Scottish Fiscal Commission

Fiscal Update

August 2024

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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 tax revenues and devolved social security spending to inform the Scottish Budget. We also publish regular commentary on the Scottish Budget. This report considers how recent developments in the economic and fiscal outlook could affect the Scottish Budget in 2024-25 and 2025-26. We are publishing this update to support the pre-Budget scrutiny work of the Scottish Parliament ahead of the 2025-26 Scottish Budget.

We would like to thank once again the hard-working staff of the Commission for their support in the production of this analysis. Our reports represent the collective view of the four Commissioners who take full responsibility for them.

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27 August 2024

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Introduction

1.1 Since our December 2023 publication the pressure on the Scottish Government's finances has increased. The Scottish Government is now facing a challenge in balancing its budget. The extent of these challenges was evidenced in mid-August when emergency controls were put in place to restrict spending in 2024-25. The 2024-25 position was tight when the Budget was set in December 2023, since then pressure over public sector pay has grown.

1.2 Decisions by the Scottish Government have played a role in these budget pressures. As well as previous public sector pay deals in Scotland being higher than in the rest of the UK, other policy commitments made by the Scottish Government such as the council tax freeze in 2024-25 and the ongoing effect of its social security reforms have contributed to the growing pressure on the Scottish Budget.

1.3 There have also been announcements by the new UK Government which will affect how much funding the Scottish Government receives, although much of the detail will not be clear until the UK Budget on 30 October 2024.

1.4 These announcements will set the scene for the next Scottish Budget. In this Fiscal Update we summarise the developments to date, highlighting where these may have implications for the Scottish Budget. This work aims to support the Scottish Parliament in its pre-Budget scrutiny process.

Timeline of changes affecting the Scottish Budget

1.5 Since the Scottish Fiscal Commission published its last forecasts in December 2023 there has been a change of Scottish First Minister and the election of a new UK Government. The Scottish Government's planned Medium-Term Financial Strategy (MTFS) was postponed from its original date in May following the resignation of the previous First Minister, and subsequently cancelled because of the pre-election period for the UK general election. We usually publish updated forecasts in May alongside the MTFS but as that did not take place, we have not updated our forecasts since December 2023. Therefore, we are publishing this Fiscal Update to set out the economic and fiscal developments since December 2023. We also explore how these, and other upcoming events will affect the 2024-25 and 2025-26 Scottish Budgets.

1.6 Since December 2023 there have been no significant confirmed changes in the Scottish Government's funding, but the pressure on spending has increased with public sector pay offers in Scotland now coming in higher than the pay policy published in May 2024. There is significant uncertainty on the level of funding the Scottish Government will receive from the UK Government ahead of the UK Budget.

1.7 The Scottish Government's funding position will become clearer over the next few months. The UK Government will set out its spending plans and announce any planned changes to UK taxes for 2024-25 and 2025-26 in the UK Budget on 30 October. As there is a new government, there is potential for some significant changes to the tax and spending plans set out by the previous UK Government. These are likely to result in changes to Scottish Government funding. The Office for Budget Responsibility (OBR) will produce updated forecasts of UK Government tax revenues and spending alongside the UK Budget. These will affect the Block Grant Adjustments (BGAs) for devolved taxes and social security.

1.8 There are several other events which will take place before the UK Budget, including a Scottish Government statement to Parliament on the fiscal position as well as the Programme for Government in early September. Later in September, the Scottish Government is expected to present its Autumn Budget Revision (ABR) to the Scottish Parliament, outlining how the 2024-25 Budget has changed as a result of changes in UK Government funding from the March UK Budget and underspends from 2023-24 carried forward to 2024-25 through the Scotland Reserve. The ABR may also reflect the emergency spending controls put in place in August, but the Scottish Government could wait until the Spring Budget Revision in January 2025 to confirm the implications.

1.9 After the UK Budget, we will begin the process of updating our economic and fiscal forecasts as the Scottish Government develops its tax and spending policies in preparation for the Scottish Budget. The Scottish Budget will confirm the Scottish Government's tax and spending plans. We will publish updated economic and fiscal forecasts alongside it.

1.10 When the 2025-26 Scottish Budget is published we will have a more complete picture of the funding and spending position. Nevertheless we can highlight important fiscal developments, the emerging economic context, and significant moments when further information will become available in the coming weeks and months.

UK Government announcements and Scottish Government response

UK Spending Audit

1.11 The UK Government's Spending Audit, published at the end of July 2024, was accompanied by several announcements which will affect the Scottish Government's funding.[1]

Public Sector Pay

1.12 The Audit included commitments on public sector pay. The recommendations of the independent Pay Review Bodies were adopted in full for 2024-25. These covered NHS England staff, teachers, armed forces, police, prison officers and Civil Servants. While the vast majority of these pay deals do not apply in Scotland, there are still implications for the Scottish Government's funding. Most pay awards are in the range of 5 to 6 per cent in 2024-25, considerably higher than the 2 per cent assumption included in the

[1] HM Treasury (2024) Fixing the foundations: public spending audit 2024-25

2021 UK Spending Review. While announcements have not been made on UK public sector pay in 2025-26, the higher pay awards in 2024-25 will result in higher levels of pay in 2025-26 than were previously expected.

1.13 The implications of this higher spending on public sector pay for departmental budgets in 2024-25, and therefore on the level of Block Grant funding, is currently unclear. The UK Government has indicated that departments will receive some additional funding but will also be expected to absorb some of the increased costs from within their current budgets. The extent to which this is additional money and the extent to which it is offset by reductions in other areas of devolved spending will become clearer in the UK Budget. However, the UK Government may wait until the publication of the Supplementary Estimates in February 2025 to confirm the final effect on departments budgets and on the Scottish Government's Block Grant.

1.14 Pay negotiations are ongoing across the Scottish public sector and are taking place before the Scottish Government has certainty on the level of funding it will have in 2024-25. The Scottish Government has already announced additional spending commitments to support pay offers above planned levels. The offers of 4.27 per cent for local authority workers and 5.5 per cent for nurses and NHS workers are both higher than the 3 per cent set out in the Government's pay policy published in May.[2,3,4] This is likely to create pressure for other pay awards to be higher than the Scottish Government had planned for. The Scottish Government is also likely to be under pressure to at least match UK pay awards, which, as indicated, are in the range of 5 to 6 per cent in 2024-25 for areas covered by the Pay Review Bodies.

1.15 The Scottish Government has estimated that in 2023-24 pay accounted for over £25 billion of resource expenditure across the devolved public sector, including local government.[5] This is over half of the resource budget.[6] Increases in public sector pay therefore have a significant effect on the Scottish Government's spending. In our December 2023 report we noted that the Scottish Government had "not set a formal guideline for public sector pay for 2024-25" and that "the average public sector pay award in 2023-24 was 6.5 per cent, 3 percentage points higher than the Scottish Government had estimated in May 2023".[7] If a Budget is set based on pay assumptions which are lower than those that materialise, this creates challenges with in-year management of the Budget, requiring the Government to reduce its planned spending on services. The recent emergency spending controls the Scottish Government has put in place for 2024-25 are the result of those challenges.

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[2] Scottish Government (12 August 2024) Local Authority Pay

[3] Scottish Government (20 August 2024) Pay offer to NHS Agenda for Change staff

[4] Scottish Government pay policy is for a 2 per cent increase to apply from April 2024 and a further 1 per cent increase to apply from January 2025, this is a cumulative 3 per cent increase but equates to 2.3 per cent increase in-year. Scottish Government (2024) Public sector pay policy 2024 to 2025

[5] Scottish Government (2024) Public sector pay policy 2024 to 2025

[6] Local Government have other sources of funding that are locally retained, and so are not part of the Scottish Budget, mainly service income and council tax. These also go towards paying local government staff salaries.

[7] Scottish Fiscal Commission (2023) Scotland's Economic and Fiscal Forecasts – December 2023

1.16 Over the last few years the Scottish Government has generally increased public sector pay by a higher percentage than was the case in England. This has the consequence that subsequent pay awards are more costly. For example, if teachers in Scotland are more highly paid than in England, then an equivalent percentage rise in teacher salaries will be more costly to implement in Scotland. This further contributes to the pressures of public sector pay on the budget.

1.17 The decisions made on public sector pay, and how those are agreed with the unions, will determine the pressures on the Scottish Budget. As public sector pay is already higher in Scotland than in England, matching or exceeding in percentage terms the pay increases given in England would result in greater pressure on the Scottish Budget. If pay awards in Scotland were lower in percentage terms than those in England this would reduce the pressure on the Scottish Budget.

Tax and social security announcements

1.18 The UK Government Spending Audit also included new policy announcements in areas that have been devolved to the Scottish Parliament. These policies will affect the Scottish Government's funding. The Scottish Government is having to make decisions on the equivalent devolved policies.

1.19 The most notable announcement from the UK Government was on Winter Fuel Payment (WFP). The UK Government has announced that from this autumn it will only be paid to older people receiving means-tested benefits rather than all people over the state pension age. This will decrease spending on WFP in England and Wales. The Scottish Government receives funding through a Block Grant Adjustment for WFP, it is estimated this will decrease by between £140 million and £160 million in 2024-25 as a result.

1.20 This is the first instance of a significant UK Government social security policy change taking place in-year with an effect on BGA funding. In response the Scottish Government has announced that eligibility for Pension Age Winter Heating Payment (PAWHP), the replacement for WFP in Scotland, will also be restricted to older people in receipt of means-tested benefits.[8] This is expected to reduce spending on PAWHP by between £140 million and £160 million. As the reduction in spending will be aligned with the reduction BGA funding, we do not expect there to be a net effect on the Scottish Government budget for 2024-25. However, as the UK Government policy change was announced after the 2024-25 Scottish Budget was set, the Scottish Government could defer the in-year adjustment to account for the reduction to the BGA until the final BGA can be calculated with outturn spending data and a reconciliation applied to a future Scottish Budget.

1.21 The application of Value Added Tax (VAT) to private schools across the UK from January 2025 will not have a direct effect on the Scottish Government's funding as VAT is a reserved tax and the UK Government will receive the additional revenue. However, applying business rates to private schools in England from April 2025 will affect Scottish Government funding.

1.22 An increase in revenue from private schools paying business rates (known as Non-Domestic Rates in Scotland) in England would increase tax revenues for the UK

[8] Scottish Government (2024) UK Government decision ends universal fuel payments

and local government in England. The UK Government could decide to allow local government to keep the additional revenues, or it could reduce grant funding from central government to local government in England. If this happened it would reduce spending by the Ministry of Housing, Communities and Local Government, and therefore the Block Grant, as that department is fully devolved in Scotland.

1.23 There will be indirect effects on the Scottish Budget from the changes to VAT and business rates for private schools as the Labour manifesto committed to using the extra revenue to fund higher spending on education. As education is fully devolved, an increase in education spending in England will result in increased funding for the Scottish Government.

1.24 The Scottish Government has already removed eligibility for charities relief from Non-Domestic Rates for private schools, so does not have the option of replicating the business rates policy to raise revenue, but it will likely still benefit from an increase in spending on education in England.

UK Budget

1.25 The new Chancellor will present her first Budget on 30 October 2024, setting out the UK Government's overall tax and spending plans. The recent Spending Audit has already highlighted the pressures on public spending and several commitments have been made which will constrain the UK Government's choices. These include two fiscal rules: for day-to-day spending to match revenues, and for debt to be falling as a share of the economy by the fifth year of the OBR forecast. There have also been commitments not to raise income tax, National Insurance or VAT rates.

1.26 The Scottish Government must broadly balance its budget as it has limited ability to save or borrow across years. The UK Government sets the fiscal position for the UK and effectively borrows on behalf of the Scottish Government, other devolved administrations and local government. The fiscal rules which the new Chancellor sets will determine the balance of tax and spending in the UK. Given the Chancellor's commitment to meet the two fiscal rules, and not to raise the three largest UK taxes, it is unclear how much public spending levels in the UK will change from the plans of the previous government.

1.27 The Institute for Fiscal Studies (IFS) has highlighted that there is potentially some "fiscal wiggle room" available through changing the definition of debt used in the rules, but "the impact of such a change would be fairly modest in scale". The IFS conclude that "any substantial and permanent increase in spending on public services or social security this autumn would likely need to be accompanied by higher taxes".[9] The commitments not to raise the rates of the three largest taxes suggest there would either need to be changes to the tax base for these taxes, or changes to other smaller taxes.

1.28 The overall fiscal position taken by the UK Government will affect the funding, and policy choices, of the Scottish Government. Changes in spending in devolved areas lead directly to changes in the Block Grant. But devolved tax and social security changes will

[9] IFS (2024) Definitions of debt and the new government's fiscal rules

also affect Scottish Government funding, and some reserved tax changes could still affect the Scottish Budget.

1.29 The new UK Government has committed to no increases in rates of income tax. However, a policy from the previous Government to freeze the higher rate threshold in the UK until 2027-28 remains in place.[10] This policy raises additional income tax revenues in England and Northern Ireland as fiscal drag means more taxpayers will pay the higher rate of tax. This increase in UK Government tax revenues increases the income tax BGA and reduces funding to the Scottish Budget. The Scottish Government will need to decide its own income tax policy including how to set tax thresholds. We note that the recent period of high inflation and associated earnings growth has resulted in a relatively stronger effect of fiscal drag in Scotland because it has a more progressive income tax system than the rest of the UK. Beyond the headline income tax rates and thresholds, any policies which affect income tax revenues across the UK (for example reforming income tax reliefs) could also affect Scottish Government funding, depending on the relative effect on Scottish and UK income tax revenues.

1.30 Changes to reserved taxes such as Capital Gains Tax (CGT) will not directly affect the Scottish Budget, but there can still be effects on Scottish tax revenues. For example, changes to CGT could result in behavioural changes which affect revenues for Land and Buildings Transaction Tax.

