Scotland's Economic and Fiscal Forecasts – Summary

May 2023 (revised version June 2023)

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Foreword

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

Our forecasts have been used to inform the Scottish Government's Medium-Term Financial Strategy 2023, also published today. Our protocol for engagement with the Scottish Government guides our interaction with the Government during the forecasting process. We would like to thank the staff of the Commission as well as officials from the Scottish Government, Revenue Scotland, Social Security Scotland, Department for Work and Pensions, HM Treasury, HM Revenue and Customs, and the Office for Budget Responsibility for their support in creating this report.

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25 May 2023

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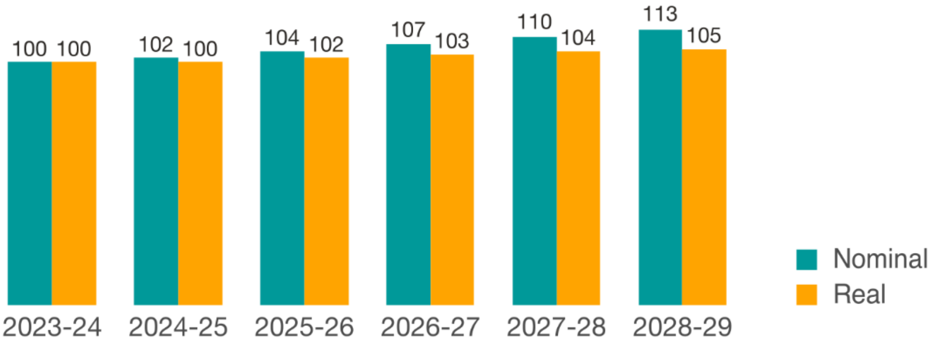
Fiscal Overview

Total funding is forecast to increase in all years in nominal terms until in 2028-29 it is 13 per cent greater than in 2023-24. Inflation will erode that growth to 5 per cent.

Resource drives this growth with increases in all years. Nominal capital funding will remain 8 per cent below 2023-24 levels throughout the period.

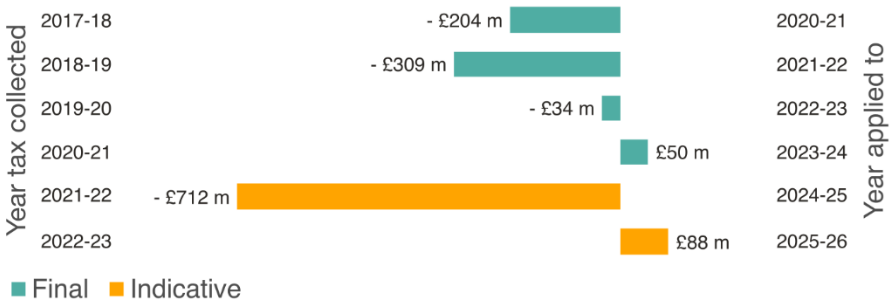
Medium-term outlook for total funding



Income tax reconciliations take place three years after the Budget when the funding was originally set.

In 2024-25 we still expect a large negative income tax reconciliation relating to 2021-22 revenues, which will exceed the fiscal framework borrowing limits. This will have a negative effect on resource funding.

Significant income tax reconciliation expected in 2024-25

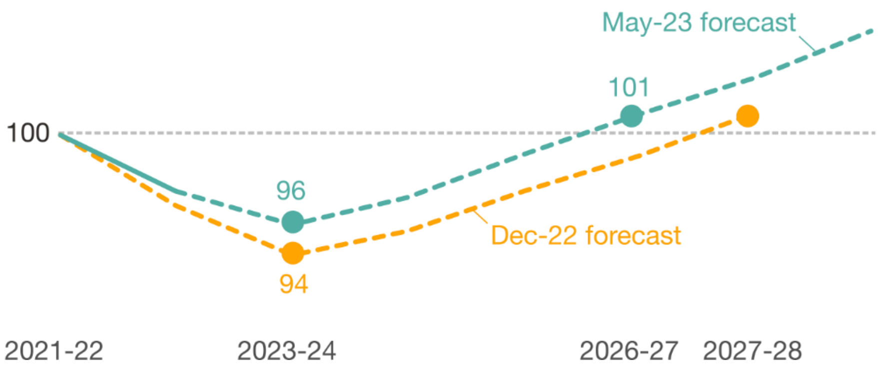


Economy

High inflation sees real disposable incomes per person fall by 4 per cent by the end of 2023-24, Scotland's highest fall in living standards on record.

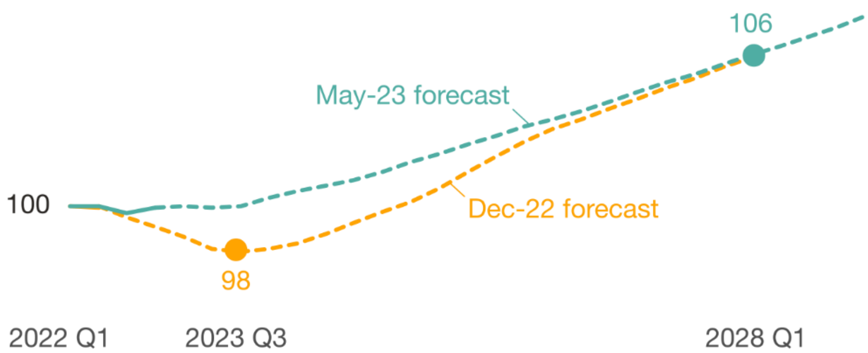
Living standards will take until 2026-27 to recover to their 2021-22 level. This outlook is improved since our December 2022 forecast reflecting lower energy price expectations.

Living standards to fall by less than previously expected

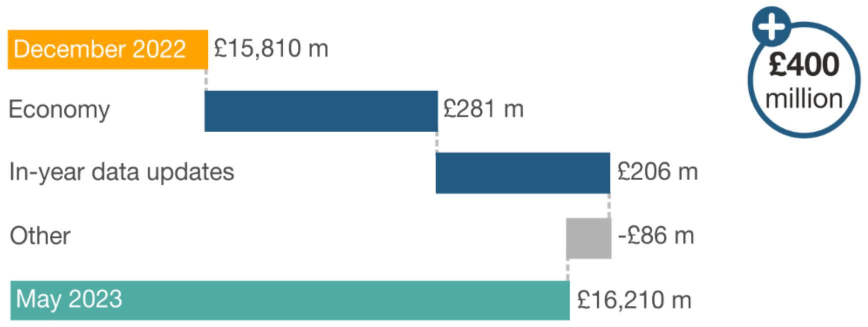


In line with the latest Gross Domestic Product (GDP) data and the improved outlook for energy prices we now forecast the economy to remain broadly flat in 2023-24 rather than fall into a shallow recession.

