Scottish Fiscal Commission

How we set policy baselines

February 2024

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This publication is available at www.fiscalcommission.scot

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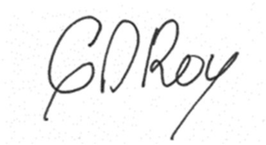
ISBN: 978-1-911637-68-4

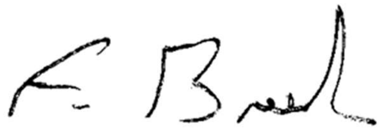
Published by the Scottish Fiscal Commission, February 2024

Foreword

The Scottish Fiscal Commission is the independent fiscal institution for Scotland. Our statutory duty is to provide independent and official forecasts of the economy, tax revenues and social security spending to inform the Scottish Budget. This report sets out our approach to setting policy baseline for our tax and social security forecasts.



Professor Graeme Roy



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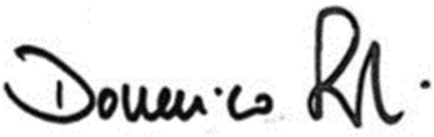

Professor Domenico Lombardi

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29 February 2024

How we set policy baselines

1 A policy baseline is the set of values we include in our forecast covering all policy aspects of the tax and social security systems. This includes factors such as tax and social security rates, thresholds, payment amounts, eligibility criteria and implementation timings. We are primarily interested in policy factors devolved to the Scottish Government. Where reserved UK Government policies affect Scottish tax revenues or social security payments, such as the income tax personal allowance, we'll generally follow the baseline used by the Office for Budget Responsibility (OBR).

2 Policy baselines are a critical part of our forecasting process. They allow us to both produce forecasts and provide costings for government policy decisions. Since we are required to forecast tax and spending five years ahead, our forecasts depend on how the tax and social security systems evolve over this period. In particular it matters how thresholds and rates will change in response to our forecast of inflation. In the absence of an explicit policy determining how this will be done, our baseline sets out our counterfactual set of values about the evolution of these main factors. The policy baseline can have a big effect on not just the forecast levels of tax and spending but also, to the extent that the government does something different from what is in the baseline, on what will count as a policy change. Annex A provides a more comprehensive explanation of policy baselines.

3 Tax revenue, funding for the Scottish Budget and social security spending are determined by Scottish Government policy decisions and legislation. Our policy baseline only affects the presentation of our forecasts for years in which there isn't an explicit government policy, and affects how policy changes are presented. Our forecasts, when shaped by our baseline assumptions, are important for longer-term planning, informing public debate and scrutiny of Government policy decisions.

4 After seven years producing forecasts and considering recent experiences with high inflation, we felt now is a good time to review our approach to policy baselines. To aid this process, we launched a consultation on setting policy baselines in May 2023.[1] In this report we set out a new approach to setting policy baselines in our forecasts informed by our experience of forecasting, the responses we received to the consultation, and our own judgement.

5 Our new approach to policy baselines is summarised below.

- We believe a clear policy baseline aids transparency, scrutiny and public understanding of our forecasts and the overall budget process. Our preferred position is that the Scottish Government clearly and publicly sets out a detailed baseline policy position for all taxes and social security spending over our five year forecast horizon. We consider that this would be consistent with the "Certainty" principle in the Framework for Tax 2021.[2]

- When this information is incomplete or missing, we will need to make our own policy baseline assumptions. Our guiding principle is maintaining neutrality with respect to inflation. Box 1 discusses what neutrality means to us in this context. We'll also consider how our

[1] Scottish Fiscal Commission (2023) Consultation on our approach to policy baselines (link)

[2] Scottish Government (2021) Framework for Tax 2021 (link)

baseline assumption can increase transparency and aid public understanding and scrutiny of Government policy changes.

- In particular, to target neutrality in our five year forecasts, we will assume thresholds and payments will rise in line with Consumer Price Index (CPI) inflation, where appropriate.
- Even with this guiding principle, there will always be a role for judgement, particularly on the finer details of complicated policy. This report sets out an initial position for each tax and social security payment.
- When in the future we need to adjust our policy baselines, we'll aim to do this as part of our spring forecast report with any adjustment and impact clearly communicated. We'll then have a stable baseline to use in our next winter forecast report published alongside the Scottish Budget.

