

Scotland's Economic and Fiscal Forecasts May 2019

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Foreword

The Scottish Fiscal Commission is the independent fiscal institution for Scotland. Our statutory duty is to provide independent and official forecasts of Scottish GDP, devolved tax revenue and devolved social security expenditure to inform the Scottish Budget. This report is our fourth set of forecasts, now covering the years to 2024-25.

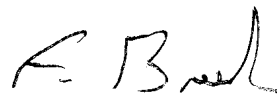
The Scottish Budget is increasingly determined by devolved tax revenues and social security spending. With the devolution of all remaining social security benefits from April 2020, our independent forecasts are now playing a greater role in the budget arithmetic. This report highlights the areas we view as potential fiscal risks to the Scottish Budget. We have focused on a few areas in more detail, but have made the report as a whole more concise. Detailed information on our modelling approaches can be found in our previous reports and in our occasional papers.

Our forecasts rely on data from a range of providers and we are grateful for their support. In particular we would like to thank Revenue Scotland for their work to ensure that we were able to incorporate as much of their data as possible in the forecasts. We would also like to thank officials from the Scottish Government, Revenue Scotland, HMRC and the OBR for their constructive challenge of our judgments and for ensuring that we considered all the available evidence.

Our forecasts represent the collective view of the Scottish Fiscal Commission, comprising the four Commissioners. We take full responsibility for the judgements that underpin them. We would like to thank once again the hard-working staff of the Commission for their support in the production of our forecasts and underpinning analysis.



Dame Susan Rice DBE



Professor Francis Breedon



Professor Alasdair Smith









Professor David Ulph







30 May 2019

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Economy		2018	2019	2020	2024	% growth
	GDP	1.3	0.8	0.9	1.3	Brexit uncertainty is expected to limit growth in 2019 and 2020, and growth in the longer term remains subdued
	Change since December 2018	-0.1	-0.4	-0.1		
	Nominal Earnings	2.6	2.6	2.7	3.2	Nominal earnings growth is higher than in our last forecast, and expected to gradually increase
	Change since December 2018	0.6	0.3	0.2		
	Real Earnings	0.2	0.4	0.8	1.2	Real earnings growth is expected to remain low
	Change since December 2018	0.5	0.1	0.3		

Tax		2018-19	2019-20	2020-21	2024-25	£ million
	Income Tax	11,486	11,703	12,332	14,613	Our forecast of income tax revenues in 2020-21 has increased by £47 million
	Non-Domestic Rates	2,885	2,803	2,853	3,318	Higher expected losses to appeals reduced the forecast in 2020-21
	LBTT	553	616	655	794	We have revised the LBTT forecast down by £25 million in 2020-21
	Scottish Landfill Tax	143	109	87	15	Revenues fall because of new incineration capacity and the ban on landfilling certain waste from 2021

Social security - Devolved		2018-19	2019-20	2020-21	2024-25	£ million
	Carer's Allowance (inc. Supplement)	186	323	344	444	2019-20 is the first full year of Carer's Allowance being devolved to Scotland
	Discretionary Housing Payments	62	64	66	73	The cost of mitigating the bedroom tax increases over time
	Employability Services	19	16	24	0	Spending peaks in 2020-21, the final year of referrals, as people move into and remain in employment
	Best Start Grant	4	21	16	18	New Early Learning and School Age Payments launch in 2019-20, increasing spending
	Best Start Foods		5	6	4	Spending decreases between 2020-21 and 2024-25 because the number of eligible people falls
	Funeral Support Payment		6	7	8	The payment amount for Funeral Support Payment increases each year, increasing spending

Social security - Illustrative		2020-21	2021-22	2022-23	2024-25	£ million
Illustrative forecast		3,039	3,169	3,310	3,638	Forecast for benefits being devolved in April 2020



