Scotland's Economic and Fiscal Forecasts

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Foreword

The Scottish Fiscal Commission is the independent fiscal institution for Scotland. Our statutory duty is to provide the independent and official forecasts of the Scottish economy, devolved taxes and devolved social security spending. Our forecasts represent the collective view of the four Commissioners who take personal responsibility for them.

Professor Graeme Roy and Dr Domenico Lombardi have both joined as Commissioners since our previous forecast report in May 2022, with Professor Roy replacing Dame Susan Rice as Chair of the Commission.

Following the COVID-19 pandemic, global events have continued to move quickly with the Russian invasion of Ukraine and rising energy prices. Closer to home there has been higher inflation, interest rates, and the cost of living crisis. As a result, the near-term outlook for the Scottish and UK economies has weakened significantly over the course of the past year. We now expect Scottish households to see the biggest real-terms fall in their disposable income since Scottish records began in 1998.

Our forecasts have been used to inform the Scottish Government's Budget for 2023-24, also published today. Our protocol for engagement with the Scottish Government has guided our interaction with the Government during the forecasting process.

We would like to thank the committed staff of the Commission as well as officials from the Scottish Government, Revenue Scotland, Social Security Scotland, DWP, HM Treasury, HMRC and the OBR for their support in creating this report.

Professor Graeme Roy

Professor Francis Breedon

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Professor David Ulph

15 December 2022

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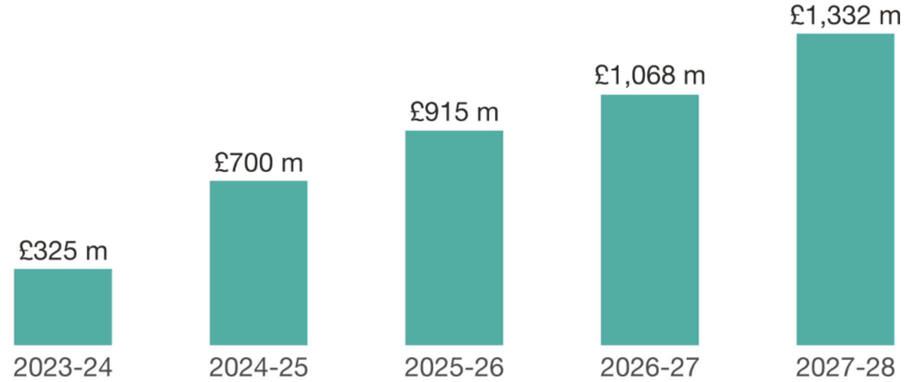
Fiscal Overview

Comparing our forecast with the BGA based on OBR forecasts, an increasingly positive income tax net position is projected, partly as a result of policy changes.

Tax net positions are uncertain, but a higher level could support future resource funding, especially towards the end of the forecast horizon.

Projected income tax net positions



There is almost £1.7 billion more resource funding in 2023-24 than in the latest position for 2022-23 because of increases in the Block Grant and social security funding, as well as improved tax net positions.

However, inflation reduces the spending power of this additional funding. We expect it to be only £279 million more in real terms.

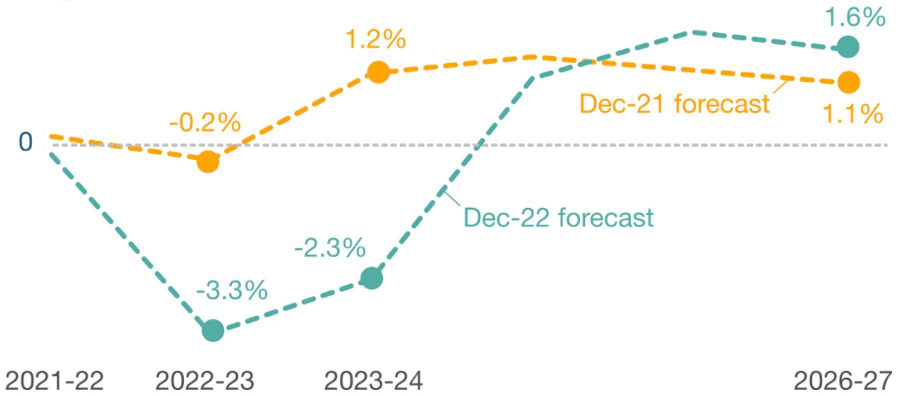
Growth in resource budget from 2022-23 to 2023-24

Economy

High inflation over 2022-23 and 2023-24 results in the greatest fall in the real value of disposable income per person since records began in 1998.

Even once inflation returns to lower levels, real disposable income per person will take time to recover, only reaching its 2021-22 level in 2027-28.

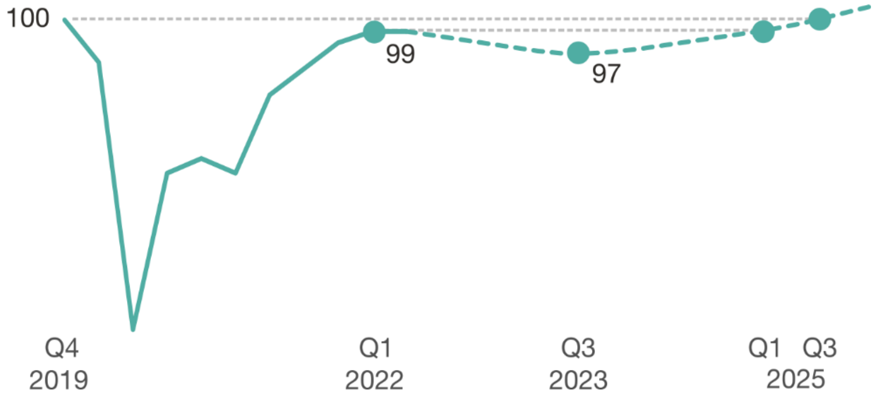
Living standards to fall



We forecast a shallow recession in the coming year, with a return to the 2022 Q1 pre-recession peak by 2025 Q1.

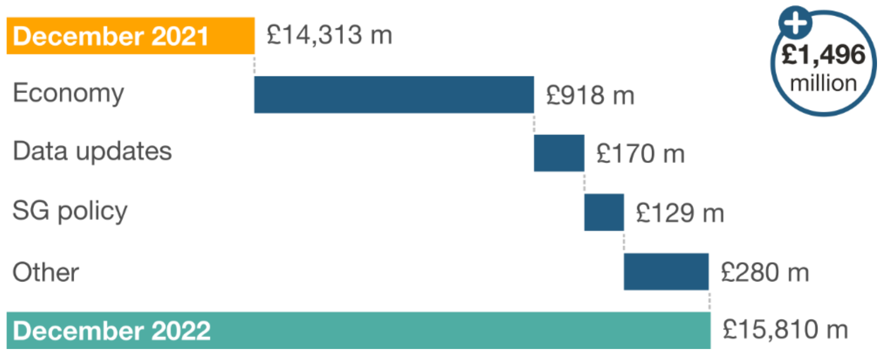
Following this, GDP does not return to pre-pandemic levels until 2025 Q3.

Recession delays return to pre-pandemic GDP level



Tax

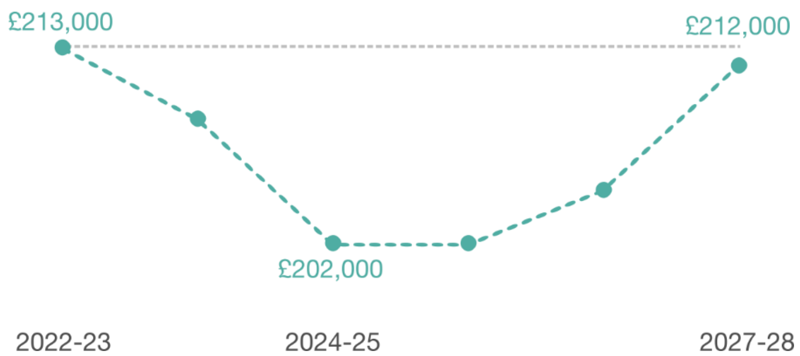
Income tax changes since December 2021 forecast



We expect high inflation leading to increased nominal earnings growth to generate a significant increase in income tax revenue.

The Scottish Government's policy decision to freeze thresholds and increase the higher and top rate of tax will also increase tax revenue.

Fall in house prices over next two years

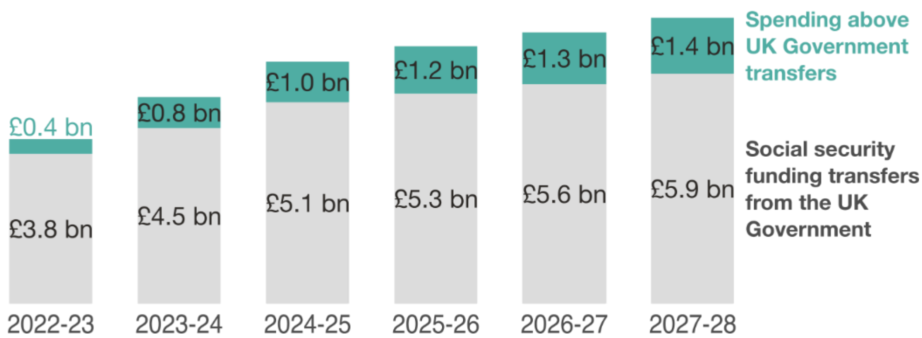


We are forecasting a decrease in house prices over the next two years because of sharp interest rate rises and increased cost of living affecting how much households can afford to spend on moving home.

We expect nominal house prices to return to 2022-23 levels by 2027-28.

Social Security

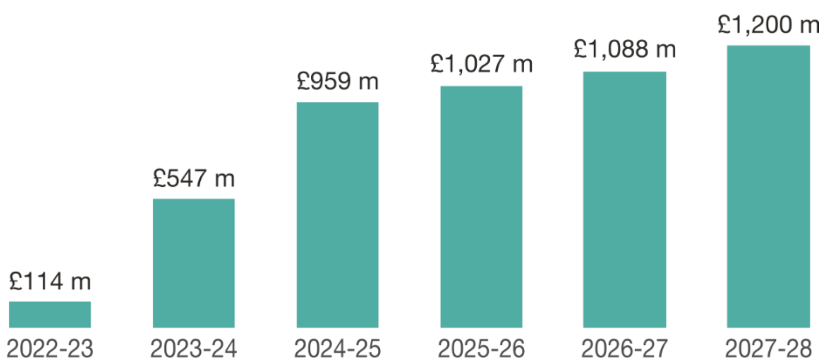
Spending increasing to £7.3 bn by 2027-28



Social Security forecast increases from £4.2 billion in 2022-23 to £7.3 billion in 2027-28.

By 2027-28, we expect the Scottish Government to spend £1.4 billion more on social security than the funding received from the UK Government.

Inflation-linked increases in spending



Most payments are uprated in line with inflation, so high inflation will drive a sharp rise in spending over the next two years.

By 2027-28 uprating increases spending by £1.2 billion.

Budget funding, £ million	**2022-23**	**2023-24**	**2024-25**	**2025-26**	**2026-27**	**2027-28**
Resource budget (nominal)	43,303	44,991				
Resource budget (2022-23 prices)	43,303	43,582				
Economy, % growth						
Gross Domestic Product	1.7	-1.0	1.2	2.1	1.9	1.5
Consumer Price Index	10.1	5.5	0.0	-1.0	0.8	1.8
Average real earnings	-4.4	-0.8	2.2	2.7	1.7	1.3
Employment	1.7	-0.5	-0.2	0.3	0.5	0.4
Tax, £ million						
Income tax	14,575	15,810	16,633	17,370	18,247	19,437
Non-Domestic Rates	2,818	3,075	3,080	3,135	3,405	3,286
LBTT	850	774	728	794	910	995
Scottish Landfill Tax	101	79	72	58	16	16
Policy announcements						
Income tax	4	129	142	150	162	175
Non-Domestic Rates		-356	-309	-288	-267	-262
LBTT	12	34	28	34	39	40
Social Security, £ million						
All devolved social security	4,187	5,244	6,163	6,554	6,903	7,267

Summary

Introduction

1 Rising prices run through all of our forecasts. Higher energy prices and their consequences for inflation more generally mean that we now think the Scottish economy has entered recession this year, and Scottish households are expected to see the biggest real-terms fall in their disposable income since Scottish records began in 1998.

2 The Scottish Government will also have to deal with the effects of higher prices and demand for higher wages in the public sector.

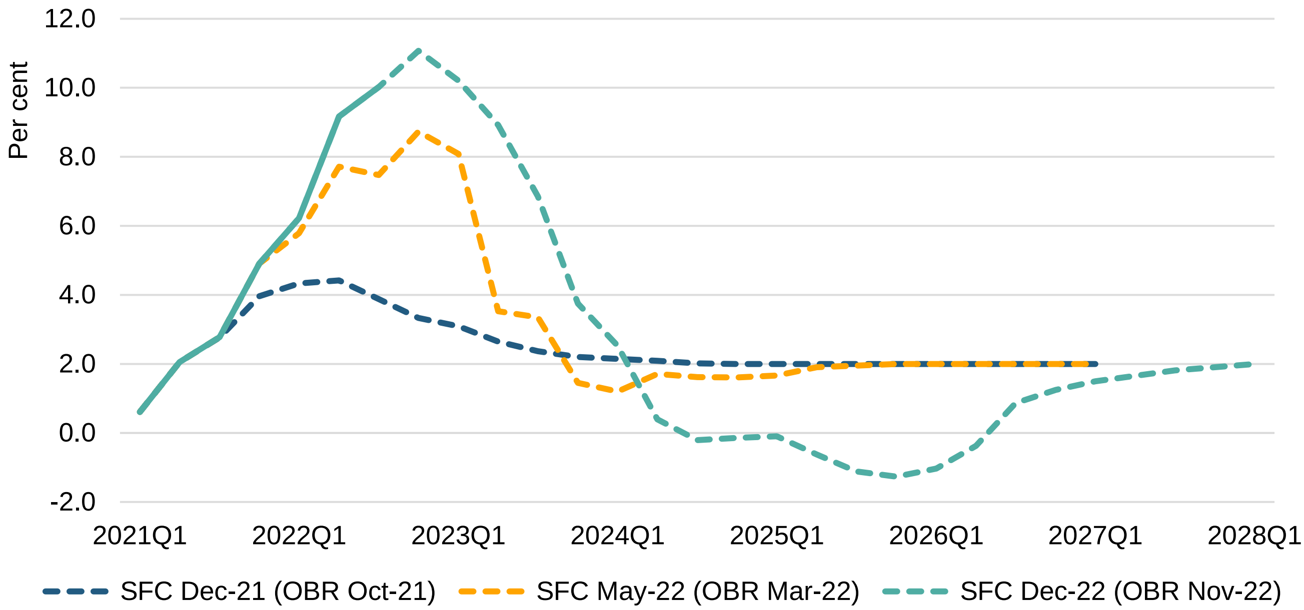
3 Nominal earnings are rising because of higher prices. This has meant upwards revisions to our income tax forecast compared to previous reports. However, as nominal earnings are rising by less than the price of goods and services, the overall effect on households is negative.

Economic outlook

4 The near-term outlook for the Scottish and UK economies has weakened significantly over the course of the year. The rise in energy and traded goods prices being driven by the conflict in Ukraine has been greater than expected earlier in the year, pushing up inflation. Interest rates have risen to levels not seen since before the 2008-09 Global Financial Crisis. All of this has intensified the costs for households and businesses. Falling real incomes mean the coming years are going to be difficult for many households, particularly those with lower incomes.

5 We expect annual Consumer Price Index (CPI) inflation to peak at around 11 per cent in 2022 Q4. The peak is lower than it might have been in the absence of the UK Government's Energy Price Guarantee. Inflation looks set to drop sharply over the course of next year as global energy prices level off and domestic inflationary pressures unwind due to the recession.

Figure 1: Consumer Price Index inflation, year-on-year growth

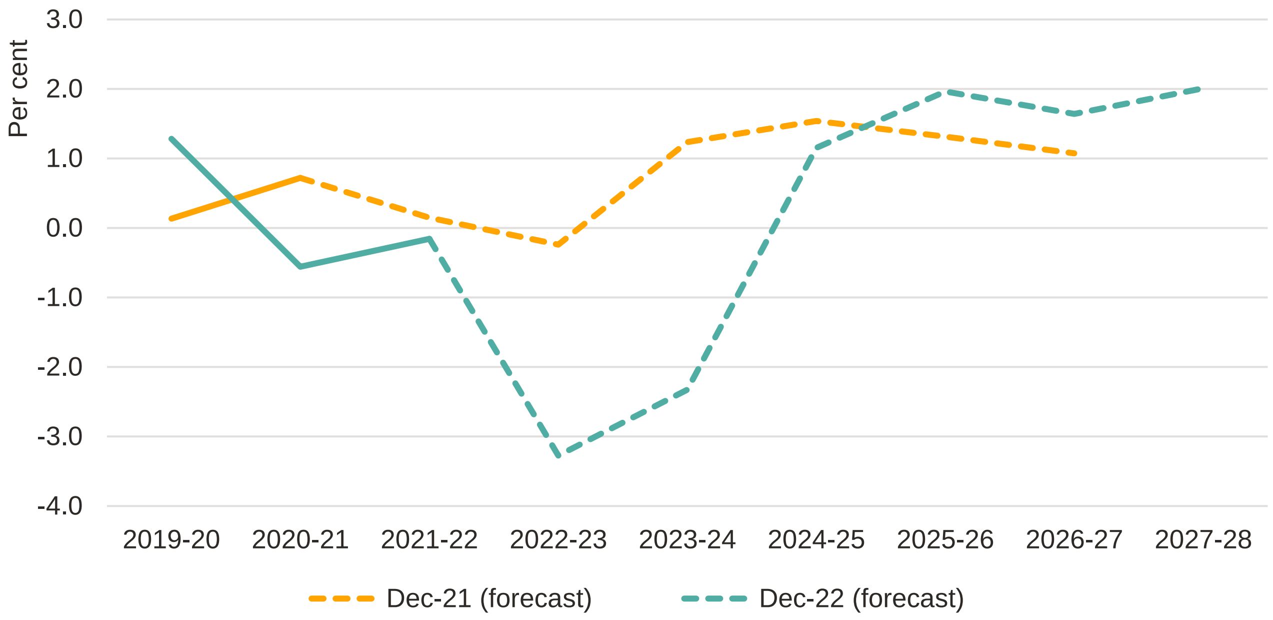


Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2022) Scotland's Economic and Fiscal Forecasts – May 2022 (link), Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – December 2021 (link). Solid lines refer to outturn available at time of publication and dashed lines refer to forecasts.

6 High inflation means that, over this year and next, Scottish households are expected to see the biggest fall in their real disposable income since records began in 1998. Even once inflation returns to lower levels, and real household incomes start to grow again in 2024-25, living standards will take time to recover to the pre-crisis 2021-22 level. Our forecast suggests that, by 2025-26, real disposable income per person will be no higher than its level a decade earlier. The global shock prolongs a period of slow growth in living standards since the Global Financial Crisis, with real disposable income per person growing on average by only 0.4 per cent per year between 2008-09 and 2021-22 compared to around 3 per cent before 2008-09.

7 High inflation and the recession will affect everyone, but there will be particular pressures on lower-income households, as they spend a larger share of income on essentials such as energy and food. Rising interest rates will add to the costs of mortgages and other forms of debt. Compared to the UK as a whole, Scotland has lower average house prices and lower average household debt as a share of income, which means that rising interest rates will tend to have a smaller effect than in the rest of the UK.

Figure 2: Real disposable income per person growth



Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – December 2021 (link), Scottish Government (2022) GDP Quarterly National Accounts (QNA): 2022 Quarter 2 (April to June) (link).
Solid lines refer to outturn available at time of publication and dashed lines refer to forecasts.

8 When the global energy price shock arrived in early 2022, the Scottish economy was still recovering from the impact of health restrictions, labour shortages and supply chain disruptions associated with the global Coronavirus (COVID-19) pandemic. Throughout 2022, the impact of higher energy prices and the acceleration of wage pressures has worsened. The economy has also been adjusting to Brexit as well as the long-term evolution of the oil and gas industry in the North East of Scotland. There is no comparable period in recent economic history when the economy has been hit by two global shocks in immediate succession while adjusting to other significant domestic pressures.

9 The underlying structure of the Scottish economy is undergoing profound shifts. The pandemic has resulted in shifts in demand and changes in labour markets including more people working from home, while some people are suffering from prolonged health effects, in part due to delays in NHS treatment. At the same time, the economy faces higher goods import prices as a result of the continuing COVID-19 restrictions in China. Rising energy prices are a terms of trade shock that the economy has to adapt to by using less energy at a higher cost. This will be a particular issue for energy intensive industries that find it difficult to pass on higher costs to consumers. Brexit is also having an effect on supply chains and on export markets for Scottish business.

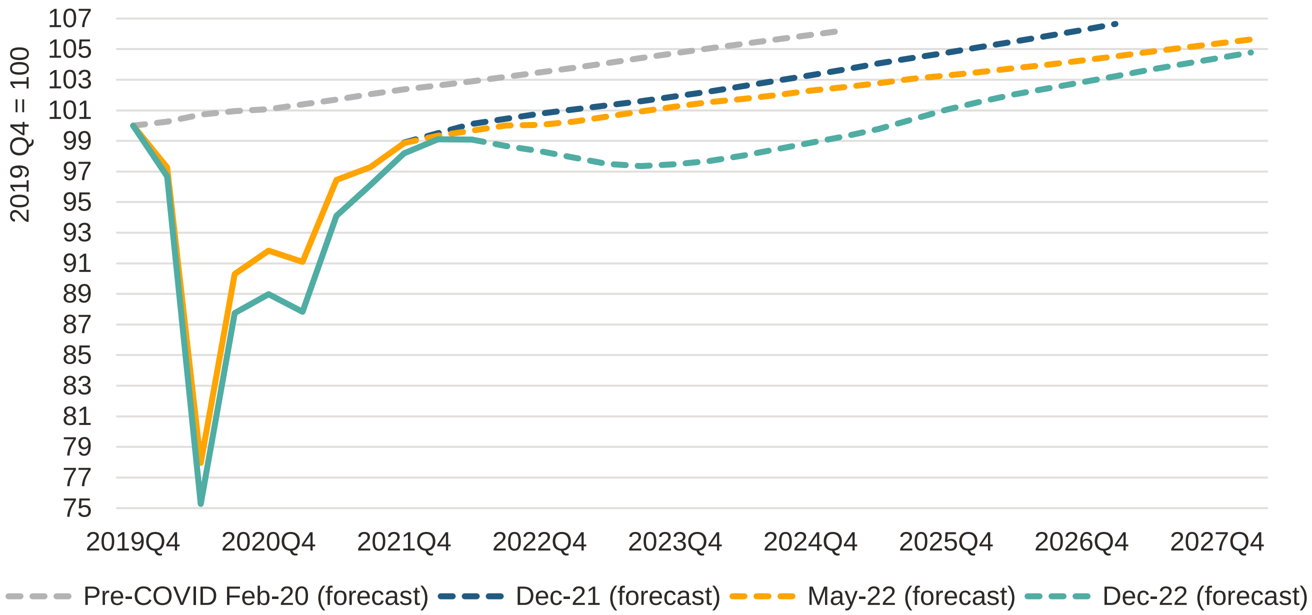
10 Over the longer term, the size of Scotland's economy is determined by its potential output. In the current context, both the underlying capacity of the Scottish economy to produce goods and services – its potential output – and the outlook for productivity growth are uncertain. We have reduced our view of the size of Scotland's potential output in recent forecasts, and are therefore forecasting a lower level and cumulative growth rate of Gross Domestic Product (GDP). This can be seen in Figure 3.

11 In the shorter term, largely reflecting the energy price shock and its inflationary consequences, our judgement is that Scotland has already entered a recession which will last six quarters, with a total peak to trough fall in GDP of 1.8 per cent. Higher prices will mean real incomes fall and put the economy into recession via both a supply and demand side shock. The recession will be dampened by higher nominal pay awards, increased benefits payments and some households running down

savings to support spending. Following the inflation shock, the level of real incomes in Scotland will be lower and expected to take time to recover. Although prolonged, we expect the recession will be shallower than the Global Financial Crisis or the COVID-19 recession.

12 The precise magnitude and duration of the recession are uncertain. While there is a lot of focus on the specific path for growth over the short term, we consider that the level of GDP in Scotland over the longer term is the most important aspect. Despite the relatively shallow nature of the recession, it is important to see it in the context of a prolonged period of slow economic growth. This slow growth is the result of globally slowing productivity growth as well as the shocks outlined at the start of this section. Sustained lower levels of GDP, relative to what we would have expected to be the case without these shocks, will mean ongoing lower incomes and will put pressure on tax receipts and public spending.

Figure 3: Scottish GDP, outturn and forecast



Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2022) Scotland's Economic and Fiscal Forecasts – May 2022 (link), Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – December 2021 (link), Scottish Fiscal Commission (2020) Scotland's Economic and Fiscal Forecasts – February 2020 (link).
Solid lines refer to outturn available at time of publication and dashed lines refer to forecasts.

13 We expect the recession in Scotland to broadly mirror the UK recession forecast by the Office for Budget Responsibility (OBR). Peak to trough, we forecast the Scottish economy to shrink by 1.8 per cent, compared to the OBR's forecast for the UK of 2.1 per cent. We expect the Scottish economy to recover to its pre-recession peak by the first quarter of 2025, one quarter behind the UK.

14 As in all our forecasts, there is significant uncertainty around the economic outlook, in this case arising from global developments. Energy prices and inflation will continue to depend on how the situation in Ukraine evolves. Another important source of uncertainty is how high inflation affects wages. So far, pay awards have remained below inflation, resulting in falling real earnings. However, with unemployment relatively low, it is possible that workers will find they can bargain for stronger pay awards, affecting both the real terms earnings outlook and potentially inflation.

15 Figure 4 shows further detail on our latest economy forecast and compares it to our December 2021 forecast, which pre-dated the Russian invasion of Ukraine.

Figure 4: Headline economy forecasts, growth rates unless otherwise specified

Per cent	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
GDP							
December 2021	10.4	2.2	1.2	1.3	1.4	1.4	
December 2022	14.0	1.7	-1.0	1.2	2.1	1.9	1.5
Consumer Price Index							
December 2021	3.3	3.7	2.3	2.0	2.0	2.0	
December 2022	4.0	10.1	5.5	0.0	-1.0	0.8	1.8
Unemployment rate							
December 2021	4.6	4.5	4.3	4.2	4.2	4.2	
December 2022	3.9	3.4	4.3	4.7	4.6	4.3	4.1

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – December 2021 (link).
Shaded cells refer to outturn available at time of publication.

Tax

Income tax

16 As shown in Figure 5, we have revised up our income tax forecast significantly since December 2021. High inflation leading to increased nominal earnings growth is the main reason for this increase. The combination of high inflation with fixed tax thresholds leads to more people moving into higher tax bands, known as fiscal drag, and tax revenues rise faster than nominal earnings. Figure 5 summarises changes in our income tax forecast since December 2021.

17 The Scottish Government has announced that in 2023-24 all non-savings, non-dividends (NSND) income tax thresholds will remain frozen at 2022-23 levels, with the exception of the top rate of income tax which will reduce to £125,140 from the current level of £150,000. They have also announced they will be increasing both the higher rate and top rate by 1 pence. From 2023-24, the higher rate will now be 42 pence and the top rate will be 47 pence. These income tax policy changes are expected to raise an additional £129 million of income tax revenue in 2023-24.

18 When creating our five-year forecasts, for years in which there is not an announced Scottish Government policy, we need to make assumptions about future income tax rates and thresholds. In May 2022 we took the decision to freeze the income tax higher rate threshold in that and future forecasts, as we judged this to be the most reasonable assumption to make in our forecasts in line with historical patterns.[1] This means that the freezing of the higher rate threshold is already included in our forecasts and the Scottish Government's decision to freeze the higher rate threshold does not yield additional revenue. We explain this in further detail in in Chapter 4.

[1] Scottish Fiscal Commission (2022) Scotland's Economic and Fiscal Forecasts – May 2022 (link)

Figure 5: Change in income tax from December 2021

£ million	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
December 2021 forecast	11,938	13,002	13,671	14,313	15,056	15,790	16,445
Economy	-	277	652	918	745	405	345
Policy	-	-	4	129	142	150	162
Other	10	58	248	449	689	1,024	1,295
December 2022 forecast	11,948	13,337	14,575	15,810	16,633	17,370	18,247

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – December 2021 (link), Scottish Fiscal Commission (2022), Scotland's Economic and Fiscal Forecasts – May 2022 (link), HMRC (2022) Scottish Income Tax Outturn Statistics: 2020 to 2021(link).
Shaded cells refer to outturn available at time of publication.

The income tax net position

19 Despite a deterioration in the forecasts of the Scottish and UK economies overall, the outlook for the income tax net position has improved significantly. Comparing our forecasts with the OBR's, the net position is expected to be £325 million in 2023-24, compared to the expected value in December 2021 of -£257 million. Relatively small changes in either the OBR or our forecasts can lead to significant changes in the projected net position. This is particularly relevant now with heightened inflation and increased geopolitical risks adding to the uncertainty of the component forecasts.

20 The more positive outlook for the net position is driven in part by Scottish Government policies to raise additional income tax. An additional £129 million of income tax revenue is set to be raised in 2023-24 following policy changes announced at this budget.

21 Since 2017-18, the Scottish Government has increased income tax rates and frozen thresholds to raise additional revenue, relative to what would be raised under UK Government policy. While the higher rate threshold is frozen in both the UK and Scotland, it is frozen at a lower level in Scotland. We estimate that the total divergence in Scottish and UK income tax policy since 2017-18 is contributing around £1 billion to the income tax net position in 2023-24.

22 Another factor is outturn data for 2020-21 published in July 2022 and discussed in our August 2022 publications, which showed Scotland to have a more positive net position than we anticipated in our December 2021 and May 2022 forecasts, driven primarily by lower than expected UK income tax revenues.

23 Changes to the OBR's and our economy forecasts have also affected the outlook for the net position. With inflation rising, both the OBR and the Commission have revised up our forecasts for nominal average earnings growth by around the same amount in 2023-24. However, the OBR have made significant downward revisions to their forecast of employment growth in 2023-24. We think this revision in the OBR's forecast of employment growth in the UK has contributed significantly to the positive shift in the net position in 2023-24.

24 From 2024-25 onwards, the OBR forecasts UK average nominal earnings growth to average 2.0 per cent. This is low by historical standards and compared to our forecast of 2.6 per cent for Scotland, leading to a further improvement in the income tax net position over the forecast horizon.

25 Over the last five years, earnings have been growing more slowly in Scotland than the UK. This has been driven in part by slowing activity in the oil and gas sector in Scotland, and growth in the

earnings in the financial services in the UK. Comparing our forecasts of earnings growth to the OBR's suggests a period of catch-up in Scottish earnings over the next five years. driven by:

- Higher energy prices and an increased emphasis on energy security leading to a more positive outlook for earnings and employment in the oil and gas sector.
- Greater alignment in the outlook for earnings growth in Scottish and UK financial services.
- Scottish households tend to have smaller mortgage debt than households in other parts of the UK, meaning they will be less affected by rising interest rates, supporting economic activity in Scotland.

26 The outlook for earnings growth is uncertain and a range of outcomes is possible. Further revisions to ours or the OBR's forecasts could see this period of catch-up in earnings in Scotland disappearing, and a weakening in the outlook for the income tax net position.

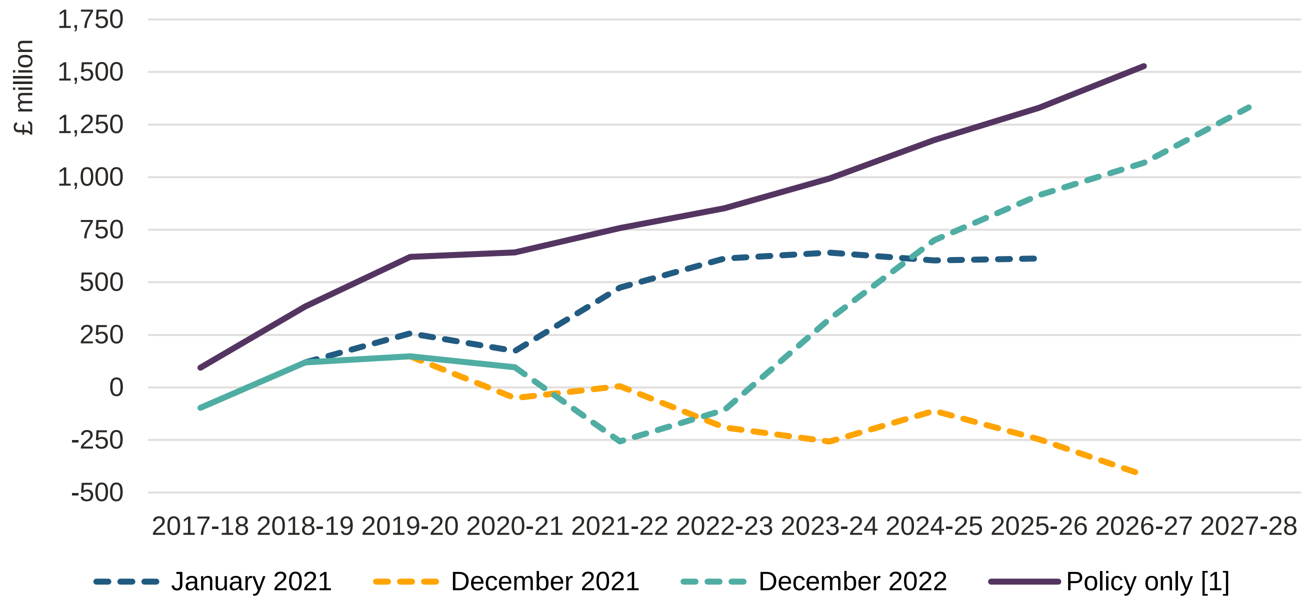
27 In summary, policy changes, revised data, and shifts in the relative economic outlook with the UK have all contributed to improved projections of the income tax net position. However, we strongly caution that the outlook remains very sensitive to changes in our or OBR's forecasts. The income tax net position for 2023-24 has increased by £582 million since our December 2021 forecast. While this is a large amount of money, it represents only 3.7 per cent of Scottish income tax revenues in this year. For context, we estimate that the OBR has an absolute forecast error of around 4.9 per cent in its two-year-ahead income tax forecasts for the UK, and so shifts in the income tax net position of this scale are not unexpected.[2]

28 The net position is the difference between two large forecast values, and there was always an expectation that estimates could move over time. We are now five years into the operation of the fiscal framework, and we can see that estimates of the net position can move year-to-year, and perhaps more than anticipated. As forecast error is an inherent part of forecasting, movement in the outlook of the net position is an inherent part of the fiscal framework, particularly with heightened economic uncertainty, and therefore requires careful budget management.

29 Figure 6 shows the latest projection of the net position compared to other recent projections.

[2] We reference the OBR figure here as a benchmark as they have a longer history of forecasts to compare. Scottish Fiscal Commission (2021) Supplementary Forecast Evaluation Report (link).

Figure 6: The income tax net position comparisons



Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2022) 'Trends in Scotland's population and effects on the economy and income tax' (link).
[1] The policy only line includes the latest policy announcements from the Scottish Government and UK Government. It is estimated on a static policy basis. Including behavioural responses would only have a small effect on the purple line and not change the overall story presented in this figure.

30 In Figure 6 the solid line is outturn data on the income tax net position, and the dashed line shows the outlook given the latest OBR and our forecasts. The net position has been revised up significantly since December 2021 and is now more in line with where it was projected to be in January 2021.

31 The policy only [1] line in Figure 6 shows our approximation of what the income tax net position would be if Scottish economic performance had exactly matched the UK, with the only difference being in income tax policy. The actual net position being below this policy only position is in line with relatively slower earnings and employment growth in Scotland compared to the UK since 2016-17. Even with a period of relative catch-up over the next five years, earnings and employment growth in Scotland still lags the UK compared to the 2016-17 starting year for income tax. Despite upwards revisions, the income tax net position remains below the hypothetical policy differences only position.

Other devolved taxes

Non-Domestic Rates

32 There are several Non-Domestic Rates (NDR) policy changes included in the 2023-24 Budget. The Scottish Government has set the poundage to the same amount as in 2022-23. The Small Business Bonus Scheme (SBBS) has been reformed. There are two transitional reliefs available, one for all properties where rateable value has substantially increased after revaluation and one for small businesses affected by SBBS changes.

33 Our NDR forecast has been affected by the ongoing revaluation of all rateable properties. The final valuation roll will not be available until 1 April 2023. Because of this ongoing revaluation, we have used an imputed roll based on an incomplete draft roll to forecast NDR. Any differences between the imputed roll and the final roll will affect our policy costings and forecasts.

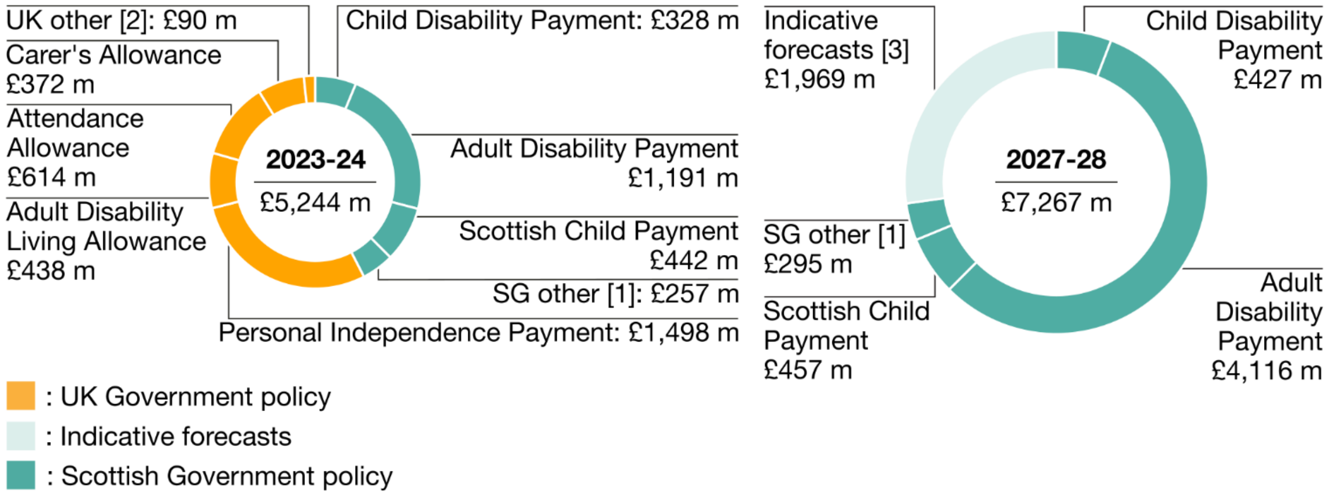
Land and Buildings Transaction Tax

34 House prices have increased further since December 2021, and this is reflected in an increase to our Land and Buildings Transaction Tax (LBTT) forecast for 2022-23. However, we have revised down our forecast from 2023-24 onwards because we expect a drop in house prices and transactions next year and the year after in response to the rapid rise in interest rates and the wider downturn.

