Scotland's Fiscal Outlook

The Scottish Government's Medium-Term Financial Strategy

December 2021

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Contents

Foreword by the Cabinet Secretary for Finance and the Economy 4

Executive Summary 6

1. Scotland's Economic Outlook 7

1.1 State of the Economy 7

1.1.1 Latest Economic Forecasts of the Scottish and UK Economies 8

1.1.2 Fiscal Implications for the Economic Outlook 10

1.2 Increasing prosperity 11

1.2.1 COVID-19 Recovery Strategy 12

1.2.2 10-Year National Strategy for Economic Transformation (NSET) 13

2. Scotland's Fiscal Outlook 14

2.1 The central scenario for the resource funding outlook 14

2.1.1 Block Grant 15

2.1.2 Devolved Taxes 16

2.1.3 Social Security expenditure 16

2.1.4 Central Scenario 17

2.2 Upside funding scenario: stronger Scottish tax performance and a looser UK fiscal stance 17

2.3 Downside scenario: weaker Scottish tax performance and a tighter UK fiscal stance . 19

2.4 Outlook for capital funding 19

Scotland's Spending Outlook 21

3.1 Capital expenditure outlook 21

3.1.1 Infrastructure investment 21

3.1.2 National Infrastructure Mission 21

3.1.3 Supply Chain Challenges 23

3.1.4 Next steps 23

3.2 Resource Spending Outlook 24

3.3 Risks to the spending outlook 25

3.3.1 Demand-led spend volatility 25

3.3.2 Pay 26

3.3.3 Growth in the public sector workforce. 27

3.3.4 Public service pensions – a mandatory workforce cost 29

3.3.5 Ageing is a significant driver of public service expenditure 30

4. Managing Fiscal Risks 31
4.1 Short, medium and long-term fiscal risks 32
4.2 Current levers for managing volatility and risk 36
4.2.1 Scotland Reserve policy 37
4.2.2 Resource borrowing policy 37
4.2.3 Capital borrowing policy 38
4.2.4 Our fiscal levers are insufficient 39
4.3 The need for a robust, comprehensive and timely review of the Fiscal Framework 40
4.4 The Resource Spending Review Framework 41
Conclusion 43
List of acronyms 44
Glossary 46
Bibliography 49
List of figures, tables and boxes 51
Annex A: Income Tax - Distributional Risks to the Scottish Budget 54
Tax base distributional differences between Scotland and the rUK 54
Illustrative scenario analysis 55
Implications for the Fiscal Framework 59
Annex B: Fiscal Framework 62
Tax 62
Social Security 63
Capital Borrowing 74

Foreword by the Cabinet Secretary for Finance and the Economy

The fourth Medium-Term Financial Strategy (MTFS) is being published today as part of a suite of fiscal publications including the 2022-23 Scottish Budget, the Resource Spending Review Framework and our Public Sector Pay Policy. In addition to these, the forthcoming publication of Scotland's first Framework for Tax will provide a solid foundation from which the design and delivery of devolved tax policy can be based - supporting the recovery, national outcomes and the pursuit of a fairer, greener and more prosperous Scotland for everyone.

Each of the documents published today has a distinct function. The Budget sets out how much money will be allocated to support services and the people of Scotland, and the total amount available to invest. The Resource Spending Review Framework frames the debate around the Scottish Government's spending priorities and the fiscal challenges it faces over the next four years, with clear plans for public spending over the medium-term to be published in the Resource Spending Review in May 2022. Decisions made in the Resource Spending Review will be focused on delivering the government's core missions for this Parliament: reducing child poverty, tackling climate change and securing a stronger, fairer and greener economy.

The role of the MTFS is to provide a medium-term perspective on the public finances, supporting a broad approach to budget evaluation and formation. It ensures that both Parliament and Government have foresight of the financial challenges we face and the opportunities that lie ahead. The MTFS also sets out the principles for how the Scottish Government will exercise its borrowing powers and the Scotland Reserve within the constraints of the Fiscal Framework.

The Scottish Government is committed to meeting the requirements of the Budget Process Review Group[1] and taking an active approach to protect the long-term fiscal sustainability of public finances through diligent management of fiscal risk. However, this has to be considered within the specific context of our current fiscal constitutional set-up, with the upcoming Fiscal Framework review offering an important opportunity to press for changes to the fiscal levers available to the Scottish Parliament.

Medium-term financial planning is challenging within our complex fiscal landscape. The MTFS ensures the Scottish Government is being honest and open with the public on the risks to the fiscal and spending outlook over the next five years. It is our job as a mature, fiscally responsible government to manage these challenges effectively, and the Scottish Government's approach to long term fiscal sustainability will enable us to deliver our core missions over this Parliament.

[1] Budget Process Review Group (2017), *Final Report* – June 2017

Kate Forbes MSP

Cabinet Secretary for Finance and Economy

Executive Summary

This is the fourth iteration of the MTFS, this time produced alongside the Scottish Budget, the Resource Spending Review Framework and Public Sector Pay Policy. The 2022 MTFS will revert to its original timetable of a Spring publication and will be published alongside the Resource Spending Review, which will set out our spending plans over the next four years.

The purpose of the MTFS is to examine the medium-term sustainability of Scotland's public finances, with a focus on the management of fiscal risk within existing constitutional and fiscal constraints. It also sets the medium-term context to annual budget decisions and the Resource Spending Review framework by presenting funding and spending scenarios over a five-year period.

Chapter 1 sets out the context for public finance and spending in Scotland by giving an overview of the national and regional economic climate and outlook over the next 5 years, using economic forecasts from the Scottish Fiscal Commission (SFC).

Chapter 2 sets out the forecast funding envelope for resource and capital, drawing on tax forecasts from the SFC and Office for Budget Responsibility (OBR), as well as forecasts of UK Government (UKG) expenditure and resulting consequentials for Scotland. It also sets out the implications of potential scenarios around the central forecast.

Chapter 3 provides a summary of the Resource Spending Review Framework. It also gives an update on the Capital Spending Review and progress against the National Infrastructure Mission, as well as highlighting key drivers of spend.

Chapter 4 discusses how we manage risks within the boundaries of our existing powers, as well as demonstrating the limitations of our current powers ahead of the Fiscal Framework review.[2]

The conclusion sets out this Government's views on the role of the MTFS and our plans to work with Parliament to review and update the document to ensure it continues to meet the expectations set out by the Budget Process Review Group (BPRG).

Finally, the Annexes provide more detailed technical modelling on tax base distributional risk, as well as key data on the components of the Fiscal Framework.

[2] To learn more about the Fiscal Framework and how it operates, please consult Scottish Government (2021), *Fiscal Framework factsheet* – November 2021

1. Scotland's Economic Outlook

This chapter provides an update on the Scottish economy, with a summary of the latest official economic and tax forecasts from the Scottish Fiscal Commission (SFC) and the Office for Budget Responsibility (OBR). The chapter also looks at the impact these updated economic forecasts have on the Scottish Budget and discusses the actions the Scottish Government is taking to deliver a fairer and greener recovery from the pandemic.

1.1 State of the Economy

The Scottish economy has continued to recover across 2021 as restrictions on economic activity have largely been lifted. However, the recent emergence of the Omicron COVID-19 variant and associated uncertainty will weigh on consumer and business confidence. The Organisation for Economic Co-operation and Development's (OECD) latest assessment from 1st December 2021 is that it could intensify imbalances that are slowing growth, raising costs, and could delay the world economy's return to pre-pandemic levels.[3]

Scotland's Gross Domestic Product (GDP) continued to edge back towards its pre-pandemic level in September and is now 1.1% below that level, having fallen over 20% at the start of the pandemic.[4] The pace of growth generally slowed in recent months, reflecting both the moderation of the boost in output from restrictions easing over the second quarter and the impact of volatile industries such as energy production. This is alongside the intensifying global supply chain issues and rising levels of inflation seen in the global economy, alongside the UK Government withdrawing COVID-19 fiscal support policies domestically.

Labour market conditions have continued to improve. The number of payrolled employees is now above pre-pandemic levels, having fallen almost 4% during 2020. Although 80,000 jobs in Scotland were still on the furlough scheme when it ended in September, emerging survey data suggests many furloughed workers have since returned to work, which should contribute to long-term economic scarring being lower than initially feared.

Trading conditions remain challenging for businesses at this stage of the pandemic, as supply chain disruption and inflationary pressures on input costs have intensified and have presented new cash flow challenges for many businesses. Businesses have also been more immediately exposed to the recent sharp rise in energy costs, particularly those without access to financial instruments that can help hedge or manage such risks.

The latest data indicates that businesses are partly absorbing some of these higher costs, but some businesses are beginning to pass these cost pressures through to consumers. As a result, inflation could rise further in the months ahead. This is largely expected to be temporary as the economy continues to rebalance, but it could still create new pressures on households' budgets and spending power.

[3] OECD (2021), *OECD Economic Outlook* – December 2021

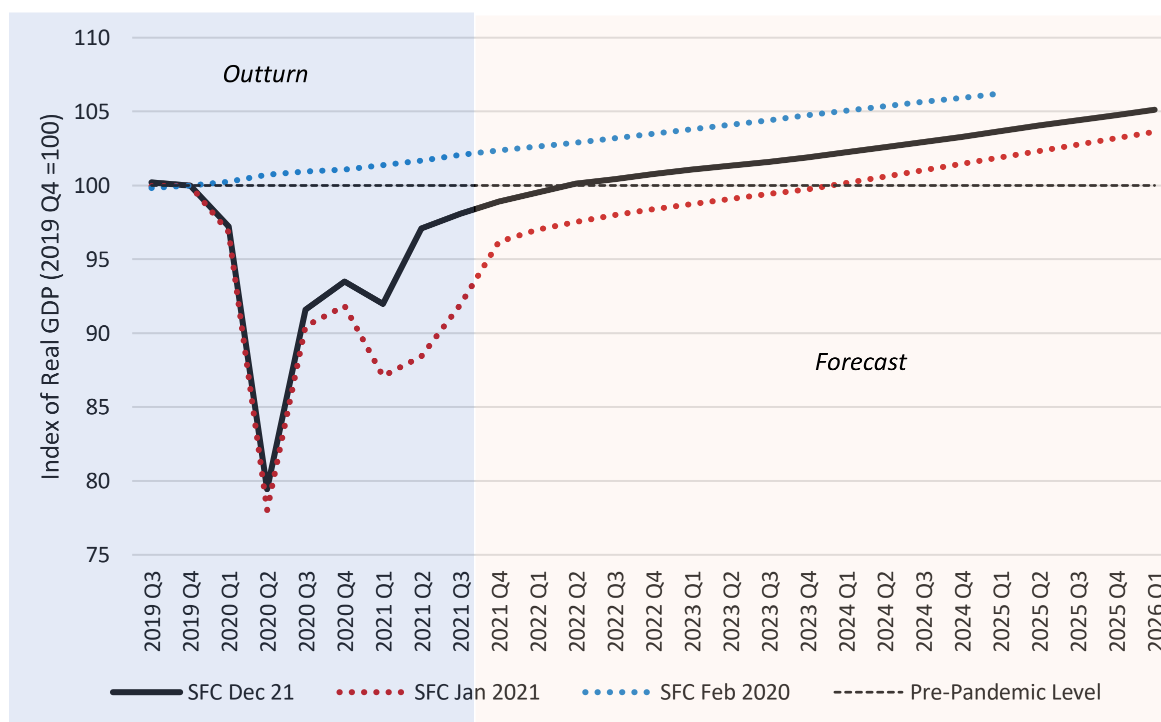
[4] Scottish Government (2021), *GDP Monthly Estimate* – September 2021

1.1.1 Latest Economic Forecasts of the Scottish and UK Economies[5]

The outlook for the Scottish and UK economies is significantly more positive than at the time of the previous Scottish Budget, although the pandemic continues to weigh upon the economy and uncertainties remain elevated.

The latest forecasts from the SFC show the Scottish economy recovering to pre-pandemic levels by Apr–Jun 2022, almost 2 years earlier than forecast at the previous Scottish Budget in Jan 2021. This is only slightly slower than the OBR's latest forecast for the UK economy, which is now expected to return to pre-pandemic levels in Jan–Mar 2022.

Figure 1: Comparison of forecasts of Scottish GDP



Scottish Fiscal Commission

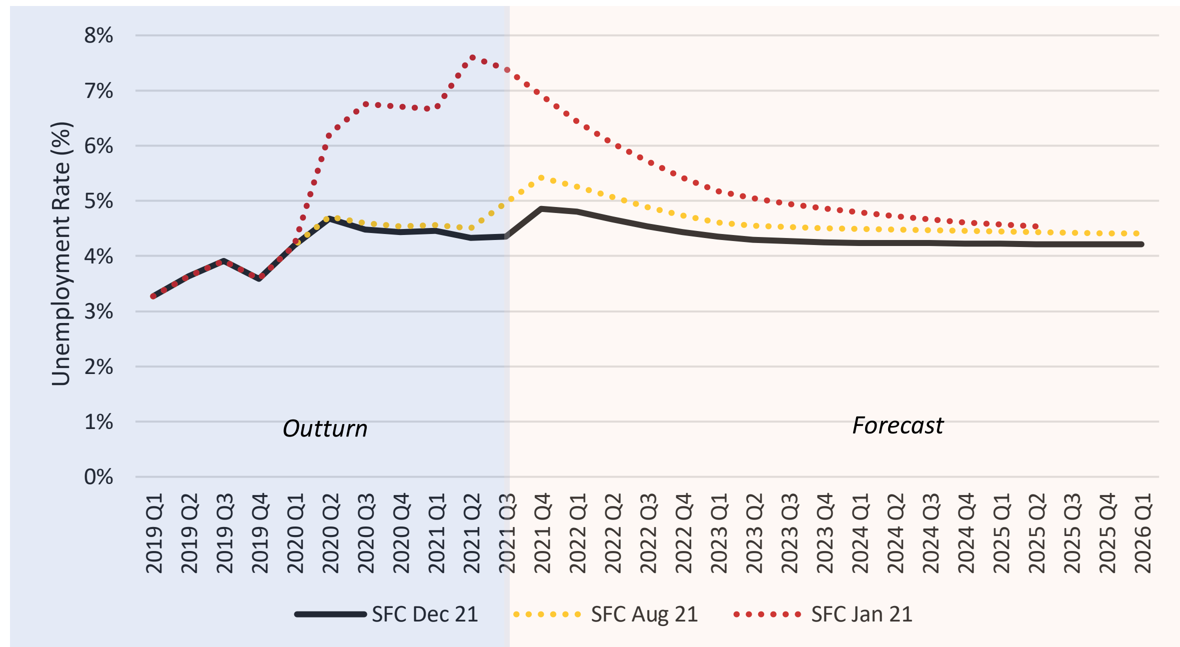
The level of long-term economic "scarring" to the Scottish economy from COVID-19 has been revised down from an anticipated permanent reduction in long-term GDP of around -3% at last year's Budget to one of around -2%, reflecting the SFC's view that the pandemic has not damaged the long-term productive capacity of the Scottish economy as much as previously feared. This is similar to the OBR's latest view of the degree of long-term scarring to the UK economy, and smaller than the 4% long-term reduction in living standards that the OBR attributes to leaving the European Union (EU).

Part of this greater degree of optimism has been driven by the resilience of the labour market. In January 2021 the SFC and OBR, along with many other external forecasters, were forecasting significant increases in unemployment as it was still unclear how far the economy would be able to recover ahead of the ending of support schemes. As the vaccine programme has been delivered and economic restrictions have been removed earlier than expected at the time, the outlook for the labour market improved in tandem. The SFC now

[5] The figures in this chapter are the latest available as of 24th November, which was the cut-off point for new data releases.

expect unemployment to peak at 4.9% in October–December 2021, reflecting a small increase after the unwinding of the Furlough scheme, although one far below the 7.6% forecast at the time of the previous Scottish Budget.

Figure 2: Comparison of forecasts of Scottish unemployment rate (%)

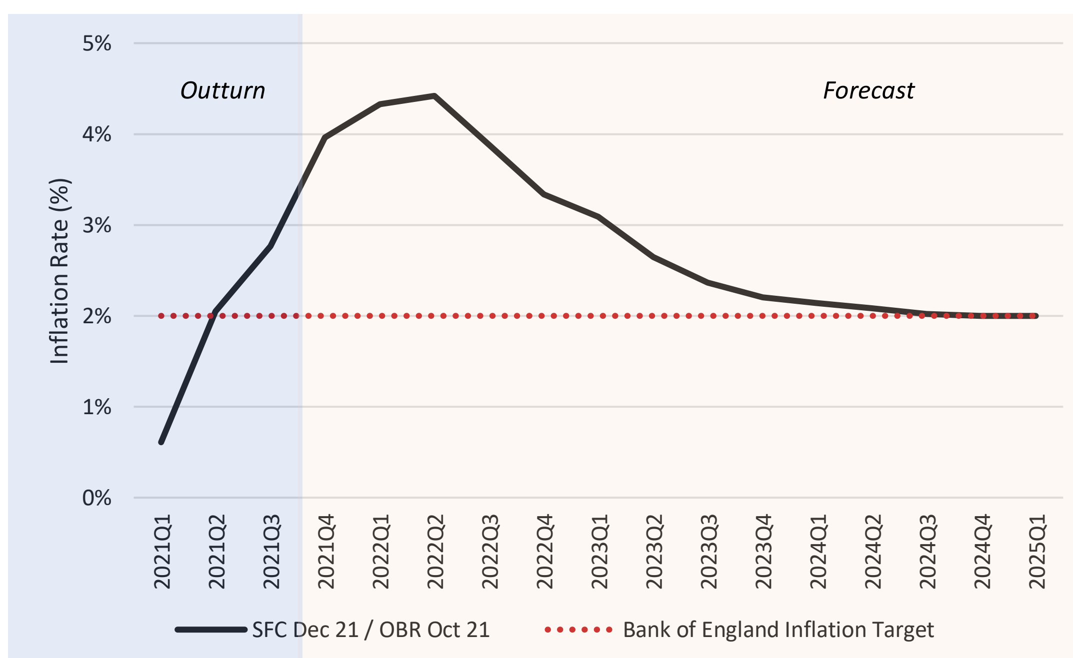


Scottish Fiscal Commission

However, the SFC's outlook for inflation has changed significantly since January 2021 when it was forecast to remain low and below the Bank of England's 2% target. The latest forecast, which is aligned with the OBR's October 2021 UK inflation forecast, has been revised up with inflation forecast to peak at 4.4% in Apr – Jun 2022 before gradually returning to 2% by the second half of 2024.

The SFC mirrors the view of the OBR that the increase in inflation is largely a temporary phenomenon, driven by the rebound in global demand for goods and services across 2021 which has put strong pressure on supply chains, particularly in the energy sector. These pressures have resulted in temporary price increases which are expected to ease as supply chains readjust to higher levels of demand.

Figure 3: Forecasts of Scottish / UK inflation rate (%)



Scottish Fiscal Commission; Office for Budget Responsibility; Bank of England

1.1.2 Fiscal Implications for the Economic Outlook

As set out in Chapter 2, the Scottish Budget is influenced both by UK Government decisions on expenditure on devolved issues, and the relative performance of devolved tax revenues. Consequently, differences between the Scottish and UK economic forecasts can have a material impact on the funding outlook for the Scottish Government.

