Scottish Fiscal Commission

Scotland's Economic and Fiscal Forecasts - Summary

May 2022

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Published by the Scottish Fiscal Commission, May 2022

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.

Susan Rice

Dame Susan Rice DBE

F. Breedon

Professor Francis Breedon

David Ulph

Professor David Ulph

31 May 2022

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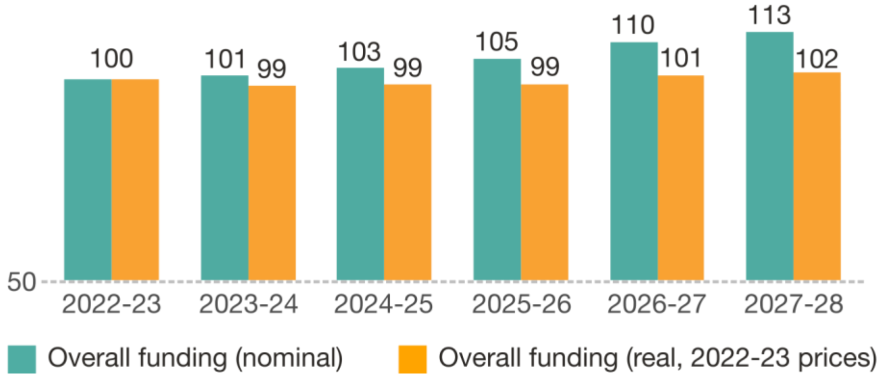
Fiscal Overview

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.

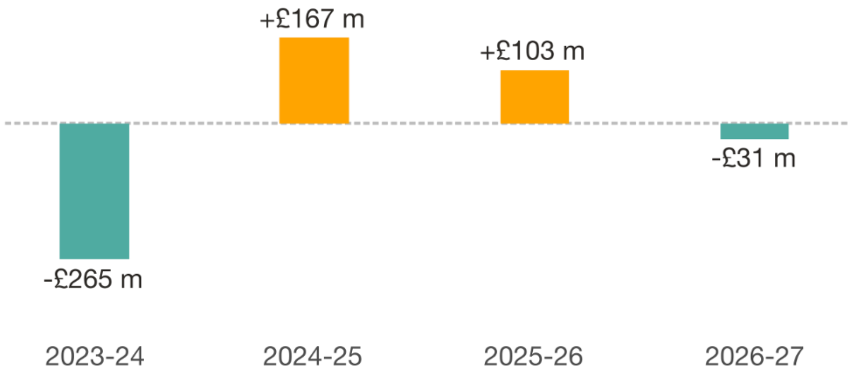
Medium term outlook for overall funding (2022-23 = 100)



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

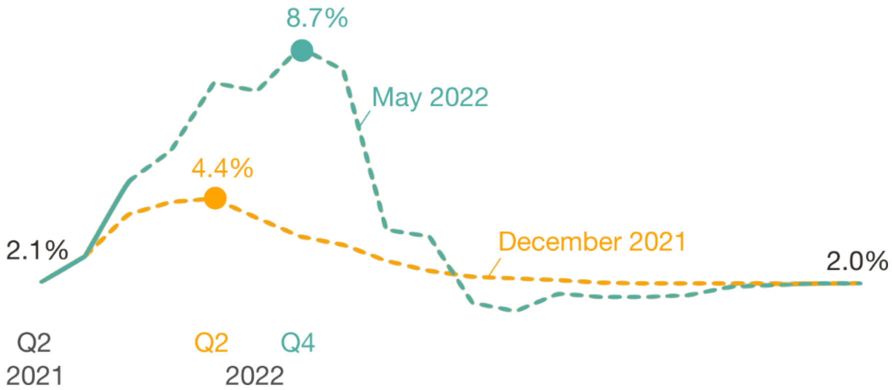


Economy

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.

