Funding for the Scottish Budget

May 2021

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Foreword

As Scotland's independent fiscal institution, we produce forecasts, analysis and commentary which provide information for the Scottish Parliament and inform the Scottish Budget. We are committed to openness and transparency in all our work and regularly produce reports to inform users of our forecasts, the approaches used to develop them, and to explain how they fit into the Scottish Budget. This report describes how funding for the Scottish Budget is determined.

The funding available for the Scottish Government to spend each year depends on a number of factors, including funding from the UK Government, revenue from Scottish taxes and borrowing by the Scottish Government.

The Scottish Government has had increasing responsibility over funding for the Scottish Budget since the devolution of tax and social security powers to the Scottish Parliament in the 2012 and 2016 Scotland Acts. It can change tax policy to increase or reduce revenue collected, borrow to supplement funding, and transfer funds between years in the Scotland Reserve. These funding arrangements were agreed between the Scottish and UK Governments and are set out in the UK Government's Statement of Funding Policy and the Fiscal Framework Agreement.

Each chapter of this report explores a different component of funding. We also explain how our forecasts affect the Scottish Budget. We welcome discussion of our work and invite you to get in touch with comments or questions.

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26 May 2021

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Chapter 1
The Scottish Budget

Introduction

1.1 The Scottish Government sets out its funding and spending plans for the year ahead in the Scottish Budget document, which is presented to the Scottish Parliament before the start of each financial year.[1] The funding and spending plans are adjusted throughout the year as more information becomes available and we refer to these plans as 'the Scottish Budget'. In this document we focus on the funding of the Scottish Budget.

1.2 The Scottish Budget has become more complex since tax and social security powers were devolved to the Scottish Parliament in the 2012 and 2016 Scotland Acts.[2,3] Funding comes from different sources, each with distinct arrangements. These include revenue from Scottish taxes, funding from the UK Government and borrowing by the Scottish Government. These funding arrangements were agreed between the Scottish and UK Governments and are set out in the UK Government's Statement of Funding Policy and the Fiscal Framework Agreement.[4,5] Our role includes forecasting revenue from Scottish taxes and assessing the reasonableness of the Scottish Government's borrowing plans.[6]

1.3 In this Chapter we provide an overview of funding for the Scottish Budget, which is around £43 billion.[7] To do this, we consider funding from two perspectives: first the type of funding, categorised based on how it can be spent, second the source of funding, related to how it is derived.

Resource, capital and financial transactions

1.4 Funding in the Scottish Budget is split into categories, based on how it can be spent. Figure 1.1 sets out a definition of three types of funding: resource, capital and financial transactions.[8]

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[1] Scottish Government (2021) Scottish Budget 2021-22 (link)
[2] Scotland Act 2012 (link)
[3] Scotland Act 2016 (link)
[4] UK Government (2020) Statement of funding policy: Funding the Scottish Government, Welsh Government and Northern Ireland Executive (link)
[5] Fiscal framework: agreement between the Scottish and UK Governments (link)
[6] Scottish Fiscal Commission Act 2016 (link)
[7] Not including funding for COVID-19 which has increased the Scottish Budget in recent years.
[8] Resource funding is split into two: fiscal resource and non-cash. As discussed later in this chapter, we don't include non-cash in our publications. With non-cash excluded we focus on fiscal resource in our publications and refer to this funding simply as resource funding.

Figure 1.1: Resource, capital and financial transactions

Resource	Capital	
	Capital (excluding financial transactions)	Financial transactions
Resource funding can be spent on day-to-day costs, such as: public sector wages, spending on goods and services, grants and subsidies. Accounts for around 87 per cent of total funding.	Capital funding can be spent on long-term investment, such as hospitals, roads and research and development. Accounts for around 12 per cent of total funding.	Financial transaction funding can only be used to make loans to or equity investments in private sector entities. These funds must be repaid to the UK Government. Accounts for around 1 per cent of total funding.

Source: Scottish Fiscal Commission

1.5 Resource funding is by far the largest part of the Scottish Budget. This funding is not ring-fenced and could be transferred to capital to fund long-term investment. Capital funding accounts for a smaller portion of the Scottish Budget. Capital funding is ring-fenced and generally used for spending on long-term investment as defined in Figure 1.1.

1.6 Financial transactions are a subset of capital funding which is ring-fenced to provide loans to, equity investments in, or guarantees for, the private sector. In the recent Scottish Budget (2021-22), the Scottish Government allocated most of the financial transaction funding to the Scottish National Investment Bank and to housing-related schemes, such as shared-equity schemes for homebuyers.[9]

1.7 For each scheme which uses financial transaction funding, the Scottish Government agrees a repayment profile with HM Treasury. While these repayment terms can vary, in its Statement of Funding Policy, the UK Government suggested a typical arrangement would be to repay 80 per cent of financial transaction funding within 20 to 25 years.[10]

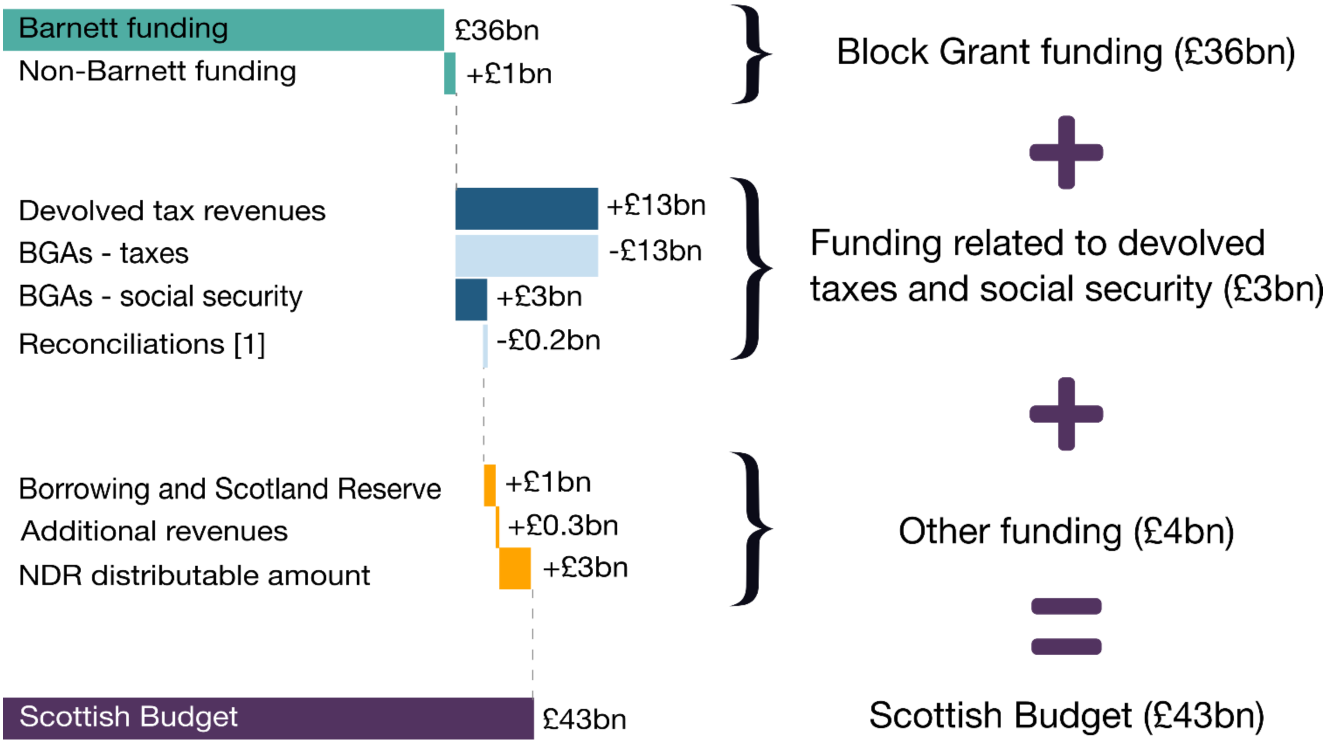
Sources of funding for the Scottish Budget

1.8 Funding for the Scottish Budget comes from different sources. In this paper, we categorise these sources into three groups: Block Grant funding, funding related to devolved taxes and social security and other funding. Figure 1.2 provides a summary of total funding for the Scottish Budget. We will discuss each component of funding in turn in later chapters.