Summary

Introduction

- 1 The Scottish Fiscal Commission produces five-year forecasts of Scottish Government tax revenues and social security expenditure, and of the Scottish economy. We also assess the reasonableness of the Scottish Government's borrowing projections.
- 2 This report sets out our official economic and fiscal forecasts to inform the Scottish Government's Medium Term Financial Strategy.
- 3 In this publication we include a new fiscal overview chapter, in which we explain the role of our forecasts, the Block Grant, and the Block Grant Adjustments (BGAs) in determining the size of the Scottish Budget. We explain how future budgets will be adjusted once the final outturn data are known and we set out an assessment of the potential size of these adjustments, known as reconciliations, to the Scottish Budget.
- 4 Because the issue of reconciliations is a central theme of this report, we start this summary with an outline of our fiscal overview before we turn to the fiscal and economic forecasts themselves.

Fiscal overview

- 5 The Scottish Government's Budget is becoming more complicated. Firstly, more tax and spending powers are being devolved to the Scottish Parliament. Secondly, adjustments need to be made to account for the differences between the forecasts and the amounts actually raised from tax or spent on social security. Together these factors create greater fiscal risks which will need to be managed using the existing limited borrowing and budget transfer powers.

Devolution of new spending powers

- 6 The devolution of all remaining social security benefits from April 2020 means an increase both in the size of the Scottish Budget and in the fiscal risks to

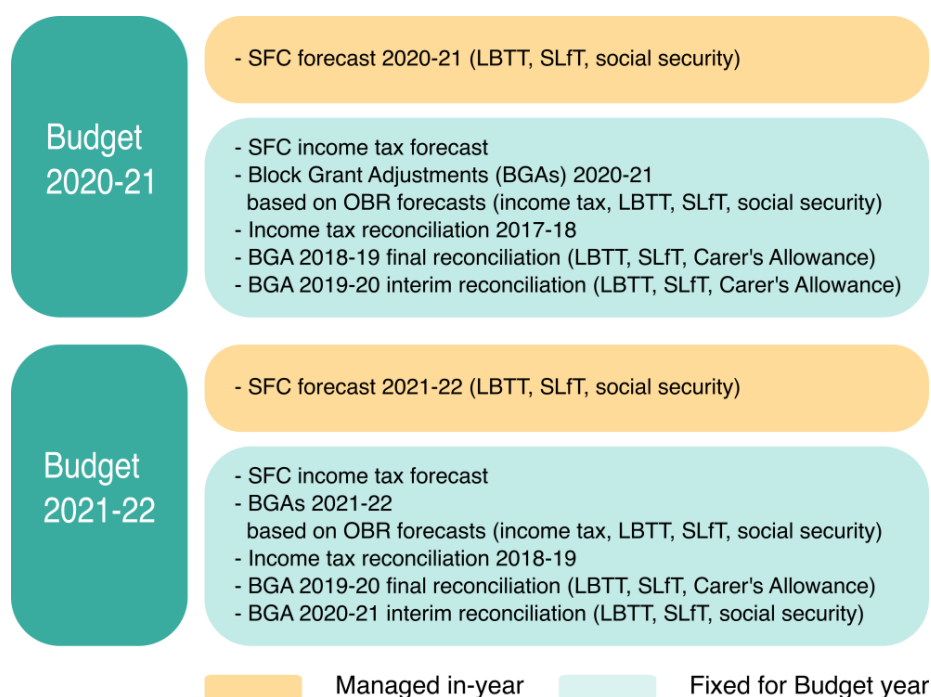
which it is exposed.¹ Next year will be the first time social security has presented a significant fiscal risk with £3.5 billion of spending devolved. The Scottish Government has committed to changing eligibility for some social security payments as well as changing how they are delivered. This is expected to further increase spending on social security.