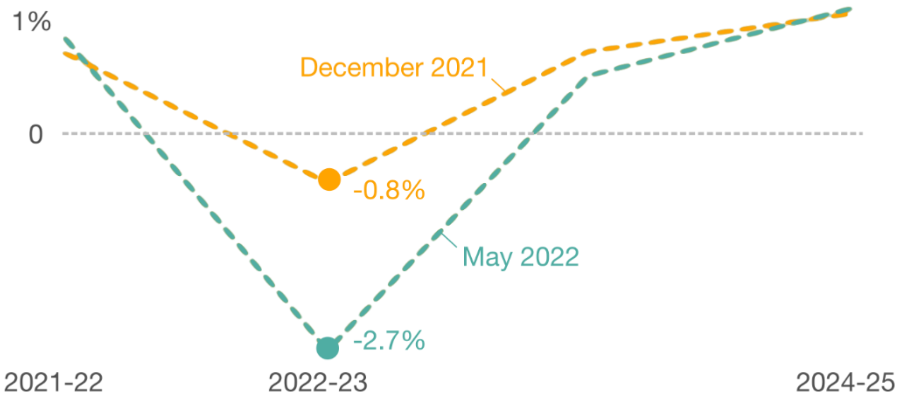
Inflation forecast raised significantly



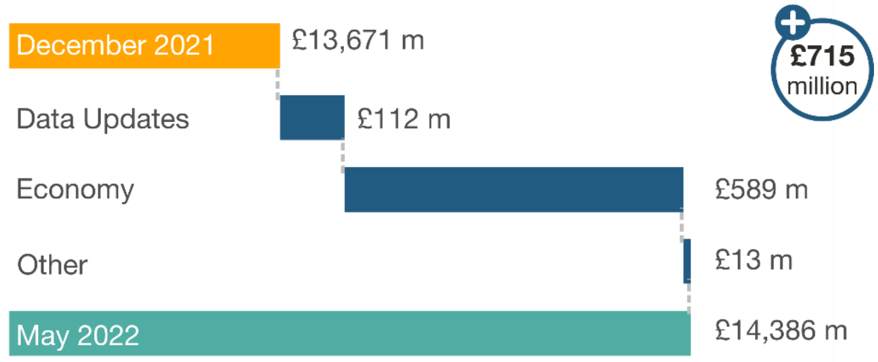
We forecast real average earnings to decrease by 2.7 per cent in 2022-23.

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



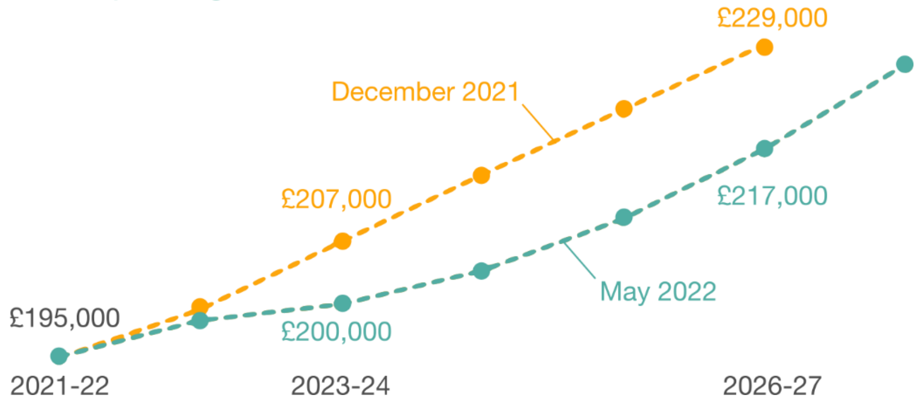
Income tax changes since December 2021 forecast



