A solid orange right-angled triangle pointing downwards and to the right.

John Mason MSP
Convener
Finance and Public Administration Committee
Scottish Parliament
Edinburgh
EH99 1SP

15 June 2023

Dear Convener

Thank you for the opportunity to provide evidence on our latest five-year economic and fiscal forecasts on 6 June. During our session, I promised to write to provide the Committee with further information on three issues.

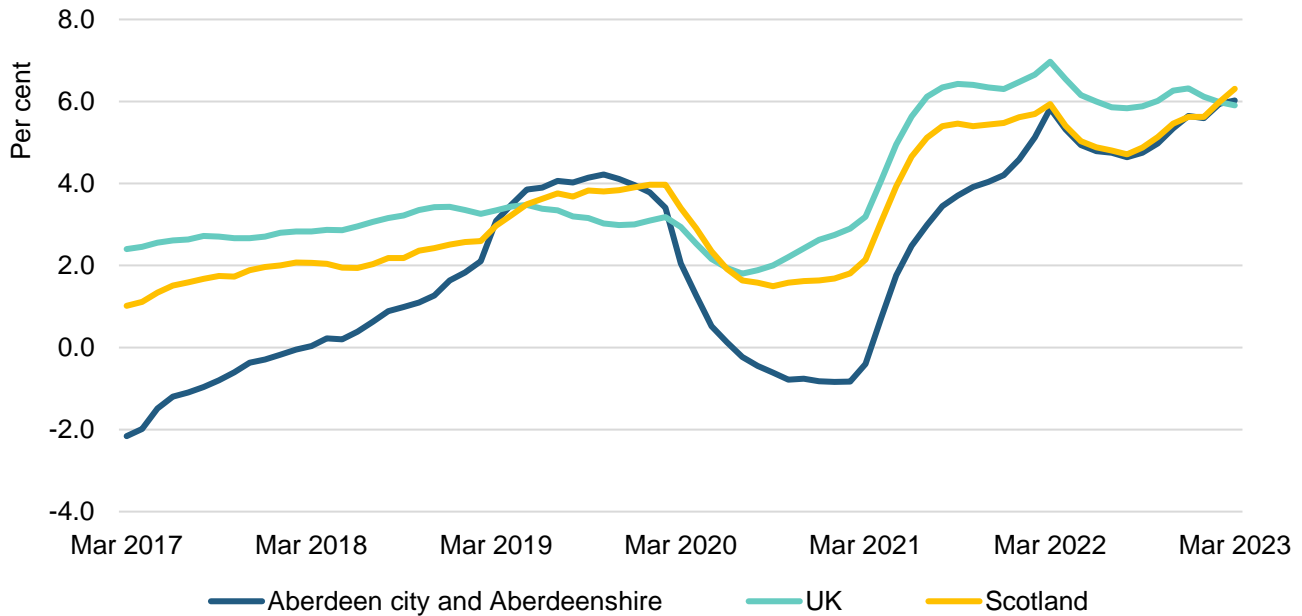
Real Time Information (RTI) regional data

One area of discussion was Scotland's average earnings relative to the UK. Mr Greer also asked about regional differences within Scotland, in particular comparing the east to the west of Scotland. I referred to Figure 3.21 in our [report](#) which shows that the gap between Scottish and UK earnings has widened since 2015-16, likely to be partly explained by the oil and gas downturn and its negative effect on high-value jobs in the North East. I also said that the Commission does not expect this divergence to continue over the next few years. When our latest forecasts are compared to the OBR's, the Scotland-UK earnings gap reduces slightly as shown in Figure 3.21 in our report. Over the longer term, the ability to replace high-earning jobs currently tied to the oil and gas sector with other job opportunities will have an important impact upon the public finances.

In forming our earnings judgement, we look at regional pay estimates from the [HMRC Pay As You Earn \(PAYE\) Real Time Information \(RTI\) data](#). Figure 1 below shows that, in the past, the North East has been a significant driver of Scotland's slower average earnings growth compared to the UK. Recently, Scottish average earnings growth has been more in line with the UK, and this appears to be driven by earnings growth in the North East of Scotland returning to higher levels.