GDP to remain broadly flat this year



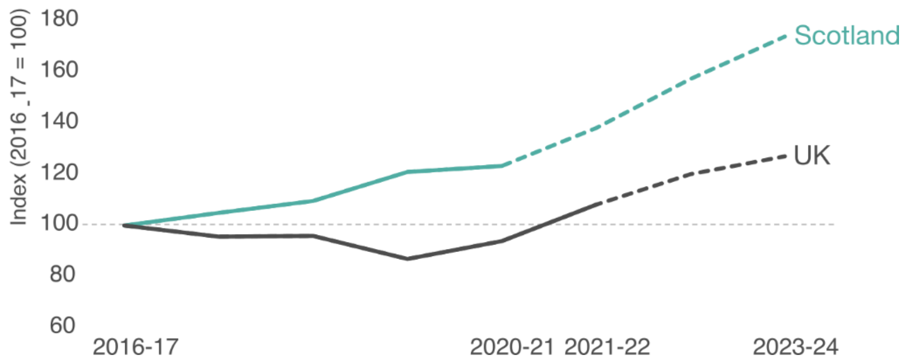
Income tax changes since December 2022 forecast



Our income tax forecast has been increased by higher employment growth, and nominal earnings growth.

Higher than expected RTI data on PAYE income tax receipts for 2022-23 also contribute positively.

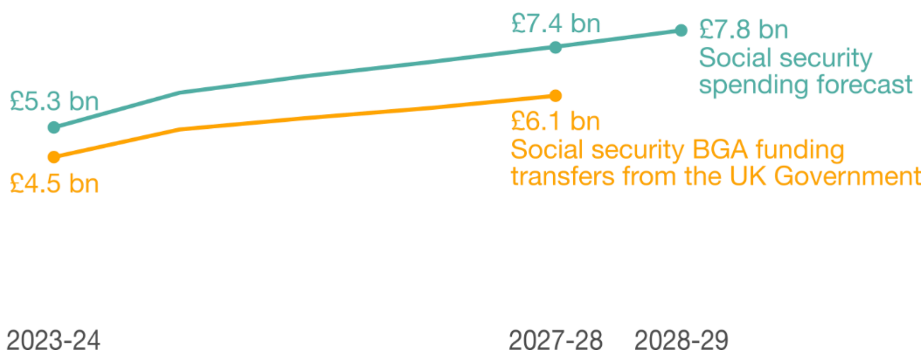
Growth in number of higher rate taxpayers



Since 2016-17, the Scottish higher rate threshold has largely been frozen. The number of higher rate taxpayers is expected to have increased by over 70 per cent in this time. The higher rate threshold freeze in the UK means the number of UK higher rate taxpayers is now also rising.

Social Security

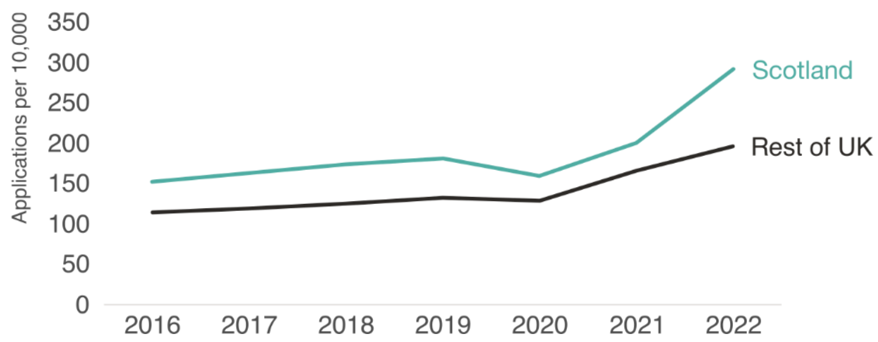
Spending increasing to £7.8 bn by 2028-29



Social security spending forecast to increase from £5.3 bn in 2023-24 to £7.8 bn in 2028-29.

By 2027-28, we expect the Scottish Government to spend £1.3 bn more on social security than the funding received from the UK Government through the BGAs.

Increased demand for disability payments for working age population



Demand for disability payments across the UK has increased substantially since 2020.

Disability payment forecasts have been revised up to reflect sustained demand at a higher-than-expected level.

	2023-24	2024-25	2025-26	2026-27	2027-28	2028-29
Budget funding, £ million						
Total budget (nominal)	51,674	52,584	53,799	55,318	56,880	58,475
Total budget (2023-24 prices)	51,674	51,772	52,462	53,305	53,919	54,344
Economy, % growth						
GDP	0.3	1.0	1.3	1.3	1.4	1.4
Consumer Price Index	4.1	0.6	0.0	0.8	1.7	2.0
Average real earnings	0.9	1.8	2.1	1.5	1.1	0.9
Employment	0.3	0.0	0.3	0.3	0.3	0.3
Tax, £ million						
Income tax	16,210	17,080	17,808	18,591	19,646	20,799
Non-Domestic Rates	3,046	3,133	3,158	3,437	3,328	3,374
LBTT	772	733	792	905	992	1,053
Scottish Landfill Tax	92	83	58	16	16	16
Policy announcements, £ million						
Income tax	-14	-31	-75	-77	-81	-14
Non-Domestic Rates	-4	-2	0	0	0	-4
LBTT	1	5	2	-5	-5	1
Social Security, £ million						
All devolved social security	5,290	6,192	6,638	7,000	7,389	7,831

Summary

Introduction

1 The outlook for the Scottish economy, devolved taxes and social security presented in this report has remained broadly unchanged since our previous December 2022 forecasts. This contrasts with the volatility seen in recent years, which has resulted in regular and significant updates to our forecasts between recent publications. Though a technical recession has been avoided, economic activity remains muted, with falling living standards as the rising cost of living continues to put pressure on households.

2 Looking at our tax and social security forecasts, the updates we have made are largely incremental. Income tax revenues have been revised up in line with higher employment growth and higher nominal earnings growth driven by inflation. Following similar revisions by the Office for Budget Responsibility (OBR) to the income tax forecast for England and Northern Ireland, the income tax net position is largely unchanged, with a small upwards revision. As we have highlighted in previous reports, we continue to expect the income tax outturn data for 2021-22, due to be published this summer, to result in a large and negative income tax reconciliation in 2024-25, currently estimated at -£712 million.

3 As with the tax forecasts, there have been upward revisions to our forecasts of social security spending. The most important factor in the revisions has been an increase related to higher demand for disability benefits. This was something we included in our forecasts in December 2022, but the latest information shows the effect is stronger than previously anticipated.

4 The overall outlook for resource funding is for modest increases in real terms throughout the five-year forecast horizon. However, the Scottish Government's Medium-Term Financial Strategy (MTFS) provides projections for resource spending for 2024-25 to 2027-28 which show spending growing more quickly than funding in the central scenario, presenting a challenge for the Government in setting the Budget in future years. For capital funding the outlook is more constrained and it is projected to fall in both nominal and real terms over the next five years.