1.31 The Labour manifesto included a commitment to reviewing Universal Credit. At present there are no details on the scope of the review. While Universal Credit is not devolved, there are devolved social security payments where eligibility is usually based on families receiving Universal Credit. The most significant of these payments is Scottish Child Payment (SCP). If the UK Government makes changes to Universal Credit, then there could be an effect on the number of people receiving SCP.

1.32 One aspect of Universal Credit which has been the subject of discussion recently is the two-child limit. The rule means that families receiving Universal Credit do not receive extra money for third and subsequent children. If the rule was removed, then the affected households would see a noticeable rise in their Universal Credit income. We do not think there would be a substantial increase in SCP eligibility from the removal of the two-child limit because most families affected are already receiving Universal Credit. New eligibility would only come from families whose income is currently too high to qualify for Universal Credit, but who would be eligible for a small award if another child element is added to their entitlement. Therefore, with a limited effect on eligibility, we would expect a change to the two-child limit to have a relatively small effect on SCP spending.

UK Spending Review

1.33 Spending reviews set out government spending plans over multiple years. The previous UK Government held its last spending review in 2021 with the current financial year (2024-25) as the last year covered by that spending review. Beyond 31 March 2025 there are no detailed departmental spending plans, just figures for growth in total resource and capital spending. This means the Scottish Government does not have certainty on the level of Block Grant funding it will receive from the UK Government

[10] OBR (2023) The impact of frozen or reduced personal tax thresholds box

beyond the end of the current financial year. The previous UK Government had set plans for total spending which would limit real terms growth in resource spending to 1 per cent while capital spending was to remain flat in cash terms. The OBR noted that these plans imply real terms cuts in non-protected areas of spending while "performance indicators for public services continue to show signs of strain".[11]

1.34 The UK Budget will set out UK Government spending plans for 2024-25 and 2025-26. Plans beyond this will be part of the next spending review, which will take place over the winter and will be published in spring 2025. This will set out departmental spending plans to at least 2027-28. The new UK Government has also committed to a more regular cycle of spending reviews. A regular cycle of spending reviews should mean that Block Grant funding is more certain and that the Scottish Government will therefore be in a better position to provide multi-year spending allocations as part of its Medium-Term Financial Strategy.

Developments since December 2023

Economy

1.35 The overall economic context for 2024-25 is broadly in line with our December 2023 forecast. In particular, expectations for Gross Domestic Product (GDP) growth this year remain similar to our previous forecast.

1.36 Headline annual Consumer Price Index (CPI) inflation fell back to the 2 per cent target in 2024 Q2, around a year earlier than we expected in December 2023. Falling global energy prices were an important feature of the more rapid than expected reduction in headline inflation, while domestically driven inflation has generally been more persistent.

1.37 One area of interest is Scottish nominal average earnings growth. In December 2023, our analysis of Real Time Information (RTI) mean pay data showed that, in 2022-23 and in the year to September 2023, nominal average earnings grew strongly in Scotland and more strongly than in the UK overall. This relative strength of Scottish pay growth was broad-based across sectors and regions. In part, this reflected tighter labour market conditions in Scotland, such as greater recruitment difficulties and higher vacancies, pushing up Scottish earnings relative to the UK. However, based on the latest RTI data, Scotland's earnings growth in the first part of 2024-25 has slowed and is now similar to the UK average. Relative earnings growth is an important factor in determining the income tax net position.

Income tax

1.38 Turning to income tax, we now have outturn data for 2022-23. From the data, we can see that 2022-23 was a relatively positive year for growth in Scottish income tax revenues, with the provisional income tax net position reaching £257 million. As this net funding position is higher than the projected negative £190 million when the 2022-23 Scottish Budget was set, there will be a positive provisional reconciliation of £447 million applied to the 2025-26 Scottish Budget.

[11] OBR (2024) Economic and fiscal outlook – March 2024

1.39 Funding from income tax in the 2025-26 budget will also depend on updated OBR and Scottish Fiscal Commission (SFC) forecasts, due to be published on 30 October and alongside the Scottish budget respectively. As we discuss in Chapter 4, 2022-23 and 2023-24 appear to have been positive years for growth in Scottish income tax revenues relative to the UK. However, at the start of 2024-25, Scottish earnings growth appears to have slowed and is now more in line with the rest of the UK. Only after both the OBR and we have updated our income tax forecasts, taking account of all these factors, will we know the complete picture for income tax funding in the 2025-26 Scottish Budget.

1.40 In our December 2023 Scotland's Economic and Fiscal Forecast (SEFF) we discussed how Scottish and UK income tax policy changes meant that, all else equal, we'd likely see the income tax net position rising over time. This is now being borne out with the latest income tax outturn data showing a positive net position. Higher tax rates, additional tax bands and lower tax thresholds mean a higher proportion of taxpayers are paying higher rates of tax in Scotland, earning the Scottish Government additional revenue over time. However, because of relatively slow growth in the Scottish economy since income tax was devolved, there remains a gap between the latest income tax net position and where it might be based on policy differences alone. Our provisional estimate of this economic performance gap means that funding in the Scottish Budget in 2022-23 was around £624 million lower than it would have been had Scottish economic performance matched the rest of the UK.

Social Security

1.41 We now have outturn for social security spending in 2023-24. Overall, social security spending was £5.3 billion. The latest estimate for the 2023-24 social security BGA funding is £4.4 billion. We estimate spending exceeded the BGA funding by around £0.9 billion. This is in line with our forecasts for 2023-24 from both December 2022 and December 2023.

1.42 Our assessment is that the gap between spending on devolved social security and the associated BGA funding is the result of policy choices made by the Scottish Government. These choices include the introduction of new payments such as Scottish Child Payment not available elsewhere in the UK, and the operational and delivery changes made when Child Disability Payment (CDP) and Adult Disability Payment (ADP) were introduced. We forecast the gap will grow in future years as the operational and delivery changes for disability payments continue to take effect. In December 2023 we forecast total spending on devolved social security in 2024-25 to be around £1.1 billion higher than the funding the Scottish Government receives through the social security BGA, with that gap growing to around £1.5 billion in 2028-29.

Conclusions

1.43 While we now have some information on how the 2024-25 Scottish Budget may change, there will still be significant uncertainty about the level of UK funding the Scottish Government receives until the UK Government presents its Budget on 30 October.

1.44 This will then set the scene for the 2025-26 Scottish Budget that is likely to be presented to Parliament in late November or early December. The Scottish Budget will include details of the Scottish Government's tax policies and its spending plans for 2025-26. The Scottish Government will need to make difficult decisions to balance the budget and ensure decisions now are sustainable in the future. As we discuss in this Fiscal Update, some of these decisions will depend upon complex interactions with UK Government decisions. Others will depend more on Scottish factors.

1.45 The 2024-25 position was tight when the Budget was set in December 2023. Since then pressure over public sector pay has grown. When the Scottish Government agrees pay deals which are above its pay policy this will further increase pressure on the Budgets for 2024-25 and future years, especially as the extent to which UK Government pay deals will be met from within existing budgets or result in increased funding is unclear. Policy commitments the Scottish Government has made, such as the council tax freeze in 2024-25, social security spending and more generous pay deals in Scotland contribute to the growing pressure on the Scottish Budget.

1.46 The Scottish Budget will be published in very different political circumstances to last year's. The Bute House Agreement between the SNP and Green Party has ended so the passage of the Budget Bill will require the Government to reach agreement with at least one other political party. If this agreement involves changes to proposed Scottish taxes or social security payments after the Budget has been published, the Scottish Fiscal Commission is required to publish additional costings.

1.47 As we set out in December 2023, in our role as the independent fiscal institution for Scotland we encourage the Scottish Government to plan its Budget over the short, medium, and long term. We note this can be challenging because of the inherent uncertainties in the Scottish Government's funding sources, but this makes it even more important to plan funding and spending recognising the potential variations in future levels of funding to ensure decisions made now are sustainable in the future.

Chapter 2
Fiscal Overview

Introduction

2.1 Since our last forecast in December 2023, there have been several developments which have affected the level of funding available in both the current financial year (2024-25) and future years.

2.2 Following the UK general election and the change in the UK Government, the new Chancellor set out a public spending audit.[12] This included several announcements which will affect Scottish Government funding, although the more precise effects will only be known at the next UK Budget which will take place on 30 October 2024. While the UK Government plans to confirm 2024-25 funding as part of the UK Budget, there may still be further changes to the Block Grant for 2024-25 as UK Government departments only get their allocations finalised at Supplementary Estimates in February 2025.

2.3 The UK Budget is expected to include further tax and spending announcements and set levels of spending for each department in 2024-25 and 2025-26. Any changes to spending or tax plans in devolved areas will result in changes to Scottish Government funding.

2.4 The Chancellor also announced that a Spending Review will be published in spring 2025 when the UK Government will set out its spending plans for the next three years.

2.5 In this chapter we discuss the implications of UK Government announcements. We then discuss the latest changes in 2024-25 as well as developments which will affect the 2025-26 Scottish Budget.

2.6 We also report on the changes to the funding position for the previous financial year 2023-24, in Annex A. The last time we reported on it, December 2023, we were three quarters into the financial year. We now know the provisional outturn position.

UK Government announcements

2.7 As discussed in Chapter 1 recent and future UK Government commitments will affect the Scottish Government's funding. The recent Spending Audit included commitments on public sector pay and changes to Winter Fuel Payment eligibility.

2.8 The next UK Budget will confirm departmental budgets for 2024-25, and set out the UK Government's tax and spending plans for 2025-26. Funding the Scottish Government receives through the Block Grant is related to Departmental Expenditure Limits (DEL) spending in devolved areas. This means the UK Budget will update the level of Block Grant funding for 2024-25 and 2025-26.

[12] HM Treasury (2024) Fixing the foundations: public spending audit 2024-25

2.9 The UK Government is undertaking a spending review over the winter, and it will be published in spring 2025. This will set out departmental spending plans to at least 2027-28. The new UK Government has also committed to a more regular cycle of spending reviews, held every two years and setting out plans for at least three years of the five-year forecast horizon.

2.10 UK Government spending plans in spending reviews will affect Scottish Government funding. A regular cycle of spending reviews should mean that Block Grant funding is more certain and that it is easier for the Scottish Government to provide multi-year spending allocations as part of its Medium-Term Financial Strategy. We note the next Scottish election in May 2026 will be in the second year of a three-year spending review, but we encourage the Scottish Government to set out multi-year spending plans even when these cross into a new parliament to support planning across the public sector.

2.11 The UK Government's Spending Audit published at the end of July included commitments on public sector pay in 2024-25. They adopted the recommendations of independent Pay Review Bodies in full. Most pay awards are in the range of 5 to 6 per cent in 2024-25 and are considerably higher than the 2 per cent assumption included in the 2021 UK Spending Review.

2.12 The implications of this higher spending for departmental budgets, and therefore on the level of Block Grant funding, is currently unclear. The UK Government estimated the pay awards will increase spending by £9.4 billion above what was planned in 2024-25, and that pay awards for the previous years have already increased wage costs in 2024-25 by £2.4 billion, a total increase of £11.8 billion. The Chancellor's statement said that at least £3 billion of this needs to be managed within existing budgets, but departments covered by these pay awards will potentially see increases in their budgets.

2.13 Pay negotiations are ongoing across the Scottish public sector. These pay deals are being negotiated before the Scottish Government has certainty on its available funding in 2024-25. The Scottish Government has already announced additional funding to support a pay offer in local authorities. The offer of 4.27 per cent is higher than the 3 per cent in 2024-25, 2025-26 and 2026-27 set out in the Government's pay policy published in May.[13,14] This will likely create pressure for other pay awards to be higher than previously planned. The Scottish Government is also likely to be under pressure to at least match UK pay awards, which are in the range of 5 to 6 per cent in 2024-25 for areas covered by the Pay Review Bodies.

2.14 Increases in public sector pay have a significant effect on the Scottish Government's spending. In our December 2023 report we noted that the Scottish Government had "not set a formal guideline for public sector pay for 2024-25" and that "the average public sector pay award in 2023-24 was 6.5 per cent, 3 percentage points higher than the Scottish Government had estimated in May 2023".[15] If a Budget is set based on pay

[13] Scottish Government (12 August 2024) Local Authority Pay

[14] Scottish Government pay policy is for a 2 per cent increase to apply from April 2024 and a further 1 per cent increase to apply from January 2025, this is a cumulative 3 per cent increase but equates to 2.3 per cent increase in-year. Scottish Government (2024) Public sector pay policy 2024 to 2025

[15] Scottish Fiscal Commission (2023) Scotland's Economic and Fiscal Forecasts – December 2023

assumptions which are lower than those that materialise, this creates challenges with in-year management of the Budget requiring the Government to reduce its planned spending on services. The recent emergency spending controls the Scottish Government has put in place for 2024-25 are the result of those challenges.

2.15 The Scottish Government has generally provided higher pay awards for the public sector in Scotland than in England over the last few years. These previously higher pay awards mean that subsequent pay awards are more costly. For example, if teachers in Scotland are more highly paid than in England, then an equivalent percentage rise in teacher salaries will be more expensive to implement in Scotland. This further contributes to the pressures of public sector pay on the budget.

2.16 The decisions made on public sector pay, and how those are agreed with the unions, will determine the pressures on the Scottish Budget. Matching the pay awards given in England would result in greater pressure on the Scottish Budget. If pay awards in Scotland were lower in percentage terms than those in England to reflect the previously higher public sector pay growth this would reduce the pressure on the Scottish Budget. Alternatively there could be pressure to exceed UK pay awards because of previously higher pay awards, this would further exacerbate the existing pressures on the Budget.

Box 2.1: Scottish public sector pay and workforce

Public sector pay is an important part of the Scottish Budget. The total public sector paybill for 2023-24 was around £25 billion, or over half of Scottish Government resource funding.[16]

The public sector in Scotland is larger than the public sector in the rest of the UK. Figure 2.1 shows that the public sector in Scotland accounts for 22.6 per cent of total Scottish employment compared to 17.6 per cent for the UK overall, or 25.8 per cent of Scottish Gross Value Added (GVA) compared to 19.3 per cent for the UK overall.