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

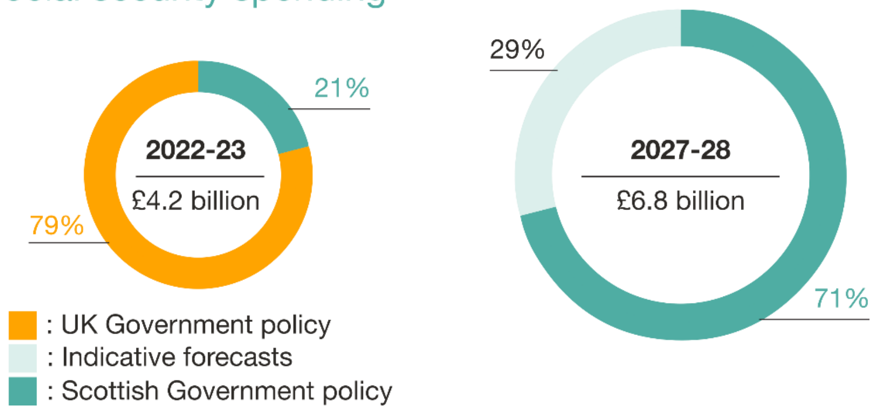


House prices will continue to rise but not as quickly as previously forecast.

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

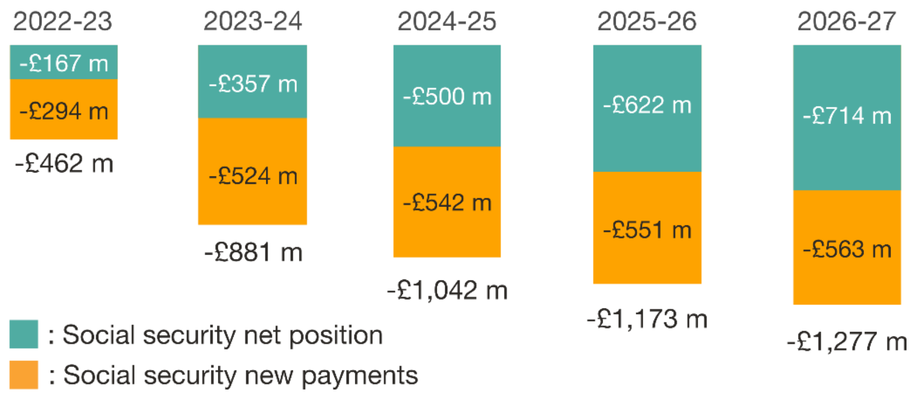
Social security spending



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.

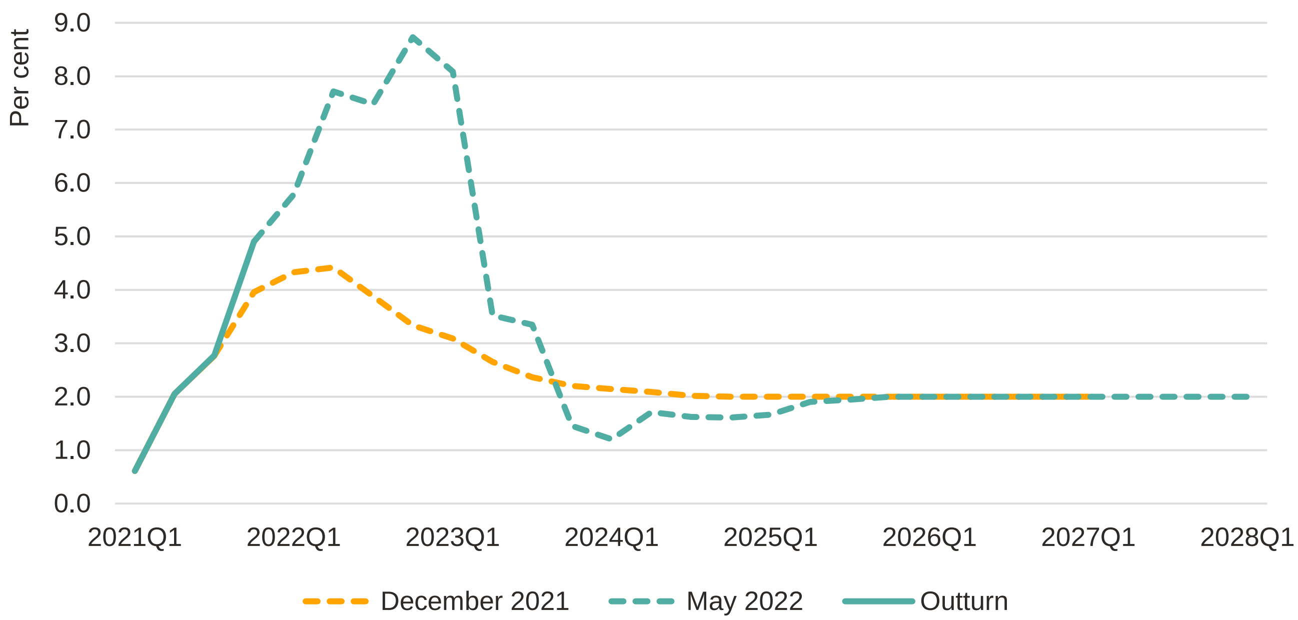
Figure 1: Headline economy forecasts, growth rates