[9] Scottish Government (2021) Scottish Budget 2021-22 (link)

[10] UK Government (2020) Statement of funding policy: funding the Scottish Government, Welsh Government and Northern Ireland Executive (link)

Figure 1.2: Sources of funding for the Scottish Budget



Source: Scottish Fiscal Commission

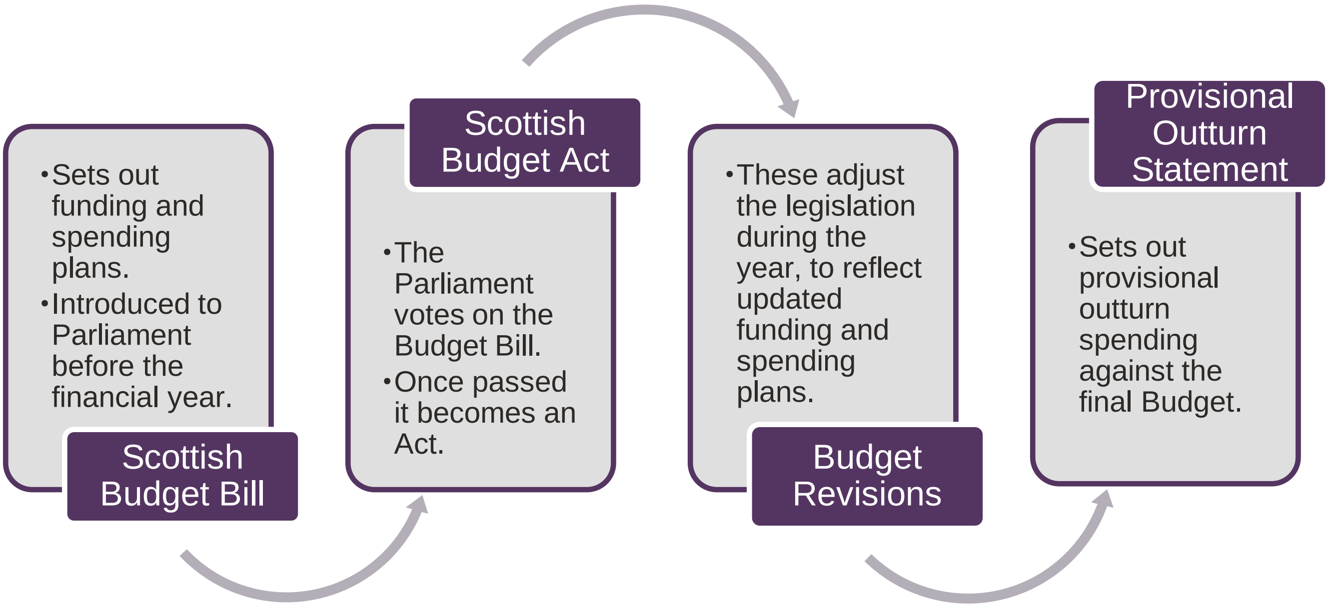
[1] Reconciliations can be positive or negative, this figure illustrates reconciliations as negative as it considers an average from the previous two Scottish Budgets.

Figures may not sum to totals because of rounding. Figures are approximate to give an idea of scale, based on previous Scottish Budgets. Funding for spending on COVID-19 is excluded.

How does the Scottish Budget change over time?

1.9 The Scottish Government's funding and spending plans change over time. These plans are set out in legislation and presented to the Scottish Parliament through the year. This process allows the Scottish Parliament to scrutinise the Budget and provides the Scottish Government with the powers to administer it. Figure 1.3 provides an overview of how changes to the Scottish Budget are presented to Parliament through the year.

Figure 1.3: How the Scottish Budget is presented to Parliament



Source: Scottish Fiscal Commission
Final outturn information is later released in the Scottish Government Consolidated Accounts and a Final Outturn Report.

1.10 The Scottish Budget is first set out in the Scottish Budget Bill which is typically introduced to the Scottish Parliament in December or January. This is determined based on information for the year ahead, including: UK and Scottish Government spending plans, forecasts of tax revenues in Scotland and the rest of the UK and the Scottish Government's planned use of borrowing and the Scotland Reserve.

1.11 The Scottish Budget Bill must be approved by the Scottish Parliament in order to become law. If there is not a coalition or majority party in Government, the Scottish Government may need to negotiate with other parties to get the Bill passed, commonly known as a 'Budget deal'. The Scottish Government may submit amendments to the Bill as a result of these negotiations. Once approved by the Scottish Parliament, it becomes the Scottish Budget Act.

1.12 The Scottish Budget is then subject to change through the year, as new information becomes available, or the Scottish Government changes its plans. Changes could include greater funding from the UK Government or redistribution of spending based on new priorities. These changes are presented to Parliament in the Budget Revisions. Budget revisions can be presented at any time but in practice there are usually two, presented in Autumn and Spring.[11] Once the financial year has ended, a Provisional Outturn Statement is made to Parliament, typically in June, setting out near-final spending information against the final Budget position. Two final outturn reports are later released, typically in December: the Scottish Government Consolidated Accounts and a Final Outturn Report.

1.13 Figure A.1 and Figure A.2 in the annex to this document give more detail on how funding for the Scottish Budget changes through the year. We publish analysis and commentary regularly. Figure 1.4 sets out our publications which discuss funding for the Scottish Budget.

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[11] Autumn Budget Revisions typically take place in September and Spring Budget Revisions typically in February. The Scottish Government can also introduce revisions at other points in the year, for example in June 2020 a Summer Budget Revision allocated additional funding the Scottish Government had received to manage the COVID-19 crisis. Scottish Government (2020) Summer Budget Revision 2020 to 2021 (link)

Figure 1.4: How our publications discuss the Scottish Budget

Scotland's Economic and Fiscal Forecasts	• Published twice a year, these set out our latest forecasts. • We also provide information on funding for the Scottish Budget, comment on any associated risks and assess the reasonableness of the Scottish Government's borrowing plans.
Forecast Evaluation Reports	• These publications identify and comment on forecast errors in previous years. • We describe how these forecast errors affect funding for the Scottish Budget.
Fiscal Updates	• These publications provide an in-year update on funding for the Scottish Budget. • In particular we focus on how and why funding has changed since our last update.

Source: Scottish Fiscal Commission

What don’t we include?

1.14 We don’t include any commentary in our publications on UK Government funding or spending in Scotland on areas which are not devolved, for example defence.

1.15 Our commentary on the Scottish Budget focuses on areas which the Scottish Government can allocate and manage. There are two parts of the Scottish Budget we don’t include in our publications: UK funded Annually Managed Expenditure (AME) and non-cash.

1.16 The UK Government classifies spending as AME when it is linked to demand and can’t be set in advance.[12] A small number of programmes devolved to the Scottish Government, and therefore in the Scottish Budget, continue to be funded by the UK Government on the basis of demand, and are labelled UK-funded AME in the Scottish Budget documents.[13] Two such areas are teachers’ pension payments and student loans. We exclude UK-funded AME from our commentary on the Scottish Budget as this funding is not available for the Scottish Government to allocate and manage.

1.17 The Scottish Government includes around £1.1 billion of non-cash funding and spending in its Budget documents.[14] This is a type of resource funding used for technical accounting adjustments and depreciation of assets.[15] The Scottish Government is not able to allocate this funding to support spending plans and as such, we don’t include non-cash when we comment on funding for the Scottish Budget.

1.18 In Figure A.3 in the annex to this document we provide a comparison setting out differences between our funding commentary and that published by the Scottish Government.