Reconciliations

- 7 The Scottish Budget has to be adjusted to account for the differences between the forecasts on which the original budget was based and the amounts actually raised from tax or spent on social security, referred to as outturn. These adjustments are known as reconciliations.
- 8 For the fully devolved taxes and benefits any differences between our forecasts and the amount raised or spent must be managed in-year by the Scottish Government.
- 9 However, the reconciliation for income tax can only occur once the final amount raised is known. The first reconciliation will happen in the 2020-21 budget and will relate to income tax raised in 2017-18.
- 10 The Scottish Block Grant is adjusted to reflect the tax and social security powers devolved to Scotland. The Block Grant is adjusted downwards in respect of devolved taxes and upwards in respect of devolved social security. These Block Grant Adjustments (BGAs) are initially based on Office for Budget Responsibility (OBR) forecasts of revenues or spending on the equivalent UK Government taxes or benefits. Once the final UK Government revenues or spending are known, reconciliations are made to the Scottish Budget.
- 11 Both income tax and BGA reconciliations are playing an increasingly important role in determining the amount available for the Budget from year to year. Each Budget will be affected by reconciliations relating to forecasts from each of the previous three years. Figure 1 shows the forecasts and reconciliations affecting the Scottish Budget 2020-21.

¹ All remaining social security benefits includes Attendance Allowance, Cold Weather Payments, Disability Living Allowance, Personal Independence Payment, Industrial Injuries Benefits, Severe Disablement Allowance and Winter Fuel Payments.

Figure 1: Forecasts and reconciliations in future budgets



Source: Scottish Fiscal Commission.

- 12 We are currently forecasting a series of large negative reconciliations for income tax over the next few years, as shown in Table 1. The latest estimates are that the Scottish Government will receive £229 million less in 2020-21, £608 million less in 2021-22, and £188 million less in 2022-23. These are all slightly larger than the reconciliations we forecast in our December 2018 report, mainly because of increases in the BGA forecasts between the Autumn Budget 2018 and the Spring Statement 2019. The actual size of the reconciliations will only be known once outturn data are available.

Table 1: Income tax reconciliations

Budget year	Outturn data available	Budget affected	Forecast reconciliation (£ million)
2017-18	Summer 2019	2020-21	-229
2018-19	Summer 2020	2021-22	-608
2019-20	Summer 2021	2022-23	-188

Source: Scottish Fiscal Commission

- 13 These negative reconciliations mean less money will be available for future Scottish Budgets. The Scottish Government will be able to manage some of this through borrowing or use of the Scotland Reserve. However, the borrowing powers available to the Scottish Government and the rules about withdrawing funds from the Scotland Reserve mean that these will not cover all of the expected reconciliations. The Scottish Government would have to adjust its spending plans or increase taxes, and this should be borne in mind when formulating current policy.

Borrowing

- 14 The Scottish Government can borrow to fund capital spending or to manage forecast errors and reconciliations. Borrowing to manage forecast errors and reconciliations is known as resource borrowing, the Scottish Government currently have no plans to borrow for this purpose. For capital borrowing, the Scottish Government plans to borrow £450 million in 2019-20 and £350 million in 2020-21. This will mean they have borrowed 65 per cent of the total capital borrowing cap by the end of 2020-21, four years after the expansion in capital borrowing limits.
- 15 If, from 2021-22 onwards, the Scottish Government borrowed £450 million a year repaid over 25 years then the current cap of £3 billion for capital borrowing would be reached in 2023-24. If the Scottish Government borrowed £250 million a year repaid over 10 years then only 80 per cent of the cap would be reached in 2023-24.
- 16 Further discussion on our assessment of the Scottish Government's borrowing projections and the fiscal risks facing the Scottish Budget can be found in Chapter 3.