Ultimately, any impact on the Scottish Budget from devolved tax revenue will reflect the performance of tax revenues in Scotland relative to the rest of the UK (rUK). However, due to outturn data publication lags forecasts from the SFC and OBR are used to inform the Scottish Budget until outturn data is known. These forecasts, and the judgements of the forecasters that inform them, can then affect the funding the Scottish Government receives at each Scottish Budget. Even relatively small differences between the OBR and SFC forecasts of the Scottish and UK economies can significantly influence the short-term funding outlook for the Scottish Government.

As Table 1 below shows, there are some significant differences of view on the economic outlook between the SFC and OBR. Whilst both institutions have a very similar outlook on unemployment, the forecasters have a differing view on earnings and employment growth at the Scottish and UK level.

Table 1: Headline economy forecasts

		2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
GDP Growth (%)	SFC Dec-21	10.4	2.2	1.2	1.3	1.4	1.4
	OBR Oct-21	10.8	4.2	1.7	1.4	1.6	1.7

Unemployment Rate (%)	SFC Dec-21	4.6	4.5	4.3	4.2	4.2	4.2
	OBR Oct-21	4.9	4.6	4.3	4.2	4.2	4.2
Avg. Nominal Earnings Growth (%)	SFC Dec-21	3.8	2.6	3.0	3.2	3.3	3.4
	OBR Oct-21	5.2	4.0	2.5	2.3	3.1	3.6
Employment Growth (%)	SFC Dec-21	1.3	1.0	0.1	-0.1	-0.2	-0.2
	OBR Oct-21	-0.1	1.3	1.0	0.5	0.4	0.4
Inflation (%)	SFC Dec-21	3.3	3.7	2.3	2.0	2.0	2.0
	OBR Oct-21	3.3	3.7	2.3	2.0	2.0	2.0

Scottish Fiscal Commission; Office for Budget Responsibility

The nature of the pandemic, which continues to affect the economy on a monthly basis, can make headline comparisons of annual GDP difficult. Although the Scottish and UK economies are forecast to perform differently in the short term, over the long-term Scottish and UK GDP are forecast to perform more similarly.

However, the SFC do identify sectors of the Scottish economy which have underperformed relative to the UK, and which may be particularly relevant for devolved tax receipts. Some of these are long term trends, such as demographic pressures and for which key levers such as migration policy remain reserved. Others reflect the differing structure of the Scottish and UK economies, with the Scottish economy more exposed to the downturn in the oil and gas industry, and the rUK benefitting relatively more from the strong performance of financial services sector particularly in London and the South East. As a result, overall devolved revenues are forecast to grow more slowly in Scotland than the rUK. In 2022-23, overall devolved taxes are forecast to be smaller than the Block Grant Adjustments for the first time and this is expected to continue for most of the forecast period.

However, the final net position will not be known until official outturn data are published. Even relatively minor differences in the outlook for the Scottish and rUK economies can significantly alter the forecast tax revenue net positions and it will be some time (2024 for Income Tax) before the true net position becomes clear.

1.2 Increasing prosperity

As we emerge from the pandemic, we must work together to seize Scotland's potential and build an economy for everyone by delivering greater, greener and fairer prosperity. We have taken significant action to support firms and households during the pandemic. Businesses have benefitted from over £4.4 billion of Scottish Government support, including the extension of 100% Non-Domestic Rates relief for all retail, leisure, aviation and hospitality premises, including nightclubs, for all of 2021-22. This, alongside other measures such as a reduction to the poundage, ensures that Scotland offers the most generous non-domestic rates regime in the UK.

We also know that for a successful recovery, and to ensure that no one is left behind, a focus on employability and skills is key. In 2021-22 we are investing more than £1 billion to

drive forward our national ambition for jobs and to equip our workforce with the future skills it needs. Our Programme for Government commits up to £70 million for the Young Person's Guarantee, which will provide at least 24,000 new and enhanced skills and training opportunities for young people. This is part of the extra £125m allocated to enhance the National Transition Training Fund, all-age skills and employability support. A further £20m is also being spent to support the long term unemployed, working with 'No One Left Behind' partners to create new fair work job opportunities of community value within the public and third sector.

We also continue to invest in our infrastructure to boost economic wellbeing, prosperity and employment, with large-scale investment in new, emerging and high-value sectors – providing businesses with the confidence to grow and diversify. The Infrastructure Investment Plan (published in February 2021) sets out a pipeline of work that will help stimulate Scotland's economy. Around 45,000 construction and maintenance jobs will be supported annually through the total capital investment over the next five years. The Plan will also encourage the creation of green jobs and stimulate a greener economic recovery.

We are also setting out new and refreshed economic strategies tailored to meet the new challenges ahead. Our COVID-19 Recovery Strategy sets out the key outcomes that will be prioritised to tackle the inequalities that COVID-19 has highlighted, alongside specific actions being undertaken to drive these outcomes and rebuilding public services. Our forthcoming 10-year National Strategy for Economic Transformation will also look to build on these priorities into the long term to create a greener, fairer and more inclusive wellbeing economy.

1.2.1 COVID-19 Recovery Strategy

The foundations of the recovery strategy need to reflect the priorities of individuals, families, businesses and communities to address the impacts of the pandemic and build resilience for the future. The process of recovery involves supporting these groups through the losses experienced during the pandemic and the construction of a different future.

The COVID-19 Recovery Strategy[6] recently published by the Scottish Government aims to:

- Address the systemic inequalities made worse by COVID-19;
- Make progress towards a wellbeing economy;
- Accelerate inclusive, person-centred public services.

The three key outcomes of the Recovery Strategy central to achieving this vision and most likely to have the greatest impact on tackling some of the inequalities and disadvantages highlighted by COVID-19 include:

- Financial security for low-income households;
- Wellbeing of children and young people, and;
- Good, green jobs and fair work.

We have set out a summary of cross cutting actions with accompanying timelines aimed at delivering these three outcomes. There is a focus on driving job creation; increasing employee earnings; reducing the cost of living; providing early and preventative support for

[6] Scottish Government (2021), *COVID-19 Recovery Strategy* - October 2021

children and families; promoting the conditions for wellbeing to flourish; and creating the conditions for fair work and a just transition.

Specific actions include ensuring every region of Scotland has a Regional Economic Partnership (REP) to encourage and co-ordinate strategic collaboration between key economic actors within regions. Businesses will be offered help, via the Green Jobs Fund, to create green sector employment and invest in equipment and premises. A skills guarantee will also be introduced for workers in carbon-intense sectors, as part of the Green Jobs Workforce Academy. In addition, support will be offered to individuals moving into new jobs or sectors, by investing in adult upskilling and retraining and creating a new Digital Skills Pipeline.

1.2.2 10-Year National Strategy for Economic Transformation (NSET)

Our long-term vision for Scotland is one of a low-carbon, wellbeing economy – a society that is thriving across economic, social and environmental dimensions, delivering sustainable and inclusive economic prosperity for Scotland's people and places.

Our forthcoming 10-Year National Strategy for Economic Transformation will build on the COVID-19 Recovery Strategy to create a greener, fairer and more inclusive wellbeing economy. The Strategy will help put us on the path to meeting our 2030 climate targets, helping restore the natural environment, stimulate innovation, create jobs, improve wellbeing for all and further embed fair work across the economy.

The Strategy will support long-term aims such as a just transition to net zero and will bring together components of other strategies and targets, such as the recommendations of the Advisory Group on Economic Recovery[7].

We will stimulate business growth by investing in innovation, expanding opportunities internationally and supporting businesses to benefit from the transformational opportunities of digitalisation. This will help create quality employment opportunities and generate revenue to invest in public services.

[7] Advisory Group on Economy Recovery (2020), *Towards a Robust, Resilient, Wellbeing Economy for Scotland* - June 2020

2. Scotland's Fiscal Outlook

Under the Fiscal Framework, three factors determine the available funding for the Scottish Budget:

- UK Government spending decisions: Through the Barnett formula, the change in the Scottish Government's Block Grant each year is determined by the change in the UK Government's spending on areas devolved to the Scottish Parliament.
- Relative growth in Scottish Government and UK Government devolved tax revenues: Under the Fiscal Framework, if Scottish devolved tax revenue per person grows relatively faster than in the rUK, the Scottish Budget is better off and vice versa. This means that Scotland's budget is influenced not only by tax policy and economic performance in Scotland, but also by tax policy and economic performance in the rest of the UK.
- Relative growth in Scottish and UK social security expenditure: Under the Fiscal Framework, if Scottish devolved social security expenditure per person grows relatively faster than in the rUK, the Scottish Budget is worse off. If UK expenditure per person grows relatively faster, additional funds are available within the Scottish Budget. Again, this means that Scotland's budget is influenced not only by policy changes within Scotland, but also what happens in the rest of the UK.

This chapter sets out possible scenarios for the Scottish Government's funding outlook based on these three factors and the latest economic and fiscal forecasts from the OBR and SFC.

2.1 The central scenario for the resource funding outlook

Figure 4 below presents the central resource funding outlook for the Scottish Government over the five-year forecast horizon of the MTFS. This is broadly driven by decisions taken by the UK Government in its Spending Review and the economic and fiscal forecasts provided by the SFC and OBR on the basis of Scottish and UK Government policies, subject to some adjustments discussed below. It also presents an upside and downside scenario for funding, indicating plausible alternative funding paths. These are discussed in more detail in sections 2.2 and 2.3 below.

Figure 4: Resource funding outlook for the Scottish Government

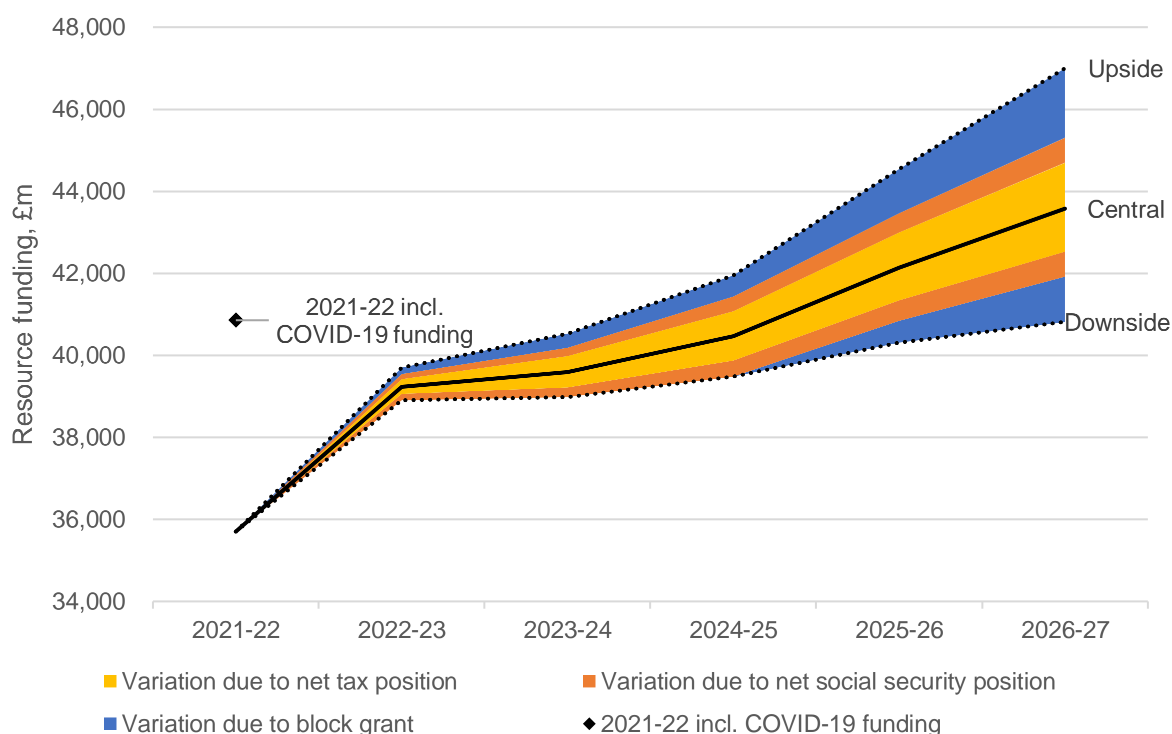


Table 2: Resource funding outlook for the Scottish Government

£ million		2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
Resource funding	Upside	35,704	39,702	40,529	41,956	44,541	46,997
	Central	35,704	39,236	39,595	40,463	42,143	43,576
	Downside	35,704	38,907	38,980	39,485	40,308	40,817

2021-22 figures do not include COVID-19 funding.

2.1.1 Block Grant

Block Grant funding from the UK Government is still the largest single component of funding for the Scottish Government, and the Barnett formula is used to determine the annual change in the grant based on new spending announced by the UK Government.

The UK Government's October 2021 Spending Review set out departmental spending plans for 2022-23, 2023-24 and 2024-25. This sets out the level of the Scottish Government's Block Grant over the same period and gives a degree of certainty about future funding. The UK Government has not made spending commitments for 2025-26 and 2026-27, so funding for those years remains more uncertain. For the central funding outlook, we have assumed that the Block Grant in these years grows in line with the OBR's forecasts for overall UK Government resource spending growth.

While the Spending Review theoretically sets the envelope for future expenditure, historically there have been changes to spending plans within a Spending Review period. Any changes to the UK Government's spending plans in future years represents a risk for the Scottish Government's funding outlook.

2.1.2 Devolved Taxes

While the Block Grant still accounts for most of the funding for the Scottish Budget (and hence creates the greatest source of uncertainty in future funding), the devolution of significant tax and social security powers has also exposed the Scottish Budget to the relative performance of the Scottish and rUK economies and the policy decisions made by the Scottish and UK Governments.

For devolved taxes, if tax revenue per head in Scotland grows faster than in the rUK, then the Scottish Budget is made better off. This means that faster economic growth in Scotland or policies that increase tax revenue per person relative to the rUK increase the funding available to the Scottish Budget. However, the converse is also true – slower economic growth in Scotland or policies that reduce tax revenue per person will reduce the funding available to the Scottish Budget.

However, it is worth highlighting that the Fiscal Framework broadly protects the Scottish Budget from economic shocks that affect both Scotland and the rest of the UK equally, as in theory any change in Scottish tax revenues should be broadly offset by an equal change in the respective Block Grant Adjustment (BGA) for that tax.

Consequently, the risk to the Scottish funding outlook over time reflects not how the Scottish economy is doing in isolation, but how it is performing relative to the rUK. A stronger (or weaker) relative economic performance over time in Scotland will result in a larger (or smaller) pool of funding available for the Scottish Government. Risks to the funding outlook include whether Scotland is more or less exposed to an economic shock or changing economic conditions than the rUK, perhaps due to differences in the sectoral composition between the two economies.

The other source of risk to the Scottish Budget reflects the policy choices made by both the UK and Scottish Governments. For example, the decision of the UK Government to freeze the Higher Rate Threshold for Income Tax until 2025-26 will increase the amount of Income Tax collected in the rest of the UK and, unless an equivalent policy change is made in Scotland, will make the Scottish Budget worse off.

2.1.3 Social Security expenditure

For devolved social security expenditure, in a similar manner to devolved taxes, what matters for the Scottish Budget is the relative growth in expenditure per head between Scotland and the rUK.

In addition to economic factors, the growth in social security expenditure over time will be heavily affected by the policy decisions made by both governments. This can include

technical changes to the eligibility of certain benefits, changes to the generosity of certain payments or decisions around the rate at which payments are increased or uprated over time.

2.1.4 Central Scenario

The central funding scenario includes the central outlook on UK Government spending from the Spending Review, alongside the latest tax revenue forecasts by the SFC and Block Grant Adjustments based on the latest OBR forecasts, which are based on the stated Scottish and UK Government policy.

Given that the Scottish Budget's funding outlook is driven by changes to UK fiscal policy, the relative economic performance of Scotland and the rUK and differences in devolved tax and social security policy between both governments, this implies that despite a degree of certainty created by the UK Government's 3-year Spending Review, the future funding outlook retains a level of volatility.

The central scenario described here is considered the most likely outcome, and is the main scenario used by the Scottish Government for planning purposes. However, it is also useful to consider alternative scenarios to help illustrate the risks to the Scottish Budget funding outlook (both positive and negative) should UK fiscal policy change in the future, or the economic and fiscal forecasts prove to be inaccurate.

Figure 4 above illustrates the resource funding outlook under a central, upside and downside scenario. In the upside and downside scenarios, different assumptions have been used about each of these three drivers of the Scottish fiscal position. These scenarios apply feasible alternative assumptions to generate plausible paths for the resource funding available to the Scottish Government. They do not represent the full range of possible outcomes, nor is it possible to assign a probability to each scenario.

The assumptions used to generate the upside and downside scenarios are described in more detail below.

2.2 Upside funding scenario: stronger Scottish tax performance and a looser UK fiscal stance

Under the upside scenario, there is an additional £470 million funding available in 2022-23, rising to £3.4 billion in 2026-27. This is driven principally by making more optimistic assumptions about UK Government fiscal policy, Scottish economic performance relative to the rest of the UK, and, to a lesser extent, the social security Block Grant Adjustment.

In this scenario, we assume the Block Grant grows somewhat faster (an additional 0.5% points per year) than currently forecast during the Spending Review period, and then substantially faster (an additional 1.5% points per year) in the final two years of the scenario. This could represent a stronger than expected recovery, providing space for the UK Government to increase spending while still meeting its fiscal rules. It could also reflect the UK Government changing its fiscal rules in response to a changed economic outlook. Box 1 discusses the current UK fiscal rules and their implications in more detail.

This scenario also assumes a relatively stronger growth in earnings and employment in Scotland compared to rUK. This increases Scottish Income Tax revenue at a greater rate than tax revenue in rUK, which under the Fiscal Framework increases the Scottish Budget. The divergence in earnings and employment growth between Scotland and rUK (0.5% points and 0.7% points in each year, respectively) is high by historical standards but provides a useful illustration of the degree of volatility that changes in relative economic performance can generate.

The upside scenario also assumes a higher Block Grant Adjustment for social security, accumulating by on average around 2 additional % points per year compared to the central forecast. This is based on the average forecast error for the OBR's Great Britain level forecasts of social security payments.

There is no reason to believe the three 'optimistic' assumptions used to generate the upside scenario will necessarily occur together. For example, we are not explicitly assuming that a change in the UK Government's fiscal stance would be more or less likely to occur alongside a relatively stronger economic performance in Scotland. Figure 4 decomposes how much of the variation in the upside scenario from the central is due to each assumption. This shows the funding outlook for adjusting only one of these assumptions in isolation from the others.

Box 1: UK fiscal targets

In October the UK Government announced its new fiscal targets. These include a revised fiscal mandate and three supplementary targets.

The new fiscal mandate is:

To have public sector net debt (excluding the Bank of England) as a share of GDP falling by the third year of the rolling forecast period.

The three supplementary targets are:

- To balance the current budget by the third year of the rolling forecast period.
- To ensure that public sector net investment does not exceed 3% of GDP on average over the rolling five-year forecast period.
- To ensure that a subset of expenditure on welfare is contained within a predetermined cap and margin set by the Treasury (the 'welfare cap').

Successive Chancellors have announced 11 different fiscal targets in the last seven years prior to this most recent announcement. Most of these have been missed before being abandoned. As such, the new fiscal rules will not necessarily bind the UK Government, and may be changed or abandoned if they look likely to be missed.