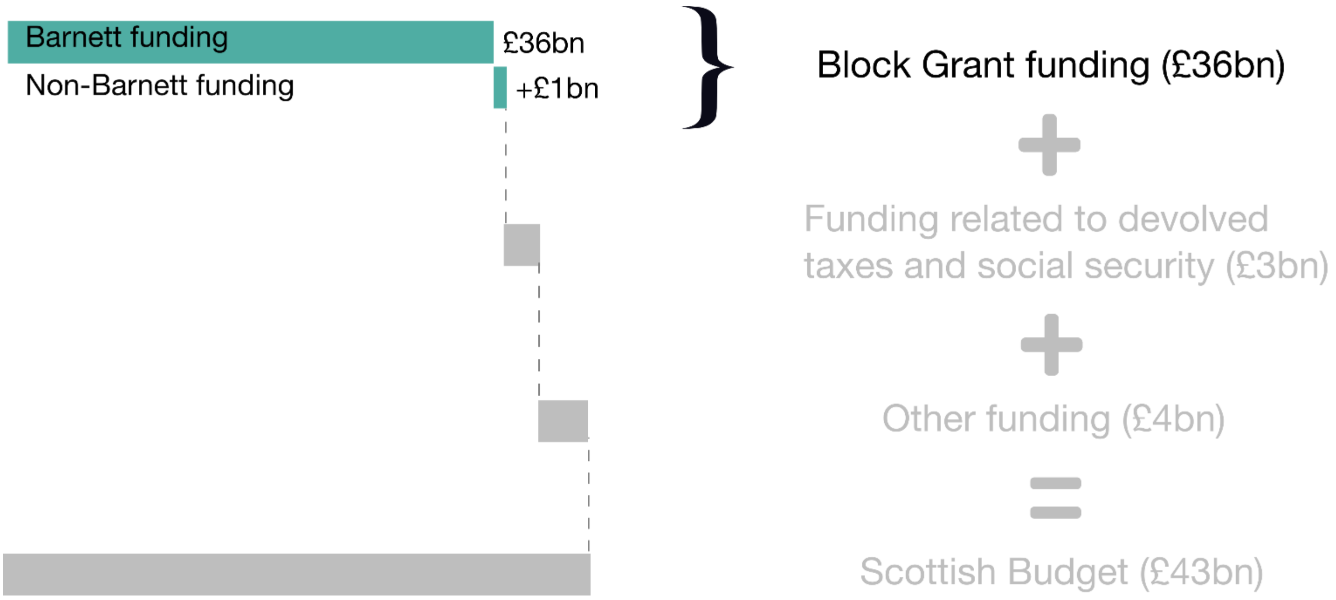
[12] UK Government (2013) How to understand public sector spending (link)
[13] Scottish Government (2021) Scottish Budget 2021-22 (link)
[14] Scottish Government (2021) Scottish Budget 2021 to 2022 (link)
[15] Audit Scotland (2020) The 2020-21 Budget Accounts Commission briefing (link)

Chapter 2
Block Grant funding

Introduction

2.1 Block Grant funding forms an important part of the Scottish Budget. The largest component of Block Grant funding is generated by UK Government spending on devolved areas in the rest of the UK, also referred to as Barnett funding. A small portion of funding is transferred outside the Barnett arrangements, or non-Barnett funding.

Figure 2.1: Funding for the Scottish Budget: Block Grant funding



Source: Scottish Fiscal Commission
Figures may not sum to totals because of rounding. Figures are approximate to give an idea of scale, based on previous Scottish Budgets. Funding for spending on COVID-19 is excluded.

2.2 When the UK Government allocates funding in the rest of the UK to be spent on areas which are devolved to the Scottish Government, the Barnett formula is applied, and a corresponding portion of funding is transferred to the Scottish Government.[16,17] This funding is split by resource, capital and financial transactions, but within these constraints the Scottish Government can choose how to allocate it.

Barnett funding through the year

2.3 Barnett funding is set before the start of each financial year based on the most recent source of UK Government spending allocations. Typically, this is the UK Budget or a UK Spending Review.

2.4 If the UK Government increases or decreases planned spending on devolved areas, Barnett funding for the Scottish Budget is adjusted accordingly. These adjustments are called 'Barnett consequentials'. The UK Government adjusts its spending plans in a document called Supplementary Estimates, which are published in February towards the end of each financial year.

[16] UK Government (2020) Statement of funding policy: funding the Scottish Government, Welsh Government and Northern Ireland Executive (link)
[17] In some circumstances the UK Government can spend directly in Scotland in devolved areas for example the powers introduced in the UK Internal Market Act (link).

At this point, final adjustments to Scottish Barnett funding are made, to reflect up to date UK Government Budget allocations. The Scottish Government may therefore receive increases or reductions in Barnett funding in February, close to the end of the financial year.

COVID-19 funding

2.5 The UK Government has significantly increased funding allocated to departments to deal with the COVID-19 crisis. A significant portion of this funding has been directly allocated to Scotland by the UK Government using reserved powers, for example through the furlough scheme. Where the UK Government has allocated funding in areas of devolved responsibility, a corresponding portion of funding is transferred to the Scottish Budget.

2.6 COVID-19 funding has formed an important part of the Scottish Budget, increasing the 2020-21 Scottish Budget by 21 per cent and the 2021-22 Scottish Budget by 8 per cent so far.[18]

2.7 We report COVID-19 funding separately from the rest of Barnett funding in our publications as we expect this funding to reduce sharply in future years as the pandemic is brought under control by lockdowns and vaccines.

Box 2.1: Non-Barnett funding

A small portion of funding, accounting for around 1 per cent of the Scottish Budget, is transferred from the UK Government to the Scottish Government, outside the Barnett arrangements.[19]

These arrangements are often set when it is not appropriate to distribute funding using a population share, for example network rail funding, which is distributed based on geography. Other examples of non-Barnett funding in recent Scottish Budgets includes: EU replacement funding, funding to implement devolution (Scotland Act Implementation funding), and city deals.[20]

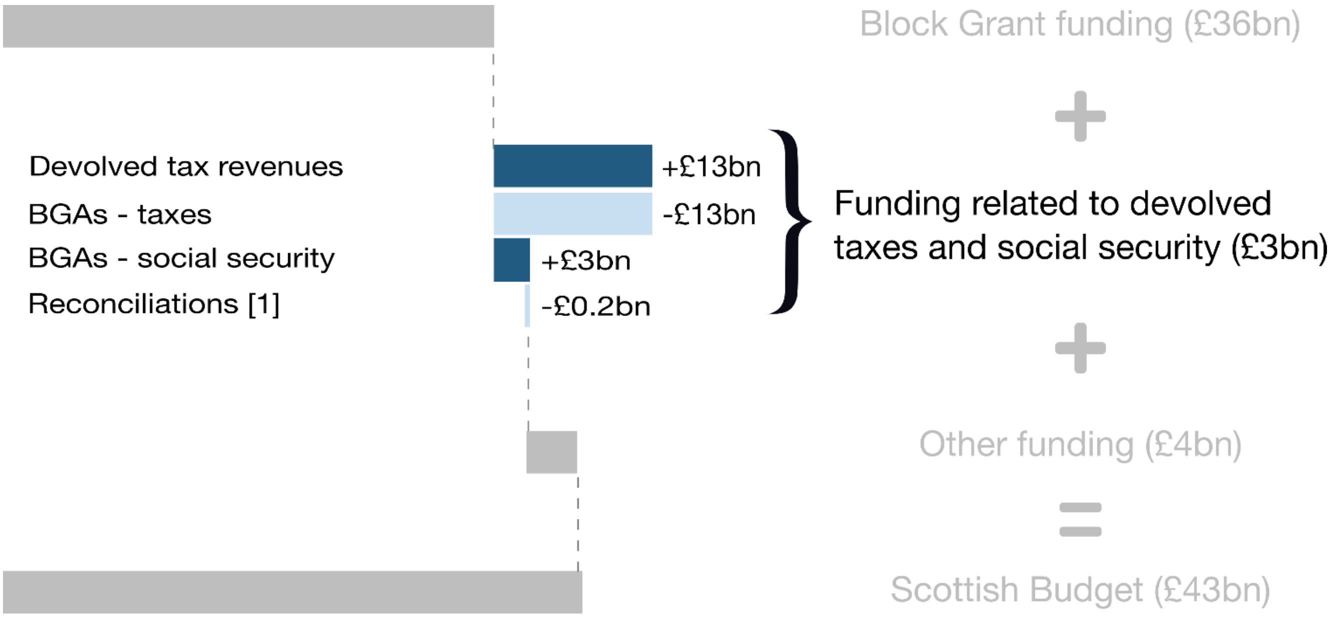
[18] COVID-19 funding in the 2021-22 Scottish Budget is calculated based on funding information published in our most recent Fiscal Update, from March 2021. We expect this to keep increasing through the financial year. Scottish Fiscal Commission (2021) Fiscal Update – March 2021 (link).
[19] UK Government (2020) Statement of funding policy (link)
[20] Scottish Fiscal Commission (2021) Fiscal Update – March 2021 (link)

Chapter 3
Funding related to devolved tax revenues and social security spending

Introduction

3.1 The Scotland Act 2016 devolved a number of tax and social security powers to the Scottish Government. The corresponding Fiscal Framework Agreement adjusted the Scottish Budget to allow for these new powers, introducing the funding related to tax revenues and social security spending discussed in this chapter.