Social security

35 We forecast overall social security spending will rise from £5.2 billion in 2023-24 to £7.3 billion in 2027-28. The existing payments administered by the Department for Work and Pensions (DWP) will continue to be replaced by new payments delivered by Social Security Scotland. The increase in expenditure over the forecast is a result of more people receiving the payments and on average people receiving higher payments over time, with inflation being a major factor in this.

Figure 7: Social security spending in 2023-24 and 2027-28



Not included in the visual: £14 million for the replacement of the devolved employability support services as an indicative forecast in 2023-24 and £4 million for Severe Disablement Allowance as UK Government Policy in 2027-28.

[1] SG other includes: Best Start Foods, Best Start Grant, Carer's Allowance Supplement, Child Winter Heating Assistance, Winter Heating Payment, Funeral Support Payment, Discretionary Housing Payments, Fair Start Scotland and Scottish Welfare Fund in 2023-24.

[2] UK other includes: Industrial Injures Disablement Benefit and Severe Disablement Allowance in 2023-24.

[3] Indicative forecasts includes: Scottish Carer's Assistance, Pension Age Disability Payment, Employment Injury Assistance, Pension Age Winter Heating Payment, Scottish Adult DLA, and an estimate for spending on Employability Services to replace the current Fair Start Scotland.

36 Our forecast for spending in 2026-27 has increased by £1.4 billion compared to our December 2021 forecast. The two major drivers of this have been higher inflation leading to payment amounts being increased by more than we forecast in December 2021, and recent increases in the number of people receiving disability payments.

Figure 8: Change in total social security spending forecasts since December 2021

£ million	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
December 2021	3,679	4,065	4,657	4,966	5,230	5,511	
December 2022	3,682	4,187	5,244	6,163	6,554	6,903	7,267
Change since December 2021	3	122	587	1,197	1,324	1,392	

Source: Scottish Fiscal Commission.
Figures may not sum because of rounding. Shaded cells refer to outturn available at time of publication.

37 Social security spending is partly funded by Block Grant Adjustments (BGAs) from the UK Government for taking on the payment of devolved benefits. The level of BGAs is based on spending on the UK payments in England and Wales and they do not include the effect of Scottish Government reforms. Any spending above the funding from the BGAs must be met by the Scottish Government from elsewhere in the budget. The Scottish Government has also introduced new payments which have no UK equivalents. As there are no BGAs these must be funded entirely from the Scottish Government budget.

38 Figure 9 shows forecasts for the difference between social security funding and spending each year. When including new payments introduced by the Scottish Government, we forecast that by 2027-28 the total spending on social security payments will be £1.4 billion more than the corresponding funding received.

Figure 9: Social security net position and new payments

£ million	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Social security net position	- 11	- 194	- 421	- 584	- 689	- 775
New social security payments	- 363	- 582	- 625	- 627	- 636	- 642
Total	- 374	- 776	- 1,046	- 1,212	- 1,325	- 1,416

Source: Scottish Fiscal Commission.
Figures may not sum because of rounding.
[1] Social security net position includes Adult Disability Payment (covered by the Personal Independence Payment BGA), Child Disability Payment and Scottish Adult Disability Living Allowance (covered by the Disability Living Allowance BGA), Pension Age Disability Payment (covered by the Attendance Allowance BGA), Scottish Carer's Assistance and Carer's Additional Person Payment (covered by the Carer's Allowance BGA), Employment Injury Assistance (covered by the Industrial Injuries Disablement Scheme BGA), Winter Heating Payment (covered by the Cold Weather Payment BGA), Pension Age Winter Heating Payment (covered by the Winter Fuel Payment BGA) and Severe Disablement Allowance (covered by Severe Disablement Allowance BGA).
[2] Social security new payments include Scottish Child Payment, Carer's Allowance Supplement, Child Winter Heating Assistance, Best Start Grant Early Learning Payment and Best Start Grant School Age Payment. We also include spending through Discretionary Housing Payments on bedroom tax mitigation and the extra costs of the new commitment to mitigating Benefit Cap deductions.

39 The majority of social security payments are increased each year by inflation. This means the higher forecasts of inflation have led to our forecasts of social security spending increasing. BGAs also increase as a result of inflation, but these only cover part of the spending forecast. UK Government funding transfers will not cover the inflation related increase in spending on the additional cost of the reforms introduced by the Scottish Government.

40 Scottish Child Payment is the most significant new benefit introduced by the Scottish Government, with forecast spending of £442 million in 2023-24. It was originally launched in February 2021 as a

weekly payment for low-income families with children aged under six. On 14 November 2022 Scottish Child Payment was extended to include all children under 16 in low-income families.

41 Adult Disability Payment (ADP) was launched nationally in Scotland in August 2022 to replace Personal Independence Payments (PIP), the existing UK Department for Work and Pensions (DWP) payment. Adult Disability Payment spending accounts for over half of the social security spending forecast for 2023-24.

42 In the period since COVID-19, in advance of the launch of ADP, there has been an increase in the number of adults receiving disability benefits in Scotland. We attribute this increase to the combined impact of the following factors:

- Eligible people considering sources of support as a response to the cost of living crisis.
- People waiting longer for NHS treatment, potentially leading to conditions worsening or treatment being less effective, to such an extent that they become eligible for disability benefits.
- Continuing long-term impacts from COVID-19, including long COVID and wider impacts of the pandemic on mental health.

43 We expect these effects will persist into the future, so have increased our forecasts for spending on disability benefits. There have also been similar increases in people receiving UK disability payments England and Wales, meaning that forecasts for funding received through BGAs have also increased.

44 Compared to PIP, the Scottish Government has made a number of reforms with the introduction of ADP. The reforms include, but are not limited to, changes designed to improve the experience of people applying for the benefit, longer awards, the ambition to increase take-up by those eligible for the payment, and changes to the terminal illness rules. Our assessment is that the implementation of these reforms will lead to more people receiving ADP and higher average payments. We forecast expenditure on ADP will be over £650 million higher than the BGA received for PIP in 2027-28. This additional spending is more uncertain than other parts of the social security expenditure forecasts as it is based on our assumptions and judgements on the impact of the Scottish Government reforms. It is important that we receive the detailed data we need on ADP to ensure we can accurately forecast the overall expenditure and changes introduced by the Scottish Government.

The funding outlook

45 The Scottish Government has set the 2023-24 Budget based on our tax and social security forecasts, UK Government spending plans, plans for using the Scotland Reserve and borrowing, and assumptions on other income sources. We consider the Scottish Government's funding assumptions for the 2023-24 Budget to be reasonable. We discuss in this report the pressures 2023-24 will bring in terms of inflation and increasing social security spending.

46 The Scottish Government has provided indicative assumptions for the years 2024-25 to 2027-28. Our forecast accompanies a one-year budget and we do not comment on the reasonableness of these assumptions. We do note pressures in future years including a large negative income tax reconciliation for 2024-25 and an increasing social security bill.

Resource budget 2023-24

47 We expect resource funding for 2023-24 to increase by £1.7 billion in nominal terms but only £279 million in real terms compared to the latest funding position for 2022-23. Resource funding makes up the majority of the Scottish Budget and is used on public services such as NHS Scotland, goods and services, and social security. The difference of £1.4 billion in the value of the nominal and real 2023-24 Budget compared to the latest 2022-23 position shows the effect higher inflation is having, eroding the spending power of the Scottish Government. We account for inflation using the GDP deflator, but CPI inflation is higher than this and may affect some areas of government spending more than the GDP deflator. Although there have been increases in funding for 2023-24, the Scottish Government is likely to face challenges in balancing its funding and spending plans.

48 Nominal resource funding for 2023-24 has increased due to greater UK Government funding via the Block Grant. There has been an improvement in the tax net position, the difference between Scottish tax revenues and their Block Grant Adjustments (BGAs). In 2022-23 the net tax position was slightly negative, it is positive for 2023-24. This change is partly driven by Scottish Government policy for income tax in freezing income tax thresholds at a lower rate than that set by the UK Government and raising tax rates. In 2022-23 a small negative tax reconciliation is applied but a positive tax reconciliation is expected for 2023-24 based on outturn data. The Scottish Budget is set based on forecasts of Scottish and UK income tax. Reconciliations are funding adjustments applied to the budget after outturn data are available. Compared to the latest position for 2022-23, for 2023-24 the Scottish Government is assuming lower amounts of reserve drawdown, borrowing and assumed other funding.

49 The Scottish Government is profiling £310 million of the proceeds from ScotWind leases in the 2023-24 Budget. In May 2022 we assessed this to be reasonable but noted it may warrant revisiting if other funding materialises. Since then, there has been a real-terms increase of £1.3 billion in the funding position for 2023-24. This is due to increased funding via the Block Grant, the tax net position moving from being forecast at -£265 million to £562 million and the final reconciliation being positive rather than negative. We still assess the profiling of ScotWind in this way to be reasonable as we expect the 2023-24 Budget will be subject to further inflationary pressure throughout the year, but this does constrain what can be deployed in future years from this source.

50 Social security spending on devolved payments is forecast to exceed specific funding from the UK Government by £194 million due to Scottish Government reforms of these payments. Together with new payments introduced by the Scottish Government, there is £776 million of social security spending not funded by BGAs in 2023-24. The gap between the BGAs and social security spending puts pressure on the Scottish Budget as other sources of funding must be used. Most of social security payments are increased each year by CPI, so inflationary pressures may exceed those captured by the GDP deflator.

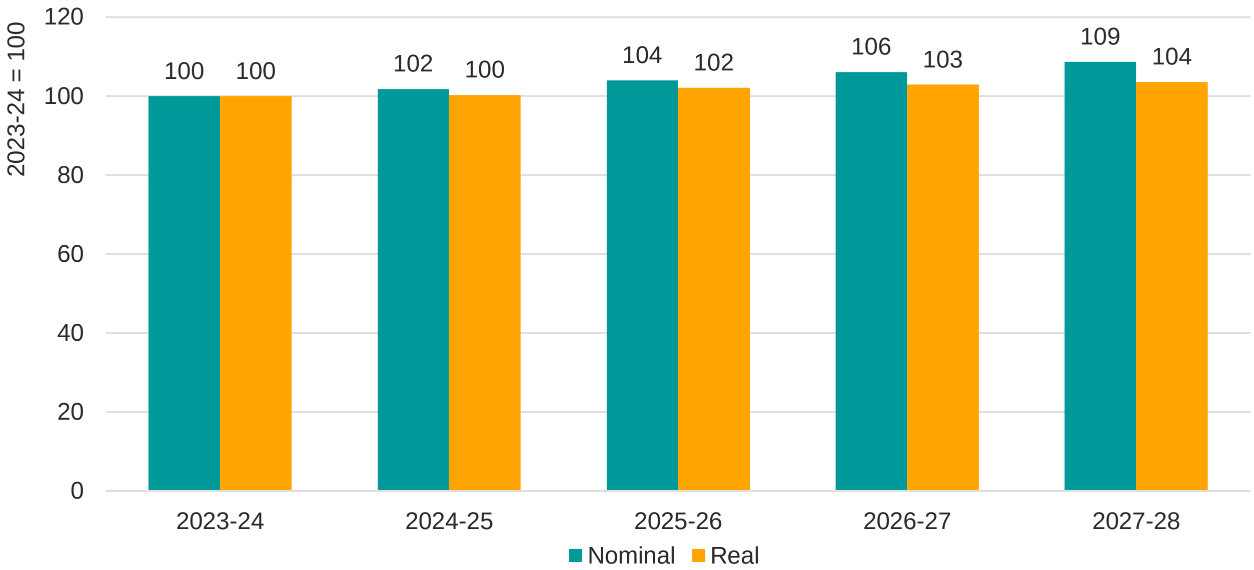
51 The 2023-24 Budget does not include planned resource drawdown from the Scotland Reserve. This is because the available balance is expected to be drawn down to support additional spending in 2022-23. The Scottish Government plans to borrow £41 million within the limit unlocked by negative forecast errors.

Resource funding in the medium term

52 Over the next five years we expect a modest but steady increase in nominal resource funding. Inflation dampens this growth substantially. In 2027-28 we expect the Scottish Government to have 4 per cent more resource funding in real terms than in the 2023-24 Budget. This is shown in

Figure 10. The medium-term funding position is indicative and based on assumptions made by the Scottish Government on the UK Government funding, other sources of income and our forecasts.

Figure 10: Five-year resource funding trends



Source: Scottish Fiscal Commission, Scottish Government.
Amounts indexed so that amount in 2023-24 is equal to 100. Real amounts have been calculated adjusting nominal amounts by the most recent GDP deflators published by the OBR in November 2022 (link).

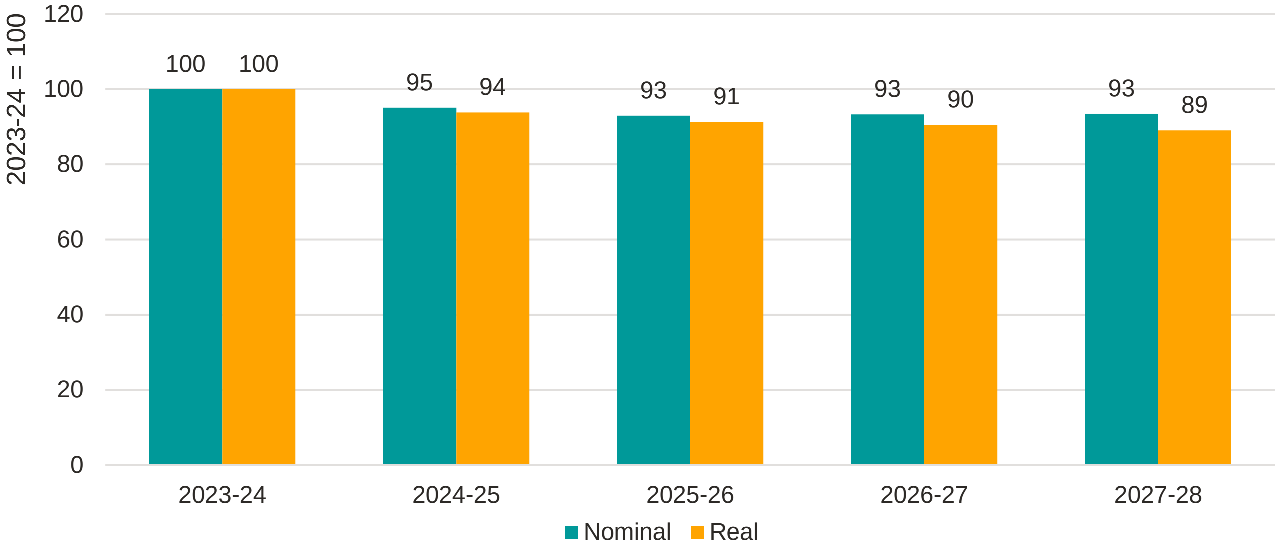
53 Our and the OBR's latest forecasts lead to the projected tax net position being increasingly positive over the medium term. The income tax net position drives this and is forecast to add £1.3 billion to the resource budget in 2027-28. This estimate is illustrative and may change depending on UK and Scottish tax policy and revenues. The large negative income tax reconciliation of £732 million expected in 2024-25 means that the resource budget for 2024-25 is only very slightly higher than for 2023-24 in real terms. This reconciliation will exceed the Scottish Government's resource borrowing limit, reducing resource funding available to portfolios. We expect that spending on devolved social security will increasingly exceed BGA funding because of Scottish Government reforms. Combined devolved and new social security payments are forecast to exceed the BGAs by £1.4 billion in 2027-28. This will reduce funding available to other portfolios.

Capital funding

54 Capital funding accounts for 12 per cent of the Scottish Budget in 2023-24 and is used to fund long-term investments such as infrastructure, hospitals, and research and development. The capital budget is flat in nominal terms between the latest position for 2022-23 and the 2023-24 Budget reflecting a real-terms cut £185 million.

55 As shown in Figure 11, this pressure is expected to continue in the medium term. This reflects less capital funding in nominal terms mainly because of reduced UK Government funding and the impact of inflation. In the 2022 Autumn Statement, the UK Government announced a freeze in capital budgets in cash terms from 2026-27 onwards.

Figure 11: Five-year capital funding trends



Source: Scottish Fiscal Commission, Scottish Government.
Amounts indexed so that amount in 2023-24 is equal to 100. Real amounts have been calculated adjusting nominal amounts by the most recent GDP deflators published by the OBR in November 2022 (link).

Capital reserve and borrowing

56 No reserve drawdowns are assumed to support the capital budget in 2023-24, but the Scottish Government plans to draw down £50 million from the Financial Transactions account. For 2023-24 and subsequent years, the Scottish Government assumes a total of £450 million in funding from borrowing, drawdowns, additional UK consequentials and other sources. The Scottish Government plans to borrow £250 million in 2023-24 and will increase this if the other funding sources do not produce £200 million. We have assessed this borrowing plan to be reasonable. However, we note that it seems unlikely the full £200 million will be available for 2023-24 given UK Government fiscal tightening on capital spending and Scottish Government plans to draw down all reserve funds in 2022-23. The Scottish Government can borrow up to £450 million each year to support capital investment and could increase their borrowing to £450 million in 2023-24. However, successive years of borrowing at that level would move the total debt stock closer to the limit of £3 billion over the next five years.

Chapter 1
Introduction

What is in this report?

1.1 In this report, published on 15 December 2022, we present our latest official five-year economic and fiscal forecasts. We create our forecasts independently, representing the collective judgements of our Commissioners. Our forecasts have been used to inform the Scottish Government's Budget 2023-24. We show how our latest December 2022 forecasts have changed compared to our December 2021 forecasts, in some places such as in the Fiscal Overview we compare to the forecasts we published in May 2022.

1.2 In this introduction we explain the process we have followed in the creation of our forecasts and then how the different elements of our forecasts relate to the Scottish Government's Medium Term Financial Strategy (MTFS) and Resource Spending Review (RSR).

1.3 This report contains the following chapters:

Summary	Our economic and fiscal forecasts, the fiscal overview and the highlights from this round of forecasts.
Chapter 2: Fiscal Overview	The main fiscal changes since our last forecasts. This includes UK Government funding and tax revenues. We assess the Scottish Government's planned borrowing and use of the Scotland Reserve.
Chapter 3: Economy	Our forecasts for the Scottish economy, including the underlying judgements.
Chapter 4: Tax	Our forecasts of devolved tax revenue.
Chapter 5: Social Security	Our forecasts of devolved social security spending.
Annex A: Policy costings	Our estimates of how much any new policies will cost or raise, and explanations of how the Commission has arrived at those estimates.
Annex B: Policy recostings	Our revised estimates of policies previously costed. Recostings may be required because of new outturn data or revisions to assumptions and judgements.
Annex C: Materiality	Our approach to handling policies which have a very small fiscal effect.
Annex D: Update of 2022-23 funding	Explanation of changes to the 2022-23 funding position since May 2022.

The process behind creating these forecasts

1.4 On 6 October 2022, we received notice from the Deputy First Minister of the publication of a Budget on 15 December 2022. Throughout this period, our interaction with the Scottish Government has been guided by our Protocol for engagement.[3]

1.5 Since the formal notification, the Commission has had two rounds of meetings to discuss our forecasts. Attendees included the Scottish Government, Revenue Scotland and Social Security Scotland. In accordance with the Protocol, details of timings and attendees are published on our website.

1.6 To finalise our forecasts for publication, our cut-off date for incorporating new data and information into the forecasts was 23 November 2022. No data or information available after 23 November were included in our forecasts.

1.7 Headline dates are:

6 October	Deputy First Minister wrote to advise that the Scottish Government intended to publish its Budget 2023-24 on 15 December 2022.
23 November	Deadline for inclusion of new data in the forecasts.
28 November	Closure of economy forecasts.
6 December	Scottish Government provided the Commission with final policy measures to be included in the forecasts.
7 December	The Commission presented the Scottish Government with final forecasts.
14 December	Call between Professor Graeme Roy, Chair of the Commission and the Deputy First Minister.
14 December	A pre-release version of the Commission's report was shared with the Deputy First Minister, the Cabinet Secretary for Social Justice, Housing and Local Government and the Minister for Social Security and Local Government.
15 December	Scotland's Economic and Fiscal Forecasts – December 2022 published.

How the Scottish Government uses our forecasts

1.8 On 15 December 2022 the Scottish Government published the Scottish Budget 2023-24 which is informed, in part, by our forecasts. The Budget sets out the Scottish Government's funding position, based on our forecasts of tax revenues, social security spending and assumptions about future funding and borrowing. We discuss these funding plans in Chapter 2. Our tax and social security forecasts are detailed in Chapter 4 and Chapter 5 respectively.

[3] Scottish Fiscal Commission (2022) Protocol for Engagement with the Scottish Government (link).

Chapter 2
Fiscal Overview

Introduction

2.1 This forecast accompanies the 2023-24 Scottish Budget. In this chapter, we compare the funding position for 2023-24 to the latest for 2022-23 and comment on these changes. We discuss how funding has changed since it was estimated in the Scottish Government's May 2022 Resource Spending Review (RSR). We show the indicative funding outlook for the next five years.

2.2 Resource funding in 2023-24 has risen in nominal terms compared to the latest funding position for 2022-23. This is mainly due to an increase in funding via the Block Grant and the projected tax net position becoming more positive than in 2022-23. This is the difference between devolved taxes revenues and their corresponding Block Grant Adjustments (BGAs).

2.3 However, 2023-24 funding is largely unchanged in real terms compared to the latest position for 2022-23. This is because of the level of inflation, which is higher now than at any time since we began producing forecasts in December 2017. The GDP deflator, the measure we use to account for inflation, is forecast to be 4.9 per cent in 2022-23.[4] It has not been this high in the last 15 years other than in the first year of the COVID-19 pandemic.

2.4 Although the 2022-23 and 2023-24 funding positions are similar in real terms, the situation in 2023-24 is considerably better than when it was estimated in the May 2022 RSR. There have been additional consequentials from the UK Government and the tax net position has moved from negative to positive. The final reconciliations that will be applied in 2023-24 are positive and not negative as expected at our May 2022 forecast.

2.5 We expect resource funding levels to increase in real terms over the next five years, but there will be pressure due to additional social security spending. This is a demand-led area of spending for the Scottish Government, so it must be met before other portfolio allocations can be made. For 2024-25 we expect a large negative income tax reconciliation relating to 2021-22, and it is likely to exceed the borrowing limits.

2.6 The capital budget is largely unchanged in nominal terms relative to the 2022-23 position. With inflation being expected to be much higher than previously forecast, that means a real-terms drop in the capital budget.

2.7 For detailed explanations of the different components of funding, we refer readers to our occasional paper, Funding for the Scottish Budget.[5] We aim to use short definitions where possible throughout this chapter.

[4] OBR (2022) Economic and Fiscal Outlook - November 2022 (link).
[5] Scottish Fiscal Commission (2021) Funding for the Scottish Budget - May 2021 (link).

Resource funding

2.8 Resource funding is the largest component of the Scottish Budget and is used for spending on the delivery of public services such as public sector wages, goods and services, grants and subsidies, and social security spending.

Overall position

2.9 Figure 2.1 shows the resource funding available in 2023-24 compared to the most up-to-date estimate of the funding position for 2022-23.[6] The resource budget is almost £1.7 billion, or 3.9 per cent, larger than last year in nominal terms.

Figure 2.1: Resource funding for the 2023-24 Budget

£ million	2022-23	2023-24
UK Spending Review baseline (Barnett) [1]	34,322	34,942
Barnett consequentials	447	1,081
of which: confirmed	406	1,081
of which: assumed	41	0
Non-Barnett funding [1]	704	715
Forecast Scottish devolved revenues [2]	14,646	16,688
Tax and non-tax BGAs	-14,713	-16,131
Social security BGAs	3,703	4,360
Adjustment for past forecast error	82	87
Reconciliations [3]	-15	46
Resource borrowing	97	41
Scotland Reserve drawdown	605	0
Other funding	901	435
of which: confirmed [4]	881	315
of which: assumed [5]	20	120
NDR distributable amount	2,766	3,047
minus: resource borrowing costs	-77	-120
minus: capital borrowing costs	-83	-112
Resource funding available for discretionary spend	43,303	44,991

Source: Scottish Fiscal Commission, Scottish Government.

Figures may not sum because of rounding. Breakdowns for 2022-23 amounts, which are updated taking into account changes since the December 2021 and May 2022 forecasts, can be found in Figure D.1 in Annex D. The comparison between the latest position for 2022-23 and that of 2023-24 is different to that presented by the Scottish Government. The Scottish Government presents changes relative to the 2022-23 position as set at the Budget Bill.

[1] In 2023-24 it consists of £609 million of EU replacement funding (£595 million for farming, £14 million for fisheries), £80 million of Network Rail resource grant, and £26 million from the Bew Review.

[2] Includes £25 million of non-tax revenues (Fines, Forfeitures and Fixed Penalties or FFFPs) in both years.

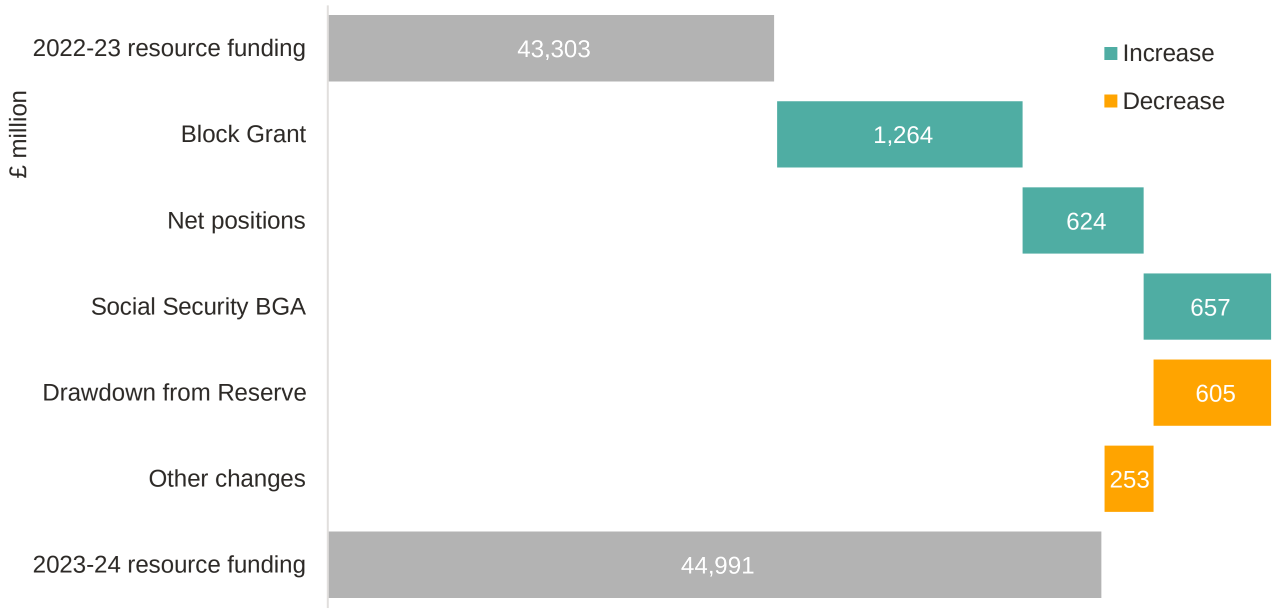
[3] In 2023-24 this is the sum of +£50 million reconciliation for income tax relating to the 2020-21 year, -£35 million and +£31 million for the final reconciliation of fully devolved taxes and devolved social security payments relating to the 2021-22 year.

[4] In 2023-24 it consists of £310 million of profiled ScotWind proceeds and £5 million from the King's and Lord Treasurer's Remembrancer (KLTR).

[5] In 2023-24 this relates to anticipated funding from the Migrant Surcharge, which should be formally confirmed at the time of 2023-24 UK Main Supply Estimates (summer 2023).

[6] See Annex D to see how we arrive at the latest funding position.

Figure 2.2: Change in resource funding from 2022-23 latest position to 2023-24 Budget



Source: Scottish Fiscal Commission, Scottish Government.
Resource funding for 2022-23 is updated taking into account changes since the December 2021 and May 2022 forecasts.

2.10 There are several drivers behind the increase in nominal funding. Figure 2.2 shows the main components, which are:

- A greater Block Grant. The UK Spending Review 2021 settlement for the Scottish Government in 2023-24 was £620 million greater than in 2022-23. The UK Autumn Statement 2022 has then allocated new funding to fully devolved UK Government departments in 2023-24, generating £634 million more Barnett consequentials than previous UK fiscal events have done for 2022-23. There is £11 million more of non-Barnett funding than in 2022-23, all from EU replacement farm funding.

- An improved overall net position comprising the tax net positions and non-tax income.[7] The most recent net position for 2022-23 is -£67 million. For 2023-24 it is forecast to be £557 million, with both income tax and Land and Buildings Transaction Tax (LBTT) contributing to the improvement. The tax net position is the difference between devolved tax revenues and their corresponding BGAs.

- Additional social security BGA funding. This reflects the UK Government decision at the Autumn Statement 2022 to uprate benefits with inflation, and higher demand for payments in the rest of Great Britain in the November 2022 OBR forecasts.

2.11 Slightly offsetting the increases were some small reductions in funding:

- The Scottish Government does not assume any drawdowns from the resource reserve – see the next section on the Scotland Reserve for more details.

- Other changes in funding and forecast error result in a deduction of £253 million. These are mainly an increase in borrowing costs, which must be paid before there is funding available

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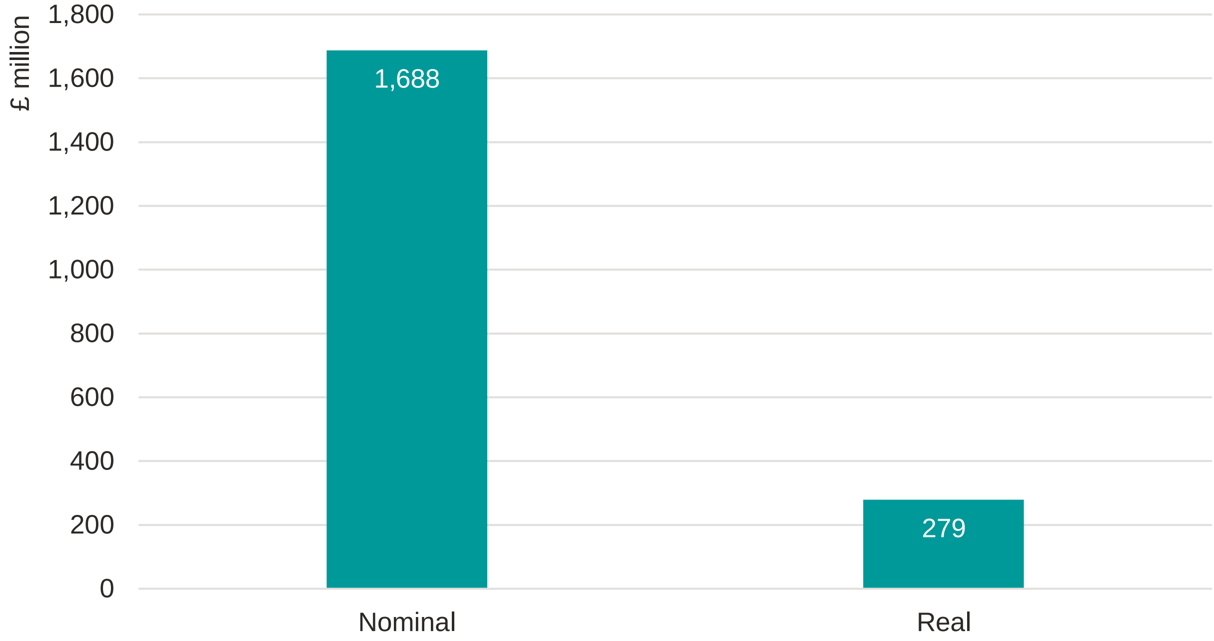
[7] Including non-tax income (FFFPs and Proceeds of Crime). Tax net positions are based on the SFC December 2022 and the OBR November 2022 forecasts for LBTT and SLfT, except for income tax. The net position for income tax is fixed once the Budget is set, and only revisited at the time of final reconciliations, once outturn data are available. Therefore, for income tax the net position is as estimated with the SFC December 2021 and OBR October 2021 forecasts.

for discretionary spend; a decrease of ‘other’ resource funding, which goes down from £901 million to £435 million; and an increase of £281 million in Non-Domestic Rates (NDR) distributable amount, which has factored in our December 2022 forecasts of the contributable amount.

2.12 High inflation means that the increase in resource funding in nominal terms does not result in much greater spending power for the Scottish Government in 2023-24. Figure 2.3 shows that in real terms only an additional £279 million is available compared to the latest funding position for 2022-23.

Figure 2.3: Growth in resource budget from 2022-23 latest position to 2023-24 Budget (2022-23 prices)

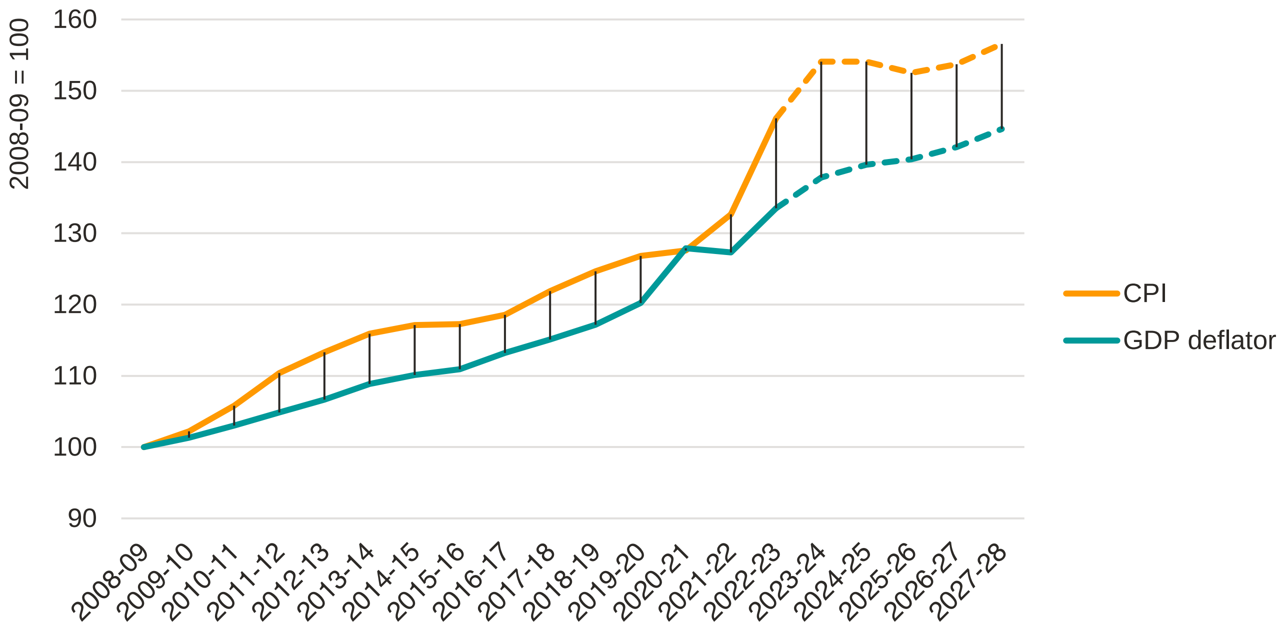


Source: Scottish Government, OBR.
Funding levels for 2022-23 take into account changes since our December 2021 and May 2022 forecasts. The comparison between the latest position for 2022-23 and that of 2023-24 is different to that presented by the Scottish Government. The Scottish Government presents changes relative to 2022-23 as set at the Budget Bill.
Real amounts have been calculated adjusting nominal amounts by the most recent GDP deflators published by the OBR in November 2022 (link).

2.13 The GDP deflator, which is used to adjust public spending for inflation, can behave differently from the Consumer Price Index (CPI) which is the standard measure of how increases in prices affect households. For more details see Box 2.1 of our May 2022 Scotland’s Economic and Fiscal Forecast.[8] This is because of how the GDP deflator is constructed. Figure 2.4 shows historical and forecast change of both indicators, indexed to their respective 2008-09 levels. Historically CPI has generally been higher than the GDP deflator, but that difference is greatest over the coming five years. The Scottish Government consumes imported commodities not captured by the GDP deflator, such as energy. Public sector workers’ expectations of pay increases are likely to be linked more to CPI than to the GDP deflator. Therefore, real-terms amounts shown throughout this chapter potentially underestimate the true scale of inflationary pressure on some areas of Scottish Government resource spending. As shown in in Figure 2.4, this difference is particularly large for 2023-24.

[8] Scottish Fiscal Commission (2022) Scotland’s Economic and Fiscal Forecasts – May 2022 (link).

Figure 2.4: Evolution of GDP Deflator and CPI



Source: Scottish Fiscal Commission, OBR (2022) Economic and fiscal outlook – November 2022 (link).

Scotland Reserve

2.14 The 2023-24 Budget does not include planned drawdown from the resource Reserve. As Figure 2.5 shows, the available balance, which is projected to be full at the end of 2021-22, is used to support additional spending in 2022-23. Underspends may arise during the remainder of the 2022-23 year and could be redeployed within 2022-23 or deferred through the Scotland Reserve. The same plan applies also to the capital account.

Figure 2.5: Scotland Reserve balances

£ million	2021-22	2022-23	2023-24
Resource			
Opening balance	405	605	0
Drawdowns	-405	-605	0
Additions	605	0	
Closing balance	605	0	0
Capital			
Opening balance	7	81	0
Drawdowns	-7	-81	0
Additions	81	0	
Closing balance	81	0	0
Financial transactions (FTs)			
Opening balance	197	14	0
Drawdowns	-197	-14	-50
Additions	14	0	
Closing balance	14	0	-50

Source: Scottish Fiscal Commission, Scottish Government.
Shaded cells refer to the Scottish Government's projected final outturn.

2.15 The 2023-24 Budget is set with £50 million planned to be drawn down from the financial transactions (FTs) account. This means that an underspend in the FTs budget in 2022-23 will be necessary or the repayment of gross FTs to the UK Government will have to be managed to leave at least £50 million in the FTs reserve at the end of 2022-23.