6 In our next forecasts, which we expect to publish in May 2024, we will apply our new approach to setting baselines from 2025-26 onwards. Our baseline assumptions and policy will remain fixed for 2024-25. The next section of this report provides more detail on our new approach to setting policy baselines. It provides a discussion on each area of our forecast. The second section of the report provides information on our consultation and the responses we received.

Box 1: Policy baseline neutrality

A neutral policy baseline means we aim to keep the tax and social security systems unchanged over our forecast horizon. If everything was static, this would be simple, we'd largely leave all rates and thresholds unchanged. However, with economic factors like price inflation, earnings, and GDP changing over time, neutrality could be interpreted in different ways. We interpret neutrality with respect to policy baselines to mean that price inflation alone does not lead to changes in real tax revenue, real take-home pay, or the real value of social security payments as a result of our policy baseline assumption.

We can show this with an example on income tax. Figure 1 illustrates some scenarios with a simple, hypothetical income tax system with tax thresholds frozen or adjusted by inflation at 2 per cent and earnings growth at 2 or 3 per cent. The figure shows the percentage change in an individual's tax paid and take-home pay between one year to the next.

With a frozen tax threshold, the amount of tax paid grows significantly more than take-home pay. With taxpayer earnings growth at 2 per cent, take-home pay falls in real terms because of the frozen tax threshold. With the threshold being adjusted with inflation and earnings growth at 2 per cent, tax paid and take-home pay both increase by 2 per cent in nominal terms and are unchanged in real terms. We see this as a neutral starting point for our policy baseline assumption.

Figure 1: Percentage change in individual tax paid and take-home pay with different tax threshold changes and nominal earnings growth rates, assuming price inflation of 2 per cent

Threshold	Taxpayer nominal earnings growth	Nominal tax paid	Nominal take-home pay	Real tax paid	Real take-home pay
Frozen threshold	2.0	3.5	1.6	1.5	-0.4
Frozen threshold	3.0	5.3	2.3	3.3	0.3
Inflation-adjusted threshold	2.0	2.0	2.0	0.0	0.0
Inflation-adjusted threshold	3.0	3.8	2.8	1.8	0.8

Source: Scottish Fiscal Commission

Longer term, even with inflation adjusted tax thresholds, real earnings growth would mean an increasing number of taxpayers move into higher tax bands. As shown in Figure 1, it would also mean tax paid growing above the growth in earnings and take-home pay. This could be seen as simply a feature of a progressive tax system.

In practice, neutrality is hard to define and could mean a number of different things. An alternative approach to neutrality would be to adjust thresholds in line with average nominal earnings growth, rather than price inflation. This would keep the number of taxpayers by band more stable and in the Figure 1 example would mean tax paid and take-home pay would grow in line with earnings growth.

For our five year forecast horizon, we believe inflation indexation of policy baselines is the most suitable definition of neutrality. In our longer-term fiscal sustainability projections, we adopt a different approach to neutrality – for example, growing thresholds in line with earnings growth instead.

How we set policy baselines

The role of the Scottish Government

7 In the UK many policy baselines are covered by legislation. For example, the Income Tax Act (2007) makes explicit what should happen to UK income tax allowances and limits in the absence of a government policy change.[3]

8 However, for Scotland, there is little information on the Scottish Government's intention for the tax system beyond one-year ahead. For a Scottish taxpayer, it is not clear what expectations they may reasonably hold about what their Scottish taxes might look like over the next five years.

9 We believe a clear statement of a baseline policy position from the Scottish Government covering the next five years would improve the transparency and consistency of our forecasts and the Scottish Budget process. We believe this would be an enhancement to Scottish taxation consistent with the Scottish Government's principle of providing certainty to taxpayers as discussed in its Framework for Tax.[4] It would provide better information to Parliament and the public about what to expect of the tax system in the coming years. It would also provide us with a clear basis against which to show the effect of alternative Government policy decisions.

10 The need for more information from the Scottish Government on a baseline policy position came through strongly in the consultation responses we received and we agree that the Scottish Government providing a clear baseline policy position is our preferred approach.

11 As Scotland's Independent Fiscal Institution, we are asking the Scottish Government to provide better guidance on baseline policy information for five years ahead.

12 The position is different for social security. For many social security payments in Scotland, as in the UK, there is already guidance for a baseline policy position written in legislation (further detail provided in the Social Security section).

How can the Scottish Government communicate a baseline position?

13 In the UK, many tax baselines are guided by legislation. Setting out a policy baseline in legislation has the advantages of being public, transparent, involves scrutiny from Parliament, and it means baselines are robust in the longer term, particularly to changes in Government.