Economy

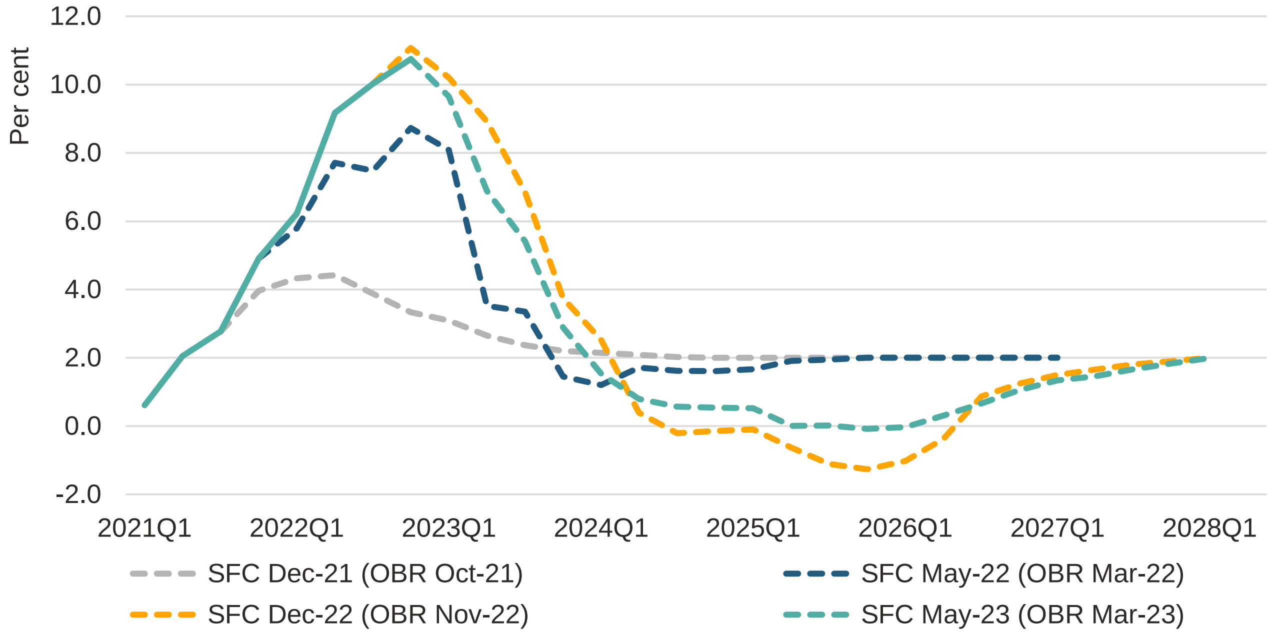
5 The overall outlook for the Scottish economy is largely unchanged since our December 2022 forecasts, with slow and fragile economic growth over the short term. In line with the latest Gross Domestic Product (GDP) data which have been mildly above expectations, we now forecast the economy to remain broadly flat this year rather than fall into a shallow recession.

6 Comparing to our December 2022 forecasts, energy prices have fallen back more quickly than expected, leading to slightly lower expectations for inflation and interest rates in the near term. This contributes to the marginally improved forecast for short-run GDP. Living standards, however, are still likely to fall this year because the overall rate of inflation – now reflecting a broader range of price rises than just energy – will continue to outpace growth in nominal household disposable

incomes. As we outlined in December, this means the coming years will continue to be difficult for many households, especially those with lower incomes.

7 Annual Consumer Price Index (CPI) inflation has come down from its peak of around 11 per cent in 2022 Q4 and is still expected to drop sharply over the course of this year, broadly on track with predictions from December.

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



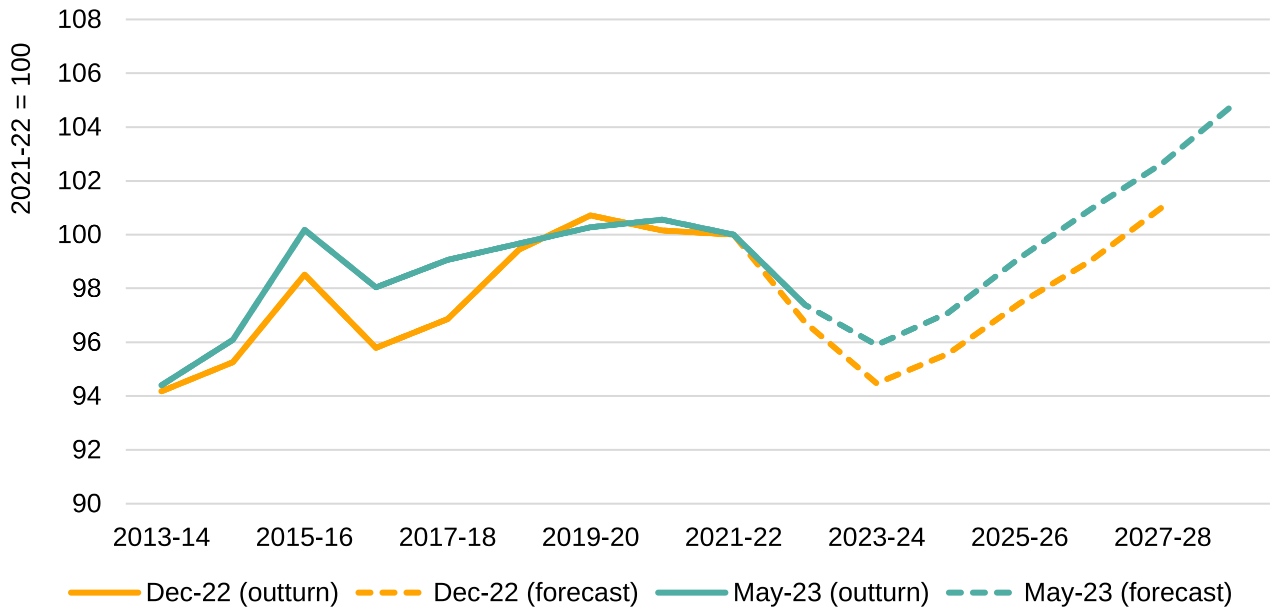
Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2022) Scotland's Economic and Fiscal Forecasts – December 2022 (link), Scottish Fiscal Commission (2022) Scotland's Economic and Fiscal Forecasts – May 2022 (link), Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – December 2021 (link), OBR (2023) Economic and fiscal outlook – March 2023 (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.

8 Below the headline rate, we continue to see some variation in inflation among different items. Energy prices are expected to stabilise at current levels or fall further. This means energy price inflation, comparing today's prices to last year's very high levels, is on track to drop substantially. In contrast, food price inflation has been accelerating and is currently almost 20 per cent.

9 As in our December 2022 forecast, Scottish households are still expected to see the biggest fall in living standards – as measured by real disposable income per person – since Scottish records began in 1998, of 4.1 per cent between 2021-22 and 2023-24. This fall is slightly shallower than we forecast in December, reflecting the lower expectations for inflation and interest rates. Even once inflation returns to lower levels and real disposable incomes start to grow again in 2024-25, living standards will take time to recover to the 2021-22 level. Our forecast suggests that, by 2025-26, real disposable income per person will be no higher than a decade earlier. The energy price shock has prolonged a period of slow growth in living standards since the 2008-09 Global Financial Crisis, with real disposable income per person growing on average by only 0.6 per cent per year between 2008-09 and 2021-22 compared to 2.5 per cent per year before 2008-09.

10 Higher living costs affect everyone, but there are particular pressures on lower-income households, as they spend a larger share of income on essentials such as energy and food. Higher interest rates add to the costs of mortgages and other forms of debt for some households. However, Scotland has lower average house prices and lower average household debt as a share of income than the UK as a whole, so higher interest rates will tend to have a smaller effect in Scotland.