While this flexibility is welcome in some respects, allowing policy to adapt to major shocks like COVID-19, it also means these fiscal targets may not be a good guide to future UK Government spending. In their most recent forecasts, the OBR expect all these targets to be met individually, but note that the space for doing so is very limited. Given past experience, a change in economic circumstances that made meeting the fiscal targets

more challenging could result in either a reduction in spending, or simply a change to new fiscal targets that are easier to meet. As such, UK fiscal targets do not typically provide a strong long-term basis for anticipating what funding the Scottish Government might receive if economic and fiscal conditions change.

2.3 Downside scenario: weaker Scottish tax performance and a tighter UK fiscal stance

Under the downside scenario, funding is reduced by £330 million in 2022-23, with the reduction increasing to £2.8 billion in 2026-27. The underlying assumptions are mostly symmetric to the assumptions used to generate the upside scenario. This includes the tax revenue forecasts, which assume Scottish earnings and employment growth 0.5% points and 0.7% points slower in each year of the forecast. The social security Block Grant similarly diverges from the central estimate, resulting in slower growth, by around 2% points in each year of the forecast, mirroring the upside scenario.

The exception is the growth in the Block Grant during the Spending Review period, which is assumed to match the central scenario. This reflects the fact that substantial reductions in resource spending plans announced through a Spending Review are generally unlikely, outside of a major economic shock. Such a shock would likely affect the funding and spending outlook of the Scottish Government substantially, likely outside the bounds of the scenarios presented in this publication. Beyond the Spending Review period, the downside risk to the Block Grant is assumed to be equal to the upside risk (i.e. 1.5% points slower growth per year than currently forecast), reflecting the wide range of possible fiscal paths the UK Government could adopt in future.

As above, there is no reason to believe the assumptions that generate the downside scenarios will be correlated with one another. Some could occur alongside components of the upside scenario. For example, an uneven recovery where economic activity improved faster than expected in rUK, but remained more subdued in Scotland, could support a looser fiscal stance from the UK Government, while weakening the Scottish Budget position through weaker tax revenue.

2.4 Outlook for capital funding

The drivers of capital funding are relatively simple compared to the factors that affect the resource funding outlook. Capital funding is primarily provided by the Block Grant and Financial Transactions (FT) allocations, with the latter determined by the UK Government's capital spending plans. The remaining sums arise from income and receipts, deployment of Scottish capital borrowing powers, from innovative financial and revenue finance models, and from recycling repayments from earlier FT loans.

Table 3 below shows the funding outlook for the capital Block Grant, including an upside and downside scenario. As with the resource outlook, the UK Government's Spending Review settlement provides a degree of certainty over the next three financial years. In 2025-26 and 2026-27, we have assumed that the capital grant funding available to the Scottish Government will grow with the OBR's forecasts for UK wide public sector

investment. However, this is highly uncertain, and capital spending is typically subject to more variation than resource spending.

For example, the UK Spending Review in October 2021 provided a Scottish capital grant allocation considerably lower than our expected allocation based on OBR forecasts. On this basis, we have adopted an assumption of the capital allocation remaining fixed in cash terms as the downside scenario.

The wide range between these scenarios demonstrates the limitations on the Scottish Government's ability to set multi-year spending plans. A more cautious approach to the funding outlook may be required in the future, which may in turn hamper our efforts towards delivering the infrastructure investment needed to achieve our National Outcomes as set by our National Infrastructure Mission.

Table 3: Capital grant funding outlook for the Scottish Government (excl. financial transactions)

£ million	£ million	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
Block Grant capital funding, excluding financial transactions	Upside	5,520	5,897	5,874	5,748	6,047	6,048
	Central	5,520	5,897	5,874	5,748	5,968	5,880
	Downside	5,520	5,897	5,874	5,748	5,748	5,748

3. Scotland's Spending Outlook

The purpose of this chapter is to provide an update on the overall spending outlook and its component parts, including:

- The Capital Spending Review and progress against the National Infrastructure Mission (NIM)
- Key drivers of spend such as pay and demand-led social security spend, which may present risks to our spending position in the future
- The Resource Spending Review framework.

3.1 Capital expenditure outlook

3.1.1 Infrastructure investment

Our *Infrastructure Investment Plan 2021-22 to 2025-26*[8], published on 4 February 2021, focuses on three core strategic themes for guiding investment decisions in Scotland:

- Enabling the transition to net zero emissions and environmental sustainability
- Driving inclusive economic growth
- Building resilient and sustainable places

Our investment in infrastructure is targeted to maximise wider economic benefits and the delivery of the National Outcomes. The investment is often made by the Scottish Government or in partnership with Local Government. Where possible, however, the Scottish Government looks to create opportunities and the right conditions to leverage additional private sector investment across Scotland.

Delivery of the National Outcomes requires input from across Scottish society, and the challenges set out in the Infrastructure Investment Plan cannot be met without input from the private sector. Our long-term vision for infrastructure is strongly aligned with our plans on mobilising private investment alongside public investment as a critical part of our economic recovery.

As well as investing in physical infrastructure, the Scottish Government, in part through its Enterprise Agencies and the Scottish National Investment Bank, uses its capital budget to invest directly in businesses, supporting them to grow and develop. This sort of investment supports research and development, innovation and creativity, with capital grant being allocated to universities and other public sector research institutions.

3.1.2 National Infrastructure Mission

The National Infrastructure Mission announced in the 2018 Programme for Government is a commitment to increase annual investment by 1% of 2017 Scottish GDP by the end of this Parliament.

[8] Scottish Government (2021), *Infrastructure Investment Plan 2021-22 to 2025-26* – February 2021

The NIM was introduced with an aim of raising Scottish infrastructure investment to internationally competitive levels; boosting broadband, transport, and low-carbon energy; and supporting inclusive economic growth. This level of investment in our vital economic and social infrastructure will protect and create jobs in the short term, and support growth and productivity in the long term.

The Scottish Government's Capital Spending Review (CSR), published in February 2021, underpins the five-year Infrastructure Investment Plan and sets out a five-year budget and vision for all infrastructure investment choices.

At the time of the CSR publication, there was uncertainty around UK allocations; OBR forecast figures were therefore used as the basis for our future planning for portfolio allocations throughout the CSR period. The UK Spending Review, published on 27 October 2021, has confirmed capital allocations that are considerably lower than our modelling, and will therefore reduce the level of capital investment we are able to deliver.

Table 4: National Infrastructure Mission Baseline

	2019-20 NIM Baseline	2021-22	2022-23	2023-24	2024-25	2025-26	5 Year Total
Capital Grant [1]	4,105	5,582	5,329	5,574	5,498	5,718 [2]	27,701
Capital borrowing	450	400	450	300	250	250	1,650
Financial Transactions [3]	652	410	592	316	306	130	1,754
Revenue Finance [4]	90	50	200	750	1,000	1,000	3,000
Total Investment	5,297	6,442	6,571	6,940	7,054	7,098	34,105
Audit Scotland modelled NIM trajectory (rounded)		5,700	6,000	6,200	6,500	6,800	31,200

[1] Capital grant figure includes UK Capital Allocation, Additional Whitehall Transfers, Estimated Capital Receipts, Fossil Fuel Levy in 2022-23 only and excludes Reserve drawdown.
[2] Estimated UK Capital Allocation is from MTFS Central Scenario figure.
[3] Includes FT Consequentials and FTs Recycled and excludes Reserve drawdown.

The UK Spending Review also set out the level of Financial Transactions available to the Scottish Government over the next 3 years. FTs can only be used to provide loans to or make equity investment in the private sector and need to be repaid. The Scottish Government has in previous budgets allocated FTs across a number of portfolio areas, including to capitalise the Scottish National Investment Bank, support investment in housing and businesses and invested in low carbon and energy efficiency schemes.

The revenue-financed investment noted in the table above includes Growth Accelerators, Green Growth Accelerators and the Learning Estates Investment Programme, which can be summarised as follows:

- Growth Accelerator is a funding mechanism in which local authorities invest in public sector enabling infrastructure to stimulate private sector investment and deliver

outcomes that grow the wider economy. On achievement of pre-agreed key milestones and targets, the Scottish Government pays a grant to the local authority equivalent to the investment (including financing costs) over a set time period (typically 25 years).

- Where targets are not met, the local authority is paid a percentage of the grant, depending on how close it was to achieving the target.
- The Green Growth Accelerator follows the principles of the Growth Accelerator and aims to unlock £200 million of additional local government investment in infrastructure projects to support Scotland's transition to an inclusive, net-zero emissions economy.
- Learning Estate Investment Programme is an outcomes-based approach to deliver high quality, well maintained, digitally enabled learning environments that achieve ambitious energy targets.
- Mutual Investment Model is a profit-sharing form of public-private revenue finance that has been developed by the Welsh Government and further developed for adoption by Scottish Government for use on specific types of infrastructure delivery, as outlined in the 2019 MTFS. As noted in the 2021 Capital Spending Review, the market is aware of the potential deployment of a Mutual Investment Model for the remaining stages of the A9 dualling programme and its use is still being explored.

As highlighted in section 2.4, there is uncertainty around the level of funding in 2025-26. Although we would still meet the NIM under the low scenario, this scenario would fail to live up to our ambitious infrastructure plans and would constrain our ability to meet our net zero targets. Should the UK Government continue to invest in local and regional infrastructure without consulting the Scottish Government, as is the case with the Levelling Up Fund investments, thereby reducing what would have otherwise come through as capital grant, achieving our NIM target could be at risk.

3.1.3 Supply Chain Challenges

There has been an upsurge in construction sector activity following a global drive to stimulate the economic recovery from COVID-19. As a result, demand for some resources is greater than the available supply, reduced productivity resulting from COVID-19 effects and mitigations has also created challenges in global supply chain logistics. In addition, the UK's exit from the EU has generated supplementary procedures for goods and materials inbound to the UK from the EU.

Such issues are affecting both the costs and delivery times of some materials. This increases the risk of projects running over budget and/or behind time. This could lead to a reduction in the quality of materials used to maintain budgets or programmes, financial disputes with contractors and a risk that private sector contractors may be less willing to bid for public sector contracts without safeguards against cost increases.

3.1.4 Next steps

Given the updated financial position following the UK Spending Review, and the ongoing pressure facing the construction sector relating to market conditions, a targeted review of the Scottish Government's CSR will be undertaken in early 2022. In conducting such a

review, the Scottish Government remains committed to the principles set out in the Infrastructure Investment Plan and the recommendations of the Infrastructure Commission for Scotland - maintaining our vision for future infrastructure to support and enable an inclusive net zero emissions economy.

3.2 Resource Spending Outlook

The Scottish Government must live within a funding settlement that is largely driven by the spending decisions of the UK Government. We have limited ability to expand it through borrowing, or to carry forward funding to spread investment and build contingency for the future.

If funding falls below expectations, the Scottish Government must adjust its spending plans accordingly. Similarly, if funding is higher than expected, the Scottish Government is able to invest more in public services that financial year, but has very limited ability to carry forward a surplus to support future spending.

In reality, our spending trajectory must mirror the funding trajectories set out in Table 2 in section 2.1.

Whilst Table 2 suggests a large increase in baseline funding from 2021-22 to 2022-23 following the UK Spending Review, block grant funding has been cut by 7% in real terms as COVID-19 funding has been withdrawn despite the ongoing effects of the pandemic. The block grant is lower than 2021-22 in every year of the UK Spending Review period.

Within this funding envelope, the Scottish Government will act to mitigate the effects of the pandemic, which we know has exacerbated inequalities across society. We will rebuild our public services, including taking vital steps to increase social care capacity and establish a National Care Service. We will ensure that our spending choices support progress towards meeting our ambitious child poverty and climate change targets, and secure a stronger, greener, fairer economy.

Those are the priorities of the Resource Spending Review set out in the framework which is published alongside this MTFS. The Resource Spending Review will develop multi-year spending plans which deliver effective services for the people of Scotland and maintain sustainable public finances. It will require us to decide how we prioritise spend and where we allocate resources to shape public services which most effectively meet the needs of an evolving population. There will be difficult choices about reprioritisation to make. As well as a tight financial envelope, there are volatility risks to the spending outlook and changing patterns of demand which will influence how we develop flexible, effective and sustainable spending plans.

The risks to the resource spending outlook are set out below. The Resource Spending Review Framework considers the impact of these as key drivers of public spending and explores the challenge and opportunities that these risks pose for the Scottish Government over the spending review period.

3.3 Risks to the spending outlook

3.3.1 Demand-led spend volatility

Expenditure on social security benefits is variable, as it is determined by the number of people who apply for support, with those considered eligible paid at the rate set in the policy. Furthermore, it depends on successfully ensuring that those eligible are able to claim their entitlements. The Scottish Government will have to meet this expenditure as it arises, even if it differs from the forecast used to set the initial Budget.

As the majority of benefits expenditure is demand-led, with budget allocations based on SFC forecasts rather than spending limits, this introduces in-year volatility and uncertainty to the Scottish Budget. The SFC reported a 3% variation from their original forecast for 2020-21[9], which, if replicated in 2022-23, would amount to over £119 million, as the SFC has forecast that social security expenditure will approach £4.0 billion in 2022-23. The continuing economic and social impacts of COVID-19 recovery add to the volatility risk associated with benefits expenditure.

Social security expenditure is forecast to rise gradually to over £5.3 billion by 2026-27, and any additional expenditure resulting from volatility will have to be managed within the limits of the Scottish Government's existing fiscal powers. In Scotland, all benefits expenditure is funded through our overall Resource budget, as opposed to a dedicated AME (Annually Managed Expenditure) budget that would be better suited to funding demand-led expenditure on this scale, as is the case in England. The review of the Fiscal Framework must provide Scotland with the powers and fiscal flexibilities necessary to manage fully the inherent risks in demand-led social security expenditure.

In 2022-23 over 90% of social security benefits expenditure will be funded through Block Grant Adjustments (BGA), which are based on OBR forecasts of benefit expenditure in England and Wales at the time the Scottish Budget is set. This will gradually reduce to around 80% by 2026-27 as additional new and replacement benefits launch, and expenditure diverges further from BGA. Once outturn data is available, reconciliations are made to the Scottish Budget to ensure that the funding available ultimately corresponds to the BGAs based on the outturn data. If expenditure in England and Wales is ultimately higher than forecast, a positive BGA reconciliation (i.e. an addition) will be made to the Scottish Budget to reflect these changes, and vice versa.

Changes between actual and forecast Scottish expenditure, and the BGA reconciliations, are managed by the Scottish Government's budget management processes, in line with the principles and policies on the use of borrowing and reserve powers as set out in Chapter 4. Further information on the BGAs and reconciliations is set out in Annex B.

The Scottish Government will continue to manage any variance between actual and forecast expenditure or BGAs, in a competent, responsible and balanced way as part of the annual budget process, in line with the principles and policies set out in the Medium-Term Financial Strategy.

[9] Scottish Fiscal Commission (2021), *Forecast Evaluation Report* – July 2021

3.3.2 Pay

Pay is a key driver of public expenditure and makes up around £21.1 billion or over half of the Scottish resource budget. The Scottish Government pay and reward policies are distinctive, fair and progressive and apply directly to 50 public bodies and act as a reference point to all of the devolved public sector workforces (including Health, Teachers, Police, Fire and Further Education Colleges) and will negotiate new pay deals in 2022-23.

The Scottish Government is committed to exploring with Trade Unions and employers further opportunities for developing non-pay benefits. Work has been ongoing towards standardising the 35 hour working week across public bodies where the pay policy directly applies, the introduction to the right to disconnect with an option to explore the 4-day working week. In the long term, this could be an opportunity to lessen the cost burden of pay awards to employers, act as a lever to improve productivity, optimise the role of automation and digitalisation of services, while creating high value job opportunities and contributing to the wellbeing economy.

In designing our pay policy, we must balance economic, fiscal and social factors and in particular the:

- changes to the cost of living (CPI Inflation 3.1% in September 2021)
- the effect of the recent 1.25% increase of National Insurance Contributions for employee and employer contributions.
- average pay in the public sector has been higher than in the private sector in recent years, with a pay ‘premium’ of just over 3% in the years prior to 2020.
- Labour market conditions have continued to improve. The number of payrolled employees is now above pre-pandemic levels, having fallen almost 4% during 2020.

The affordability of pay uplifts, consistency across the industrial relations landscape and recognition of performance across public services contribute to a fair and fiscally sustainable approach to public sector pay. This is crucial given it accounts for half of the Scottish Government resource budget.

The 2022-23 Public Sector Pay Policy was announced alongside the Scottish Budget, continuing the progressive principles of recent years. Specifically, it outlined a cash uplift of £775 for public sector workers earning up to £25,000, £700 for workers earning between £25,000 and £40,000, and a cash uplift of £500 for those who earn above £40,000 alongside the adoption of a £10.50 public sector wage floor by April 2022 – building on the impact of the real Living Wage.

In addition to the main single-year pay policy option, we have also offered the option for public sector bodies to choose a multi-year approach. This would be supported by multi-year spending plans and is connected to public service reform and broader changes to terms and conditions.

To illustrate the potential future paybill costs, we have modelled three theoretical public sector pay award scenarios – which exclude pension costs (see Table 5).

Table 5: Illustrative cumulative paybill costs (£ billion)

	Baseline (2022-23)	2023-24	2024-25	2025-26	2026-27
Illustration of 1% pay award					
Total	21.1	21.29	21.50	21.71	21.93
Additional cost including Basic Award		0.21	0.21	0.21	0.21
Illustration of 2% pay award					
Total	21.1	21.29	21.71	22.14	22.58
Additional cost including Basic Award		0.42	0.43	0.43	0.43
Illustration of 3% pay award					
Total	21.1	21.50	22.14	22.78	23.43
Additional cost including Basic Award		0.63	0.64	0.64	0.65

Note: This is the cost of the basic award including employer on-costs but excluding pension costs.
The paybill costs include all bodies within the Scottish Devolved public sector. The central scenario of 1% workforce growth is based off the average previous five-year growth of the Scottish Devolved public sector.

To give context to pension costs to employer the table below sets out the employer contribution rates for each of the defined benefit pension schemes in operation in Scotland.