Other income

2.16 The Scottish Government plans to use 41 per cent, or £310 million, of the proceeds generated by the ScotWind auction process to support spending in 2023-24.[9] This is in line with plans set out in the May 2022 RSR.

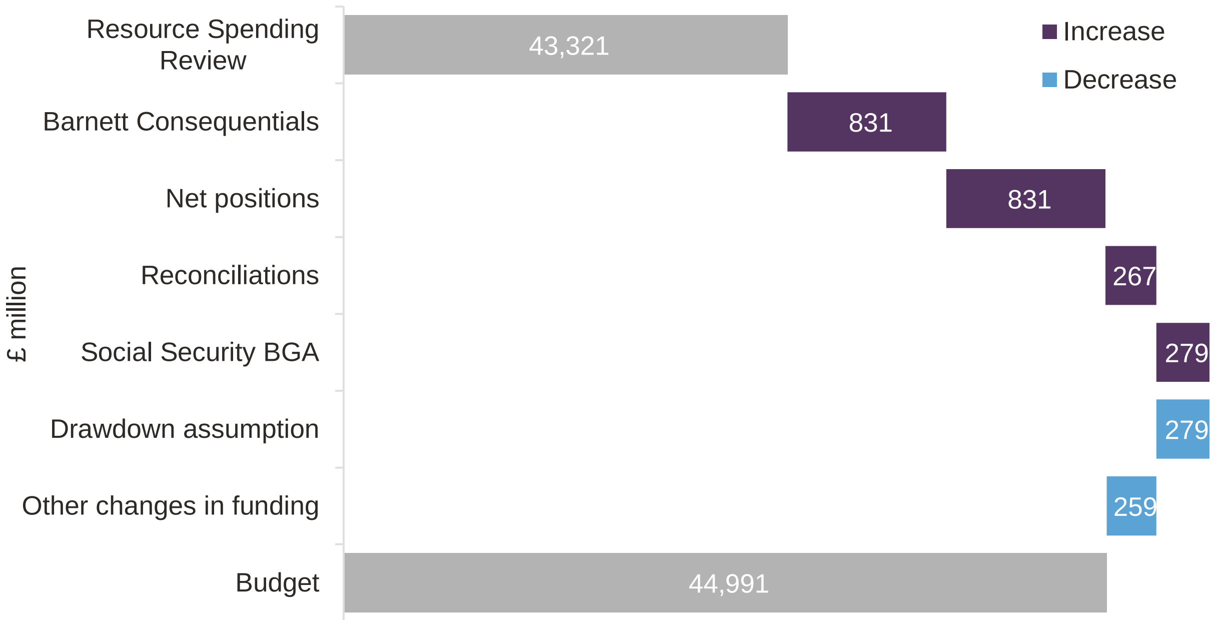
2.17 Other income also comprises £5 million from the King's and Lord Treasurer's Remembrancer and an assumed £120 million from the Migrant Surcharge.

Changes in funding for 2023-24 since the May 2022 RSR

2.18 The May 2022 Resource Spending Review (RSR) sets out the Scottish Government's spending plans from 2023-24 to 2026-27. Spending allocations were based on funding estimates made using Scottish Government assumptions and our May 2022 forecasts.[10] The RSR set a framework for future spending, but the funding position and spending allocations for each year are subject to changes. Funding for 2023-24 has changed since then and has implications for spending plans.

2.19 Figure 2.6 shows how the nominal-terms funding levels for 2023-24 have changed relative to what had been estimated in May 2022 as part of the RSR. This nominal change in funding does not reflect the effects of inflation on the budget, which is higher than was estimated when the RSR was published. The nominal terms increase in funding is £1.7 billion.

Figure 2.6: Changes to 2023-24 funding since May 2022 RSR (Nominal Terms)



Source: Scottish Fiscal Commission, Scottish Government.

[9] The first round of auctions of ScotWind, including the clearing process, generated £756 million. £96 million have been profiled in 2022-23, £310 million in 2023-24 and the RSR plan is to use the balance in 2024-25.
[10] Scottish Fiscal Commission (2022) Scotland's Economic and Fiscal Forecasts – May 2022 (link).

2.20 As with the increase in funding from 2022-23 to 2023-24, the changes to 2023-24 funding since the RSR in May 2022 are mainly driven by:

- An increase in the Block Grant, as Barnett consequentials have been generated from new UK Government spending in devolved areas announced at the Autumn Statement 2022.
- A significant improvement to the tax net positions following our December 2022 forecasts and the BGAs, which were recalculated based on the OBR's November 2022 forecasts.
- Tax reconciliations to the 2023-24 Budget, we expected these to be negative in May 2022, but these will be positive following the release of outturn data for 2020-21 (income tax) and 2021-22 (all other devolved taxes and social security).
- The social security BGA added a small increase of £272 million.

2.21 Changes which remove funding from 2023-24 include:

- The removal of the resource reserve drawdown planned at the RSR. As explained in paragraph 2.14, use of the Reserve in 2022-23 means we do not expect there will be any balance to drawdown.
- Other changes including a decision to take out less resource borrowing; an increase in borrowing costs; and a reduction in the NDR distributable amount given the latest forecasts of the NDR contributable amount.
- Extra inflation not captured by the March 2022 GDP deflators, which erodes real-terms funding further.

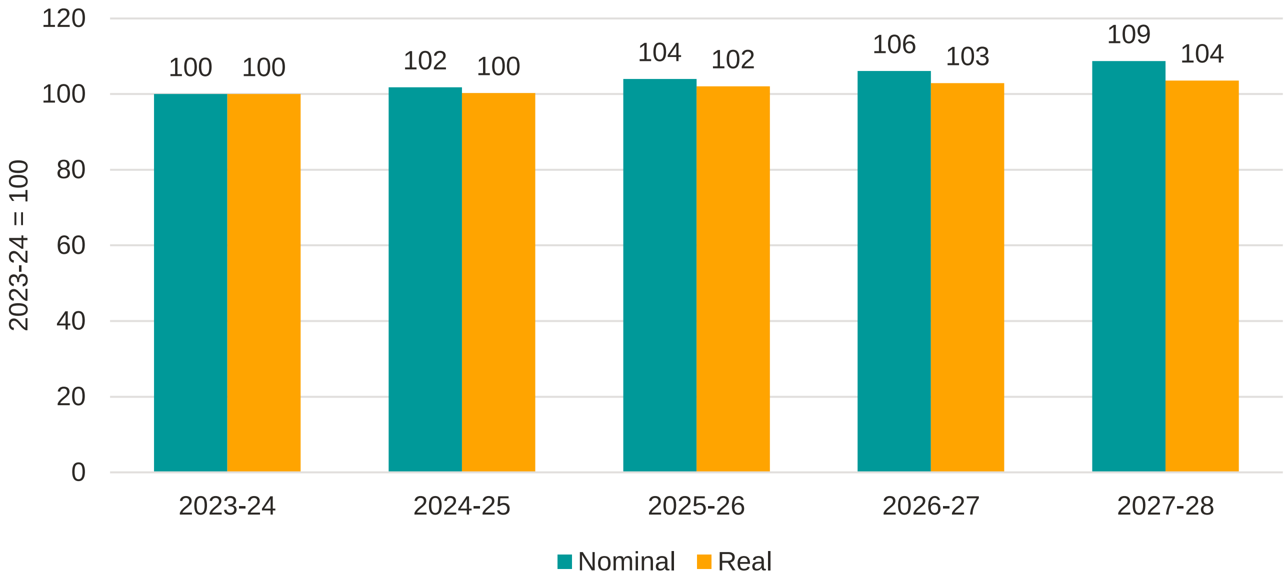
2.22 The result of all these movements is that the 2023-24 funding position is £1.3 billion greater in real terms than when it was estimated in May 2022 for the RSR.[11] However, that figure potentially understates the actual impact of inflation, as discussed in paragraph 2.13.

Five-year outlook

2.23 Figure 2.7 shows that we expect nominal resource funding levels to increase modestly but steadily throughout the next five years. This is based on our medium-term forecasts and assumptions from the Scottish Government. Inflation dampens this increase substantially, but by the end of the five-year period the Scottish Government is expected to have 4 per cent more resource funding in real terms than in the 2023-24 Budget. The medium-term outlook is indicative and is likely to change.

[11] Since May 2022, an additional £1.7 billion in funding has been made available for 2023-24. We now expect inflation to be higher than we did in May. This increase in forecast inflation affects the whole resource budget, not just the additional funding. After taking both factors into account, the funding position for 2023-24 is £1.3 billion higher in real-terms than we forecast in May.

Figure 2.7: Five-year resource funding trends



Source: Scottish Fiscal Commission, Scottish Government.
Amounts indexed so that amount in 2023-24 is equal to 100. Real amounts have been calculated adjusting nominal amounts by the most recent GDP deflators published by the OBR in November 2022 (link).

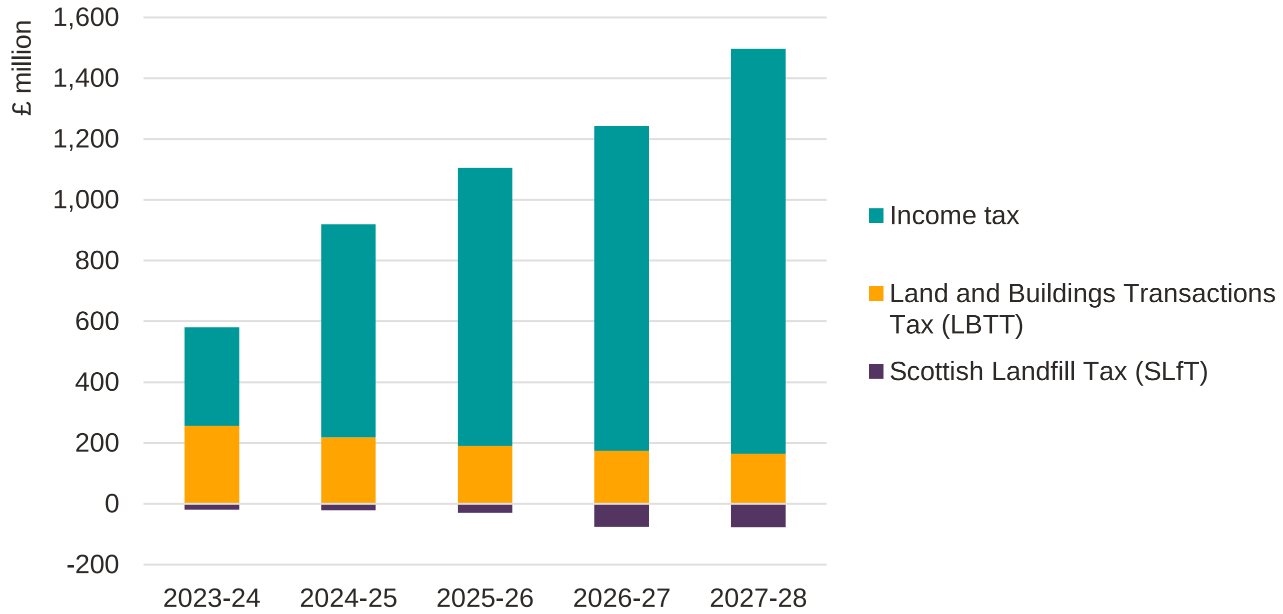
2.24 The change in funding levels reflects the direction set in the Autumn Statement 2022. The UK Government outlined that from 2025-26, after the current UK Spending Review, public spending would grow slower than previously planned. Spending plans have been capped to grow by 1 per cent a year in real terms, rather than in line with nominal UK GDP growth. This would result in savings of up to £42 billion for the UK Government over three years relative to previous plans.[12]

2.25 This will slow growth in the Scottish Block Grant through the application of the Barnett formula. However, the UK Government has allocated an additional £15.5 billion in the next two years to fully devolved areas, generating substantial Barnett consequentials for the remaining two years of the UK Spending Review. The consequentials for 2023-24 and 2024-25 may become part of the baseline Block Grant for later years if the UK Government does not deem this additional funding to be a one-off. This would help offset the slower growth in UK overall resource spending planned for after the UK Spending Review. The Scottish Government has assumed this in the indicative funding information depicted in Figure 2.7. We will assess the reasonableness of this, and other funding assumptions made for the years beyond 2023-24, at the next Medium Term Financial Strategy.

2.26 Following the UK Spending Review, UK Government policy plans on spending reduce the assumed levels of resource funding, however, our projection of the tax net position goes in the opposite direction driving a growth in resource funding towards the end of the five years. This is shown in Figure 2.8. The main driver is income tax and we note the income tax net position to subject to change and uncertainty. Income tax is forecast to raise more revenues than its BGA removes from the Scottish Government budget. One factor in this is the Scottish Government policy to raise additional income tax through freezing thresholds at lower levels than the UK Government in England and Northern Ireland, and to increase tax rates relative to those areas. Chapter 4 covers this in more detail.

[12] UK Government (17 November 2022) Autumn Statement 2022: Table 5.1 – Policy Decisions (link)

Figure 2.8: Projection of tax net positions



Source: Scottish Fiscal Commission, OBR.
Tax net positions are the difference between the December 2022 SFC forecasts of devolved tax revenue and the Block Grant Adjustments (BGAs) calculated with the November 2022 forecasts from the OBR.

2.27 The tax net positions are projected based on available data, they are indicative and are updated as more timely data become available. See section 'The income tax net position' in Chapter 4 for further discussion of how the income tax net position can be subject to change. Small changes in the OBR or our forecasts can move the projected net position. This is particularly relevant now with heightened inflation and geopolitical risks adding to uncertainty.

2.28 We expect social security spending to put pressure on resource allocations to portfolios in the medium term. Social security BGAs are included in funding for the Scottish Budget and our forecasts set the budget for social security spending. The social security net position is the difference between specific funding through social security BGAs and devolved payments. Figure 2.9 shows the social security net position becoming increasingly negative over time and spending on new payments adding progressively to the social security bill.

Figure 2.9: Social security net position and new payments

£ million	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Social security net position [1]	-11	-194	-421	-584	-689	-775
New social security payments [2]	-363	-582	-625	-627	-636	-642
Total	-374	-776	-1,046	-1,212	-1,325	-1,416

Source: Scottish Fiscal Commission.
Figures may not sum because of rounding.
[1] Social security net position includes Adult Disability Payment (covered by the Personal Independence Payment BGA), Child Disability Payment and Scottish Adult Disability Living Allowance (covered by the Disability Living Allowance BGA), Pension Age Disability Payment (covered by the Attendance Allowance BGA), Scottish Carer's Assistance and Carer's Additional Person Payment (covered by the Carer's Allowance BGA), Employment Injury Assistance (covered by the Industrial Injuries Disablement Scheme BGA), Winter Heating Payment (covered by the Cold Weather Payment BGA), Pension Age Winter Heating Payment (covered by the Winter Fuel Payment BGA) and Severe Disablement Allowance (covered by Severe Disablement Allowance BGA).
[2] Social security new payments include Scottish Child Payment, Carer's Allowance Supplement, Child Winter Heating Assistance, Best Start Grant Early Learning Payment and Best Start Grant School Age Payment. We also include spending on bedroom tax and Benefit Cap mitigation through Discretionary Housing Payments.

2.29 For devolved social security payments the Scottish Government has made changes to eligibility and operational delivery which have led us to forecast that spending will increasingly exceed BGAs.

2.30 Taking the social security net position and new payments together shows how much greater spending on social security will be than the funding received. Figure 2.9 shows that this almost doubles from £776 million in 2023-24 to £1,416 million in 2027-28. Within existing expectations of funding, this means social security will account for an increasing proportion of Scottish Government resource spending, putting pressure on funding for other portfolios. Further information on social security forecasts and funding is presented in Chapter 5.

2.31 As in previous forecasts, in 2024-25 we still expect a large negative reconciliation relating to 2021-22 income tax revenues, which we currently estimate at -£732 million. This would exceed the resource borrowing limit of £300 million per year, so the balance would need to come from other sources. The projected increase in funding in 2024-25 would otherwise be greater, both in nominal and real terms.

2.32 Although the expectation is that there will be more resource funding over time in real terms, it does not necessarily mean there will be more money available for day-to-day public services as a result of the challenge arising from inflationary pressures that may not be captured in the GDP deflator. Figure 2.9 shows that we forecast increases in the social security spending over and above what is funded by the UK Government. As it currently stands, these demand-led payments will reduce resource funding for other portfolios.

Resource assessment

2.33 The Scottish Government has set the 2023-24 Budget based on our tax and social security forecasts, UK Government spending plans, plans for using the Scotland Reserve and borrowing, and assumptions on other income sources. We consider the Scottish Government's funding assumptions and borrowing plans for the 2023-24 Budget to be reasonable.

2.34 The resource budget for 2023-24 is similar to that of 2022-23 in real terms, with increases in the Block Grant and tax revenues mostly offset by high rates of inflation. The Scottish Government is likely to face challenges balancing its spending plans against the resource budget available. For example, social security spending is forecast to increase more than the BGA funding and inflationary pressures on some areas of government spending might exceed those captured by our standard inflation measure, the GDP deflator.

2.35 However, the funding position has become less challenging than it was forecast in May 2022. This is a result of increased funding from the UK Government through Barnett consequentials and social security BGAs, along with stronger tax revenues in Scotland improving the tax net position. The reconciliations that will be applied in 2023-24 are now positive rather than negative. On the other hand, the Scotland Reserve was an important source of funding in 2022-23, but there is currently no scope to draw from it in 2023-24. Between 2021-22 and 2022-23, it has been used at its full capacity.

2.36 The combined effect of these changes is that there is £1.3 billion more resource funding for 2023-24 in real terms than estimated in May 2022. However, we have highlighted that the impact of inflation may be understated and may erode the value of the additional resource.

2.37 The Scottish Government profiled the proceeds from ScotWind at the RSR given an estimated funding outlook in May 2022. At the time, 2023-24 looked challenging because of both an expected negative income tax position and a negative indicative tax reconciliation. Although both have been reversed, and Barnett consequentials have increased, the allocation of ScotWind funds has not changed. In May 2022, we encouraged the Scottish Government to reconsider this profiling should other funding become available. As noted, the additional £1.3 billion in real terms since May 2022 is based on the GDP deflator, which might not capture the true scale of cost pressures for all portfolios. However, we also highlight upcoming pressures from the large reconciliation in 2024-25 and pressures from social security spending in future years. We, therefore, encourage the Scottish Government to continue to monitor the profiling of the ScotWind proceeds and to consider this, alongside pressures coming for future years, in the next Medium Term Financial Strategy.

2.38 While the estimated funding position for 2023-24 has improved since May 2022, the outlook for later years is more constrained. We continue to expect that spending on devolved social security will exceed the funding received through BGAs because of the reforms introduced by the Scottish Government. This demand-led component of spending will reduce funding available to other portfolios. Similarly, we still expect a large negative reconciliation in 2024-25, which will exceed the Scottish Government's resource borrowing limit and will reduce funding that would otherwise be available to portfolios.

Capital funding

2.39 Capital funding is used for long-term investment such as hospitals, roads, and research and development. Financial transactions are a special type of capital funding which is used to make loans to or buy stakes in private sector entities to attain capital investment policy goals.

Overall position

2.40 Figure 2.10 shows that capital funding levels for 2023-24 are largely unchanged in nominal terms relative to the 2022-23 Budget. However, with the increase in inflation, its real value in 2023-24 is substantially lower than in the previous year.

Figure 2.10: Capital funding for the 2023-24 Budget

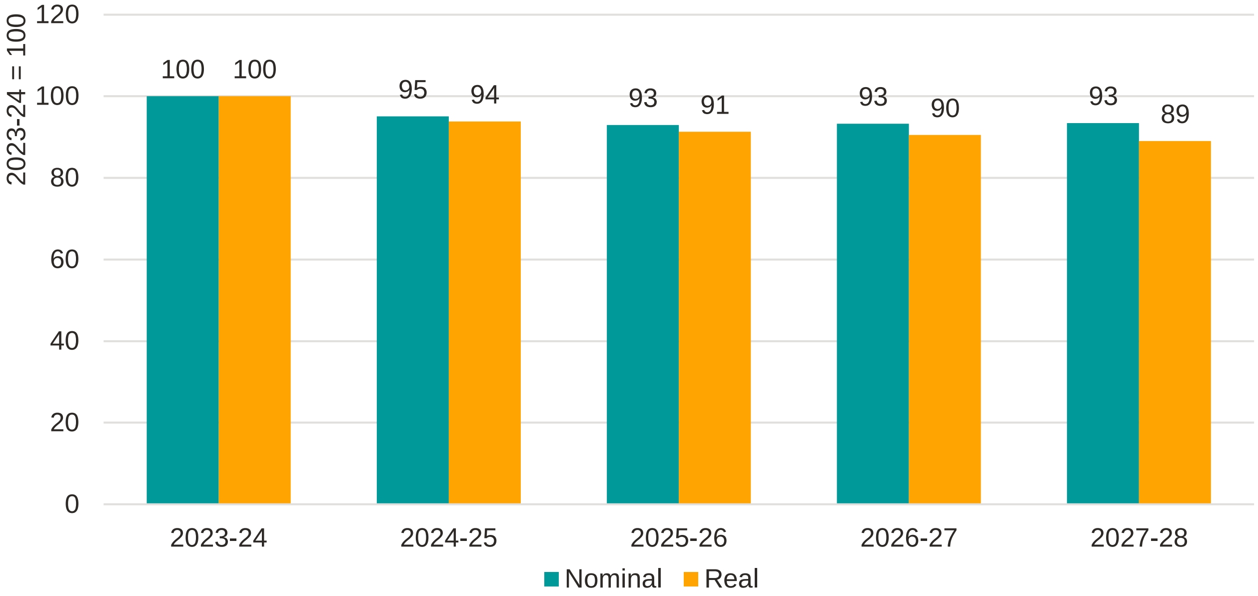
£ million	2022-23	2023-24
Capital (Excluding FTs)		
UK Spending Review baseline (Barnett)	4,469	4,757
Barnett consequentials	13	0
Non-Barnett funding [1]	718	632
Capital borrowing	450	250
Scotland Reserve drawdown	81	
Other funding	132	300
of which: assumed [2]	20	300
of which: confirmed	112	
Total capital funding (excluding FTs)	5,863	5,939
Financial transactions		
UK Spending Review baseline (Barnett)	466	186
Scotland Reserve drawdown	14	50
Other funding	0	188
of which: assumed [3]	0	188
Total financial transactions	480	424
Total capital funding	6,343	6,363

Source: Scottish Fiscal Commission, Scottish Government.
Figures may not sum because of rounding. Breakdowns for 2022-23 amounts, which are updated taking into account changes since the December 2021 and May 2022 forecasts, can be found in Figure D.2 in Annex D. The comparison between the latest position for 2022-23 and that of 2023-24 is different to that presented by the Scottish Government. The Scottish Government present changes relative to 2022-23 as set in the Budget Bill.
[1] In 2023-24 it consists of £632 million of Network Rail capital grants.
[2] In 2023-24 it consists of £100 million of anticipated City Deals and £200 million of funding arising from either additional consequentials or underspends carried forward to the reserve. If these fail to materialise, capital borrowing will increase to plug the gap.
[3] Relates to compensation from HM Treasury for a historical error in how FTs had been allocated. The amount has not yet been confirmed.

Five-year outlook

2.41 Unlike for resource funding, Figure 2.11 shows that capital funding (including FTs) is expected to fall notably in nominal terms in 2024-25. From then, we expect it to remain frozen at a slightly lower level, while inflation gradually erodes its real-terms value.

Figure 2.11: Five-year capital funding trends



Source: Scottish Fiscal Commission, Scottish Government.
Amounts indexed so that amount in 2023-24 is equal to 100. Real amounts have been calculated adjusting nominal amounts by the most recent GDP deflators published by the OBR in November 2022 (link).

2.42 Compared to our May 2022 forecast, the capital funding outlook for 2026-27 and 2027-28 is more constrained. This is a result of the UK Government Autumn Statement 2022 announcing a freeze in capital budgets in cash terms from the end of the current UK Government Spending Review period, from 2025-26 onwards. This policy has been reflected in the OBR's forecasts of capital investment, which the Scottish Government uses for its estimates of capital Barnett funding after the UK Spending Review period. Capital funding is frozen from 2025-26 at a lower level than in previous years as the Scottish Government assumes FTs funding will not continue after the UK Spending Review.

Borrowing

2.43 The Scottish Government's approach to capital borrowing is to secure £450 million a year from all sources of funding other than the UK Spending Review baseline. This comprises £250 million a year through borrowing repayable within 15 years, and £200 million through Scotland Reserve drawdowns, unanticipated consequentials, redeployments in-year and other capital funding sources. If some or all of the £200 million does not emerge, the Scottish Government will increase borrowing to make up for the shortfall.

2.44 For 2022-23, currently the Scottish Government deems the £200 million of other funding unlikely to arise. Therefore, although this is a neutral change in terms of capital funding levels, the Scottish Government has revised up its borrowing plans to £450 million. This ensures the projected borrowing costs, which affect the 2023-24 Budget, are as prudent as possible. However, these plans may change over the remainder of 2022-23. £450 million is the maximum that can be borrowed under the fiscal framework.

2.45 For the 2023-24 Budget, Figure 2.11 shows that the planned borrowing reverts to the standard approach, where the Scottish Government aims to keep the borrowing at £250 million a year and this is the basis for the projected borrowing costs affecting the resource budgets in future years beyond 2023-24.

Capital assessment

2.46 The capital budget has reduced by £185 million in real terms (2022-23 prices) compared to the latest capital funding position for 2022-23. The capital budget will continue to be constrained in real and nominal terms over the forecast period.

2.47 In May 2022 we concluded that the new approach to capital borrowing was reasonable and more sustainable than the previous one. We recommended that the £200 million of assumed capital funding from other sources be risk-assessed and reviewed yearly and committed to monitor whether the other sources of funding emerged.

2.48 For 2022-23, the first year in which the new approach has applied, borrowing plans have been revised up to £450 million as the assumed other funding is now deemed less likely to emerge. Although these plans may change, if confirmed they would affect how sustainable the current approach to capital borrowing is.

2.49 In 2023-24, the Scottish Government has set the capital budget assuming £200 million will come from sources other than borrowing. However, the UK Autumn Statement 2022 did not result in any capital consequentials for the remainder of the UK Spending Review period, and it set out that capital budgets for UK Government departments will be frozen in nominal terms for the next few years. This makes new Barnett consequentials less likely. The Scottish Government plans to use all accrued funds in the capital reserve to support investment in 2022-23, though it is assumed £50 million will be drawn down. Therefore, in 2023-24 reserve drawdowns are less likely to be a source to support the £200 million of other capital funding required to sustain the borrowing policy.

2.50 The capital debt stock is currently at 60 per cent of the overall limit.[13] Interest rates have almost trebled since May 2022, which slows the repayment of principal on the first half of the life of the loans. Given the latest borrowing plans for 2022-23, our models suggest that the Scottish Government will have to either reduce the baseline borrowing or take out loans at durations shorter than 15 years by the early 2030s to remain within the fiscal framework limits. A one-off instance in which some or all those £200 million of assumed funding do not materialise and borrowing is used to meet the shortfall means the adjustment would have to come sooner and be of a greater scale.

2.51 Conversely, if other funding exceeded £200 million in one or more years, and the Scottish Government reduced capital borrowing below £250 million, the approach would once again become sustainable. The Scottish Government would also safeguard additional capacity for future borrowing, provided the £200 million remained likely to emerge every year.

2.52 Therefore, we find the capital borrowing plans for 2023-24 to be reasonable. However, it is less likely that the assumed £200 million of other income used in setting the 2023-24 Budget will emerge, given UK Government capital spending plans and the situation of the capital reserve. This brings a risk to applying the same funding assumptions and borrowing plans for future years.

[13] Projected to increase to 73 per cent with the latest 2022-23 borrowing plans.

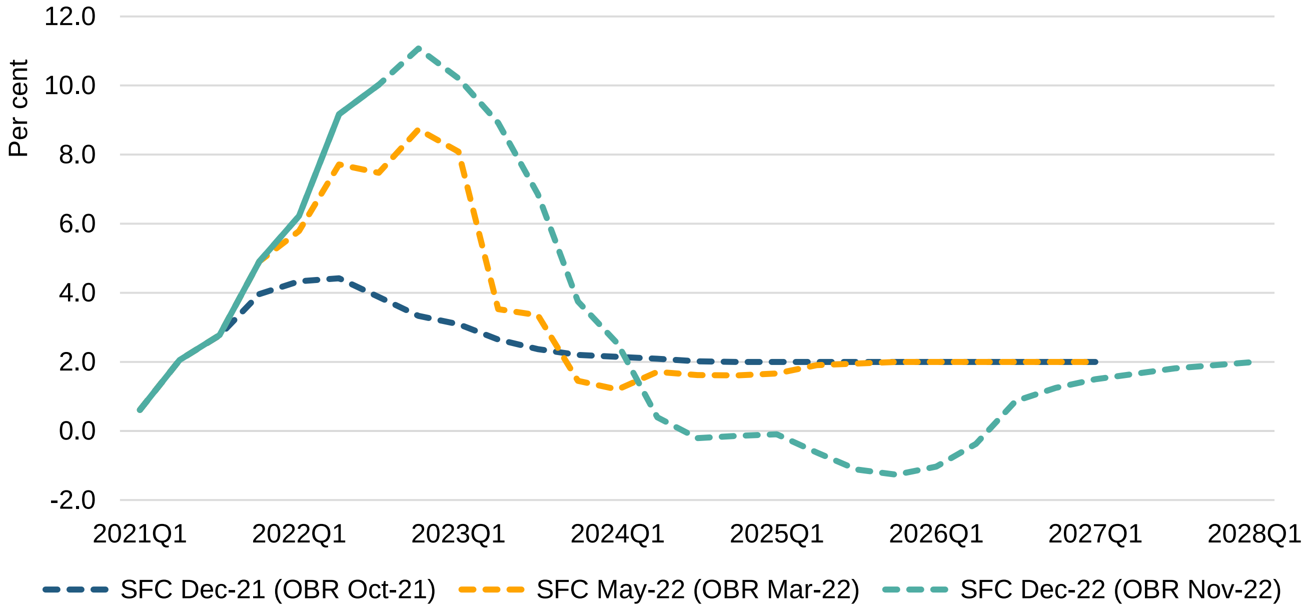
Chapter 3
Economy

Forecast summary

3.1 The near-term outlook for the Scottish and UK economies has weakened significantly over the course of the year. The rise in energy and traded goods prices being driven by the conflict in Ukraine has been greater than expected earlier in the year, pushing up inflation. Interest rates have risen to levels not seen since before the 2008-09 Global Financial Crisis. All of this has intensified the costs for households and businesses. Falling real incomes mean the coming years are going to be difficult for many households, particularly those with lower incomes.

3.2 We expect annual Consumer Price Index (CPI) inflation to peak at around 11 per cent in 2022 Q4. The peak is lower than it might have been in the absence of the UK Government's Energy Price Guarantee. Inflation looks set to drop sharply over the course of next year as global energy prices level off and domestic inflationary pressures unwind due to the recession.

Figure 3.1: Consumer Price Index inflation, year-on-year growth

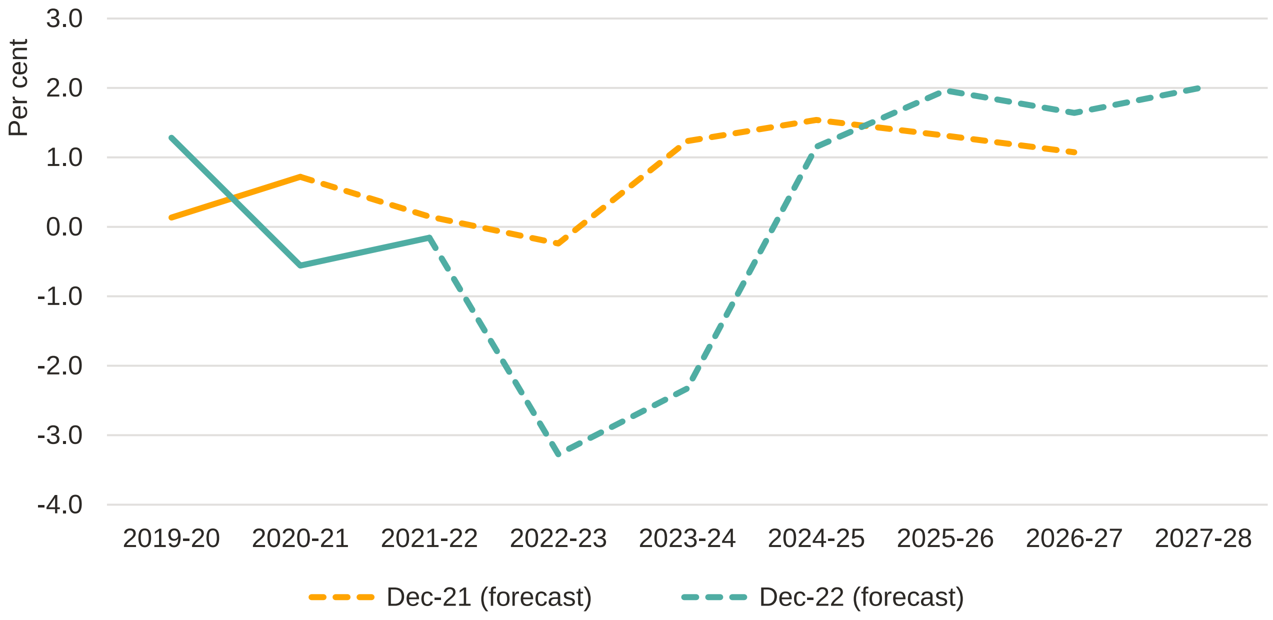


Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2022) Scotland's Economic and Fiscal Forecasts – May 2022 (link), Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – December 2021 (link), OBR (2022) Economic and fiscal outlook – November 2022 (link), OBR (2022) Economic and fiscal outlook – March 2022 (link), OBR (2021) Economic and fiscal outlook – October 2021 (link).
Solid lines refer to outturn available at time of publication and dashed lines refer to forecasts.

3.3 High inflation means that, over this year and next, Scottish households are expected to see the biggest fall in their real disposable income since records began in 1998. Even once inflation returns to lower levels, and real household incomes start to grow again in 2024-25, living standards will take time to recover to the pre-crisis 2021-22 level. Our forecast suggests that, by 2025-26, real disposable income per person will be no higher than its level a decade earlier. The global shock prolongs a period of slow growth in living standards since the Global Financial Crisis, with real disposable income per person growing on average by only 0.4 per cent per year between 2008-09 and 2021-22 compared to around 3 per cent before 2008-09.

3.4 High inflation and the recession will affect everyone, but there will be particular pressures on lower-income households, as they spend a larger share of income on essentials such as energy and food. Rising interest rates will add to the costs of mortgages and other forms of debt. Compared to the UK as a whole, Scotland has lower average house prices and lower average household debt as a share of income, which means that rising interest rates will tend to have a smaller effect than in the rest of the UK.

Figure 3.2: Real disposable income per person growth



Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – December 2021 (link), Scottish Government (2022) GDP Quarterly National Accounts (QNA): 2022 Quarter 2 (April to June) (link).
Solid lines refer to outturn available at time of publication and dashed lines refer to forecasts.

3.5 When the global energy price shock arrived in early 2022, the Scottish economy was still recovering from the impact of health restrictions, labour shortages and supply chain disruptions associated with the global Coronavirus (COVID-19) pandemic. Throughout 2022, the impact of higher energy prices and the acceleration of wage pressures has worsened. The economy has also been adjusting to Brexit as well as the long-term evolution of the oil and gas industry in the North East of Scotland. There is no comparable period in recent economic history when the economy has been hit by two global shocks in immediate succession while adjusting to other significant domestic pressures.

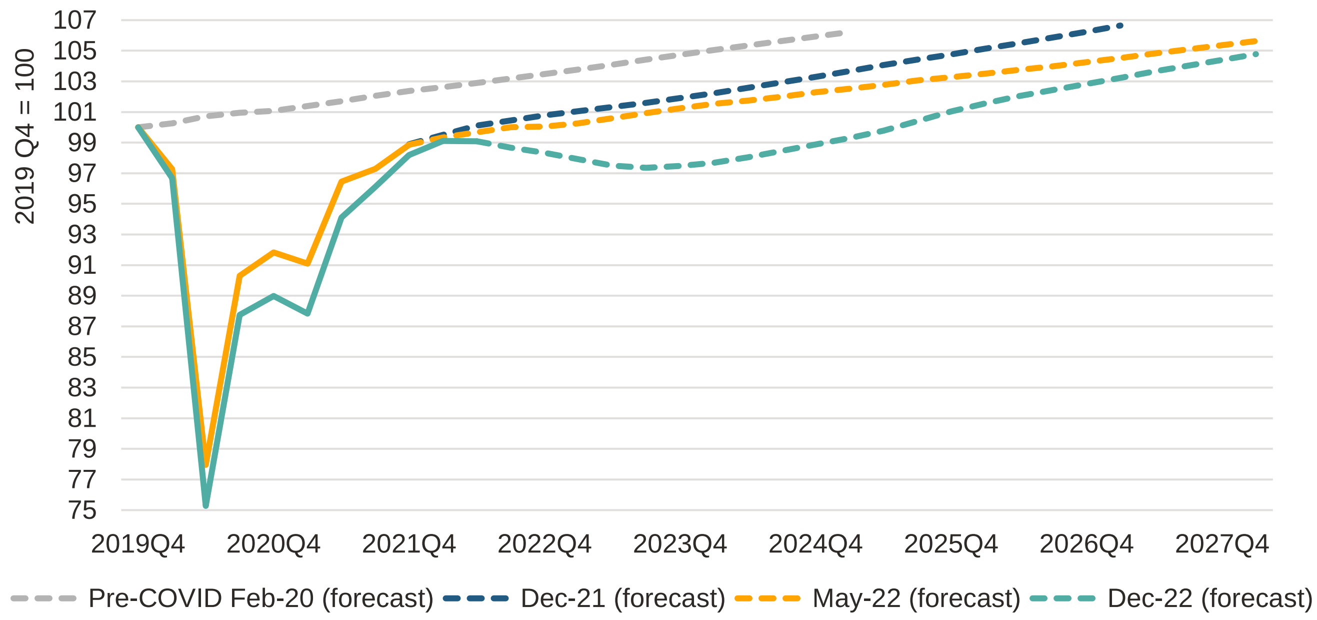
3.6 The underlying structure of the Scottish economy is undergoing profound shifts. The pandemic has resulted in shifts in demand and changes in labour markets including more people working from home, while some people are suffering from prolonged health effects, in part due to delays in NHS treatment. At the same time, the economy faces higher goods import prices as a result of the continuing COVID-19 restrictions in China. Rising energy prices are a terms of trade shock that the economy has to adapt to by using less energy at a higher cost. This will be a particular issue for energy intensive industries that find it difficult to pass on higher costs to consumers. Brexit is also having an effect on supply chains and on export markets for Scottish business.