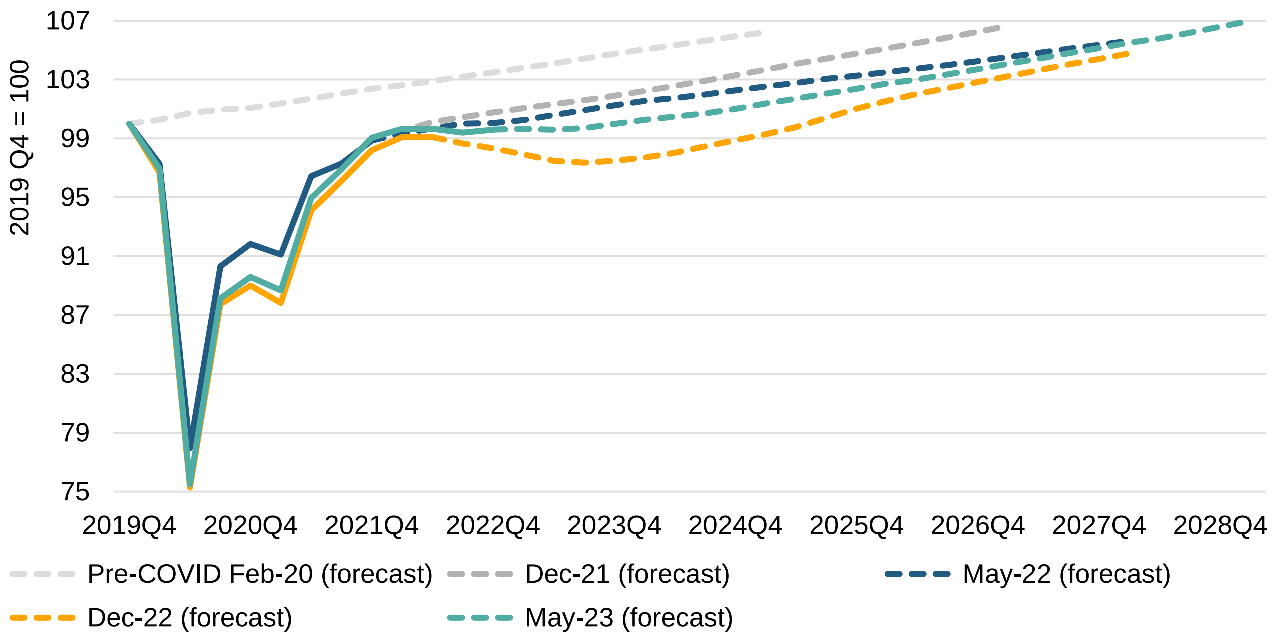
Figure 2: Real disposable income per person, 2021-22 equals 100



Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2022) Scotland's Economic and Fiscal Forecasts – December 2022 (link).
Solid lines refer to outturn available at time of publication and dashed lines refer to forecasts. Amounts indexed so that 2021-22 is equal to 100.

11 As emphasised in our December 2022 report, when looking at GDP, we consider that the level of GDP in Scotland over the longer term is more important than the specific path for growth over the short term. Although we are no longer forecasting a technical recession, the overall environment remains one of slow and fragile economic growth. Even if a recession was to occur later in the year, or emerge in future revised data, we do not expect the underlying economic picture to be meaningfully different from that in this report.

Figure 3: Scottish GDP, 2019 Q4 equals 100



Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2022) Scotland's Economic and Fiscal Forecasts – December 2022 (link), 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. Amounts indexed so that 2019 Q4 is equal to 100.

12 As we noted in recent reports, the uncertainty around our economy forecasts has been greater than usual and, generally, this is also true this time around. The main source of uncertainty continues to be inflation, particularly its 'core' component which excludes energy and food. A wage-price spiral, which would keep inflation and interest rates higher for longer, also remains a risk.

13 Figure 4 shows further detail on our latest economy forecast and compares it to our December 2022 forecast.

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

Per cent	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28	2028-29
GDP							
December 2022	1.7	-1.0	1.2	2.1	1.9	1.5	
May 2023	2.0	0.3	1.0	1.3	1.3	1.4	1.4
Consumer Price Index							
December 2022	10.1	5.5	0.0	-1.0	0.8	1.8	
May 2023	10.0	4.1	0.6	0.0	0.8	1.7	2.0
Unemployment rate							
December 2022	3.4	4.3	4.7	4.6	4.3	4.1	
May 2023	3.3	3.8	4.1	4.1	4.1	4.1	4.1

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2022) Scotland's Economic and Fiscal Forecasts – December 2022 (link).
Shaded cells refer to outturn available at time of publication.

Tax

14 We expect devolved Scottish taxes to raise £20.1 billion of revenue in 2023-24, which is £384 million higher than in our December 2022 forecasts. Much of this change can be attributed to an increase in our forecast for income tax. We have seen a slight improvement in the underlying economy forecast as well as higher than expected Real Time Information (RTI) data on Scottish income tax Pay As You Earn (PAYE) receipts. Rising nominal earnings growth combined with tax thresholds that are fixed in nominal terms are driving up income tax revenues.

15 For Non-Domestic Rates (NDR) a new valuation roll was published on 1 April 2023, resulting in a small revision when included in our forecast. Our forecast for residential Land and Buildings Transaction Tax (LBTT) has increased because we revised our house prices forecast up slightly since December 2022 in light of a slightly more positive outlook for the economy. We have revised up our estimate of the amount of waste produced in 2022-23 and this has increased our forecast for Scottish Landfill Tax (SLfT).

The income tax net position

16 The income tax net position shows how the funding received from Scottish income tax revenues compares to the reduction in funding from the income tax Block Grant Adjustment (BGA). Estimates of the income tax net position can be calculated by comparing our forecasts to forecasts of BGA which is based on the OBR's forecasts.

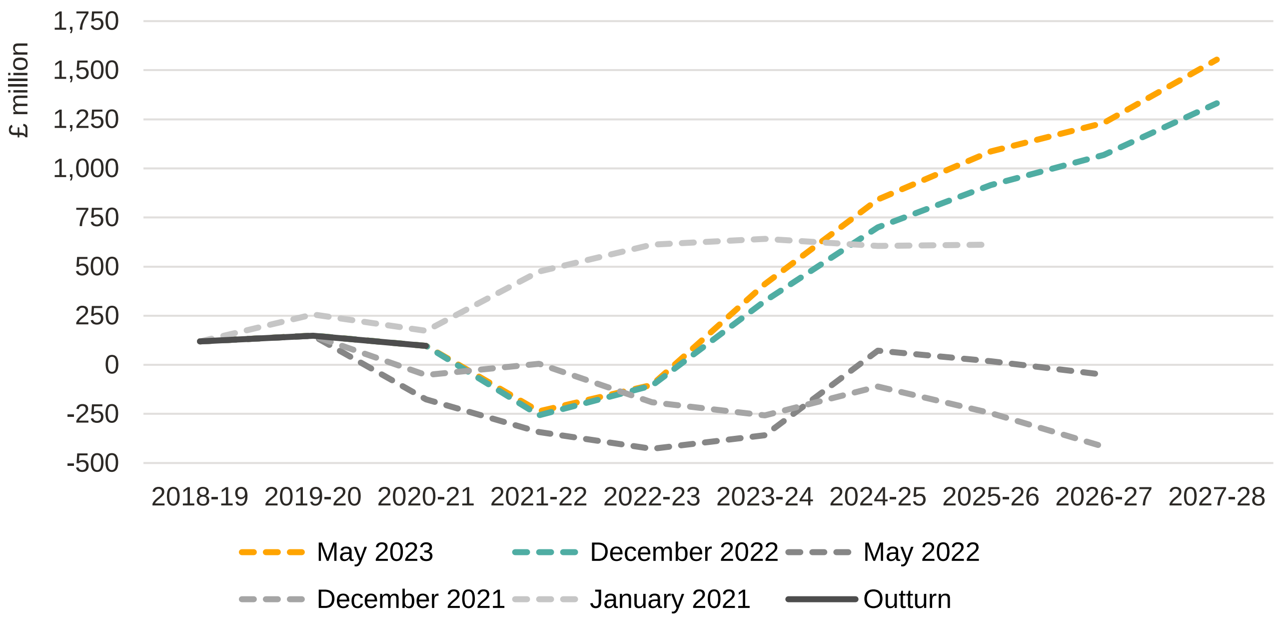
17 In December 2022 our forecasts showed improvements in the net tax position over the five-year horizon compared to previous forecasts. Since then there have been further, although less