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



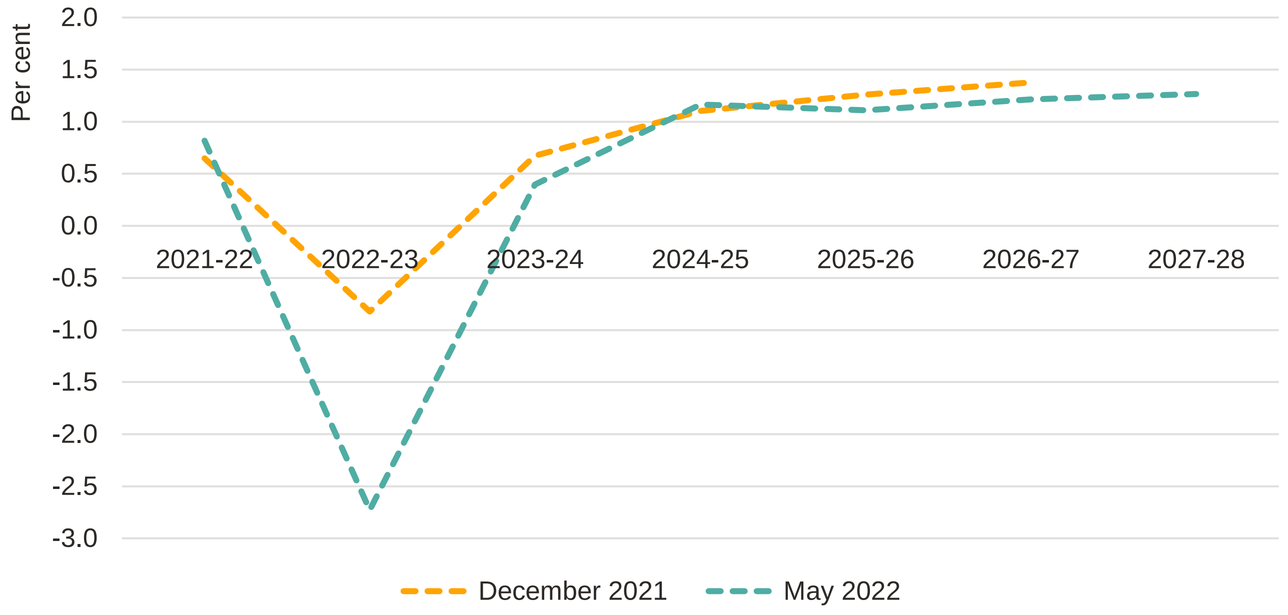
Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – December 2021 (link), OBR (2022) Economic and Fiscal Outlook – March 2022 (link), OBR (2021) Economic and Fiscal Outlook – October 2021 (link).
The year-on-year CPI inflation peak in 2022 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 of our May 2022 publication.[1]

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.[2] 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

[1] Scottish Fiscal Commission (2022) Scotland's Economic and Fiscal Forecasts (link)
[2] Office for Budget Responsibility (2022) Economic and Fiscal Outlook – March 2022 (link)
Bank of England (2022) Monetary Policy Report – May 2022 (link)

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.