Figure 1: RTI mean pay, annual (12 month on 12 month) growth



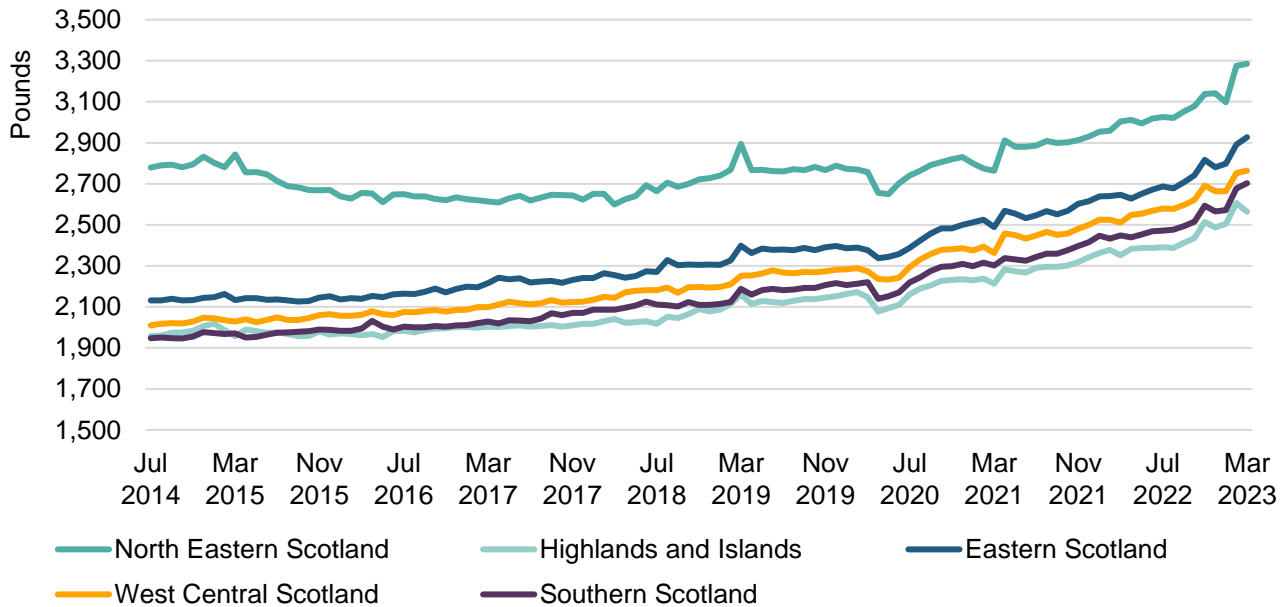
Source: ONS (2023) Earnings and employment from Pay As You Earn Real Time Information, seasonally adjusted ([link](#))

Mr Greer also asked about differences in earnings across Scotland. Figure 2 presents the available RTI data, which as Mr Greer said, shows a higher level of earnings in North Eastern and Eastern Scotland, and lower earnings in Southern and West Central Scotland and Highlands and Islands.

For the purposes of our forecasts and Scottish income tax, what really matters is how the picture has changed since 2016-17. This is due to how the Fiscal Framework operates and the important comparison between the Block Grant Adjustments and devolved tax revenues. As shown in Figure 1, the most significant factor here is the relatively slower growth rate of earnings in North Eastern Scotland, closing the levels gap with other regions.



Figure 2: RTI mean pay, monthly level



Source: ONS (2023) Earnings and employment from Pay As You Earn Real Time Information, seasonally adjusted ([link](#))

Capital spending

Ms Thomson asked about comparisons of public sector capital investment in the UK and internationally. This is not something we look at directly, or make a policy recommendation upon, but I thought the following information may be helpful:

[Government investment spending | Government at a Glance 2021 | OECD iLibrary \(oecd-ilibrary.org\)](#)

These data show the UK in comparison to the OECD and EU average for Government investment as a share of GDP. There are, of course, important caveats to any such comparison but it hopefully provides a useful reference.

The Resolution Foundation also recently published a review of capital spending in the UK which may provide useful additional background information including around annual volatility in spending.

[Cutting the cuts - The Inquiry \(resolutionfoundation.org\)](#)

Income tax earnings to net position rule

During the evidence session, we mentioned a rule of thumb we use when thinking about the effect of earnings growth on the income tax net position. Roughly speaking, we expect each 0.1 percentage point divergence of earnings growth in Scotland relative to the rest of the UK would shift the income tax net position by around £25 million – as per paragraph 4.17. This effect is roughly symmetric for higher or lower earnings growth.

This figure is annual, and the impact would be cumulative if sustained over a period of time. For example, if Scottish earnings growth lagged or outperformed earnings growth in the rest of the UK by minus or plus 0.1 percentage points for five consecutive years, then the net position would widen by roughly minus or plus £125 million.

I hope this additional information is useful.

Yours sincerely

A handwritten signature in black ink that reads "Graeme Roy".

Professor Graeme Roy