substantial, improvements in the income tax net position in light of our and the OBR's latest forecasts. Figure 5 shows the different estimates of the income tax position since January 2021.

18 As we have stressed in previous reports, we continue to advise caution over the high outlook for the income tax net position. From experience, we can see that revisions to the outlook are quite common. The underlying Scottish and UK income tax forecasts are very large, with the income tax net position driven by the difference between the two. Relatively small changes in either forecast can lead to significant changes in estimates of the net position. In Figure 5 we show previous estimates of the net position back to January 2021 to illustrate this variability. Caution over the estimated income tax net position is particularly relevant now as the uncertainty around inflation makes variations in forecasts of income tax revenues in Scotland and the rest of the UK more likely.

19 As in December 2022, a divergence in earnings growth between our and the OBR's forecasts continues to be the main driver of the strongly positive estimated income tax net position for Scotland. In March 2023, the OBR forecast UK average nominal earnings growth of 2.0 per cent per year between 2024-25 and 2027-28, the same as in their previous forecast. This is lower than both our forecast of 2.6 per cent per year average nominal earnings growth in Scotland across the same period and the average UK earnings growth of 2.7 per cent per year between 2011 and 2022. If Scottish and UK earnings growth turn out to be closer in the coming years, the net position is likely to be materially lower than currently estimated.

Figure 5: The income tax net position comparison



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

Income tax reconciliations

20 When the Scottish Budget is set, funding from Scottish 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. We can derive indicative estimates of future income tax reconciliations by comparing our latest forecasts and the latest forecast Block Grant Adjustments (BGAs) to those used in the Budget setting forecasts.

21 As we have highlighted in recent publications, we continue to expect a large and negative income tax reconciliation for the Budget year 2021-22. Comparing our and the OBR's latest forecasts indicates a large negative reconciliation for 2021-22 of -£712 million. Final outturn data should be available in July 2023, with the resulting reconciliation being applied to the Scottish Budget for 2024-25.

22 The forecasts underpinning the Scottish Budget for 2021-22 were made during a time of significant uncertainty around Coronavirus (COVID-19). Figure 6 shows how forecasts of Scottish income tax revenues and the BGA have been updated since the 2021-22 Scottish Budget was set based on our January 2021 forecasts.

Figure 6: Scottish income tax (SIT) revenue forecast and BGA for 2021-22

£ million	Budget setting	Latest	Total Change
SIT	12,263	13,387	1,124
BGA	-11,788	-13,624	-1,836
Net position	475	-237	-712

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

23 In January 2021 we stated that the high Budget setting net position of £475 million largely arose because of the significant uncertainty around COVID-19 and its effects on the data and judgements used in our and the OBR's forecasts, as well as issues with the timing of forecasts.[1] We did not expect Scottish tax revenues to perform significantly differently to the UK in 2021-22. We cautioned that a negative reconciliation was likely, suggesting a value of -£300 million if the net position was closer to the lower 2020-21 value. Given the latest forecasts, the net position is now estimated to be -£237 million in 2021-22, leading to an indicative reconciliation estimate of -£712 million.

24 The reconciliation can still change between the final indicative estimate and the outturn data. For example, for the 2020-21 reconciliation, the final indicative estimate published in May 2022 was out by £221 million, a 1.8 per cent error when compared to the 2020-21 outturn. However, in general, as we get closer to the publication of outturn, we expect indicative reconciliation estimates to become more accurate. Some uncertainty always remains about the precise value of the reconciliation, with potential errors in both our and the OBR's forecasts.

25 Despite the uncertainty, we expect the 2021-22 reconciliation will be large, negative, and greater than the Scottish Government's borrowing powers or potential use of the Scotland Reserve. We are expecting to receive final outturn data for 2021-22 from HM Revenue and Customs (HMRC) in July 2023 and we will discuss the final reconciliation that will be applied to the 2024-25 Scottish Budget in our next Forecast Evaluation Report.

The effect of fiscal drag

26 Tax thresholds in Scotland and the UK have been rising by less than inflation. Over time, this is leading to increased fiscal drag, with the bulk of taxpayers paying a higher average effective tax rate and many taxpayers moving into higher tax bands. While this is happening in both Scotland and the UK, the effect is greater in Scotland.

[1] Scottish Fiscal Commission (2021) Scotland's Economic and Fiscal Forecasts – January 2021 (link), see paragraphs 2.8 and 2.22 to 2.26

27 The personal allowance, which is set by the UK Government but applies across the whole of the UK, has risen by only £70 since 2019-20 and is set to stay at £12,570 until 2027-28. As peoples' incomes rise with inflation, this means a greater proportion of their earnings will be subject to taxation.

28 On top of the freezing of the personal allowance, since 2017-18 the Scottish Government has increased income tax rates and largely frozen thresholds. 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 have led to higher average effective tax rates for many taxpayers.