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.[3] 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 of our May 2022 publication.[4]

[3] Scottish Government (2022) Coronavirus in Scotland (link) accessed 26 May 2022
[4] Scottish Fiscal Commission (2022) Scotland's Economic and Fiscal Forecasts (link)

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.

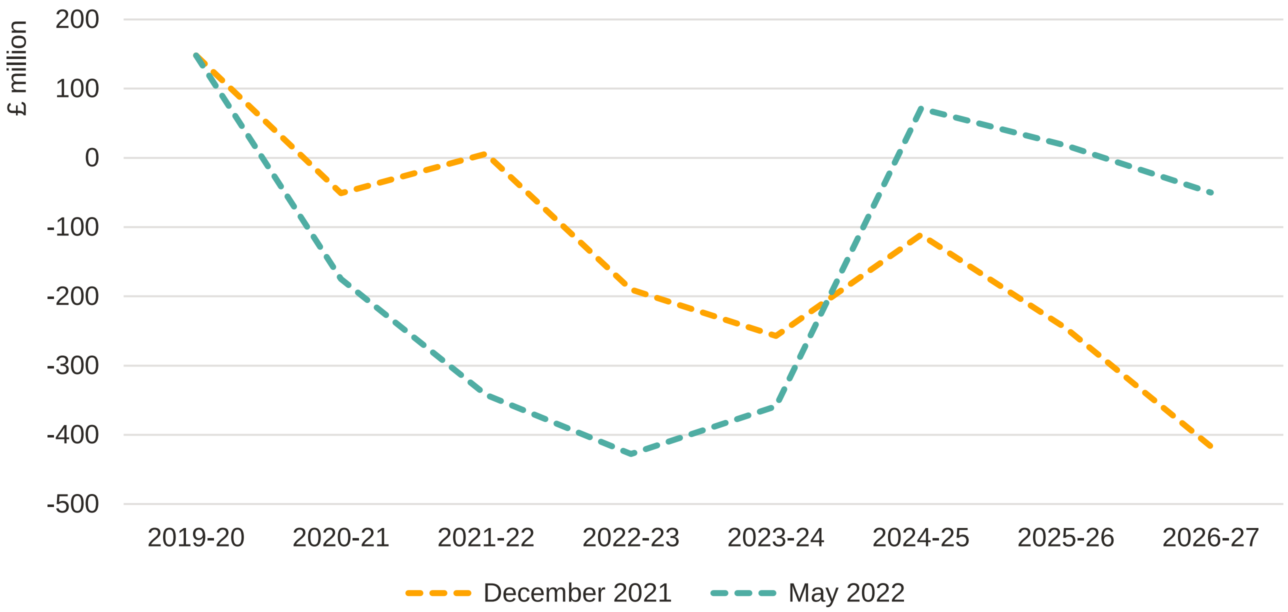
15 The tax net position is the difference between the tax revenue devolved to Scotland and the Block Grant Adjustments (BGA). The BGA is the amount deducted from the Block Grant to account for tax foregone by the UK Government. Our forecasts of income tax, LBTT and Scottish Landfill Tax (SLfT) are compared to the BGAs which are based on OBR forecasts of corresponding UK Government tax revenues.[5] 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 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.[6] 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.

[5] Non-Domestic Rates are included differently in the Scottish Budget.
[6] 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)

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 of our May 2022 publication.[7]

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 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.