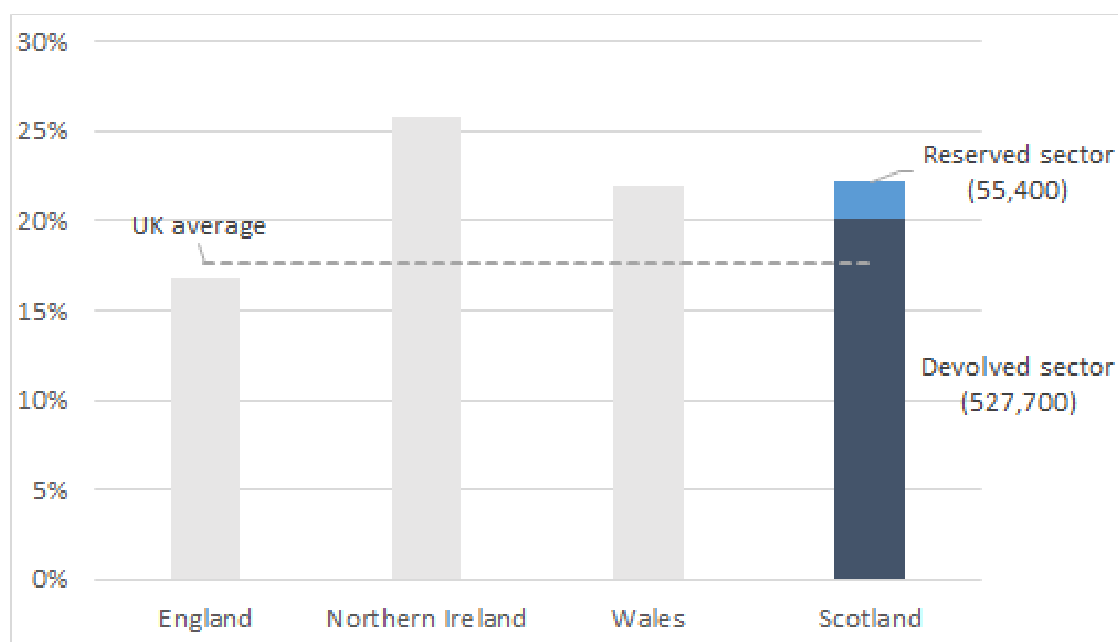
Table 6: Current employer pension contribution rates

	Civil Service	NHS	LGPS	Teachers	Police	Firefighters	Judicial
Employer	26.6 – 30.3%	20.9%	20.5% (average)	23%	29.4%	39.1%, 24.5%, 26.8%	51.4%

3.3.3 Growth in the public sector workforce.

The size and distribution of the workforce in the devolved public sector directly influences the Scottish Budget position. As of 2021 Q2, 583,100 individuals, representing around 22% of all Scottish workers, worked in the public sector. Around 48% of these workers are in Local Government and 34% in the NHS. The Scottish public sector is proportionally larger than the UK average of 18%, with the average in England being 17%.

Figure 5: Proportion of people employed by the public sector: UK nations headcount (2021 Q2)



Public Sector Employment (Office for National Statistics); Public Sector Employment in Scotland (Scottish Government)

Over the last 5 years the number of Public Sector devolved workers has increased by 1% per year on average. Over the coming years, further public services will be introduced such as an expansion in Social Security and NHS National Care services. As a result, we anticipate that the public sector in Scotland will continue to grow. The relative larger and growing size of the Scottish public sector carries with it a greater fiscal risk to the Scottish Budget.

To illustrate the potential future costs, based solely on historical trends on growth, we have modelled three scenarios based on assumptions around the pay award and future workforce growth.

Table 7: Illustrative cumulative pay award and workforce costs (£ billion)

	Baseline (2022-23)	2023-24	2024-25	2025-26	2026-27
Low Scenario - 1% pay award, 0.5% workforce growth					
Total	21.1	21.4	21.7	22.0	22.4
Difference from Central Scenario		-0.32	-0.64	-0.96	-1.29
Central scenario - 2% pay award, 1% workforce growth					
Total	21.1	21.7	22.3	23.0	23.7
High Scenario - 3% pay award, 1.5% workforce growth					
Total	21.1	22.0	23.0	24.0	25.0
Difference from Central Scenario		0.32	0.64	0.96	1.29

Note: This is the cost of the basic award including employer on-costs but excluding pension costs.
The paybill costs include all bodies within the Scottish Devolved public sector. The central scenario of 1% workforce growth is based off the average previous five-year growth of the Scottish Devolved public sector.

3.3.4 Public service pensions – a mandatory workforce cost

Within the UK, policy is largely reserved to Westminster in respect of public sector pensions and wholly reserved in respect of state pensions, private sector pensions, and pensions taxation policy. Public sector pensions are an important element of current and future Scottish Government obligations. Pension scheme membership is also provided as part of public servants' terms and conditions.

Employers pay pension contributions on their employees' pensionable pay and total costs increase with workforce size, paybill and number of employees who are pension scheme members. Pension costs are part of an employer's on-costs and are taken into account when assessing the affordability of pay awards and in workforce planning. Scottish Ministers remain committed to public service pensions that are affordable, sustainable and fair to Scotland's public servants and the communities they serve.

Employer pension contributions, along with the those paid by scheme members, are used to meet the cost of pensions in payment. Scheme cash flow shortfalls are met through UK Government funding mechanisms (Annually Managed Expenditure or AME) in the case of the NHS and Teachers' schemes, or through Scottish Government resource budget in the case of the Police and Firefighters' schemes.[10]

The figures in the Scottish Budget represent "net public pensions expenditure" for the Teachers' and NHS pension schemes. The contributions paid into the scheme by members and employers are effectively converted to AME, with HM Treasury providing additional AME when required to meet expenditure. Actual amounts vary year to year, and a pension scheme may be in surplus or deficit (so, having more income than expenditure versus requiring additional AME from HM Treasury). This AME budget is ring-fenced for Teachers' and NHS pensions.

UK Government decisions on overarching policies, such as the discount rate used to value scheme liabilities as part of quadrennial scheme valuations, affect the Scottish public service pension schemes. For example, the UK Government's 2018 announcement of a decrease to the discount rate contributed to increased employer pension contribution rates from 1 April 2019, which increased pension contribution costs across relevant public sector employers in Scotland by more than £500 million for 2019-20. The Scottish Government received Barnett consequentials to cover some of this cost and provided additional funding itself to help make up the shortfall for employers.

In the medium-term, the upcoming round of public service pension scheme valuations – the 2020 scheme valuations – is the next pension event that could change pension costs for employers participating in the Scottish NHS, Teachers', Firefighters' and Police pensions schemes, and in the reserved Civil Service and Judicial pension schemes. In 2021, HM Treasury ran a consultation on the methodology for setting the discount rate. The discount

[10] Pension schemes for the civil service and the judiciary are reserved schemes. While employer pension contributions are paid to these schemes in respect of Scottish devolved public sector employees/appointees, scheme cash flow is managed by the Cabinet Office and the Ministry of Justice, respectively, with shortfalls topped up by UK Government-funded AME. The Scottish Local Government Pension Scheme is a funded scheme, managed locally, with some non-local authority public bodies as participating employers. Member and employer contributions are invested; resulting returns on investment are added to fund assets used to pay pensions.

rate to be used in the 2020 scheme valuations will be set by HM Treasury in due course. The employer pension contribution rates set in 2019-20 for these schemes will remain in effect until new rates are set and implemented from 1 April 2024.

3.3.5 Ageing is a significant driver of public service expenditure

An ageing population puts increasing pressures on public expenditure, in particular pensions, health and social care. The predominant portion of a person's health care is required in old age and, in particular, the year and months before death. The Scottish population is ageing; by mid-2043, it is projected that 22.9% of the population will be of pensionable age, compared to 19.0% in mid-2018. At the same time, as the proportion of working-age population decreases, this means that public services and social security payments for all need to be funded on a smaller active economy.

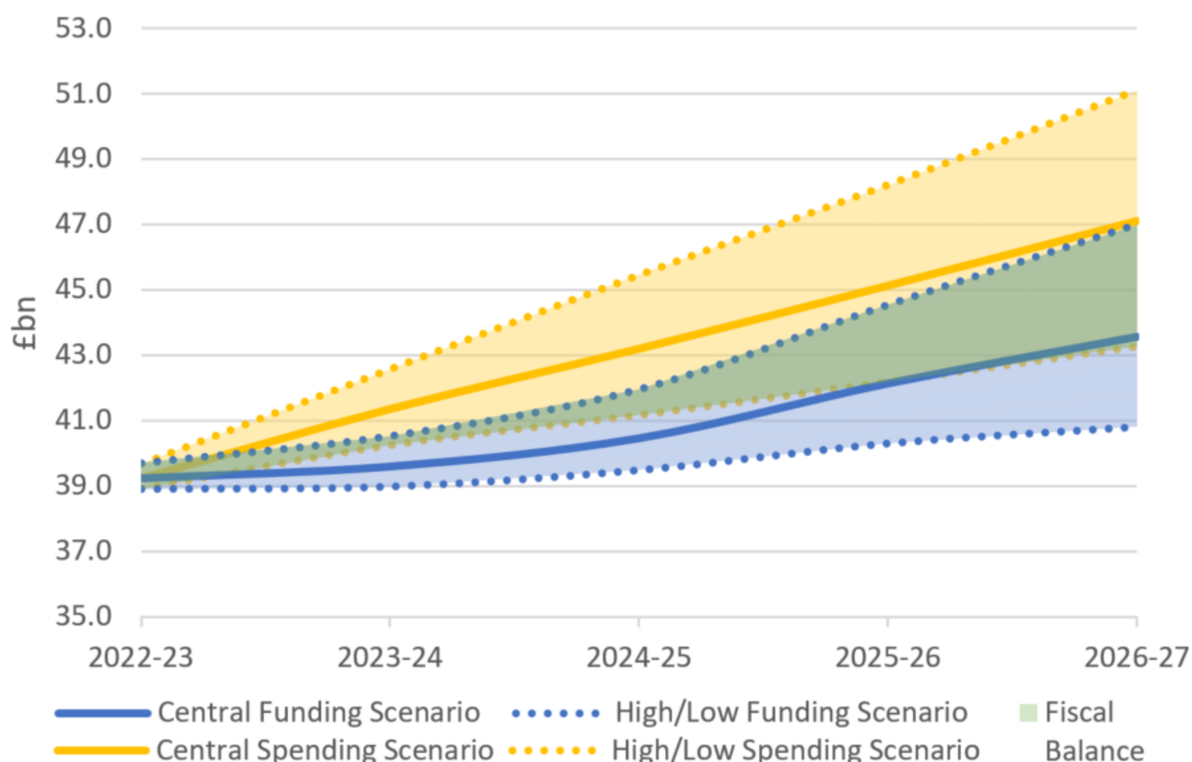
Equally, as medical research and advancement allow, people are living longer, fuller lives. While these scientific and medical advancements are worth celebrating, they also fundamentally alter the demographic make-up of our society, our tax base and the needs that public services will need to meet. While we are living longer, we are also experiencing higher and more complex care needs, with the incidence of comorbidity increasing. While these changes are gradual and not necessarily significant over the period of this MTFS, policy interventions are required early in order to maintain the affordability of health care and the pension system over the long term. For health, this requires both more efficient service delivery and sustained and concerted action to manage demand through self-care, prevention and health improvement.

4. Managing Fiscal Risks

This chapter brings together the funding and spending scenarios and discusses the different sources of fiscal risk that need to be managed, as well as our ability to manage those risks with the available fiscal tools - namely the Scotland Reserve and resource and capital borrowing powers.

Figure 6 below shows how the funding and spending scenarios compare. As with last year's document, the funding scenarios are from section 2.1 based on the SFC forecasts and the information we have from the UK Government about projected levels of spend at UK level and the shape of the block grant. This year, rather than being based on percentage increases, the illustrative spending scenarios were developed to support the upcoming Resource Spending Review Framework consultation. They therefore reflect a more detailed understanding of spending pressures in the medium term, including new commitments. In reality, we know that public spending will mirror the funding forecasts set out in the MTFS, unless there are significant changes to the Fiscal Framework or our tax measures.

Figure 6: Modelled funding and spending scenarios



The drivers of public spending identified in chapter 3 illustrate the variable and growing demands on public funding over the spending review period. If we compare our central funding forecast with our mid spending projection, this suggests a growing gap which reaches approximately £3.5 billion in 2026-27. At the extremes, the low funding compared with the high spending trajectory opens an estimated gap of approximately £10.3 billion in 2026-27, while a high funding combined with a low spending trajectory gives a £3.7 billion surplus.

These are not forecasts, and the wide range demonstrates the inherent uncertainties. However, they illustrate the need for a robust Resource Spending Review to help us make

informed decisions about how we best use the funding available to meet the evolving needs of the population.

With limited resources, increased investment in the Scottish Government's priorities will require efficiencies and reductions in spending elsewhere: we need to review long-standing decisions and encourage reform to ensure that our available funding is delivering effectively for the people of Scotland. The Resource Spending Review will, through evidence and consultation, develop four-year spending plans with the aim of managing the financial risks we face and maximising the impact of our available funding.

4.1 Short, medium and long-term fiscal risks

The Scottish Government operates within a tight Fiscal Framework, with limited fiscal powers and levers.

On the funding side, the Scottish Budget is subject to volatility from in-year consequentials, arising from UK spending decisions. It also experiences volatility as a result of forecast error relating to devolved tax receipts, and the Block Grant Adjustments for devolved tax receipts and social security spending.

On the spending side, under or overspending on budgets is a risk that requires constant management. In particular, demand-led social security spending is a source of substantial uncertainty, where actual spending can diverge from forecasts, in response to contingencies occurring in real time. The Scottish Government's financial management needs to be agile to respond to this volatility, using the limited budget management tools available to us.

Our ability to manage the short and medium to long-term risks across Scottish Government funding and spending can often be constrained by the limitations on our budget management tools. Table 8 and Table 9 set out some of these risks in more detail as well as the potential mitigation strategies and some of the limitations the Scottish Government currently faces.

Table 8: Summary of key short-term risks to fiscal sustainability

Risk	Mitigation
UKG spending decisions	In both 2020 and 2021, the UK Government held its Budget close to the start of the next financial year. As a result, the Scottish Government had to undertake its Budget without clarity on UK Government tax policy and using provisional BGAs. That is not the case this year, so there is greater clarity on the funding envelope for the Scottish Budget (though it remains a risk for future years). However, there remains a continued risk of the Scottish Budget having to manage significant in-year changes, resulting from UK Government decisions to increase or decrease spending. While there is potential for in-year changes in any budget year, COVID-19 increases this risk at present. To date,

	however, the UK Government has not agreed to requests for further measures to support the management of such volatility, for example, by extending the previous Barnett guarantee, or automatic flexibility to carry over funds received late in the financial year, beyond the limitations of the Scotland Reserve. Without additional powers, the Scottish Government can use draw-downs and carry-forwards through the Scotland Reserve as well as reprioritising spending to manage this risk. However, it cannot use resource borrowing and the limits on the available powers are so restrictive that it is impossible to guarantee the ability to fully control for unpredicted UK spending decisions.
Forecast "error"	All forecasts are inevitably subject to error and the Scottish Budget is therefore exposed to volatility when devolved tax revenue and social security expenditure turn out to be different from their original forecasts. The Scottish Government can, subject to given limits, use resource borrowing and the Scotland Reserve to manage any negative reconciliation repayments that occur as a result of forecast error. However, historical reconciliations have already exceeded the annual £300 million borrowing limit to deal with forecast error, and this is likely to occur more regularly in the future as the current borrowing and reserve powers are not protected in real terms.
In-year revenue volatility caused by asymmetrical economic performance between Scotland and the rUK	A significant part of the Scottish Budget is now funded via devolved tax revenue and is therefore, directly exposed to the performance of the Scottish economy. The Fiscal Framework does protect the Scottish Budget from symmetrical economic shocks that affect both the Scottish and rUK economies to a similar degree. For example, any change to tax revenues should be offset by a broadly equal change in the corresponding Block Grant Adjustment, leaving the Scottish Budget no better or worse off. However, the Scottish Budget is not protected from asymmetric economic risk where the Scottish economy is affected to a greater or lesser degree than the rUK, such as due to sectoral composition differences between both economies. The Scottish Government can, subject to given limits, use resource borrowing (for any forecast error caused by an asymmetric shock) and / or the Scotland Reserve to manage any direct impact on the net position, however due to the

	limits and restrictions on these powers reprioritising spending is likely to be required to manage this risk.

Table 9: Summary of key medium- to long-term risks to fiscal sustainability

Risk	Mitigation
Reduction in Block Grant growth caused by UK spending decisions A key downside risk to the Scottish Budget over the medium-term	Given the current funding arrangements, affordability of spending over the medium-term is largely driven by UK Government decisions and spending. This was illustrated by previous UK Government decisions on austerity prior to the pandemic, where the resource block grant given to the Scottish Government by the UK Government in 2019-20 was over £1.2 billion lower in real terms than in 2010 -11. The Scottish Government has the option to take different decisions on devolved taxes to keep the Scottish fiscal position in balance, but these powers remain limited. Similarly, it can make use of its limited reserve and capital borrowing powers to smooth the budget trajectory. However, such action limits the ability to use these instruments for in-year volatility management. While this risk has been reduced somewhat by the publication of a 3-year UK Spending Review, residual risk remains a challenge for the Scottish Government to manage, given we have no guarantee of the consequentials we will receive.
Changes to the Block Grant Adjustments	The Block Grant Adjustments applied to the Scottish Government budget are currently calculated using the Indexed Per Capita (IPC) method which fully protects the Scottish Budget from slower overall population growth. However, the IPC method does not protect from demographic changes such as changing labour force participation rates or an ageing population. Many key levers to address demographic risk, including migration policy, remain reserved to the UK Government. In line with the Fiscal Framework Agreement, the BGA arrangements will be reviewed as part of the forthcoming Fiscal Framework Review and no default method will be assumed. Alongside consideration of other methods for adjusting the block grant, such as the Comparable Method, which does not fully protect the Scottish Budget from slower population growth, wider risks such as demographic changes should also be considered in that review.

Fundamental changes to the operation of finance in devolved policy making as a result of the UK Internal Market Act The UK Government's use of these powers may also result in reduced funding for the Scottish Budget, blurs accountability and risks poor targeting of spend	The Scottish Government remains fundamentally opposed to the introduction of financial assistance powers as part of the Internal Market Act, and their ongoing use by the UK Government. The Internal Market Act was imposed without the consent of the Scottish Parliament and undermines the devolution settlement by allowing UK Ministers to spend directly on a wide range of devolved matters - therein bypassing parliamentary scrutiny and accountability at Holyrood. We will continue to press the UK Government to clarify how it intends to use the powers of the Internal Market Act and how it will engage Devolved Administrations to reduce the risk of duplicating or poorly targeting spend.
Structural differences in UK and Scottish economic performance Scotland's exposure to global commodity markets, in particular the oil price, is relatively greater and there are differences in the sectoral composition of the Scottish and UK economies	Our economic policies are the key long-term mitigation to ensure prosperity and tax revenue growth. For example, our forthcoming 10-Year National Strategy for Economic Transformation will build on the COVID Recovery Strategy to create a greener, fairer and more inclusive wellbeing economy. At its heart will be policies to stimulate business growth by investing in innovation, expanding opportunities internationally and supporting businesses to benefit from the transformational opportunities of digitalisation. However, the different sectoral composition of the Scottish and rUK economies could pose a risk in the medium-term (for example, see Annex B of the January 2021 MTFS, which discusses this risk in greater detail)[11].
Compositional differences in UK and Scottish tax base Differences in the composition of the tax base can pose a risk to the Budget.	As discussed in detail in Annex A, differences in the composition of the tax base between Scotland and the rUK can pose a risk to the Budget if earnings growth is unequal across the income distribution. This includes an illustration of how such a risk could be mitigated via an alternative Block Grant Adjustment mechanism which should be reviewed as part of the Fiscal Framework Review in 2022.
Pay agreements are a key driver of public sector costs and spending	The Scottish Government's pay and reward policies aim to balance fairness and affordability, informed by dialogue with trade unions, alongside workforce planning that focuses on delivering governmental priorities.

[11] Scottish Government (2021), *Medium-Term Financial Strategy* - January 2021

Demand pressures caused by an ageing population The fiscal pressures of an ageing population are most apparent in our health and social care system	We have committed to maintaining funding growth for health and social care at comparatively high levels. Nonetheless, we need to maximise the opportunities to mitigate the fiscal pressures. Managing demands on the health system through public health improvement and prevention is a key element not only in improving people's health for better outcomes but also in managing the financial risks of health demand pressures. We continue to shift the balance of care towards mental health, and to primary, community and social care. We know that in many circumstances outcomes improve and fewer interventions are required when care is delivered in a community setting.