3.7 Over the longer term, the size of Scotland's economy is determined by its potential output. In the current context, both the underlying capacity of the Scottish economy to produce goods and services – its potential output – and the outlook for productivity growth are uncertain. We have reduced our view of the size of Scotland's potential output in recent forecasts, and are therefore forecasting a lower level and cumulative growth rate of Gross Domestic Product (GDP). This can be seen in Figure 3.3.

3.8 In the shorter term, largely reflecting the energy price shock and its inflationary consequences, our judgement is that Scotland has already entered a recession which will last six quarters, with a total peak to trough fall in GDP of 1.8 per cent. Higher prices will mean real incomes fall and put the economy into recession via both a supply and demand side shock. The recession will be dampened by higher nominal pay awards, increased benefits payments and some households running down savings to support spending. Following the inflation shock, the level of real incomes in Scotland will be lower and expected to take time to recover. Although prolonged, we expect the recession will be shallower than the Global Financial Crisis or the COVID-19 recession.

3.9 The precise magnitude and duration of the recession are uncertain. While there is a lot of focus on the specific path for growth over the short term, we consider that the level of GDP in Scotland over the longer term is the most important aspect. Despite the relatively shallow nature of the recession, it is important to see it in the context of a prolonged period of slow economic growth. This slow growth is the result of globally slowing productivity growth as well as the shocks outlined at the start of this section. Sustained lower levels of GDP, relative to what we would have expected to be the case without these shocks, will mean ongoing lower incomes and will put pressure on tax receipts and public spending.

Figure 3.3: Scottish GDP, outturn and forecast



Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2022) Scotland's Economic and Fiscal Forecasts – May 2022 (link), Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – December 2021 (link), Scottish Fiscal Commission (2020) Scotland's Economic and Fiscal Forecasts – February 2020 (link).
Solid lines refer to outturn available at time of publication and dashed lines refer to forecasts.

3.10 We expect the recession in Scotland to broadly mirror the UK recession forecast by the Office for Budget Responsibility (OBR). Peak to trough, we forecast the Scottish economy to shrink by 1.8 per cent, compared to the OBR's forecast for the UK of 2.1 per cent. We expect the Scottish economy to recover to its pre-recession peak by the first quarter of 2025, one quarter behind the UK.

3.11 As in all our forecasts, there is significant uncertainty around the economic outlook, in this case arising from global developments. Energy prices and inflation will continue to depend on how the situation in Ukraine evolves. Another important source of uncertainty is how high inflation affects wages. So far, pay awards have remained below inflation, resulting in falling real earnings. However, with unemployment relatively low, it is possible that workers will find they can bargain for stronger pay awards, affecting both the real terms earnings outlook and potentially inflation.

3.12 We continue to monitor our Scottish Uncertainty Index, published for the first time in our August 2021 forecast report.[14] The updated indicator, up to October 2022, can be found in the economy supplementary tables accompanying this report. It shows a rise in uncertainty after Russia's invasion of Ukraine at the start of 2022 and has remained relatively elevated in recent months. Overall, uncertainty is comparable with that of the UK as a whole.

3.13 Figure 3.4 shows further detail on our latest economy forecast and compares it to our December 2021 forecast, which pre-dated the Russian invasion of Ukraine.

Figure 3.4: Headline economy forecasts, growth rates unless otherwise specified

Per cent	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
GDP							
December 2021	10.4	2.2	1.2	1.3	1.4	1.4	
December 2022	14.0	1.7	-1.0	1.2	2.1	1.9	1.5
Consumer Price Index							
December 2021	3.3	3.7	2.3	2.0	2.0	2.0	
December 2022	4.0	10.1	5.5	0.0	-1.0	0.8	1.8
Average nominal earnings							
December 2021	3.8	2.6	3.0	3.2	3.3	3.4	
December 2022	4.2	4.4	4.1	2.5	2.1	2.7	3.2
Average real earnings							
December 2021	0.6	-0.8	0.7	1.1	1.3	1.4	
December 2022	0.0	-4.4	-0.8	2.2	2.7	1.7	1.3
Employment							
December 2021	1.3	1.0	0.1	-0.1	-0.2	-0.2	
December 2022	1.7	1.7	-0.5	-0.2	0.3	0.5	0.4
Unemployment rate							
December 2021	4.6	4.5	4.3	4.2	4.2	4.2	
December 2022	3.9	3.4	4.3	4.7	4.6	4.3	4.1

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – December 2021 (link).
Shaded cells refer to outturn available at time of publication. Nominal earnings are adjusted for inflation using the Consumer Expenditure Deflator.

[14] Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – August 2021 (link).

3.14 Our economy forecasts were finalised on 23 November 2022. No new data or information received after this date were incorporated into the forecasts.

Forecast comparisons

3.15 Figure 3.5 shows how our December 2022 forecast of GDP growth in calendar years compares to a range of other forecasts for Scotland and the UK.

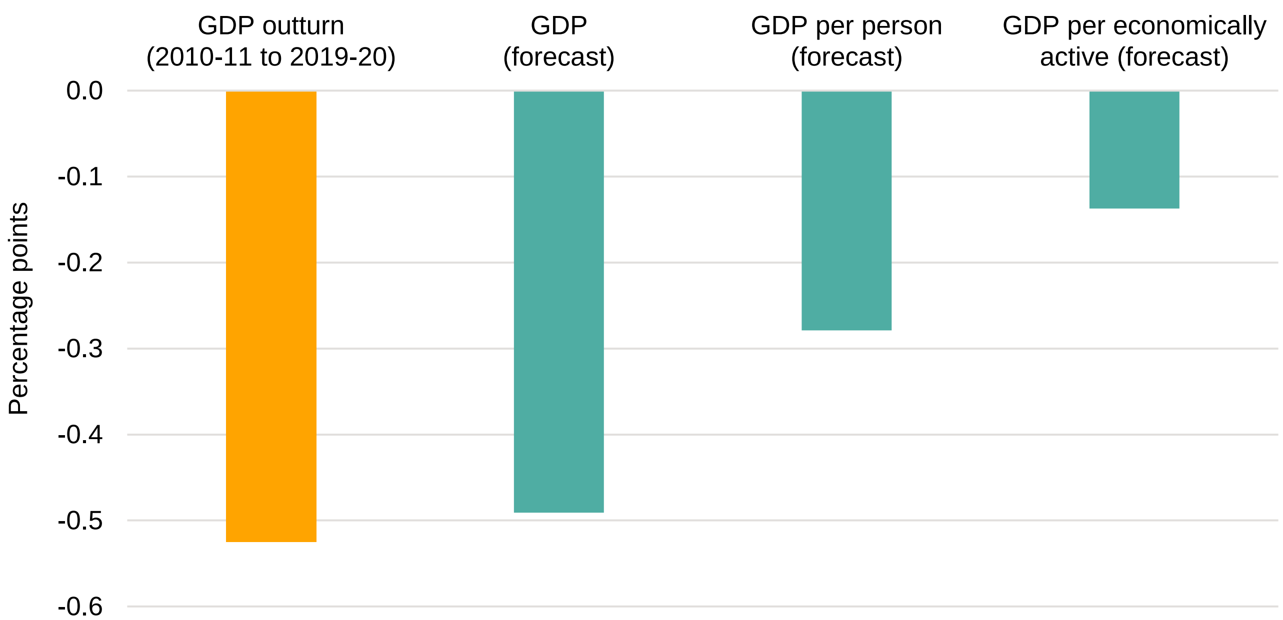
Figure 3.5: Forecast comparison, GDP growth rates in calendar years

Per cent	2021	2022	2023	2024	2025	2026	2027
Scotland: SFC December 2022	7.9	5.0	-1.2	0.7	1.9	2.1	1.6
Scotland: FAI October 2022	7.9	3.6	-0.6	0.8			
UK: OBR November 2022	7.5	4.2	-1.4	1.3	2.6	2.7	2.2
UK: NIESR November 2022	7.5	4.6	0.7	1.7	1.6	1.6	1.6
UK: BoE November 2022	7.5	4.25	-1.5	-1.0	0.5		
UK: HMT average of forecasters Nov 2022	7.5	4.2	-0.9				

Source: Scottish Fiscal Commission, Fraser of Allander Institute (2022) FAI Economic Commentary 2022 Q3 (link), OBR (2022) Economic and fiscal outlook – November 2022 (link), NIESR (2022) UK Economic Outlook – November 2022 (link), Bank of England (2022) Monetary Policy Report – November 2022 (link), HM Treasury (2022) Forecasts for the UK economy: November 2022 (link).

3.16 Compared to the OBR's forecasts for the UK, we forecast annual GDP growth in Scotland to be around 0.5 percentage points lower on average from 2023-24 to 2027-28. Figure 3.6 shows this gap in forecast growth rates is in line with historical outturn data over the last decade. This divergence exists mainly because of slower population growth, with the gap nearly halving on a 'GDP per person' basis. Once demographics and differences in labour market trends are also accounted for, that is on a 'GDP per economically active' basis, there is a remaining small gap of 0.1 percentage points. This remaining divergence exists mostly because of differences in our and the OBR's forecasts of the output gap in 2023-24.

Figure 3.6: Average annual gap in GDP growth between Scotland and UK, 2023-24 to 2027-28



Source: Scottish Fiscal Commission, OBR (2022) Economic and fiscal outlook – November 2022 (link).
Orange bar refers to outturn available at time of publication and teal bars refer to forecasts.

3.17 To allow comparisons of our headline GDP forecasts in financial and calendar year terms, Figures 3.7 and 3.8 show our latest and previous forecasts of GDP growth on both annual bases.

Figure 3.7: SFC latest and previous forecasts, GDP growth rates in financial years

Per cent	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
December 2021	10.4	2.2	1.2	1.3	1.4	1.4	
December 2022	14.0	1.7	-1.0	1.2	2.1	1.9	1.5

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – December 2021 (link).

Figure 3.8: SFC latest and previous forecasts, GDP growth rates in calendar years

Per cent	2021	2022	2023	2024	2025	2026	2027
December 2021	6.7	3.8	1.3	1.3	1.4	1.4	
December 2022	7.9	5.0	-1.2	0.7	1.9	2.1	1.6

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – December 2021 (link).

Main judgements

Figure 3.9: Economy forecast main judgements

Issue	December 2021	December 2022
1. Spare capacity, or output gap	Output gap was -10.7 per cent of trend GDP in 2020-21, gradually returning to zero	Output gap of around -2 per cent of trend GDP emerging in 2023-24, as GDP falls below trend following the recession, before gradually returning to zero
2. Trend productivity	Growth of 0.6 per cent in 2021-22 and 1.1 per cent in 2022-23, increasing to 1.7 per cent in 2026-27	Growth of 0.1 per cent in 2022-23 and 0.5 per cent in 2023-24, increasing to 1.1 per cent in 2027-28 broadly in line with OBR's November 2022 assumption
3. Long-run unemployment rate	4.2 per cent over the forecast period	4.1 per cent over the forecast period
4. Nominal average annual earnings	Growth of 3.8 per cent in 2021-22, boosted by compositional effects. Growth increasing from 2.6 per cent in 2022-23 to 3.4 per cent in 2026-27	Growth of 4.4 per cent in 2022-23 and 4.1 per cent in 2023-24, reducing to 3.2 per cent in 2027-28
5. Population projections	Scottish population aged 16 to 64 falls every year from 2020-21 onwards	Scottish population aged 16 to 64 peaks at mid-2023, then shrinks throughout the forecast
	Net international migration based on the ONS 2018-based '0 per cent net EU' scenario of around 4,000 annually	Net international migration of 19,000 in 2020-21 (outturn), 30,000 in 2021-22, and 29,000 in 2022-23. For 2023-24 onwards, revised up to the ONS interim 2020-based principal scenario of around 10,000 annually, in line with OBR's November 2022 assumption
6. Forecasts of the UK	Based on OBR UK October 2021 forecast	Based on OBR UK November 2022 forecast
7. Oil and gas	North Sea oil and gas activity contributes to slower recovery in GDP, employment and earnings in Scotland than in the UK	Neutral impact of UK Continental Shelf activity on onshore economy
8. Savings ratio	Savings ratio spiked to almost 20 per cent in 2020-21, falling in 2021-22 to nearly reach its long-run average of 8 per cent	Savings ratio in 2023-24 falling to its long-run average of around 9 per cent, and remaining broadly stable at that level over the forecast
9. Second round effects	No material effect of any Scottish Government policy changes on economic growth	No change

Source: Scottish Fiscal Commission

Developments in the Scottish economy

UK Continental Shelf oil and gas activity

3.18 The conflict in Ukraine has prompted a push for greater energy independence, including plans for new net zero compatible oil and gas projects and commitments to accelerate the transition to renewables and low carbon energy sources.[15] In addition, while volatile, high oil prices have helped raise investors' confidence within the industry.

3.19 Due to the maturity of the basin, it is unlikely that future investment and production will fundamentally reverse the long-run structural decline of the oil and gas sector in Scotland. However, we now expect a more stable outlook for North Sea activity over the next five years, with a neutral effect on the onshore economy.

3.20 As a result, we no longer expect that the performance of the oil and gas sector will be a factor that lowers Scotland's employment and average earnings growth relative to the UK over the next five years.

GDP and expenditure components

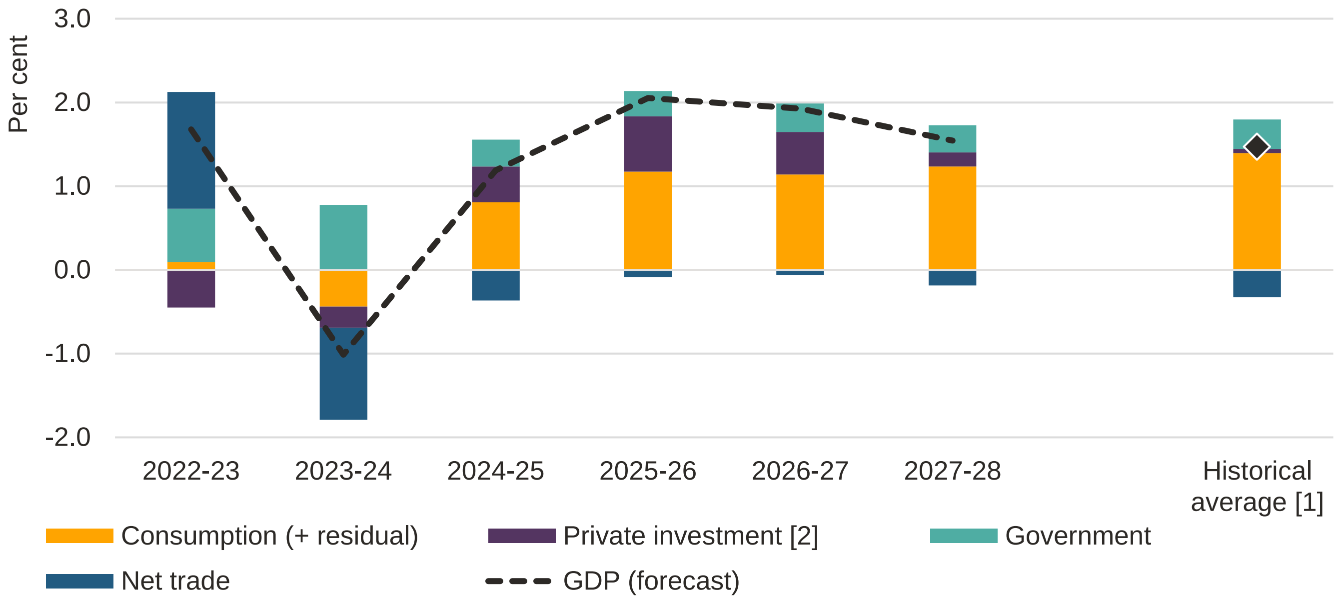
3.21 Falling real incomes and higher interest rates are weighing on demand and driving the economy into recession in the short term. Overall, we forecast GDP to decline by 1.0 per cent in 2023-24, before growing 1.2 per cent in 2024-25. GDP growth is expected to stay elevated in the following years as demand catches up to meet the potential output of the economy.

3.22 We expect the fall in real disposable incomes will lead to a drop in household expenditure in 2023-24. Consumption increases from 2024-25 onwards as real household incomes gradually recover. The savings ratio is expected to fall from its pandemic highs over this year and next, which will support consumption. However, it will likely remain around its long-run average as higher interest rates might limit the extent to which households run down their savings to sustain discretionary spending, or indeed lead some households to increase precautionary savings.

3.23 Business investment also declines in 2023-24 but grows thereafter as the economy recovers from the recession. Government expenditure is increased in 2023-24, supporting the economy through the downturn, but its contribution to GDP growth diminishes significantly in later years in line with lower spending plans by the Scottish and UK Governments. The UK recession and global economic slowdown mean the contribution of net trade to GDP is negative in 2023-24, before turning broadly neutral over the rest of the forecast horizon.

[15] Department for Business, Energy and Industrial Strategy (2022) British energy security strategy (link)

Figure 3.10: Contributions to growth in GDP by component of expenditure



Source: Scottish Fiscal Commission, Scottish Government (2022) GDP Quarterly National Accounts (QNA): 2022 Quarter 2 (April to June) (link).
[1] Historical average is based on growth from 1999-00 to 2019-20.
[2] Private investment includes business and housing investment.

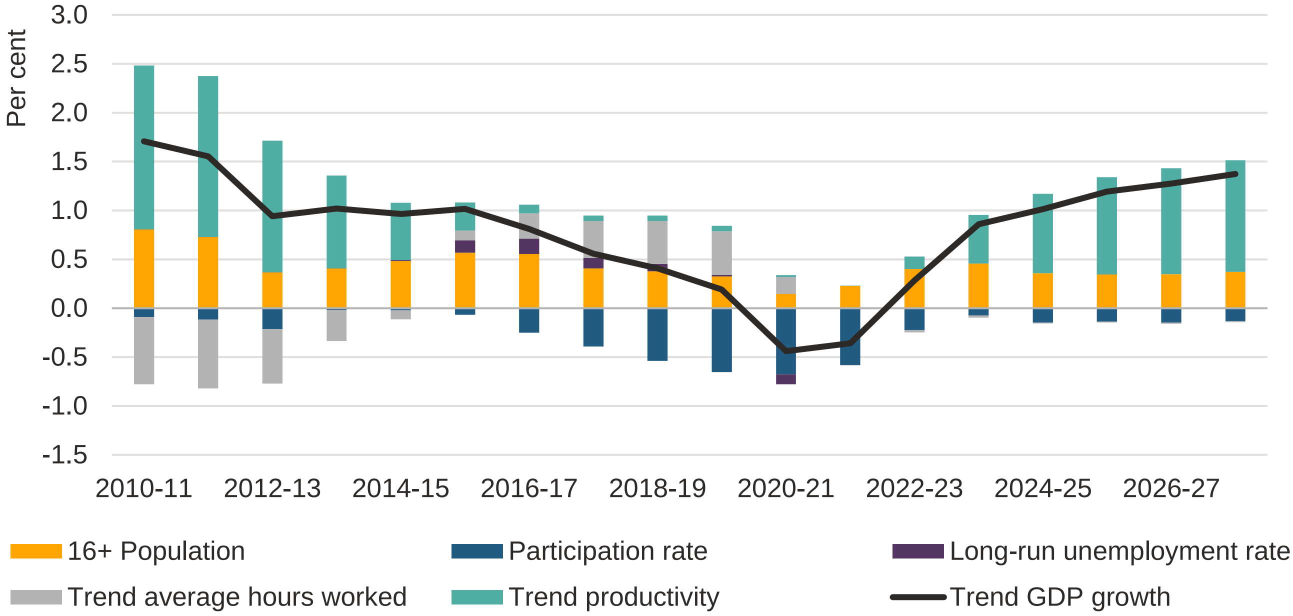
Long-run outlook

3.24 Trend GDP is based on: the capacity of the economy to supply and efficiently allocate the labour force; the average numbers of hours worked; and advances in technology, working practices, and human and physical capital that drive trend productivity growth.

3.25 Scotland's trend GDP growth rate has been slowing since the Global Financial Crisis, averaging 0.9 per cent between 2010-11 and 2019-20 compared to 2.0 per cent between 1999-00 and 2009-10. This has been driven by falling productivity and population growth and a declining participation rate. We expect productivity growth to pick up, in line with the expected path at UK level, and to be the main driver of trend GDP growth over the medium to long term. Trend GDP growth rises over the forecast period from 0.9 per cent in 2023-24 to 1.4 per cent in 2027-28.

3.26 Growth in trend GDP is 0.3 percentage points higher in 2027-28 than we forecast in May 2022. This is because of higher outturn and forecast population growth and an upward adjustment to our participation rate projection for people aged over 65. These factors more than offset a downward revision to productivity growth due to the impact of higher input prices for businesses.

Figure 3.11: Trend GDP growth and contribution of components, 2010-11 to 2027-28



Source: Scottish Fiscal Commission

Figure 3.12: Trend GDP growth and contribution of components, 2020-21 to 2027-28

Year (growth in per cent)	Trend GDP growth	16+ population	16+ participation rate	Long-run unemployment rate	Trend average hours worked	Trend productivity
2020-21	-0.4	0.1	-0.7	-0.1	0.2	0.0
2021-22	-0.4	0.2	-0.6	0.0	0.0	0.0
2022-23	0.3	0.4	-0.2	0.0	0.0	0.1
2023-24	0.9	0.5	-0.1	0.0	0.0	0.5
2024-25	1.0	0.4	-0.1	0.0	0.0	0.8
2025-26	1.2	0.3	-0.1	0.0	0.0	1.0
2026-27	1.3	0.3	-0.1	0.0	0.0	1.1
2027-28	1.4	0.4	-0.1	0.0	0.0	1.1

Source: Scottish Fiscal Commission
Figures may not sum because of rounding.

Trend GDP growth components

The labour force and employment capacity

3.27 We have long been forecasting a declining participation rate in Scotland, driven by demographic change, recent data on participation rates in different age groups, and the effects of the pandemic. Overall, declining labour force participation continues to act as a drag on trend GDP. In August 2022, we published a report setting out the long-term fiscal pressures that arise from Scotland's demographic trends.[16] This was in preparation for our Fiscal Sustainability Report which will be published in March 2023.

[16] Scottish Fiscal Commission (2022) Trends in Scotland's population and effects on the economy and income tax (link).

3.28 Since our previous forecasts, we have been reviewing how we incorporate a rising State Pension age into our projections of labour market participation for people aged over 65. Consistent with emerging trends in labour market statistics, we have revised upwards our projection of the participation rate for people aged over 65 to better reflect the impact of the 2026-28 State Pension age rise. This increases our overall participation rate projection, so that there is less of a decline over the forecast period.

3.29 The pandemic saw a fall in the labour force, particularly for people aged 50 to 64.[17] There has been some discussion recently about the relationship between increasing ill health in the UK and Scotland and its effect on labour market participation. We discuss rising ill health in **Chapter 5 Box 5.3**. However, a recent Institute of Fiscal Studies (IFS) study showed that rising inactivity at the UK level for those aged 50 to 64 has been because of a large outflow from employment into retirement rather than health-related inactivity. In addition, the IFS and other studies found that those citing health reasons for their inactivity are largely people who have already been inactive for several years and so more distant from the labour market. [18] If rising ill health continues to be limited mostly to the long-term economically inactive population then there is unlikely to be much of an effect on the participation rate, but more widespread inactivity due to ill health is a downside risk to the labour force participation that we will continue to monitor.

3.30 We have also revised up our total population projections and this results in a small increase in our forecast for the size of the labour force.

3.31 Outturn migration data has been stronger than expected since the start of the pandemic and HMRC data show high levels of visa applications. Scotland has also welcomed over 20,000 Ukrainians since the Russian invasion.[19] As the conflict continues, we assume that high international migration for 2021-22 continues into 2022-23. These factors together increase the mid-2023 population projection by around 70,000 compared to our December 2021 forecast. From 2023-24, we move to the ONS principal assumption for migration which gives around 10,000 net inward international migration each year, 6,000 people per year higher than the 0 per cent net EU assumption we had been using previously. The higher migration assumption from 2023-24 increases the size of the labour force by around 15,000 by 2027-28.

Productivity and hours worked

3.32 Productivity growth has been slowing globally since the Global Financial Crisis of 2007-08 in what is known as the productivity puzzle.[20] Other global challenges exacerbating the long-term decline in productivity growth include the COVID-19 pandemic and the Russian invasion of Ukraine which have increased energy prices.

3.33 Long-term challenges specific to Scotland's productivity growth include productivity disparities between regions and low levels of business investment. Upside factors include strong finance and energy sectors and a highly educated workforce.[21]

3.34 Following the 2015 oil price crash, there has been negligible average growth in output per hour worked. In light of recent higher oil and gas prices and energy security issues, our judgement is that

[17] Office for National (2022) HI11 Regional labour market: Headline indicators for Scotland (link)
[18] Institute for Fiscal Studies (2022) Is worsening health leading to more older workers quitting work, driving up rates of economic inactivity? (link), Financial Times (2022) Britons now have the worst access to healthcare in Europe, and it shows (link), ONS (2022) Half a million more people are out of the labour force because of long-term sickness (link).
[19] Scottish Government (2022) Ukraine Sponsorship Scheme in Scotland: statistics – November 2022 (link)
[20] Bank of England (2017) Productivity puzzles – speech by Andy Haldane (link)
[21] The Productivity Institute (2021) Scotland's Productivity Challenge: Exploring the issues (link)

oil and gas activity in Scotland will not act as a drag on the Scottish economy over the medium term. This means a higher productivity and earnings growth contribution from this sector. Longer term, as oil and gas production in the North Sea declines, there are opportunities for the oil and gas sector to transition into renewables, but it remains to be seen if this can generate the same level of economic activity as oil and gas production.

3.35 The downside of higher oil and gas prices is that it increases costs for the general public and businesses, which in turn weighs on productivity growth.

3.36 On balance, we expect productivity growth to pick up over the medium term and to be the main driver of growth of Scotland's economy. We project trend productivity growth of 0.5 per cent in 2023-24, rising to 1.1 per cent by 2027-28 which is similar to the OBR's forecast of potential productivity growth for the UK. This is 0.2 percentage points lower than we forecast in May 2022, reflecting the impact of higher input prices for businesses.

Comparisons to the OBR

3.37 Figure 3.13 shows that Scotland has lower forecast population growth and a slightly weaker projection for the labour force participation rate than the OBR's forecasts for the UK. These differences mean Scottish GDP growth is around 0.4 percentage points lower in the final year of the forecast.

Figure 3.13: SFC and OBR trend GDP growth and contribution of components in 2027-28

Forecast (growth in per cent)	Trend GDP growth	16+ population	16+ participation rate	Long-run unemployment rate	Trend average hours worked	Trend productivity
SFC Dec-22	1.4	0.4	-0.1	0.0	0.0	1.1
OBR Nov-22	1.7	0.6	0.0	0.0	0.0	1.2
Gap	-0.4	-0.2	-0.1	0.0	0.0	0.0

Source: Scottish Fiscal Commission, OBR (2022) Economic and fiscal outlook – November 2022 (link).
Figures may not sum because of rounding. Potential output growth is approximately equal to the sum of the growth rates of population, employment rate, average hours and productivity.

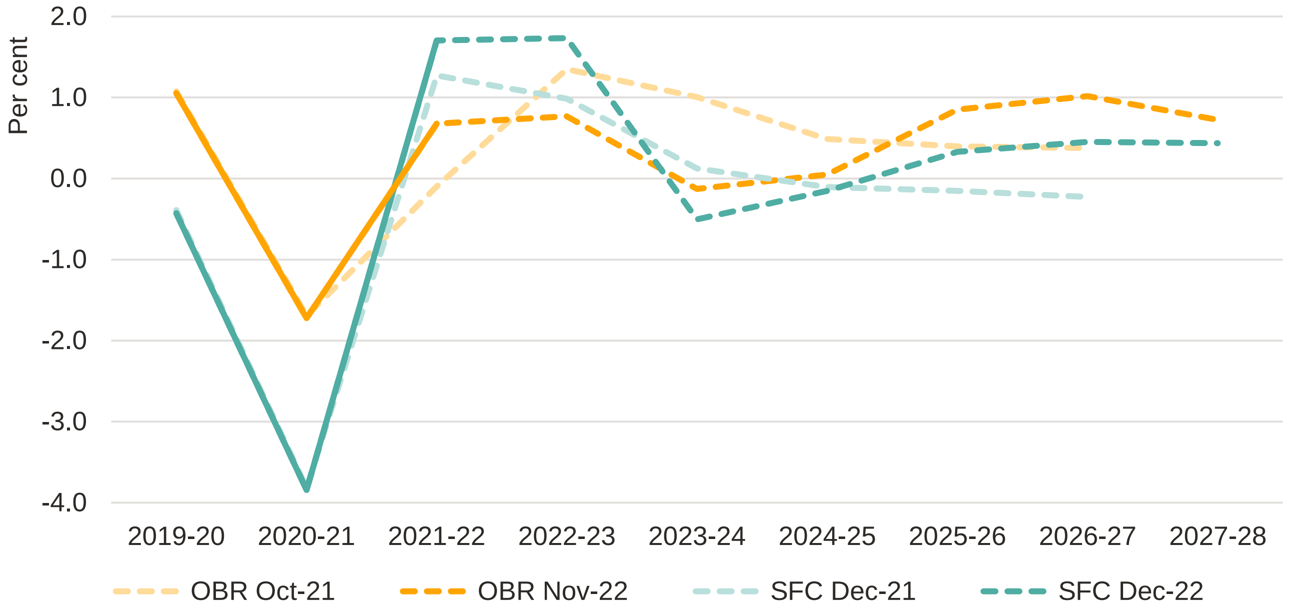
Labour market

3.38 As the recession takes hold, we forecast that the unemployment rate rises from its current historical lows to a peak of 4.7 per cent in 2024 Q4. This is still lower than most past recessions. The rise in unemployment lags the fall in GDP, as it is likely that vacancies will first fall from their current record-high levels before redundancies are made. The unemployment rate then falls gradually over the rest of the forecast towards its long-run trend of 4.1 per cent.

3.39 Reflecting the economic downturn and rising unemployment, we now expect lower employment growth in 2023-24 than we forecast in December 2021. This downward revision is partly offset by the new adjustment we incorporated for the 2026-28 State Pension age increase, which has resulted in a higher labour market participation rate and therefore a larger labour force and higher employment than would otherwise have been the case. This means that our downward revision of 2023-24 employment growth is smaller than the OBR's for the UK, contributing to a positive shift in the income tax net position in 2023-24.

3.40 In later years, our employment growth forecast is higher than in December 2021, reflecting a higher population growth forecast and the upward adjustment to our participation rate projection of those aged over 65. Figure 3.14 shows our latest December 2022 forecast of employment growth, alongside our December 2021 forecast and the OBR's forecasts for the UK.

Figure 3.14: Employment growth, SFC Scotland and OBR UK



Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – December 2021 (link), OBR (2022) Economic and fiscal outlook – November 2022 (link), OBR (2021) Economic and fiscal outlook – October 2021 (link).
Solid lines refer to outturn available at time of publication and dashed lines refer to forecasts.

Earnings

3.41 Nominal average earnings growth has risen over the course of 2022-23 compared to our previous forecasts but remains below inflation. Nominal pay growth is in line with ongoing tightness in the labour market, driven by a combination of record-high vacancies and a shrinking labour force in the wake of the pandemic, as well as with higher inflation. We expect nominal pay growth to remain above our previous forecasts in 2023-24, with inflation becoming the main factor in pay settlements. Meanwhile, recruitment and retention difficulties are starting to ease, as weakening economic conditions lead to slowing hiring intentions and workers becoming more cautious about changing jobs.[22]

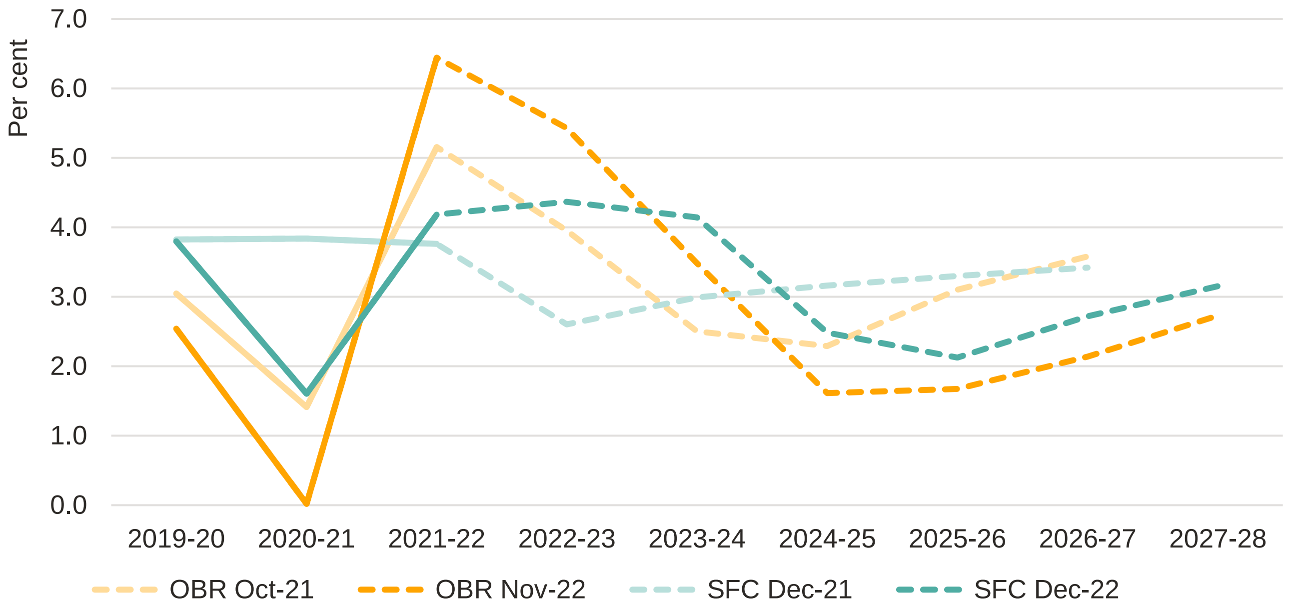
3.42 We now expect nominal earnings to grow by 4.1 per cent in 2023-24, faster than we forecast in December 2021. Nominal earnings growth falls back to 3.2 per cent by 2027-28, consistent with productivity growth, unemployment at its trend, and inflation of around 2 per cent. Figure 3.15 shows our latest December 2022 forecast of nominal average earnings growth, alongside our December 2021 forecast and the OBR's forecasts for the UK.

3.43 Over the next five years, we expect a slight recovery in Scottish nominal average earnings relative to the UK, though they remain below historical standards as a share of UK. This is shown in Figure 3.16. Possible factors driving this period of catching-up with the UK include:

[22] Bank of England (2022) Monetary Policy Report – November 2022 (link), Bank of England (2022) Agents' summary of business conditions – 2022 Q3 (link).

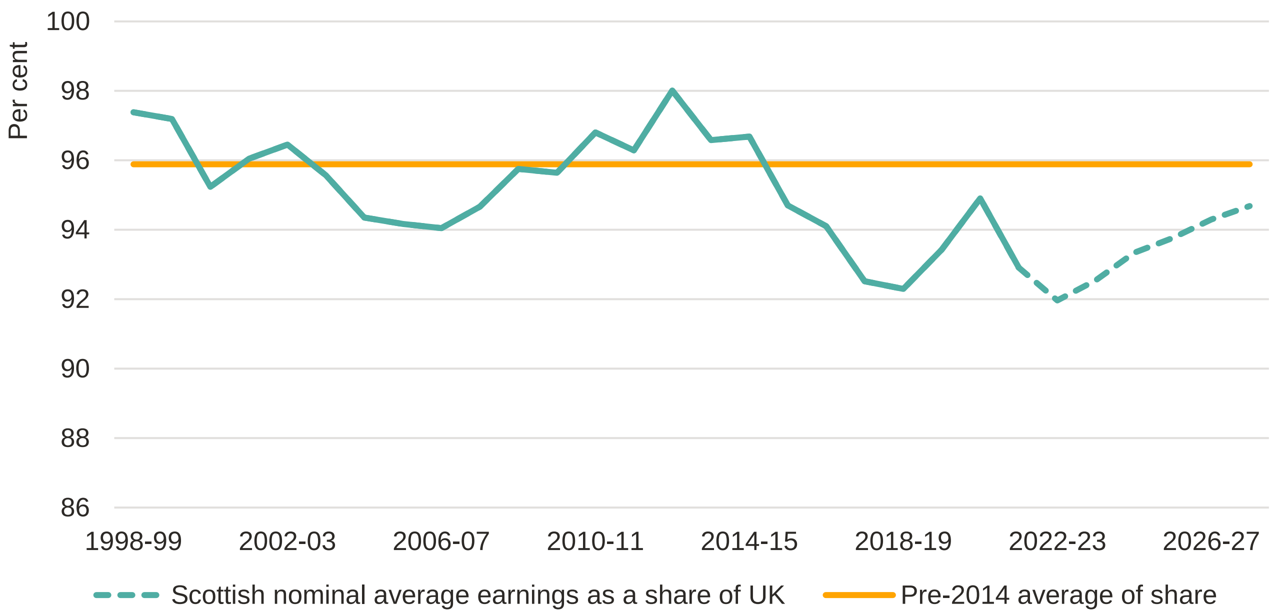
- Higher energy prices and an increased emphasis on energy security leading to a relatively more positive outlook for earnings and employment in the oil and gas sector.
- Greater alignment in the outlook for earnings growth in Scottish and UK financial services.
- Scottish households tend to have smaller mortgage debt than households in other parts of the UK, meaning they will be less affected by rising interest rates, supporting economic activity in Scotland.

Figure 3.15: Nominal average earnings growth, SFC Scotland and OBR UK



Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – December 2021 (link), OBR (2022) Economic and fiscal outlook – November 2022 (link), OBR (2021) Economic and fiscal outlook – October 2021 (link).
Solid lines refer to outturn available at time of publication and dashed lines refer to forecasts.

Figure 3.16: Scottish average earnings as a share of UK, SFC Scotland and OBR UK forecasts



Source: Scottish Fiscal Commission, OBR (2022) Economic and fiscal outlook – November 2022 (link).
Solid lines refer to outturn available at time of publication and dashed lines refer to forecasts.