The public sector in Scotland has higher average pay than in the rest of the UK. Figure 2.1 also shows that, before taxes, the median pay for a full-time public sector employee in Scotland was £2,400 higher than in the UK in 2023, which was up from £700 in 2019. After taxes, the average full-time public sector employee in Scotland was still earning more than the UK average, around £1,500 in 2023 which was up from around £400 in 2019.[17]

Figure 2.1: Public sector average earnings and workforce size, Scotland and UK

Geography	Gross median annual earnings, 2023 (£)	Employment share, 2024 Q1 (per cent) [1]	GVA share, 2023 (per cent)
Scotland	39,100	22.6	25.8
UK	36,700	17.6	19.3

Source: ONS (2024) Earnings and hours worked, UK region by public and private sector: ASHE Table 25, Scottish Government (2024) Public sector employment statistics for 1st Quarter 2024, ONS (2024) Public sector employment, UK: March 2024, Scottish Government (2024) GDP Quarterly National Accounts: 2024 Quarter 1 (January to March) – Table D, ONS (2024) GDP output approach – low-level aggregates (28 June 2024).

[1] Based on figures excluding effects of major reclassifications.

16 Scottish Government (2024) Public sector pay policy 2024 to 2025
17 Scottish Government (2024) Public sector: economic overview

2024-25: changes since December 2023

2.17 We last estimated funding for the 2024-25 financial year in December 2023, when the 2024-25 Scottish Budget was presented to the Scottish Parliament.[18] While we cannot yet provide a fully updated position for 2024-25, we set out some changes affecting available funding that we are already aware of. The Scottish Government may include these in its Autumn Budget Revision (ABR) expected in September 2024. Some of these changes will also affect funding available in 2025-26.

2.18 Since December 2023 there have been increases in funding because of additional Block Grant funding from the UK Government. Underspends from 2023-24 which were not anticipated in December 2023 will now be used in 2024-25.

2.19 The 2024-25 Budget position was tight when it was set in December 2023. Although there have been some increases in funding, those confirmed so far are mostly not recurring and will only be available to the Scottish Government to use once. Until the UK Budget in October there is still a lot of uncertainty on the overall funding position, while pressure from public sector pay is growing. In the face of this uncertainty, Scottish Government spending decisions could have fiscal consequences for the current and future years.

Block Grant

2.20 Since December 2023 there have been two changes to UK departmental budgets, with consequences for the Block Grant. These are the UK Spring Budget 2024,[19] and the Main Supply Estimates 2024-25.[20] Together, they have increased the Block Grant across resource and capital by £691 million. Figure 2.2 shows these changes which comprise:

- An increase of £731 million in resource funding, of which £293 million was generated at the UK Spring Budget 2024 because of increased spending on devolved areas in England in 2024-25. An additional £437 million was confirmed at the 2024-25 UK Main Estimates as a result of increased funding to cover higher employer contributions to unfunded public service pension schemes. The Scottish Government will need to also meet the cost of higher employer pension contributions and therefore this does not represent an increase in potential spending.

- A reduction of £39 million between capital and Financial Transactions (FTs) since December 2023. There is an increase of £13 million for capital, but this is more than offset by a reduction of £53 million in FTs. Not all of these were announced at the Budget and Main Estimates. The reduction in FTs is a deferred cut from 2023-24 which was announced at UK Supplementary Estimates in February 2024.[21]

2.21 The UK Budget on 30 October 2024 will confirm UK spending plans for 2024-25 and so may result in further changes to the Block Grant in-year. While the UK Government

[18] Scottish Government (2023) Scottish Budget: 2024 to 2025

[19] HM Treasury (2024) Spring Budget 2024

[20] HM Treasury (2024) Main supply Estimates 2024 to 2025

[21] HM Treasury (2024) Supplementary Estimates 2023-24

plans to confirm 2024-25 funding as part of the UK Budget there may still be further changes to the Block Grant for 2024-25 as UK Government departments will not get their final allocations for the year confirmed until Supplementary Estimates in February 2025.

Figure 2.2: 2024-25 Barnett consequentials since December 2023

Type of funding (£ million)	Changes up to August 2024
Resource	+731
Capital (excluding FTs)	+13
Financial Transactions (FTs)	-53
Total	+691

Source: Scottish Fiscal Commission, Scottish Government.

Figures may not sum because of rounding.

Block Grant Adjustments

2.22 The Office for Budget Responsibility (OBR) will produce updated forecasts alongside the next UK Budget. These will result in in-year changes to the fully devolved tax and social security Block Grant Adjustments (BGAs). The OBR's March 2024 forecasts implied in-year reconciliations of zero for social security, and a reduction of around £50 million in funding to reflect higher Stamp Duty Land Tax revenues in England and Northern Ireland than previously forecast.

2.23 The UK Government has announced that Winter Fuel Payment (WFP) will become restricted to older people on low incomes, with the change coming into effect this winter. WFP was due to be devolved in September, so the change in policy does not automatically apply in Scotland.

2.24 The BGA will decrease because the UK Government will be spending less on WFP. The UK Government currently estimates this will save the UK Government £1.4 billion in 2024-25,[22] a reduction in spending of nearly 75 per cent.[23] The OBR will produce a revised forecast alongside the UK Budget which will be used to estimate a revised BGA.

2.25 The Scottish Government has announced that eligibility for Pension Age Winter Heating Payment (PAWHP), the replacement for WFP in Scotland, will also be restricted to older people in receipt of means-tested benefits. [24] This is expected to reduce spending by a similar amount to the reduction in BGA funding. As the UK Government WFP policy change was announced after the 2024-25 Scottish Budget was set, the Scottish Government can opt to either adjust funding for the Winter Fuel Payment BGA in-year or defer the adjustment until the BGA can be calculated with outturn spending data and a reconciliation applied. Deferring the adjustment would mean that 2024-25 spending

[22] UK Government (2024) Fixing the foundations: public spending audit 2024-25
[23] The last forecast for UK Government spending on Winter Fuel Payment was £1.9 billion in 2024-25. DWP (2024) Benefit expenditure and caseload tables 2024
[24] Scottish Government (2024) UK Government decision ends universal fuel payments

would fall while social security BGA funding would remain the same potentially releasing funding for alternative spending in 2024-25.

Scotland Reserve

2.26 The Scotland Reserve is an instrument that allows the Scottish Government to move funding between financial years with separate accounts for resource, capital, and FTs.

2.27 Figure 2.3 shows, that the Scottish Government fully used the available funding in 2023-24, drawing down £250 million for resource, £32 million for capital, and £44 million for FTs.

2.28 Provisional outturn data for 2023-24 shows underspends of £292 million, £162 million from resource and £130 million from capital. The Scottish Government now plans to draw these amounts down in full in 2024-25.[25] We expect this to be included in the ABR. There would need to be underspends in 2024-25 for reserve funding to be available for drawdown in 2025-26 and later budgets.

Figure 2.3: Scotland Reserve position over time

£ million	2023-24	2024-25
Resource		
Opening balance	250	162
Drawdowns	250	162
Additions	162	0
Closing balance	162	0
Capital (excluding FTs)		
Opening balance	32	130
Drawdowns	32	130
Additions	130	0
Closing balance	130	0
Financial Transactions (FTs)		
Opening balance	44	1
Drawdowns	44	1
Additions	1	0
Closing balance	1	0

Source: Scottish Fiscal Commission, Scottish Government.

Figures may not sum because of rounding.

[25] Scottish Government (2024) Budget - provisional outturn 2023 to 2024: briefing note - 20 June 2024. See Paragraph 24.

ScotWind

2.29 ScotWind is the leasing of designated areas of the seabed for the purpose of developing offshore wind farms. From the first round of leasing, it generated £756 million in funding for the Scottish Government, of which £96 million were used in 2022-23.

2.30 The Scottish Government has a remaining £660 million of ScotWind proceeds available to spend. In December 2023 the Scottish Government planned to use £460 million in 2023-24 and £200 million in 2024-25. Plans for 2023-24 have been revised and no ScotWind proceeds were used in this year, as shown in Figure 2.4. There are £460 million of ScotWind proceeds remaining to be used in 2024-25 or future years.

Figure 2.4: Use of ScotWind proceeds over time

£ million	2022-23 (outturn)	2023-24 (outturn)	2024-25 (planned)
Balance at start of year	756	660	660
Drawdowns	96	0	200
Balance remaining	660	660	460

Source: Scottish Fiscal Commission, Scottish Government.

Figures may not sum because of rounding.

2025-26 Budget

2.31 The 2025-26 Scottish Budget will be published later in 2024. In it, the Scottish Government will set out its tax and spending policies. We will produce updated forecasts of the economy, tax revenues, and social security spending alongside the Scottish Budget. By then, the OBR will have updated forecasts of UK Government tax revenues and spending, and the UK Government will have set out its own tax and spending plans in its budget on 30 October 2024.

2.32 Therefore, the 2025-26 Scottish Budget will provide a more complete picture of the funding and spending position than we can at present. At the moment we only have a partial picture of how the Scottish Government's funding is likely to change since our last publication in December 2023. We have discussed developments from UK Government tax and spending plans in Chapter 1, we therefore focus on the income tax reconciliation and Scottish Government borrowing plans.

Provisional income tax reconciliation

2.33 Income tax outturn data for 2022-23 was published in July 2024.[26] It shows both Scottish and UK income tax revenues were higher in 2022-23 than we and the OBR expected when the 2022-23 Budget was set. However, Scottish income tax revenues have been revised up by more than the income tax Block Grant Adjustment (BGA). As a result, there is a positive provisional reconciliation of £447 million that will be applied to the 2025-26 Scottish Budget. This provides additional funding for that year.

[26] HM Revenue and Customs (2024) Scottish Income Tax Outturn Statistics: 2022 to 2023

2.34 While the income tax reconciliation will make a positive contribution to funding, it is less positive than the £732 million we expected in December 2023. The £285 million reduction in the provisional reconciliation is mostly because of revisions in historical income tax data, which have lowered Scottish revenues relative to UK Government revenues.

Scottish Government borrowing plans

2.35 The Scottish Government will set out its borrowing plans for 2025-26 in its next Budget. Resource borrowing takes place through the National Loans Fund, but for capital borrowing the Scottish Government has the option of issuing bonds. The Scottish Government has previously stated that it is considering options to issue bonds in the latter half of the 2025-26 financial year.[27]

2.36 If the Scottish Government plans to issue bonds during 2025-26, these will need to be set out in the 2025-26 Budget and we will assess the reasonableness of those borrowing plans at the time of the Budget.

[27] Scottish Government (2023) Scottish Government capital borrowing and bonds: memorandum

Chapter 3
Economy

Developments since our last forecast

3.1 In this section we discuss developments in the economy since our last forecast in December 2023. We mainly cover the outlook in the current year for inflation, interest rates, Gross Domestic Product (GDP), and earnings, which are the main determinants of our fiscal forecasts.

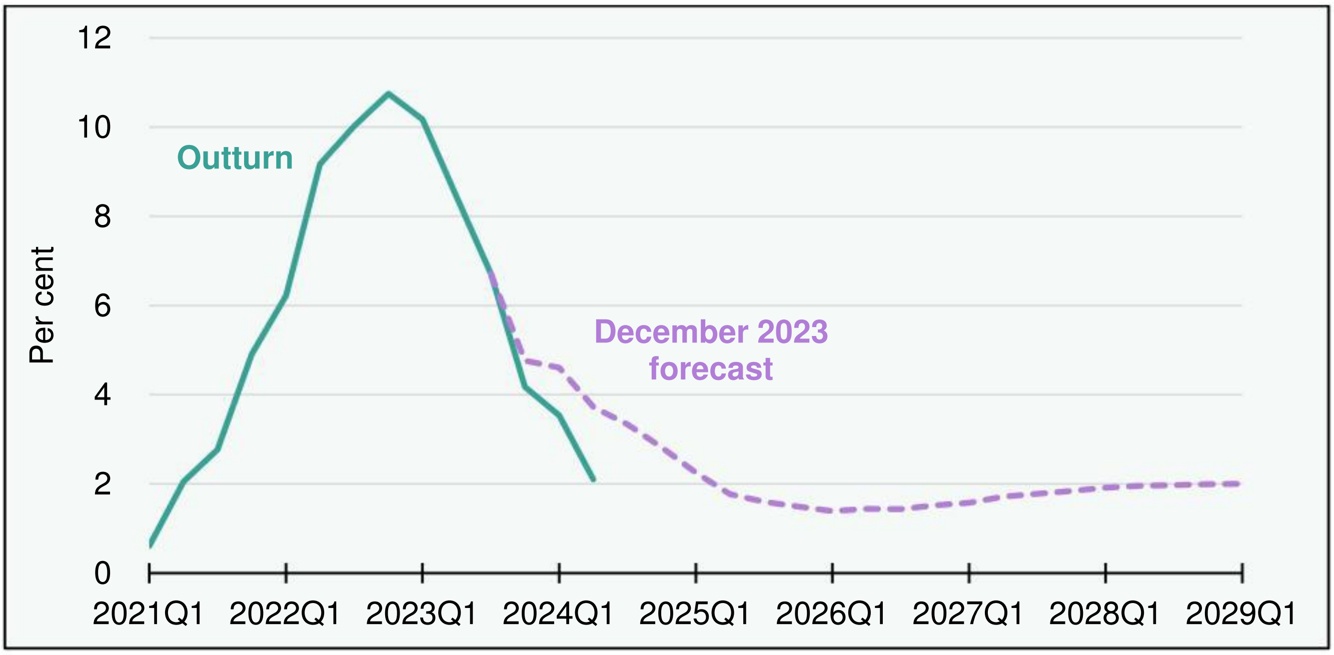
Overall economic context for 2024-25

3.2 The overall economic context for 2024-25 is broadly in line with our December 2023 forecast. One area of interest is the recent realignment of Scottish nominal average earnings growth to the UK, following a period where Scottish earnings grew faster. We explore this in more detail in the next sub-section.