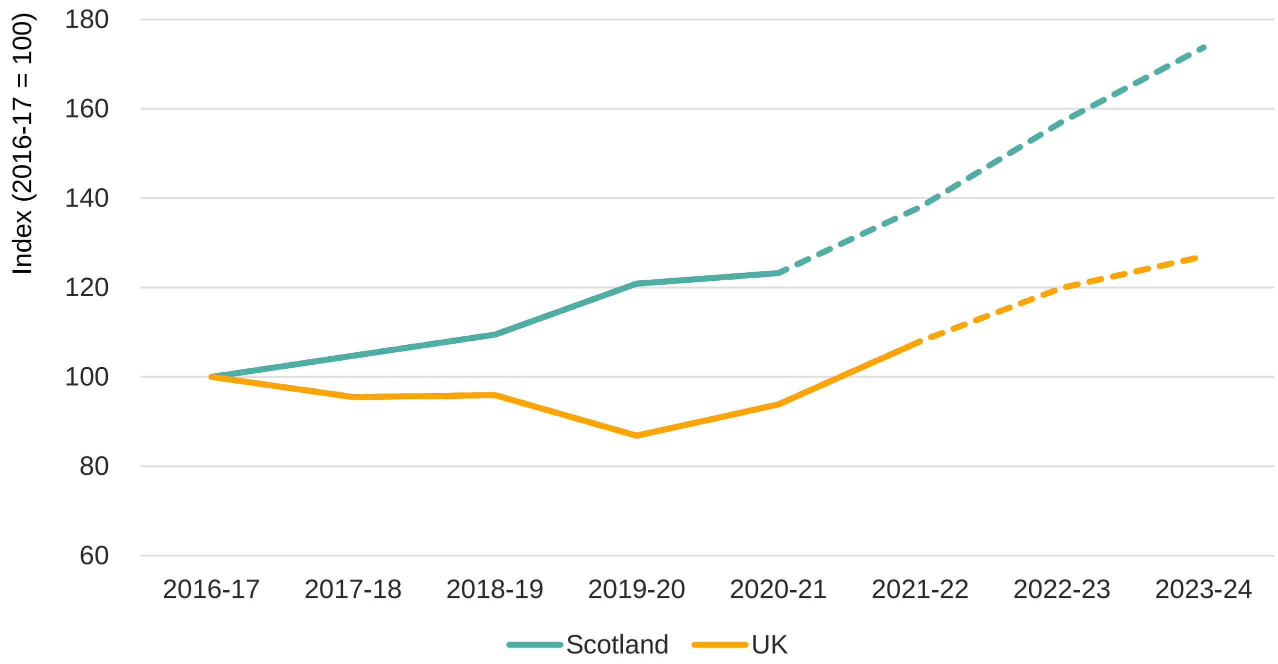
29 In 2016-17, prior to the devolution of income tax to Scotland, the higher rate threshold was £43,000 in both Scotland and the rest of the UK. Since income tax was devolved in 2017-18, the Scottish Government has largely kept the higher rate threshold frozen, or limited it to only small increases. In 2023-24, the higher rate threshold in Scotland is £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 UK higher rate threshold has risen more slowly and is set at £50,270 in 2023-24, then frozen until 2027-28.

30 These policies have had a large effect on the number of higher rate taxpayers. Figure 7 shows how the number of higher rate taxpayers has changed in Scotland and the UK since 2016-17. The number of higher rate taxpayers in Scotland is expected to have grown by about 74 per cent between 2016-17 and 2023-24. In 2023-24, we expect 17.8 per cent of all Scottish taxpayers to pay the higher rate of tax, compared to 11.6 per cent in 2016-17.

31 In contrast, the number of higher rate taxpayers in the UK fell between 2016-17 and 2019-20, when the higher rate threshold was being increased rapidly. With the UK higher rate threshold largely frozen since 2020-21, the number of higher rate taxpayers in the UK is gradually climbing again, though at a slower rate than in Scotland. Overall, we estimate that the number of higher rate taxpayers in the UK will have increased by around 27 per cent since 2016-17.

32 The growth in the number of higher rate taxpayers as well as the differences between Scotland and the UK are almost entirely driven by policies around the higher rate threshold and the general increase in nominal earnings driven by inflation across the whole of the UK. The more rapid growth in the number of higher rate taxpayers in Scotland is not driven by faster earnings growth or shifts in the income distribution relative to the UK.

Figure 7: Growth in higher rate income taxpayers in Scotland and UK



Source: Scottish Fiscal Commission
Solid lines show outturn available at time of publication and dashed line shows forecast. Amounts indexed so that 2016-17 is equal to 100.
The Scottish series is from the Scottish Fiscal Commission forecast and is consistent with HMRC income tax outturn data on the number of NSND income taxpayers. UK values are on a different basis, consistent with SPI data and covering all of income tax, not just the NSND element (link).
Forecast UK values are from the OBR (2023) and are for the whole of the UK, including Scotland: OBR (2023) Economic and Fiscal Outlook – March 2023 (link).

Social Security

33 We forecast that spending on social security will increase from £5.3 billion in 2023-24 to £7.8 billion in 2028-29. This increase arises because we expect the number of people receiving payments to increase. Furthermore, the average amount people receive increases overtime primarily due to most of the payments being uprated with inflation. The largest increase for the number of people receiving payment is for Adult Disability Payment where we forecast the caseload will increase from around 420,000 in 2023-24 to 660,000 in 2028-29.[2]

Figure 8: Change in social security spending forecast since December 2022

£ million	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27	2027-28	2028-29
December 2022	3,682	4,187	5,244	6,163	6,554	6,903	7,267	
May 2023	3,682	4,208	5,290	6,192	6,638	7,000	7,389	7,831
Change since December 2022		21	45	30	84	97	122	

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

34 Our forecast for spending in 2027-28 has increased by £122 million since December 2022. The change in the forecast mainly reflects the higher than previously expected demand for disability payments seen across the UK and the higher number of successful applications to Child Disability

[2] The Adult Disability Payment figures include people receiving Personal Independence Payment.

Payment (CDP). This increase in spending is partly offset by refinements to our Adult Disability Payment (ADP) modelling, a lower inflation forecast, adjustments to the number of carers eligible for Carer Support Payment (CSP), and a lower caseload forecast for Scottish Child Payment (SCP).

35 The increase in CDP is informed by new data received from Social Security Scotland in March 2023. These data were not available to us when we prepared our forecasts in December 2022. It shows that compared to our forecasts in December 2022 the number of applications approved has been higher and their average payment is lower. The effect from the higher number of approved applications outweighs the effect of lower payment amounts so incorporating these data increase the forecast for the number of children and young people receiving CDP by 7,000 and spending by £41 million in 2027-28.

36 The Scottish Government receives funding for devolved social security payments from the UK Government in the form of Block Grant Adjustments (BGAs). The level of BGAs is based on spending on the UK payments they replace and does not include the effect of Scottish Government reforms. The Scottish Government has also introduced new payments for which there are no UK equivalents and which are only available in Scotland. Any spending above the level of funding received from the BGAs and on new payments must be met from the overall Scottish Budget.

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 [1]	-19	-210	-369	-495	-581	-654
New social security payments [2]	-353	-546	-584	-598	-611	-620
Total	-372	-756	-953	-1,093	-1,191	-1,274

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), Carer Support Payment 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] New social security 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.

37 We estimate that by 2027-28 total spending on social security payments will be £1.3 billion more than the funding received through BGAs. While our forecast of spending has increased since December 2022, the estimate of the BGA funding for social security has increased by more, meaning that the gap between spending and BGA funding in 2027-28 has narrowed by £142 million. This narrowing of the gap only represents a small proportion of the overall social security spending. Estimates for the net position are determined by our forecasts for spending in Scotland and the OBR's forecasts for England and Wales, so changes to either forecast can lead to changes in the net position.

38 In our December 2022 forecasts, we revised up our forecast for Adult Disability Payment (ADP) to account for an increase in successful applications for working age disability payments across the UK. This was considered to be the result of multiple interlinking factors, including more people on NHS waiting lists for diagnoses and treatment, the increasing number of people economically inactive because of long-term sickness, and the financial pressures people were experiencing with

the cost of living crisis. This increase in demand has strengthened for working age groups and is also now evident for child and pension age payments too. Therefore, since December 2022, we have increased the level of the effect for ADP and extended this higher demand assumption to Child Disability Payment (CDP) and Pension Age Disability Payment (PADP). As this is a UK-wide effect, the social security BGAs reflect a similar increase in the OBR's forecasts for spending on equivalent benefits in England and Wales.