4.2 Current levers for managing volatility and risk

The Fiscal Framework provides the Scottish Government with limited reserve and borrowing powers.

The Scotland Reserve allows the Scottish Government to smooth spending within and between years, carry forward underspend and assist in the management of tax volatility. Within its normal limits, the Scotland Reserve is capped in aggregate at £700 million, with an annual drawdown limit of £250 million for resource and £100 million for capital. However, the triggering of the 'Scotland-specific economic shock' provision in 2021-22, largely as a result of timing differences between the OBR's November 2020 and the SFC's January 2021 forecasts[12], means that there is no drawdown limit for the Reserve in 2021-22 through to 2023-24.

The Scottish Government can borrow to support day-to-day (resource) spending only in very specific circumstances, primarily to address forecast error in relation to devolved tax receipts and social security spending and the corresponding BGAs. For example, where there is a shortfall in forecast tax receipts or an increase in demand-led social security spending; it cannot borrow to support discretionary resource spending.

The total limit for resource borrowing is £1.75 billion and the normal annual limit for forecast error is £300 million per year. Due to the triggering of the 'Scotland-specific economic shock' provision of the Fiscal Framework, the annual borrowing limit has been raised to £600 million until 2023-24.

The total limit for capital borrowing to support investment in infrastructure is £3 billion, with annual borrowing limited to £450 million.

The Scotland Reserve is the only mechanism for the Scottish Government to retain underspent funds for future years. The limitations on the use of the Reserve and the volatility relating to forecasts mean that it is neither feasible nor desirable for the Scottish Government to build up substantial balances in the Reserve. If the Scottish Government intentionally underspent its budget to carry forward funds to future years, there is a

[12] See paragraphs 78-82 of the Scotland Act 2012 and 2016: annual implementation report 2021

significant risk that the Reserve limit would be breached and therefore these funds would be returned to the UK Government and lost permanently.

A key constraint faced by the Scottish Government is that all of these limits are set in nominal terms even though the size of the Scottish economy, budget, devolved tax revenues and social security benefit expenditure rises over time. Consequently, over time the Scottish Government's current levers for managing volatility and risk are being effectively eroded in their real term capacity.

For example, since 2017-18 when the limits were initially implemented had they grown in line with inflation then by 2021-22 they would have been around 7% larger. Had they grown in line with the forecast cumulative size of devolved tax revenues they would have been around 19% higher and had they grown in line with the size of the total Scottish Government fiscal resource budget (in cash terms) the limits would have been around 36% higher including additional COVID-19 funding or around 21% higher excluding additional COVID-19 funding.

There are various arguments around how such limits could be indexed, however it is clear that even over a relatively short period of time, the real term effectiveness of the Scottish Government's current levers to manage the risks and volatility within the Fiscal Framework has been eroded. It is imperative that during the upcoming Fiscal Framework review a system is implemented to index any nominal limits within the Fiscal Framework in real terms.

In the meantime, whilst it is operating within these limitations, the Scottish Government uses the following guidelines when managing the budget.

4.2.1 Scotland Reserve policy

We will prioritise use of the Scotland Reserve to carry forward any forecast underspends for use in the subsequent financial year. This retains sufficient capacity in the reserve to be able to also carry forward any additional underspend that emerges later in the budget process (i.e., at provisional and final outturn stages) and mitigates the risk of funds being lost to the Scottish Government.

From 2017-18 to 2019-20, average underspends have been in excess of £350m. By prioritising use of the Reserve for this purpose, we ensure that sufficient capacity remains, so that, where excess tax receipts or additional underspends emerge from the Provisional Outturn and Final Outturn Processes, these can be added to the Scotland Reserve for use in future years.

Our aim is to ensure that excess funds in the Reserve will be used as far as possible to smooth resource funding over time, to achieve a stable spending trajectory. However, this may be balanced against urgent and more immediate requirements such as funding COVID-19 emergent needs.

4.2.2 Resource borrowing policy

The use of resource borrowing is complementary to the use of the Scotland Reserve. The Scottish Government must balance the need for flexibility against the additional costs of

borrowing compared to the Reserve to find a solution that is most appropriate to the circumstances.

Our resource borrowing powers will be used in a way that balances the principles of flexibility, stability and value for money, as set out in the 2019 Medium-Term Financial Strategy:

- Resource borrowing is an important tool to help achieve stable funding and spending trajectories, in order to ensure macroeconomic stability. Repayment terms would be as short as possible, to minimise servicing costs, subject to the need to smooth resource spending over time.
- In the context of the constraints outlined above, the scope for reductions in spending and/or use of any funds held in the Scotland Reserve would generally be considered first, before any decision is taken on resource borrowing.

The Scottish Government will assess all planned resource borrowing decisions to smooth the funding trajectory over five years. In order to promote budget stability and maintain flexibility in the Reserve, Scottish Government budgets will assume full borrowing against known and/or forecast tax and social security reconciliations. Any in-year volatility will be managed within the resulting overall budget envelope.

As noted, other than to respond to changes in demand for social security spending, resource borrowing cannot be used to respond to emerging spending pressures, for example, to respond to the impacts of COVID-19.

Given the restrictions on resource borrowing under the existing Fiscal Framework, the only risks created by borrowing are those on future years' resource budgets resulting from borrowing repayments. It is therefore prudent to consider the medium-term impact on the Scottish Budget of reconciliations, borrowing and borrowing repayments in totality. Given the annual limits and short repayment periods, there is no risk of breaching the cumulative limit, and there is also no re-financing risk.

Conversely, there are considerable risks related to forecast error, economic shocks and funding outlooks, depending on UK Government decisions. The resource borrowing powers do not address these sufficiently.

The Scottish Government will make full use of resource borrowing in 2022-23. The full budget impact of borrowing and reconciliations over the period, plus further detailed analysis on this work, can be found in Annex B

These issues, alongside the broader range of tools currently available, must be considered in depth as part of the Fiscal Framework Review in 2022.

4.2.3 Capital borrowing policy

The two key considerations for the medium-term with respect to capital borrowing decisions are the headroom against the cumulative Fiscal Framework limits and affordability of ongoing borrowing repayments.

Capital borrowing powers will be used in a way that balances the principles of flexibility, stability, value for money and intergenerational fairness, alongside supporting the delivery of the NIM.

The 2020-21 Budget sets out the baseline for NIM in 2019-20 of £5.3 billion, which will increase by £1.56 billion by the end of the current Parliament in 2025-26. In order to achieve this increase in investment, capital borrowing will be required as part of a combination of funding sources that also include capital grant, financial transactions and alternative revenue-finance models, including private finance.

While the Scottish Government can borrow commercially or issue bonds for capital investment purposes, the National Loans Fund currently remains the preferred source of capital borrowing. Given the medium-term impact on resource costs, this remains the optimum compromise between value for money, resource cost impact and maximising the use of the Fiscal Framework limits.

The term-structure of borrowing will be chosen to strike the right balance between flexibility (requiring shorter-term lengths); value for money (requiring shorter-term lengths); stability (suggesting longer-term lengths); and intergenerational fairness (term length corresponds to asset life).

The Scottish Government will ensure that a minimum of £300m capital borrowing headroom will be available to be drawn down in the year following the period covered by the NIM (2026-27).

Over the period of the NIM, our policy is to borrow between £250 million and £450 million annually to ensure that there is sufficient investment planned to support economic growth, and that investment increases overall year-on-year.

All borrowing drawdown decisions will take into account the in-year budget management position, the interest rate environment and the impact over the five-year term versus the assumptions made in the Scottish Budget.

4.2.4 Our fiscal levers are insufficient

The Scottish Government continues to take a proactive approach in using the powers that are available across taxation, borrowing and the reserve.

Scotland's forthcoming first Framework for Tax will set out the principles and strategic objectives that underpin our Scottish Approach to Taxation, as well as our approach to decision making, engagement and how we manage and sequence tax policy around the fiscal cycle. Deployed within the context of COVID-19 and the recovery, the Framework provides a solid foundation for the design and delivery of tax policies that support our national outcomes and our pursuit of a fairer, greener and more prosperous Scotland for everyone.

The Framework also demonstrates our commitment to open government and transparency and embodies our ambition for excellence in tax policy and delivery. It includes a high-level programme of work for this Parliament, in line with our manifesto and public commitments.

As set out in the Framework for Tax, evaluation remains a key aspect of tax policy making, assessing the extent to which changes have achieved their intended aims. It also helps examine the drivers for tax performance and underlying dynamics of the tax base. As part of this, we will shortly publish an evaluation of our 2018-19 Income Tax reforms. This will include an assessment of the scale of the behavioural effects and the amount of revenue estimated to have been raised by the policy. This evaluation will form a key part of our

understanding of Income Tax performance in Scotland, alongside our ongoing analysis of the fiscal and economic risks.

However, the current devolved fiscal levers have clear limitations in terms of managing risk that restrict our ability to maintain and expand the tax base, raise devolved tax revenues and support the economy.

As set out in the January 2021 MTFS, there is a growing body of evidence that the scale of potential forecast error under the Fiscal Framework exceeds the level of flexibility provided by existing borrowing levers.

Scottish Government analysis noted that, based on the 2018/19 Budget forecasts, there was between a 5% and 17% probability of negative Income Tax reconciliations exceeding -£300 million. Updating this analysis to include all devolved taxes and social security benefits allows us to assess the total reconciliation risk. Based on the forecasts for the 2020/21 budget it is estimated that there is now between an 8% and 24% probability of total negative reconciliations breaching the £300 million annual borrowing powers for forecast error.

Part of this increase in the risk estimate reflects the inclusion of the additional fully devolved taxes (LBTT and SLfT) and social security benefits with a BGA mechanism (although Income Tax remains by far the largest driver of the overall risk). However, as noted earlier the limits on Scottish Government borrowing and reserve flexibility have been fixed since the Fiscal Framework was agreed. Since the size of the economy, and alongside that tax revenues and social security benefit expenditure, increase over time, the Scottish Government's practical ability to manage risk is therefore effectively being eroded each year.

However, even if the limits had been adjusted over time to account for this, they would still have been insufficient to allow the Scottish Government to adequately manage the volatility inherent in the forecasting process.

There is a clear and reasonable case to revise the current borrowing and reserve powers, ensuring appropriate and sufficient budget management tools. The forthcoming review of the Fiscal Framework provides an ideal opportunity to make these much-needed changes, to facilitate adequate risk management over the medium-term.

4.3 The need for a robust, comprehensive and timely review of the Fiscal Framework

The Fiscal Framework Agreement states that a review of the Fiscal Framework should be undertaken by the Scottish and UK Governments after the Scottish Parliament elections in 2021, and that this will be informed by an independent report that will be presented to both governments by the end of 2021.

In October 2021, the Scottish and UK Governments agreed to commission an independent report focusing on the Block Grant Adjustments, including a call for stakeholder input, prior to a broader review of the Fiscal Framework. Both governments are working towards the Review beginning as early in 2022 as possible.

Views from stakeholders other than the two Governments will be sought as part of the process.

As set out in the Programme for Government in September 2021, the Scottish Government will use the Fiscal Framework review to push for a substantial increase in the fiscal power of the Scottish Parliament, to allow us to begin to manage our key risks over the medium-term:

- Removal of the caps on capital borrowing, which constrain our ability to invest in the economy and public services, to be replaced by a prudential borrowing scheme – the same power local authorities already enjoy.
- Removal of the restriction on resource borrowing to fund day-to-day costs, an increase in the borrowing cap for forecast errors to £600 million, and an increase in the Scotland Reserve drawdown to £700 million per year.
- Strengthening of Scotland's tax powers with the devolution of VAT, and full powers over Income Tax and National Insurance contributions.

In addition, there is a range of additional substantive issues to be covered as part of the Review. These issues were discussed in detail in the MTFS published in January 2021, having previously been identified in the joint working group report between the Scottish Government and the Scottish Parliament's Finance and Constitution and Social Security Committees.[13] It remains crucial that the Review considers the arrangements for intergovernmental engagement and co-ordination. This should include how we minimise friction in interactions between the two governments' tax and social security regimes to ensure that the Scottish Government has maximum flexibility in its policy choices and ability to manage the impacts of UK policy choices through the Fiscal Framework and vice versa.

We also continue to seek a resolution on the outstanding dispute concerning the disproportionate impact of personal allowances increases on Scottish revenues, and the appropriate application of the spillover provision in the current Fiscal Framework Agreement. While the scale of the financial impact is disputed, both parties accept that a direct spillover effect arises from the UK Government's changes to the Personal Allowance and that the Scottish Government is due a transfer of funding. The Scottish Government will seek to conclude the dispute process at the earliest possible opportunity to ensure that the funding is available to support the funding position for 2022-23. Issues relating to the spillovers provisions should be considered in more detail as part of the forthcoming review of the Fiscal Framework.

4.4 The Resource Spending Review Framework

Within the limitations of the current Fiscal Framework, however, controlling expenditure is our primary lever to maintain a sustainable trajectory for Scotland's public finances.

The Resource Spending Review Framework is published alongside this year's MTFS. The Resource Spending Review will develop spending plans for the remainder of this parliamentary term which support the government's ambitions and provide stakeholders, delivery partners and organisations and individuals across Scotland with some certainty on which to base their own forward planning. The Framework sets the scene for the development of those spending plans and launches the public consultation. The intention is

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[13] Scottish Parliament Finance and Constitution and Social Security Committees and Scottish Government (2020), *The scope and terms of reference for the independent report and review of the Fiscal Framework* – October 2020

to publish multi-year spending plans in May 2022 to provide stakeholders, delivery partners and organisations and individuals across Scotland with some certainty on which to base their own forward planning.

The mission for the Resource Spending Review is to deliver effective services for the people of Scotland and maintain sustainable public finances. It must do this within a tight budgetary envelope and challenging fiscal outlook as explored in Chapters 1 and 2 of this MTFS. That means that choices must be made about how funding is allocated and our priorities for investment.

To do this, the Resource Spending Review will adopt an approach which is outcomes focused, evidence informed and consultative. Spending plans will be assessed against three core priorities, which draw on the commitments the Scottish Government has made in the Programme for Government and COVID-19 Recovery Strategy:

- To support progress to meet our child poverty targets;
- To address climate change, and;
- To secure a stronger, fairer, greener economy

Underpinning these priorities is our core public finance principle of fiscal sustainability. We must adapt and future-proof our public services, using our limited resources as efficiently and effectively as possible, and investing in long-term preventative measures to ensure that we are able to meet the needs of future generations as well as our own.

Conclusion

This is the fourth edition of the Scottish Government's Medium-Term Financial Strategy. The role of the MTFS is to set out Scotland's fiscal outlook over the next five years, including financial opportunities and risks that may impact our fiscal position. In line with the recommendations of the Budget Process Review Group, the document does not set out new spending plans or explain how prioritisation decisions will be made to meet policy objectives. For capital expenditure, these decisions were made as part of the Capital Spending Review in February 2021. As noted in Chapter 3, a targeted review of the Scottish Government's CSR will be undertaken in early 2022. For resource, these questions will be answered by the publication of a Resource Spending Review alongside the next MTFS in May 2022.

Publication of the Resource Spending Review will mark the first occasion in over a decade where the Scottish Government will have publicly committed to multi-annual spending plans, providing greater clarity and certainty to bodies across the public sector to enable them to plan for the medium-term. The Resource Spending Review Framework, published alongside this MTFS, sets out some of the challenges involved in getting to that point and opens up a public conversation about how these challenges should be managed and resolved.

The challenges highlighted in this MTFS have also highlighted the need for a continued focus on medium-term financial planning. As set out in Chapter 4, we currently have limited levers to manage considerable levels of uncertainty and fiscal risk in order to smooth public expenditure over the medium-term. This means that forecasting, controlling and prioritising expenditure is our primary lever for managing fiscal risk, to enable us better to target our spending decisions in order to tackle some of the more strategic and long-term risks to fiscal sustainability, such as changing demographics and climate change. The upcoming Resource Spending Review will provide an opportunity to set out a clear direction for how this spending can be used most effectively to support our priorities.

The publication of these comprehensive multi-annual spending plans will have implications for the content of the MTFS in the future. We welcome the recommendations made by the Finance and Constitution Committee in the previous session of the Scottish Parliament to review the role, content and purpose of the MTFS. We will work collaboratively with the newly formed Finance and Public Administration committee over the coming months to identify what further improvements can be made to this document, to ensure it continues to play an important role in our budget-setting process.

List of acronyms

AGER	Advisory Group on Economic Recovery
AME	Annually Managed Expenditure
BPRG	Budget Process Review Group
BGA	Block Grant Adjustment
COVID-19	Coronavirus Disease 2019
CPI	Consumer Price Index
CSR	Capital Spending Review
EU	European Union
FFFP	Fines, Forfeitures and Fixed Penalties
FT	Financial Transaction
GDP	Gross Domestic Product
HM	Her Majesty's
HMRC	Her Majesty’s Revenue and Customs
HMT	Her Majesty’s Treasury
IIP	Infrastructure Investment Plan
IPC	Indexed Per Capita
LBTT	Land and Buildings Transaction Tax
MSP	Member of the Scottish Parliament
MTFS	Medium-Term Financial Strategy
NDR	Non-Domestic Rates
NHS	National Health Service
NIM	National Investment Mission
NLF	National Loans Fund
NPF	National Performance Framework
NSET	[10-Year] National Strategy for Economic Transformation
NSND	Non-savings, and non-dividend
OBR	Office for Budget Responsibility
OECD	Organisation for Economic Co-operation and Development
ONS	Office for National Statistics
PAYE	Pay As You Earn
PfG	Programme for Government
PIP	Personal Independence Payment

RPI	Retail Price Index
REP	Regional Economic Partnership
rUK	Rest of the United Kingdom (i.e. England, Wales and Northern Ireland)
SDA	Severe Disablement Allowance
SFC	Scottish Fiscal Commission
SLfT	Scottish Landfill Tax
UC	Universal Credit
UK	United Kingdom
URL	Universal Resource Locator
VAT	Value Added Tax
YOY	Year on Year

Glossary

Austerity	a set of policies that aim to reduce government budget deficits, usually through spending cuts, tax increases, or a combination of both.
Barnett Formula	a formula used by HM Treasury to calculate consequentials which form the Block Grant to devolved governments in Scotland, Wales and Northern Ireland. The Barnett formula seeks to give these governments a proportion (or consequential) of UK expenditure incurred in policy areas which are devolved.
Budget	a document prepared by the government to present its anticipated tax revenues and proposed spending/expenditure for the coming financial year.
Block Grant	the grant received by the Scottish Government made up consequentials of UK expenditure, calculated by the Barnett Formula.
Block Grant Adjustment (BGA)	deductions from the Scottish Government's total Block Grant to reflect devolved tax receipts or social security expenditure.
Capital Borrowing	money borrowed specifically for the purpose of Capital Expenditure.
Capital Expenditure	money spent on providing or improving non-current assets, which include land, buildings and equipment, which will be of use or benefit in providing services for more than one financial year.
Consequentials or Barnett Consequentials:	a Barnett Consequential is the change to a devolved administration's assigned budget as a consequence of changes in spending by the UK Government.
Deficit	occurs when a government spends more money than it takes in.
Demand-led	refers to expenditure which can be predicted at the beginning of the year e.g. the payment of benefits which will depend on the number of eligible claimants. Usually managed through Annually Managed Expenditure (AME).
Fair work	work that supports job security, fair reward, and opportunities for personal and workplace development
Fiscal Framework	the Fiscal Framework agreement was published alongside the Scotland Act 2016 setting out the new

	funding arrangements, fiscal rules and borrowing powers for the Scottish Government.
Fiscal Framework Review	the Fiscal Framework is due to be reviewed in 2022. The review will be informed by an independent report, due to be completed in early 2022, on the Block Grant Adjustment arrangements.
Funding Outlook	projection of future funding built up by forecasting separate elements of funding and then aggregating these to produce a path for the total level of potential funding.
Furlough (or COVID-19 Job Retention Scheme)	a scheme, which ran from May 2020 to September 2021, through which the UK Government paid up to 80% of people’s wages for employees unable to work because their place of work has been forced to close, up to a maximum of £2,500 per month.
Gross domestic product	a measure of the size and health of a country’s economy over a period of time (usually one quarter or one year).
Income Distribution	covers how a country's total GDP is distributed amongst its population.
Just transition	the approach to addressing climate change and creating a more cohesive and resilient economy that improves the opportunities, life chances, and wellbeing of every citizen in our country.
Levelling Up Fund	a £4.8 billion infrastructure investment programme established in 2021 by the UK Government, targeted at regenerating town centres and high streets, upgrading local transport, and investing in cultural and heritage assets. The funding is being delivered using the UK Internal Market Act.
National Outcomes	the Scottish Government’s broad policy aims.
Net zero	achieving an overall balance between emissions produced and emissions taken out of the atmosphere.
Outturn Data	official published statistics about actual revenues and expenditure.
Public sector enabling infrastructure	investment in public sector assets to stimulate private sector investment e.g., road junctions and train station improvements; not investment in the private sector directly.
Reconciliations	adjustments to address historical budgets’ forecast errors.

