 2021-22 later this year.

5.94 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 uncertainty will reduce, the pressure to the budget may increase if spending proves to be higher than we forecast, since the commitments being made now will have long-term spending implications.

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[90] Bank of England (2022) Monetary Policy Report – May 2022 (link)
[91] Scottish Child Payment would not be sensitive to higher inflation this year, as the Scottish Government has already committed to a rate of £25 per week for 2023-24.
[92] Scottish Fiscal Commission (2021) Forecast Evaluation Report – July 2021 (link)

Annex A

Policy Costings

Introduction

A.1 This annex sets out the steps and judgements taken to arrive at our costings of changes in Scottish Government policy since our December 2021 forecasts were published.

New policy costings

A.2 Figure A.1 shows a summary of new policy costings included in our forecasts. In this table negative numbers represent lower tax revenues or higher social security spending, and positive numbers are for higher tax revenues or lower social security spending. In the later sections covering the individual policy measures, social security changes are shown as positive if they increase spending.

Figure A.1: Policy costings

£ million	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Increase Scottish Child Payment to £25	-18	-60	-61	-62	-62	-63
Benefit Cap mitigation	-4	-11	-15	-18	-20	-22
Remove Best Start Foods income thresholds	-	-6	-6	-6	-6	-6
Changes to Self-Isolation Support Grant	14	-	-	-	-	-
Longer processing time for natural PIP transfers to ADP	-7	-15	-2	-	-	-

Source: Scottish Fiscal Commission

Social Security

Title of measure

Increase weekly Scottish Child Payment to £25 for each child

Measure description

A.3 The Scottish Government announced in March that the weekly rate of Scottish Child Payment will increase from £20 to £25 per week for each child by the end of 2022.[93]

The cost base

A.4 The cost base is our forecast of the number of children receiving Scottish Child Payment under current policy and economic assumptions, including the planned expansion to children aged 6 to 15 later this year.

Figure A.2: Scottish Child Payment caseload forecast

Thousands	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Scottish Child Payment caseload	304	328	326	324	322	316

Source: Scottish Fiscal Commission
The figure for 2022-23 includes around 200,000 children aged 6 to 15 who will not receive payment until eligibility is extended to older children, which we assume will be in December 2022.

A.5 In this base forecast, Scottish Child Payment is assumed to be uprated in line with CPI inflation. Under our current economy forecast this would mean the next uprating would be an increase of 7.5 per cent, from £20 to £21.50 per week.

Figure A.3: Weekly Scottish Child Payment in baseline and under new policy

£ per week	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Baseline policy	20.00	21.50	22.25	22.60	23.05	23.50
New policy	20.00	25.00	25.85	26.25	26.75	27.30

Source: Scottish Fiscal Commission
Under both policies the rate for 2023-24 is assumed to be introduced in December 2022.

The costing

A.6 The costing is calculated by applying the difference in weekly payment rates to our forecast of the number of children receiving Scottish Child Payment.

A.7 Over 300,000 children receiving around an extra £3.50 per week gives additional annual spending of around £60 million. The £25 weekly rate is assumed to apply from the start of December 2022, so costs in 2022-23 are roughly a third of the full annual impact seen in later years.

[93] Scottish Government (2022) Tackling Child Poverty Delivery Plan 2022-26 (link)

Figure A.4: Costing of increase in weekly Scottish Child Payment to £25 per child

£ million	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Policy costing	18	60	61	62	62	63

Source: Scottish Fiscal Commission

A.8 In our December costing of the April 2022 doubling of Scottish Child Payment from £10 to £20 per week we added a behavioural adjustment to allow for higher take-up of both SCP and the underlying qualifying benefits in response to the higher payment. Our judgement is that this second increase, taking place in the same calendar year, is unlikely to have a material behavioural impact over and above the response to the £20 rate, so we have made no further behavioural adjustment.

Uncertainties about the costing

A.9 Costs could be higher if more children are receiving Scottish Child Payment, for example if unemployment is higher than expected, or families with older children have higher take-up than we have assumed, or inflationary pressures on households drive higher take-up of Universal Credit.

A.10 Costs could be lower if the extension to older children is delayed, or if fewer families than expected receive Universal Credit, or if there is a smaller behavioural response to the £20 rate than we have assumed.