3.3 Headline annual Consumer Price Index (CPI) inflation fell back to the 2 per cent target in 2024 Q2, around a year earlier than we expected in December 2023, as shown in Figure 3.1. Falling global energy prices were a key feature of the more rapid than expected reduction in headline inflation, while domestically driven inflation has generally been more persistent.

Figure 3.1: Consumer Price Index (CPI) inflation, UK, year-on-year growth

CPI back to 2 per cent target in 2024 Q2, a year earlier than we assumed last December



Description of Figure 3.1: Line chart showing the latest outturn data for CPI inflation along with our December 2023 forecast. Outturn CPI is below our last forecast for 2024-25.

Source: Scottish Fiscal Commission (2023) Scotland's Economic and Fiscal Forecasts – December 2023, ONS (2024) Consumer price inflation tables – July 2024.

3.4 On 1 August 2024 the Bank of England (BoE) announced an interest rate cut in response to falling headline inflation, but remains cautious about the domestic inflation outlook. The BoE had held off cutting rates in previous meetings this year, so interest rates have been slightly higher than our December 2023 forecast.

3.5 Mainly as a result of lower inflation, real disposable income per person – a measure of living standards – has been above our expectations from December 2023. The latest data shows it increased in 2023-24, after the previous year's record fall. However, the outlook in the near term remains challenging as the downward pressure from higher prices and the recent period of higher interest rates may continue for some time.

3.6 The latest GDP data has also been slightly above expectations, leading some forecasters to revise up their outlook for economic growth in 2024 to around 1 per cent. However, there are potential risks from global economic and political instability such as escalation of events in the Middle East. In December 2023, we forecast GDP growth of 0.7 per cent for Scotland in 2024. Figure 3.2 shows this is still close to recent independent forecasts for Scotland and the UK.

Figure 3.2: Scottish and UK forecasts for GDP in 2024, growth rates

Per cent	2023 (outturn)	2024
Scotland: SFC December 2023	0.1	0.7
Scotland: FAI June 2024	0.1	0.7
Scotland: EY August 2024	0.1	0.9
UK: OBR March 2024	0.1	0.8
UK: NIESR August 2024	0.1	1.1
UK: BoE August 2024	0.1	1.25
UK: HMT average of forecasters Jul 2024	0.1	1.0

Source: Scottish Fiscal Commission (2023) Scotland's Economic and Fiscal Forecasts – December 2023, Fraser of Allander Institute (2024) FAI Economic Commentary Q2 2024, Ernst & Young (2024) EY ITEM Club Scottish Summer Forecast – August 2024, OBR (2024) Economic and fiscal outlook – March 2024, National Institute of Economic and Social Research (2024) UK Economic Outlook – August 2024, Bank of England (2024) Monetary Policy Report – August 2024, HM Treasury (2024) Forecasts for the UK economy: July 2024.

Earnings

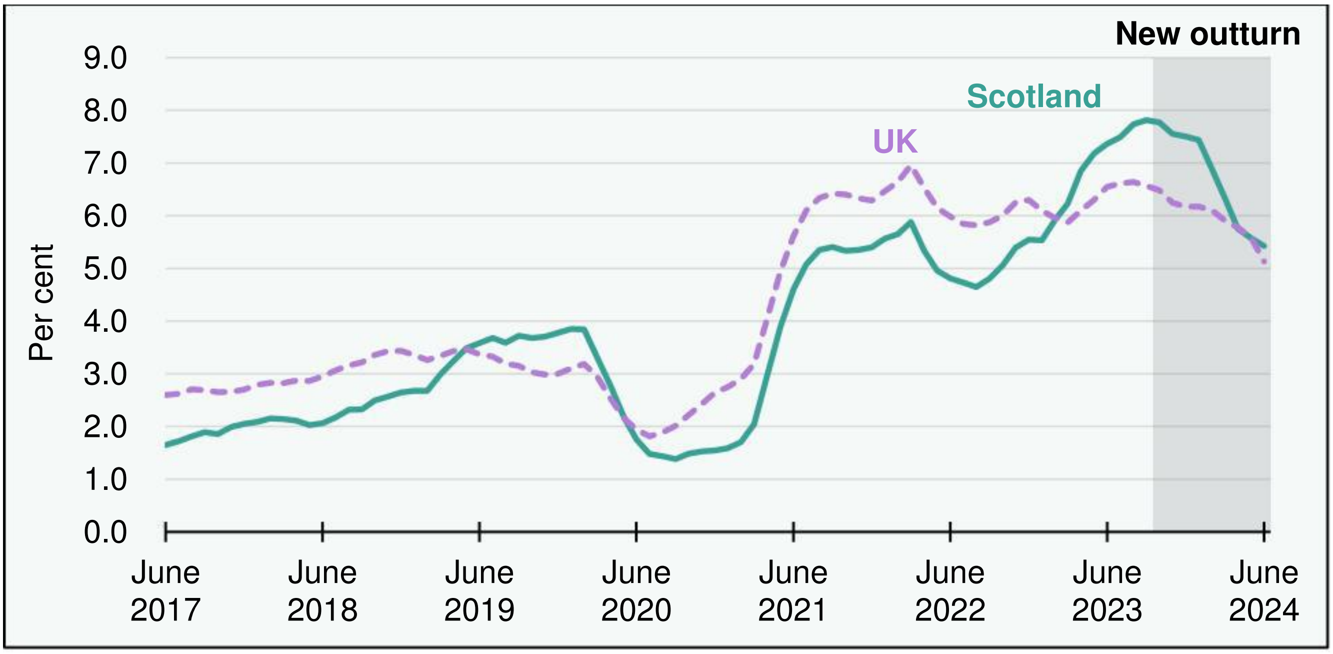
3.7 In December 2023, our analysis of Real Time Information (RTI) mean pay data showed that, in 2022-23 and in the year to September 2023, nominal average earnings growth was strong in Scotland and above the UK average. This relative strength of Scottish pay growth was broad-based across sectors and regions. In part, this reflected tighter labour market conditions in Scotland as greater recruitment difficulties and higher vacancies pushed up Scottish earnings relative to the UK.

3.8 Based on the latest RTI data, Scotland's earnings growth has recently slowed and is now similar to the UK average, as shown in Figure 3.3. This is in line with labour market indicators such as Adzuna job vacancies data which indicate convergence in labour market tightness between Scotland and the UK.

3.9 For 2024-25, our December 2023 forecast of Scottish earnings growth and the OBR's November 2023 forecast for the UK were similar (3.6 per cent and 3.3 per cent respectively). The OBR's March 2024 forecast of UK earnings growth for 2024-25 was 3.1 per cent. We will continue to monitor the RTI data, and what this means for growth in Scottish earnings relative to the UK, ahead of our next forecast.

Figure 3.3: RTI mean pay rolling annual growth, Scotland and the UK

Scotland's annual pay is now growing in line with the UK, after a period of faster growth



Description of Figure 3.3: Line chart of RTI data from June 2017 to June 2024 showing mean pay rolling annual growth in Scotland was faster than in the UK for 2022-23 and 2023-24, having usually lagged the UK, and has now largely realigned with the UK average.

Source: Scottish Fiscal Commission, ONS (2024) [Earnings and employment from Pay As You Earn Real Time Information, seasonally adjusted – August 2024.]

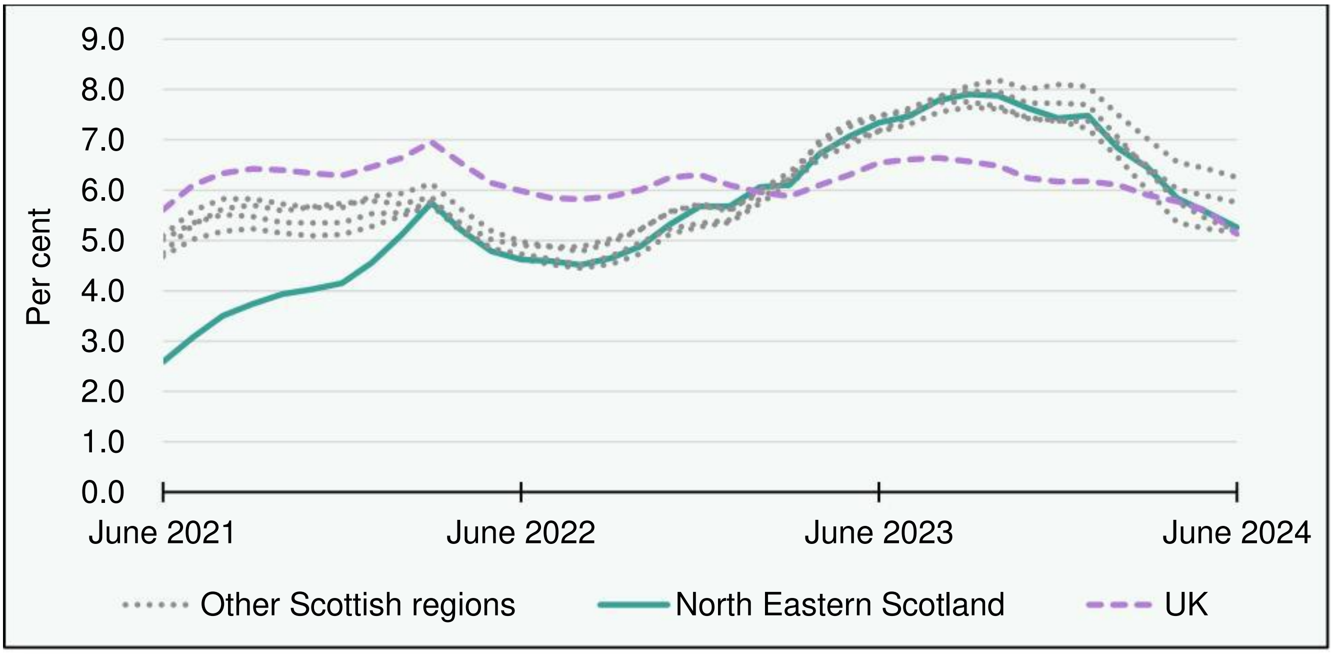
The shaded area for new outturn denotes data from October 2023 to June 2024 (inclusive) released since our December 2023 forecast.

Mean pay growth on a rolling annual basis is the percentage change in mean pay over the latest twelve months compared to the previous twelve months. In March 2023 and March 2024, rolling annual growth is equal to financial-year growth for 2022-23 and 2023-24 respectively.

3.10 Figure 3.4 shows that all Scottish regions had pay growth improving relative to the UK in 2022-23 and 2023-24. This includes the North East, where pay growth caught up with other Scottish regions in early 2022 and was no longer acting as a drag on Scotland's earnings growth. Over the last six months, all Scottish regions have seen pay growth slowing and largely realigning with the UK average.

Figure 3.4: RTI mean pay rolling annual growth, Scottish regions and the UK

In all Scottish regions, pay growth has recently slowed down towards the UK average



Description of Figure 3.4: Line chart of RTI data from June 2021 to June 2024 showing mean pay rolling annual growth in all Scottish regions was faster than in the UK for 2022-23 and 2023-24, after lagging the UK, and has now largely realigned with the UK average.

Source: Scottish Fiscal Commission, ONS (2024) [Earnings and employment from Pay As You Earn Real Time Information, seasonally adjusted – August 2024.]

3.11 In December 2023, our analysis of RTI data up to September 2023 showed that the strength of Scottish earnings growth relative to the UK was being driven by pay growth in the services sector, which accounts for around three quarters of the Scottish economy. Within services, the finance and insurance sector in Scotland was seeing faster pay growth than in the UK, after a period when it had been a drag on Scotland's relative earnings growth.

3.12 Since our December 2023 forecast, financial services earnings growth has become more similar between Scotland and the UK, with the pay growth gap recently turning negative again as shown in Figure 3.5. This pattern is similar for other services sectors such as information and communication services or professional services.

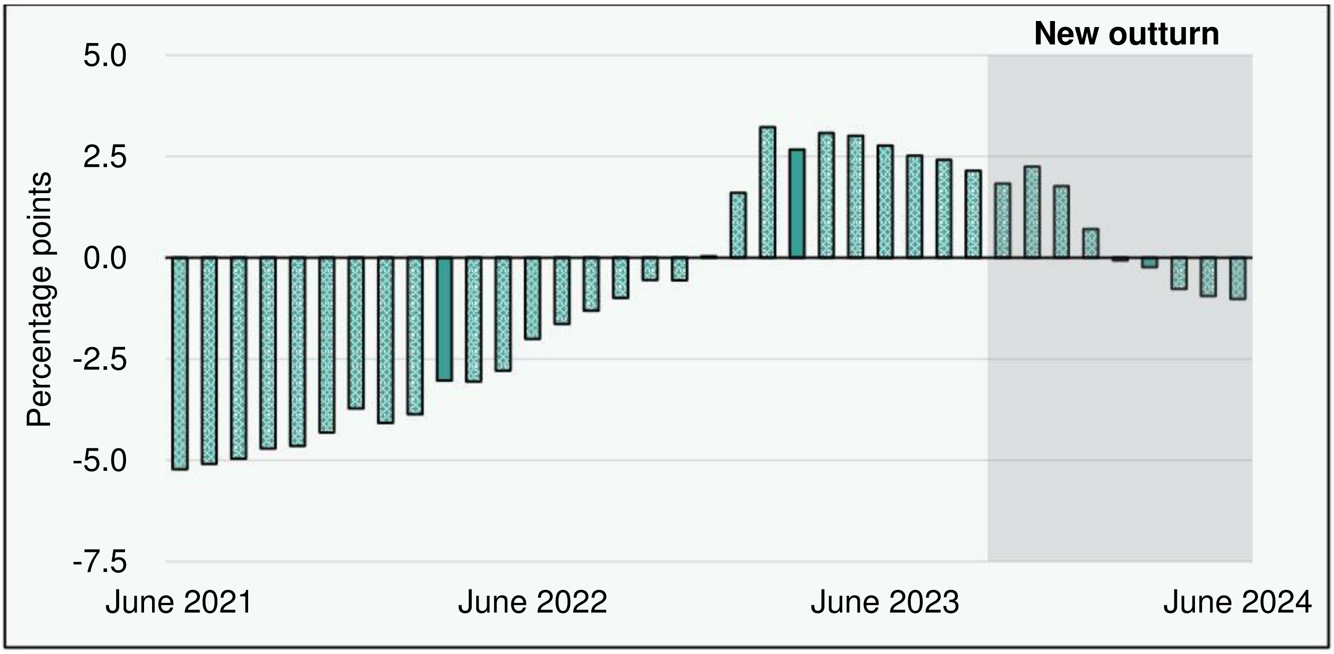
3.13 The pattern in Figure 3.5 could be related to the different composition of financial sector activities taking place in Scotland compared to the rest of the UK – primarily in London and the South East. Scotland's financial services are focused more on pension and insurance services where earnings are steady, whereas London has a bigger weight in investment activities where pay is more sensitive to volatility in bonuses. In 2021-22, financial services activity grew strongly across the UK (4.9 per cent), favouring stronger earnings growth in London and the South East through bonuses. In contrast, financial services activity across the UK recorded slower growth in 2022-23 (0.5 per cent) and contracted in 2023-24 (-1.3 per cent), which could explain the improvement in Scotland's earnings growth relative to the UK in these years.[28] If 2024-25 proves to be a

[28] ONS (2024) [GDP data tables – Quarter 1 (Jan to Mar) 2024, quarterly national accounts]

stronger year for financial services, this could again favour pay growth in the rest of the UK.