14 Another approach may be for the Scottish Government to publish its baseline five-year policy position as part of its Medium Term Financial Strategy (MTFS). As part of our forecasting process for the MTFS, we will ask the Scottish Government to provide us with, or to update, its baseline policy position. We expect any information shared to be made public as part of our report and the MTFS report. We will make a judgement on a case by case basis on whether any baseline position shared by the Government extends beyond the current parliament.

15 For us to adopt a policy baseline from the Scottish Government, we need a sufficiently clear and detailed statement of the Government's position. We'll judge on a case by case basis whether

[3] UK Parliament Legislation (2022) Income Tax Act 2007 (link) See section 57: Changes over time
[4] Scottish Government (2021) Framework for Tax 2021 (link)

sufficient information has been provided for us to change our baselines and the final decision on the details of which baselines to use rests with the Commissioners.

SFC policy baseline assumptions

16 If the baseline policy information provided by the Scottish Government is incomplete, we will have to make our own baseline policy assumptions. The rest of this section focuses on how the SFC will set its baseline policy assumptions in the future if sufficient information is not provided by the Scottish Government.

17 Our guiding principles for setting our policy baselines are neutrality, transparency, and independence. With our new approach, we aim to enhance public debate and scrutiny of policy changes. In particular, to achieve neutrality in our policy baselines, we will now adjust all tax thresholds and payments in our policy baseline assumptions in line with inflation unless there is a strong reason to take a different approach.

18 The tax and social security systems are complicated. Though we have our guiding principle of maintaining neutrality through inflation uprating, we think there is still a role for judgement in some cases. The individual tax and social security sections discuss how our principles will be applied in practice and where there may still be some scope for judgment.

19 Each time we publish a forecast, we'll include details of the baseline policy used. When in future we need to adjust our approach to setting baselines, either in response to a change in the Government's position or because our judgement about what constitutes a reasonable baseline has changed, our intention would be to do this as part of our spring publication of Scotland's Economic and Fiscal Forecasts (SEFF). We would then explain the reasoning for this change in approach as part of our report and quantify the effect. This would provide us with a stable approach to setting policy baselines for our subsequent winter SEFF published alongside the Scottish Budget.

Income tax

20 Our new baseline assumption is to adjust all Scottish tax bands in line with CPI inflation. As is convention in the UK, we will use the outturn or forecast annual rate of CPI in September one year to set tax bands the year ahead.[5] We had previously assumed the higher, advanced and top rate thresholds would remain frozen over our forecast horizon. We will now assume all three tax bands rise in line with inflation. We will apply this new approach from 2025-26 onwards.

21 We often talk about tax thresholds, which illustrate the point above which different rates of tax are paid on a gross income basis. For example, the higher rate threshold is currently £43,662 in Scotland, and typically individuals with a gross income above £43,662 would pay the higher rate of tax of 42 per cent. However, from an operational and legislative perspective, it is the tax limits or bands that matter. This determines the point at which different tax rates apply based on an individual's taxable income, that is, after the personal allowance is deducted. Arithmetically, tax thresholds are the personal allowance plus the tax band. This matters as not everybody has the same personal allowance, and so thresholds can vary from individual to individual, but the tax bands remain fixed once taxable income has been determined.

[5] For example, at the point of our December 2025 SEFF, we would use the published September 2024 figure for CPI inflation to set tax bands in 2025-26. We would then use our forecast of CPI inflation in Q3 2025 to set tax bands for 2026-27 and so on.

22 Income tax is partially devolved. The Scottish Government sets tax rates and bands while the UK Government sets the personal allowance. This means tax thresholds are influenced by both Scottish and UK Government decisions. We recognise there are arguments both ways for whether our baseline assumption should apply to income tax thresholds or bands. Taxpayers are primarily interested in tax thresholds, and retaining neutrality from a taxpayers perspective would require thresholds are inflation adjusted. However, on balance, we believe it is better to apply our inflation indexation assumption to tax bands. This is more consistent with how legislation is set and means our baseline is not subject to change because of decisions by the UK Government, allowing us to focus on the policy decisions of the Scottish Government.

Non-Domestic Rates

23 The amount of Non-Domestic Rates (NDR) to be charged to a property is determined by applying one of three rates – the Basic Property Rate (BPR), Intermediate Property Rate (IPR) or Higher Property Rate (HPR) – to the property's rateable value, which is set to reflect the notional annual rental value of the property. The rate applied is determined by the rateable value of the property.