Figure 3.1: Funding for the Scottish Budget: funding related to devolved tax revenues and social security spending



Source: Scottish Fiscal Commission

[1] Reconciliations can be positive or negative, this figure illustrates reconciliations as negative as it considers an average from the previous two Scottish Budgets.

Figures may not sum to totals because of rounding. Figures are approximate to give an idea of scale, based on previous Scottish Budgets. Funding for spending on COVID-19 is excluded.

3.2 The Scottish Government has responsibility for collecting devolved tax revenues and spending on devolved social security that is managed in the Scottish Budget. Corresponding Block Grant Adjustments (BGAs) were introduced, supplementing or reducing the Scottish Budget to reflect the devolved powers. Devolved tax revenues contribute around £13 billion of funding to the Scottish Budget. Tax BGAs reduce funding by around £13 billion while social security BGAs increase funding by £3 billion.

3.3 The Scottish Budget is set in advance of each financial year based on forecasts. Over time, new information on revenues and spending becomes available, and the forecasts are updated or aligned with these data. The Scottish Government's funding is then altered in response to the outturn data and revised forecasts. Some of these changes in funding are called reconciliations.

3.4 In this Chapter we discuss the three components of funding which are related to devolved taxes and social security: revenues from devolved taxes, Block Grant Adjustments (BGAs) and reconciliations.

Scottish tax revenues and social security spending

3.5 A number of devolved taxes and social security payments have been devolved to the Scottish Parliament. The Scottish Government therefore has responsibility for these areas: it can introduce Scottish policies, which may alter revenues or spending, and it collects around £16 billion in tax revenue and spending around £4 billion on social security payments.[21]

3.6 Around £13 billion of devolved tax revenues are directly included in the Scottish Budget, including revenues from: Land and Buildings Transaction Tax (LBTT), Scottish Landfill Tax (SLfT) and Scottish income tax. Non-Domestic Rates (NDR) revenues are around £3 billion, but as we explain in Chapter 5, this is not directly included in the Scottish Budget.[22]

3.7 When the Scottish Budget is first set, our forecasts are used to determine how much funding will be received from devolved taxes and how much should be allocated to spend on devolved social security. As the Scottish Government collects and spends this money directly, it monitors this funding and spending through the year, and where necessary, adjusts its plans where actual revenues and spending are different to our forecasts.

Block Grant Adjustments

What are Block Grant Adjustments?

3.8 Block Grant Adjustments (BGAs) reduce or supplement the Scottish Budget to reflect the Scottish Government now having responsibility for collecting tax revenues and spending on social security directly.[23]

3.9 Tax BGAs reduce the Scottish Budget by around £13 billion to reflect the Scottish Government's ability to collect Scottish tax revenues directly and social security BGAs increase the Scottish Budget by around £3 billion to reflect the Scottish Government's responsibility to make devolved social security payments.[24,25]

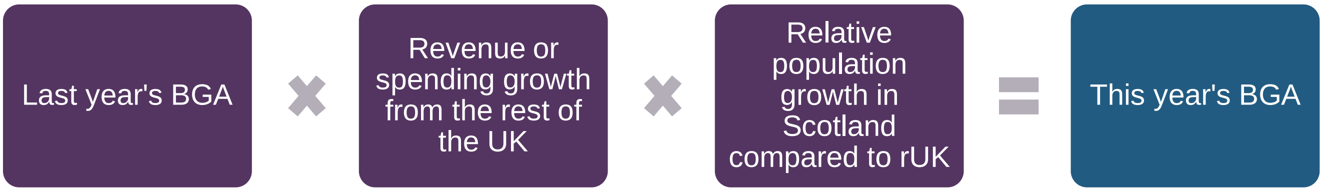
3.10 BGAs are based on revenue and spending growth in the rest of the UK. In essence they reflect what would have been raised or spent in Scotland, had Scottish revenues or spending grown in line with the rest of the UK. Differences in growth between Scotland and the rest of the UK could be caused by: policy divergence, variation in economic growth or differences in population composition. Tax revenues and social security spending can be compared to their respective BGA to calculate whether the Scottish Budget has increased or reduced by devolution of the power to the Scottish Government.

[21] Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts (link)
[22] Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts (link)
[23] Fiscal framework: agreement between the Scottish and UK Governments (link)
[24] Some smaller social security payments are not funded by BGAs. Payments with UK equivalents are instead included in Barnett funding, calculated by UK Government spending allocations for the corresponding benefits in the rest of the UK. New payments introduced by the Scottish Government don't receive corresponding funding.
[25] The Scottish Budget also includes non-tax BGAs which relate to revenues collected from fines, forfeitures and fixed penalties and proceeds of crime.

How are Block Grant Adjustments calculated?

3.11 Each Block Grant Adjustment started with Scottish revenues or spending in the year before devolution. They are then adjusted each year by the corresponding revenue or spending growth in the rest of the UK, adjusted for differences in population growth, as shown in Figure 3.2.

Figure 3.2: Block Grant Adjustment calculations



Source: Scottish Fiscal Commission

3.12 At the time the Scottish Budget is initially set, BGAs are calculated using OBR forecasts of revenue or spending growth in the rest of the UK. The BGAs are later adjusted for updated forecasts or outturn information.

3.13 For all devolved taxes and social security, with the exception of income tax, BGAs are updated in two stages. The first update takes place when the OBR publishes revised forecasts alongside the UK Government's fiscal event, typically in the autumn. This update occurs during the financial year and is called an 'in-year reconciliation'. The second update occurs when outturn information is released. This update is applied to the following Scottish Budget and is called a 'final reconciliation'.[26]

Income tax reconciliations

3.14 Income tax funding for the Scottish Budget is set in advance of the financial year, based on our forecast of Scottish revenue and the OBR's forecast, which is used to set the BGA. These forecasts remain fixed until outturn data are released, which tend to be around 16 months after the financial year.

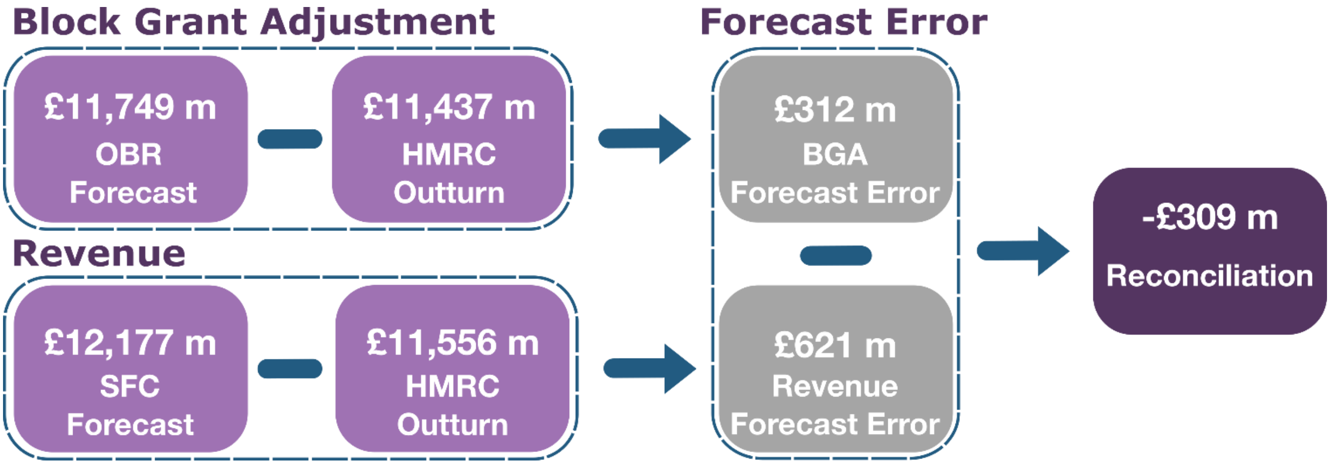
3.15 An adjustment is then calculated, to align funding with outturn information, called an 'income tax reconciliation'. This reconciliation will be applied to the following Scottish Budget. Because of the delay in outturn information, income tax reconciliations are applied to Budgets three years after the revenue was collected.[27]

3.16 As an ongoing process, income tax reconciliations will be applied to every Scottish Budget. Figure 3.3 shows how the reconciliation for 2018-19 income tax was calculated.