Resource Borrowing	money borrowed specifically for the purpose of Resource Expenditure.
Resource Expenditure	money that is spent on day-to-day resources and administration costs.
Resource Spending Review	a review to balance the spending ambitions of the new Scottish Government within its fiscal constraints.
Scotland Reserve	enables the Scottish Government to manage volatility associated with the fiscal powers.
Social Security	monetary assistance from the state for people with an inadequate or no income.
Tax Credits	a means-tested government payment to help with day-to-day expenses for working people on low incomes.
UK Spending Review	allocation of funding to government departments.
Universal Credit	a UK social security payment to help eligible individuals pay for living costs
Volatility	the tendency to change rapidly and unpredictably.
Wellbeing economy	an economy that is inclusive and that promotes sustainability, prosperity and resilience, where businesses can thrive and innovate, and that supports all of our communities across Scotland to access opportunities that deliver local growth and wellbeing.

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List of figures, tables and boxes

Figure 1: Comparison of forecasts of Scottish GDP 8
Figure 2: Comparison of forecasts of Scottish unemployment rate (%) 9
Figure 3: Forecasts of Scottish / UK inflation rate (%) 10
Table 1: Headline economy forecasts 10
Figure 4: Resource funding outlook for the Scottish Government 15
Table 2: Resource funding outlook for the Scottish Government 15
Box 1: UK fiscal targets 18
Table 3: Capital grant funding outlook for the Scottish Government (excl. financial transactions) 20
Table 4: National Infrastructure Mission Baseline 22
Table 5: Illustrative cumulative paybill costs (£ billion) 27
Table 6: Current employer pension contribution rates 27
Figure 5: Proportion of people employed by the public sector: UK nations headcount (2021 Q2) 28
Table 7: Illustrative cumulative pay award and workforce costs (£ billion) 28
Figure 6: Modelled funding and spending scenarios 31
Table 8: Summary of key short-term risks to fiscal sustainability 32
Table 9: Summary of key medium- to long-term risks to fiscal sustainability 34
Figure A.1: Contribution to total NSND Income Tax liabilities by income distribution, 2019-20 55
Figure A. 2: Histogram of two simulated tax bases for two hypothetical countries 56
Table A.1: Summary statistics 56
Table A.2: Scenario 1 - uniform 2% growth in earnings across all taxpayers in country A and B 57
Table A.3: Annual growth (%) in average monthly pay of UK PAYE employees by income decile, September 2021 58
Table A.4: Scenario 2 - 2% growth in earnings for taxpayers in country A and B earning below £34,000 and 3% earnings growth for all taxpayers in country A and B earning above £34,000 58
Table A.5 Scenario 3 - 2% growth in earnings for all taxpayers in country A and B earning between £28,675 and £34,000 and 3% earnings growth for all taxpayers in country A and B earning above £34,000 or below £28,675 59
Figure A.3: Current IPC BGA mechanism 60
Figure A.4: Proposed "by band" BGA mechanism 60
Table A.6: Comparing alternative BGA indexation methods for NSND Income Tax 61
Table B.1: Forecasts of tax revenues and Block Grant Adjustments 62
Table B.2: Forecasts of social security expenditure and Block Grant Adjustments (£ million) [4] 63
Table B.3: Confirmed Income Tax reconciliation applying to 2022-23 Budget (£ million) 65
Table B.4: Forecast Income Tax reconciliation applying to 2023-24 Budget (£ million) 65
Table B.5: Forecast Income Tax reconciliation applying to 2024-25 Budget (£ million) 65

Table B.6: 2021-22 revenue forecast (£ million) ... 66
Table B.7: 2021-22 in-year BGA reconciliations (£ million)... 66
Table B.8: change in net position for 2021-22 Scottish Budget (£ million) ... 67
Table B.9: 2020-21 final BGA reconciliation (£ million) ... 67
Table B.10: 2020-21 outturn compared with forecasts (£ million) ... 68
Table B.11: 2021-22 expenditure forecast (£ million) ... 68
Table B.12: 2021-22 in-year BGA reconciliation (£ million) ... 69
Table B.13: Change in net position for 2021-22 Scottish Budget (£ million) ... 70
Table B.14: Social security 2020-21 final BGA reconciliation (£ million) ... 70
Table B.15: 2020-21 social security outturn compared with forecasts (£ million)[1] ... 71
Table B.17: 2020-21 final BGA reconciliation (£ million) ... 73
Table B.18: 2020-21 outturn compared with forecasts (£ million) ... 73
Table B.19: Reconciliations applying to 2022-23 Budget... 74
Table B.20: Capital borrowing and repayment schedule... 75
Table B.21: Medium-term impact of reconciliations and resource borrowing (£ million)... 76
Chart B.1: Incremental effect of different borrowing strategies on the Scottish Budget at 2022-23 Scottish Budget ... 77

Annexes

The Scottish Government's Medium-Term Financial Strategy 2022/23 to 2026/27

Annex A: Income Tax - Distributional Risks to the Scottish Budget

As noted in the January 2021 MTFS publication[14] compositional differences in the Scottish and rUK Income Tax bases can pose a risk to the Scottish Budget, particularly if earnings growth or tax revenue growth is not uniform across the income distribution.

In this annex we look at these concerns in more detail. We begin by undertaking illustrative modelling that investigates how sensitive relative tax revenue growth can be based on tax base distributional differences between two different hypothetical taxpayer populations. These go on to show that even if earnings growth is identical in both tax bases, unless it is completely uniform across the income distribution, then tax base compositional differences can mean that tax per head growth is not equal.

In turn, this could pose a risk to the Scottish Budget and we go on to discuss how some of these issues may materialize in practice in the context of Scottish Income Tax. We then consider some possible solutions to manage these risks, which we argue should be considered as part of the Fiscal Framework Review in 2022.

Tax base distributional differences between Scotland and the rUK

Income Tax devolution in Scotland has only been in operation for a relatively short period of time and our understanding of Scotland's Income Tax base is continually evolving as new sources of data are published.

As well as variations between Scotland and the rUK in the sectoral composition of each economy, or in the demographic characteristics of the population, there are also significant differences in the distribution of the Income Tax base[15]. Most importantly, there are relatively fewer high-Income Taxpayers in Scotland than in the rest of the UK and their earnings are also typically lower.

Updating work published in our previous MTFS publication in January 2021, Figure A.1 below shows some further analysis of the 2019-20 outturn data published in July 2021. This broadly reiterates previous findings showing that Scotland had relatively more taxpayers in the £15,000 to £43,000 NSND income bracket than in the rUK excl. Wales.[16] However, significant differences start to emerge at the higher end of the income distribution. For example, the proportion of taxpayers earning £100,000 or more was considerably higher in the rest of the UK excluding Wales than in Scotland (2.9% vs. 1.8%) whilst incomes per head in that cohort were also 24% higher in the rUK[17].

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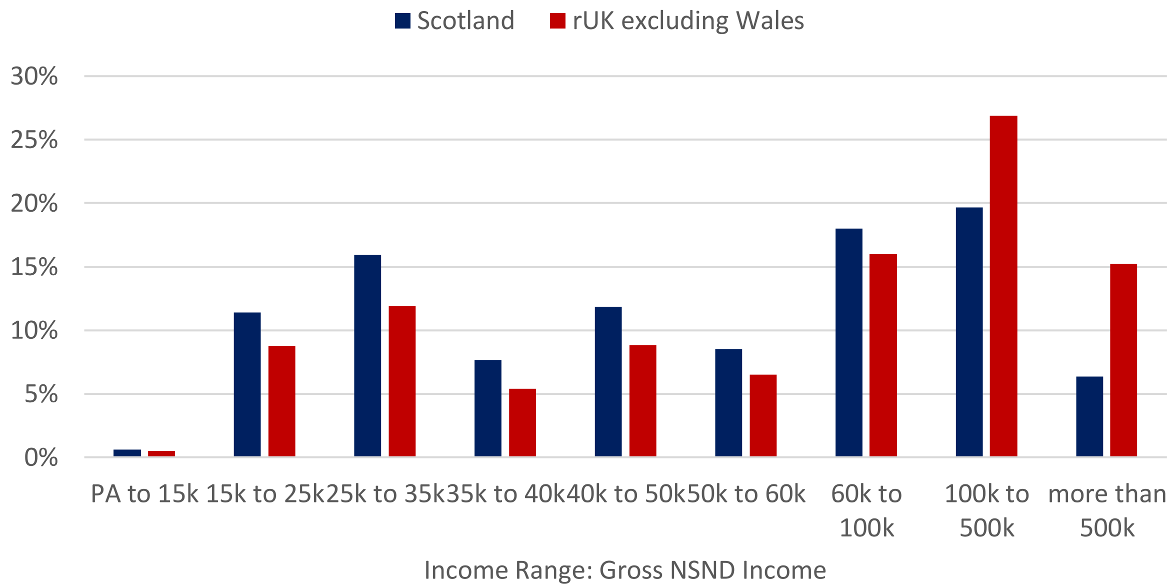
[14] Scottish Government (2021), *Scotland's Fiscal Outlook: The Scottish Government's Medium-Term Financial Strategy* – January 2021

[15] Due to the devolution of NSND Income Tax to Wales in 2019-20 the Block Grant Adjustment will be indexed on the performance of NSND Income Tax in the rUK excluding Wales.

[16] This is an extension of the analysis in the Scottish Income Tax Outturn Statistics using data from the Real Time Information (RTI) and Self-Assessment system. The published outturn statistics are available here. This analysis, and the results, may therefore be different from the Survey of Personal Incomes (SPI) which is based on a representative sample of Scottish taxpayer records.

[17] Please note, a direct comparison between the 2018-19 distributional analysis published in Annex B of the January 2021 MTFS and the 2019-20 distributional analysis published here cannot be made as the 2018-19 figures define the rUK as including Wales, whereas the 2019-20 figures published here define the rUK as excluding Wales.

Figure A.1: Contribution to total NSND Income Tax liabilities by income distribution, 2019-20



HMRC 2019-20 NSND Income Tax Outturn Statistics

As a result, Scotland raised a relatively smaller proportion of liabilities from individuals earning £100,000 or more in 2019-20 (26% vs. 42%).

A key concern for Scotland's Budget is whether or not these distributional differences then have a material impact on how quickly Income Tax revenues grow in both Scotland and the rUK over time.

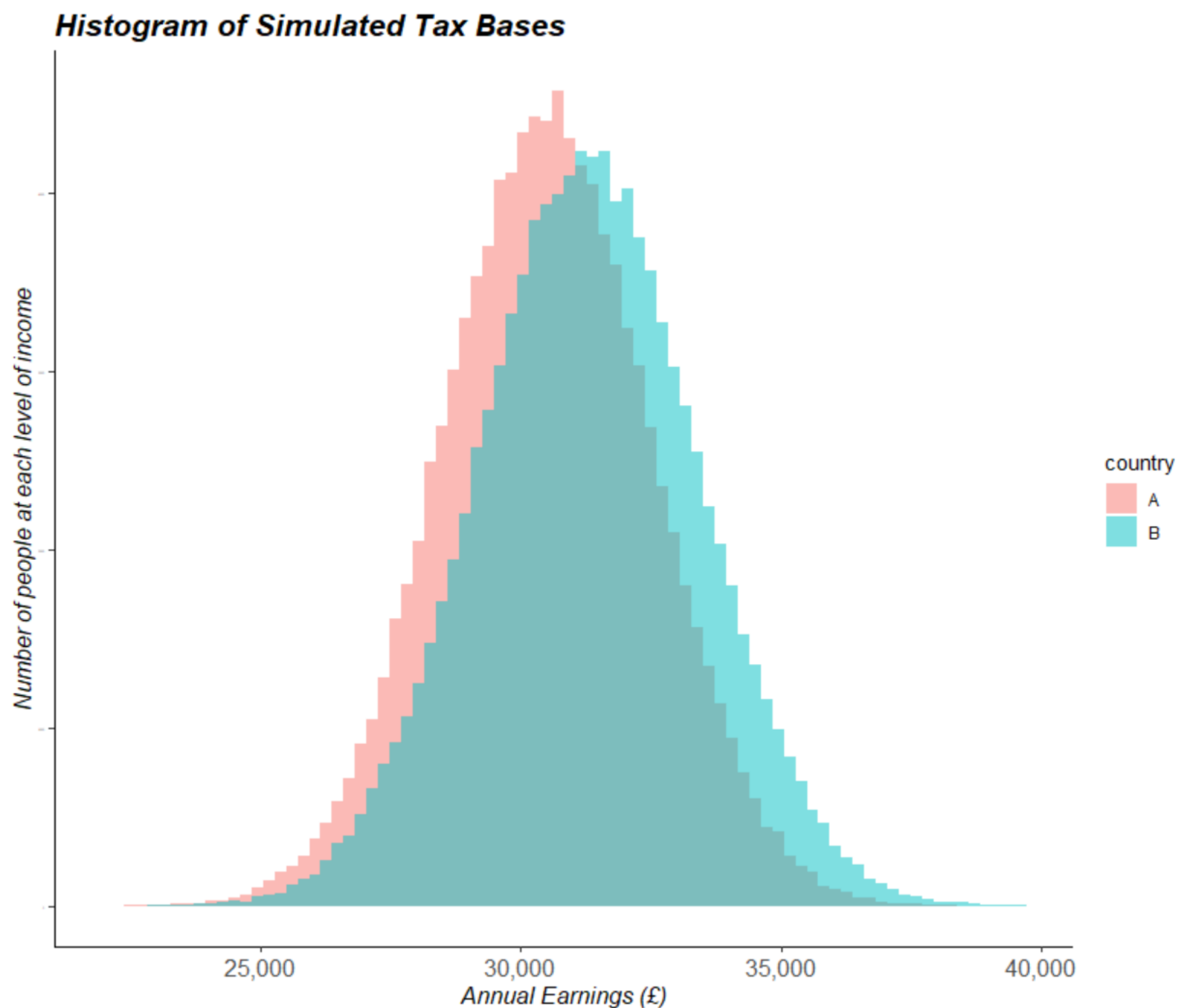
Illustrative scenario analysis

One method to explore this issue in more detail is by applying illustrative scenario analysis. For example, consider two simulated tax bases shown below in Figure A.2. These are artificially generated tax bases for 2 hypothetical countries – A and B[18]. Both countries have a 100,000-person labour force although country B's labour force has marginally higher average annual earnings of £31,300 relative to country A with average annual earnings of £30,500[19]

[18] It is worth noting that, as per Figure A.2, we would not expect tax base distributions to be as normally distributed as these and would tend to have longer right hand tails, although this does not take away from the validity of the results.

[19] The choice to simulate a tax base distribution centred around £30,000 is relatively arbitrary, although the latest Annual Survey of Hours and Earnings data for 2021 found that the average annual gross pay for all employee jobs in Scotland was just under £30,000 whilst in the UK it was just under £31,500.

Figure A. 2: Histogram of two simulated tax bases for two hypothetical countries



It is then possible to construct an illustrative progressive Income Tax system, apply this equally in both countries and calculate the amount of tax generated in each country as laid out in Table A.1.

Table A.1: Summary statistics

	Tax rate	Share % of Labour Force (Country A)	Share % of Labour Force (Country B)
Earnings below £26,500	0%	2%	1%
Earnings between £26,500 and £32,000	20%	75%	62%
Earnings between £32,000 and £34,000	40%	19%	27%
Earnings above £34,000	45%	4%	10%

	Average Annual Earnings	Average Tax Paid per Person
Country A	£30,500	£858

Country B	£31,300	£1,076
Ratio A/B	97%	80%

Although these are artificial simulations for illustrative purposes, there are intentionally constructed similarities with devolved Non-Saving Non-Dividend (NSND) Income Tax between Scotland and the rUK. We know that Scotland, whilst having a broadly similar shaped taxpayer base to the rUK in the middle of the income distribution, does have relatively fewer top end taxpayers and relatively more taxpayers at the lower end of the income distribution.

We also know that, in the baseline year when NSND Income Tax was devolved, tax per head in Scotland was around 80% the level of that in the rUK despite evidence that the level of average earnings in Scotland was broadly similar to the UK as a whole.

However as noted above, the primary concern is not the relative level of tax per head between Scotland and the rUK but rather it is the relative rate that tax per head grows over time. Under the Fiscal Framework, if tax per head in Scotland grows faster than in the rUK the Scottish Budget is better off, and it is worse off if tax per head grows at a slower pace than in the rUK.

The following scenario analysis examines how earnings growth, the shape of the income distribution and tax per head growth interact with each other and what this might mean in terms of risk to the Scottish Budget via the current Fiscal Framework.

The first scenario simply grows the earnings of every single taxpayer in both countries by the same uniform growth rate of 2%[20] across the income distribution.

As can be seen in Table A.2, as long as earnings grow uniformly by the same rate in both countries, and as long as tax thresholds in both countries also grow by the same rate, then both average earnings and the average tax paid per head grows symmetrically by 2% in each country.

Table A.2: Scenario 1 - uniform 2% growth in earnings across all taxpayers in country A and B

	Growth (%)	
	Average Earnings (£)	Average Tax per Head (£)
Country A	2.0%	2.0%
Country B	2.0%	2.0%

In other words, the different levels of tax per head and the differences in the taxpayer earnings distribution has no impact on the overall relative growth of each countries tax base, as long as earnings growth is uniform across the tax base distribution and the tax system thresholds are also adjusted in tandem to avoid fiscal drag (that is, people moving

[20] The choice of a 2% growth rate is relatively arbitrary, although using the ONS RTI earnings data, annual growth in average pay for PAYE employees in Scotland has averaged around 2.4% since July 2014.

into higher tax bands as a result of a faster earnings increases relative to the increase in the tax thresholds).