24 Each year, the Scottish Government sets the BPR, IPR and HPR for NDR through Scottish Statutory Instruments. The rates set by these, and the thresholds for each rate, last only for a single financial year, and therefore new Scottish Statutory Instruments are enacted each year.[6]

25 The BPR (also known as "poundage") is set under powers granted to the Scottish Ministers by the Local Government (Scotland) Act 1975, which does not constrain the Ministers in the rate they can set.[7] The IPR and HPR and the thresholds for them are set under the authority of the Local Government etc. (Scotland) Act 1994, which says that the regulations "may be framed by reference to such factors as the [Scottish Ministers think] fit".[8] This means that there is nothing in legislation that specifies or suggests a default for what happens to NDR rates and thresholds from one year to the next.

26 While the rates are set year-on-year, rateable values are periodically updated only in a revaluation year, in line with rental values as of 1 April in the preceding year (called the "tone date"). Updates may take place in between if there are material changes to properties, but still reflect values as at the tone date, so such changes do not reflect any inflation in rental values since the tone date. The most recent revaluation year was 2023-24, after which they are due to take place every three years.[9]

27 Our baseline in non-revaluation years is therefore to assume that the rateable value thresholds, which determine whether the BPR, IPR or HPR is applicable, will not change. This is because these are thresholds between rateable values and rateable values do not change in these years. However, we assume that the BPR, IPR and HPR increase in line with CPI inflation each year, as this maintains revenue in real terms and is therefore the neutral approach.

28 In a revaluation year, it might be necessary for us to make changes to our approach if we wish to maintain a neutral baseline.

[6] For 2024-25, these are the Non-Domestic Rate (Scotland) Order 2024 (link) for the basic property rate, and the Non-Domestic Rates (Levying and Miscellaneous Amendment) (Scotland) Regulations 2024 (link) for the intermediate and higher property rates.
[7] Local Government (Scotland) Act 1975 (link), section 7B
[8] Local Government etc. (Scotland) Act 1994 (link), section 153
[9] Local Government (Scotland) Act 1975 (link), section 37(1), as amended by subsequent legislation

Land and Buildings Transaction Tax

29 Land and Buildings Transaction Tax (LBTT) is a tax applied to transactions for residential and non-residential land and property. It consists of different tax rates and bands for different types of properties and transactions. In principle, without any external information, we would apply inflation uprating to the LBTT bands in line with our approach outlined above. However, we believe the existing legislation already provides a policy baseline.

30 The rates and bands for LBTT are specified in secondary legislation in the Land and Buildings Transaction Tax (Tax Rates and Tax Bands) (Scotland) Order 2015.[10] The rates and bands specified in the legislation apply at the fixed levels in perpetuity unless there is an amendment to legislation.

31 For residential property transactions, with the exception of a strictly temporary adjustment which applied for a short time during the COVID-19 pandemic, the rates and bands are unchanged since LBTT was introduced (to replace Stamp Duty Land Tax in Scotland) in April 2015. For non-residential property transactions the rates and bands were last changed in January 2019 when the threshold for the higher rate was reduced, the tax rate for the lower band was reduced and the higher tax rate increased.

32 For residential property transactions, Additional Dwelling Supplement (ADS) is an additional charge added to LBTT. It is paid by individuals buying a residential property in Scotland when they already own one or more residential properties anywhere in the world and are not replacing a main residence, and by companies any time that they purchase a residential property. ADS is applied as a percentage of the entire purchase price for properties with a value greater than £40,000. The £40,000 level for ADS was specified in a 2016 amendment to Land and Buildings Transaction Tax (Scotland) Act 2013 and is unchanged since the introduction of ADS in 2016[11]. The rate at which ADS is applied is also specified in the 2016 amendment to Land and Buildings Transaction Tax (Scotland) Act 2013, but has been increased in subsequent amendments in 2019 and 2022. These increases in the ADS rate are considered policy changes rather than a form of uprating.

33 As the rates and bands for LBTT and ADS are specified at a fixed level in legislation with no regular uprating applied historically, our baseline assumption is that the rates and bands will remain fixed at their current levels in future years of our forecasts.