3.44 Our forecast of Scottish average earnings growth includes an assumption for devolved public sector basic pay growth of 2.5 per cent in 2023-24. Unlike previous budgets, the Scottish Government has not set a formal guideline for public sector pay this year and so we needed to make our own assumption on outcomes. The Scottish Budget confirms the approach in the May 2022 Resource Spending Review that it is for individual public bodies to balance their overall pay bill within their total available resources. Our assumption on pay growth was made by considering the average pay award agreed for 2022-23 and what a possible pay uplift might be next year when inflation is expected to fall back. This assumption also broadly reflects the challenges and pressures facing individual public bodies within the current context of rising costs and constrained budgets.

3.45 The assumption is solely required for our economy and income tax forecasts, with only limited impact on our earnings forecast of which the devolved public sector accounts for around 20 per cent. We do not model Scottish Government spending except for Social Security, and our pay growth assumption does not feed into the Scottish Budget's spending projections.

Chapter 4
Tax

Overview

4.1 In this chapter we present our tax forecasts and discuss the effect they have on the 2023-24 Scottish Budget. High inflation and earnings growth, increased interest rates, and a number of policy changes are having a big effect on our tax forecasts.

4.2 For income tax we expect increases in earnings resulting from inflation to generate a significant growth in tax revenue, as rates are being increased but thresholds remain fixed in nominal terms. On the other hand, a number of new policies will be introduced for Non-Domestic Rates (NDR) at a time when non-domestic properties are undergoing a revaluation, which are likely to reduce revenue. We are forecasting lower Land and Buildings Transaction Tax (LBTT) revenues as higher interest rates reduce house prices and transactions. We summarise our tax forecasts in Figure 4.1 and show the changes from our December 2021 forecast in Figure 4.2.

Figure 4.1: Summary of tax forecasts

£ million	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Income tax	14,575	15,810	16,633	17,370	18,247	19,437
Non-Domestic Rates	2,818	3,075	3,080	3,135	3,405	3,286
Land and Buildings Transaction Tax	850	774	728	794	910	995
Scottish Landfill Tax	101	79	72	58	16	16
Total	18,343	19,738	20,512	21,357	22,578	23,734

Source: Scottish Fiscal Commission
Figures may not sum because of rounding.

Figure 4.2: Summary of changes to our tax forecasts since December 2021

£ million	2022-23	2023-24	2024-25	2025-26	2026-27
Income tax	904	1,496	1,577	1,580	1,802
Non-Domestic Rates	9	-158	-88	-95	-113
Land and Buildings Transaction Tax	100	-23	-111	-87	-14
Scottish Landfill Tax	0	-4	-13	-13	-2
Total	1,013	1,312	1,365	1,385	1,673

Source: Scottish Fiscal Commission
Figures may not sum because of rounding.

4.3 We expect devolved Scottish taxes to raise £19.6 billion of revenue in 2023-24, an upwards revision of £1.1 billion since our December 2021 forecasts. The majority of this change can be attributed to an increase in our forecast for income tax. We are in a period of high inflation with income tax thresholds remaining fixed. While the economy is struggling in real terms, increasing nominal earnings are driving up income tax revenues.

4.4 House prices have grown further since December 2021, and this is reflected in an increase to our LBTT forecast for 2022-23. However, we have revised down our forecast from 2023-24 onwards because we expect a drop in house prices and transactions next year and the year after in response to the rapid rise in interest rates and the wider economic downturn.

4.5 The rateable values of all non-domestic properties are being reassessed for the 2023 valuation roll. Based on the incomplete draft roll available during the forecast period, rateable values are broadly increasing, which is expected as rateable values have generally increased in previous revaluations. In a revaluation year we assume, before policy decisions are factored in, that the Scottish Government sets the poundage to achieve revenue neutrality in real terms in Non-Domestic Rates income over the forecast period, so increased rateable values do not necessarily increase revenue.

4.6 Our illustrative forecasts of aggregates levy, air departure tax and assigned Value Added Tax (VAT) are available in supplementary figures accompanying this publication and available on our website.

Tax policy changes

4.7 We have produced cost estimates of a number of tax policy changes that have been introduced in the 2023-24 Scottish Budget. These are shown in Figure 4.3.

Figure 4.3: Summary of Budget 2023-24 tax policy changes

£ million	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Income tax	4	129	142	150	162	175
Non-Domestic Rates		-356	-309	-288	-267	-262
LBTT	12	34	28	34	39	40
Total	16	-192	-138	-104	-66	-47

Source: Scottish Fiscal Commission
Figures may not sum because of rounding.

4.8 The Scottish Government has announced that in 2023-24 all non-savings, non-dividends (NSND) income tax thresholds will remain frozen at 2022-23 levels, with the exception of the top rate of income tax which will reduce to £125,140 from the current level of £150,000. The Scottish Government also announced it will be increasing both the higher rate and the top rate by 1 pence. From 2023-24, the higher rate will now be 42 pence and the top rate will be 47 pence.

4.9 When creating our five-year forecasts, for years in which there is not an announced Scottish Government policy, we need to make assumptions about future income tax rates and thresholds. In May 2022 we took the decision to freeze the income tax higher rate threshold in that forecast and future forecasts, as we judged this to be the most reasonable assumption to make in line with historical patterns.[23] This means that the freezing of the higher rate threshold in 2023-24 is already included in our forecasts and the Scottish Government's decision to freeze the higher rate threshold does not yield additional revenue. Further detail is provided in the income tax section below.

4.10 There are several Non-Domestic Rates policy changes included in the 2023-24 Budget. The Scottish Government have set the poundage at the same amount as in 2022-23. The Small

[23] Scottish Fiscal Commission (2022) Scotland's Economic and Fiscal Forecasts – May 2022 (link).

Business Bonus Scheme (SBBS) has been reformed. There are two transitional reliefs available, one for all properties where rateable value has substantially increased after revaluation and one for small businesses affected by SBBS changes.

4.11 The Additional Dwelling Supplement (ADS) is an additional charge added to any Land and Buildings Transaction Tax (LBTT) which may be due from purchasing an additional property. The Scottish Government will raise the tax rate on ADS from 4 per cent to 6 per cent. This policy will come into effect immediately and we expect it to raise £34 million in 2023-24.

Tax forecasts and the Scottish Budget

4.12 For income tax, Land and Buildings Transaction Tax (LBTT) and Scottish Landfill Tax (SLfT), our tax forecasts must be considered alongside the associated Block Grant Adjustments (BGAs) to understand the net effect on the funding for the Scottish Budget. Non-Domestic Rates have a separate funding process to other taxes for which we provide a detailed explanation in our occasional paper.[24]

4.13 The net position shows how much funding the Scottish Government is receiving from Scottish tax revenues compared to the BGAs. Figure 4.4 shows the net positions for income tax, LBTT and SLfT.

Figure 4.4: Tax net positions

£ million	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Income Tax								
BGA	11,852	13,594	14,681	15,485	15,932	16,455	17,179	18,105
Scottish revenue	11,948	13,337	14,575	15,810	16,633	17,370	18,247	19,437
Net Position	96	-256	-107	325	700	915	1,068	1,332
LBTT								
BGA	397	642	717	517	509	604	735	830
Scottish revenue	517	807	850	774	728	794	910	995
Net Position	121	164	133	256	219	190	175	165
SLfT								
BGA	87	-102	103	99	93	87	92	94
Scottish revenue	107	125	101	79	72	58	16	16
Net Position	20	23	-3	-19	-21	-29	-76	-77
Total taxes								
Net position	237	-69	24	562	898	1,076	1,167	1,419

Source: Scottish Fiscal Commission, Scottish Government.
Figures may not sum because of rounding. Shaded cells refer to outturn available at the time of publication. Negative figures for the net position represent a negative funding effect on the Scottish Budget, where the BGA reduces funding by more than the tax revenue.

[24] Scottish Fiscal Commission (2021) Funding for the Scottish Budget (link).

The income tax net position

4.14 The outlook for the Scottish and UK economies is challenging, with real disposable household incomes expected to fall over the coming year. However, despite a deterioration in the forecasts of the Scottish and UK economies overall, the outlook for the income tax net position has improved considerably. Based on the latest forecasts by us and the OBR, the net position is expected to be £325 million in 2023-24, compared to the value of -£257 million that we forecast in December 2021. Relatively small changes in either our or the OBR's forecasts can lead to significant changes in the projected net position. This is particularly relevant now with heightened inflation and increased geopolitical risks adding to the uncertainty of the component forecasts.

4.15 The more positive outlook for the net position is driven in part by Scottish Government policy to raise additional revenues from income tax. An additional £129 million of income tax revenue is set to be raised in 2023-24 following policy changes announced at this budget.

4.16 Since 2017-18, the Scottish Government has increased income tax rates and frozen thresholds which have had the effect of raising additional revenue, shifting in a more revenue raising direction than the UK Government. While the higher rate threshold is frozen in both the UK and Scotland in 2023-24, it is frozen at a lower level in Scotland, likely resulting in relatively faster income tax revenue growth. We estimate that the total divergence in Scottish and UK income tax policy since 2017-18 should be contributing around £1 billion to the income tax net position in 2023-24.

4.17 Another factor is outturn data for 2020-21 published in July 2022 and discussed in our August 2022 publications, which showed Scotland to have a more positive net position than we anticipated in our December 2021 and May 2022 forecasts, driven primarily by lower than expected UK income tax revenues.

4.18 Changes to the OBR's and our economy forecasts have also affected the outlook for the net position. With inflation rising, both us and the OBR have revised up our forecasts for nominal average earnings growth by around the same amount in 2023-24. However, the OBR has made significant downward revisions to its forecast of employment growth in 2023-24. We think this revision in the OBR's forecast of employment growth in the UK has contributed significantly to the positive shift in the net position in 2023-24.

4.19 From 2024-25 onwards, the OBR forecast UK average nominal earnings growth to average 2.0 per cent. This is low by historic standards and compared to our forecast of 2.6 per cent average nominal earnings growth in Scotland, leading to a further improvement in the income tax net position over the forecast period.

4.20 Over the last five years, earnings have been growing more slowly in Scotland than in the UK, driven in part by slowing activity in the oil and gas sector in Scotland, and a strong performance in earnings growth in financial services in the UK. This has led to a decline in the level of earnings in Scotland relative to the UK. Comparing our forecasts of earnings growth to the OBR's suggests a period of catch-up in Scottish earnings over the next five years driven by:

- Higher energy prices and an increased emphasis on energy security leading to a relatively more positive outlook for earnings and employment in the oil and gas sector.
- Greater alignment in the outlook for earnings growth in Scottish and UK financial services.

- Scottish households tend to have smaller mortgage debt than households in other parts of the UK, meaning they will be less affected by rising interest rates, supporting economic activity in Scotland.

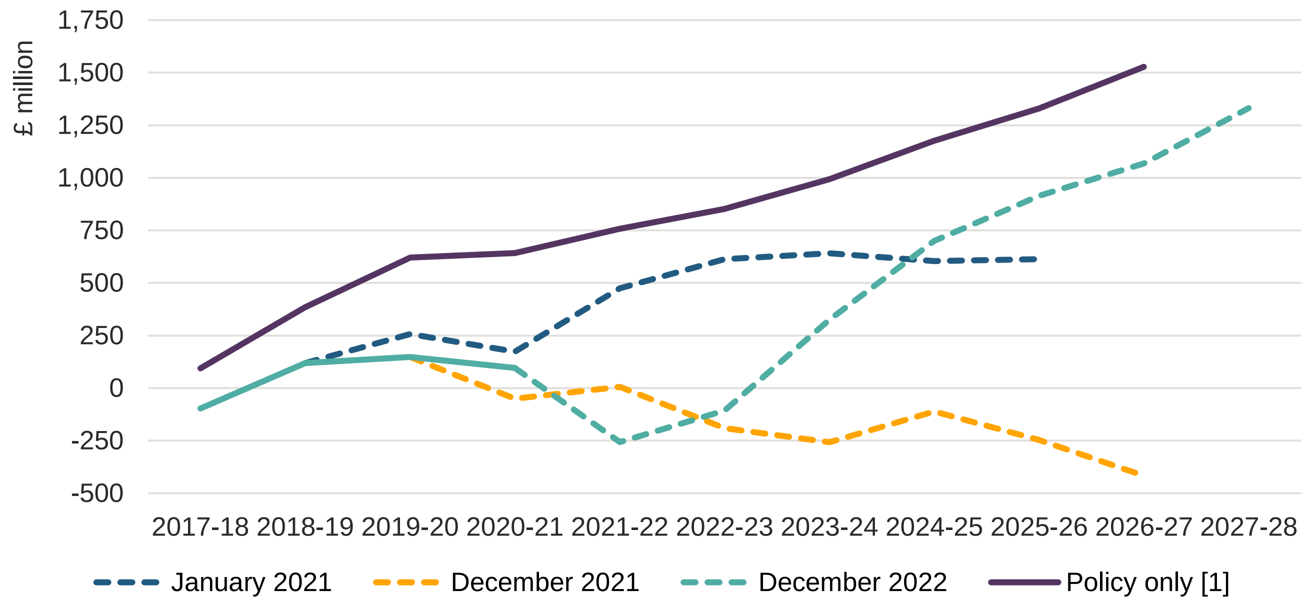
4.21 The outlook for earnings growth is uncertain. Further revisions to ours or the OBR's forecasts could see this period of catch-up in earnings in Scotland disappearing, and a weakening in the outlook for the income tax net position.

4.22 In summary, policy changes, revised data, and shifts in the relative economic outlook with the UK have all contributed to improved projections of the income tax net position. However, we strongly caution that the outlook for the income tax net position is very sensitive to changes in ours and the OBR's forecasts. The income tax net position for 2023-24 has increased by £582 million since our December 2021 forecast. While a large amount of money, this represents only 3.7 per cent of Scottish income tax revenues in this year. For context, we estimate that the OBR has an absolute forecast error of around 4.9 per cent in its two-year-ahead income tax forecasts for the UK, and so shifts in the income tax net position of this scale are not surprising.[25]

4.23 The net position is the difference between two large forecast values, and there was always an expectation that estimates could move over time. We are now five years into the operation of the fiscal framework, and we can see that estimates of the net position can move year-to-year, and perhaps more than anticipated. As forecast errors are an inherent part of forecasting, movement in the outlook of the net position is an inherent part of the fiscal framework, particularly with heightened economic uncertainty, therefore requiring careful budget management.

4.24 Figure 4.5 shows the latest projection of the net position compared to other recent projections.

Figure 4.5: The income tax net position comparisons



Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2022) 'Trends in Scotland's population and effects on the economy and income tax' (link).
[1] The policy only line includes the latest policy announcements from the Scottish Government and UK Government. It is estimated on a static policy basis. Including behavioural responses would only have a small effect on the purple line and not change the overall story presented in this figure.

[25] We reference the OBR figure here as a benchmark as they have a longer history of forecasts to compare. SFC (2021) Supplementary Forecast Evaluation Report (link)

4.25 In Figure 4.5 the solid line is outturn data on the income tax net position, and the dashed line shows the outlook given the latest OBR and SFC forecasts. The net position has been revised up considerably since December 2021 and is now more in line with where it was projected to be in January 2021.

4.26 The policy only line in Figure 4.5 shows our approximation of what the income tax net position would be if Scottish economic performance had exactly matched the UK, with the only difference being in income tax policy. The actual net position being below this policy only position is in line with relatively slower earnings and employment growth in Scotland compared to the UK since 2016-17. Even with a period of relative catch-up over the next five years, earnings and employment growth in Scotland still lags the UK compared to the 2016-17 starting year for income tax. Despite upwards revisions, the income tax net position remains below the hypothetical policy differences only position.

Income tax reconciliations

4.27 When the Scottish Budget is set, funding from income tax for the financial year is based on forecasts and does not change during the year. Only when outturn information on income tax revenues becomes available is funding brought in line with outturn and a reconciliation applied to the following Scottish Budget. Following the publication of income tax outturn data for 2020-21 in July 2022, a reconciliation of £50 million will be applied to the Scottish Budget for 2023-24. This is the first positive income tax reconciliation since income tax was devolved and we discussed this further in our August 2022 Forecast Evaluation Report.[26]

4.28 We can derive illustrative estimates of future income tax reconciliations by comparing our latest forecasts to the latest forecast BGAs. We show outturn and illustrative estimates of income tax reconciliations in Figure 4.6.

Figure 4.6: Outturn and illustrative estimates of income tax reconciliations

Collection year	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23
Applies to Budget for	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Reconciliation (£ million)	-204	-309	-34	50	-732	83

Source: Scottish Fiscal Commission
Shaded cells refer to outturn available at time of publication.

4.29 Comparing the latest OBR and SFC forecasts indicates a large negative reconciliation for 2021-22 of -£732 million which would be applied to the 2024-25 Scottish Budget. Figure 4.7 shows how forecasts of Scottish income tax revenues and the BGA have changed since the 2021-22 Scottish Budget was set based on our January 2021 forecasts.

Figure 4.7: Scottish income tax revenue forecast and BGA for 2021-22

£ million	Budget setting	Latest	Total Change
SIT	12,263	13,337	1,074
BGA	-11,788	-13,594	-1,806
Net position	475	-256	-732

Source: Scottish Fiscal Commission.
Figures may not sum because of rounding.

[26] Scottish Fiscal Commission (2021) Forecast Evaluation Report – August 2022 (link).

4.30 Our forecast of Scottish income tax in January 2021 was a lot more positive than the BGA based on November 2020 OBR forecasts. We highlighted at the time that it was highly likely that the net tax position was overly positive. Revisions in the OBR forecasts have contributed more to the indicative reconciliation than changes in our forecast. The final figure for the 2021-22 reconciliation will only be known once outturn data for 2021-22 is published, which we expect to be in July 2023. We have discussed this large reconciliation at length in our May 2022 Scotland's Economic and Fiscal Forecasts as well as our August 2022 Forecast Evaluation Report.[27][28]

Non-Domestic Rates

4.31 Our Non-Domestic Rates (NDR) forecast has been impacted by the ongoing revaluation of all rateable properties. The final valuation roll will not be available until 1 April 2023. Because of this ongoing revaluation, we have used an imputed roll based on an incomplete draft roll to forecast NDR. Any differences between the imputed roll and the final roll will affect our policy costings and forecasts.

Non-Domestic Rating Account

4.32 NDR operates from a separate account, called the Non-Domestic Rating Account or NDR pool. 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 amount and the distributable amount as well as changes from previous years. Full details on how NDR funding works can be found in our occasional paper, Funding for the Scottish Budget.[29]

4.33 We forecast the contributable amount of NDR, which is the revenue collected by local authorities and pooled nationally. The pooled revenue is then redistributed as the distributable amount to local authorities as part of the local government finance settlement.

4.34 Our forecast is used by the Scottish Government to inform the decision about how much will be distributed to local authorities in the year ahead. The Government can choose to distribute more or less than the forecast contributable amount in any given year so long as the total amount collected is eventually distributed back to local authorities. The calculation of the distributable amount takes account of three factors:

- The estimated closing balance of the account from the previous financial year.
- Estimated prior year adjustments to be carried over from the previous financial year.
- The amount forecast to be raised in the year ahead. This year the forecast is based on an incomplete draft revaluation roll, as the 2023 new valuation roll will not be available until 1 April 2023. This introduces additional uncertainty into our forecast, covered in more detail in the NDR section of this chapter.

4.35 The distributable amount is set in the Budget and remains unchanged during the financial year. This means that the Scottish Government does not need to manage any NDR forecast error during the year. The distributable amount for 2023-24 is set at £3,022 million.

[27] Scottish Fiscal Commission (2022) Scotland's Economic and Fiscal Forecasts – May 2022 (link)
[28] Scottish Fiscal Commission (2021) Forecast Evaluation Report – August 2022 (link)
[29] Scottish Fiscal Commission (2021) Funding for the Scottish Budget (link)

4.36 Figure 4.8 shows our updated estimate of the pool balance based on the latest information. The distributable amount set leads to a projected balance of -£83 million at the end of 2022-23.

4.37 The Scottish Government plans to bring the account back into balance by 2024-25. The cumulative balance peaks at -£200 million in 2021-22, and is then reduced between 2022-23 and 2023-24. From 2025-26 onwards, the Scottish Government plans to match the distributable amount to our forecast of the contributable amount. Figure 4.8 shows the plan for the Non-Domestic Rating Account over our forecast period.

Figure 4.8: Illustrative projected balance of the Non-Domestic Rating Account

£ million	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Provisional contributable amount (A)	2,054	2,829	3,075	3,080	3,135	3,405	3,286
Net effect of prior year adjustments (B)	-104	54	-11	0	0	0	0
Distributable amount (C)	2,090	2,766	3,047	3,013	3,135	3,405	3,286
Annual balance (D) (A + B – C)	-140	117	17	66	0	0	0
Cumulative balance (E) (Previous year E + D)	-200	-83	-66	0	0	0	0

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 2021-22; 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'.

4.38 The audited balance of the pool will be determined by our forecast accuracy. For 2023-24 there is additional uncertainty in the forecast caused by revaluation which may affect the pool balance. The balance will also be determined by the difference between the start of year estimates provided by local authorities to the Scottish Government after the start of the financial year in April (the provisional contributable amount in Figure 4.8) and the final audited NDR income returns for the financial year. The difference is termed the prior year adjustment.

4.39 Contributions to the pool are determined by local authorities' own estimates of collections for the year, submitted to the Scottish Government after the start of the financial year. This means that the balance of the pool could be positive despite our projection of a negative balance if local authorities report a high level of collections in their start-of-year estimates.

Income tax

4.40 Our latest forecast is presented in Figure 4.9. We have increased our forecast for income tax in all years of the forecast. The forecast increases are driven mainly by changes in the underlying economy forecasts with higher nominal growth in wages than expected in our December 2021 forecast.

Figure 4.9: Forecast revenue for non-savings, non-dividend income tax

£ million	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Revenue	11,948	13,337	14,575	15,810	16,633	17,370	18,247	19,437

Source: Scottish Fiscal Commission, HMRC (2022) Scottish income Tax Outturn Statistics: 2020 to 2021 (link).
Shaded cells refer to outturn available at time of publication.

Contributions to changes in income tax

4.41 Our latest income tax forecast is made at a time of uncertainty and the economies of Scotland and the UK face challenges that are discussed in Chapter 3. In our economy forecasts we have revised up our outlook for nominal earnings growth, driven in part by higher levels of inflation. In Figure 4.10 we show the effect of those changes between December 2021 and our latest forecast. The effect is greatest in 2023-24 and 2024-25.

4.42 In our May 2022 forecast we changed our assumption about the Higher Rate Threshold (HRT) in Scotland.[30] We now assume that the HRT will remain frozen at its 2022-23 level until the end of the forecast. Comparing to our December 2021 forecast, this change introduced in May 2022 increases our forecast by between £129 million and £503 million.

4.43 The data updates section includes a number of changes. We have updated our models to include the latest income tax outturn data for 2020-21, the latest Public Use Tape (PUT) data for 2019-20, and Real Time Information (RTI) data up to September 2022. The timely RTI data indicates that income tax growth is weaker in 2022-23 than 2021-22.

4.44 In the UK Budget in November 2022 the Chancellor announced that the UK wide personal allowance would be frozen at its current level until 2028. In our May 2022 forecast we assumed that the personal allowance would be frozen to 2025-26. The new announcement increases the amount of income tax revenues in 2026-27 and 2027-28. Other UK Government policy announcements, including behavioural responses to the reversal of the increase in National Insurance Contributions which affect income tax revenues, indirectly add between £56 million and £140 million to our forecast.

Figure 4.10: Change in NSND income tax revenue since December 2021

£ million	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
December 2021	11,938	13,002	13,671	14,313	15,056	15,790	16,445
Economy		277	652	918	745	405	345
Baseline change May 2022				129	246	364	503
Data Updates	10	57	235	170	150	217	183
UK policy		1	13	42	59	52	204
UK policy indirect effects				56	101	140	74
Triple Lock for Pensions				43	82	147	181
Incorporations				9	49	104	149
December 2022 forecast pre-measures	11,948	13,337	14,571	15,681	16,490	17,219	18,086
Policy costings			4	129	142	150	162
December 2022 forecast post-measures	11,948	13,337	14,575	15,810	16,633	17,370	18,247
Change since December 2021	10	335	904	1,496	1,577	1,580	1,802

Source: Scottish Fiscal Commission, Scottish Government, HMRC (2021) Scottish Income Tax Outturn Statistics: 2019 to 2020 (link).
Figures may not sum because of rounding. Shaded cells refer to outturn available at time of publication.

[30] Scottish Fiscal Commission (2022) Scotland's Economic and Fiscal Forecasts – May 2022 (link).

4.45 The UK Government has confirmed its commitment to the pension triple lock, and this means that pensions will rise by at least 2.5 per cent from 2024-25 onwards, and by 10.1 per cent in 2023-24. As pensions are taxable this increases forecast income tax by £43 million in 2023-24.

Scottish Government policy

4.46 The Scottish Government has announced income tax policy changes for 2023-24:

- Reducing the top rate threshold to £124,150 from £150,000
- Freezing the basic rate band in 2023-24 at £13,118
- Freezing the starter rate band in 2023-24 at £2,162
- Increasing the higher rate of tax to 42 pence
- Increasing the top rate of tax to 47 pence.

4.47 The higher rate threshold will remain fixed at £43,662 in line with our baseline assumption.

4.48 We anticipate a small forestalling effect from the reduction in the top rate threshold, where taxpayers arrange their affairs to bring forward some of their income into 2022-23 to reduce their liability. This effect increases revenue by £4 million in 2022-23 and reduces slightly the amount that is raised in 2023-24.

4.49 We expect that this package of policy changes will raise around £129 million in 2023-24 increasing to £162 million by the end of the forecast period. Figure 4.11 shows how each of the changes to thresholds and rates contributes to the total policy costing.

Figure 4.11: Contributions to income tax policy change

£ million	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Total policy	4	129	142	150	162	175
Top rate threshold reduction to £125,140	4	8	13	14	15	16
Basic rate band freeze		18	19	20	21	22
Starter rate band freeze		6	6	6	6	6
Top rate increased by 1p to 47p		3	3	3	3	3
Higher rate increased by 1p to 42p		92	98	104	114	125
RTI adjustment		3	3	3	4	4

Source: Scottish Fiscal Commission
Figures may not sum because of rounding.

4.50 The greatest contribution to the increase in our forecast arises from the increase in the higher rate which accounts for around 70 per cent of total policy yield. For more detail including behavioural responses, see the full policy costing details in Annex A.

Freezing the higher rate threshold

4.51 In May 2022 we took the decision to freeze the income tax higher rate threshold in that and future forecasts. When creating our five-year forecasts, for years in which there is no announced Government policy, we need to make assumptions about future income tax rates and thresholds.

We decided to freeze the higher rate threshold because doing so was consistent with the approach by the Scottish Government since income tax was devolved and not doing so would have introduced an under-forecasting bias to our income tax forecasts. We discussed this decision in depth in our May 2022 report.[31]

4.52 In Figure 4.10 we show how our forecast has changed since December 2021. In December 2021, prior to our May 2022 decision to freeze the higher rate threshold in our baseline, we assumed the higher rate threshold would rise to £45,357 in 2023-24, in line with lower levels of inflation of around 4 per cent at the time. The effect on income tax revenue of the difference between our December 2021 baseline higher rate threshold assumption of £45,357 and our December 2022 frozen baseline higher rate threshold assumption of £43,662 is to add £129 million to income tax revenues in 2023-24.[32] Importantly, the effect on revenues is different to a hypothetical policy costing which compared a freeze in the higher rate threshold to inflation uprating of the higher rate threshold today with far higher levels of inflation.

4.53 When we started preparing our December 2022 income tax forecasts, we were already assuming the income tax threshold would remain frozen in 2023-24, and the effect of this was captured in our forecasts of income tax revenues. As such, the Scottish Government's decision to freeze the higher rate threshold does not change our forecasts, as it is already factored in, and there is no associated policy costing. The Scottish Government remains free to set income tax rates and thresholds how it chooses. Our baseline assumptions only affect the counter-factual against which policy decisions are measured.

Scottish and UK policy divergence

4.54 Since 2017-18, the Scottish Government has increased income tax rates and frozen thresholds, shifting policy in a more revenue raising direction than the UK Government. The introduction of the intermediate rate of 21 pence in 2018-19, the freezing of the higher rate threshold, the increase in the higher rate of tax to 42 pence and the increase in the top rate of tax to 47 pence mean that all taxpayers in Scotland earning over £27,850 pay more income tax in 2023-24 than they would in the rest of the UK.

4.55 In 2016-17, prior to the devolution of income tax to Scotland, the higher rate threshold was £43,000 in both Scotland and the rest of the UK. Since income tax was devolved in 2017-18, the Scottish Government has largely kept the higher rate threshold frozen, or limited it to only small increases. In 2023-24, the higher rate threshold in Scotland will be £43,662, a £662 increase over seven years. In contrast, the UK Government increased the higher rate threshold in the rest of the UK rapidly from 2016-17, reaching £50,000 by 2019-20. Since 2020-21, the higher rate threshold has risen more slowly, and is set at £50,270 in 2023-24.

4.56 These diverging policies have had a significant effect on the number of higher rate taxpayers. Figure 4.12 shows how the number of higher rate (HR) taxpayers has changed in Scotland and the UK since 2016-17, based on outturn data published by HMRC. Largely as a result of differences in the higher rate threshold, the number of higher rate taxpayers in Scotland has grown by about 23 per cent since 2016-17 compared to a 10 per cent drop in the rest of the UK. In 2023-24, we expect 18.4 per cent of all Scottish taxpayers to pay the higher rate of tax, compared to 11.6 per cent in 2016-17.

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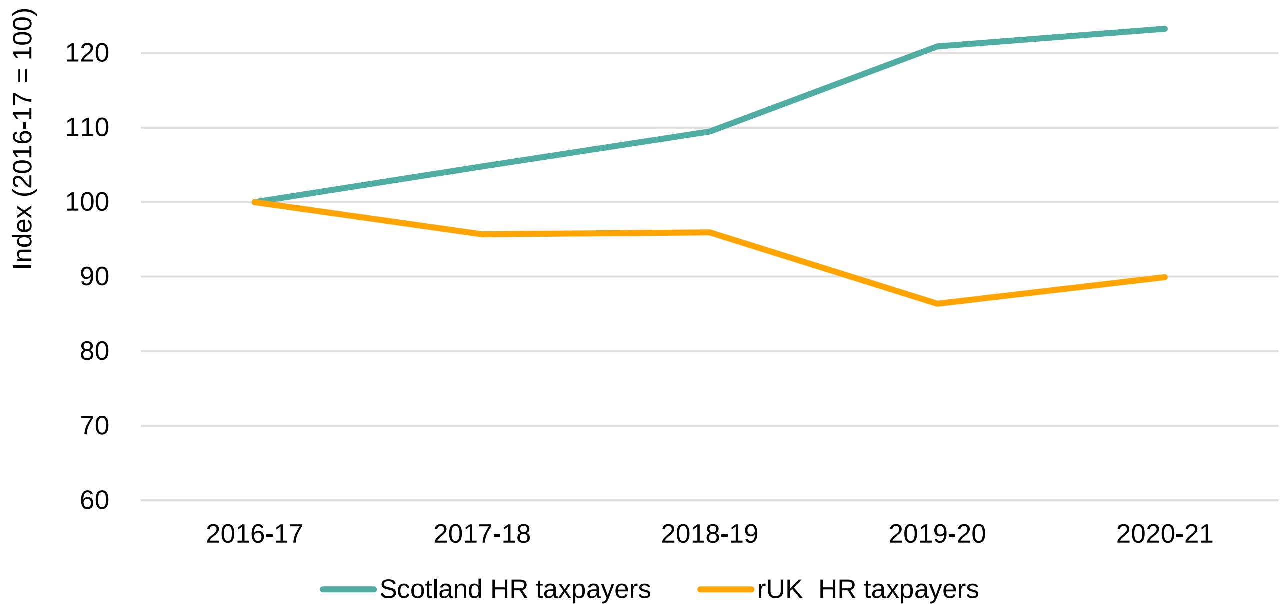
[31] Scottish Fiscal Commission (2022) Scotland's Economic and Fiscal Forecasts – May 2022 (link).

[32] To note by coincidence the effect on income tax revenue of our change in higher rate threshold baseline assumption of £129 million is equal (after rounding) to the revenue gained from the Scottish Government's policy decisions shown in Figure 4.11.

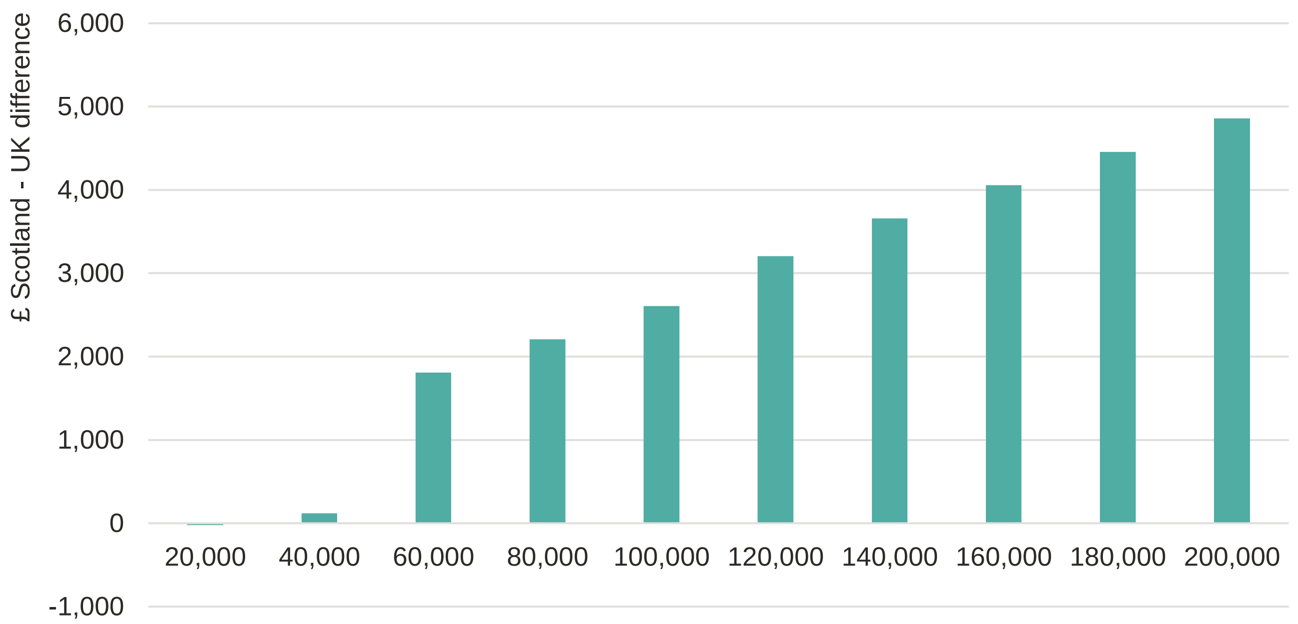
Figure 4.12: Growth in number of higher rate income tax payers in Scotland and rest of the UK (rUK)



Source: Scottish Fiscal Commission, HMRC (2022) Scottish Income Tax Outturn Statistics: 2020 to 2021 (link).
Note that the vertical axis begins at 60 per cent.

4.57 The latest policy changes announced by the Scottish Government to increase the higher rate of tax to 42 pence means that there is also a 2 pence difference between what higher rate taxpayers pay in Scotland compared to rest of the UK. We show the difference in income tax liabilities between individual taxpayers in Scotland and the rest of the UK in Figure 4.13.

Figure 4.13: Difference in income tax liabilities between individual Scottish and rest of UK taxpayer in 2023-24



Source: Scottish Fiscal Commission.

4.58 People in Scotland earning over £27,850 will pay more income tax in Scotland than they would in the rest of the UK. As an illustration, an individual earning £60,000 per year would pay around £1,800 more in income tax per year living in Scotland than in the rest of the UK.

4.59 All else equal, the lower thresholds and higher tax rates can be expected to lead to faster income tax revenue growth in Scotland relative to the UK. We estimate that this revenue raising policy divergence in Scotland adds around £1 billion per year to the net position in 2023-24. However, the income tax net position is projected to be only £325 million in 2023-24, largely as a result of slower earnings and employment growth in Scotland compared to the rest of the UK since 2016-17.

4.60 National Insurance Contributions (NIC) are reserved and therefore the rates and thresholds are the same across the whole of the UK. In 2023-24, the amount paid by most employees drops from 12 per cent to 2 per cent for earnings above £50,270, in line with the income tax higher rate threshold in the rest of the UK. For earnings between £43,662 and £50,270 in Scotland, an income tax rate of 42 per cent and a NICs rate of 12 per cent will be applied, meaning a marginal tax rate of 54 per cent between these thresholds.

Comparison to OBR

4.61 In Figures 4.14 and 4.15 we compare our income tax forecast to the OBR's forecast of NSND income tax in the rest of the UK, the basis for the income tax BGA calculation.

Figure 4.14: Forecast drivers comparison between OBR and SFC (growth rates)

Source	Per cent change	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Income tax revenue	OBR [1]	15.2	8.4	5.9	3.3	3.7	4.8	5.8
Income tax revenue	SFC [2]	11.6	9.3	8.5	5.2	4.4	5.1	6.5
Employment	OBR	-1.1	0.8	-0.1	0.0	0.9	1.0	0.7
Employment	SFC	1.7	1.7	-0.5	-0.2	0.3	0.5	0.4
Average nominal earnings	OBR	6.5	5.4	3.5	1.6	1.7	2.1	2.7
Average nominal earnings	SFC	4.2	4.4	4.1	2.5	2.1	2.7	3.2
Total nominal earnings	OBR [3]	8.0	6.3	3.3	1.5	2.3	2.9	3.2
Total nominal earnings	SFC	6.7	6.3	3.6	2.3	2.5	3.2	3.6

Source: Scottish Fiscal Commission, OBR (2022) Economic and fiscal outlook – November 2022 (link).
Figures may not sum because of rounding. Shaded cells refer to outturn available at time of publication.
[1] UK non-savings, non-dividends (NSND) excluding Scottish Income Tax (SIT) and Welsh Rates of Income Tax (WRIT).
[2] Scottish non-savings, non-dividends income tax.
[3] This refers to OBR's wages and salaries series.