39 The largest difference between spending and funding is for working age disability payments. Our forecast for expenditure on ADP is £569 million higher than the level of funding from the Personal Independence Payment (PIP) BGA in 2027-28. This difference reflects our assessment of the effect of the Scottish Government reforms introduced with ADP as it replaces PIP. These reforms include the ambition to maximise the take-up of the payment amongst those eligible and improvements to the payment delivery in terms of support available, application process, the types of supporting information used for the decision-making and appeal processes. The additional spending associated with these reforms is more uncertain than other parts of the forecast as it is based on our judgements of the scale of the overall effect. We have been refining our assumptions for ADP since we produced our initial costing in August 2021.[3] Further adjustments will be introduced to the forecast as new data become available, however, it may take several years for the full effect of the reforms to be assessed.

Fiscal Overview

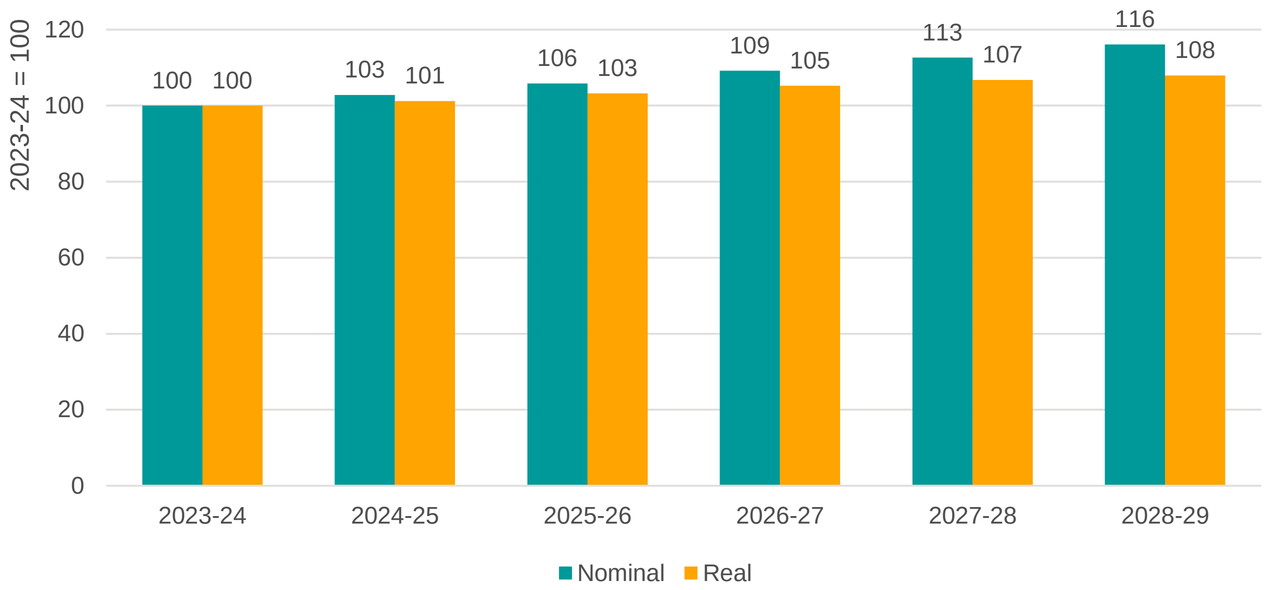
40 The five-year funding position for the Scottish Government depends on UK Government funding, tax revenues, borrowing and reserve plans, and other funding sources. Within the funding position the Scottish Government has made assumptions about future funding from the UK Government and income from other sources. We consider the Scottish Government's resource and capital borrowing plans to be reasonable.

Resource funding

41 Total resource funding is forecast to grow from £45.3 billion in 2023-24 to £52.6 billion in 2028-29, an increase of 16 per cent in nominal terms. In real terms, after accounting for inflation, resource funding grows by 8 per cent over the same period.

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

Figure 10: Five-year resource funding trends



Source: Scottish Fiscal Commission, Scottish Government.
Amounts indexed so that 2023-24 is equal to 100.
Real amounts have been calculated adjusting nominal amounts by the GDP deflators published in OBR (2023) Economic and Fiscal Outlook – March 2023 (link).

42 The largest component of resource funding is the Block Grant from the UK Government. The level of the funding up to 2024-25 is based on funding set out in the UK Spending Review 2021, with updates applied to reflect changes from subsequent UK fiscal events. From 2025-26 onwards the Scottish Government anticipates that the resource funding will grow with the OBR's March 2023 forecasts of total UK Government spending.

43 Resource funding also rises as a result of improvements over the forecast horizon in the tax net position, which is the difference between Scottish tax revenues and their BGAs. The largest factor in the increasing revenue net position is the positive income tax net position, which is forecast to grow from £325 million in 2023-24 to £1,554 million in 2027-28. The income tax net position should be interpreted with caution as it is sensitive to changes in our and the OBR's forecasts – relatively small changes in either forecast can lead to substantial changes in the projected net position.

Figure 11: Summary of the Scottish Government's resource funding position

£ million	2023-24	2024-25	2025-26	2026-27	2027-28	2028-29
UK Government funding [1]	36,832	37,383	38,153	39,038	40,135	41,263
Social security BGAs	4,434	5,132	5,435	5,697	6,003	6,325
Revenue net position [2]	569	1,053	1,235	1,339	1,656	1,752
Reconciliations [3]	46	-687	88	86		
Other fiscal framework powers [4]	41	300	0	0	0	0
Other funding [5]	3,339	3,354	3,007	3,255	3,177	3,225
Total resource funding available	45,260	46,535	47,917	49,415	50,971	52,566
Social security spending	5,290	6,192	6,638	7,000	7,389	7,831
NDR Distributable Amount	3,047	3,069	3,158	3,437	3,328	3,374
Total resource funding for all other devolved spending areas	36,923	37,274	38,121	38,978	40,254	41,361

Source: Scottish Fiscal Commission, Scottish Government.
Figures may not sum because of rounding.
[1] UK Government funding includes the 2021 Spending Review settlement and any Barnett consequentials generated since then.
[2] Revenue net position includes tax revenues, Proceeds of Crime (POC), and Fines, Forfeitures, and Fixed Penalties (FFFPs).
[3] Reconciliations for any years other than 2023-24 are indicative and subject to change. They are based on the most recent forecasts (Scottish Fiscal Commission May 2023 for revenues, OBR March 2023 for tax and social security BGAs). Indicative reconciliations in 2024-25 are mostly for income tax relating to 2021-22 (-£712 million), but also include the remainder of 2022-23 BGA reconciliation not already adjusted in-year in Autumn 2022 (-£2 million for fully devolved taxes, +£25 million for social security, +£3 million for non-tax elements).
[4] Other fiscal framework powers consist of resource borrowing and drawdowns from resource reserve. However, there are no plans to draw down any funding from the Scotland Reserve, so the amounts shown are entirely resource borrowing plans.
[5] Other funding includes the NDR distributable amount and 'other' funding sources such as income from the Migration Surcharge. It also removes the cost of capital and resource borrowing repayments from available funding.

44 The overall outlook is for resource funding to increase in nominal and real terms over the next five years. However, after accounting for social security spending and NDR being ring-fenced to local authorities, the funding available to all other portfolios is expected to fall in real terms between 2023-24 and 2024-25.