Figure 3.5: Scotland-UK gap in RTI mean pay rolling annual growth, finance sector

In the finance and insurance sector, the pay growth gap between Scotland and the UK has turned slightly negative again since our December 2023 forecast



Description of Figure 3.5: Column chart of the Scotland-UK mean pay growth gap from June 2021 to June 2024 for the finance and insurance sector. It shows the gap turned positive in January 2023 and has recently become slightly negative again.

Source: Scottish Fiscal Commission, ONS (2024) Earnings and employment from Pay As You Earn Real Time Information, seasonally adjusted – August 2024.

Solid fill columns denote financial-year values such as 2021-22, 2022-23, and 2023-24.

The shaded area for new outturn denotes data from October 2023 to June 2024 (inclusive) released since our December 2023 forecast.

3.14 We continue to have concerns about the quality of labour market data for Scotland, and we believe there is significant uncertainty around the Labour Force Survey (LFS) statistics for Scotland. We discuss this in more depth in our 2024 Statement of Data Needs.[29] As a result, it is challenging to draw conclusions from the LFS on the recent performance of the Scottish labour market relative to the UK.

Longer-term prospects

3.15 In this section we provide an overview of key trends in labour productivity, which is the main driver of GDP and earnings growth in the long run. Productivity growth has slowed globally since the 2008-09 Global Financial Crisis (GFC), as we highlighted in previous

[29] Scottish Fiscal Commission (2024) Statement of Data Needs – August 2024

reports.[30] The latest statistics show annual productivity growth in Scotland averaged 0.6 per cent from 2011 to 2023 compared to 1.7 per cent from 1999 to 2010.[31]

3.16 Over the last five years, productivity growth has been weak across all Scottish regions, as shown in Figure 3.6. The North East had the lowest rate, likely reflecting the decline in North Sea oil and gas activity over the last decade which has knock-on implications for the onshore supply chain. This is consistent with the analysis in Box 4.1 of this report showing the fall in the income tax revenue premium in Aberdeen. Box 3.1 in our December 2023 report discussed our outlook for the North Sea and our view remains largely unchanged.

3.17 In December 2023, we forecast annual productivity growth of 1.1 per cent by 2028-29, broadly in line with the OBR's forecast for the UK. The underlying assumption is that productivity growth in Scotland and the UK will remain subdued and will not return to the pre-GFC average.

Figure 3.6: Output per hour (2019 prices), average annual growth since 2018

Per cent	Average annual productivity growth since 2018 [1]
UK	0.5
Scotland	0.7
North Eastern Scotland	0.2
Highlands and Islands	0.8
Eastern Scotland	0.5
West Central Scotland	0.9
Southern Scotland	0.5

Source: Scottish Government (2024) Labour productivity statistics: 2023, ONS (2024) Subregional productivity: labour productivity indices by UK ITL2 and ITL3 subregions.

[1] For UK and Scotland, averages are from 2018 to 2023 (inclusive) based on the Scottish Government publication. For the Scottish regions, averages are from 2018 to 2022 (inclusive) based on the ONS data.

3.18 Productivity growth depends on a number of factors including investment, technological progress, education and training standards, global connectivity and trade, and government policy. For our forecasts, we monitor these factors as part of our judgement making process. Overall, we think conditions for productivity growth in Scotland broadly align with the UK, and we have typically mirrored the OBR's productivity growth rate in past forecasts. We will consider the OBR's assessment of the new UK government's policies to raise productivity when we prepare our next economy forecast.

[30] Scottish Fiscal Commission (2023) Scotland's Economic and Fiscal Forecasts – December 2023, Scottish Fiscal Commission (2018) Forecasting the long-run potential of the Scottish economy.

[31] Scottish Government (2024) Labour productivity statistics: 2023

Chapter 4
Tax

Income tax

Overview

4.1 Scottish income tax revenues grew strongly in 2022-23, with growth in Scotland higher than in the rest of the UK. This growth contributed to a positive income tax net position in 2022-23, and a positive provisional reconciliation of £447 million to be applied in the 2025-26 Scottish Budget.

4.2 Real Time Information (RTI) income tax data suggests continued high growth in 2023-24. This growth has been driven by high inflation and rapidly rising nominal wages, with RTI earnings data showing higher earnings growth in Scotland than the UK in 2022-23 and 2023-24. Tax policies which have fixed tax thresholds and led to fiscal drag in a high inflation context have also contributed to rapidly rising Scottish income tax revenues.

4.3 From 2017-18 to 2021-22, growth in Scottish income tax revenues lagged behind where it might have been given policy differences between Scotland and the UK, due to relatively slow growth in Scottish earnings and employment. Higher Scottish earnings growth in 2022-23 and 2023-24 has closed some of this gap. However, there is still an economic performance gap in Scottish income tax revenues of around £600 million per year, once account is made of the different policy choices in Scotland. In addition, the latest data suggests Scottish earnings growth is slowing relative to the UK, meaning the period of catch-up in Scottish income tax revenues may be coming to an end in 2024-25.

4.4 In this chapter we also discuss two significant corrections to UK income tax data made this year which have reduced revenues, with one also affecting Scottish income tax data.

Outturn data, the net position and reconciliations in 2022-23

4.5 Funding in the 2022-23 Scottish Budget depended in part on our December 2021 forecast of Scottish income tax (SIT) revenues and the corresponding Block Grant Adjustment (BGA). The BGA was based on the OBR's November 2021 forecast of income tax revenues in the rest of the UK. Comparing our forecasts to the BGA, suggested an income tax net position of negative £190 million, and funding for the Scottish Budget was set based on this value.

4.6 We now have income tax outturn data for 2022-23.[32] Figure 4.1 compares the outturn data to the original budget setting forecasts for 2022-23. Outturn data shows the provisional net position to be positive at £257 million, leading to a provisional £447 million reconciliation, the largest reconciliation to date.

[32] HMRC (2024) Scottish Income Tax Outturn Statistics: 2022 to 2023

Figure 4.1: Scottish income tax outturn and BGA for 2022-23 compared to forecasts

£ million	Budget setting	Outturn	Total change
Scottish income tax	13,671	15,169	1,498
BGA	-13,861	-14,912	-1,051
Net position	-190	257	447

Source: Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts - December 2021 , HMRC (2024) Scottish income tax outturn statistics: 2022 to 2023, OBR (2021) Economic and fiscal outlook – October 2021.

The outturn BGA and net position are provisional

4.7 Both the SFC and the OBR underestimated income tax revenues. Inflation in 2022-23 was significantly higher than expected when both these forecasts were produced. This has led to high nominal earnings growth which when combined with frozen tax thresholds and fiscal drag, led to increasing income tax revenues. Overall, we underestimated Scottish income tax revenues by more than the OBR underestimated UK income tax revenues, leading to a positive reconciliation.

4.8 In Box 4.1 in our December 2023 report we discussed how the more progressive income tax system in Scotland should lead to a positive and rising net position and we are now observing this in data. The HMRC outturn statistics show that combined growth in revenue from higher rate and top rate taxpayers was around 3 percentage points higher in Scotland than in the equivalent bands in the UK in 2022-23. The distribution of tax rates in Scotland has resulted in a greater proportion of taxpayers crossing into a higher tax band than in the rest of the UK, which increases the net position.[33]

Recent forecasts and data corrections

4.9 Since December 2023 there have been two separate corrections related to income tax data published by HMRC. Both these corrections have affected recent SFC and OBR income tax forecasts and projections of the net position and reconciliations. As with all statistics, historical income tax figures can get revised because of new information becoming available, methodological revisions and improvements, or the discovery of errors in the production process. When revisions occur, it is important that these are communicated clearly and transparently to all stakeholders. HMRC publishes data in line with the standards set out in the Code of Practice for Statistics, which includes guidance on revisions.[34] While it is important to understand these errors, the overall impact on the Scottish Budget is small.

4.10 The first is a correction to the Scottish and Welsh income tax outturn statistics in each year from 2016-17 to 2021-22.[35] HMRC found there were duplicate records for some taxpayers who appeared in both the Pay As You Earn (PAYE) and Self Assessment systems. This had led to an overestimate of income tax across the UK in all years dating back to 2016-17, with Scottish income tax being overestimated by £118 million or around 0.9 per cent in 2021-22. However, because the issue affected tax estimates in both Scotland and the rest of the UK tax estimates, with a similar magnitude and

[33] Scottish Fiscal Commission (2023) Scotland's Economic and Fiscal Forecasts – December 2023 – Figure S4.10

[34] UK Statistics Authority (2022) Code of Practice for Statistics

[35] HMRC (2024) Scottish Income Tax Outturn Statistics: 2022 to 2023

direction of error, the impact on the net position is not as substantial as the headline effect on tax revenues. The correction means a relatively small reduction in the net position in each year and the Scottish and UK Governments are in ongoing discussions about how to handle the impact.

4.11 Second, in February 2024, HMRC issued a correction to their monthly statistics on tax receipts, affecting estimates of UK income tax receipts in 2022-23 and 2023-24.[36] We don't use this data in our forecasts, but the OBR place significant weight on it for their income tax forecasts on which the BGA is based. In February 2024, UK wide total PAYE receipts, which includes income tax and class 1 National Insurance Contributions (NICs), were revised up by £1.8 billion (0.5 per cent) in 2022-23 and by £6.5 billion (2.2 per cent) in 2023-24. The correction has no effect on estimates of Scottish income tax revenues so our December 2023 forecast was not affected.

4.12 Normally, estimates of previous years' income tax revenues would be fairly stable, as we don't get much new data or information until the final outturn are published. However, these corrections have meant far more movement in estimates of 2022-23 revenues in recent forecasts than we'd normally expect, as shown in Figure 4.2.

Figure 4.2: Scottish income tax outturn and BGA for 2022-23 compared to Budget setting forecasts and to December 2023

£ million	Budget setting	December 2023	Outturn	Change since December 2023
Scottish income tax	13,671	15,309	15,169	-140
BGA	-13,861	-14,768	-14,912	-144
Net position	-190	542	257	-285
Reconciliation		732	447	-285

Source: Scottish Fiscal Commission (2024) Scotland's Economic and Fiscal Forecasts, HMRC (2024) Scottish Income Tax Outturn Statistics: 2022 to 2023, OBR (2021, 2023) Economic and fiscal outlook.

The outturn BGA, net position and subsequent reconciliation are provisional

4.13 In December 2023, we overestimated income tax revenues in 2022-23 by £140 million. Had we been working with the corrected outturn data, our December 2023 estimate of 2022-23 income tax would have been significantly more accurate. In December 2023, we had forecast income tax revenues to grow by 11.5 per cent 2021-22 and 2022-23. Applying this growth rate to the now corrected 2021-22 outturn figure suggests our forecast would have been £15,179 million, a forecast error of only £10 million.

4.14 In March 2024, based on updated OBR forecasts, the estimated BGA for 2022-23 was revised up by £180 million, largely reflecting the correction to the HMRC monthly tax receipts data.

[36] HMRC (February, 2024) HMRC tax receipts and National Insurance contributions for the UK (monthly bulletin)

4.15 Overall, these data corrections account for the majority of the movement in estimates of the 2022-23 net position and reconciliations between December 2023 forecasts and the publication of outturn data.

4.16 The scale of the provisional £285 million revision to the net position between the latest forecasts and the publication of outturn is not unusual in the context of forecast error. However, this is the first time the revision has been driven by data corrections, with the forecasts themselves otherwise proving accurate. When we and the OBR publish our next forecasts they will be based on the corrected outturn data.

The income tax net position over time

4.17 We have updated our income tax net position decomposition analysis. We have modelled different scenarios showing how changes in headline employment, average earnings and policy have affected the net position. This sort of scenario analysis is illustrative and doesn't fully capture all the factors that can affect the net position. Factors that we cannot directly account for with our current methodology, such as changes in the shape of the income distribution, are captured in the other factors category. In addition, policy divergence is modelled on a static basis, with changes in behaviour implicitly captured in the other factors category.