Figure 4.15: Forecast drivers comparison between OBR and SFC (cumulative growth paths)

Source	Index 2020-21 = 100	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Income tax revenue	OBR [1]	115	125	132	137	142	149	157
Income tax revenue	SFC [2]	112	122	132	139	145	153	163
Employment	OBR	99	100	100	100	101	102	102
Employment	SFC	102	103	103	103	103	104	104
Average nominal earnings	OBR	107	112	116	118	120	123	126
Average nominal earnings	SFC	104	109	113	116	119	122	126
Total nominal earnings	OBR [3]	107	113	116	119	122	126	130
Total nominal earnings	SFC	107	113	118	120	123	127	132

Source: Scottish Fiscal Commission, OBR (2022) Economic and fiscal outlook – November 2022 (link).
Figures may not sum because of rounding. Shaded cells refer to outturn available at time of publication.
[1] UK non-savings, non-dividends (NSND) excluding Scottish Income Tax (SIT) and Welsh Rates of Income Tax (WRIT).
[2] Scottish non-savings, non-dividends income tax.
[3] This refers to OBR's wages and salaries series.

4.62 Differences between ours and the OBRs economy forecasts are discussed in Chapter 3. We expect income tax revenue growth to be slightly lower in Scotland than in the rest of the UK in 2021-22. The tax policies that have been introduced in Scotland and increases in nominal earnings lead to larger growth in Scottish income tax revenues than in the rest of the UK in the later years of the forecast.

Non-Domestic Rates

Forecast

4.63 Non-Domestic Rates (NDR), also known as business rates, are payable by the occupiers of non-domestic properties. Our latest forecast is shown in Figure 4.16. For 2023-24 the tax is forecast to raise £3,075 million.

Figure 4.16: Forecast revenue for Non-Domestic Rates

£ million	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
NDR	2,108	2,818	3,075	3,080	3,135	3,405	3,286

Source: Scottish Fiscal Commission, Scottish Government (2022) Non-domestic rates income statistics (link).
Shaded cells refer to provisional outturn available at time of publication.

Changes since December 2021

4.64 Figure 4.17 shows how our forecast has changed since December 2021.

Figure 4.17: Change in Non-Domestic Rates revenue since December 2021

£ million	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
December 2021	2,083	2,809	3,233	3,167	3,231	3,519
Assumption change	13	-185	8	-40	-79	-42
Methodology change	-59	97	-27	-105	-15	-2
Data update	71	94	36	48	41	44
Policy recosting	0	3	-1	0	0	0
Inflation update	0	-1	182	317	244	154
December 2022 forecast pre-measures	2,108	2,818	3,431	3,388	3,423	3,673
Policy costing	0	0	-356	-309	-288	-267
December 2022 forecast post-measures	2,108	2,818	3,075	3,080	3,135	3,405
Change since December 2021	25	9	-158	-88	-95	-113

Source: Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – December 2021 (link), Scottish Government (2021) Non-domestic rates income statistics (link).
Figures may not sum because of rounding. Shaded cells refer to provisional outturn available at time of publication.

Data updates

4.65 We have made several data updates in our model. These include:

- Notified returns of councils' NDR revenue and reliefs for 2021-22.
- Mid-year estimates of councils' NDR revenue and reliefs claimed for 2022-23.
- Revaluation appeals data up to Q1 2022-23.

4.66 Together, these updates increase the December 2021 forecast of 2022-23 revenues by £94 million. Within this, the mid-year estimates of NDR revenue and reliefs for 2022-23 have increased our forecast by £28 million in 2022-23, compared to our December 2021 forecast. We have adjusted the mid-year estimates for empty property relief (EPR) and appeals losses to strengthen our modelling of likely final values, as these estimates historically increase after mid-year estimate provision.

4.67 We have also used an imputed valuation roll containing draft or estimated rateable values of all properties for 2023-24 in our model. More detail on how this roll was made is in the Assumptions and methodology section.

Inflation forecast

4.68 Increased inflation forecasts since December 2021 have increased projected baseline NDR revenue before policy decisions on poundage are included. We assume that the Scottish Government sets poundage, the percentage of rateable value that non-domestic properties pay in rates, in line with rising inflation. We discuss inflation in detail in Chapter 3. Because inflation is forecast to be higher in 2023-24 than we had previously modelled, the projected poundage for 2023-24 is higher than in our December 2021 forecast. This raises our baseline forecast of NDR revenue in 2023-24 by £182 million.

Assumption and methodology changes

4.69 Rateable value is the taxable value of a property. We usually base rateable value for the next financial year on the current valuation roll, with adjustments for appeals losses and rateable value growth during the year.

4.70 A new valuation cycle is beginning in 2023-24, so we cannot use the previous year's valuation roll for this forecast. Our forecast for 2023-24 onwards uses rateable values taken from an imputed valuation roll because the 2023 new valuation roll will not be available until 1 April 2023.

4.71 To generate the imputed valuation roll, we calculated the change in rateable value of properties listed on the incomplete draft valuation roll, grouped by location, use and rateable value. We then applied these changes to the current rateable values of all similar properties that were not included on the draft roll to create a new imputed valuation roll covering all properties. The complete imputed roll contains a mix of draft values and imputed values. We used this imputed valuation roll to estimate future rateable values.

4.72 To estimate the future values of NDR reliefs, we used the imputed roll and data from the 2022 billing system to estimate the change in the gross NDR bills of properties already claiming reliefs, and therefore the estimated change in value of reliefs claimed.

4.73 The introduction of a new two-stage appeals system has been rescheduled from 1 January 2023 to 1 April 2023 since our last forecast. We have included it in our modelling and described the new system in detail in our December 2021 and May 2022 publications. The effects of the new system on appeals losses are not yet known. Our modelling of appeals losses may change as appeals data becomes available.

Budget 2023-24 Policy Changes

4.74 Budget policy costing are provided in Figure 4.18. Our forecast accounts for five new policies introduced in the 2023-24 Scottish Budget:

- Transitional relief to cap gross bill increases for some properties that increase in value at revaluation.
- Freezing 2023-24 poundage at 49.8 pence.
- Changes to the Small Business Bonus Scheme (SBBS) eligibility thresholds.
- A second transitional relief for current SBBS recipients that will cap net NDR bill increases to £600, £1,200 and £1,800 over the next three years.
- Increasing the threshold at which properties are liable to pay the Higher Property Rate (HPR) from £95,000 to £100,000. This change is below materiality threshold but is included because it affects other modelling.

Figure 4.18: NDR policy costings

£ million	2023-24	2024-25	2025-26	2026-27	2027-28
Baseline	3,431	3,388	3,423	3,673	3,547
Raising HPR threshold	-1	-2	-2	-1	-1
Freeze Poundage at 49.8p	-308	-310	-307	-325	-317
Transitional relief	-60	-15	-3	0	0
SBBS changes	53	57	56	59	57
Transitional relief (SBBS)	-40	-39	-33	0	0
Forecast with policy changes	3,075	3,080	3,135	3,405	3,286
Difference	-356	-309	-288	-267	-262

Source: Scottish Fiscal Commission.

4.75 Transitional relief will cap the gross bill increase to less than a certain percentage increase for the next three years for properties that increase in value at revaluation. The percentage increase cap will be different depending on the new rateable value of the property. There is more detail in Annex A. The cap will increase in 2024-25 and in 2025-26, leading to increased NDR revenue. The cap will decrease net NDR revenue by £60 million in 2023-24, including some displacement of other relief expenditure.

4.76 The poundage will be kept at 49.8 pence for 2023-24, the same rate as 2022-23. The poundage freeze will lower forecast NDR revenue in 2023-24 by £308 million. The poundage was also frozen in 2022-23 and in several previous years, as we show in Figure 4.19.

4.77 The rateable value thresholds for 100 per cent and 25 per cent relief will decrease, reducing the number of eligible properties. The threshold for receiving no SBBS relief will increase. Two tapers will be introduced between thresholds. There is more detail in Annex A. We are forecasting that the new thresholds and rates will increase NDR revenue by £53 million in 2023-24.

4.78 The increase in revenue from SBBS changes will be offset for three years by a second transitional relief for properties currently receiving SBBS relief that will receive less relief under the new SBBS system. This relief will cap the change in net bills paid at £600 in 2023-24, with the cap increasing to £1,200 and then £1,800 in the following two years. The cap will decrease NDR revenue by £40 million in 2023-24. This transitional relief is also available to current recipients of Rural Rates Relief but this has not been costed as it is below materiality.

4.79 There are changes to Fresh Start relief and Business Growth Accelerator relief which we have not included in our policy costings. There is also a new rates exemption for renewable energy plant and machinery. The cost of these policy changes is below our materiality threshold and we provide further detail in Annex C. Enterprise Area relief and Day Nursery relief have been extended, but we assumed extension of these reliefs to our forecast horizon in our baseline assumptions so this does not change the forecast.

Forecast uncertainty

4.80 The main source of uncertainty is that we have based our forecast on estimated new rateable values from an imputed valuation roll. The final 2023 valuation roll will not be available until

1 April 2023. This introduces uncertainty into our forecast because rateable values may be lower or higher than we have estimated.

4.81 The assessment of all rateable value across the NDR tax base is carried out by Scottish Assessors and is undertaken with reference to a single date to ensure fairness. This 'tone date' for revaluation of properties for the 2023 valuation roll was 1 April 2022. Once a new valuation roll is available, changes to rateable values at revaluation may lead to changes in forecasts of NDR revenue, relief amounts, and policy effects. We do not have data on how many properties may claim reliefs after revaluation but have estimated this as described in the 'Assumptions and methodology' section.

4.82 Our assumptions around appeals from the 2023 cycle onwards may change once data from the new appeals system become available. We do not have any data to suggest how the changes to the appeals system will affect the lodging or processing of appeals. We have assumed that appeals losses will happen earlier than in the previous cycle because of the shorter cycles and changes in appeals processing. We may revise our assumptions as more data becomes available.

4.83 Once a new valuation roll is available and we have received data on appeals in the 2023 revaluation cycle, the uncertainty we have described should lessen.

4.84 The poundage is the percentage of rateable value that non-domestic properties are liable to pay in rates. Prior to the policy decision by the Scottish Government to freeze the poundage in 2023-24, we assumed poundage would be set to achieve revenue neutrality, taking into account inflation, increases in rateable value after revaluation and assumed appeal losses over the next revaluation cycle.

4.85 From 2024-25, we use CPI inflation to model the poundage, with increases in inflation contributing to increases in poundage. Although we have used a projected poundage based on CPI in our NDR forecast for 2024-25 onwards, the Scottish Government may choose to set the poundage at a different value.

4.86 In Figure 4.19 we compare our projected poundage based on CPI inflation forecasts against actual poundage set by the Scottish Government in previous budgets. The poundage has rarely increased exactly in line with inflation, either in revaluation years or otherwise. We discussed our process for setting policy baselines in our occasional paper.[33] We will continue to keep the NDR poundage policy baseline under review.

Figure 4.19: Projected poundage and actual poundage in past years

Poundage (pence)	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Projected poundage	47.9	49.5	49.8	50.0	50.5	54.8
Actual poundage	48.0	49.0	49.8	49.0	49.8	49.8

Source: Scottish Fiscal Commission

Land and Buildings Transaction Tax

Forecast

4.87 Land and Buildings Transaction Tax (LBTT) is payable on transactions of residential and non-residential properties and land. Additional Dwelling Supplement (ADS) is an LBTT supplement on

[33] Scottish Fiscal Commission (2019) Approach to Policy Costing (Link).

purchases of additional residential properties, such as second homes or buy-to-let properties. Our forecast is shown in Figure 4.20.

4.88 We have revised our overall forecast up in 2021-22 and 2022-23 compared to December 2021 because of higher outturn data. We have made downward revisions to the forecast from 2023-24 onwards because of higher interest rates and the wider economic downturn which we expect to reduce both prices and number of transactions.

Figure 4.20: Forecast revenue for Land and Buildings Transaction Tax

£ million	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Residential (including ADS)	559	621	557	510	566	669	740
Non-residential	248	229	216	218	228	241	255
Total	807	850	773	728	794	910	995

Source: Scottish Fiscal Commission, Revenue Scotland (2022) Annual Report and Accounts 2021-22 – Devolved Tax Accounts (link)

Figures may not sum because of rounding. Shaded cells refer to outturn available at time of publication. LBTT revenue is net of repayments, excludes penalties and interest and also excludes revenue losses.

Residential LBTT

4.89 We expect higher interest rates and the wider economic downturn to have a big effect on the housing market. We are forecasting that demand for properties will decrease from next year and expect both house prices and transactions to drop slightly over the next two years. This forecast slower period in the Scottish housing market follows a period of recent relatively strong growth.

4.90 In December 2021 we expected high demand for properties to ease slightly in 2021-22 but outturn data show that this was a record year for residential property transactions and revenue declared following the significant decline in 2020-21 because of the pandemic. The high revenue declared has continued into the first two quarters of 2022, which is higher than at the same point in 2021-22. While we have seen a slightly lower number of transactions so far in 2022-23, a higher proportion (16 per cent compared to 13 per cent) are in the top two tax bands and this fiscal drag effect is driving up revenues.

4.91 The distribution of transactions across bands has also changed. We based our December 2021 forecast on 2019-20 data where around 10 per cent of transactions were in the top two tax bands. Our current forecast is based on 2021-22 data when 14 per cent of transactions were in the top two bands, but are responsible for 82 per cent of revenue. The proportion of transactions with a value of £1 million and above has more than doubled in the past five years. Properties at this value now represent roughly 13 per cent main residential LBTT (excluding ADS) of revenue.

4.92 We expect the average value of properties transacted in Scotland to rise to a record high in 2022-23. This is the average value of property transactions in the year, not the value all properties in Scotland, so a higher proportion of transactions at the higher end of the market will increase the average value. If the proportion of transactions at the upper end of the market begin to decrease, then we would expect the average value of properties transacted to also decrease.

4.93 Figure 4.21 shows how different factors have affected our residential LBTT forecast.

Figure 4.21: Change in total residential LBTT (including ADS) forecast since December 2021

£ million	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
December 2021	506	523	561	596	628	661
Model updates	12	-6	-25	-40	-54	-67
Data updates	31	65	70	72	74	82
Prices	0	32	-13	-64	-83	-90
Transactions	10	-6	-71	-82	-33	43
December 2022 forecast pre-measures	559	608	523	482	532	630
Policy costing	0	12	34	28	34	39
December 2022 forecast post-measures	559	621	557	510	566	669
Changes since December 2021	53	98	-4	-85	-62	8

Source: Scottish Fiscal Commission, Revenue Scotland (2022) Annual Report and Accounts 2021-22 – Devolved Tax Accounts (link)

Figures may not sum because of rounding. Shaded cells refer to outturn available at time of publication. LBTT revenue is net of repayments, excludes penalties and interest and also excludes revenue losses.

House prices

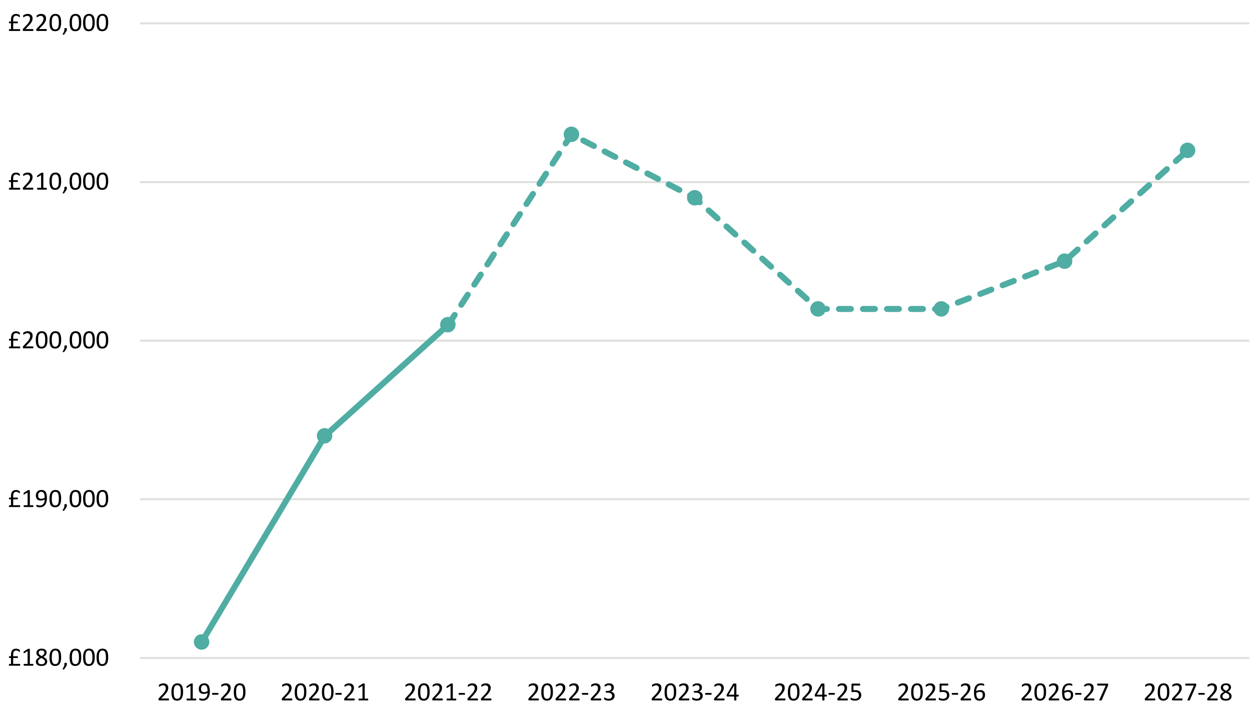
4.94 Interest rates have increased since December 2021, particularly so in the second half of 2022. Higher interest rates reduce the amount that homebuyers can borrow as mortgage repayments become less affordable. We are also forecasting real disposable household incomes over 2022-23 and 2023-24 to fall significantly, and more sharply than we expected in December 2021.

4.95 Figure 4.22 shows our forecast of Scottish house prices. From 2023-24 our forecast for house prices is also driven by our outlook on the relationship between household disposable incomes and house prices. Since December 2021 we have seen changes in macroeconomic conditions that would have an effect on this relationship. We have seen inflation increase which is affecting how much people are spending on the cost of living and likely reducing the amount that can be saved towards buying a house or contributing to monthly mortgage payments.

4.96 We are forecasting a 2.1 per cent decrease in average house prices in 2023-24 followed by a further 3.0 per cent decrease in 2024-25. We expect prices to remain steady in 2025-26 before increasing in 2026-27. We expect prices in 2027-28 to be roughly the same in nominal terms as they are in 2022-23.

4.97 The overall housing market remains very tight, with low stock keeping prices up. Because of this we do not expect prices to fall much in the long term and when we expect them to stop falling at the end of 2024-25, prices will be roughly what they were at the beginning of 2022. The Scottish Government has also announced a freeze on rent increases until the end of March 2023 which may put downwards pressure on house prices.

Figure 4.22: Forecast of average house prices



Source: Scottish Fiscal Commission, Registers of Scotland (2022) – House price statistics (link)
Solid lines refer to outturn available at time of publication and dashed lines refer to forecasts. Note that the vertical axis begins at £180,000.

Property transactions

4.98 We are expecting a 10.8 per cent decrease in transactions in 2022-23 but most of this is transaction volumes returning to a normal level following a record year in 2021-22. We expect demand for residential properties to drop during a recession which explains the rest of the drop in 2022-23.

4.99 We are expecting a further 10.8 per cent drop in 2023-24 followed by a 2.6 per cent drop in 2024-25 bringing transactions volumes down 23 per cent to 85,000 from a peak of 110,000 in 2021-22. We expect the economy to already be out of recession in 2025-26 and this is when we are forecasting that transactions will increase, reaching 2022-23 levels by 2027-28.

Comparison to OBR

4.100 OBR published their latest house price and transactions forecasts for the UK in their November 2022 Economic and fiscal outlook.[34] They are expecting house prices to decrease by 4.2 per cent in 2023-24 and 4.0 per cent in 2024-25 before they begin to rise as economic recovery takes hold. These decreases are larger than we are forecasting for Scotland. The narrative is similar for transactions though the expected downturn is sharper but less prolonged for UK.

[34] Office for Budget Responsibility (2022) – Economic and fiscal outlook – November 2022 (link)

Figure 4.23: Comparison of SFC and OBR house price and transactions growth rates

Per cent	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
House prices SFC	6.0	-2.1	-3.0	-0.1	1.6	3.1
House prices OBR	9.2	-4.2	-4.0	2.1	3.2	3.6
Transactions SFC	-10.8	-10.8	-2.8	9.6	14.6	5.3
Transactions OBR	-14.0	-15.4	0.6	11.0	15.2	8.6

Source: Scottish Fiscal Commission, Office for Budget Responsibility (2022) – Economic and fiscal outlook – November 2022 (link)

4.101 UK house prices rose 9.6 per cent in 2021-22 and 9.2 per cent in 2022-23, compared to 3.8 per cent and 6.0 per cent in Scotland, respectively. Prices across the UK have increased rapidly since the pandemic and so are arguably more vulnerable to cooling demand which would affect both prices and transactions. As recent increases in Scotland have not been as large, we do not expect as big an effect.

4.102 Average house prices and the average household debt as a share of income are lower in Scotland compared to the rest of UK. This means that as interest rates rise across the UK, homeowners and prospective homebuyers may be less vulnerable to higher mortgage payments in Scotland. We are expecting the Scottish housing market to be more resilient than the rest of the UK.

Non-residential LBTT

4.103 The outlook for non-residential property is different than for residential property. Figure 4.24 shows how our non-residential LBTT forecast has changed since December 2021. Outturn for 2021-22 is £35 million higher than we forecast in December 2021. This increase is largely because of a small number of higher value transactions being completed at the top end of the non-residential market in the second half of the year compared to the first. Our forecast for 2022-23 is similar to December 2021 but has decreased compared to our May 2022 forecast. We assumed that the higher revenues in 2021-22 represented a real change in the market rather than a temporary effect from pandemic recovery and so applied an uplift across the forecast horizon. Outturn data for the first two quarters of 2022-23 are similar to the first two quarters of 2021-22 but suggests the record high non-residential LBTT revenues in the second half of 2021-22 have not continued.

4.104 Our forecast from 2023-24 onwards is driven by our economy forecast for GDP, which has been revised down in levels since December 2021. We have also made some further amendments to our assumptions around prices and transactions because of higher interest rates and the wider economic downturn.

4.105 We expect transactions to decrease each year until 2024-25 and then begin to rise from 2025-26 as we expect the recession to end. We anticipate that prices will fall by 2.2 per cent in 2023-24 and then rise gradually for the remainder of the forecast horizon but slower than our December 2021 forecast.

Figure 4.24: Change in non-residential LBTT forecast since December 2021

£ million	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
December 2021	215	226	235	243	253	262
Model updates	-1	-59	-62	-64	-66	-68
Data updates	34	67	70	72	75	77
Prices	0	1	-11	-13	-18	-21
Transactions	0	-6	-15	-21	-15	-9
December 2022	248	229	216	218	228	241
Changes since December 2021	34	3	-19	-26	-24	-21

Source: Scottish Fiscal Commission, Revenue Scotland (2022) Annual Report and Accounts 2021-22 – Devolved Tax Accounts (link).
Figures may not sum because of rounding. Shaded cells refer to outturn available at time of publication. LBTT revenue is net of repayments, excludes penalties and interest and also excludes revenue losses.

Forecast uncertainty

4.106 There is uncertainty surrounding our price and transactions assumptions. House prices are particularly sensitive to interest rates and a larger than expected rise from Bank of England in the coming months is a notable source of downside risk to house prices. Other risks include further economic shocks and the cost of living more rapidly outpacing the growth in incomes.

4.107 For non-residential LBTT future tax revenue is heavily influenced by how many very large transactions take place during a given financial year. This means that 1 per cent of transactions account for 28 per cent of non-residential LBTT revenue, making the variability of only very few transactions significant for the annual tax take.

Policy costings

Additional Dwelling Supplement

4.108 Additional Dwelling Supplement (ADS) is chargeable where a transaction is for an additional dwelling purchased for over £40,000. The Scottish Government will raise the tax rate on ADS from 4 per cent to 6 per cent. This policy will come into effect immediately and we expect it to raise £188 million over the forecast period. We have provided further detail on how we have produced this policy costing in Annex A.

4.109 An increase to the rate means more ADS will be paid per transaction and more LBTT revenue. We expect a behavioural effect where an increase in the rate means some individuals may decide not to purchase a property that would qualify for ADS.

4.110 As ADS-liable transactions also pay the main residential LBTT, the effect of the policy change on transactions also has an effect on residential LBTT. Home movers and first-time buyers are in a position to absorb most of the lost ADS transactions so we expect some of the lost residential LBTT to be recouped by them.

Figure 4.25 Impact of changes to ADS rate on Residential LBTT (including ADS)

£ million	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Additional net ADS revenue	13	40	31	37	43	43
Change in residential LBTT	-1	-6	-3	-3	-3	-4
Total policy costing	12	34	28	34	39	40

Source: Scottish Fiscal Commission.
Figures may not sum because of rounding.

Scottish Landfill Tax

Forecast

4.111 Figure 4.25 provides our forecast of Scottish Landfill Tax (SLfT). We expect SLfT to raise £79 million in 2023-24. We are forecasting a significant drop in revenue after 31 December 2025 when the Scottish Government plan to introduce the ban on landfilling Biodegradable Municipal Waste (BMW).

Figure 4.26: Forecast revenue for Scottish Landfill Tax

£ million	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Revenue	125	101	79	72	58	16	16

Source: Scottish Fiscal Commission, Revenue Scotland (2022) Annual Report and Accounts 2021-22 - Devolved Taxes Accounts (link).
Shaded cells refer to provisional outturn available at the time of publication. SLfT revenue is net of repayments, excludes penalties and interest and also excludes revenue losses.

Changes since December 2021

4.112 Since December 2021 we have made some model changes which have increased our forecast revenues. However, outturn in the first half of 2022-23 has been lower than expected which has cancelled out the effect of the model changes. Overall, this indicates that an unusually high amount of waste was sent to landfill in 2021-22.

4.113 We expect more incineration capacity overall as we have increased our estimation of total incineration throughput in Scotland from existing sites. However, a delay in some facilities becoming operational means we expect more revenue in 2022-23 and 2023-24.

4.114 As we expect Scottish GDP and household consumption to fall in future years, we also expect less waste to enter landfill.

4.115 We have altered our model in the expectation that as more incineration goes online some of the resulting ash will begin to be landfilled. We expect to see this rise from 2023-24 onwards.

Figure 4.27: Change in SLfT forecast since December 2021

£ million	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
December 2021	123	101	83	85	70	18
Model changes	-1	11	15	17	15	8
Determinants	0	1	-7	-6	-9	-9
Incineration	0	4	4	-8	-6	0
Outturn	3	-16	-16	-16	-13	-1
December 2022	125	101	79	72	58	16
Change since December 2021	2	0	-4	-13	-13	-2

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – December 2021 (link), Revenue Scotland (2022) Annual Report and Accounts 2021-22 – Devolved Taxes Accounts (link). Figures may not sum because of rounding Shaded cells refer to provisional outturn available at the time of publication. SLfT revenue is net of repayments, excludes penalties and interest, and also excludes revenue losses.

Forecast Uncertainty

4.116 The main cause of forecast uncertainty is with the BMW ban. In order for the BMW ban to be viable around 0.5 million tonnes of incineration capacity will be needed by the end of 2025. This requires building schedules to be completed on time for three incineration sites. How much ash from incineration will be landfilled is also uncertain. We will continue to monitor this closely and may need to change our forecasts if it becomes apparent that the practical implementation of the ban is at risk.

4.117 There is also uncertainty as to how much of standard rated waste will be affected by the BMW ban. Last year SLfT revenues were much higher than anticipated and questions remain as to whether the full year data for 2021-22 or the quarterly data for the first half of 2022-23 is more representative.

Chapter 5
Social security

Overview

5.1 In this chapter, we present our forecast of devolved social security spending and its changes since the 2022-23 Scottish Budget was published in December 2021. We forecast that devolved social security spending will increase from £5.2 billion in 2023-24 to £7.3 billion in 2027-28.[35]

5.2 As shown in Figure 5.1, we forecast that spending in 2026-27 will be £1.4 billion higher than we forecast for that year in December 2021.

5.3 There are a number of factors driving the increase in spending; one of these is inflation. Since the previous Budget in December 2021, inflation was higher than expected, and as a result the uprating applied to most of the payments lead to higher spending. Our social security spending forecast increases by £352 million by 2026-27 because of the effect of higher inflation.

5.4 This forecast also includes our indicative forecasts for additional spending on social security policy commitments, the devolution of Winter Fuel Payment and the package of measures announced in the March 2022 Tackling Child Poverty Delivery Plan.[36] Including these commitments and the other policy measures introduced since the previous Budget in our forecast increases spending by £418 million in 2026-27.

5.5 The change in the spending forecast also reflects increased demand for Adult Disability Payment (ADP) following the COVID-19 pandemic and the latest evidence on the transfers of individuals' awards of disability payments from DWP to Social Security Scotland. Revising our ADP forecast to reflect the increase in demand seen across the UK increases spending by £186 million by 2026-27.

Figure 5.1: Change in total social security spending forecasts since December 2021

£ million	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
December 2021	3,679	4,065	4,657	4,966	5,230	5,511	
December 2022	3,682	4,187	5,244	6,163	6,554	6,903	7,267
Change since December 2021	3	122	587	1,197	1,324	1,392	

Source: Scottish Fiscal Commission

Figures may not sum because of rounding. Shaded cells refer to outturn available at time of publication.

5.6 At the end of this chapter, we discuss how our forecasts of social security spending increasingly exceed the equivalent funding expected from the UK Government. The Scottish Government receives funding through the Block Grant Adjustments (BGAs) for devolved social security payments. Increases in spending in a devolved payment will be covered by its BGA, if the UK

[35] Our forecasts cover spending on the payments to individuals and households, but not the associated administration costs, which are budgeted for separately by the Scottish Government.

[36] Scottish Government (2022) Best Start, Bright Futures: tackling child poverty delivery plan 2022 to 2026 (link)

equivalent also increases proportionally. The Scottish Government has introduced a number of measures across different payments, aiming to increase the number of eligible people in payment, and is developing more client focussed processes. We forecast these measures lead to spending exceeding BGA funding. This difference has to be funded from elsewhere in the Scottish Budget. Similarly, new payments without a UK equivalent must be funded entirely from the Scottish Budget.

5.7 The uncertainty in our forecast grows toward the end of the forecast period as we have less evidence for future changes in the policy and administration of the payments or the wider changes in the population and economy.

5.8 One of the main areas of uncertainty is the effect of operational and policy changes as the Scottish Government introduces new payments and its replacement payments for those devolved from the UK Government. The uncertainty attached to the implementation of new policies and approaches for complex demand-led payments and the behavioural response to these will continue to be a feature of our forecasts until we have multiple years' worth of outturn data available.

Forecasts

5.9 Spending on social security payments increases over the forecast horizon both because we expect the number of people in receipt of payments, also known as the caseload, to increase and because, on average, clients tend to receive higher payments over time.

5.10 We forecast that most caseloads will increase because of underlying trends in the prevalence of disabilities, the introduction of new policies, the effect of operational or delivery changes, and because of the higher number of people receiving payments observed in the latest data.

5.11 In addition, there are three components which contribute to the increases in the average payments. Firstly, the majority of payments are increased each year with inflation. Secondly, on top of inflation-linked increases, there may also be policy changes to increase the payment rate, for example the increase from £20 to £25 per week for Scottish Child Payment (SCP) in November 2022. Finally, clients can receive different payment rates in their disability payments, and, historically over time, a rising proportion receive a higher level of payment.

5.12 Adult Disability Payment (ADP) opened for applications from people living in pilot areas in March 2022 and was rolled out across Scotland in August 2022. We expect spending on ADP to double from £2,047 million in 2022-23 to £4,116 million by 2027-28. Uprating payment levels by inflation accounts for over £750 million of this increase in the ADP spending. The remainder of the increase reflects our expectation that the historical growing prevalence of reported disability and the latest increase in demand in Personal Independence Payment (PIP) across the UK will continue into the future, leading to more people receiving the payment. In addition, we expect that the operational and policy changes introduced by the Scottish Government will lead to higher caseload and higher average payment levels.

5.13 Similarly, we expect an increase in the number of people receiving Child Disability Payment compared to those receiving Disability Living Allowance (DLA) for Children because of the changes in policy and procedures introduced by the Scottish Government when the payment was launched nationally in November 2021.

5.14 Our spending forecasts include a set of indicative forecasts for additional spending associated with the Scottish Government's social security policy commitments presented in the Resource Spending

Review (RSR) and Medium-Term Financial Strategy (MTFS).[37,38] Our forecasts contain estimates of spending on Scottish Carer's Assistance, Pension Age Disability Payment, Employment Injury Assistance, Pension Age Winter Heating Payment and the assumed Scottish Adult Disability Living Allowance. We also include an indicative forecast for the replacement of the current Fair Start Scotland devolved employability service. Our forecasts for these indicative costings are based on limited information because the Scottish Government's policy intentions are not confirmed yet. Our additional spending forecast arises from the Scottish Government's different approach to social security as set out in the Social Security Charter.[39]

5.15 The majority of payments are uprated with inflation. We revised our payment rate and average payment amount forecasts based on the latest available statistics published by ONS, and our inflation forecast. Our uprating estimates and spending forecast are based on a 10.1 per cent increase in most payment rates in April 2023. Our inflation assumptions from 2024-25 onwards are consistent with the OBR's November 2022 Economic and Fiscal Outlook.[40] We assume a 6.9 per cent uprating in April 2024. In subsequent years the inflation forecasts fall below zero so we assume frozen payment rates in the following two years.

5.16 In November 2022, the Scottish Government extended the eligibility for SCP to children aged under 16 and increased the weekly payment rate from £20 to £25. The increase in the number of eligible children and the larger payments increases annual spending by over £300 million from 2023-24 onwards.

[37] Scottish Government (2022) Resource Spending Review – May 2022 (link)
[38] Scottish Government (2021) The Scottish Government's Medium-Term Financial Strategy – May 2022 (link)
[39] Scottish Government (2019) Social Security Scotland: our charter (link)
[40] Office for Budget Responsibility (2022) Economic and fiscal outlook – November 2022 (link)

Figure 5.2: Social security spending forecasts

£ million	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Adult Disability Payment [1]	1,739	2,047	2,690	3,218	3,513	3,794	4,116
Best Start Foods	14	13	17	20	20	20	20
Best Start Grant	14	21	20	20	19	19	19
Carer’s Allowance Supplement	58	44	50	58	65	70	74
Child Disability Payment [2]	227	269	328	374	396	417	427
Child Winter Heating Assistance	5	5	5	5	5	5	5
Discretionary Housing Payments	76	85	84	91	94	99	105
Employability Services [3]	26	24	25	25	25	25	25
Employment Injury Assistance [4]	80	79	84	87	85	82	81
Funeral Support Payment	10	12	12	13	13	13	14
Pension Age Disability Payment [5]	515	540	614	684	740	770	802
Pension Age Winter Heating Payment [6]				180	184	186	185
Scottish Adult Disability Living Allowance [7]	464	440	438	417	372	329	294
Scottish Carer's Assistance [8]	294	312	372	437	498	549	582
Scottish Child Payment	56	226	442	469	462	460	457
Scottish Welfare Fund	36	36	36	36	36	36	36
Self-Isolation Support Grant	62	9					
Severe Disablement Allowance	7	6	6	5	5	4	4
Winter Heating Payment		21	24	24	24	24	24
Total spending	3,682	4,187	5,244	6,163	6,554	6,903	7,267

Source: Scottish Fiscal Commission, Social Security Scotland, Scottish Government.

Figures may not sum because of rounding. Shaded cells refer to outturn available at time of publication.

[1] Adult Disability Payment includes spending on the UK Government Personal Independence Payment, until all existing clients are receiving Adult Disability Payment.

[2] Child Disability Payment spending in 2021-22 and 2022-23 includes spending on the UK Government Disability Living Allowance for Children, while recipients are transferred to the new payment.

[3] Employability Services is an indicative forecast and includes spending on Fair Start Scotland service and additional funding for the replacement of the devolved employability support service.

[4] Employment Injury Assistance is an indicative forecast and includes our estimate of the change in the baseline Industrial Injuries Disablement Scheme and changes arising from the introduction of Employment Injury Assistance policy.

[5] Pension Age Disability Payment is an indicative forecast and includes our estimate of the change in the baseline Attendance Allowance and changes arising from the introduction of Pension Age Disability Payment policy.

[6] Winter Fuel Payment is expected to be devolved in winter 2024 and replaced by Pension Age Winter Heating Payment.

[7] Scottish Adult DLA is an indicative forecast and includes our estimate of the change in the baseline DLA Adult and changes arising from the assumed introduction of Scottish Adult DLA and associated policy.

[8] Scottish Carer's Assistance is an indicative forecast and includes our estimate of the change in the combined baseline of Carer’s Allowance and assumed changes arising from the introduction of Scottish Carer's Assistance.

Changes since December 2021

5.17 Since December 2021, our forecasts have been updated to reflect the latest data trends, revised assumptions on future spending and the introduction of new policies. Figure 5.3 shows the change in spending forecasts for each of the social security payments.

Figure 5.3: Change in total social security spending forecasts since December 2021, by payment

£ million	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
December 2021	3,679	4,065	4,657	4,966	5,230	5,511
December 2022	3,682	4,187	5,244	6,163	6,554	6,903
Change since December 2021, of which:	3	122	587	1,197	1,324	1,392
Adult Disability Payment [1]	5	99	368	630	707	761
Best Start Foods	- 1	- 0	5	9	9	10
Best Start Grant	- 3	3	2	2	2	2
Carer’s Allowance Supplement	- 2	2	4	8	11	12
Child Disability Payment [2]	1	3	23	45	46	46
Child Winter Heating Assistance	0	1	1	1	1	1
Discretionary Housing Payments	- 2	5	3	9	11	12
Employability Services [3]	- 1	- 0	12	20	25	25
Employment Injury Assistance [3]	- 1	- 1	3	7	5	4
Funeral Support Payment	- 2	- 0	- 0	- 0	- 0	- 0
Pension Age Disability Payment [3]	- 4	- 5	39	83	112	117
Pension Age Winter Heating Payment [3]				180	184	186
Scottish Adult Disability Living Allowance [3]	- 10	- 5	21	34	22	14
Scottish Carer's Assistance [3]	- 7	- 3	24	57	86	104
Scottish Child Payment	- 0	29	80	109	101	97
Scottish Welfare Fund	0	0	0	0	0	0
Self-Isolation Support Grant	30	- 6				
Severe Disablement Allowance	- 0	- 0	0	0	- 0	- 0
Winter Heating Payment		0	3	2	2	2

Source: Scottish Fiscal Commission, Social Security Scotland, Scottish Government.