Scottish Landfill Tax

34 Scottish Landfill Tax (SLfT) is paid on the disposal of waste to landfill sites. It is paid per tonne of waste with a standard and lower rate. In the absence of any external information, our policy baseline would be to increase the standard and lower rates in line with CPI inflation. However, we believe there is a clear position on the baseline provided through statements by the Scottish Government and the UK Government. The stated policy objective of the Scottish Government in successive Scottish Budgets is to apply the same rates in Scotland as are applied by the UK Government for England and Northern Ireland "…to avoid any potential for what is referred to as "waste tourism" to emerge as a result of material differences between the tax rates...".[12] The UK Government's stated position is that "Increasing the lower and standard rates of landfill tax by RPI in recent years has helped maintain a strong price incentive to divert waste away from landfill."[13]

[10] The Land and Buildings Transaction Tax (Tax Rates and Tax Bands) (Scotland) Order 2015 (link)
[11] Land and Buildings Transaction Tax (Scotland) Act 2013 (link), schedule 2A, as amended by subsequent legislation
[12] Scottish Parliament, meeting of the Finance and Public Administration Committee, 07-03-2023 (link)
[13] Hansard, Finance Bill (Second sitting), 16-01-2024 (link)

35 Therefore, our baseline for SLfT is for the standard and lower rates to be uprated each year by the Retail Prices Index (RPI).

Illustrative tax forecasts

36 We currently produce illustrative forecasts for taxes that were included in the Scotland Act 2016 but where the devolution has yet to be implemented. At present we produce illustrative forecasts for Aggregates Levy, Air Passenger Duty and VAT assignment.

37 The Air Departure Tax (Scotland) Act 2017 made provisions for the replacement of Air Passenger Duty, but the detail of tax bands and rates will be defined in subordinate legislation prior to implementation.[14] Similarly, for Aggregates Levy, while the Scottish Government has published the Aggregates Tax and Devolved Taxes Administration (Scotland) Bill, tax rates and bands will be defined in subordinate legislation.[15] Therefore, for Scottish Aggregates Tax and Air Departure Tax we will establish our baseline position once the respective subordinate legislation is available.

38 For VAT assignment, the Scottish Government will not have any direct control over policy. Given current expectations of how VAT assignment would work, once VAT assignment is implemented, we would simply adopt the same baseline as the OBR for the UK.

Social security

39 For social security the policy baseline is concerned with annual increases to the different payment amounts for each payment. Figure 2 shows the uprating requirements for different social security payments based on the Social Security (Scotland) Act 2018. While there has been no statutory requirement to uprate the amounts for the payments in the second column of Figure 2, in the last two years the Scottish Government increased them with inflation.

Figure 2: Uprating requirements for Social Security Payments

Statutory duty to uprate	No statutory requirement to uprate
Adult Disability Payment	Best Start Foods
Carer Support Payment	Best Start Grant Pregnancy and Baby, Early Learning and School Age payments
Child Disability Payment	Child Winter Heating Payment
Employment Injury Assistance	Pension Age Winter Heating Payment
Funeral Support Payment	Winter Heating Payment
Pension Age Disability Payment	
Scottish Adult Disability Living Allowance	
Scottish Child Payment	
Severe Disablement Allowance	

Source: Scottish Fiscal Commission

40 In previous forecasts our approach to baselines for social security was that all payments with a statutory duty for the Scottish Government to uprate would have payment rates uprated by CPI each year, with the CPI rate from the preceding September applied the following April (for example the rate of CPI in September 2023 will be used to increase the payment amounts at the start of April

[14] Air Departure Tax (Scotland) Act 2017 (link), section 17(1)
[15] Aggregates Tax and Devolved Taxes Administration (Scotland) Bill (link), section 12(3)

2024). For payments with no statutory requirement for the Scottish Government to uprate we assumed the payment rates would be fixed in cash terms in all future years. This has meant that when rates for these payments have been increased with inflation we have presented the cost of the increase in the payment rate as a policy change.

41 Now, in line with our stated principle of neutrality, our baseline for social security payments will be that all payment amounts are increased by inflation each year with the CPI rate from the preceding September applied the following April. The exceptions to the approach are Scottish Welfare Fund and Discretionary Housing Payments. For the Scottish Welfare Fund in each budget the Scottish Government allocates a fixed amount of funding to local authorities who administer the payment and determine the value of awards. Discretionary Housing Payments are also administered by local authorities with payment amounts either determined by local authorities or by the effect of the bedroom tax or benefit cap on recipient households.