[26] Non-BGAs are subject to different reconciliation processes. The BGA for fines forfeitures and fixed penalties is reconciled once, when outturn information is released. The BGA for proceeds of crime is not reconciled as the BGA is subject to a dispute between the UK and Scottish Governments.

[27] For example, 2018-19 income tax outturn information was published in Autumn 2020. This allowed the reconciliation to be calculated which was then applied to the 2021-22 Scottish Budget.

Figure 3.3: 2018-19 income tax reconciliation



Source: Scottish Fiscal Commission

3.17 Reconciliations can be positive or negative and have a significant effect on the Scottish Budget. Negative reconciliations are generated because the Scottish Budget was set with too much funding, positive reconciliations because the Scottish Budget was set with too little funding (because of errors in OBR and SFC forecasts).

3.18 In January 2021 we discussed the possible scale and variation of future income tax reconciliations.[28] The conclusions were:

- Over time income tax reconciliations should be positive as often as they are negative
- Negative income tax reconciliations exceeding £300 million – the Government's normal annual resource borrowing limit – could occur around three times every ten years.
- Larger negative income tax reconciliations exceeding £600 million – the Government's extended annual resource borrowing limit – could occur around once every ten years.[29]

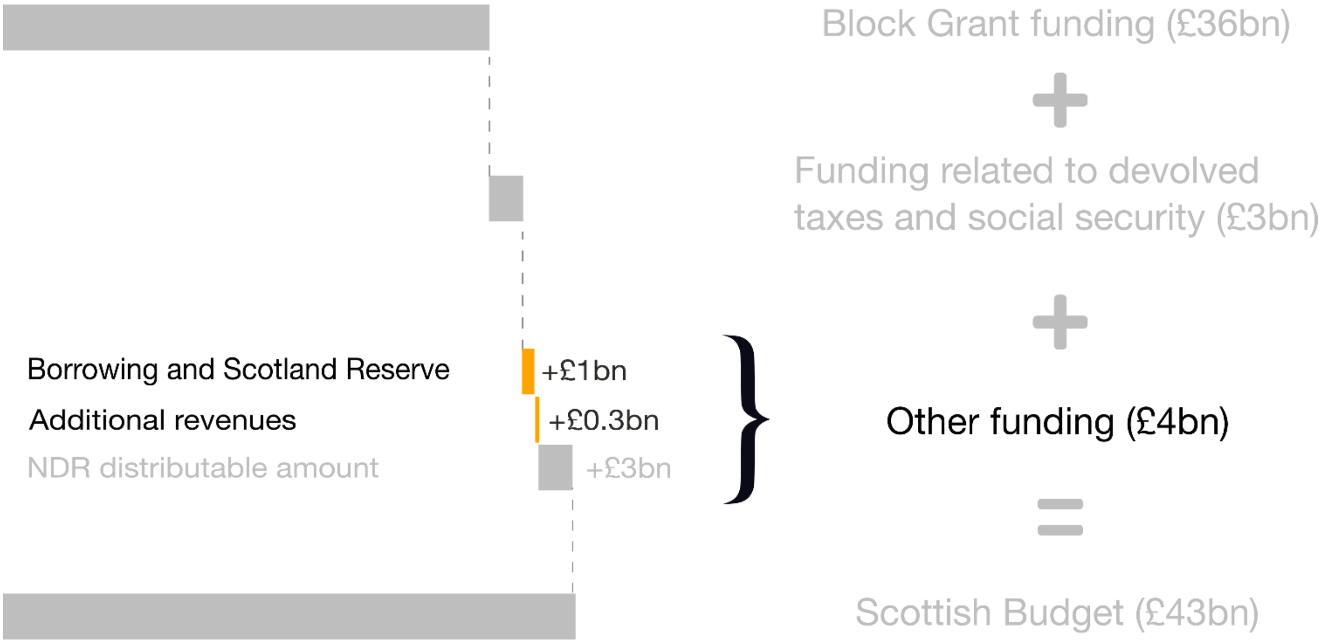
[28] Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – January 2021 (link)
[29] The extended resource borrowing limit is unlocked by the triggering of a Scotland-specific economic shock. This is discussed in Chapter 4.

Chapter 4
The Scotland Reserve, borrowing and additional revenues

Introduction

4.1 The Scottish Government can transfer funds between years using the Scotland Reserve and borrow for both resource and capital spending.[30]

Figure 4.1: Funding for the Scottish Budget: borrowing, Scotland Reserve and additional revenues



Source: Scottish Fiscal Commission
Figures may not sum to totals because of rounding. Figures are approximate to give an idea of scale, based on previous Scottish Budgets. Funding for spending on COVID-19 is excluded.

4.2 The Scotland Reserve and borrowing are tools to manage the Scottish Budget, supplementing funding in particular years and transferring funding into later years. We assess the reasonableness of the Scottish Government's borrowing plans each year by considering the context of the plans and the limits of the fiscal framework.

4.3 The Scottish Budget includes a small amount of funding, around £250 million, of revenues from other sources ('additional revenues'). This funding is recorded separately to other streams as it is not generated by the Barnett formula and is not recorded by HM Treasury.

Scotland Reserve

4.4 The Scottish Government is required to maintain a balanced budget, matching its spending to available funding each year. As the Scottish Government cannot overspend its budget, outturn spending will come in below the allocated Budget which results in underspends, a natural part of normal budget management. The Scotland Reserve allows the Scottish Government to transfer any

30 Scottish Government (2016) Fiscal framework: agreement between the Scottish and UK Governments (link)

unspent funds from one financial year to the next. The Reserve can also be used to build up funds, up to the total limit of £700 million.

4.5 The Scotland Reserve is split by resource and capital, with no limits on payments into the reserve, but annual drawdown limits of £250 million resource and £100 million capital. The annual drawdown limits are removed in the occurrence of a Scotland-specific economic shock. When the annual drawdown limits are removed the Scottish Government is able to manage greater underspends but the £700 million cap constrains how high the balance can be built up.

Box 4.1: Scotland-specific economic shock

A Scotland-specific economic shock is defined in the Fiscal Framework agreement by two criteria: annual GDP growth in Scotland on a four quarters basis (4Q-on-4Q), is below 1.0 per cent and 4Q-on-4Q growth in Scotland is 1.0 or more percentage points below the UK.

The triggering of a shock provides additional powers to the Scottish Government, including:

- an increase in the annual resource borrowing limit from £300 million to £600 million
- a removal of the £250 million resource drawdown limit and the £100 million capital drawdown limit on the Scotland Reserve
- the overall £1,750 million limit on resource borrowing and £700 million limit on the Scotland Reserve both remain in place.

Once a shock is triggered, the relaxation of limits applies to the financial year in which the shock is triggered plus the following two financial years. Even if future forecasts or outturn data remove the shock, the relaxation of limits is not revoked.

Borrowing

Resource borrowing

4.6 Resource borrowing powers are available to the Scottish Government, within annual and overall limits, when they have been “unlocked” by negative forecast errors. Negative forecast errors include: devolved tax revenues lower than forecast, devolved social security spending higher than forecast, changes to the Block Grant Adjustments which have a negative effect on the Scottish Budget and any negative reconciliations.[31] The Scottish Government can borrow for the combined effect of all negative forecast errors, within the limits set out in Figure 4.2, without accounting for any positive forecast errors.[32]

[31] For example, we calculated a total of £509 million negative forecast errors in the 2020-21 Scottish Budget, which unlocked borrowing powers up to the annual limit of £300 million. These negative forecast errors consist of: -£207 million reconciliations, £145 million reduction in forecast 2020-21 tax revenues, £90 million increase to forecast 2020-21 social security spending and £67 million in negative changes to the 2020-21 social security BGAs. Although positive forecast errors also occurred, only negative errors unlock borrowing powers.

[32] For example, if there were negative and positive forecast errors of -£100 million and +£50 million, the Scottish Government would be able to borrow £100 million for the negative error, with the positive error having no effect on the borrowing limits.