Figures may not sum because of rounding. Shaded cells refer to outturn available at time of publication.

[1] Adult Disability Payment includes spending on the UK Government Personal Independence Payment, until all existing clients are receiving Adult Disability Payment.

[2] Child Disability Payment spending in 2021-22 and 2022-23 includes spending on the UK Government Disability Living Allowance for Children, while recipients are transferred to the new payment.

[3] Indicative forecasts of assumed social security policy commitments introduced to inform the Scottish Government's Resource Spending Review in May 2022.

5.18 Figure 5.4 shows the main reasons our headline forecasts have changed since December 2021. It shows changes in spending broken down into categories such as policy changes or inflation and details the most significant drivers of the change in spending.

Figure 5.4: Change in social security spending forecasts since December 2021

£ million	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
December 2021	3,679	4,065	4,657	4,966	5,230	5,511
Underlying trends, of which:	2	63	189	320	434	551
Increase in PIP demand		-1	5	69	134	186
Reassessment indicators	0	13	17	40	66	90
Pension age caseload	5	20	50	79	105	133
Other [1]	-3	31	117	132	129	142
Inflation / Payment uprating		7	273	530	450	352
Indicative forecast			14	226	309	345
Scottish Government policy announcements	-0	28	91	90	89	94
UK Government policy changes	3	6				
Population projections [2]	0	5	12	16	19	24
Other Spending	-3	14	7	15	21	27
December 2022	3,682	4,187	5,244	6,163	6,554	6,903
Change since December 2021	3	122	587	1,197	1,324	1,392

Source: Scottish Fiscal Commission

Figures may not sum because of rounding. Shaded cells refer to outturn available at time of publication.

[1] This category covers several other factors which individually do not have a major effect, but together lead to a £142 million increase in 2026-27.

[2] Population projections reflects higher recent and future migration. Our assumptions on future migration are in line with the OBR's November 2022 forecasts. More detail can be found in Figure 3.9 in Chapter 3.

Underlying trends

5.19 Since our December 2021 publication, our models have been updated with a further year of outturn data. Overall, as a result of the new data we have increased the number of people we forecast to be in receipt of a payment and, in some cases, increases in the average payment amounts. For some payments such as Severe Disablement Allowance or the Scottish replacement for DLA for adults, the data updates have reduced our spending forecast. In aggregate, changes to the underlying trends have increased our forecast by £189 million in 2023-24 and £551 million by 2026-27.

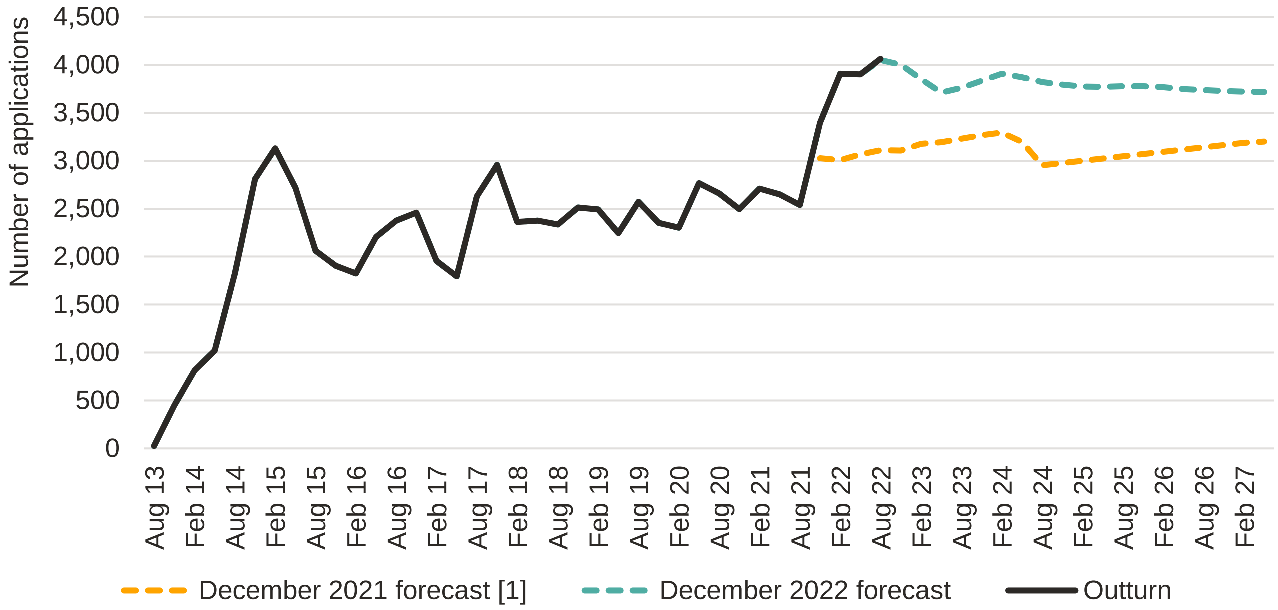
5.20 Increases in the Adult Disability Payment (ADP) spending explain most of the change in the devolved social security spending. Since December 2021, we expect that the change in the underlying trends will increase ADP spending by £510 million in 2026-27. In the following sections, we present the main elements driving the change in ADP spending.

Increase in UK-wide demand for Personal Independence Payment

5.21 The number of successful applications to Personal Independence Payment (PIP) across the UK has increased above our previous assumptions for higher demand because of the long-term effects of COVID-19.

5.22 Figure 5.5 shows that the number of successful applications has been considerably higher than we forecast in December 2021. We have increased our previous assumption to reflect the higher demand for ADP throughout the forecast period. In our forecast, we assume that the increasing NHS waiting list for diagnoses and treatment, the increasing number of people economically inactive because of long-term sickness, and the financial pressures because of the current cost of living crisis will sustain a higher demand for the payment. Box 5.3 contains further details on the relationship between ill health, disability and long-term inactivity.

Figure 5.5: Successful applications to PIP and ADP baseline forecast



Source: Scottish Fiscal Commission, Department for Work and Pensions.
[1] In December 2021, an adjustment for higher demand was included as an additional caseload rather than a number of successful applications. The December 2021 successful applications forecast has been derived from that caseload adjustment.
Solid lines refer to outturn available at time of publication and dashed lines refer to forecasts.

5.23 In producing our spending forecast for ADP, we have assumed that the increase in demand will not result in a direct increase in the additional caseload for ADP as there is a finite number of people in the population who are eligible for ADP. Therefore, we assume that the increase in the current demand for disability payments across the UK will dampen the growth in the additional number of future applications received for ADP relative to our previous forecasts.

Reassessment indicators

5.24 Analysis of case transfer from Disability Living Allowance (DLA) to Personal Independence Payment (PIP) identified a lack of clarity in the data published by DWP. In December 2021, our models used data on the number of people exiting DLA who are reassessed into PIP to inform the modelling of the ADP reassessed caseload. This approach was missing a group of clients who had received DLA in the past, who were not successful at their first application to PIP, but accessed PIP after submitting a new application later, rather than after being directly reassessed into PIP at their initial attempt. We now have a better understanding of how these clients appear in the data. Including this group of clients in our forecast increases the number of monthly successful applications adding an additional £90 million to the forecast in 2026-27.

5.25 The increase in spending because of the lack of clarity in the reassessment indicators differs from what it was presented in our May 2022 forecast. In Figure 5.5, we have grouped together the direct effect of including this missed group of clients, and the indirect effect of lowering our forecast of ADP additional spending because we are now able to refine our estimate of the pool of people in the population not currently in receipt of payment, but who have received DLA in the past.

Pension age caseload

5.26 Since our December 2021 forecast, PIP data updates have increased our forecast of the number of people over the State Pension age and receiving ADP. The increase is because the number of working age clients in PIP reaching the State Pension age has increased and the exits from this group have decreased, as this group no longer have award reviews.

Inflation

5.27 Most payment rates are increased based on the previous year's inflation and the inflation forecast is used to uprate the payment rates for future years.

5.28 Our December 2021 inflation forecast assumed that payment rates would increase by 3.9 per cent in April 2023 and 2.4 per cent in April 2024. Our December 2022 forecast incorporates the 10.1 per cent outturn uprating in April 2023 and an increased uprating of 6.9 per cent in April 2024, consistent with the OBR's November 2022 forecast.[41] We now expect frozen payment rates through 2025-26 and 2026-27 as inflation is forecast to fall below zero by late 2024.[42]

5.29 Higher inflation increases the payment rates and spending forecast from 2023-24 onwards, as discussed in **Box 5.1**.

[41] OBR (2022) Economic and fiscal outlook – November 2022 (link).
[42] OBR (2022) Economic and fiscal outlook – November 2022 (link)

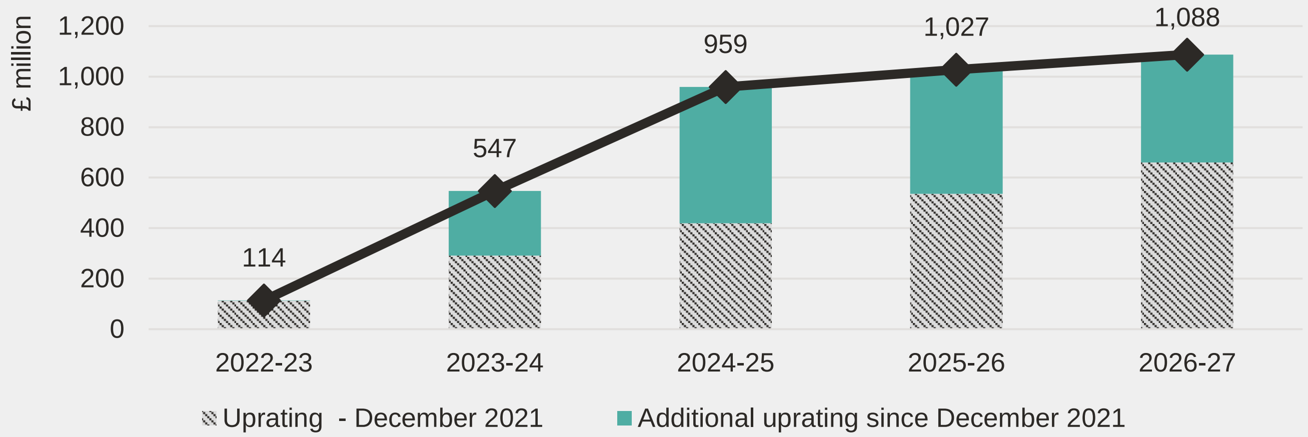
Box 5.1: Cumulative effect of inflation

Inflation is a major driver of the forecast increase in social security expenditure. Figure 5.6 isolates the cumulative effect of inflation on the spending forecast since our previous Budget forecast in December 2021.

Relative to 2021-22, isolating the effect of inflation shows an increase in spending of £547 million in 2023-24 and a cumulative increase of £1.1 billion by 2026-27.

Although forecasts for inflation drop to below zero leading to no uprating being applied for 2025-26 and 2026-27, the increases in inflation forecasts for earlier years are carried into future years in the cumulative position.

Figure 5.6: £1.1 billion inflation-linked increases in spending from 2021-22 [1]



Source: Scottish Fiscal Commission
[1] These figures differ from the change in spending presented in Figure 5.4 as those are contingent on previous changes to the forecast.

UK Government policy changes

5.30 Since December 2021, the UK Government has implemented operational delays to the award review in Personal Independence Payment (PIP). Based on the OBR assessment of these changes, we have proportionally adjusted our Adult Disability Payment (ADP) forecast.

5.31 We do not think the other UK Government measures introduced in the Autumn Budget 2022 will have a material effect on devolved social security spending.

Scottish Government policy announcements

5.32 Since December 2021, the Scottish Government has announced several policy changes. The majority of those were presented in our May 2022 publication.[43]

5.33 Our May 2022 forecasts included the increase of the weekly Scottish Child Payment (SCP) rate to £25, the removal of income thresholds from Best Start Foods, automation of Best Start Grant Early Learning and School Age payments, and the March 2022 announcement of 6 per cent uprating for some payments. Annex B includes our latest view of the costs for the SCP increase of the payment amount to £25 and the changes to Best Start Foods. We now assume that the Best Start Foods income thresholds will be removed midway through 2023-24 rather than at the start of the financial

[43] Scottish Fiscal Commission (2022) Scotland's Economic and Fiscal Forecasts – May 2022 (link).

year. Since our May 2022 forecast, the Scottish Government has announced the payment rates for Best Start Foods, the three Best Start Grant payments, Child Winter Heating Assistance, and Winter Heating Payment will increase by 10.1 per cent from April 2023.

5.34 We have also produced policy costings to reflect changes to the case transfer policies from UK disability payments to ADP. We estimated the net cost for working age clients who will transfer from DLA to ADP as a result of reporting a relevant change of circumstance, choosing to transfer, their award being scheduled for review, or if they reach the end of their DLA award. The net cost of these natural case transfers is £5 million in 2027-28. We also estimated the additional cost of longer timescales for undertaking reviews for change of circumstance and award review cases as a result of the additional time to transfer the client's award from PIP to ADP. We estimate that the longer processing times increase spending by £15 million in 2023-24 because the process will take longer than under PIP.

5.35 Our previous forecast included the Scottish Government's commitment to mitigate Benefit Cap deductions through Discretionary Housing Payments (DHP). We initially estimated this would cost an additional £4 million in 2022-23, rising to £22 million by 2027-28. We have now revised down our estimates to factor in the UK Government's decision to increase the Benefit Cap threshold to £22,000. The higher threshold means that fewer people will be affected by the Benefit Cap and their deductions will be smaller, so the cost of mitigating it will be lower. We have also increased our DHP forecast in 2022-23 by £5 million to reflect Scottish Government's investment, to be used at the discretion of local authorities, to provide additional support to eligible households as a result of the cost of living crisis.

5.36 Other policies included under Scottish Government policy announcements in the May 2022 publication were the reduction in the amount and the potential drop in take-up resulting from changes to the Self-Isolation Support Grant, and the extension of Child Winter Heating Assistance to young clients receiving ADP.

5.37 We now think that the relaxation of habitual residence requirements for Ukrainian refugees may have a small material effect on spending. We have not produced a specific costing for this but have adjusted our population assumption to allow for higher recent migration, including large numbers under the Ukraine visa schemes.

5.38 **Annex A** presents a detailed description of the policies, that have a material effect on the Scottish Budget, announced since our May 2022 forecasts were published, and **Annex B** contains our latest estimates for the policies costed in our previous forecast.

Indicative forecasts of Scottish Government policy commitments

5.39 Our forecasts include updates to the indicative forecasts of future policy commitments that we introduced to inform the Scottish Government's Resource Spending Review in May 2022.

5.40 These include estimates of additional spending associated with the Scottish Government's social security policy commitments for the devolved payments currently administered by the UK Government. We have estimated spending on Scottish Carer's Assistance (SCA), Pension Age Disability Payment (PADP), Employment Injury Assistance, Pension Age Winter Heating Payment and the assumed Scottish Adult Disability Living Allowance We also include an estimate for spending on services to replace the current Fair Start Scotland devolved employability service. Our May 2022 publication provides a detailed explanation of these spending estimates.[44]

5.41 These forecasts have greater uncertainty than other parts of our forecast as the key policy details, for example on launch dates, are yet to be confirmed. Since our previous forecast in May 2022, we have changed some of our assumptions on the timings and implementation of some of the payments. In order to avoid a two-tier system of entitlement and protect safe and secure case transfer from Carer's Allowance, we now assume that Carer's Additional Person Payment, which is a payment to qualifying people caring for more than one person receiving a disability payment, will be introduced after the case transfer from Carer's Allowance to SCA is completed, rather than at the time of SCA national launch. In line with the introduction of existing Scottish disability payments, we have also included a pilot for PADP in autumn 2024, and changed the timing for the national introduction of PADP from summer 2024 to spring 2025. Our indicative forecasts will be updated as more information becomes available.

Figure 5.7: Additional spending from indicative forecasts

£ million	2023-24	2024-25	2025-26	2026-27	2027-28
Scottish Carer's Assistance [1]		15	55	76	80
Pension Age Disability Payment		8	42	53	64
Employment Injury Assistance			0	2	3
Employability Services	14	22	25	25	25
Pension Age Winter Heating Payment		180	184	186	185
PADP costings knock-on effect on CA/CAS		1	2	3	3
Total additional spending	14	226	309	345	361

Source: Scottish Fiscal Commission
Figures may not sum because of rounding.
[1] Scottish Carer's Assistance estimate includes knock-on effect on Carer's Allowance Supplement (CAS)

Funding related to social security

5.42 Most social security spending is funded differently to other parts of the Scottish Budget because the Scottish Government receives Block Grant Adjustments (BGAs) from the UK Government for devolved payments. This funding is based on the UK payments they replace and does not include the effect of Scottish Government reforms. Any spending above the level of funding received through the BGAs must be met from the overall Scottish Budget. The social security net position is the difference between our forecasts of devolved social security payments and the corresponding BGAs. This is forecast to be increasingly negative, growing to £775 million by 2027-28.

5.43 The Scottish Government has introduced new payments which are only available in Scotland and must be funded entirely from the Scottish Budget, such as Scottish Child Payment. The spending on these payments is forecast to increase to £642 million by 2027-28.[45]

[44] Scottish Fiscal Commission (2022) Scotland's Economic and Fiscal Forecasts – May 2022 (link).
[45] The bulk of the 'new social security payments' figure are Scottish Child Payment and Carer's Allowance Supplement, but it also includes Best Start Grant Early Learning and School Age payments, Child Winter Heating Assistance, and spending through Discretionary Housing Payments on bedroom tax mitigation and the extra costs of the new commitment to mitigating Benefit Cap deductions.

5.44 Taking together the social security payments with a BGA and the new payments introduced by the Scottish Government, the difference between the level of funding received from the UK Government and total social security spending in Scotland is forecast to increase each year, rising from £374 million in 2022-23 to £1,416 million in 2027-28.

Figure 5.8: Social security net position and new payments

£ million	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Social security net position [1]	- 11	- 194	- 421	- 584	- 689	- 775
New social security payments [2]	- 363	- 582	- 625	- 627	- 636	- 642
Total	- 374	- 776	- 1,046	- 1,212	- 1,325	- 1,416

Source: Scottish Fiscal Commission
Figures may not sum because of rounding.
[1] Social security net position includes Adult Disability Payment (covered by the Personal Independence Payment BGA), Child Disability Payment and Scottish Adult Disability Living Allowance (covered by the Disability Living Allowance BGA), Pension Age Disability Payment (covered by the Attendance Allowance BGA), Scottish Carer's Assistance and Carer's Additional Person Payment (covered by the Carer's Allowance BGA), Employment Injury Assistance (covered by the Industrial Injuries Disablement Scheme BGA), Winter Heating Payment (covered by the Cold Weather Payment BGA), Pension Age Winter Heating Payment (covered by the Winter Fuel Payment BGA) and Severe Disablement Allowance (covered by Severe Disablement Allowance BGA).
[2] Social security new payments include Scottish Child Payment, Carer's Allowance Supplement, Child Winter Heating Assistance, Best Start Grant Early Learning Payment and Best Start Grant School Age Payment. We also include spending through Discretionary Housing Payments on bedroom tax mitigation and the extra costs of the new commitment to mitigating Benefit Cap deductions.

5.45 The Scottish Government also receives an element of funding added to the Block Grant for payments or schemes mirroring or replacing those available in the rest of the UK. We treat these as being funded by the UK Government and these payments are not included in Figure 5.8.[46]

Social security payments with a Block Grant Adjustment

5.46 The main drivers of the negative net position forecast for social security are the changes in eligibility and operational delivery introduced for devolved payments.

5.47 We forecast that the introduction of Adult Disability Payment (ADP) and the commitment to introduce Scottish Carer's Assistance (SCA) with some policy changes, such as the change in eligibility and making an additional payment to people caring for more than one person, will lead to the ADP and SCA combined negative net position rising to over £786 million in 2027-28.

[46] This includes Best Start Grant Pregnancy and Baby payment, Funeral Support Payment, Best Start Foods, £10.9 million of the Discretionary Housing Payments budget, the Scottish Welfare Fund, Self-Isolation Support Grant, and devolved employability support services.

Figure 5.9: Comparison of social security spending forecast and BGAs

£ million	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Block Grant Adjustments [1]	3,343	3,703	4,360	5,006	5,231	5,467	5,739
Spending on social security payments with BGAs [2]	3,326	3,714	4,554	5,427	5,815	6,156	6,513
Net position (BGA less spending), of which:	17	- 11	- 194	- 421	- 584	- 689	- 775
Attendance Allowance	1	5	7	- 4	- 40	- 53	- 67
Carer's Allowance	- 0	3	- 7	- 42	- 88	- 115	- 127
Cold Weather Payment	0	- 19	- 21	- 21	- 21	- 21	- 21
Disability Living Allowance	16	24	37	60	74	82	110
Industrial Injuries Disablement Scheme	1	- 1	- 2	- 4	- 5	- 6	- 8
Personal Independence Payment	- 1	- 24	- 208	- 411	- 504	- 573	- 659
Severe Disablement Allowance	0	0	0	- 0	- 0	- 0	- 1
Winter Fuel Payment	0	0	0	0	- 1	- 2	- 2

Source: Scottish Fiscal Commission

Figures may not sum because of rounding. Shaded cells refer to outturn available at time of publication.

[1] The latest BGA estimates are based on the OBR's November 2022 forecasts (link).

[2] Our forecasts of social security spending reflect spending in Scotland on the current payments and additional spending arising from the Scottish Government's policy changes, including our indicative forecasts of future policy commitments.

5.48 Since December 2021, our forecast for spending on Personal Independence Payment (PIP) in Scotland in the absence of Adult Disability Payment (ADP) and the OBR's PIP BGA are more closely aligned because of changes in both forecasts. We have introduced some adjustments to capture a group of clients classified as reassessed that were not previously included in our forecast but were already included in the OBR's forecast, which has increased our forecast while leaving the OBR's unchanged. On the other hand, the UK Government has paused the full rollout from Disability Living Allowance (DLA) to PIP in England and Wales. This decreased their PIP forecast and mirrors the Scottish Government position for clients in receipt of DLA. The 2026-27 net position for PIP has grown from -£214 million in our December 2021 forecast to -£573 million in our current forecast. This better reflects our judgement of the cost of launching ADP.

5.49 Grouping the DLA and PIP BGAs and comparing this with our combined spending forecast for Child Disability Payment (CDP), Scottish Adult DLA and ADP provides a more robust comparison than considering these in isolation. This is because the BGA projections combine the funding for adult and child DLA and because of the way ADP and Scottish Adult DLA interact in Scotland.

5.50 Firstly, we assume that there are more natural transfers from Scottish Adult DLA to ADP, than there would have been if the payments would have not been devolved. This means that our Scottish Adult DLA forecast is lower, and our ADP forecast is higher, than the OBR's corresponding BGA forecasts.

5.51 Secondly, there are also differences in modelling approaches and the data used to estimate the BGAs and to produce our forecast. We have not updated our CDP forecast with new data since the national launch in November 2021 because of data constraints. While the limited data available indicate that CDP is operating at a level of spending that is broadly in line with our forecast, not having access to the detailed data means there is greater uncertainty in our forecast. The contribution of child DLA to the combined disability benefit BGA has increased as the OBR has incorporated the effect of higher demand in England and Wales in its forecast.

5.52 The combined DLA and PIP net position reflects a large negative position because of the additional spending on CDP and ADP by the end of the forecast period. The full additional cost of ADP and CDP over and above the BGA will have to be fully funded by the Scottish Government from the overall Scottish Budget.

5.53 Our forecasts include indicative estimates of additional spending on the replacement payments for Carer's Allowance, Attendance Allowance, Industrial Injuries Disablement Scheme and Winter Fuel Payment. The introduction of the replacement payments further increases the funding gap. Combined spending on the replacement payments, specifically Scottish Carer's Assistance (SCA), Pension Age Disability Payment, Pension Age Winter Heating Payment and Employment Injury Assistance, is forecast to be £204 million higher than the corresponding BGAs by 2027-28.

5.54 We expect a £127 million negative funding position for SCA against the BGA for Carer's Allowance by 2027-28. We forecast spending on SCA will increase as a result of the eligibility changes that we assume will be introduced after the payment is launched, the introduction of Carer's Additional Person Payment and the increase in the eligible disability payments caseloads in Scotland. A detailed breakdown of the spending on carers payments can be found in the Supplementary Figures accompanying this publication and available on our website.

5.55 Detailed comparisons between our forecasts and the corresponding BGAs can be found in the Supplementary Figures accompanying this publication and available on our website.

New and other payments without BGAs

5.56 New social security payments include Carer's Allowance Supplement, Scottish Child Payment (SCP), Child Winter Heating Assistance, Best Start Grant Early Learning Payment, and Best Start Grant School Age Payment. We also include spending on bedroom tax and Benefit Cap mitigation through Discretionary Housing Payments. These payments do not receive associated funding from the UK Government.

5.57 Overall spending on the new social security payments, is expected to increase from £363 million in 2022-23 to £642 million in 2027-28. The largest new payment is the SCP contributing £457 million by 2027-28, and most of the increase in spending on new payments comes from the SCP extension to cover children aged over six, and the increase of the weekly payment amount to £25.

Inflation and funding position

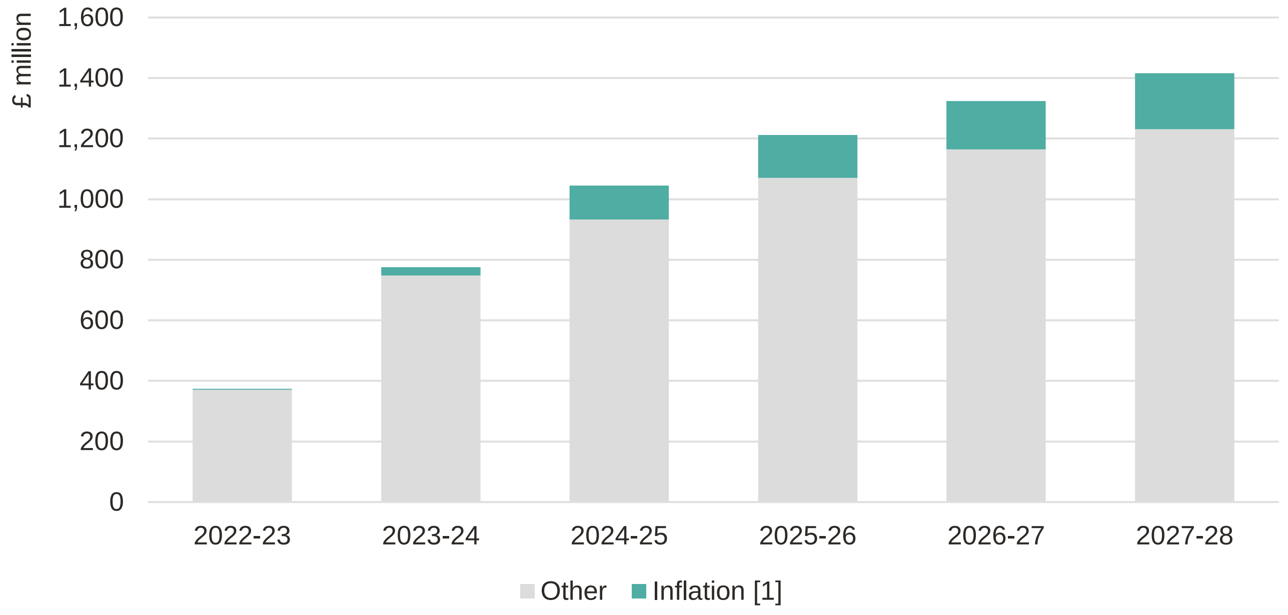
5.58 Inflation has had a direct effect on the uprating of most payments and increases spending above our December 2021 forecast.

5.59 The net budget position for social security is partly protected from the effect of inflation on spending, as the forecasts used to estimate the BGAs are based on the same inflation assumptions. For example, Severe Disablement Allowance will be uprated by 10.1 per cent in April 2023 both in Scotland and in England and Wales, and the OBR and our inflation assumptions are the same for future years.

5.60 Additional inflation-linked spending on payments without UK funding, such as SCP or the additional spending on replacement payments with a corresponding BGA, such as ADP, will not be funded by the UK Government transfer, and will be covered by the Scottish Government.

5.61 Figure 5.10 shows the inflation effect on spending above UK Government transfers. By 2027-28, we expect the Scottish Government to spend £1.4 billion more on social security than the funding received from the UK Government. Of these, spending above the UK Government transfers, £185 million is because of the cumulative effect of inflation that is not matched by corresponding increases in the BGAs.

Figure 5.10: Inflation effect on spending above UK Government transfers



Source: Scottish Fiscal Commission.
[1] Effect of inflation on spending from 2021-22.

Forecast uncertainty

5.62 Our forecasts account for changes in the historical trends in the number of people in receipt of payments, their payment amount, and wider changes to the population and economic outlook. Access to timely and relevant statistical data, firm details on future policy developments and changes that may affect the access to, or the delivery of, the payments are essential to reduce the uncertainty in our forecasts.

Data access

5.63 In our Statement of Data Needs 2022, we highlighted the importance of having access to high quality data in order to produce accurate forecasts.[47] The quality and availability of data also directly affects our ability to support parliamentary scrutiny of the Scottish Budget when producing and evaluating our forecasts.

5.64 We recognise that the introduction of a new social security system in Scotland is challenging. It involves the development of multiple operational systems to process all devolved and new payments as well as the implementation of new processes and the recruitment and training of staff. At this point, we are not able to assess the effect of the new operational processes and how the new policies are being applied. These changes may result in changes in the number of people receiving the payments and those people receiving different levels of awards.

5.65 At present, there are only limited data available to us on the Scottish disability payments. We have not incorporated data on Child Disability Payment (CDP) into our forecasts after the point of the

[47] Scottish Fiscal Commission (2022) Statement of Data Needs – August 2022 (link).

national launch, in November 2021. Data available do not cover all relevant elements of the payment yet. Revising our forecast on partial data could result in forecast errors and further subsequent revisions. In addition, the Scottish Government's different approach to administering social security payments reduces our capacity to use data from the rest of the UK to inform our CDP forecast. Our current forecast for CDP carries a greater level of uncertainty than if Social Security Scotland had been able to provide us with the required data.

5.66 We are concerned that the CDP data dissemination issues will carry over to Adult Disability Payment (ADP) statistics. A break in data series or change in the data collected compared to the data published for Personal Independence Payment (PIP) will present a much larger risk to the Scottish Budget because it makes up a larger proportion of social security spending.

5.67 The Commission welcomes the ongoing engagement with the Scottish Government and Social Security Scotland. Social Security Scotland has indicated that it aims to share relevant data with the Commission in advance of the next fiscal event so that we can incorporate it in our forecast.

Effect of policy developments

5.68 Forecasting new payments and policies is highly uncertain and heavily based on assumptions and judgements. These assumptions and judgements are informed by a systematic process of consultation with policy officials and those responsible for delivery as well as by evidence from the introduction of previous payments or reforms. Even after payments and policies have been introduced, the uncertainty attached to the costing only reduces when the relevant outturn data are available.

5.69 In particular, the costing of ADP is highly uncertain relative to our other forecasts because of the current data access limitations and changes to the operational processes which may take several years to assess. In addition, the Scottish Government's review of the payment may result in changes to the eligibility criteria. The Scottish Government has commenced a review of the mobility criteria and aims to start an independent review in summer 2023.[48] Consultations for the review of ADP have not yet been conducted and hence we have not yet changed any of our forecast assumptions. Revision of the existing policy may result in changes in eligibility and spending.

5.70 The Scottish Government plans to transfer most people receiving UK Government disability or carers' payments to Scottish payments by the end of 2025. We have produced indicative forecasts for Scottish Carer's Assistance (SCA), Pension Age Disability Payment (PADP), Employment Injury Assistance, Pension Age Winter Heating Payment and the Scottish Adult Disability Living Allowance. We also estimated spending to replace the current Fair Start Scotland devolved employability support service. These indicative forecasts are based on Scottish Government policy intentions. Currently, there are no public announcements for the specific timings for the replacement of the remaining devolved payments administered by DWP so we assume that these will be progressively introduced. Our forecasts for these payments have been revised since our May 2022 forecast as more information on the implementation of PADP and SCA is available. If there are further changes to our assumptions, for example, if these payments are delivered later than we have assumed or there is a wider communication campaign at launch, the spending on these payments may differ from our current forecasts.

[48] Scottish Government (2022) Social Security (Scotland) Act 2018: Progress Report 2021-2022 (link)

Outturn revisions

5.71 The Commission produced a Forecast Evaluation Report in August 2022; this allows us to understand our forecast errors and to draw lessons to improve our forecasts.[50] In that report, we evaluated how our previous forecast compared to the provisional Social Security Scotland outturn spending for 2021-22. That report identified a large percentage of the forecast error that could not be explained either by errors in our caseload or average payment forecasts.

Box 5.2: Revised forecast evaluation using final audited outturn for 2021-22

In our Forecast Evaluation Report in August 2022, we quoted total spending of £3,754 million and a forecast error of 4 per cent, or £136 million, based on provisional outturn. While we would normally expect some non-material changes between the provisional and final audited outturn, the final audited spending on devolved social security in 2021-22 was £72 million lower than in the provisional outturn, at £3,682 million, giving a revised forecast error of 2 per cent, or £64 million.

The adjustment made during the audit process has reduced the spending for most of the Social Security Scotland benefits by between 1 and 3 per cent. In most cases these changes are small in absolute terms, but for some of the larger benefits they are above our £5 million materiality threshold, with PIP reduced by £45 million, DLA reduced by £11 million, and Attendance Allowance reduced by £9 million. These changes are explained in Audit Scotland's Annual Audit Report on Social Security Scotland.[49]

Figure 5.11: January 2021 forecast error for 2021-22 using provisional and audited outturn

Forecast error	Forecast (£ million)	Outturn (£ million)	Error (£ million)	Relative Error (%)
Error reported using provisional outturn	3,618	3,754	136	4
Updated error using audited outturn	3,618	3,682	64	2

Source: Scottish Fiscal Commission, Social Security Scotland, Scottish Government.

5.72 We have included a supplementary document with our Forecast Evaluation Report in August 2022, explaining the effect of the data revision on our forecast error analysis.[51]

Economic outlook

5.73 The uncertainties around the economy and inflation forecasts are discussed in more detail in Chapter 3. Our current forecasts are consistent with the OBR's November 2022 inflation forecast.[52] The April 2023 uprating is now fixed to 10.1 per cent, so further changes in inflation should not be a risk to the 2023-24 Budget year. However, we assume a 6.9 per cent uprating in April 2024 followed by two years in which inflation is negative and payment rates are frozen. There is a risk that the current uprating assumption will be revised up if inflation does not fall as expected in 2024.

[49] Audit Scotland (2022) Social Security Scotland annual audit 2021/22 (link).
[50] Scottish Fiscal Commission (2022) Forecast Evaluation Report – August 2022 (link).
[51] Scottish Fiscal Commission (2022) Forecast Evaluation Report – August 2022; Chapter 4 – Social Security – Supplementary Tables (link).
[52] Office for Budget Responsibility (2022) Overview of the November 2022 Economic and fiscal outlook (link).

5.74 A more prolonged economic slowdown is a downside risk to the forecast. We currently forecast a relatively mild recession with unemployment rising but staying below 5 per cent. The depth and length of the recession could lead to changes in the eligibility for Scottish Child Payment as more or fewer households may become eligible for, or claim, Universal Credit.

5.75 Our understanding is that the cost of living crisis may be one of the factors behind the recent increase in new claims for Personal Independence Payment. A worsening of the current situation may result in applications from eligible people, who may have not previously applied. Box 5.3 contains further details on the relationship between ill health, limiting disability and long-term inactivity.

Box 5.3: Ill health, limiting disability and long-term inactivity

For working-age people there are two issues which could inform our understanding of the recent increases in new claims for disability benefits in Scotland and the rest of Great Britain.

NHS waiting times. The latest data for Scotland show that NHS waiting lists in Scotland have grown by 14 per cent in the last year and at the end of September 2022 were at a level 54 per cent higher than the quarterly average before the pandemic.[53] Delays in access to treatment could lead to people's health conditions worsening such that they are more likely to be eligible for disability benefits than if they had to wait less time for treatment.[54]

Falls in economic participation due to long-term sickness. At UK level the number of people economically inactive because of long-term sickness has increased compared to before the pandemic. The ONS suggests the rise at UK level could be a result of NHS waiting times, long COVID and the ageing workforce.[55] They also show that two-thirds of the rise in long-term sickness has been from people who were already inactive for other reasons, meaning the overall impact on labour supply could be more limited. There has been a similar but less significant rise in economic inactivity because of long-term sickness at Scotland level.[56] People not in the workforce due to ill health may be eligible to receive an out-of-work ill-health benefit (such as Universal Credit with a limited capability for work component). Although eligibility for disability benefits is not based on income, a rise in the number of working age people in receipt of out-of-work ill-health benefits could lead to an increase in disability benefit caseload as around two-thirds of people in Scotland in receipt an out-of-work ill-health benefit also receives a disability benefit.[57]

We will continue to review the data and evidence in relation to these issues to ensure we capture the scale and duration of the impacts in future social security forecasts.

[53] Public Health Scotland (2022) Inpatient, Day Case and Outpatient Stage of Treatment Waiting Times, Monthly and quarterly data to 30 September 2022. (link)
[54] Office for Budget Responsibility (2002) November 2022 Economic and fiscal outlook – welfare spending (link)
[55] Office for National Statistics (2022) Half a million more people are out of the labour force because of long-term sickness. (link)
[56] Office for National (2022) HI11 Regional labour market: Headline indicators for Scotland (link)
[57] Department for Work and Pensions (2022) Benefit combinations (link)

Annex A
Policy Costings

Policy Costings

Introduction

A.1 This annex sets out the steps and judgments taken to arrive at our costings of changes in Scottish Government policy since our May 2022 forecasts were published.

New Policy Costings

A.2 Figure A.1 shows a summary of new policy costings included in our forecasts. In this table negative numbers represent lower tax revenues or higher social security spending, and positive numbers are for higher tax revenues or lower social security spending. In the later sections covering the individual policy measures, social security changes are shown as positive if they increase spending.

A.3 There is no policy costing for freezing the Higher rate threshold as this is included in our baseline assumption. Further details can be found in in our publication, Scotland's Economic and Fiscal Forecasts – May 2022.[58]

[58] Scottish Fiscal Commission (2022) Scotland's Economic and Fiscal Forecasts – May 2022 (link).