[7] Scottish Fiscal Commission (2022) Scotland's Economic and Fiscal Forecasts (link)

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".[8] 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 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

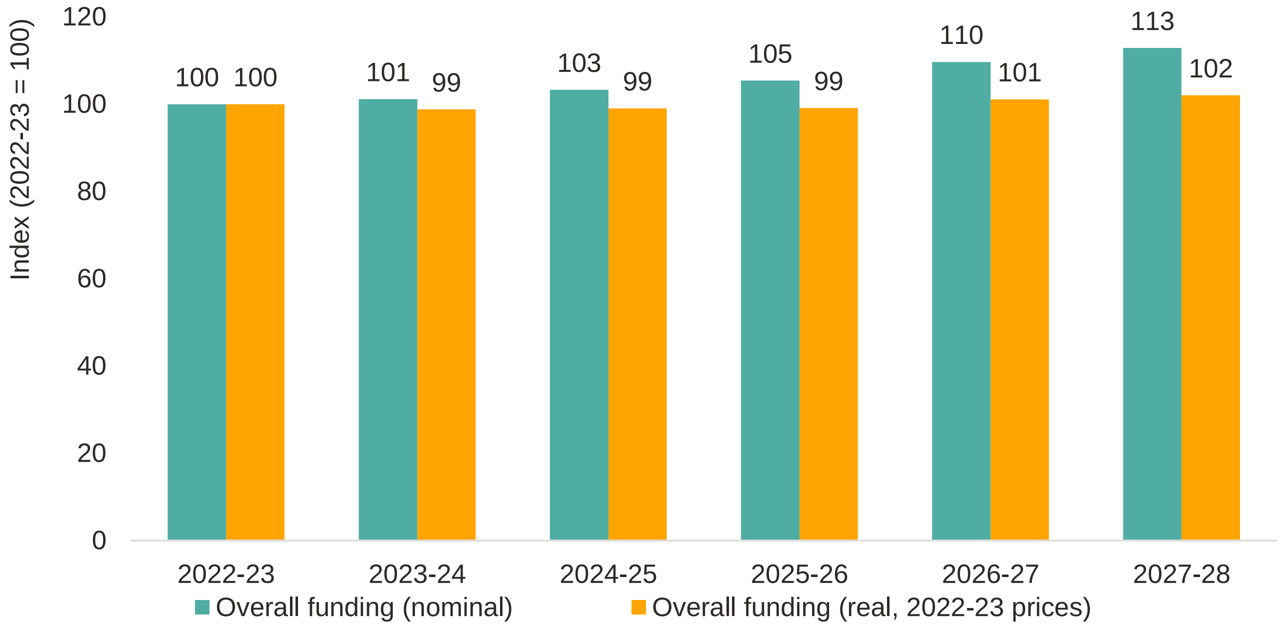
26 The Scottish Government has set its RSR plans for the next four years, 2023-24 to 2026-27, based on a forecast funding position. We include an additional year of funding for 2027-28 based on our own projections including our five-year tax and social security forecasts. The funding position depends 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

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

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 of our May 2022 publication for more details.[9]

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 of our May 2022 publication.[10]

29 The relatively flat level of resource funding is because of several factors. Firstly, the UK Government's Spending Review in October 2021[11] 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.

[9] Scottish Fiscal Commission (2022) Scotland's Economic and Fiscal Forecasts (link)
[10] Scottish Fiscal Commission (2022) Scotland's Economic and Fiscal Forecasts (link)
[11] HM Treasury (2021) Autumn Budget and Spending Review 2021 (link)

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 of our May 2022 publication.[12]