Figure 4.2: Resource borrowing powers

£ million	Annual limit	Overall limit	Negative forecast errors required?
Normal	300	1,750	Yes
Scotland-specific economic shock	600	1,750	Yes

Source: Scottish Fiscal Commission

4.7 Resource borrowing takes place through the UK Government's National Loans Fund. The National Loans Fund is regarded as the central UK Government's borrowing and lending account. It makes loans to various public sector bodies including the Scottish Government.[33] There is a requirement for repayments of resource borrowing to be between 3 and 5 years.

Capital borrowing

4.8 The Scottish Government can borrow for spending on long-term investment, also known as capital spending, up to the limits set out in Figure 4.3. There are no changes to capital borrowing powers in the event of a Scotland-specific economic shock.

Figure 4.3: Capital borrowing powers

£ million	Annual limit	Overall limit	Negative forecast errors required?
	450	3,000	No

Source: Scottish Fiscal Commission

4.9 Capital borrowing can be accessed through the UK Government from the National Loans Fund, as a commercial loan (directly from a bank or other lender) or through the issue of bonds. A normal term of borrowing is set at 10 years, but longer or shorter borrowing terms can be agreed.

4.10 Capital borrowing to date has been through the National Loans Fund with a variety of repayment terms, historically 25, 20 and 10 year terms.

Additional revenues

4.11 The Scottish Budget includes a small amount of funding, around £250 million, of revenues from other sources. This funding is recorded separately to other streams as it is not generated by the Barnett formula and is not included in HM Treasury limits.

4.12 An example of funding in this category is when businesses voluntarily repaid Non-Domestic Rates reliefs to the Scottish Government. As this funding was collected by the Scottish Government from Scottish businesses, it was not recorded by HM Treasury; however it appeared in the Scottish Budget as it was collected and spent by the Scottish Government.

4.13 In our publications we refer to this as 'other' funding and we provide details of where this funding has come from in our publications.

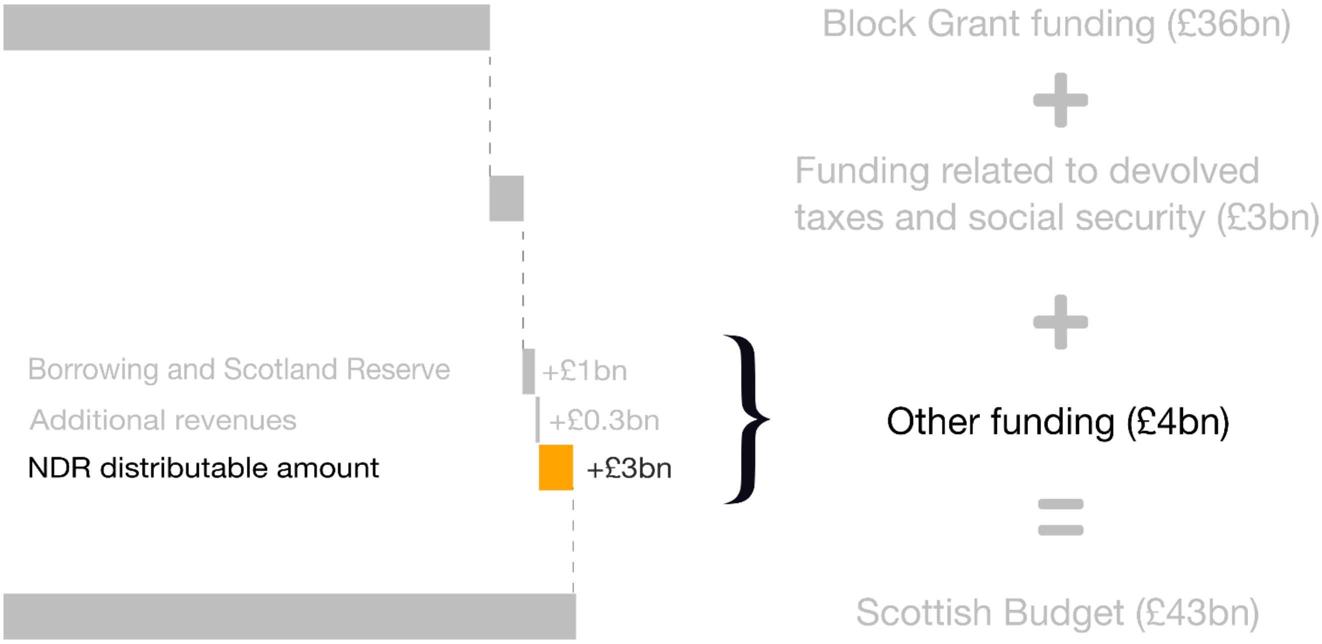
[33] UK Government (2021) HMT central funds (link)

Chapter 5
Non-domestic rates distributable amount

Introduction

5.1 Non-Domestic Rates (NDR), also known as business rates, are a tax paid by the occupiers of non-domestic properties. They apply to a wide range of properties regardless of whether they are used for business purposes, including shops, offices, hotels, factories, warehouses, leisure centres and village halls. NDR come into the Scottish Budget in a different way to other devolved taxes.

Figure 5.1: Funding for the Scottish Budget: NDR distributable amount



Source: Scottish Fiscal Commission
Figures may not sum to totals because of rounding. Figures are approximate to give an idea of scale, based on previous Scottish Budgets. Funding for spending on COVID-19 is excluded.

5.2 In this chapter we first discuss how the Scottish Government funds local authorities before explaining how NDR revenue fits into the Scottish Budget, the operation of the Non-Domestic Rating Account and how funding for NDR is generated by UK Government policies.

Funding of local authority councils

5.3 There are 32 local authorities in Scotland. Each council is responsible for a range of services, such as schools, housing, social work, street lighting, refuse collection and planning. Local authorities are funded from three sources, which is sometimes referred to as general funding. Service income, which is income that councils receive as a result of a direct service such as local authority housing, is excluded from general funding categorisation.

Figure 5.2: Summary of local authority funding 2018-19

Funding source	Description	Proportion of total funding in 2018-19
Non-Domestic Rates (NDR)	NDR are a property tax paid by the owner/occupier or tenant of a non-domestic property, such as business premises and third and public sector properties.	22%
Scottish Government Grant or General Revenue Grant (GRG)	Is a grant paid to local authorities by the Scottish Government.	58%
Council tax	Council Tax is a tax system based on dwellings and is collected and retained by local authorities.	20%

Source: Scottish Fiscal Commission, Scottish Government (2020) Local government funding 2020-21: process overview (link)

5.4 The overall distribution of the total general funding to each local authority is based on a funding formula that is agreed in a series of discussions with councils.[34]

5.5 The next step is to subtract the funding that each local authority will receive from NDR and council tax. The amount each council can raise from these mainly depends on the size of their population and number of businesses in the area. Essentially it is only the Scottish Government grant or General Revenue Grant (GRG) that can be adjusted to ensure that each council receives its calculated fair share of the total funding.

5.6 The Scottish Government grant therefore works as a balancing item, providing the remainder of the needed funding. This may mean one council receives a lot more grant funding than another council.

5.7 More generally the level of funding to local authorities in any financial year is not affected by variations of non-domestic rates or council tax. Any shortfalls or equivalent adjustments needed are made to the levels of the GRG paid by the Scottish Government.

How is NDR revenue collected?

5.8 NDR revenue is collected by local authorities. The revenue is then collected or ‘pooled’ centrally by the Scottish Government and then redistributed back to local authorities. This process has been in place since the Scottish Parliament was formed and is different to Council Tax which is collected directly by local authorities and retained by local authorities. Because Council Tax does not feature in the Scottish Budget, we do not forecast Council Tax revenue; however because NDR revenue is pooled and redistributed to local authorities in the Scottish Budget we are responsible for forecasting this. NDR revenue is managed through the Non-Domestic Rating Account, also known as the NDR pool.[35]

[34] The Scottish Government set out the process for allocating local authorities funding in the following publication: Scottish Government (2020) Local government funding 2020-2021: process overview (link)
[35] An explanation of the NDR rating account can be found in Scottish Government (2019) Non-Domestic Rating Account: 2018-19 (link).

Figure 5.3: Non-Domestic Rates

Source: Scottish Fiscal Commission

NDR revenue in the Scottish Budget

5.9 We forecast the amount of NDR revenue collected by local authorities and pooled nationally, which is known as the contributable amount. This can be thought of as the amount collected by local authorities through the course of the year which flows to the Scottish Government.