Public sector pay

42 We do not provide policy costings or analysis of the effect of public sector pay decisions. However, public sector pay is an important component of our economy and income tax forecasts and for considering pressures on Scottish Government spending plans. In previous forecasts, when we haven't had government policy, we've used judgement to decide on a value for public sector pay growth in our forecasts, informed by factors such as inflation, labour market conditions, and historic government pay decisions. To simplify this process and make it more transparent, we will now set public sector pay awards in our baseline to match the rate of CPI inflation in the absence of a Scottish Government pay policy. We'll apply this approach in our May 2024 forecasts from 2025-26 onwards.

43 This baseline assumption will be overwritten if and when we get a clear policy steer from the Scottish Government on public sector pay awards.

Our consultation

44 In May 2023 we launched a consultation on our approach to policy baselines. We received a small number of high quality and detailed responses from some of our main stakeholders. This section provides an overview of responses to the questions posed in the consultation.

Question 1: What should our objective be in approaching policy baselines?

45 In our consultation, we identified a number of objectives that may be considered in selecting an approach to setting policy baselines. These objectives may conflict with each other under different approaches, and no approach will maximise all objectives simultaneously. Annex B lists and explains the objectives from our consultation. We asked stakeholders what they believed should be the highest priority objectives.

46 Neutrality was the most commonly identified highest priority among our stakeholders. For further information on what we mean by neutrality, see Box 1. Informing public debate and aiding scrutiny of policy changes, as well as forecast independence were also identified as high priorities. Forecast accuracy was mentioned as the top priority by one stakeholder.

Question 2: Should we adopt a judgement-based or rules-based approach?

47 All consultation respondents said that judgement should continue to play a role in how we set policy baselines. Simple rules are helpful and transparent, but there could be circumstances where simple rules breakdown, particularly on the finer detail of policy. For example, if the Government makes a statement about it intention for a particular policy baseline, but we feel this is only a short term position or not credible. In this instance, we may use judgement to use a different baseline in our forecasts.

Question 3: How should the approach be implemented?

48 Consultation respondents were largely supportive of using inflation indexation as a starting point for our forecast baselines while maintaining a role for judgement in setting baselines where necessary.

Question 4: When should changes be made?

49 Consultation respondents were largely supportive of making changes as soon as possible. It was suggested that when any changes are made, now or in the future, forecasts should be clearly restated on the basis of the new forecast baseline.

Question 5: What is the role of the Scottish Government?

50 One point that came through strongly from stakeholders was on the role of the Scottish Government in providing clear and detailed guidance on a baseline policy position. This is illustrated by a quote from the Fraser of Allander response:

- "Clearly in an ideal world the Commission would be furnished with a detailed plan on indexation of baseline policies for indexing tax thresholds. That would ensure consistency between the statements of the Scottish Government and the SFC, and increase transparency in the public discourse. This should be the gold standard that the SFC should aim for going forward."

51 This view was echoed by other stakeholders.

52 Consultation respondents agreed there were a range of mechanisms that could be used by the Government to communicate its baseline policy position, either through legislation, statements in parliament or through written reports. Consultations respondents identified risks with these approaches, suggesting that the Commission needed to retain a role for judgement in interpreting the Government's position.

Annex A
What is a policy baseline?

A.1 Taking the income tax higher rate threshold as an example, to forecast income tax, we need a value for the higher rate threshold to use in each year of our five-year forecast. In our December 2023 forecast, we assumed that the higher rate threshold would remain fixed at its current level over the next five years. At the start of our forecasting process, the set of values used for the higher rate threshold is our policy baseline.

A.2 This concept extends across all our tax and social security forecasts. We need detailed policy information to produce our five year forecasts of Scottish taxes and social security spending. Factors which can be considered a policy include tax rates and thresholds, allowances, social security payment eligibility criteria, payment amounts and the timing for implementation of any changes.

A.3 When the Scottish Government has previously made a clear policy decision, or there is a legislative basis for the policy parameter, we include this in our policy baseline. For example, in the UK legislation, it is explicit that many tax thresholds will rise in line with inflation. That is not generally the case in Scottish tax legislation. When there is no government policy decision or legislation in place, for example in later years of the forecast, we need a system in place to create our policy baseline.

A.4 The policy baseline we use affects what counts as a policy change and how policy changes are estimated. An example around the income tax higher rate threshold is illustrated in Figure 3.