45 If the UK Government alter departmental allocations in future UK Budgets or Spending Reviews to reduce spending in devolved areas, the Block Grant funding available for the Scottish Government will be lower than currently assumed.

46 Devolved social security spending is forecast to cost more than the funding received from the social security BGAs and social security spending is forecast to grow more quickly than the overall level of funding available to the Scottish Government. This means social security spending will account for a larger proportion of total resource spending in future years.

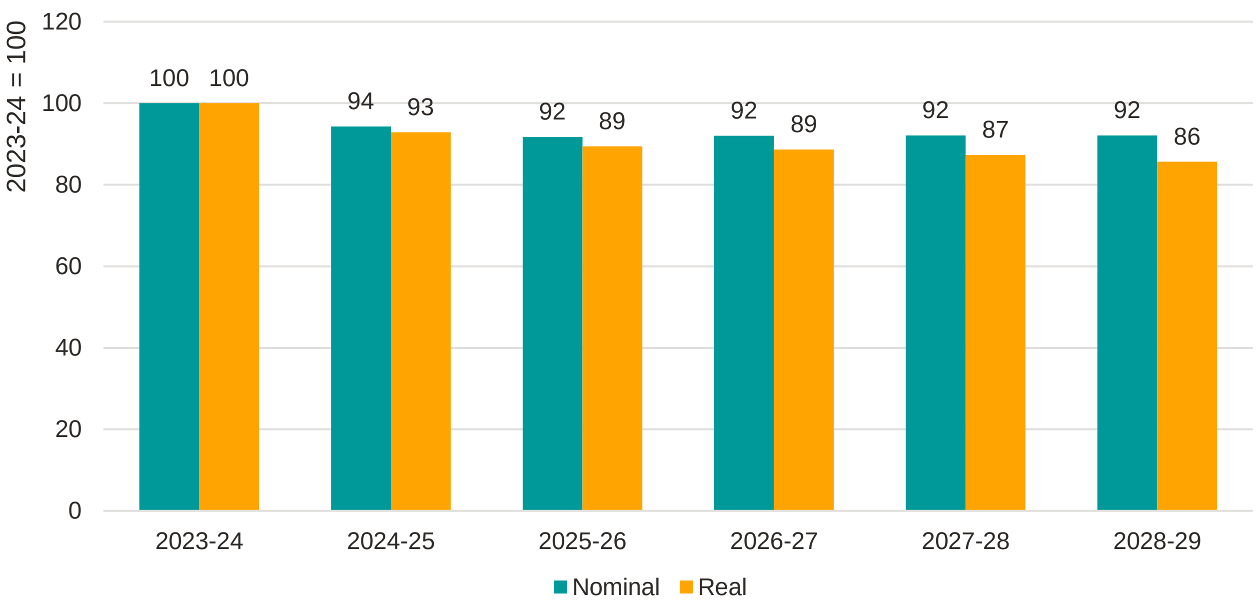
47 There will be pressure on the Scottish Government Budget in 2024-25 from a large negative revenue reconciliation, currently forecast to be -£687 million, primarily because of a large negative income tax reconciliation. The Scottish Government plans to use its borrowing powers in full to offset these reconciliations, but because there is a resource borrowing limit of £300 million under the fiscal framework, the remaining £387 million will need to be met from elsewhere within the Scottish Government's resource funding.

48 The Scottish Government's MTFS presents Government projections for overall resource spending, providing additional context for the consideration of the funding outlook. These projections draw upon our latest forecasts but also the Government's own assessment of the Scottish Government spending demands for areas such as health and education, which are not within our remit to forecast. Based on the Scottish Government's judgements, its projections show resource spending growing by more than funding. The Government estimates that in its central scenario spending could exceed funding by 2 per cent (£1 billion) in 2024-25 rising to 4 per cent (£1.9 billion) in 2027-28. As the Scottish Government is required to have a balanced budget, the challenge of such a gap will have to be addressed each year in the budget setting process.

Capital Funding

49 Capital funding is used to fund long-term investments such as infrastructure, hospitals, and research and development. It is projected to fall in nominal terms the first half of the forecast horizon before stabilising at 92 per cent of the current level. In real terms, the capital budget in 2028-29 is expected to be 14 per cent smaller than in 2023-24.

Figure 12: Five-year capital funding trends



Source: Scottish Fiscal Commission, Scottish Government.
Amounts indexed so that 2023-24 is equal to 100.
Real amounts have been calculated adjusting nominal amounts by the GDP deflators published in OBR (2023) Economic and Fiscal Outlook – March 2023 (link).

50 Block Grant funding from the UK Government is the largest component of capital funding. The Scottish Government expects it to fall between 2023-24 and 2024-25 before remaining at roughly the same level until 2028-29. For 2023-24 and 2024-25 this is based on the UK Spending Review 2021, updated for the UK Spring Budget 2023. From 2025-26 onwards the Scottish Government assumes it will follow the OBR's March 2023 forecasts of Public Sector Gross Investment, which is effectively zero growth.

51 The Scottish Government plans to use its borrowing powers to contribute to capital funding at a level of £250 million each year. It assumes further funding of £200 million from sources other than the Block Grant. If this other funding does not materialise in full then the Scottish Government plans to increase borrowing to meet the shortfall, so annual capital borrowing could reach up to £450 million

in future years. Successive years of borrowing more than £250 million would move the total debt stock closer to the limit of £3 billion. We expect the total debt stock to meet 90 per cent of the limit in 2028-29 if £250 million is borrowed in each year of the forecast.

52 As the debt stock and annual borrowing limits have been fixed in cash terms since 2016, the ability of the Scottish Government to invest in more capital spending is constrained with inflation eroding the real value of the limits. However, increases in borrowing would lead to increased debt repayments in future years, which could place pressure on resource funding in future.

Additional Information

Abbreviations

ADP	Adult Disavility Payment
BGA	Block Grant Adjustment
BGAs	Block Grant Adjustments
CDP	Child Disavility Payment
CPI	Consumer Price Index
CSP	Carer Support Payment
FFFPs	Fines, Forfeitures, and Fixed Penalties
HMRC	His Majesty's Revenue and Customs
HMT	His Majesty's Treasury
LBTT	Land and Buildings Transaction Tax
MTFS	Medium-Term Financial Strategy
NDR	Non-Domestic Rates
NHS	National Health Service
NSND	Non-savings, non-dividend
OBR	Office for Budget Responsibility
OECD	Organisation for Economic Cooperation and Development
PADP	Pension Age Disability Payment
PAYE	Pay As You Earn
PIP	Personal Independence Payment
POC	Proceeds of Crime
RTI	Real Time Information
SCP	Scottish Child Payment
SEFF	Scotland's Economic and Fiscal Forecasts
SFC	Scottish Fiscal Commission
SG	The Scottish Government
SIT	Scottish income tax
SLfT	Scottish Landfill Tax
SPI	Survey of Personal Incomes

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).[4]

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.[5]

[4] OECD (2014) Recommendation on Principles for Independent Fiscal Institutions (link).
[5] Scottish Fiscal Commission (2018) Compliance with the Code of Practice for Statistics and Error Policy (link).

Correspondence and enquiries

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All figures 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 report please contact the responsible analyst:

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