5.10 The Scottish Government sets the distributable amount, the amount that is redistributed back to local authorities based on our forecasts of the contributable amount. As discussed later in this chapter, the distributable amount is also based on the accumulated balance in the Non-Domestic Rating Account and the overall financial outlook for the Scottish Budget. These extra factors mean that the distributable amount is the amount used in the Budget, in comparison to our forecast of the contributable amount.

5.11 The distributable amount is set in the Budget and remains unchanged during the financial year, which means the Scottish Government does not need to adjust the Budget during the year if our forecasts change. Any shortfalls or equivalent adjustments related to NDR revenue are made to the levels of the General Revenue Grant paid by the Scottish Government.

5.12 The Scottish Budget is set based on the level of the NDR distributable amount.

Box 5.1: What is the contributable amount? A technical explanation

The contributable amount is the amount of NDR revenue which local authorities transfer to the Scottish Government. This may not be the same as the total amount of NDR collected by local authorities. The Scottish Government operates certain policies which allow local authorities to retain some NDR revenue, which is not included in the contributable amount.[36] Local authorities also fund a share of any discretionary reliefs they award from their own budgets, which will reduce the amount of NDR they collect but not the amount they transfer to the Scottish Government.

The Scottish Government requires local authorities to provide reliefs ('mandatory reliefs') for certain types of properties or occupiers. Examples include reliefs for charities and reliefs for occupiers of small properties. These mandatory reliefs are entirely funded by the Scottish Government and reduce the contributable amount collected by local authorities.

In addition, local authorities are able to award discretionary reliefs which are generally part-funded from their own budgets. For example, while the Scottish Government mandates an 80 per cent relief to registered charities, local authorities can raise it to 100 per cent. The 20 per cent relief awarded at the discretion of local authorities is still included in the contributable amount even when local authorities do not collect the revenue.

Non-Domestic Rating Account

5.13 NDR operates out of a separate account, called the Non-Domestic Rating Account or NDR pool. This separate account shows how NDR is ring-fenced, remaining separate from the rest of the Scottish Budget, and all revenues collected are ultimately paid back to local authorities. The balance of the Non-Domestic Rating Account depends on both the contributable and distributable amounts as well as changes from previous years.

5.14 The contributable amount used to calculate the position of the Non-Domestic Rating Account is not our forecast, but is based on local authorities' estimates of the NDR revenue they expect to collect in the financial year. These estimates are submitted to the Scottish Government after the start of the financial year and are known as the provisional contributable amount.

5.15 Differences between the provisional contributable amount and the final audited NDR income returns for the financial year are termed the prior year adjustment and are applied to the following year's balance of the Rating Account.

5.16 Each year the Scottish Government sets the distributable amount.[37] Government can choose to distribute more or less than the forecast contributable amount in any given year. Distributing more to local authorities than is collected will require funding to be taken from the Non-Domestic Rating Account, which can go into deficit.

5.17 The calculation of the distributable amount by Government takes account of four factors:

[36] There are currently two such policies that allow local authorities to retain a part of their NDR income: the Business Rate Incentivisation Scheme (BRIS) and Tax Incremental Financing (TIF).
[37] Although our forecasts of the contributable amount are used by the Scottish Government to set the distributable amount, for the position of the Non-Domestic Rating Account in any given year is based on local authorities estimates of the NDR they will collect produced at the start of the financial year.

- the estimated closing balance of the Non-Domestic Rating Account from the previous financial year
- estimated prior year adjustments to be carried over from the year before
- the amount forecast to be raised in the year ahead
- the overall position and outlook for the Scottish Budget.

5.18 This means that the balance of the Non-Domestic Rating Account depends on a number of factors including: our forecast accuracy, local authority forecast accuracy and the distributable amount set by the Scottish Government. The balance of the this Account could, for example, be positive despite a projection of a negative balance if local authorities report a high level of collections on their start-of-year estimates.

Box 5.2: The NDR rating account

The calculation of the NDR rating account is set out in Figure 5.4 with the position in March 2021.

Figure 5.4: Illustrative projected balance of the Non-Domestic Rating Account – March 2021

£ million	2018-19	2019-20	2020-21	2021-22
Provisional contributable amount (A)	2,883	2,890	1,916	2,139
Net effect of prior year adjustments (B)	-82	-36	-129	-68
Distributable amount (C)	2,636	2,853	1,868	2,090
Annual balance (D) (A + B – C)	165	1	-80	-20
Cumulative balance (E) (E from previous year + D)	24	25	-56	-75

Source: Scottish Fiscal Commission, Scottish Government.
Figures may not sum because of rounding.
Shaded cells refer to outturn at the time of publication.
The projected balance is provisional because at time of publication, we do not have the audited NDR income figures for 2019-20; it is based on the provisional outturn figures provided on the Notified returns. The presentation differs slightly to that in the published audit of the NDR rating account, mainly because of the presentation of line B – 'net effect of prior year adjustments'.

5.19 The Non-Domestic Rating Account is a record of the payments and ensures that all NDR revenue is repaid to local authorities over a number of years. A negative balance on the Account means that cash from the Scottish Consolidated Fund (SCF) has been used to fund the distributable amount and this must be subsequently repaid in future years. It reduces the working balance available to the Scottish Government but does not denote borrowing; for this reason the Scottish Government consider the overall cash management position of the Scottish Budget and the SCF when setting the distributable amount.[38]

[38] In practice there is no separate NDR fund and no distinct NDR payments or receipts flow into or out of the Scottish Government or the Scottish Consolidated Fund. The local authority cash funding is calculated based on the combination of GRG entitlement plus the share of distributable amount less NDR collections it has received.

Funding for Non-Domestic Rates

5.20 NDR have been the responsibility of the Scottish Government since the start of devolution in 1999. There is no Block Grant Adjustment for NDR, unlike the other devolved taxes. Instead changes in UK Government policy on NDR result in funding changes through Barnett funding. For example, at the start of the COVID-19 crisis the UK Government announced a number of NDR reliefs for England. These reliefs reduce NDR revenue in England and therefore required the UK Government to increase funding to local authorities. The Scottish Government then received Barnett funding as a result of the additional funding to English local authorities. The Scottish Government used this funding to introduce similar reliefs in Scotland.

Annex A
The Scottish Budget

Introduction

A.1 This annex sets out supporting detail on the Scottish Budget. We present how the Scottish Budget changes through the year. This includes information on how each publication fits into the budgetary process and how each component of funding evolves through the year.

A.2 We also provide information on how the funding as discussed in this document compares to information published by the Scottish Government.

How does the Scottish Budget change over time?

A.3 The Scottish Budget is set in advance of each financial year based on information for the year ahead. As new information becomes available, the Scottish Budget is adjusted.

A.4 Figure A.1 below sets out the publications which form part of this process, providing information which allows funding to be updated, and presenting any changes to the Scottish Parliament. Figure A.2 provides detail on how each component of funding changes through the year to adjust for this new information.

Figure A.1: Typical timings of publications which change funding for the Scottish Budget

Typical Month	Publication	How does this affect the Scottish Budget?
June - October	Outturn tax and social security data from previous years	Final reconciliations are calculated from outturn data, which are applied to the following Scottish Budget.
November	UK autumn fiscal event [1]	Typically the UK Budget. This affects the Scottish Budget as it: • Provides updated spending allocations which determine the block grant. • Sets UK tax and social security policy which could affect Scottish tax revenues and the BGAs.
	OBR forecasts [2]	These forecasts are used to set the BGAs for the Scottish Budget.
December	Scottish Budget Bill introduced	Scottish Government's funding and spending plans introduced to the Scottish Parliament.
	SFC forecasts	SFC forecasts are used to set the Scottish Budget.
March	Scottish Budget Act	Scottish Parliament has voted to approve the Budget Bill and it becomes an Act.
	UK spring fiscal event [1]	Updated UK Government spending plans could adjust Barnett funding.
	OBR forecasts [2]	Updated OBR forecasts could be used to update BGAs for Scottish Budget.
May	UK Main estimates	The UK Government publishes spending allocations which adjusts Barnett funding for the Scottish Budget.
	Medium term financial strategy	Scottish Government sets out its five year funding and spending plans.
	SFC forecasts	These forecasts provide an in-year update on tax revenues and social security spending.
September	Autumn Budget Revision	The Scottish Government amends its Budget for any changes since it was voted through Parliament.
November	UK autumn fiscal event	Provides information on UK spending plans, which could change Barnett funding in the Scottish Budget.
	OBR forecasts	Forecasts used to update the BGAs for all taxes and social security except income tax. This changes funding for the Scottish Budget.
December	SFC forecasts	These forecasts provide an in-year update on tax revenues and social security spending.
February	Supplementary estimates	UK Government adjusts its spending allocations for changes since the main estimates. These adjustments change funding for the Scottish Budget.
	Spring Budget Revision	Scottish Government adjusts its Budget for any funding and spending changes since the Autumn Budget Revision.
June	Provisional Outturn Statement	The Scottish Government announces pre-audit outturn information from the previous Scottish Budget.