A.11 Costs in 2022-23 could have a large relative error if the higher rate is introduced earlier or later than we have assumed.

A.12 In one respect the introduction of the policy makes total spending on Scottish Child Payment more certain in the short term, as the commitment to a payment rate of £25 per week removes the uncertainty about the next uprating of Scottish Child Payment, which would otherwise be sensitive to how inflation develops this year.

Title of measure

Remove income thresholds from Best Start Foods

Measure description

A.13 The Scottish Government confirmed in March this year that the income thresholds which limit eligibility for Best Start Foods would be removed in 2023-24.[94]

A.14 Best Start Foods is a payment towards the costs of being pregnant or looking after children under three. It is currently available to families who receive Universal Credit or Tax Credits, but only if their income is below a threshold. For Universal Credit claimants the threshold is roughly equivalent to working sixteen hours a week at the National Living Wage, restricting eligibility to only the lowest income households.

A.15 The policy change will remove these thresholds, putting eligibility for Best Start Foods on to a similar basis as Best Start Grant and Scottish Child Payment.

The cost base

A.16 The cost base is our baseline forecast of spending on Best Start Foods.

Figure A.5: Baseline forecast of Best Start Foods spending with income thresholds in place

£ million	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Baseline BSF spending	12	12	12	11	11	11

Source: Scottish Fiscal Commission

The costing

A.17 We model the removal of the income thresholds by increasing the assumed proportion of children under three who are in eligible households. Once the thresholds are removed we assume this will be similar to the Scottish Government estimate of eligibility for Early Learning Payment, and will follow the same trend as our assumed path for Scottish Child Payment eligibility.

Figure A.6: Eligibility for Best Start Foods in baseline and under new policy

Per cent	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Eligibility with thresholds	28.0	28.0	28.0	28.0	28.0	28.0
Eligibility without thresholds	28.0	44.0	44.5	45.0	45.5	45.5

Source: Scottish Fiscal Commission

A.18 Our projection of the population of children under three is around 140,000, and the annual value of an ongoing Best Start Foods award is £234. The assumed increase in eligibility represents around an additional 20,000 beneficiaries once we account for our take-up assumption of 86 per cent, and gives an annual cost of around £6 million, just above our £5 million materiality threshold.

[94] Scottish Government (2022) Best Start, Bright Futures Tackling Child Poverty Delivery Plan 2022-26 (link)

Figure A.7: Costing of removing Best Start Foods income thresholds

£ million	2023-24	2024-25	2025-26	2026-27	2027-28
Policy costing	6	6	6	6	6

Source: Scottish Fiscal Commission

Uncertainties about the costing

A.19 We do know how much is currently being spent on Best Start Foods, but there is a lot of uncertainty about the underlying eligibility and take-up rates. If current eligibility rates are higher than we assume, then the costs of removing the thresholds would be lower. If the true level of eligibility under the current income thresholds is lower, this would imply that the current take-up rate is higher, increasing the additional costs of removing the thresholds.

A.20 We have assumed that the policy will take effect from April 2023. If the change is not implemented until later in the year, then the costs in 2023-24 will be lower.

Title of measure

Discretionary Housing Payments Benefit Cap mitigation

Measure description

A.21 The Benefit Cap is a UK Government policy designed to limit the total amount of benefits a household can receive. In Scotland it usually limits a family's weekly benefits to the equivalent of £20,000 annually, through a deduction from their Universal Credit or Housing Benefit award.

A.22 The Scottish Government has committed to "work with local authorities to mitigate the Benefit Cap as fully as we can within the scope of devolved powers, taking immediate steps to support as many families as possible in 2022."[95]

A.23 We model this as being implemented through Discretionary Housing Payments, under a similar approach as is currently used for bedroom tax mitigation, with the Scottish Government committing to fully reimburse councils when they award Discretionary Housing Payments to mitigate Benefit Cap deductions, and issuing guidance that councils should do this whenever possible.[96]

The cost base

A.24 The cost base is the total value of the Benefit Cap deductions being made in Scotland. Statistics published by DWP show that in November 2021 around 4,000 households were subject to an average weekly deduction of £48, giving an annualised value of around £10 million.