However, it is not necessarily the case that earnings grow uniformly across an entire income distribution. For example, the latest data from HMRC's Real Time Indicator database for September 2021 shows that annual pay growth for employees in the PAYE system in the UK has not been even across the distribution with higher earnings growth for the top earning PAYE employees. In fact, the top 1% of PAYE employees saw annual average pay growth in September almost twice that of the bottom 10% of PAYE employees.

Table A.3: Annual growth (%) in average monthly pay of UK PAYE employees by income decile, September 2021

	Percentile						
	10th	25th	50th	75th	90th	95th	99th
Annual Earnings Growth (%)	3.70%	5.30%	6.00%	5.90%	6.10%	6.60%	6.90%

ONS: HMRC RTI Earnings and Employment data

Although pay discrepancies are not always skewed in such a fashion (for example across 2016 pay growth was much stronger for the bottom 25% of PAYE employees than elsewhere in the income distribution) it is unusual historically for earnings growth to be uniform across every income decile.

Consequently, the following scenarios look at the impact of uneven earnings growth across the income distribution. Scenario 2 allows those at the top end of the income distribution in both countries to have their earnings grow 1 percentage point faster than those at the lower end of the income distribution. This is again a relatively arbitrary choice of growth rates, although it somewhat mirrors the latest RTI data for September 2021 where earnings growth at the very top of the employee income distribution was around one percentage point higher than the median employee. However, the scale of the difference does not change the overall pattern of the results.

Table A.4: Scenario 2 - 2% growth in earnings for taxpayers in country A and B earning below £34,000 and 3% earnings growth for all taxpayers in country A and B earning above £34,000

	Growth (%)	
	Average Earnings (£)	Average Tax per Head (£)
Country A	2.0%	2.7%
Country B	2.1%	3.5%

As can be seen, despite earnings growth at each level of income being the same in both countries, the differences in the tax base distribution causes average earnings growth to be marginally higher in Country B, and more importantly for tax per head growth to be significantly higher.

This highlights the fact that if earnings growth is not uniform across all levels of earnings, then differences in the tax base distribution do start to matter in terms of comparing the relative growth of tax per head in each country.

Scenario 2 is weighted in Country B's favour. We know that Country B has disproportionately more taxpayers in the higher end of the income distribution and consequently faster earnings growth in this area not only results in higher overall average earnings growth than in Country A, but because of the progressive nature of the tax system disproportionately higher tax per head growth.

Scenario 3 instead considers a situation where earnings growth is not just higher for those in the higher end of the income distribution, but also for those at the lower end of the distribution where Country A has a comparative advantage. Again, the choice of earnings growth rate differential is relatively unimportant (as long as it is uneven across the distribution) and does not alter the overall narrative of the findings. However, it has been purposely calibrated to ensure that overall average earnings growth is equal in both Country A and B.

Table A.5 Scenario 3 - 2% growth in earnings for all taxpayers in country A and B earning between £28,675 and £34,000 and 3% earnings growth for all taxpayers in country A and B earning above £34,000 or below £28,675

	Growth (%)	
	Average Earnings (£)	Average Tax per Head (£)
Country A	2.2%	3.7%
Country B	2.2%	4.0%

As can be seen from Scenario 3, despite both Country A and B having the same average earnings growth of 2.2% and despite both countries having the same exact growth rates at every single level of income, the distributional differences in their tax bases and the progressive nature of the tax system means that Country B still grows its average tax per head faster than Country A.

Consequently, even if average earnings in each tax base grow at equal rates over time and earnings at each level of income grow at the same rate in each country, differences in the tax base distribution means that tax per head can still grow faster in one tax base relative to the other.

Implications for the Fiscal Framework

The results from this scenario analysis have specific relevance to the Scottish Budget and the current Fiscal Framework. It suggests that there is a risk that even if Scotland grew its economy and/ or average earnings at the same rate as the rUK, the Scottish Budget could be made worse off if earnings growth is not uniform across the income distribution due to the differences in the structure of the existing tax base.

Were there to be a sustained difference in earnings growth at higher marginal tax rates (even if it were the same in both Scotland and the rUK) then the different structure of the

tax base could result in tax per head receipts growing persistently slower in Scotland relative to the rUK over time. This could then potentially undermine the long-term sustainability of the current Fiscal Framework. Even if the Scottish and rUK economies saw similar earnings growth the Scottish Budget could still be worse off, arguably a contradiction with the Smith Commission principles. Consequently, it is imperative that tax base distributional risk is considered in the upcoming Fiscal Framework Review in 2022.

The importance of addressing this risk has already been demonstrated in Wales. The Welsh Fiscal Framework incorporates a “by-band” component into the Block Grant Adjustment mechanism to address similar concerns around the differences in the Welsh tax base distribution relative to the rUK.

For example, Figure A.3 below shows how the Indexed Per Capita (IPC) Block Grant Adjustment (BGA) mechanism currently operates for devolved Scottish taxes. The key thing is that the BGA grows in line with the growth in total rUK tax revenue which is then weighted by differences in population growth between Scotland and the rUK.

Figure A.3: Current IPC BGA mechanism

$$Change\ (\%)\ in\ BGA_t = Change\ (\%)\ in\ Total\ rUK\ Tax\ Revenue_t\ \times\ Relative\ change\ in\ Scot\ /\ rUK\ Pop$$

A possible solution to tax base distributional risk is outlined in Figure A.4 below. Effectively there are individual BGAs by each tax band notated by the subscript " *i* “. Using the example of Income Tax, the rUK has 3 tax bands, the Starter Rate, Higher Rate and Additional Rate. Each band is given its own individual BGA which is then aggregated into a final total BGA.

Figure A.4: Proposed “by band” BGA mechanism

$$Change\ (\%)\ in\ BGA_t = \sum_i \left[Change\ (\%)\ in\ Total\ rUK\ Tax\ Revenue_{i,t}\ \times Relative\ change\ in\ Scot\ /\ rUK\ Pop\right]$$

This by band mechanism helps control for any disproportional tax per head growth from various parts of the income distribution by effectively growing the BGA by a weighted average, where the weights reflect how much was originally raised by band in Scotland in the baseline year.

Table A.6 below shows the BGA calculated using this IPC by band approach, compared to the existing IPC approach. Such a mechanism helps control for periods where tax base distributional differences are driving the faster relative growth in tax per head between Scotland and the rUK. For example, between 2016-17 and 2019-20 around 42% of the cumulative increase in total rUK NSND Income Tax revenue was solely driven by an increase in tax revenue paid by Additional Rate taxpayers in the rUK (1.2% of the tax base). In

comparison in Scotland only 19% of the cumulative increase in total Scottish NSND tax revenue was driven by an increase in tax revenue paid by Additional Rate taxpayers (0.6% of the tax base). This is despite the fact that the amount of tax paid per person for Additional Rate taxpayers in Scotland grew by almost 6% between 2016-17 and 2019-20. Almost six times faster than the 0.8% growth in tax paid per person for Additional Rate taxpayers in the rUK across the same time period.

Table A.6: Comparing alternative BGA indexation methods for NSND Income Tax

(£m)	2016-17	2017-18	2018-19	2019-20
IPC BGA	10,719	11,013	11,437	11,685
IPC By Band BGA	10,719	10,962	11,343	11,600
Difference		-52	-94	-84
Cumulatively				-230

To conclude, the illustrative scenario analysis demonstrates that the relative composition of two different tax bases can have a material impact on the relative growth rates of tax revenue generated per person. It can be the case that even if average earnings growth in both tax bases is the same, and even if the growth rate of earnings is the same at each level of income, tax per head can still grow faster in one tax base relative to the other due to compositional differences.

There are solutions to mitigate this risk, such as using an alternative "By-Band" Block Grant Adjustment mechanism inspired by a similar approach used in the Welsh Fiscal Framework . As shown in Table A.6 above, the Scottish Budget would have been cumulatively better off across the three years by £230m had such a mechanism been in place for devolved Income Tax since 2016-17. The significant impact such a mechanism would have had on the Scottish Budget across a relatively brief period of time, highlights the need for tax base compositional risk to be considered as part of the upcoming review of the Fiscal Framework.

Annex B: Fiscal Framework

This Annex sets out the implications of the Fiscal Framework for the Scottish Budget. The Fiscal Framework Technical Note sets out more detail on how the Fiscal Framework operates including the evolution of the fiscal powers of the Scottish Parliament, the timelines for reconciliations and how they affect the Scottish Budget, the limits of the borrowing powers and Scotland Reserve, and the Fiscal Framework Review.[21]

This Annex details the latest BGAs published alongside the 2022-23 UK Budget on 27 October 2021, which have been updated following the publication of final outturn data for [insert which outturn has been published, which affected the final BGAs]. The latest SFC revenue and expenditure forecasts have been published alongside the 2022-23 Scottish Budget.

Tax

Table B.1 shows the latest forecasts for tax revenues from the SFC and the latest BGA estimates following the 2022-23 UK Budget.

Table B.1: Forecasts of tax revenues and Block Grant Adjustments

		2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
Income Tax[2]	Revenue	11,833	11,938	13,002	13,671	14,313	15,056	15,790	16,445
	BGA[1]	-11,685	-11,989	-12,996	-13,861	-14,571	-15,167	-16,036	-16,862
	Difference	+148	-51	+6	-190	-257	-111	-246	-417
LBTT[2]	Revenue	597	517	720	749	796	839	881	924
	BGA[1]	-533	-397	-620	-664	-688	-717	-753	-802
	Difference	+64	+121	+101	+86	+108	+122	+128	+122
SLfT[2]	Revenue	119	107	123	101	83	85	70	18
	BGA[1]	-99	-87	-90	-82	-82	-77	-69	-78
	Difference	+20	+20	+34	+18	+1	+9	+1	-60
Total	Revenue	12,549	12,562	13,846	14,521	15,193	15,980	16,741	17,387
	BGA[1]	-12,316	-12,473	-13,706	-14,607	-15,340	-15,961	-16,859	-17,742
	Difference	+233	+89	+140	-86	-148	+20	-117	-355

Note 1: The BGAs shown are calculated using the Indexed Per Capita (IPC) indexation method. This method in practice determines the BGAs applied to the budget.

Note 2: The 2019-20 Income Tax, LBTT and SLfT and 2020-21 LBTT and SLfT revenue and Block Grant Adjustment are outturn figures.

Figures may not sum due to rounding.

[21] Scottish Government (2021), *Fiscal framework: factsheet* - November 2021

The forecasts of tax revenues and BGAs for 2022-23 inform the Scottish Budget.

Forecasts of future years provide an indication of the level of revenues that the SFC anticipates, but these figures will not be used to set future budgets, which will draw upon updated SFC forecasts.

Social Security

Table B.2 shows the SFC's latest expenditure forecasts for social security benefits and the latest BGA estimates following the 2022-23 UK Budget. Executive competence for Cold Weather Payments (CWP) will transfer to the Scottish Government in 2022-23 and BGAs were agreed for CWP for the first time alongside the 2022-23 UK Budget.

Table B.2: Forecasts of social security expenditure and Block Grant Adjustments (£ million)[4]

		2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
Attendance Allowance	Expenditure	-528	-519	-545	-575	-600	-628	-653
	BGA[1]	521	521	545	579	605	630	648
	Difference	-6	+2	0	+4	+5	+3	-5
Personal Independence Payment	Expenditure	-1,626	-1,734	-1,948	-2,322	-2,588	-2,806	-3,034
	BGA[1]	1,585	1,723	1,933	2,176	2,390	2,619	2,820
	Difference	-41	-11	-15	-146	-198	-187	-214
Disability Living Allowance	Expenditure	-722	-700	-710	-721	-712	-699	-687
	BGA[1]	721	687	687	692	664	639	657
	Difference	-1	-13	-23	-29	-48	-61	-29
Carer's Allowance[2, 3]	Expenditure	-296	-301	-315	-348	-380	-412	-445
	BGA[1]	291	295	323	351	378	413	453
	Difference	-5	-6	+8	+3	-3	0	+8
Industrial Injuries Disablement Scheme	Expenditure	-83	-81	-81	-81	-80	-79	-78
	BGA[1]	81	79	79	80	78	77	75
	Difference	-1	-1	-1	-1	-2	-2	-3
Severe Disablement Allowance	Expenditure	-7	-7	-6	-6	-5	-5	-4
	BGA[1]	8	7	6	5	4	4	3
	Difference	0	0	0	0	-1	-1	-2
Cold Weather Payments	Expenditure	N/A	N/A	-21	-21	-21	-21	-22
	BGA[1]	N/A	N/A	14	14	14	14	14
	Difference	N/A	N/A	-7	-7	-7	-7	-8

TOTAL SS	Expenditure	-3,262	-3,343	-3,626	-4,074	-4,387	-4,650	-4,922
	BGA[1]	3,207	3,313	3,587	3,898	4,134	4,395	4,670
	Difference	-55	-30	-38	-176	-253	-255	-252

Note 1: The BGAs shown are calculated using the Indexed Per Capita (IPC) indexation method. This method in practice determines the BGAs applied to the budget.
Note 2: The 2020-21 Social Security expenditure and Block Grant Adjustment are outturn figures.
Note 3: Carer's Allowance Expenditure Forecast does not include Carer's Allowance Supplement expenditure.
Note 4: There are minor differences in the methodology used to calculate the SFC's spending forecasts and the BGA forecasts, which are based on expenditure outturn and OBR forecasts, so comparisons should be interpreted with caution.
Figures may not sum due to rounding.

Benefits Yet to Commence

Responsibility for Winter Fuel Payments has yet to be transferred to the Scottish Government and therefore these payments are not funded from within the Scottish Budget. The Department for Work and Pensions will continue to make these payments to people in Scotland for winter 2022-23. An update will be provided in due course.

Reconciliations and implications for the Scottish Budget

The forecasts for Scottish tax revenues and social security expenditure, and the corresponding BGAs, are based on the latest available information at the time of the Budget. Once outturn data are available, reconciliations are made to the Scottish Budget to ensure that the funding available ultimately corresponds to actual revenues and the BGAs based on the outturn data.

Reconciliations are made for both the revenues and the BGA for Income Tax. For Fully Devolved Taxes (LBTT and Scottish Landfill Tax), Social Security, and Non-Tax Revenues (Fines, Forfeitures and Fixed Penalties - FFFP), reconciliations are only made to the BGA element of funding.

In relation to Income Tax, a reconciliation for both revenues and the BGA for the 2019-20 financial year will be applied to the 2022-23 Scottish Budget. Updated forecasts for the other past years - 2020-21 and 2021-22 – do not have any immediate impact on the Scottish Budget. Under the Fiscal Framework, a single reconciliation takes place three years after the original Budget was set and the updated forecasts in the interim have no direct impact.

In relation to the Fully Devolved Taxes, Social Security benefits and FFFP, reconciliations for the BGAs for 2020-21 financial year will be applied to the 2022-23 Scottish Budget.

The Fully Devolved Taxes and Social Security BGAs are also subject to an additional in-year reconciliation which takes place within each financial year, based on the latest OBR forecasts. There is no in-year reconciliation for FFFP.

Income Tax

For Scottish Income Tax, outturn data is normally available around 16 months after the end of the financial year. Given this long lag of availability of outturn data, Income Tax revenue and BGAs are fixed for three years from the time the Budget is set. A single reconciliation is then applied to the Budget three financial years after the Budget is set, e.g the reconciliation for 2018-19 Income Tax was applied to the 2021-22 budget. Provisional outturn data for 2019-20 Income Tax was published 22 July 2021, which has been confirmed by HMRC's publication of its Trust Statement[22]. Table B.3 shows the confirmed 2019-20 Income Tax reconciliation applying to the 2022-23 Budget.

Table B.3: Confirmed Income Tax reconciliation applying to 2022-23 Budget (£ million)

2022-23 Income Tax	Revenues	BGA*	Net Position
Forecast as of Budget 2019-20	11,684	-11,501	+182
Outturn	11,833	-11,685	+148
Outturn against forecast	+149	-184	-34

* The BGA has been revised upward – this has a negative effect on net revenues.
Figures may not sum due to rounding.

The potential scale of the reconciliations applying to the 2023-24 and 2024-25 Budgets are shown in tables B.4 and B.5 using the latest forecasts.

Table B.4: Forecast Income Tax reconciliation applying to 2023-24 Budget (£ million)

2020-21 Income Tax	Revenues	BGA	Net Position	Forecast Reconciliation
Forecast as of Budget 2020-21	12,365	-12,319	+46	
Latest forecast	11,938	-11,989	-51	-97
Change	-427	+330		

Figures may not sum due to rounding.

Table B.5: Forecast Income Tax reconciliation applying to 2024-25 Budget (£ million)

2021-22 Income Tax	Revenues	BGA	Net Position	Forecast Reconciliation
Forecast as of Budget 2021-22	12,263	-11,788	+475	
Latest forecast	13,002	-12,996	+6	-469
Change	+739	-1,208		

[22] HM Revenue and Customs (2021), *HMRC annual report and accounts: 2020 to 2021* – November 2021

Figures may not sum due to rounding.

Based on the latest forecasts, the reconciliation to the Scottish Budget 2023-24 for 2020-21 Income Tax is expected to be negative £97m. A reconciliation of negative £469 million is expected to apply to the Scottish Budget 2024-25 to account for 2021-22 Income Tax.

However, these forecasts are not certain and the final position will not be known for sure until outturn receipts are available for 2020-21 in summer 2022, and for 2021-22 in summer 2023.

Fully Devolved Taxes

Revenue Scotland manages and collects Land and Buildings Transaction Tax (LBTT) and Scottish Landfill Tax (SLfT) and these revenue streams feed in to the Scottish Budget as they are collected. There is no reconciliation required for these revenues; the Scottish Government manages any variance between what was forecast and actual revenues as part of its in-year budget management process. The latest 2021-22 revenue forecasts for LBTT and SLfT and the previous revenue forecasts are shown in Table B.6.

Table B.6: 2021-22 revenue forecast (£ million)

LBTT	SFC Revenue Forecast – Budget 2021-22	586
	SFC Revenue Forecast – Budget 2022-23	720
	Change	+134
SLfT	SFC Revenue Forecast – Budget 2021-22	88
	SFC Revenue Forecast – Budget 2022-23	123
	Change	+35

Figures may not sum due to rounding.

The BGAs for these taxes are reconciled in two stages. An in-year reconciliation is made within the same financial year. This is usually on the basis of OBR forecasts produced alongside the UK Autumn Budget. The in-year reconciliations for 2021-22 LBTT and SLfT are shown in table B.7.

Table B.7: 2021-22 in-year BGA reconciliations (£ million)

LBTT	Forecast BGA – UK Spending Review November 2020	-515
	Forecast BGA – 2022-23 UK Budget October 2021	-620

	In-year reconciliation to 2021-22 Budget	-104
SLfT	Forecast BGA – UK Spending Review November 2020	-95
	Forecast BGA – 2022-23 UK Budget October 2021	-90
	In-year reconciliation to 2021-22 Budget	+5

Figures may not sum due to rounding.

As set out in Table B.8, the net effect on the Scottish Budget 2021-22 of the latest fully devolved revenue forecasts, when compared to the in-year BGA reconciliations, is +£71m, (comprising £30m for LBTT and £41m for SLfT).