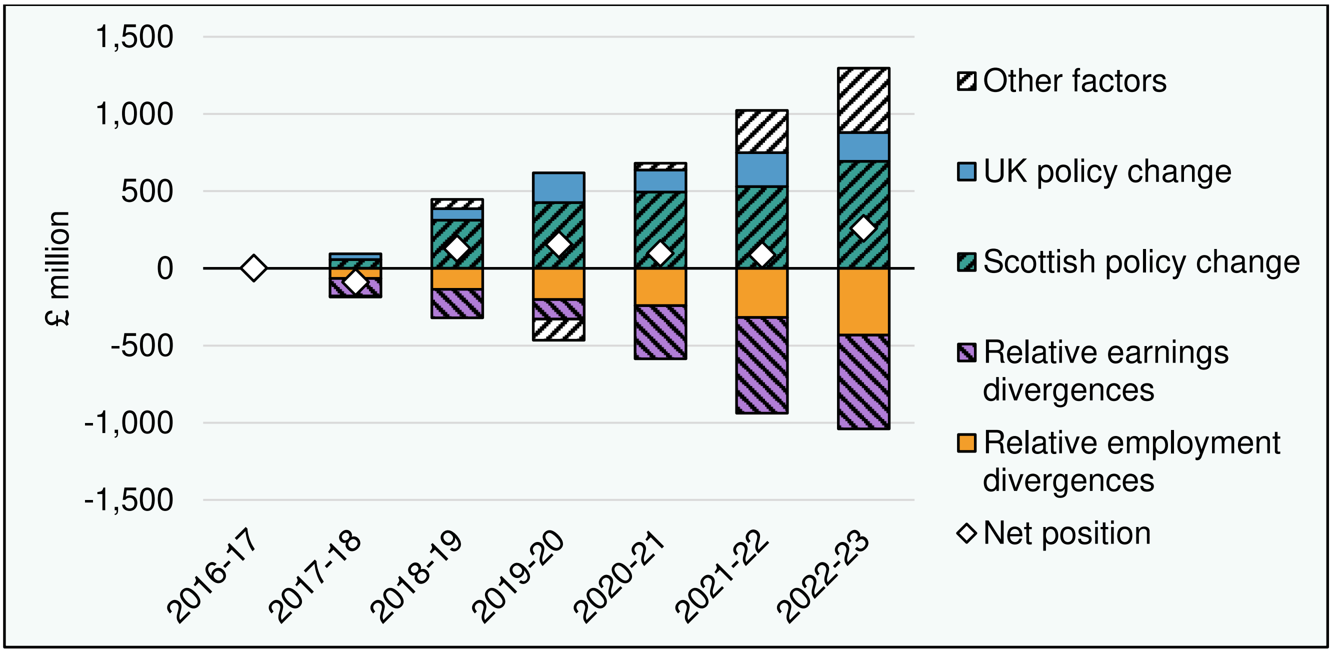
4.18 Figure 4.3 shows how the income tax net position has moved since 2016-17, along with our estimates of how different factors have contributed. Relatively slower economic growth has acted as a drag on Scottish income tax revenues. Scottish average earnings have grown 3.1 per cent lower than in the rest of the UK between 2016-17 and 2022-23 while employment has grown 3.2 per cent lower. In 2022-23 this lower growth in Scottish average earnings and employment has detracted around £1,040 million from the income tax net position.

4.19 Policy changes in Scotland, including increasing tax rates, creating new tax bands, and freezing tax thresholds, have all contributed positively to the net position. Policy changes in the UK have also contributed positively though to a lesser extent. Overall we estimate that policy divergence between Scotland and the UK will have added around £881 million to the income tax net position in 2022-23.

4.20 Other economic factors which we cannot directly control for in this analysis, including changes in the shape of the income distribution and changes in taxpayer behaviour, are also now affecting the income tax net position, adding around £400 million in 2022-23.

Figure 4.3: Illustrative contributions to the income tax net position

UK and Scottish policy contribute positively to net position with relative earnings and employment divergences contributing negatively



Description of Figure 4.3: Combination line and bar chart illustrates the different factors which have contributed to the income tax net position between 2016-17 and 2022-23, with relative earnings and employment divergences contributing negatively, and Scottish and UK policy change as well as other factors contributing positively.

Source: Scottish Fiscal Commission.

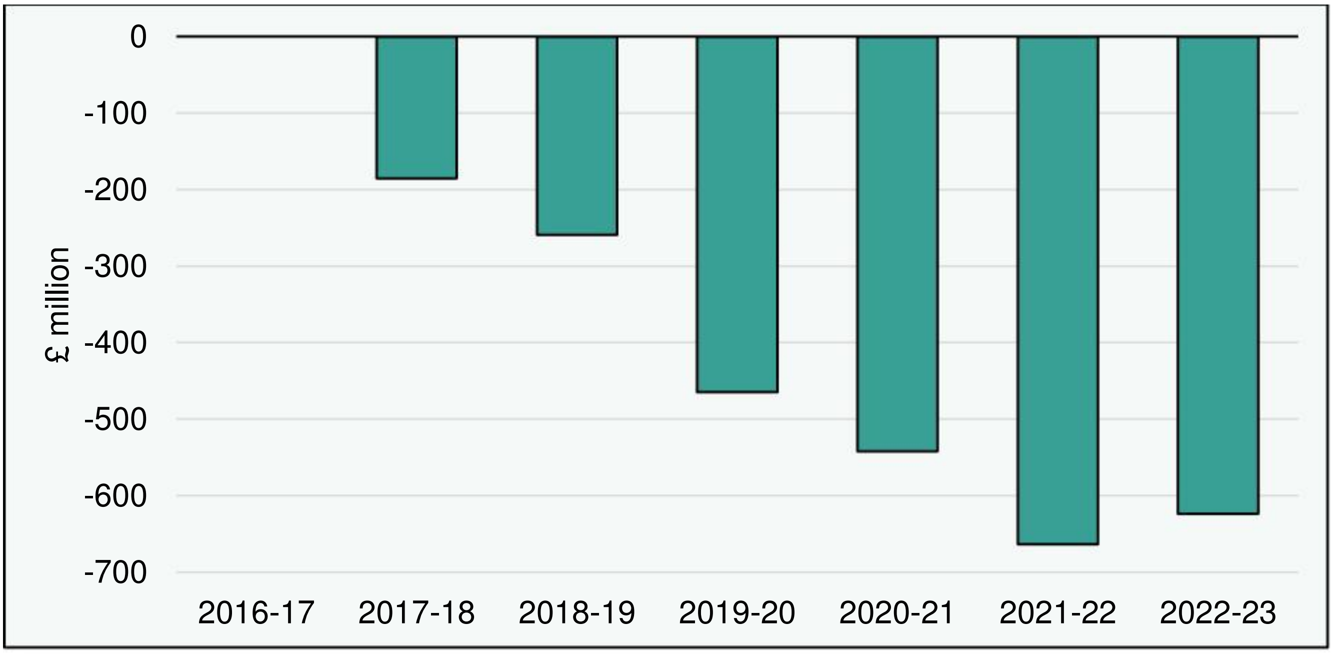
Behavioural effects are not considered when calculating the effect of Scottish policy changes.

4.21 Policy differences between Scotland and the UK increase the net position by £881 million. However, after taking account of slower economic growth and other factors, the net position is only £257 million, a difference of £624 million. We call this difference the economic performance gap.

4.22 Figure 4.4 summarises our estimates of this performance gap over time. The performance gap improved from minus £663 million in 2021-22 to minus £624 million in 2022-23, showing a small catch-up in Scottish income tax revenues after having account for policy differences. Box 4.1 on the oil and gas industry discusses one significant contribution to this gap. Changes in the performance gap reflect the relative growth of the Scottish economy compared to the rest of the UK. From its current negative level, if the Scottish economy broadly matches the UK economy for growth, we'd expect the economic performance gap to remain stable.

Figure 4.4: Economic performance gap

There is a performance gap of £624 million in 2022-23 once account is made of the different policy choices in Scotland



Description of Figure 4.4: Bar chart showing the economic performance gap between Scotland and the rest of the UK between 2016-17 and 2022-23.

Source: Scottish Fiscal Commission.

The income tax net position in 2023-24 and beyond

4.23 RTI data on PAYE income tax suggests there will be a positive income tax net position in 2023-24, following on from the year before. The RTI data shows revenue growth of 14.4 per cent in Scotland, compared to 12.0 per cent in the rest of the UK. There are several differences between RTI and the eventual outturn data but this does suggest a further improvement in the income tax net position. As an illustrative calculation, these RTI growth rates suggest the income tax net position rising to £658 million in 2023-24, which would imply a positive reconciliation of £334 million to be applied in the 2026-27 Scottish Budget.

4.24 Both 2022-23 and 2023-24 have been positive years for the net tax position for the Scottish Budget, but this needs to be seen in the context of relatively weak growth in the Scottish economy and income tax revenues since 2016-17. As discussed in Chapter 3, Scottish average earnings growth has fallen to be more in line with the rest of the UK in recent months, possibly marking the end of the recent period of catch-up. Overall, as discussed in Box 4.1 of our December 2023 SEFF, policy differences between Scotland and the UK mean the net position is likely to rise over time, though as we have shown in Figure 4.4 there remains a negative performance gap.

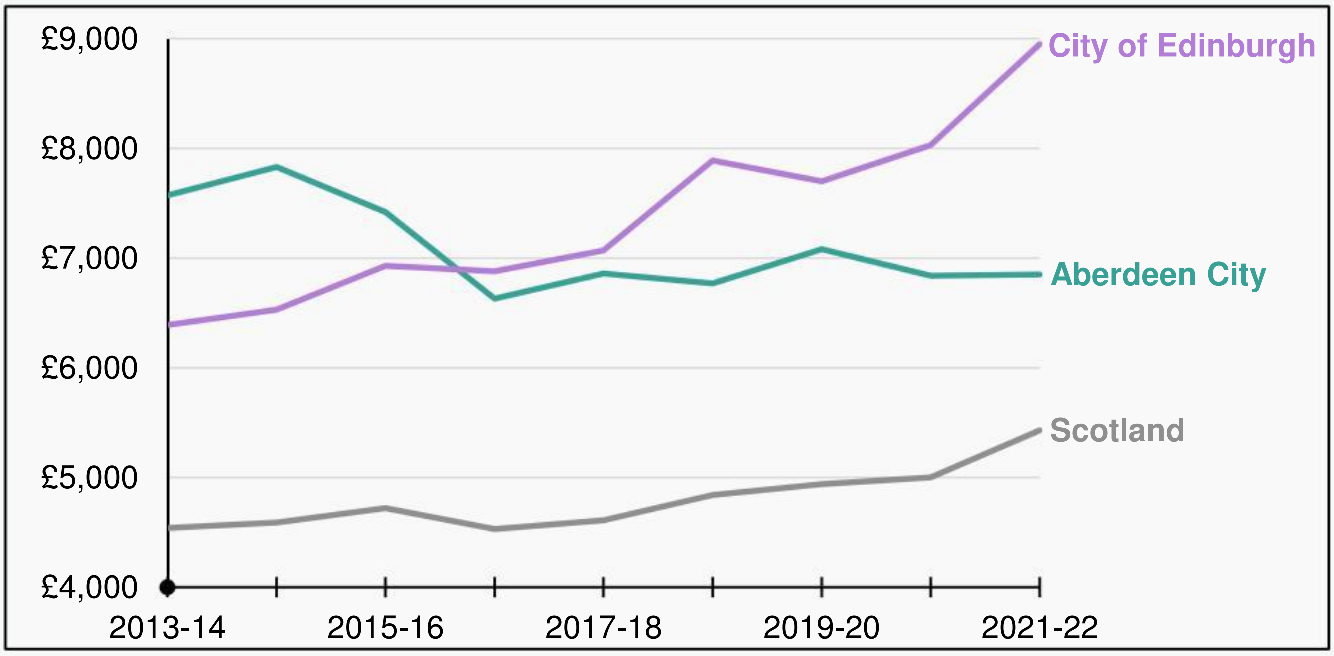
Box 4.1: Income tax and the oil and gas industry

The oil and gas industry and its supply chain are highly paid. This contributes to Scottish income tax revenues and therefore the Scottish Budget. However, over the last decade, North Sea oil and gas activity has been declining. This section looks at how this has affected Scottish income tax revenues.

Figure 4.5 shows mean average income tax revenue in Scotland and selected regions up to 2021-22. Aberdeen City has a clear premium in average income tax paid compared to the Scottish average, assumed to be largely driven by the activities around North Sea oil and gas. This premium has fallen from around £3,000 per person in 2013-14 to £1,400 in 2021-22, a fall of over half. Compared to 2016-17 (the baseline year for income tax devolution), the premium has fallen by around £680, or 32 per cent. Regions with a similar premium (Edinburgh, East Lothian, East Renfrewshire) have not seen the premium fall over the period. The City of Edinburgh has now overtaken Aberdeen City as the highest average tax revenue region of Scotland.

Figure 4.5: Average income tax, selected Scottish regions, 2013-14 to 2021-22

Average income tax raised in Aberdeen City overtaken by City of Edinburgh



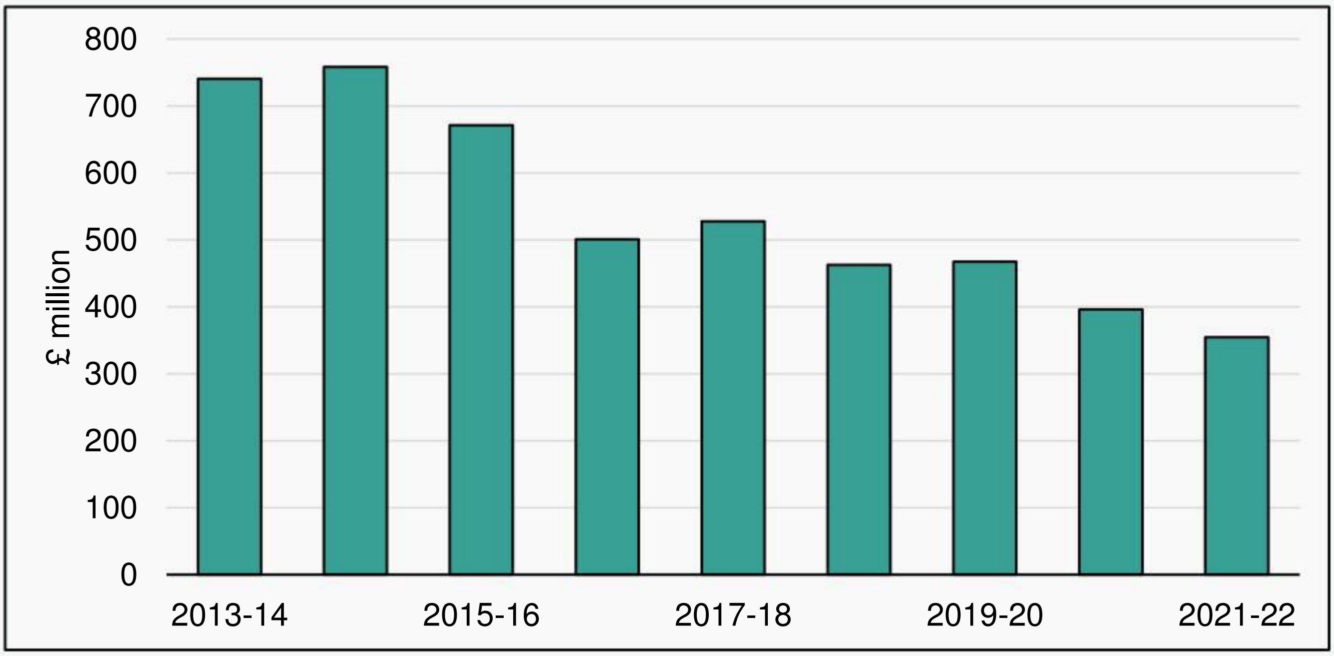
Description of Figure 4.5: Line chart showing taxpayers in Aberdeen and Edinburgh paid higher than the Scottish average between 2013-14 and 2021-22.