December	Consolidated Accounts	Final accounts for the Scottish Budget are published.
	Final Outturn Report	Final outturn information for the Scottish Budget is published.

Source: Scottish Fiscal Commission

Darker shaded cells indicate times which are before or after the financial year which the Scottish Budget sets funding and spending for. Publications during these times involve preparing the Scottish Budget and publishing outturn information.

[1] While we typically expect the UK Budget to occur in the autumn, this was delayed to spring for 2020-21 and 2021-22 UK Budgets.

[2] In recent years, because the UK Budget has been in March, after the Scottish Budget, the autumn OBR forecasts are used to calculate provisional BGAs while spring updated BGAs. The Scottish Government has had the option to select provisional or updated BGAs in the Scottish Budget.

Figure A.2: How does each type of funding change over time?

Area	What is the Budget set based on?	How does this change during the year?	What's the effect of final outturn?
Block Grant – Barnett	UK Government spending plans	Funding is adjusted through the year where UK Government spending differs from plans.	Funding changes up until the UK Government publishes Supplementary Estimates, typically in February. There are no further adjustments for outturn.
Block Grant – Non-Barnett	Case by case arrangements	Case by case arrangements.	Case by case arrangements.
Block Grant Adjustments (BGAs), except income tax	Latest OBR forecasts	Funding is adjusted once in-year to update for the OBR's autumn forecasts.	Outturn information after the year allows calculation of how much the BGAs should be adjusted to reflect outturn. This adjustment is then applied to the next Scottish Budget. [1]
Scottish income tax revenue and income tax BGA	Latest forecasts: SFC for income tax revenues and OBR for the BGA.	This funding is not updated during the year.	Outturn information published around 16 months after the financial year allows the calculation of how much the forecast revenue and BGA should be adjusted to reflect outturn. This adjustment is called a reconciliation and applied to the next Scottish Budget, three years after the financial year. [2]
Fully devolved taxes – Land and Buildings Transaction Tax and Scottish Landfill Tax	Latest SFC forecasts	The Scottish Government collects this tax directly, monitoring funding in-year.	Determines the final budget position.
Social security spending	Latest SFC forecasts	The Scottish Government spends on social security directly, monitoring funding in-year.	Determines the final budget position.
Borrowing and Scotland Reserve	Scottish Government plans	If plans change during the year.	Determines the final budget position.
Additional revenues	Scottish Government expected revenues	If expectations change.	Funding will reflect revenues collected.
Non-Domestic Rates distributable amount	Scottish Government plans based on SFC forecasts	This funding is not updated during the year.	No effect on this Scottish Budget, managed in future years.

Source: Scottish Fiscal Commission

[1] For example, outturn information for revenues and spending in 2021-22 is expected to be published in 2022-23. Adjustments to the BGAs will then be calculated and applied to the 2023-24 Scottish Budget.

[2] For example, outturn income tax information for 2021-22 is expected to be available in 2023-24. This allows the reconciliation to be calculated which will be applied to the 2024-25 Scottish Budget.

How do our publications compare to the Scottish Budget documents?

A.5 As set out in this publication, we categorise funding for the Scottish Budget into three groups: Block Grant funding, funding related to devolved taxes and social security and other funding. This funding information is included in the Scottish Government's Scottish Budget documents, but presented differently. Figure A.3 maps out where information from our funding table appears in the 2021-22 Scottish Budget document.[39]

Figure A.3: Where does funding information from our publications appear in the Scottish Budget document?

<table>
<tr><th colspan="2">Funding from SFC publications</th><th>Table in Scottish Budget document</th></tr>
<tr><td>Block Grant funding</td><td>Barnett
Non-Barnett</td><td rowspan="3">Table A.02: Scottish Government Budget Control Limits 2019-20 to 2021-22</td></tr>
<tr><td>Funding related to devolved taxes and social security</td><td>Scottish tax revenues
Tax BGAs
Social security BGAs
Reconciliations</td></tr>
<tr><td rowspan="3">Other funding</td><td>Borrowing</td></tr>
<tr><td>Scotland Reserve
Additional revenues</td><td>Table A.06: Reconciliation of Funding to Spending Plans'</td></tr>
<tr><td>NDR distributable amount</td><td>Table 5.11 Local Government Spending Plans (Level 3)
Table 5.13: Scottish Fiscal Commission (SFC) Non-Domestic Rate Income Forecast</td></tr>
</table>

Source: Scottish Fiscal Commission, Scottish Government (2021) Scottish Budget 2021 to 2022 (link).

A.6 In Annex A of the Scottish Budget documents, the Scottish Government sets out total funding for the Scottish Budget. To do this, the Scottish Government presents two funding tables:

- The first includes funding which is in line with expenditure control limits set by HM Treasury. In the recent Scottish Budget, this was titled 'Table A.02: Scottish Government Budget Control Limits 2019-20 to 2021-22'.
- The second includes additional funding which is not included in HM Treasury control limits. This includes information such as: the Scotland Reserve, anticipated funding and additional revenues. An example of additional revenues is the voluntary repayment of NDR reliefs by businesses. In the recent Scottish Budget, this was 'Table A.06: Reconciliation of Funding to Spending Plans'.

A.7 The distributable amount for NDR is not included in either of these funding tables. Rather, it is allocated in Local Authority spending plans, as set out in Figure A.3.

[39] Scottish Government (2021) Scottish Budget 2021 to 2022 (link)

A.8 In our reports we combine information from both the funding tables in the Annex of the Scottish Budget document and the NDR distributable amount. As discussed in Chapter 1, we exclude non-cash and UK funded AME. By presenting this information we set out the total funding available for the Scottish Government to manage and allocate towards spending plans.

Additional information

Abbreviations

AME	Annually Managed Expenditure
BGA	Block Grant Adjustment
BRIS	Business Rate Incentivisation Scheme
COVID-19	Coronavirus
EU	European Union
GDP	Gross Domestic Product
GRG	General Revenue Grant
HMRC	Her Majesty’s Revenue and Customs
HMT	Her Majesty’s Treasury
LBTT	Land and Buildings Transaction Tax
MTFS	Medium Term Financial Strategy
NDR	Non-Domestic Rates
OBR	Office for Budget Responsibility
OECD	Organisation for Economic Co-operation and Development
SCF	Scottish Consolidated Fund
SEFF	Scotland’s Economic and Fiscal Forecasts
SFC	Scottish Fiscal Commission
SG	The Scottish Government
SLfT	Scottish Landfill Tax
TIF	Tax Incremental Financing
TMI	Tax Motivated Incorporations
UK	United Kingdom

A full glossary of terms is available on our website:

https://www.fiscalcommission.scot/explainers/glossary/

Professional Standards

The Commission is committed to fulfilling our role as an Independent Fiscal Institution, in line with the principles set out by the Organisation for Economic Cooperation and Development (OECD).[40]

The Commission also seeks to adhere to the highest possible standards for analysis. While we do not produce official statistics, we voluntarily comply as far as possible with the UK Statistic Authority's Code of Practice for Statistics. Further details and our statement of voluntary compliance can be found on our website.[41]

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

Correspondence and enquiries

We welcome comments from users about the content and format of our publications. If you have any feedback or general enquiries about this publication or the commission, please contact info@fiscalcommission.scot. Press enquiries should be sent to press@fiscalcommission.scot.

All charts and tables in this publication have also been made available in spreadsheet form on our website. For technical enquiries about the analysis and data presented in this paper please contact the responsible analyst:

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