Table B.8: change in net position for 2021-22 Scottish Budget (£ million)

Fully Devolved Tax	In-Year BGA Reconciliation	Change in SFC revenue forecast from 2021-22 Scottish Budget	Net Position
LBTT	-104	134	+30
SLfT	5	35	+41
TOTAL	-99	+170	+71

Figures may not sum due to rounding

Outturn data becomes available in the autumn following the end of each financial year. Using these outturn figures, a final reconciliation is applied to the Block Grant in the financial year two years after the Budget was set. Table B.9 shows the final reconciliations for 2020-21 LBTT and SLfT BGAs applying to the 2022-23 Scottish Budget.

Table B.9: 2020-21 final BGA reconciliation (£ million)

LBTT	Forecast BGA – 2021-22 Scottish Budget January 2021[1]	-391
	Outturn	-397
	Reconciliation to 2022-23 Budget[2]	-6
SLfT	Forecast BGA – 2021-22 Scottish Budget January 2021[1]	-87
	Outturn	-87
	Reconciliation to 2022-23 Budget[2]	+0

Note 1: As a UK Budget had not been published at the time of the Scottish Budget in January 2021, provisional Block Grant Adjustments (BGAs) were used to inform the Scottish Budget as directed under the Fiscal Framework. Updated BGAs were produced at the UK Budget in March. However, the provisional BGAs were used to inform the Scottish Budget.

Note 2: The final BGA reconciliation effectively calculates the difference between the in-year forecast of the BGA (used to calculate the in-year reconciliation) and the outturn data.
Figures may not sum due to rounding.

Table B.10 shows the confirmed net effect on the budget for 2020-21 LBTT and SLfT and compares outturn to forecasts.

Table B.10: 2020-21 outturn compared with forecasts (£ million)

		Revenues	BGA	Net Position
LBTT	Forecast as of Budget 2020-21	641	-557	+85
	Outturn	517	-397	+121
	Outturn against forecast	-124	+160	+36
SLfT	Forecast as of Budget 2020-21	116	-87	+29
	Outturn	107	-87	+20
	Outturn against forecast	-9	0	-9

Figures may not sum due to rounding.

Social Security

The latest 2021-22 expenditure forecasts for Social Security and the previous expenditure forecasts are shown in Table B.11.

Table B.11: 2021-22 expenditure forecast (£ million)

Attendance allowance	SFC Expenditure Forecast – Budget 2021-22	-550
	SFC Expenditure Forecast – Budget 2022-23	-519
	Change	+30
Personal independence payment	SFC Expenditure Forecast – Budget 2021-22	-1669
	SFC Expenditure Forecast – Budget 2022-23	-1734
	Change	-65
Disability living allowance	SFC Expenditure Forecast – Budget 2021-22	-696
	SFC Expenditure Forecast – Budget 2022-23	-700
	Change	-5
Carer's allowance	SFC Expenditure Forecast – Budget 2021-22	-306

	SFC Expenditure Forecast – Budget 2022-23	-301
	Change	+5
Industrial injuries disablement scheme	SFC Expenditure Forecast – Budget 2021-22	-80
	SFC Expenditure Forecast – Budget 2022-23	-81
	Change	-1
Severe disablement allowance	SFC Expenditure Forecast – Budget 2021-22	-7
	SFC Expenditure Forecast – Budget 2022-23	-7
	Change	+0
Total social security	SFC Expenditure Forecast – Budget 2021-22	-3,308
	SFC Expenditure Forecast – Budget 2022-23	-3,343
	Change	-34

Figures may not sum due to rounding.

As with the fully devolved taxes, the BGAs for benefits are reconciled in two stages. An in-year reconciliation is made within the same financial year. This is usually on the basis of OBR forecasts produced alongside the UK Autumn Budget. The in-year reconciliations to the 2021-22 Social Security BGAs are shown in Table B.12.

Table B.12: 2021-22 in-year BGA reconciliation (£ million)

Attendance allowance	Forecast BGA – UK Spending Review November 2020	546
	Forecast BGA – 2022-23 UK Budget October 2021	521
	In-year reconciliation to 2021-22 Budget	-25
Personal independence payment	Forecast BGA – UK Spending Review November 2020	1,682
	Forecast BGA – 2022-23 UK Budget October 2021	1,723
	In-year reconciliation to 2021-22 Budget	+42
Disability living allowance	Forecast BGA – UK Spending Review November 2020	685
	Forecast BGA – 2022-23 UK Budget October 2021	687
	In-year reconciliation to 2021-22 Budget	+2
Carer's allowance	Forecast BGA – UK Spending Review November 2020	309
	Forecast BGA – 2022-23 UK Budget October 2021	295

	In-year reconciliation to 2021-22 Budget	-14
Industrial injuries disablement scheme	Forecast BGA – UK Spending Review November 2020	81
	Forecast BGA – 2022-23 UK Budget October 2021	79
	In-year reconciliation to 2021-22 Budget	-1
Severe disablement allowance	Forecast BGA – UK Spending Review November 2020	7
	Forecast BGA – 2022-23 UK Budget October 2021	7
	In-year reconciliation to 2021-22 Budget	-1
Total social security	Forecast BGA – UK Spending Review November 2020	3,310
	Forecast BGA – 2022-23 UK Budget October 2021	3,313
	In-year reconciliation to 2021-22 Budget	+3

Figures may not sum due to rounding.

Table B.13 sets out the net effect on the Scottish Budget 2021-22 of the latest total devolved social security expenditure forecasts when compared to the total in-year BGA reconciliations, is negative £31m.

Table B.13: Change in net position for 2021-22 Scottish Budget (£ million)

Fully Devolved Tax	In-Year BGA Reconciliation	Change in SFC expenditure forecast from 2021-22 Scottish Budget	Net Position
Total social security benefits with a BGA[1]	+3	-34	-31

1) Carer's Allowance, Attendance Allowance, Child Disability Payment, Disability Living Allowance, Adult Disability Payment, Industrial Injuries Disablement Allowance, Severe Disability Allowance
Figures may not sum due to rounding

Outturn data becomes available in the autumn following the end of each financial year. Using these outturn figures, a final reconciliation is applied to the Block Grant in the financial year two years after the Budget was set. Table B.14 shows the reconciliation for the 2020-21 Social Security BGAs applying to the 2022-23 Scottish Budget.

Table B.14: Social security 2020-21 final BGA reconciliation (£ million)

Attendance allowance	Forecast BGA – 2021-22 Scottish Budget January 2021[1]	531
	Outturn	521

	Reconciliation to 2022-23 Budget[2]	-9
Personal independence payment	Forecast BGA – 2021-22 Scottish Budget January 2021[1]	1,555
	Outturn	1,585
	Reconciliation to 2022-23 Budget[2]	+30
Disability living allowance	Forecast BGA – 2021-22 Scottish Budget January 2021[1]	719
	Outturn	721
	Reconciliation to 2022-23 Budget[2]	+2
Carer's allowance	Forecast BGA – 2021-22 Scottish Budget January 2021[1]	289
	Outturn	291
	Reconciliation to 2022-23 Budget[2]	+1
Industrial injuries disablement scheme	Forecast BGA – 2021-22 Scottish Budget January 2021[1]	84
	Outturn	81
	Reconciliation to 2022-23 Budget[2]	-2
Severe disablement allowance	Forecast BGA – 2021-22 Scottish Budget January 2021[1]	8
	Outturn	8
	Reconciliation to 2022-23 Budget[2]	0
Total social security	Forecast BGA – 2021-22 Scottish Budget January 2021[1]	3,185
	Outturn	3,207
	Reconciliation to 2022-23 Budget[2]	+22

Note 1: As a UK Budget had not been published at the time of the Scottish Budget in January, provisional Block Grant Adjustments (BGAs) were used to inform the Scottish Budget as directed under the Fiscal Framework. Updated BGAs were produced at the UK Budget in March. However, the provisional BGAs were used to inform the Scottish Budget.
Note 2: The final BGA reconciliation effectively calculates the difference between the in-year forecast of the BGA (used to calculate the in-year reconciliation) and the outturn data.
Figures may not sum due to rounding.

Table B.15 shows the confirmed net effect on the budget for 2020-21 Social Security benefits and compares outturn to forecasts.

Table B.15: 2020-21 social security outturn compared with forecasts (£ million)[1]

		Expenditure	BGA	Net Position
Attendance allowance	Forecast as of Budget 2020-21	-532	535	+3
	Outturn	-528	521	-6

	Outturn against forecast	+5	-14	-9
Personal independence payment	Forecast as of Budget 2020-21	-1,583	1,601	+19
	Outturn	-1,626	1,585	-41
	Outturn against forecast	-43	-16	-60
Disability living allowance	Forecast as of Budget 2020-21	-718	669	-49
	Outturn	-722	721	-1
	Outturn against forecast	-4	+52	+48
Carer's allowance	Forecast as of Budget 2020-21	-292	303	+12
	Outturn	-296	291	-5
	Outturn against forecast	-4	-13	-17
Industrial injuries disablement scheme	Forecast as of Budget 2020-21	-80	85	+5
	Outturn	-83	81	-1
	Outturn against forecast	-2	-4	-6
Severe disablement allowance	Forecast as of Budget 2020-21	-7	9	+1
	Outturn	-7	8	+0
	Outturn against forecast	+0	-1	-1
Total social security	Forecast as of Budget 2020-21	-3,213	3,203	-10
	Outturn	-3,262	3,207	-55
	Outturn against forecast	-49	+5	-45

Figures may not sum due to rounding.
Note 1: There are minor differences in the methodology used to calculate the SFC's spending forecasts and the BGA forecasts, which are based on expenditure outturn and OBR forecasts, so comparisons should be interpreted with caution

Non-Tax revenue

Fines, Forfeitures and Fixed Penalties

Revenue from Fines, Forfeitures and Fixed Penalties (FFFP) is paid into the Scottish Consolidated Fund after being collected by the Scottish Courts and Tribunals Service. No reconciliation takes place for revenue, as the Scottish Government deals with any variation between forecast and receipts through in-year budget management. The SFC does not provide revenue forecasts for FFFP and instead the Scottish Government calculates its own estimates.

The latest Scottish Government 2021-22 revenue forecast for FFFP and the previous revenue forecasts are shown in Table B.16.

Table B.16: 2021-22 revenue forecast (£ million)

FFFP	SG Revenue Forecast – Budget 2021-22	25
	SG Revenue Forecast – Budget 2022-23	19

Change	-6

Figures may not sum due to rounding.

Unlike the devolved taxes, there is only one round of reconciliation for the BGA. Outturn data are normally available three months after the end of the financial year, and the reconciliation is applied to the Block Grant for the financial year thereafter (i.e. two years after the Budget was set).

Table B.17 shows the final reconciliation for the 2020-21 FFFP BGA applying to the 2022-23 Scottish Budget.

Table B.17: 2020-21 final BGA reconciliation (£ million)

FFFP	Forecast BGA – Budget 2020-21	-24
	Outturn	-20
	Reconciliation to 2022-23 Budget	+4

Figures may not sum due to rounding.

Table B.18 shows the confirmed net effect on the budget for 2020-21 FFFP and compares outturn to forecasts.

Table B.18: 2020-21 outturn compared with forecasts (£ million)

		Revenues	BGA	Net Position
FFFP	Forecast as of Budget 2020-21	25	-24	+1
	Outturn	14	-20	-5
	Outturn against forecast	-11	+4	-7

Figures may not sum due to rounding.

Proceeds of Crime

Revenue seized under the Proceeds of Crime Act 2002 is also subject to a BGA. The basis on which this is carried out is currently the subject of dispute between the Scottish and UK Governments and the BGA remains at -£4m while the dispute remains unresolved.[23] The Scottish and UK Governments agreed to consider this issue as part of the review of the Fiscal Framework.

Final outturn revenue recovered under the Proceeds of Crime Act in 2020-21 is £5.2 million. The Scottish Government receives all revenues recovered under the Proceeds of Crime Act, however, outturn revenues are hypothecated for spend on community projects.[24] Due to

[23] See the Fiscal Framework outturn report 2019 for further background.
[24] Further information can be found at the Cashback for Communities website

this hypothecation of funds and the negative £4 million BGA, the net position for the Scottish Budget is negative £4 million while this BGA remains in force.

No reconciliation takes place while the BGA remains the subject of dispute between the Scottish and UK Governments.

Reconciliations applying to 2022-23 Budget

Table B.19 sets out the reconciliations which will be applied to the 2022-23 Budget.

Table B.19: Reconciliations applying to 2022-23 Budget

Income Tax 2019-20		-34
Of which:		
Final revenue reconciliation	+149	
Final BGA reconciliation	-184	
LBTT 2020-21 BGA reconciliation		-6
SLfT 2020-21 BGA reconciliation		+0
FFFP 2020-21 BGA reconciliation		+4
PoC 2020-21 BGA reconciliation		N/A
Social Security 2020-21 BGA reconciliation		+22
Total Reconciliation Requirement		-14.7

Sources of Data

To view the various sources of data for Tax and Social Security that have been used to compile this Annex B, please see the data annex in the Fiscal Framework factsheet.

Capital Borrowing

The 2022-23 Scottish Budget confirmed the intention to borrow the annual maximum of £450 million capital, assumed to be over a period of 20 years. It was also assumed that £300m capital borrowing would be taken in 2023-24. Final decisions on all future borrowing will be taken over the course of the applicable financial years.

Chapter 5 sets out the Scottish Government's policy of borrowing between £250 million and £450 million over the remaining period of the National Infrastructure Mission.

On the basis of existing and planned borrowing included in the table, the Scottish Government will have accumulated £2.42 billion in capital debt by the end of 2022-23, 81% of its overall limit. However, as repayments of principle increase over time this ensures sufficient borrowing headroom will be available to support the National Infrastructure Mission in subsequent financial years.

Table B.20: Capital borrowing and repayment schedule

£million	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
Debt Stock at start of Year	283	607	1,036	1,258	1,617	1,744	2,064	2,421	2,609	2,730
New In Year Borrowing	450	250	405	200	400	450	300	250	250	-
Principal Repayments	-	7	26	52	60	64	65	65	66	67
Interest Repayments	-	8	11	13	14	14	13	12	12	11
Existing Resource Cost	-	15	37	64	74	78	78	78	78	78
Resource Cost of Projected Borrowing	-	-	-	-	-	14	40	61	91	106
Projected Total Resource Cost	0	15	37	64	74	92	117	139	168	184
Debt Stock at end of Year	1,036	1,258	1,617	1744.	2,064	2,421	2,609	2,730	2,829	2,661
Percentage of Debt Cap	35%	42%	54%	58%	69%	81%	87%	91%	94%	89%
Notional Borrowing Repayments	9.4	20.5	20.5	20.5	20.5	20.5	20.5	20.5	20.5	20.5
Headroom	1,964	1,742	1,383	1,256	936	579	391	270	171	339

*New In Year Borrowing from 2021-22 is projected borrowing based on the current Central Scenario.

Resource Borrowing

As set out in Chapter 5, the Scottish Government will make full use of resource borrowing in 2022-23. Table B.21 below shows the full budget impact of borrowing and reconciliations over the period.

Table B.21: Medium-term impact of reconciliations and resource borrowing (£ million)

	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Known and Forecast Reconciliations	- 207	-319	-15	-97	-470	-
Planned Resource Borrowing	207	319	15	97	300	-
Projected Resource Cost of Resource Borrowing	-	21	76	109	121	164
Net Impact	-	21	76	109	-48	164
YOY Net Impact		21	55	33	-157	212

The incremental impact of resource borrowing, the costs of resource borrowing and known and forecast Income Tax reconciliations is as follows:

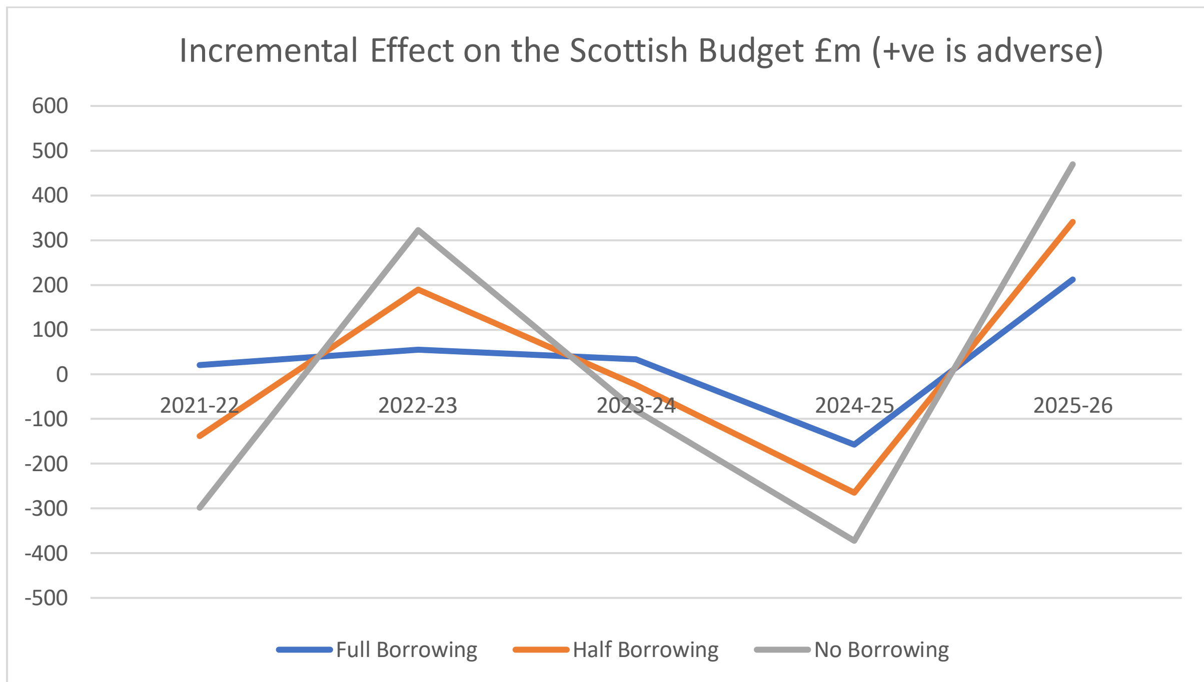
- The projected resource cost of borrowing line comprises repayments of both principal and interest, both of which impact the resource budget.
- All drawdowns are based on National Loans Fund (NLF) annuity structure loans, this is the only source of resource borrowing available to the Scottish Government under the Fiscal Framework.
- These loans are priced at 11 basis points above the equivalent UK par Gilt yield. Assumptions in Table B.21 use the implied forward rates as of 23 November 2021 plus a premium of 50 basis points.
- NLF annuity loans have principal deferred in the first (semi-annual repayment) period.
- A five-year tenor is assumed in all cases (the maximum allowable under the Fiscal Framework).

As stated in 4.1.2 The Scottish Government will assess all planned Resource Borrowing decisions to smoothen the funding trajectory over five years. The graphs below demonstrate what this trajectory would look like under three scenarios:

- Borrowing the full allowance – as per table above
- Borrowing half the available allowance
- Borrowing nothing

In the case of 'no borrowing' the swings in the funding position are most pronounced for both budgets. The graphs below show the impact in the original and future budget years, taking into consideration actual or expected borrowing for reconciliations in each of the years as well as repayment of borrowing and interest in subsequent fiscal years.

Chart B.1: Incremental effect of different borrowing strategies on the Scottish Budget at 2022-23 Scottish Budget



Note: Positive values connote reconciliation requirements and repayments which reduce the budget.

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