Figure A.1: Policy costings summary

£ million	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Income Tax						
Additional rate threshold reduction	4	8	13	14	15	16
Additional rate increase to 47p		3	3	3	3	3
Higher rate increase to 42p		92	98	104	114	125
Basic rate band freeze		18	19	20	21	22
Starter rate band freeze		6	6	6	6	6
RTI adjustment		3	3	3	4	4
Total income tax policy	4	129	142	150	162	175
Non-Domestic Rates						
Increase Higher Property Rate threshold		-1	-2	-2	-1	-1
Freeze Poundage at 49.8p for 2023-24		-308	-310	-307	-325	-317
Transitional relief for gross bill increases after revaluation		-60	-15	-3	0	0
Changes to Small Business Bonus Scheme (SBBS) thresholds and rates		53	57	56	59	57
SBBS transitional relief		-40	-39	-33	0	0
Land and Buildings Transaction Tax						
Increase in the Additional Dwelling Supplement (ADS) rate from 4 per cent to 6 per cent	12	34	28	34	39	40

Source: Scottish Fiscal Commission.

Taxes

Title of measure

Income tax Policy for 2023-24 – additional rate threshold reduction

Measure Description

A.4 The additional rate threshold for Scottish non-saving, non-dividend (NSND) income tax will be set at £125,140 in 2023-24. This measure matches the cut in the top rate threshold announced by the UK government at the autumn statement in November 2022.

The cost base

A.5 The cost base for this policy is all of those taxpayers who earn more than £124,150 per year. There are two effects to this policy. Firstly, those who already pay additional rate (that is they earn over £150,000) will pay the additional rate on an extra £24,860 of their income. Secondly, those taxpayers who earn over £125,140 and currently pay tax at the higher rate of 41 pence will now pay tax at the additional rate of 46 pence on those earnings.

The costing

A.6 Figure A.2 shows how much we expect this policy to raise. In addition to our usual behavioural modelling, we have modelled a forestalling effect. When a tax change is announced in advance, some taxpayers may have the flexibility to bring forward income and take advantage of the higher threshold in 2022-23. In Scotland, only NSND income tax is affected by policy and this type of income tends to be difficult to move between years. We estimate that the overall effect is less than £1 million but there is a reduction of around £4 million in 2023-24.

Figure A.2: Income tax decrease in additional rate threshold

£ million	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Static costing		33	35	37	40	43
Behavioural change of which:	4	-25	-22	-23	-25	-28
METR effect		-14	-15	-16	-17	-19
AETR effect		-6	-7	-7	-8	-8
Forestalling effect	4	-4				
Post-behavioural costing	4	8	13	14	15	16

Source: Scottish Fiscal Commission.

Uncertainties about the costing

A.7 When tax rates and thresholds change, taxpayers may change their behaviour. We model these changes but taxpayer's behaviour could change in ways that we have not anticipated. Our forecast of the revenues raised by the policy also depend on how earnings change. If earnings are lower than expected in our forecast then revenues will be lower.

Title of measure

Income Tax policy for 2023-24 – increase in additional rate to 47 pence

Measure Description

A.8 The additional rate is increased from 46 pence to 47 pence in 2023-24.

The cost base

A.9 The cost base for this policy is all of those taxpayers who earn more than £125,140 per year. Those taxpayers will pay tax at 47 pence on income over £124,150.

The costing

A.10 Figure A.3 shows how much we expect this policy to raise.

Figure A.3: Income tax increase in Additional rate to 47 pence

£ million	2023-24	2024-25	2025-26	2026-27	2027-28
Static costing	32	34	35	37	40
Behavioural change, of which:	-29	-31	-32	-34	-37
METR effect	-29	-31	-32	-34	-37
AETR effect	0	0	0	0	0
Post-behavioural costing	3	3	3	3	3

Source: Scottish Fiscal Commission.

Uncertainties about the costing

A.11 When tax rates and thresholds change, taxpayers may change their behaviour. We model these changes, but taxpayer's behaviour could change in ways that we have not anticipated. Our forecast of the revenues raised by the policy also depend on how earnings change. If earnings are lower than expected in our forecast then revenues will be lower.

Title of measure

Income Tax policy for 2023-24 – higher rate increase to 42 pence

Measure Description

A.12 The higher rate is increased from 41 pence to 42 pence in 2023-24.

The cost base

A.13 The cost base for this policy is all of those taxpayers who earn more than £43,662 per year. Those taxpayers will pay tax at 42 pence on non-savings, non-dividend (NSND) income over £43,662. This policy has two impacts, the first is that for those earning over the higher rate threshold they will pay extra income tax. For those taxpayers who earn over the additional rate threshold of £125,140, they will pay 1 pence extra on £81,478 as well as their liability for income above the additional rate threshold.

The costing

A.14 Figure A.4 shows how much we expect this policy to raise.

Figure A.4: Income tax – increase in higher rate to 42 pence

£ million	2023-24	2024-25	2025-26	2026-27	2027-28
Static costing	128	137	146	158	173
Behavioural change, of which:	-36	-39	-41	-45	-49
METR effect	-30	-32	-34	-37	-41
AETR effect	-6	-6	-7	-7	-8
Post-behavioural costing	92	98	104	114	125

Source: Scottish Fiscal Commission

Uncertainties about the costing

A.15 When tax rates and thresholds change, taxpayers may change their behaviour. We model these changes but taxpayer's behaviour could change in ways that we have not anticipated. Our forecast of the revenues raised by the policy also depend on how earnings change. If earnings are lower than expected in our forecast then revenues will be lower.

Title of measure

Income Tax policy for 2023-24 – basic rate band freeze

Measure Description

A.16 The basic rate band for Scottish NSND Income tax will be remain at its 2022-23 level of £13,118 in 2023 24.

The cost base

A.17 The cost base for this policy is all of those taxpayers whose NSND taxable earnings are between £14,732 and £25,668 year. On these earnings, they will pay the basic rate of income tax of 20 pence. On any earnings over £25,668 and up to higher rate threshold of £43,662, income tax is due at a rate of 21 pence.

The costing

A.18 Figure A.5 shows how much we expect this policy to raise.

Figure A.5: Income tax basic rate band freeze

£ million	2023-24	2024-25	2025-26	2026-27	2027-28
Static costing	19	20	20	21	22
Behavioural change, of which:	-1	-1	-1	-1	-1
METR effect	0	0	0	0	0
AETR effect	0	-1	-1	-1	-1
Post-behavioural costing	18	19	20	21	22

Source: Scottish Fiscal Commission.

Uncertainties about the costing

A.19 When tax rates and thresholds change, taxpayers may change their behaviour. We model these changes, but taxpayer's behaviour could change in ways that we have not anticipated. Our forecast of the revenues raised by the policy also depend on how earnings change. If earnings are lower than expected in our forecast then revenues will be lower.

Title of measure

Income Tax policy for 2023-24 – starter rate band freeze

Measure Description

A.20 The starter rate band for Scottish NSND Income tax will be frozen at £2,162 in 2023-24.

The cost base

A.21 The cost base for this policy is all of those taxpayers who earn more than £12,570 per year. Scottish taxpayers will pay tax at the starter rate of 19 pence on the first £2,162 of their NSND taxable income or on their earnings over £12,570 if they do not earn more than £14,732.

The costing

A.22 Figure A.6 shows how much we expect this policy to raise.

Figure A.6: Starter rate band freeze

£ million	2023-24	2024-25	2025-26	2026-27	2027-28
Static costing	6	6	6	6	6
Behavioural change, of which:	0	0	0	0	0
METR effect	0	0	0	0	0
AETR effect	0	0	0	0	0
Post-behavioural costing	6	6	6	6	6

Source: Scottish Fiscal Commission.

Uncertainties about the costing

A.23 When tax rates and thresholds change, taxpayers may change their behaviour. We model these changes, but taxpayer's behaviour could change in ways that we have not anticipated. Our forecast of the revenues raised by the policy also depend on how earnings change. If earnings are lower than expected in our forecast then revenues will be lower.

Title of measure

Non-Domestic Rates – All material changes to NDR reliefs and rates

A.24 Figure A.7 shows a summary of the five new policy costings included in our NDR forecasts. In this table negative numbers represent lower tax revenues, and positive numbers are for higher tax revenues.

A.25 All policy impacts are calculated using an imputed valuation roll for 2023-24, described in detail in the Chapter 4 section on NDR. This is a source of uncertainty as the imputed roll may be different to the actual valuation roll, which will be available on 1 April 2023.

Figure A.7: Non-Domestic Rates policy costings

£ million	2023-24	2024-25	2025-26	2026-27	2027-28
Increase Higher Property Rate threshold	-1	-2	-2	-1	-1
Freeze Poundage at 49.8p for 2023-24	-308	-310	-307	-325	-317
Transitional relief for gross bill increases after revaluation	-60	-15	-3	0	0
Changes to Small Business Bonus Scheme (SBBS) thresholds and rates	53	57	56	59	57
SBBS transitional relief	-40	-39	-33	0	0

Source: Scottish Fiscal Commission.

Title of measure

Non-Domestic Rates – Change to Higher Property Rate threshold

Measure Description

A.26 The threshold for the rateable value of a property liable for paying Higher Property Rate (HPR) has been increased from £95,000 to £100,000. This costing would normally be at the limit of materiality but affects all subsequent costings so it has been included.

A.27 To calculate the impact of this policy we changed the HPR threshold within the model and calculated the change in revenue this caused.

Title of measure

Non-Domestic Rates – Poundage set at 48.9 pence

Measure Description

A.28 The poundage has again been set at 49.8 pence, the same rate as in 2022-23. The decrease in revenue because of this policy is larger than the decrease in revenue caused by previous poundage freezes due to the rise in forecast inflation. Historical poundages are discussed further in Chapter 4.

The cost base

A.29 This rate applies to all properties liable for NDR.

The costing

A.30 Figure A.7 in this annex shows how much we expect this policy to cost.

Uncertainties about the costing

A.31 As discussed in more detail in Chapter 4, poundage has been frozen or increased at below-inflation rates for several years, which has caused our forecast of NDR revenue to be higher than actual NDR revenue. Projected poundage rises after 2023-24 in our model.

Title of measure

Non-Domestic Rates – Transitional relief for properties increasing in value at revaluation

Measure Description

A.32 Properties that increase in rateable value at revaluation face an increase in their NDR bill. This transitional relief will apply for the next three years and will cap the gross bill increase for all properties that increased in value at revaluation.

A.33 The cap will be a percentage increase cap and will be different depending on the new rateable value of the property, shown in Figure A.8. These caps are cumulative over the three years of the revaluation cycle. For example, if a property increases in value from £10,000 to £20,000 (100 per cent increase) the rates increase will be capped at 12.5 per cent in 2023-24, 41 per cent in 2024-25, and 93 per cent in 2025-26.

Figure A.8: Transitional relief caps by year and rateable value

Rateable Value	2023-24 per cent cap	2024-25 per cent cap	2025-26 per cent cap
Small (up to £20,000)	12.5	25.0	37.5
Medium (£20,001 to £100,000)	25.0	50.0	75.0
Large (Over £100,000)	37.5	75.0	112.5

Source: Scottish Government.

The cost base

A.34 This relief applies to all properties liable for NDR.

The costing

A.35 Figure A.7 shows how much we expect this policy to cost over the next three years.

Uncertainties about the costing

A.36 We used the projected rateable values in an imputed valuation roll to forecast this relief, as the final 2023-24 valuation roll is not available. Actual values after revaluation may differ.

A.37 The transitional relief costing is presented here as a net change to the NDR income forecast. This includes an adjustment for some displacement of existing relief expenditure that would have occurred had transitional relief not been in place, as properties benefiting from transitional relief will receive, all else equal, a lower amount of another relief they may also have been eligible to receive. We have also modelled transitional relief as gross costing minus relief displacement to examine this minor issue. The allocation of this relief displacement among existing reliefs has not been modelled as there is uncertainty in modelled relief costs due to the use of an imputed valuation roll.

Title of measure

Non-Domestic Rates – Changes to Small Business Bonus Scheme relief

Measure Description

A.38 The Small Business Bonus Scheme (SBBS) is a relief that provided 100 per cent rates relief for properties with a rateable value under £15,000, and 25 per cent relief for properties between £15,000 and £18,000. Ratepayers with multiple properties with a cumulative RV of less than £35,000 could receive 25 per cent relief on each property with an RV of less than £18,000.

A.39 The rateable value threshold for 100 per cent SBBS relief will decrease from £15,000 to £12,000, so fewer properties will be eligible for 100 per cent SBBS relief. The rateable value threshold for 25 per cent relief will decrease from £18,000 to £15,000. The combined rateable value cap of £35,000 for properties occupied by the same ratepayer remains but relief can only be claimed for properties with a rateable value below £20,000. Car parks, car spaces, advertisements and betting shops are excluded from eligibility.

A.40 This change also introduces two tapers. One for properties with rateable values from £12,001 to £15,000, tapering from 100 per cent relief to 25 per cent. The second for properties with rateable values from £15,001 to £20,000 tapers from 25 per cent relief to no relief.

The cost base

A.41 This measure was costed by examining the projected rateable values of small businesses valued under £20,000 and the combined rateable values of business owning such properties, including existing SBBS recipients. Car parks, car spaces, advertisements and betting shops were removed from the dataset before costing.

The costing

A.42 Figure A.7 shows how much we expect this policy to raise.

Uncertainties about the costing

A.43 We used the projected rateable values in an imputed valuation roll to forecast this policy, as the final 2023-24 valuation roll is not available. Actual values after revaluation may differ.

A.44 We could not always tell when properties were occupied by the same ratepayer from available records.

A.45 Properties eligible for multiple reliefs may claim a different relief if their SBBS relief decreases. This behavioural change has not been modelled.

Title of measure

Non-Domestic Rates – Transitional relief for properties affected by SBBS changes

Measure Description

A.46 The policy is a three-year transitional scheme for properties losing Small Business Bonus Scheme Relief or Rural Rates Relief. Rates paid for properties losing or receiving less SBBS relief will have a maximum £600 increase per year to March 2026.

A.47 This policy also includes transitional relief for some properties claiming Rural Rates relief. This has not been costed as the number of properties receiving rural rates relief and qualifying for this transitional relief is small enough to make this below materiality.

The cost base

A.48 Changes to SBBS including introduction of two-tiered taper system, are presented in the measure above. They are shown separately from SBBS transitional relief because SBBS transitional relief only applies over next three years.

The costing

A.49 Figure A.7 shows how much we expect this policy to cost over the next three years.

Uncertainties about the costing

A.50 The same uncertainties apply as when costing the changes to SBBS relief.

Title of measure

Increase in the Additional Dwelling Supplement (ADS) rate from 4 per cent to 6 per cent

Measure Description

A.51 ADS is chargeable when a residential property is bought for over £40,000 when the buyer already owns other residential property and a main residence has not been replaced. The buyer can reclaim the ADS if a previous main residence is sold within 18 months of the purchase of a new main residence.

A.52 The Scottish Government will raise the tax rate on ADS from four per cent to six per cent. This will come into effect on 16 December 2022. Transitional provisions will apply for transactions where contracts are entered into (missives signed) on or before 15 December 2022.

The cost base

A.53 The cost base is all transactions for which ADS is due. In 2021-22, there were 25,123 such transactions on this effective date. This represents 23 per cent of all properties submitting a residential LBTT return. We use this proportion as the basis for our ADS forecasting.

The costing

Figure A.9 Impact of changes to ADS rate on residential LBTT (including ADS)

£ million	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Additional net ADS	13	40	31	37	43	43
Effect on residential LBTT	-1	-6	-3	-3	-3	-4
Total costing	12	34	28	34	39	40

Source: Scottish Fiscal Commission.

A.55 We start by estimating the distribution of gross ADS (before any repayments), based on outturn data for previous years. As there are transitional provisions for those transactions where contracts are entered into before the policy is introduced, we have assumed that all ADS-liable transactions that complete up to and including 31 January 2023 will pay the four per cent rate. This is because evidence suggests the average time of completion from missives being signed in six to eight weeks.

A.56 The policy is being implemented immediately which gives prospective buyers no time to plan for a new higher tax rate. Because of this we are not expecting a forestalling response.

A.57 We therefore assume that from 1 February 2023, all ADS-liable transactions will pay the new higher rate of 6 per cent. We estimate that 16 per cent of transactions occur in February and March. The static costing row in Figure A.10 shows the effect on our forecast of increasing the rate to 6 per cent from 1 February onwards.

A.58 To calculate the response by taxpayers to the policy change (the behavioural effect) we compare the effective tax rates before and after the policy change. With a higher rate of tax we expect fewer transactions to occur and we calculate the transactions lost using the OBR elasticities.[59]

[59] OBR (2017) Supplementary forecast release – SDLT elasticities (link)

Figure A.10 Impact of changes to ADS rate on net ADS revenues

£ million	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Static costing	17	67	56	63	74	77
Behavioural response	-3	-26	-26	-27	-31	-33
Post-behavioural costing	13	40	31	37	43	43

Source: Scottish Fiscal Commission.

A.59 ADS-liable transactions also pay the main residential LBTT, the effect of this policy change on transactions also has an effect on residential LBTT.

A.60 We assume the rest of the market is in a position to absorb most of the 'lost' ADS transactions. We assume that 50 per cent of transactions lost to ADS will be absorbed by home movers and first-time buyers in the first year of this policy, a figure that we expect increase to 75 per cent from 2024-25. The behavioural response in Figure A.11 represents this expectation.

Figure A.11 Impact of changes to ADS rate on residential LBTT Revenues

£ million	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Static costing	-2	-12	-10	-11	-13	-15
Behavioural response	1	6	8	8	10	11
Post-behavioural costing	-1	-6	-3	-3	-3	-4

Source: Scottish Fiscal Commission.

Uncertainties about the costing

A.61 There is uncertainty about the extent of both behavioural responses to the policy change. The costing uses OBR elasticities for the UK that the OBR places a high degree of uncertainty around.

A.62 There is uncertainty around the extent of the replacement of lost ADS transactions with home movers and first-time buyers.

A.63 The policy costing is based on our forecasts for the housing market and ADS receipts and therefore estimates also depend on the accuracy of our main Residential LBTT forecasts

Annex B
Policy recostings

Introduction

B.1 In this section we present updated versions of previous policy costings for which we do not yet have outturn data that includes the effects of the policy. For example, changes made to income tax in 2022-23 will not be present in the data until summer 2024.

B.2 We may also sometimes present updated costings for older policies if we have revised key judgements or assumptions, particularly in response to new evidence.

Policy recostings

B.3 Figure B.1 shows the latest recostings. Tax measures are shown as a positive figure where they generate additional revenue and negative if they reduce revenue. Social Security costings are shown as positive if they reduce spending, and negative if they increase spending, to give a consistent treatment of the impact each measure has on the Scottish Budget.

B.4 Figure B.2 then shows the change since the versions which were presented in either Annex A or Annex B of our May 2022 forecast publication.[60]

Figure B.1: Latest policy recostings

£ million	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Income tax: higher rate threshold freeze in 2022-23	107	100	96	104	115	124
NDR: 50 per cent RHL capped relief until June 2022	-33					
Scottish Child Payment increase to £20 per week	-99	-197	-209	-206	-205	-204
Scottish Child Payment increase to £25 per week [1]	-32	-53	-56	-55	-55	-55
Benefit Cap mitigation	-1	-3	-8	-9	-10	-12
Remove Best Start Foods income thresholds		-3	-5	-5	-6	-6
Changes to Self-Isolation Support Grant in May 2022	16					

Source: Scottish Fiscal Commission.

[1] Costing for increasing Scottish Child Payment to £25 now includes the full cost of increasing the rate in November 2022 rather than April 2023, some of which was previously included in the costing of the £20 rate.

60 Scottish Fiscal Commission (2022) Scotland's Economic and Fiscal Forecasts – May 2022 (link).

Figure B.2: Change since last costing

£ million	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28
Income tax: higher rate threshold freeze in 2022-23	-10	-12	-19	-18	-13	-10
NDR: 50 per cent RHL capped relief until June 2022	24					
Scottish Child Payment increase to £20 per week	-1	-18	-25	-20	-17	-15
Scottish Child Payment increase to £25 per week [1]	-13	7	5	6	7	8
Benefit Cap mitigation	3	7	7	9	10	10
Remove Best Start Foods income thresholds		3	1	1	1	1
Changes to Self-Isolation Support Grant in May 2022	2					

Source: Scottish Fiscal Commission.

[1] Costing for increasing Scottish Child Payment to £25 now includes the full cost of increasing the rate in November 2022 rather than April 2023, some of which was previously included in the costing of the £20 rate.

Annex C
Materiality and policy costings

Introduction

C.1 Some policies announced by the Scottish Government will have a very small effect relative to the size of the Scottish Budget. The Commission publishes detailed information on policies which have a material effect on the Scottish Budget, which are covered in **Annex A**. This annex covers the policies which do not have a detailed costing, some of which are still included in our forecasts. We explain the approach for each policy below.

C.2 Our approach to materiality was first introduced in our December 2018 Scotland's Economic and Fiscal Forecasts publication. We reviewed our materiality policy and set out increased materiality thresholds in **Annex C** of our January 2021 Scotland's Economic and Fiscal Forecasts publication.[61] We will review our materiality policy again in 2023.

C.3 We also consider materiality in our approach to error correction, published in our statement of compliance with the Code of Practice for Statistics.[62] We categorise errors based on materiality and then use this to help us decide on an appropriate response.

Materiality policy

Negligible policies

C.4 The Commission has set thresholds under which policies will be deemed to be negligible and will not be costed. The threshold for negligible policies is £2 million.

Small policies

C.5 For policies over £2 million but under a threshold of £5 million a decision will be made whether to cost the policy or not.

C.6 Our criteria for when not to cost a small policy require some, or all, of the following:

- a high degree of confidence that the cost of the policy is low, even if there is a high degree of relative uncertainty as to the precise cost
- the cumulative changes being made do not push the policy above the materiality threshold
- limited risk of significant behavioural response.

C.7 We also consider the level of political and media interest in the cost of the policy.

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[61] Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – January 2021 (link).
[62] Scottish Fiscal Commission (2022) Statement of Voluntary Compliance with the Code of Practice for Statistics and Error Policy (link).

Materiality decisions for December 2022

C.8 Since we published our May 2022 forecasts, the Commission has decided not to produce costings for the following policy changes.

C.9 Firstly, some small policies are judged not to be material, and are not shown in **Annex A**, but are still included in our forecasts. This is typically because they are simple to model, for example the decision to uprate some of the smaller Social Security Scotland payments by 10.1 per cent from April 2023. The small measures included in this forecast are as follows:

- Indefinite extension of the Non-Domestic Rates relief for day nurseries beyond June 2023. Our baseline assumption was that the relief would continue, so this does not change our forecast.
- Non-Domestic Rates Enterprise Areas relief is extended by one year to the end of March 2024. Our baseline assumption was that the relief would continue, so this does not change our forecast.
- Small changes to Business Growth Accelerator relief and Fresh Start relief in Non-Domestic Rates (including an increase in the rateable value upper threshold to be eligible for this relief, from £95,000 to £100,000), which will allow relief to continue while taking into account revaluation.
- The Self-Isolation Support Grant has been increased from £225 to £250 during October 2022, and it has continued to be available beyond the October 2022 end date we had assumed in previous forecasts. This slightly increases our forecast of spending for this year.
- There is a small change in Winter Heating Payment, removing restrictions on eligibility for people who live in alternative accommodation such as care homes. This change was introduced in regulations laid on 16 November 2022. It increases our caseload forecast by 20,000 and adds an extra £1 million annually to our forecast.
- From April 2023, Best Start Foods, Best Start Grant, Child Winter Heating Assistance and Winter Heating Payment will all be uprated in line with CPI inflation of 10.1 per cent.

C.10 The second category is changes which we judge to be small or negligible and for which there is no estimate included in our forecast. These are:

- Non-Domestic Rates rating exemptions for prescribed plant and machinery used in onsite renewable energy generation and storage in Scotland from April 2023.
- At the time we finalised our forecasts we did not know how long Self-Isolation Support Grant would continue to be available. We judged that spending was unlikely to be material beyond this financial year, so did not produce a forecast beyond 2022-23. The Scottish Government announced on 7 December 2022 that the payment will stop in January 2023, so we now know there will be no spending beyond this financial year.

Assessing cumulative materiality

C.11 One of the criteria for deciding whether or not to cost small policies is to check if the cumulative changes would be above our materiality threshold. We also keep under review the policies we have previously not costed to ensure that none of these are now above the thresholds.

C.12 In Figure C.1 we show all of the materiality decisions we have made since we introduced our original materiality policy in December 2018.

Figure C.1: Policies not costed since December 2018

Policy	Description and reason not to cost	Timing of original decision
6 per cent uprating	Our May 2022 forecasts included the small costs associated with the March 2022 decision to uprate several social security payments by 6 per cent from April 2022.	Scotland's Economic and Fiscal Forecasts May 2022
Voluntary DLA transfers	In May 2022 the Scottish Government introduced regulations which included provision to enable people receiving DLA who were under 65 when PIP was introduced to voluntarily request a transfer to ADP. The costs were included in our forecast and were estimated to be less than £5 million.	Scotland's Economic and Fiscal Forecasts May 2022
Automation of Best Start Grant	Our May 2022 forecasts included the small costs of automating some Best Start Grant payments to families already receiving Scottish Child Payment.	Scotland's Economic and Fiscal Forecasts May 2022
Child Winter Heating Assistance eligibility for ADP recipients	Child Winter Heating Assistance eligibility was extended to some younger Adult Disability Payment recipients. The small costs were included in our forecast.	Scotland's Economic and Fiscal Forecasts May 2022
Changes to Self-Isolation Support Grant eligibility in late 2021 and early 2022	There were several changes to eligibility criteria in response to the Omicron wave of the pandemic. It is possible that some of these individually had a material impact, but they were all superseded by the new system introduced in May 2022 and we did not attempt to produce costings.	Scotland's Economic and Fiscal Forecasts May 2022
Ukraine regulations	Emergency legislation in March 2022 allowed people fleeing Ukraine to access benefits without meeting all the usual residence requirements. We now think it is possible that this will have a material effect given the large numbers of people who have arrived under the Ukraine visa schemes.	Scotland's Economic and Fiscal Forecasts May 2022
Miscellaneous changes to the Five Family Payments	Regulations laid in September 2022 included various changes to eligibility criteria. We assessed these as having negligible costs, based on draft regulations.	Scotland's Economic and Fiscal Forecasts May 2022
Best Start Foods eligibility during pregnancy	Regulations clarified the eligibility criteria for Best Start Foods during pregnancy in cases where a partner or appointee makes the claim. We estimate that this has negligible costs.	Scotland's Economic and Fiscal Forecasts May 2022
Non-Domestic Rates solar panel relief	Business Growth Accelerator relief was extended to give full relief to any rise in rateable value from installing solar panels. We estimated that the value of this relief would be negligible.	Scotland's Economic and Fiscal Forecasts December 2021

Figure C.1 (continued): Policies not costed since December 2018

Policy	Description and reason not to cost	Timing of original decision
Child Winter Heating Assistance eligibility for PIP recipients	Eligibility was extended to include some Personal Independence Payment recipients. We included the costs in our forecast, but they were below our negligibility threshold.	Scotland’s Economic and Fiscal Forecasts December 2021
Best Start Foods thresholds uprated	The income thresholds for Best Start Foods eligibility rose in line with the National Living Wage. We estimated the costs were negligible.	Scotland’s Economic and Fiscal Forecasts December 2021
Child Winter Heating Assistance uprating	An uprating of 6 per cent was announced for April 2022. We included the higher rate in our forecast, but the cost is negligible.	Scotland’s Economic and Fiscal Forecasts December 2021
Afghan residence requirements	Residence requirements were changed so people evacuated from Afghanistan could access devolved social security assistance. We estimated that this would not have material costs.	September 2021
Best Start Foods – increase to £4.50	The weekly value was increased from August 2021 and the income thresholds were uprated. We included the small costs in our August 2021 forecast.	May 2021
Non-Domestic Rates – Local Authority Discretionary Sports Club Relief	A costing of £3 million was included in the Barclay Review of Non-Domestic Rates. We estimated that this policy change fell below our £5 million threshold for small policies.	Scotland’s Economic and Fiscal Forecasts January 2021
Non-Domestic Rates – RV threshold for Fresh Start relief	The rateable value threshold for Fresh Start relief from Non-Domestic Rates was increased from £65,000 to £95,000. We estimated that the change fell under our £2 million threshold.	Scotland’s Economic and Fiscal Forecasts January 2021
District Heating Networks relief	District heating networks installed on or after 1 April 2021 and powered by renewables, energy from waste, or waste heat will receive 90 per cent relief, rather than 50 per cent. We estimated that this change was negligible.	Scotland’s Economic and Fiscal Forecasts January 2021
Child Disability Payment – Pilot	The CDP pilot ran from the July 2021 to November 2021. We estimated that the additional spending was negligible.	Scotland’s Economic and Fiscal Forecasts January 2021
Social Security Administration and Tribunal Membership (Scotland) Bill	This is a series of administrative changes which we believe will have no material effect on spending.	In advance of the bill being introduced in April 2020
Non-Domestic Rates – Reverse Vending Machine Relief	All Reverse Vending Machines will be eligible for 100 per cent relief so adding them to the valuation roll had no effect on NDR income.	Scotland’s Economic and Fiscal Forecasts February 2020
The Revenue Scotland Tax Powers Act 2014 (Amendment) Regulations 2020	This is an administrative change which we believe has no financial implications.	Scotland’s Economic and Fiscal Forecasts February 2020
Young Carer Grant	An annual payment for young carers with an estimated cost of less than £1 million.	Scotland’s Economic and Fiscal Forecasts December 2018

Annex D
Update of 2022-23 funding

Introduction

D.1 The 2022-23 Scottish Budget was introduced to the Scottish Parliament on 9 December 2021, setting out the Scottish Government's tax and portfolio spending allocations for that year. Our December 2021 SEFF explained the funding position as it was at that time.[63]

D.2 In May 2022 we published a Fiscal Update showing how funding had changed since the Budget had been presented in parliament.[64] We take the numbers from that publication as the starting point for the funding information in Figures D.1 and D.2.

D.3 Since our last Fiscal Update, the UK Government announced the Growth Plan 2022 containing some policies with immediate effect on devolved taxes. The Scottish Government followed that with an Emergency Budget Review, as well as the statutory Scottish Autumn Budget Revision. However, most of the measures on the Growth Plan have now been reversed.

Resource

D.4 Figure D.1 shows the changes to the resource funding position since the last Fiscal Update. Since May 2022, resource funding for 2022-23 has increased by £536 million. The reasons behind the changes are:

- An additional £41 million of consequentials came from the Chancellor of the Exchequer's announcement of a doubling of the Household Support Fund in England in May 2022, as part of the second cost of living financial package. These were not added to the 2022-23 UK Main Supply Estimates, reflected in our last Fiscal Update. Instead, the Scottish Government expect them to be formally granted at the end of the financial year through the 2022-23 UK Supplementary Estimates.

- An additional £57 million of devolved revenues, made up of £32 million as a result of our December 2022 forecast of devolved taxes (+£53 million for LBTT, -£21 million for SLfT), and £25 million of non-tax income that we had previously included within the other funding line. This latter change has no effect on the overall funding position.

- An additional £42 million from BGAs (fully devolved taxes and social security combined) following their recalculation based on the latest November 2022 forecasts from the OBR. These were adjusted in-year at the Autumn Budget Revision.

- An additional £82 million of resource borrowing, as the negative forecast error on the BGAs based on the OBR November 2022 forecasts unlocked extra resource borrowing power.

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[63] Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – December 2021 (link).
[64] Scottish Fiscal Commission (2022) Fiscal Update – May 2022 (link).

- An additional £205 million from resource reserve drawdown. This increases the total amount drawn down in 2022-23 to £605 million, which is all the projected available balance at the time of publication.

- An overall increase of £269 million in the other line, largely explained by assumed funding materialising in larger amounts than expected, as well as some unanticipated funding.

- A deduction of £160 million to account for the repayment of borrowing. Prior to May 2022 we did not present this as it was a non-voted spending allocation, and so was not part of the funding position. However, in line with the Scottish Government's new presentation, we now deduct it from total resource funding showing funding available for discretionary spending.

Figure D.1: Up-to-date 2022-23 resource funding position

£ million	May 2022 Fiscal Update	Changes since 31 May 2022	Most current position
UK Spending Review baseline (Barnett)	34,322		34,322
Barnett consequentials	406	+41	447
of which: assumed		+41	41
of which: confirmed			406
Non-Barnett funding	704		704
Forecast Scottish devolved revenues	14,589	+57	14,646
of which: devolved tax revenues	14,589	+32	14,621
of which: devolved non-tax revenues		+25	25
Tax and non-tax BGAs	-14,639	-74	-14,713
Social security BGAs	3,587	+116	3,703
Adjustment for past forecast error	0	+82	82
Reconciliations	-15		-15
Resource borrowing	15	+82	97
Scotland Reserve drawdown	400	+205	605
Other funding	632	+269	901
of which: assumed [1]	510	-490	20
of which: confirmed [2]	122	+759	881
NDR distributable amount	2,766		2,766
minus: resource borrowing costs		-77	-77
minus: capital borrowing costs		-83	-83
Resource funding available for discretionary spend	42,767	+536	43,303

Source: Scottish Fiscal Commission, Scottish Government.
Figures may not sum because of rounding.
[1] Note that the assumed 'Other funding' when the Budget was set was £620 million, but we decreased it to £510 million in our Fiscal update of May 2022 to avoid double counting, as one of the underlying assumptions had been additional assumed consequentials which by then had been confirmed. It now consists of £10 million of anticipated extra funding from the King's and Lord Treasurer's Remembrancer (KLTR), and £10 million of extra cash in the Scottish Consolidated Fund.
[2] Consists of £375 million of compensation for past years in the income tax spillover dispute, £155 million of Migrant Surcharge, £126 million of reprofiled voluntary NDR payments from 2021-22, £96 million of ScotWind proceeds, £94 million of Machinery of Government transfers, £30 million of other small sources of funding combined, and £5 million from KLTR.

Capital

D.5 Figure D.2 shows the changes on the capital funding position since the last Fiscal Update.[65] Since May 2022, capital funding has decreased by £122 million. The reasons behind the changes are:

- A movement of £200 million from other assumed funding to capital borrowing. The Scottish Government expected these funds to be extra balances in the reserve, consequentials or other sources. These funds are unlikely to materialise, so the Scottish Government now plans to borrow instead to make up the shortfall. This plan may be revisited if other funding increases. The reduction in assumed other capital funding is partly offset by £20 million of anticipated capital Machinery of Government (MoG) transfers, leading to an overall reduction for this line of £180 million.

- A reduction of £63 million in planned drawdowns from the capital reserve. The current plan is to draw down £81 million, all the projected balance available.

- A reduction of £32 million from other confirmed funding. This is an extra £33 million between City Deals and MoG transfers, offset by an adjustment of -£65 million to account for the Scottish Government's contribution to Ukraine as part of a UK-wide aid package.

- A reduction of £47 million on the drawdown from the financial transactions (FTs) reserve. The 2022-23 Budget had been set with £61 million of planned drawdown. However, the balance available in the FTs reserve ended up being lower than that. This reduction ensures that the drawdown is within available balances.

[65] Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – May 202 (link).

Figure D.2: Up-to-date 2022-23 capital position

£ million	May 2022 Fiscal Update	Changes since 31 May 2022	Most current position
Capital (Excluding FTs)			
UK Spending Review baseline (Barnett)	4,469		4,469
Barnett consequentials	12	+0.4	13
Non-Barnett funding	718		718
Capital borrowing	250	+200	450
Scotland Reserve drawdown	144	-63	81
Other funding	344	-212	132
of which: assumed [1]	200	-180	20
of which: confirmed [2]	144	-32	112
Total capital funding (excluding FTs)	5,937	-75	5,863
Financial transactions			
UK Spending Review baseline (Barnett)	466		466
Scotland Reserve drawdown	61	-47	14
Total financial transactions	527	-47	480
Total capital funding	6,464	-122	6,343

Source: Scottish Fiscal Commission, Scottish Government.

Figures may not sum because of rounding.

[1] The amount still assumed relates to £20 million of anticipated capital Machinery of Government transfers.

[2] At the time of setting the 2022-23 Budget, the confirmed 'Other funding' was £100 million of City Deals and £44 million of Fossil Levy.

Additional Information

Abbreviations

ADP	Adult Disability Payment
ADS	Additional Dwelling Supplement
AETR	Average Effective Tax Rate
BGA	Block Grant Adjustment
BMW	Biodegradable Municipal Waste
BoE	Bank of England
CA	Carer’s Allowance
CDP	Child Disability Payment
CPI	Consumer Price Index
CWHA	Child Winter Heating Assistance
DHP	Discretionary Housing Payment
DLA	Disability Living Allowance
DWP	Department for Work and Pensions
EPR	Empty Property Relief
EU	European Union
FAI	Fraser of Allander Institute
FFFPs	Fines, Forfeitures and Fixed Penalties
GDP	Gross Domestic Product
HMRC	His Majesty’s Revenue and Customs
HMT	His Majesty’s Treasury
HRT	Higher Rate Threshold
IFS	Institute of Fiscal Studies
ISBN	International Standard Book Number
KLTR	King’s and Lord Treasurer's Remembrancer
LBTT	Land and Buildings Transaction Tax
METR	Marginal Effective Tax Rate
MoG	Machinery of Government
MTFS	Medium Term Financial Strategy
NDR	Non-Domestic Rates
NHS	National Health Service
NIC	National Insurance Contributions
NIESR	National Institute of Economic and Social Research
NSND	Non-Savings and Non-Dividends
OBR	Office for Budget Responsibility
OECD	Organisation for Economic Cooperation and Development
ONS	Office for National Statistics
PADP	Pension Age Disability Payment
PAWHP	Pension Age Winter Heating Payment
PAYE	Pay As You Earn
PIP	Personal Independence Payment
PUT	Public Use Tape
QNA	Quarterly National Accounts
RHL	Retail, Hospitality and Leisure
RSR	Resource Spending Review
RTI	Real Time Information
RV	Rateable value
SBBS	Small Business Bonus Scheme
SCA	Scottish Carer’s Assistance
SCP	Scottish Child Payment

SFC	Scottish Fiscal Commission
SG	The Scottish Government
SIT	Scottish Income Tax
SLfT	Scottish Landfill Tax
STA	Short-Term Assistance
VAT	Value Added Tax
WA	Withdrawal Agreement
WRIT	Welsh Rates of Income Tax

A full glossary of terms is available on our website:

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

Professional Standards

The Commission is committed to fulfilling our role as an Independent Fiscal Institution, in line with the principles set out by the Organisation for Economic Cooperation and Development (OECD).[66]

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.[67]

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

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