Kenneth Gibson MSP
Convener
Finance and Public Administration Committee
The Scottish Parliament
Edinburgh

29 February 2024

Dear Convener,

Today the Scottish Fiscal Commission has published a short paper [How we set policy baselines – Scottish Fiscal Commission](#). Although this may appear to be largely a technical issue, it is an important part of our forecasts, and has implications for our policy costings.

A policy baseline is the set of assumptions we include in our forecast covering all policy aspects of the tax and social security systems. Policy baselines are a critical part of our forecasting process, allowing us to both produce forecasts and provide costings for government policy decisions. We are required to forecast tax and spending five years ahead so our forecasts depend on how the tax and social security systems evolve over our forecast horizon. In the absence of an explicit policy from the Scottish Government, our baseline sets out our counterfactual set of values for the evolution of these key factors. The policy baseline has the potential to have a large effect on the forecast levels of tax and spending and, to the extent that the government does something different from what is in the baseline, on what will count as a policy change.

Tax revenue, funding for the Scottish Budget and social security spending are determined by Scottish Government policy decisions and legislation. Our policy baseline only affects the presentation of our forecasts for years in which there isn't an explicit government policy, and affects how policy changes are presented. Our forecasts, when shaped by our baseline assumptions, are important for longer-term planning, informing public debate and scrutiny of Government policy decisions.

In the paper, we outline an updated approach to setting policy baselines, which we believe will improve transparency and scrutiny of our forecasts and the Scottish Budget process. In short:

- As Scotland's official forecaster, our preferred position is that the Scottish Government clearly and publicly sets out a detailed baseline policy position for all taxes and social security spending over our five year forecast horizon. I have written to the Deputy First Minister to highlight this point.

- When this information is incomplete or missing, we will need to make our own policy baseline assumptions. Our guiding principle is maintaining neutrality with respect to

inflation. We'll also consider how our baseline assumption can increase transparency and aid public understanding and scrutiny of Government policy changes.
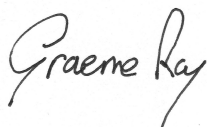
- In particular, to target neutrality in our five year forecasts, where appropriate, we will assume thresholds and payments will rise in line with Consumer Price Index (CPI) inflation.

We'll be applying this new approach in our next forecasts, expected to accompany the Scottish Government's Medium Term Financial Strategy in May. We'll only apply new baseline assumptions in our forecasts from 2025-26 onwards, leaving the 2024-25 budget year unaffected.

As we say in our paper, our preferred position as a forecaster is for the Scottish Government to clearly and publicly set out a baseline policy position for all taxes and social security spending. If this information is not provided, we'll apply our own policy baseline assumptions. In our policy baseline assumptions, one of the most significant changes in approach compared to our last forecast would be for income tax. Unless we get different guidance from the Scottish Government on baselines, we'll assume the higher, advanced and top rate tax bands rise in line with CPI inflation, rather than remaining frozen. In the absence of policy changes, this would reduce forecast income tax revenues over the next five years. We'll make sure the effect of these changes is spelled out in full in our forecast report.

I believe this new approach will bring greater transparency and improved scrutiny of Government policy changes, and I would be happy to discuss this in further detail.

Yours sincerely

Graeme Roy

Professor Graeme Roy