The costing

A.25 We start from the annualised current value of benefit cap deductions in Scotland, at £10 million in late 2021.

A.26 We then grow this over time to account for uprating of benefits. The level of the Benefit Cap itself is not regularly uprated, so for a fixed population of the benefit recipients, the number and value of deductions will rise over time, particularly when inflation is high. The UKMOD microsimulation model suggests that the total value would rise to £23 million by 2025-26.[97] As a sense check on this very fast growth, the data published by DWP show that when the £20 Universal Credit uplift was removed in September 2021, the annualised value of deductions fell from £16 million to £10 million. Under our current inflation forecast the uprating of Universal Credit, Tax Credits and Child Benefit across 2022 and 2023 will be enough to increase the total benefits package of a family with three children by more than £20 per week, so we expect the total value of deductions to return to at least its mid-2021 level in 2023.

A.27 We then make an assumption about the proportion of these deductions councils will actually manage to mitigate. We have set a relatively high coverage assumption of 60 per cent this year, rising to 80 per cent by 2024-25, informed by the Scottish Government's intention to spread best practice. This gives a gross static cost of £7 million this year, rising to £20 million by 2027-28.

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[95] Scottish Government (2022) Best Start, Bright Futures Tackling Child Poverty Delivery Plan 2022-26 (link)
[96] There are practical limits in identifying these households, and legal limits in terms of the scope of Discretionary Housing Payments.
[97] The estimate was derived from a modified version of UKMOD version A3.0+ from the Centre for Microsimulation and Policy Analysis (CeMPA) at the University of Essex. Full details of the model are available in the UKMOD country report 2019-2025 (link)

A.28 The Scottish Government already pays councils for some Benefit Cap mitigation through the £10.9 million budget to cover Discretionary Housing Payments paid for reasons other than bedroom tax mitigation. We assume that final cost of the policy for Scottish Government will be net of around £3 million that councils are already spending. The arrangements for this are still to be agreed between the Scottish Government and local authorities, and our assumption should not be taken as pre-judging or limiting the eventual funding arrangements.

A.29 We finally add a small behavioural adjustment. We do not make detailed assumptions on exactly how households will respond to effectively no longer being subject to the Benefit Cap, but at the current average deduction of nearly £50 per week, it would only take 2,000 additional households to generate material additional costs of £5 million. Our judgement is that it is likely that full mitigation of the Benefit Cap will lead to more people remaining capped. We think the most likely way that this would happen would be through a gradual build-up of families who may be slower to move out of the scope of the cap through a move into work. We have added a behavioural adjustment, which builds up to £5 million by the end of the forecast.

A.30 This gives a final net costing which rises from £4 million in 2022-23 to £22 million by 2027-28.

Figure A.8: Costing of Benefit Cap mitigation

£ million	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Gross value of deductions	12	18	20	23	24	25
Value after coverage assumption	7	13	16	18	19	20
Net off current spending	-3	-3	-3	-3	-3	-3
Static net cost	4	10	13	15	16	17
Behavioural adjustment	0	1	2	3	4	5
Final costing	4	11	15	18	20	22

Source: Scottish Fiscal Commission

Uncertainties about the costing

A.31 If unemployment or inactivity rates are higher than expected, for example because of a recession, or in a scenario where public health restrictions are reapplied, then the number of families subject to the Benefit Cap could increase. Higher inflation could also lead to higher spending as the gap between uprated benefit awards and the fixed level of the cap would be wider.

A.32 Our costing assumes that best practice can be spread so that by 2024-25 at national level around 80 per cent of Benefit Cap deductions will be identified and mitigated. Awards of Discretionary Housing Payments will still be made at the discretion of councils, who may have varying levels of success in identifying and mitigating Benefit Cap deductions. This could lead to lower coverage and lower spending.

A.33 Our costing assumes a static response from households which face new or rising benefit cap deductions because of benefit uprating. It is possible that significant numbers of households will move out of the scope of the cap, for example by moving into work, or claiming disability benefits, in which case spending would be lower.