Figure 3: How baseline assumptions affect policy costings

		Baseline policy assumption	
		Frozen threshold	Threshold rises with inflation
Government policy decision	Threshold reduced	Positive yield policy costing	Positive yield policy costing
	Frozen threshold	No policy costing	Positive yield policy costing
	Threshold rises by less than inflation	Negative yield policy costing	Positive yield policy costing
	Threshold rises by inflation	Negative yield policy costing	No policy costing
	Threshold rises by more than inflation	Negative yield policy costing	Negative yield policy costing

Source: Scottish Fiscal Commission

A.5 Lower income tax thresholds generally yield higher tax revenue. As is shown in Figure 3, the baseline assumption made can affect whether or not a policy costing is provided, and also the direction and magnitude of the policy costing. This is why a clear and transparent approach to forecast policy baselines is essential for aiding scrutiny of Government policy decisions.

A.6 Each time we produce a forecast, the effect of our policy baseline on tax revenues or social security spending is fully factored into what we call our pre-measures forecast – a forecast which does not include any new policy changes. Our policy baseline creates the starting point from which a government policy change can be considered. Only when a policy decision is different to our policy baseline, with a potential difference to our pre-measures forecast of tax revenue or social security spending, would we consider this to be a policy change. Effectively, we compare the policy decision to our no-policy change counterfactual. We only consider Scottish Government policy changes as part of this process. Changes in policy by the UK Government that affect our forecast feature in our pre-measures forecast.

A.7 The public needs to be able to understand how decisions taken by government on tax and spending affect budgets. How we set our policy baseline has important implications for how these decisions are framed and communicated.

Annex B
Objectives of setting policy baselines

B.1 Figure 4, replicated from our consultation, lists the objectives we identified for setting policy baselines.

Figure 4: Objectives of setting policy baselines

Objective	Consultation Questions
Forecast accuracy	Are there clear expectations about the pattern of policy setting behaviour? If our policy baseline diverges from these expectations, it may introduce a bias to our forecasts and reduce accuracy. For example, we previously assumed the higher rate threshold would rise in line with inflation, and the Scottish Government consistently fixed it to rise by less than inflation. This introduced a source of policy change error to our forecasts.
Forecast independence	Could the approach be influenced by government, political parties or others? Could the approach be perceived as having been influenced by government, political parties or others?
Neutrality	Does our approach maintain the current policy status quo? How does our baseline affect tax revenues, post-tax incomes and social security spending in nominal and real terms? Varying decisions around tax thresholds in our baseline would mean taxpayers could feature in different tax bands or payments in our forecast, and shift the structure of the system over the longer term. For example, freezing thresholds in cash terms can lead to people going into a higher tax bracket when their real income has not changed – a process known as fiscal drag. To what extent should this be considered in our approach to setting baselines?
Informing public debate	Does our approach help inform public understanding and debate about tax and social security policy options? Does our approach frame the debate in a helpful and transparent way? For example, if we index thresholds, does it make sense to the public that keeping a threshold fixed from one year to the next is effectively a policy change?
Resilience to political change	Will our approach remain robust to changes in the Scottish Government or changes in political objectives? If the current government supports a particular baseline, but this is not in a legislation, does it still apply in the next Scottish Parliament?
Transparency and accessibility	Is our approach transparent and easy to understand?

Source: Scottish Fiscal Commission

Additional information

Abbreviations

ADS	Additional Dwelling Supplement
BPR	Basic Property Rate
CPI	Consumer Price Index
GDP	Gross Domestic Product
HPR	Higher Property Rate
IPR	Intermediate Property Rate
LBTT	Land and Buildings Transaction Tax
MTFS	Medium Term Financial Strategy
NDR	Non-Domestic Rates
OBR	Office for Budget Responsibility
OECD	Organisation for Economic Cooperation and Development
RPI	Retail Price Index
SEFF	Scotland's Economic and Fiscal Forecasts
SFC	Scottish Fiscal Commission
SLfT	Scottish Landfill Tax
UK	United Kingdom
VAT	Value Added 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).[16]

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 Statistics Authority's Code of Practice for Statistics. Further details and our statement of voluntary compliance can be found on our website.[17]

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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For general enquiries about this publication or the commission and how we work please contact info@fiscalcommission.scot

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

This publication is available at www.fiscalcommission.scot

ISBN: 978-1-911637-68-4

Published by the Scottish Fiscal Commission, February 2024