Source: Scottish Fiscal Commission, HMRC (2024) Statistics about personal incomes.

An estimate of the total value of the income tax 'premium' from the North East can be obtained by comparing the income tax actually paid by taxpayers in Aberdeen City and Aberdeenshire and the theoretical tax paid if taxpayers in those two areas paid the Scottish average level of tax. This is shown in Figure 4.6.

Figure 4.6: North East Scotland income tax premium, 2013-14 to 2021-22

The North East Scotland income tax premium has steadily fallen since 2013-14



Description of Figure 4.6: Column chart showing how the North East Scotland income tax premium has gradually fallen from £741 million in 2013-14 to £355 million in 2021-22, peaking in 2014-15 at £758 million.

Source: Scottish Fiscal Commission, HMRC (2024) Statistics about personal incomes.

In 2013, this premium was worth around £750 million to Scottish income tax revenues, around 6.3 per cent of total income tax revenues. The decline in the premium (compared to a scenario where it had remained static) reduced Scottish income tax revenues by around £386 million (3 per cent) since 2013-14, or £146 million (1 per cent) since 2016-17. As of 2021-22, the premium was still worth around £355 million (2 per cent). If this earnings and income tax revenue premium in Aberdeen City and Aberdeenshire eventually disappears and revenues converge with the Scottish average, this could reduce Scottish income tax revenues further.

Chapter 5
Social Security

Updates since December 2023

5.1 In this section we provide an update on social security spending and funding. We now have provisional outturn for social security spending in 2023-24. Overall, social security spending was £5.3 billion. The latest estimate for the 2023-24 social security Block Grant is £4.4 billion. In terms of the social security net position, this means we estimate spending exceeded the Block Grant Adjustment (BGA) funding by around £0.9 billion. This is in line with our forecasts for 2023-24 from both December 2022 and December 2023.

5.2 When considering the difference between social security spending and the BGA funding it is useful to separate payments into three groups: new payments introduced by the Scottish Government since 2018 with no associated funding; other Scottish Government payments that replaced UK Government payments where funding is within the wider Block Grant; and replacement payments which have associated BGA funding from the UK Government.

5.3 Total spending on the first group of payments, those with no associated funding, was approximately £570 million in 2023-24. Scottish Child Payment (SCP) is the most significant of these payments with spending of £429 million.

5.4 For the second group of payments, where funding is included in the Block Grant and cannot be directly compared, total spending in 2023-24 was around £100 million.

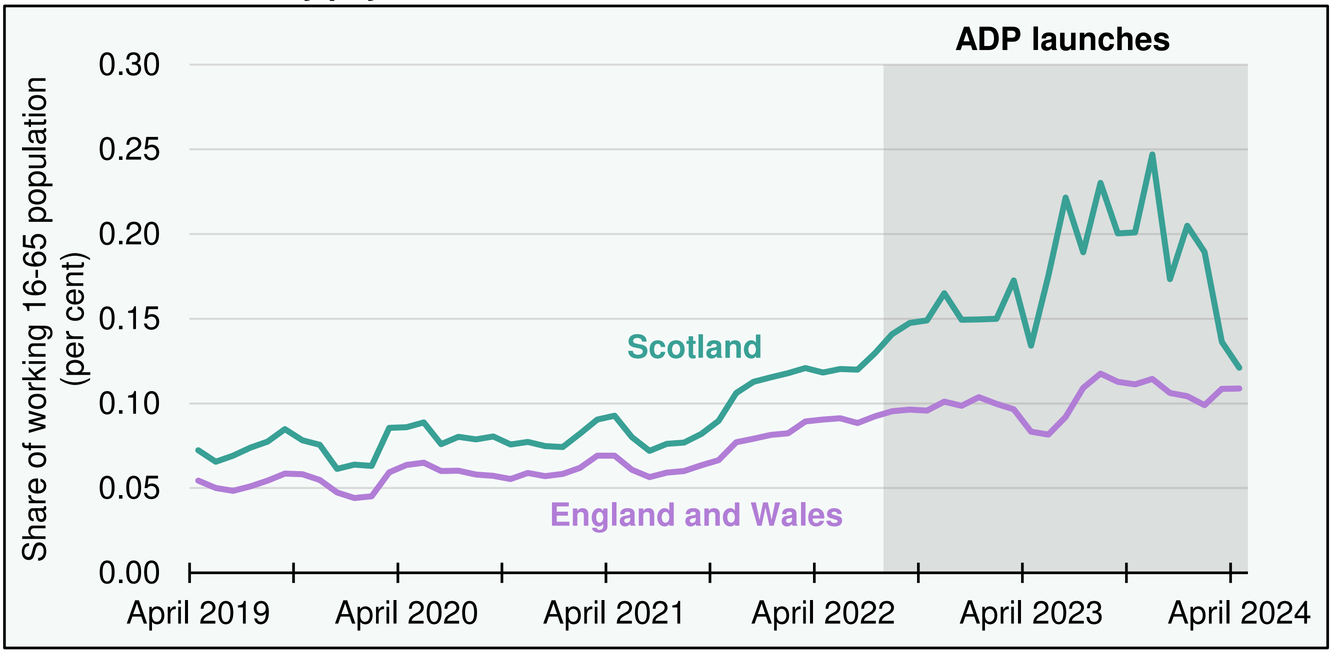
5.5 For the third group, those with associated BGA funding, in 2023-24 the gap between the relevant BGA funding and spending for these payments was £225 million. This difference is broadly in line with our expectations from our forecasts for 2023-24 prepared in December 2022. We attribute the difference to delivery and operational changes to payments to improve the experience of people applying and receiving them leading to additional spending.

5.6 The difference between spending and associated BGA funding is largest for Adult Disability Payment (ADP) and Personal Independence Payment (PIP). The estimated gap between the ADP and PIP outturn spending from 2023-24 and the latest position for the 2023-24 BGA for PIP was £153 million.

5.7 As well as through the higher expenditure outturn, the effect of delivery and operational changes can be seen in the number of people applying for and receiving payments. Figure 5.1 shows successful new applications as a proportion of the 16 to 65 population for ADP in Scotland and for PIP in England and Wales. While there have been increases in successful new applications as a proportion of the population since the COVID-19 pandemic for both PIP in England and Wales and ADP in Scotland, this rate in Scotland has been higher since the Scottish Government introduced ADP to replace PIP in March 2022.

Figure 5.1: Monthly flow of successful new applications to PIP and ADP

Awards for disability payments have risen in Scotland since the introduction of ADP



Source: Scottish Fiscal Commission.

Description of Figure 5.1: Line chart showing the number of successful applications to PIP and ADP, expressed as a share of the respective population aged 16 to 65 in England and Wales on the one hand and Scotland on the other. The gap between Scotland and England and Wales widened with the introduction of ADP, but has recently narrowed.

Figures may not sum because of rounding.

Successful applications to PIP have been estimated using the number of new awards with a duration of less than three months.

5.8 Our assessment is that the gap between spending on devolved social security and the associated BGA funding is the result of policy choices made by the Scottish Government. These choices include the introduction of new payments such as SCP not available elsewhere in the UK, and the operational and delivery changes made when CDP and ADP were introduced.

5.9 We forecast the gap will grow in future years as the operational and delivery changes for disability payments continue to take effect. In December 2023 we forecast total spending on devolved social security in 2024-25 to be around £1.1 billion higher than the funding the Scottish Government receives through the social security BGA, with that gap growing to around £1.5 billion in 2028-29. This gap must be met from the overall Scottish Budget and social security spending will account for an increasing share of the resource budget, rising from 13 per cent in 2024-25 to 15 per cent in 2028-29.

Policy context for social security forecasts

5.10 The social security spending forecasts and funding estimates presented above are based on existing UK and Scottish Government policies. In this section we highlight policy announcements since our last forecast and areas where there could be changes in the future.

5.11 The Scottish Government has set up an independent review of ADP. Its work began in February 2024 with the final report due in July 2025. If the Scottish Government decides to make further changes to ADP in response to the review and these changes lead to an increase in spending, then the social security net position could widen further.

5.12 BGA social security funding that the Scottish Government receives is determined by spending on the equivalent payments in England and Wales, so UK Government changes to those payments can lead to a change in the level of BGA funding. On 29 July 2024 the UK Government announced that from this autumn, Winter Fuel Payment (WFP) eligibility will change and will only be targeted to older people who receive means-tested benefits, rather than everyone over the State Pension age. This is expected to considerably decrease spending on WFP in England and Wales, as currently just over a tenth of the state pension age population is in receipt of the qualifying benefits. Because of this the associated BGA funding for Scotland will proportionally decrease. The Scottish Government estimates this will reduce the BGA by between £140 million and £160 million in 2024-25.

5.13 In response to the UK Government policy change, the Scottish Government has announced that, it will also restrict eligibility for Pension Age Winter Heating Payment (PAWHP), the Scottish Government replacement for WFP, to older people who receive relevant means-tested benefits. Compared to our December 2023 forecast of £180 million for PAWHP in 2024-25, we expect the change will reduce spending by a similar amount to the reduction in BGA funding, £140 million to £160 million. This means we do not expect there to be an effect on the overall gap between spending on social security payments and the funding received through the BGA.

5.14 UK Government changes to disability and carer benefits in England and Wales could also have an effect on social security BGA funding. While there has been no announcements of specific policy changes, in a recent speech on the labour market the UK Government Work and Pensions Secretary referenced OBR forecasts of the rise in spending forecasts for sickness and disability benefits. Also, the previous UK Government held a consultation on a health and disability green paper from April 2024 (prior to the UK General Election) until July 2024. The new UK Government has yet to publish a response to the consultation, but if some of the policy measures proposed in the green paper were to be introduced in England and Wales and reduced spending on PIP, this would reduce the PIP BGA funding and widen the social security net position.

5.15 There are also a number of devolved social security payments where eligibility is determined by receipt of a reserved payment. The most significant of these is SCP where eligibility is usually based on families receiving Universal Credit, or Child Tax Credit. If the UK Government made changes to any of these payments that led to changes in the number of people eligible then there could be an effect on the number of people receiving SCP and total spending.

5.16 For example, the Labour manifesto included a commitment to reviewing Universal Credit. At present there are no details on the scope of the review. One aspect of Universal Credit which has been the subject of discussion recently is the two-child limit. The rule means that families receiving Universal Credit do not receive extra money for third and subsequent children. If the rule was removed then the affected households would see a noticeable rise in their Universal Credit income. We don’t think there would be a substantial increase in SCP eligibility from the removal of the two-child limit because the vast majority of families affected are already receiving Universal Credit. New eligibility would only come from families whose income is currently too high to qualify for Universal Credit, but who would be eligible for a small award if another child element is added to their entitlement. Therefore, with a limited effect on eligibility, we would expect a change to the two-child limit to have a relatively small effect on SCP spending.

Annex A
Changes to the 2023-24 Budget since December 2023

A.1 Since our December 2023 forecast, the total funding available to the Scottish Government in 2023-24 has decreased by £61 million. The UK Government published its Supplementary Estimates for 2023-24 in late February 2024, which generated Barnett funding.[37] The Scottish Government made its final decisions on borrowing and drawdowns at the end of March. We have also had the provisional outturn data.

A.2 The Scottish Budget was amended at the Spring Budget Revision (SBR) in February 2024.[38] At that point, available funding was £197 million higher than in December 2023. We outline changes to the funding position in two stages: first up to the SBR, and then up to the provisional outturn.

A.3 The financial year 2023-24 has now ended, and the provisional outturn position is available. With funding for that year now largely settled, we do not expect to report on 2023-24 again.

A.4 Resource funding in 2023-24 has remained largely stable since December 2023, decreasing by £29 million (less than 0.1 per cent change). Figure A.1 shows the changes. The SBR presented to the Scottish Parliament was based on a slightly higher level of funding, but after final funding decisions it fell back by £102 million.