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

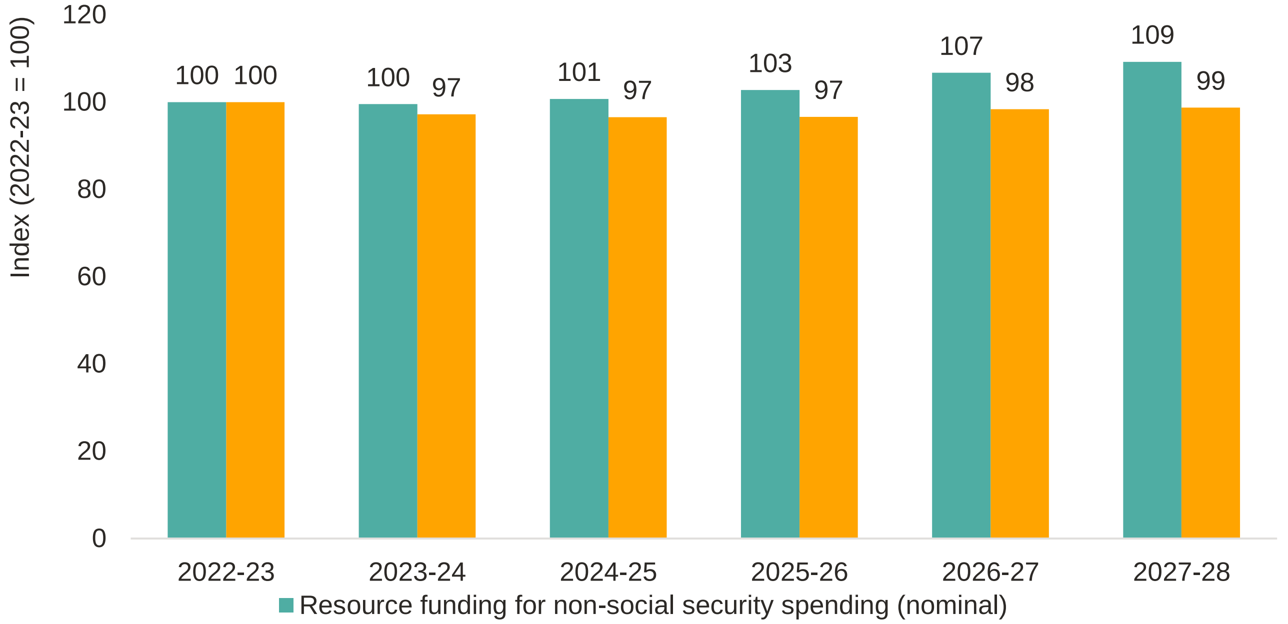
£ million	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
UK Government funding [1]	39,019	39,956	41,232	42,466	44,118	45,512
Other funding [2]	3,238	3,463	3,307	3,036	3,324	3,294
Tax net position	-51	-265	167	103	-31	-54
Final reconciliations [3]	-15	-221	-817	-238	-	-
Resource borrowing	15	110	300	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 of our May 2022 publication for more details.[13]

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.

[12] Scottish Fiscal Commission (2022) Scotland's Economic and Fiscal Forecasts (link)
[13] Scottish Fiscal Commission (2022) Scotland's Economic and Fiscal Forecasts (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 of our May 2022 publication for more details.[14]

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

[14] Scottish Fiscal Commission (2022) Scotland's Economic and Fiscal Forecasts (link)

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.[15] 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

[15] 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.[16] 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.

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

Additional Information

Abbreviations

BGA	Block Grant Adjustment
COVID-19	Coronavirus
CPI	Consumer Price Index
DWP	Department for Work Pensions
GDP	Gross Domestic Product
HMRC	Her Majesty's Revenue and Customs
HM Treasury	Her Majesty's Treasury
LBTT	Land and Buildings Transaction Tax
MTFS	Medium Term Financial Strategy
NDR	Non-Domestic Rates
OBR	Office for Budget Responsibility
ONS	Office for National Statistics
RSR	Resource Spending Review
RTI	Real Time Information
SIT	Scottish Income Tax
SLfT	Scottish Landfill 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).[17]

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.[18]

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

Correspondence and enquiries

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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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Published by the Scottish Fiscal Commission, May 2022