Title of measure

Changes to Self-Isolation Support Grant from May 2022

Measure description

A.34 From 1 May 2022 Scotland's public health advice has moved to a 'stay at home' message and COVID-19 testing for the general population has stopped.[98] Eligibility for the Self-Isolation Support Grant (SISG) was based on the requirement to isolate, so this would have removed all eligibility for SISG, but the Scottish Government also announced that SISG would continue to be available at a lower rate of £225 for people who have tested positive through a PCR test, and meet the criteria around income levels and loss of income. With COVID-19 testing centres now closed, most applicants will need to request a test specifically for the purpose of establishing eligibility for SISG.

The costing

A.35 Our costing is an estimate of the reduction in spending on SISG from moving from the system in place up to the end of April to the new system from May onwards, including the reduction in eligibility, the lower payment amount, and any take-up effects from reduced availability of testing.

A.36 We first set our baseline forecast of the path for SISG spending under the arrangements before May 2022. This is based on COVID-19 infection and case rates falling back towards the levels we had assumed in our December 2021 forecast. This gives a base forecast of £25 million. We then assume that from May 2022 onwards there will be only around 2,500 awards per month, receiving £225 each. This leaves an estimated £11 million spending in 2022-23 most of which is in April, with only around £0.6 million per month for May through to October.

Figure A.9: Costing of May 2022 changes to Self-Isolation Support Grant

£ million	2022-23
Baseline spending	25
Spending under new policy	11
Costing	-14

Source: Scottish Fiscal Commission

Uncertainties about the costing

A.37 Our forecasts assume that prevalence of COVID-19 remains low and steady, and that SISG will be stopped altogether at the end of October 2022, when the current discretionary arrangements for compensation for self-isolation are due to stop.[99] The Scottish Government will review the eligibility criteria for SISG at the end of June, so spending could be lower if eligibility stops or is further restricted after this review. If COVID-19 infections rise again, spending could be higher, and there is the potential for much higher spending in the event that a vaccine-resistant variant emerges and public health restrictions are reintroduced.

[98] Scottish Government (2022) New 'stay at home' guidance published (link)
[99] Scottish Parliament (2021) Coronavirus (Discretionary Compensation for Self-isolation)(Scotland) Bill (link)

Title of measure

Longer processing time for natural PIP transfers to Adult Disability Payment

Measure description

A.38 The completion time for processing clients with an existing PIP award who transfer from PIP to ADP and have an award review will be longer than the current DWP PIP processing times for people having award reviews. The additional time is a result of the time it will take to transfer clients and because of clients having longer to provide their supporting evidence.

The costing

A.39 Clients will continue receiving their PIP award for an extra period of time before transferring to ADP. Clients who then have their award increased will get their payment backdated; clients whose award is decreased or disallowed at review will not have to pay this back. This results in an additional cost.

A.40 After discussions with the Scottish Government, we have assumed that this will on average take an extra five months, based on a mid-point of their range of estimates of the possible increase in processing time.

A.41 We have added an off-model adjustment to factor in the cost of clients who have their payment decreased following a change of circumstance or award review and so receive their higher existing award for longer. This is costed by analysing the average payment of clients who are unsuccessful at review and calculating the difference in cost from them receiving this payment for a further five months. This increases the cost of the ADP forecast by £15 million by 2023-24 but has no cost after 2024-25.

Figure A.10: Costing of the longer processing time for natural PIP transfers to ADP

£ million	2022-23	2023-24	2024-25
Policy costing	7	15	2

Source: Scottish Fiscal Commission

Uncertainties about the costing

A.42 We have assumed that this will take an extra five months, however, this is just an estimate and it may take longer to process these clients. If it does then the cost of this policy may be higher than we have forecast. This costing also relies on our assumptions about how many people will be successful at ADP award reviews and after change of circumstance requests, so this also adds uncertainty. This is a small cost relative to the overall ADP forecast, but it adds to the overall ADP uncertainty.

Annex B

Policy Recostings

Introduction

B.1 In this section we present updated versions of previous policy costings for which we do not yet have outturn data that includes the effects of the policy. For example, changes made to income tax in 2020-21 will not be present in the data until summer 2022.

B.2 We may also sometimes present updated costings for older policies if we have revised key judgements or assumptions, particularly in response to new evidence.