[37] HM Treasury (2024) Supplementary Estimates 2023-24
[38] Scottish Government (2024) Scottish Budget 2023 to 2024: spring budget revision

Figure A.1: 2023-24 Budget – resource funding position over time

Source of funding (£ million)	Position in Dec 23	Changes up to Feb 24	Position at SBR	Changes up to Aug 24	Latest position
Block Grant					
Barnett baseline [1]	34,942		34,942		34,942
Barnett consequentials	1,399	+260	1,659	+157	1,815
Non-Barnett funding [2]	715		715		715
Fiscal framework funding					
Forecast devolved revenues [3]	16,722	-15	16,707	-10	16,697
Tax and non-tax BGAs	-16,129		-16,129		-16,129
Social security BGAs	4,405		4,405		4,405
Adjustment for forecast error, of which:	87		87	+63	150
Reconciliations	46		46		46
Borrowing	41		41	+63	104
Scotland Reserve drawdown	251		251	-1	250
Other sources					
Other funding, of which:	863	-172	691	-311	380
Assumed	353	-136	216	-216	
Confirmed [4]	510	-36	474	-95	380
Non-Domestic Rates (NDR) distributable amount	3,047		3,047		3,047
Less: resource borrowing costs	-114		-114		-114
Less: capital borrowing costs	-103		-103		-103
Resource funding available for discretionary spend	46,083	+73	46,156	-102	46,054

Source: Scottish Fiscal Commission, Scottish Government.

Figures may not sum because of rounding. Amounts exclude IFRS16 funding adjustments.

[1] As set in the Spending Review 2021.

[2] Funding agreed between the UK and Scottish Governments at the Spending Review 2021 which is not based on the use of the Barnett formula. It comprises £595 million for EU replacement farm funding, £14 million for EU replacement fisheries funding, £26 million for the Bew Review and £80 million for the Rail Resource Grant.

[3] These include £34 million for Fines, Forfeitures and Fixed Penalties (FFFPs).

[4] The latest position comprises £161 million of Migrant Surcharge, £145 million of Budget Cover Transfers, £27 million of capital-to-resource budget switch over and above what came via the Barnett formula, £26 million of Crown Estate Income, £20 million for a correction to the Home Office comparability factor, and £1 million of resource City Deals.

A.5 For the SBR, the Scottish Government estimated an increase of £260 million in Barnett consequentials from the UK Supplementary Estimates 2023-24. By the year-end there was a further increase of £157 million in Barnett consequentials as the confirmed amount from the UK Supplementary Estimates 2023-24 exceeded the Scottish Government's SBR assumptions.

A.6 At the time of the SBR, there was a reduction of £15 million in forecast revenues from fully devolved taxes, mostly related to Land and Building Transaction Tax (LBTT). This forecast of LBTT revenues produced by Revenue Scotland included two more months of outturn data compared to our December 2023 forecasts. Subsequently, the provisional outturn data confirmed a further decrease of £10 million in devolved tax revenue, with most of this shortfall also attributed to LBTT.

A.7 The Scottish Government decided to increase its borrowing by £63 million for resource spending.

A.8 Other funding changes:

- There was a reduction of £172 million in other sources of funding, encompassing both assumed and confirmed funds at the time of SBR. This was primarily due to the planned use of ScotWind proceeds being revised down from £460 million to £310 million and a £17 million provision made to manage International Financial Reporting Standard 16 (IFRS 16) adjustments while budget cover was not available.
- A further reduction of £311 million from other funding between assumed and confirmed sources has happened since the SBR. The Scottish Government decided to not spend the £310 million of ScotWind proceeds they had planned to use in 2023-24, meaning these could be used in later years. Partly offsetting this decrease in funding were £15 million more Crown Estate income than previously expected, £27 million of capital-to-resource budget switch, and £17 million to undo the IFRS 16 related working provision made at the SBR.[39]

A.9 Capital funding has also been relatively stable since December 2023, decreasing by £32 million (a fall of 0.5 per cent). Figure A.2 shows the changes to 2023-24 capital funding.

[39] The Scottish Government received a guarantee of a £60 million capital to resource budget switch from the HM Treasury. The guarantee was made that these switches would be received organically through the Barnett formula as UK departments agreed capital to resource switches. At UK Supplementary Estimates 2023-24 only £33 million came through as Barnett funding, hence HM Treasury reflected a further £27 million as non-Barnett amounts.

Figure A.2: 2023-24 Budget – capital funding position over time

£ million	Source of funding	Position in Dec 23	Changes up to Feb 24	Position at SBR	Changes up to Aug 24	Latest position
Capital (Excluding financial transactions)						
Block Grant	Barnett baseline [1]	4,757		4,757		4,757
	Barnett consequentials	63	+56	119	-6	113
	Non-Barnett funding [2]	638		638	-6	632
Fiscal framework funding	Capital borrowing	450		450	-150	300
	Scotland Reserve drawdown	30	+3	32		32
Other funding	Other funding, of which:	22	+77	99	+6	105
	Assumed	22	+77	99	-99	0
	Confirmed [3]	0		0	+105	105
Total capital funding (excl. FTs)		5,960	+135	6,095	-156	5,939
Financial transactions (FTs)						
Block Grant	Barnett baseline	186		186		186
	Barnett consequentials	-12	-11	-23		-23
Fiscal framework funding	Scotland Reserve drawdown	44		44		44
Other funding	Other funding, of which:	188		188		188
	Assumed	176		176	-176	0
	Confirmed [4]	12		12	+176	188
Total FTs		405	-11	394	0	394
Total capital funding		6,365	+124	6,489	-156	6,333

Source: Scottish Fiscal Commission, Scottish Government.

Figures may not sum because of rounding. Amounts exclude IFRS16 funding adjustments.

[1] As set in the Spending Review 2021.

[2] £632 million of capital grant funding for Network Rail agreed between the UK and Scottish Governments at the Spending Review 2021.

[3] The latest position, confirmed at UK Supplementary Estimates 2023-24, consists of £82 million from capital City Deals, £17 million from Budget Cover Transfers, and £6 million from the UK's Regional Investment Fund.

[4] £188 million for a one-off correction of a historical error on FTs funding.

A.10 At the time of SBR, the Scottish Government estimated an increase of £45 million in Barnett consequentials from the upcoming UK Supplementary Estimates 2023-24. This was made up of an increase of £56 million in capital and a reduction of £11 million for Financial Transactions (FTs). The publication of the Supplementary Estimates confirmed that capital consequentials exceeded the assumed amount by £36 million. The Scottish Government decided to surrender £27 million of those for the capital-to-resource budget switch and decided to defer £15 million to 2024-25. For FTs the confirmed consequentials were substantially more negative – a reduction of £64 million. HM Treasury have allowed the Scottish Government to defer £54 million to 2024-25.

A.11 An increase of £3 million in how much the Scottish Government planned to draw down from the reserve. This was following a revised available balance, as final audited accounts for 2022-23 confirmed the actual capital underspend in that year.

A.12 £6 million for Regional Investment Fund were moved from Non-Barnett funding to other funding as it was misclassified as Barnett. This had no net effect on capital funding.

A.13 A reduction of £150 million in the amount of capital borrowing taken out at the year-end: £300 million rather than the £450 million previously planned.

A.14 An increase of £77 million in assumed other funding (excluding FTs), bringing it to £99 million: £82 million of City Deals and £17 million of Budget Cover Transfers, all of which were confirmed as they emerged by the year-end.[40]

A.15 The other FTs funding that had been estimated at the SBR were confirmed following UK Supplementary Estimates 2023-24: a correction of £188 million for error in historic allocations of this kind of funding.

[40] Budget Cover Transfers (BCT) occur when UK Government departments transfer some of their budget to the Scottish Government. This becomes funding that the Scottish Government can spend but is outside of its Block Grant.

Annex B
Restated forecasts for new policy baselines

B.1 We presented our new approach to policy baselines in a recent occasional paper "How we set policy baselines".[41] In this annex we provide a restated December 2023 forecast for our Scottish income tax, Non-Domestic Rates and Social Security forecasts. We are doing this to show the effect of the change in policy baselines and provide an adjusted starting point for our next budget forecasts.

Tax

Income tax

B.2 Since December 2023, we have amended our baseline for Scottish income tax (SIT) by applying our default baseline assumptions set out in the baselines paper. We now uprate all band thresholds inline with inflation Figure B.1 shows how this new baseline would have affected our December 2023 forecast.

Figure B.1: Change in December 2023 SIT forecast from amended baseline

£ million	2023-24	2024-25	2025-26	2026-27	2027-28	2028-29
December 2023	17,357	18,844	19,873	20,856	22,056	22,981
Baseline change	0	0	-142	-232	-329	-492
December 2023 restated	17,357	18,844	19,732	20,624	21,727	22,489

Source: Scottish Fiscal Commission.

B.3 In December 2023, in our baseline we assumed the higher, advanced and top rate tax thresholds would remain frozen. With our new baseline, we assume the higher, advanced and top rate bands rise with inflation. This has reduced our forecast of income tax revenues from 2025-26 onwards, as shown in Figure B.1.

B.4 Looking ahead to the next Scottish Budget, we will retain the same approach to baselines as we have used here. Any policy changes will be considered against a baseline of tax bands increasing in line with inflation.

Non-Domestic Rates

B.5 Since our last forecast, we have amended our baseline for Non-Domestic Rates (NDR). Figure B.2 shows how this new baseline would have affected our December 2023 forecast. This does not include any data released since that publication (such as the 1 April 2024 valuation roll snapshot), nor does it incorporate any model updates made since then.

[41] Scottish Fiscal Commission (2024) – How we set policy baselines

Figure B.2: Change in December 2023 NDR forecast from amended baseline

£ million	2023-24	2024-25	2025-26	2026-27	2027-28	2028-29
December 2023	3,007	3,143	3,219	3,600	3,522	3,517
Baseline change	0	0	10	15	20	30
December 2023 restated	3,007	3,143	3,229	3,615	3,542	3,548

Source: Scottish Fiscal Commission.

Figures may not sum because of rounding.

B.6 The gross NDR for which a property is liable is paid at one of three rates: the Basic Property Rate (BPR), the Intermediate Property Rate (IPR), or the Higher Property Rate (HPR). The rate paid depends on the rateable value of the property and is applied to the entire rateable value, not just to the portion above the relevant threshold.

B.7 The Scottish Government sets all three rates each year, as well as the thresholds between the rates. In our December 2023 forecast, we assumed the Scottish Government would increase the BPR (that is, the rate itself, not the threshold) in line with inflation from 2025-26 onwards, but would not change the difference between IPR and BPR, and the difference between HPR and BPR. This meant we assumed the IPR and HPR would increase, but by less than inflation. We assumed thresholds would not change.

B.8 Our new baseline is to assume that the Scottish Government increases all three of these rates in line with inflation. This leads to slightly higher forecasts of revenue from the IPR and HPR from 2025-26 onwards. Our assumption that thresholds are fixed remains unchanged.[42]

Social Security

B.9 As set out in our February policy baselines paper, we now assume that the baseline policy position for payments with no statutory requirement to be uprated will be uprated using September Consumer Price Index (CPI) inflation in the previous year. This change affects Best Start Foods, Best Start Grant, Child Winter Heating Payment, Pension Age Winter Heating Payment (PAWHP), and Winter Heating Payment. In Figure B.3, we have excluded the effect of uprating our December 2023 forecast for PAWHP. Presenting this effect relative to our December 2023 forecast would have been inaccurate because of the policy change to restrict the payment older people who receive eligible benefits.

B.10 Introducing the baseline uprating assumption increases the social security spending forecast by £2 million in 2025-26, rising to £6 million in 2028-29.

[42] Scottish Fiscal Commission (2024) How we set policy baselines

Figure B.3: Change in December 2023 social security forecast from amended baseline

£ million	2023-24	2024-25	2025-26	2026-27	2027-28	2028-29
December 2023	5,299	6,283	6,861	7,253	7,616	7,999
Baseline change, of which			2	4	5	6
Best Start Foods			1	1	1	2
Best Start Grant			1	1	1	2
Child Winter Heating Payment			0	0	1	1
Winter Heating Payment			1	1	2	2
December 2023 restated	5,299	6,283	6,863	7,257	7,621	8,005

Source: Scottish Fiscal Commission (2023) Scotland's Economic and Fiscal Forecasts – December 2023.

Figures may not sum because of rounding.

Figure B.4: December 2023 restated forecast, uprated using CPI inflation

£ million	2023-24	2024-25	2025-26	2026-27	2027-28	2028-29
Best Start Foods	14	18	21	21	22	22
Best Start Grant	22	21	22	22	23	23
Child Winter Heating Payment	7	9	10	10	11	12
Winter Heating Payment	22	24	26	26	26	26

Source: Scottish Fiscal Commission.

Figures may not sum because of rounding.

Abbreviations

ABR	Autumn Budget Revisions
ADP	Adult Disability Payment
ASHE	Annual Survey of Hours and Earnings
BGA	Block Grant Adjustment
BoE	Bank of England
CDP	Child Disability Payment
CGT	Capital Gains Tax
CPI	Consumer Price Index
EU	European Union
GDP	Gross Domestic Product
GFC	Global Financial Crisis
GVA	Gross Value Added
FT	Financial Transaction
HMRC	His Majesty's Revenue and Customs
HMT	His Majesty's Treasury
HPR	Higher Property Rate
IFS	Institute for Fiscal Studies
IPR	Intermediate Property Rate
LBTT	Land and Buildings Transaction Tax
LFS	Labour Force Survey
MTFS	Medium Term Financial Strategy
NDR	Non-Domestic Rates
NIESR	National Institute of Economic and Social Research
OBR	Office for Budget Responsibility
ONS	Office for National Statistics
PAYE	Pay As You Earn
PAWHP	Pension Age Winter Heating Payment

PIP	Personal Independence Payment
RTI	Real Time Information
SBR	Spring Budget Revision
SCP	Scottish Child Payment
SEFF	Scotland’s Economic and Fiscal Forecasts
SFC	Scottish Fiscal Commission
SG	The Scottish Government
SIT	Scottish Income Tax
VAT	Value Added Tax
WFP	Winter Fuel Payment

A full glossary of terms is available on our website: Glossary | Scottish Fiscal Commission.

Professional standards

The SFC 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).[43]

The SFC 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 Statistics Authority's Code of Practice for Statistics. Further details and our statement of voluntary compliance can be found on our website.[44]

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 SFC, 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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[43] OECD (2014) Recommendation on Principles for Independent Fiscal Institutions - OECD

[44] Scottish Fiscal Commission (2022) Statement of Voluntary Compliance with the Code of Practice for Statistics and Error Policy | Scottish Fiscal Commission

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