Policy re-costings

B.3 Figure B.1 presents the latest recostings. Tax measures are shown as a positive figure where they generate additional revenue and negative if they reduce revenue. Social Security costings are shown as positive if they reduce spending, and negative if they increase spending, to give a consistent picture of the impact each measure has on the Scottish Budget.

B.4 Figure B.2 shows the change since the previous edition of each costing. In most cases this comparison is against the versions presented in Annexes A and B of our December 2021 forecast publication, but the costing for devolution of the Non-Domestic Rates empty property relief has not been presented since January 2021.

Figure B.1: Latest policy recostings

£ million	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Income tax: 2020-21 higher rate threshold policy	52	59	63	61	62	66	69	73
Income tax: higher rate threshold freeze in 2022-23	-	-	117	112	115	122	128	135
NDR: Devolution of Empty Property Relief [1]	-	-	-	105	104	105	114	113
NDR: Empty Property Relief reset period [1]	-	2	2	2	3	3	3	3
NDR: Retail, Hospitality, Leisure and Airports relief	-	-696	-	-	-	-	-	-
NDR: set poundage to 49.8p in 2022-23	-	-	-40	-49	-47	-47	-50	-54
NDR: 50 per cent RHL capped relief until June 2022	-	-	-56	-	-	-	-	-
Adult Disability Payment [2]	-	-	-42	-263	-378	-482	-590	-707
Carer's Allowance Supplement double payment in December 2021	-	-20	-	-	-	-	-	-
Fair Start Scotland extension	-	-18	-19	-12	-4	0	-	-
Self-Isolation Support Grant: Extension of eligibility in early 2021	-1	-34	-	-	-	-	-	-
Self-Isolation Support Grant: Restriction of eligibility in October 2021	-	18	-	-	-	-	-	-
Scottish Child Payment increase to £20 per week	-	-	-99	-180	-184	-186	-189	-189

Source: Scottish Fiscal Commission

[1] Last published January 2021, Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts - January 2021 (link).

[2] The Adult Disability Payment costing includes the effect on payments to carers, net effect of the case transfer costing and the processing time costing from Annex A.

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 threshold policy	1	3	6	3	2	3	2
Income tax: higher rate threshold freeze in 2022-23	-	-	11	6	4	4	4
NDR: Devolution of Empty Property Relief [1]	-	-	-	17	14	12	-
NDR: Empty Property Relief reset period [1]	-	0	0	0	0	0	-
NDR: Retail, Hospitality, Leisure and Airports relief	-	0	-	-	-	-	-
NDR: set poundage to 49.8p in 2022-23	-	-	0	-6	-5	-6	-6
NDR: 50 per cent RHL capped relief until June 2022	-	-	0	-	-	-	-
Adult Disability Payment [2]	-	-	-4	-30	-21	-24	-23
Carer's Allowance Supplement double payment in December 2021	-	0	-	-	-	-	-
Fair Start Scotland extension	-	0	1	1	1	0	-
Self-Isolation Support Grant: Extension of eligibility in early 2021	0	-14	-	-	-	-	-
Self-Isolation Support Grant: Restriction of eligibility in October 2021	-	4	-	-	-	-	-
Scottish Child Payment increase to £20 per week	-	-	4	5	-1	-1	-3

Source: Scottish Fiscal Commission

[1] Change shown is since version published in January 2021. Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts - January 2021 (link)

[2] The Adult Disability Payment costing includes the effect on payments to carers, net effect of the case transfer costing and the processing time costing from Annex A.

Annex C

Materiality and Policy Costings

Introduction

C.1 Some policies announced by the Scottish Government will have a very small effect relative to the size of the Scottish Budget. The Commission publishes detailed information on policies which have a material effect on the Scottish Budget, which are covered in Annex A. This Annex covers the policies which do not have a detailed policy costing approach, some are still included in our forecasts while others are not. We explain the approach for each policy below. Our approach to materiality was first introduced in our December 2018 Scotland's Economic and Fiscal Forecasts publication. We reviewed our materiality policy and set out increased materiality thresholds in Annex C of our January 2021 SEFF publication.[100]

C.2 We also consider materiality in our approach to error correction, published in our statement of compliance with the Code of Practice for Statistics.[101] We categorise errors based on materiality and then use this to help us decide on an appropriate response.

Materiality Policy

Negligible policies

C.3 The Commission has set thresholds under which policies will be deemed to be negligible and will not be costed. The threshold for negligible policies is £2 million.

Small policies

C.4 For policies over £2 million but under a threshold of £5 million a decision will be made whether to cost the policy or not.

C.5 Our criteria for when not to cost a small policy are unchanged from December 2018 and require some, or all, of the following:

- 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

C.6 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.

[100] Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – January 2021 (link)
[101] Scottish Fiscal Commission (2022) Statement of Voluntary Compliance with the Code of Practice for Statistics and Error Policy (link)

Materiality decisions for May 2022

C.7 Since we published our December 2021 forecasts, the Commission has decided not to produce costings for the following policy changes, split into two groups.

C.8 Firstly, some small policy changes are judged to not to be material, but are still included in our forecasts. This is typically because they are simple to model, for example uprating decisions on smaller payments. These are not shown in Annex A, but are included in the total estimate of policy changes in Chapter 5 and in the supplementary tables showing the changes since our December forecasts.

- In March 2022 the Scottish Government announced that Best Start Grant, Funeral Support Payment, Carer's Allowance Supplement and Child Winter Heating Assistance would be uprated by 6 per cent in April 2022.[102]

- In May 2022 the Scottish Government introduced regulations so that people receiving Working Age DLA could request a change of circumstances or voluntarily request a transfer to ADP. We assume these regulations apply until DLA clients are moved to the new Scottish DLA payment. The additional spending on ADP combined with reduced spending on DLA is less than £5 million each year.

- In March 2022 the Child Poverty Delivery Plan included an announcement that by the end of 2022, Best Start Grant Early Learning and School Age payments will be paid automatically to families who are already receiving Scottish Child Payment.

- The Scottish Government have confirmed that the extension of Child Winter Heating Assistance eligibility to some PIP recipients announced in September 2021 will also apply to Adult Disability Payment.

C.9 The second group are policy changes which we judge to be small or negligible and have not included in the forecast.

- There have been several changes to the eligibility conditions for Self-Isolation Support Grant since we closed our previous forecasts in late November 2021. These included extending eligibility in response to the emergence of the Omicron variant, and subsequently tightening eligibility.[103] It is possible that individually or in aggregate these changes may have had an impact above the £5 million materiality threshold, but as these changes have all been superseded by the system in place from May 2022, we have not attempted to produce costings.

- In March 2022 the Scottish Government laid emergency legislation, to ensure that Ukrainian refugees could access devolved social security assistance without having to meet the habitual residence or past presence residence requirements.[104] This may have material costs if large numbers of people arrive through the Ukraine Family Scheme and Ukraine Sponsor scheme and claim social security assistance. We have not produced a policy costing but the population projection underlying all our forecasts includes a higher assumed level of international migration this year as a result of the war in Ukraine.

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[102] Scottish Government (2022) Increase in social security benefits (link)
[103] The sequence of changes to eligibility in November 2021, December 2021, January 2022 and March 2022 can be seen in the supporting document to the relevant statutory guidance for councils (link)
[104] Scottish Government (2022) The Social Security (Residence Requirements) (Ukraine) (Scotland) Regulations 2022: policy note (link)

- The Scottish Government have provided draft regulations to the Scottish Commission on Social Security which are primarily to enable the extension of Scottish Child Payment to older children and the automation of Best Start Grant, but also include small changes to eligibility criteria for Scottish Child Payment, Best Start Grant and Best Start Foods.[105] We estimate that these changes will have negligible costs and have made no change to our forecasts.

- The Scottish Government have laid regulations to clarify the eligibility criteria for Best Start Foods in cases where a claim is made by a partner or appointee of a pregnant woman. We estimate that these changes will have negligible costs.[106]

Assessing cumulative materiality

C.10 One of the criteria for deciding whether or not to cost small policies is to check if the cumulative policy changes would be above our materiality threshold. We also keep under review the policies we have previously not costed to ensure that none of these are now above the thresholds.

C.11 In Figure C.1 we show a cumulative list of all the materiality decisions we have made since we introduced the original materiality policy in December 2018.

[105] Scottish Commission on Social Security (2022) Scottish Commission on Social Security letters: The Best Start Foods, Best Start Grants and Scottish Child Payment (Miscellaneous Amendments) Regulations 2022 (link)
[106] Scottish Government (2022) The Welfare Foods (Best Start Foods)(Scotland)Amendment Regulations 2022 (link)

Figure C.1: Policies not costed since December 2018

Policy	Description and reason not to cost	Timing of original materiality decision
Non-Domestic Rates solar panel relief	Business Growth Accelerator relief was extended to give full relief to any rise in rateable value from installing solar panels. We estimated that the value of this relief would be negligible.	Scotland's Economic and Fiscal Forecast December 2021
Child Winter Heating Assistance eligibility	Eligibility was extended to include some Personal Independence Payment recipients. We included the costs in our forecast but they were below our negligibility threshold.	Scotland's Economic and Fiscal Forecast December 2021
Best Start Foods thresholds uprated	The income thresholds for Best Start Foods eligibility rose in line with the National Living Wage. We estimated the costs were negligible.	Scotland's Economic and Fiscal Forecast December 2021
Child Winter Heating Assistance uprating	An uprating of 6 per cent was announced for April 2022. We included the higher rate in our forecast, but the cost is negligible.	Scotland's Economic and Fiscal Forecast December 2021
Afghan residence requirements	Residence requirements were changed so people evacuated from Afghanistan could access devolved social security assistance.[107]	September 2021
Best Start Foods – increase to £4.50	The weekly value was increased from August 2021 and the income thresholds were uprated.	May 2021
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 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 was negligible.	Scotland's Economic and Fiscal Forecast January 2021
Child Disability Payment – Pilot	The CDP pilot ran from the July 2021 to November 2021. We estimated that the additional spending was negligible.	Scotland's Economic and Fiscal Forecast January 2021
Social Security Administration and Tribunal Membership (Scotland) Bill	This is a series of administrative changes which we believe will have no material effect on 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 so adding them to the valuation roll 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 which we believe has no financial implications.	Scotland's Economic and Fiscal Forecasts February 2020
Young Carer Grant	An annual payment for young carers with an estimated cost of less than £1 million.	Scotland's Economic and Fiscal Forecasts December 2018

Source: Scottish Fiscal Commission

There have also been a 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.

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

Annex D

Fiscal Overview technical details

Data for 2027-28

D.1 The amounts for the year 2027-28 on our funding tables did not come from the Scottish Government. This is because this year is beyond the period covered by the RSR, which gets published alongside this report. Similarly, the GDP deflators forecasted by the OBR, which we use to analyse the funding levels in real terms, end in 2026-27.

D.2 We covered 2027-28 in our Fiscal Overview chapter because our report includes forecasts for devolved taxes and devolved social security spending for this year too. However, we had to make several assumptions to arrive at the amounts for 2027-28. These are:

- That the UK Spending Review Baseline (Barnett) and the Barnett consequentials increase at the same rate as from 2025-26 to 2026-27.
- That the non-Barnett funding and the 'Other' funding are fixed at the previous year's amounts.
- That the GDP deflator will grow 2 per cent in 2027-28, in line with the Bank of England's target inflation rate.

Reconciliation of SFC and SG presentation of funding

D.3 As explained in paragraph 2.33 the Scottish Government is now presenting its funding position differently than in the past. In particular, many funding sources are now grouped into a single line called 'Other funding sources'.

D.4 Since we have decided to stick with our presentational style for consistency and clarity, there is a divergence on how both organisations present the funding position. Figure D.1 shows how both can be reconciled.

Figure D.1: Reconciliation of funding presentations

£ million	2023-24	2024-25	2025-26	2026-27
SG's 'Other Funding Sources'	**416**	**-119**	**-317**	**-265**
Remove from the definition of 'Other':				
Indicative Income Tax reconciliations	-221	-817	-238	-
Resource borrowing	110	300	119	-
Cost of resource borrowing	-110	-124	-169	-191
Cost of capital borrowing	-100	-122	-144	-166
Scotland Reserve assumption	279	250	113	87
Add to the definition of 'Other':				
Income from Fines, Forfeitures and Fixed Penalties (FFFPs)	25	25	25	25
Equals SFC's 'Other' resource funding, of which:	**483**	**419**	**26**	**30**
Migrant Surcharge	120	120	120	120
Queen’s and Lord Treasurer's Remembrancer (QLTR)	5	5	5	5
Income tax spillover [1]	-77	-133	-154	-152
ScotWind proceeds	310	350	0	0
Non-tax income (FFFPs and Proceeds of Crime)	25	25	25	25
'Other' [2]	100	52	30	32

Source: Scottish Fiscal Commission, based on Scottish Government information.
Figures may not sum because of rounding.
[1] The spillover amounts are still subject to negotiation but the SG have included them to indicate available funding in future years.
[2] 'Other' is an SG assumption on additional income from any of the above sources, or additional UKG funding exceeding amounts assumed in Figure 2.1.

Additional Information

Abbreviations

AA	Attendance Allowance
ADP	Adult Disability Payment
ADS	Additional Dwelling Supplement
APD	Air Passenger Duty
BGA	Block Grant Adjustment
BGAs	Block Grant Adjustments
BSG	Best Start Grant
BSF	Best Start Food
BMW	Biodegradable Municipal Waste
CA	Carer’s Allowance
CAPP	Carer's Additional Person Payment
CAS	Carer’s Allowance Supplement
CDP	Child Disability Payment
COFOG	Classification of Functions of Government
CPI	Consumer Price Index
COVID-19	Coronavirus
CWHA	Child Winter Heating Assistance
DACYP	Disability Assistance for Children and Young People
DHP	Discretionary Housing Payment
DLA	Disability Living Allowance
DWP	Department for Work and Pensions
EIA	Employment Injuries Assistance
EPR	Empty Property Relief
EU	European Union
FAI	Fraser of Allander Institute
FFFPs	Fines, Forfeitures & Fixed Penalties
FSP	Funeral Support Payment
FT	Financial Transaction
FTs	Financial Transactions
GDP	Gross Domestic Product
HMRC	Her Majesty’s Revenue and Customs
HM Treasury	Her Majesty’s Treasury
IIDS	Industrial Injuries Disablement Scheme
LBTT	Land and Buildings Transaction Tax
LIWHA	Low Income Winter Heating Assistance
MTFS	Medium Term Financial Strategy
NDR	Non-Domestic Rates
NHS	National Health Service
NI	National Insurance
NIESR	National Institute of Economic and Social Research
NIM	National Infrastructure Mission
NPV	Net Present Value
NRS	National Records of Scotland
NSND	Non-Savings and Non-Dividends
OBR	Office for Budget Responsibility
OECD	Organisation for Economic Cooperation and Development
Ofgem	Office of Gas and Electricity Markets
OGA	Oil and Gas Authority
OGUK	Oil and Gas UK
ONS	Office for National Statistics
PADP	Pension Age Disability Payment
PAWHA	Pension Age Winter Heating Assistance

PAYE	Pay As You Earn
PCR	Polymerase Chain Reaction
PIP	Personal Independence Payment
PSCE	Public Sector Current Expenditure
QLTR	Queen's and Lord Treasurer's Remembrancer
QNA	Quarterly National account
RHL	Retail, Hospitality and Leisure
RSR	Resource Spending Review
RTI	Real Time Information
rUK	Rest of the UK: England, Wales and Northern Ireland
RV	Rateable Value
SA	Self Assessment
SCA	Scottish Carer's Assistance
SCP	Scottish Child Payment
SDA	Severe Disablement Allowance
SEFF	Scotland's Economic and Fiscal Forecasts
SFC	Scottish Fiscal Commission
SISG	Self-Isolation Support Grant
SIT	Scottish Income Tax
SLfT	Scottish Landfill Tax
SWF	Scottish Welfare Fund
UC	Universal Credit
UK	United Kingdom
UKCS	UK Continental Shelf
UKMOD	UK tax-benefit microsimulation model
VAT	Value Added Tax
WFP	Winter Fuel Payment
WRIT	Welsh Rates 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).[108]

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.[109]

[108] OECD (2014) Recommendation on Principles for Independent Fiscal Institutions (link)
[109] 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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