Social security

- 17 From April 2020 the Scottish Government will become responsible for the payments for all the benefits being devolved. Social security spending is harder to control than other areas of spending. Spending will be determined by the number of eligible people who apply for the benefit, all of whom must be paid. The Scottish Government will have to meet this expenditure as it arises, even if it differs from the forecast used to set the budget initially.
- 18 In 2020-21 we estimate £3.5 billion will be spent by the Scottish Government on social security, not including any additional expenditure for policy changes that may be introduced. This forecast expenditure should be compared with the £447 million forecast to be spent on social security in 2019-20.²
- 19 The Scottish Government is changing social security as it's devolved. As responsibility for delivery of the benefits transfers to the new organisation, Social Security Scotland, the benefits will be reformed and delivery of those benefits changed from the current system administered by the Department for Work and Pensions. Consequently we have to produce forecasts with a lack of historical data as well as uncertainty about implementation plans. The recent Audit Scotland report on social security devolution highlighted the challenges of implementing the devolution of social security benefits.³ Issues

² As shown in Table 2, £447 million is the forecast spend on the Scottish Government's social security portfolio. It does not include spending on Healthy Start Vouchers/Best Start Foods or the employability services.

³ Audit Scotland (2019) Social Security: Implementing the devolved powers ([link](#))

with operational delivery or any delays in implementation of the new benefits will affect our forecasts.

- 20 Our forecasts of benefits currently in the Scottish Budget are shown in Table 2 and further information can be found in Chapter 5. We have produced illustrative forecasts of the new benefits being devolved and these are shown in Table 3 and discussed in Chapter 3.

Table 2: Summary of social security forecast informing the Scottish Budget

£ million	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Carer's Allowance	152	286	304	325	351	371	393
Carer's Allowance Supplement	34	37	40	42	45	48	51
Discretionary Housing Payments	62	64	66	68	69	71	73
Best Start Grant	4	21	16	16	17	17	18
Funeral Support Payment		6	7	7	7	8	8
Scottish Welfare Fund	33	33	33	33	33	33	33
Scottish Government social security portfolio – total expenditure	285	447	466	491	522	548	575
Healthy Start Vouchers / Best Start Foods		5	6	4	4	4	4
Employability Services	19	16	24	23	13	1	0
Total benefit expenditure	304	467	495	518	539	553	578

Source: Scottish Fiscal Commission.

Figures may not sum because of rounding.

Table 3: Summary of illustrative social security forecast

£ million	2020-21	2021-22	2022-23	2023-24	2024-25
Attendance Allowance	530	545	563	584	605
Cold Weather Payments	16	16	16	16	16
Disability Living Allowance	628	591	556	522	499
Industrial Injuries Benefit	82	82	82	82	82
Personal Independence Payment	1,607	1,757	1,914	2,068	2,250
Severe Disablement Allowance	8	7	7	6	6
Winter Fuel Payment	168	170	173	176	180
Total	3,039	3,169	3,310	3,455	3,638

Source: Scottish Fiscal Commission

Figures may not sum because of rounding.

Introduction of new benefits

- 21 Whenever changes are made to benefits there will be a degree of uncertainty about how those changes are implemented and how people eligible for the benefit respond. Forecasting spending on a new benefit, or on a significantly changed benefit, will therefore be subject to a greater degree of uncertainty than forecasts of spending on unchanged benefits.
- 22 The Scottish Government launched the Best Start Grant Pregnancy and Baby Payment in December 2018. Take-up of the benefit and resultant spending has been much higher than our initial forecast produced in September 2018. This higher take-up was, in part, a result of the Scottish Government's early promotion of the benefit through social media. These communications encouraged parents to claim the new benefit; including those whose child had been born before the launch. The Pregnancy and Baby Payment received 4,000 applications on the first day it was introduced,⁴ compared to our forecast of 4,000 payments in the whole of 2018-19.⁵ There have been 9,770 awards made up to the end of February 2019.⁶ In our September Forecast Evaluation Report we will compare the final amount spent in 2018-19 to our forecasts.
- 23 Based on the evidence we have seen from the introduction of the Pregnancy and Baby Payment we have revised up our forecast of spending on the Best Start Grant in 2019-20 by £8 million to £21 million, a 67 per cent increase.
- 24 The Scottish Government plans to introduce two new payments for the Best Start Grant this year, as well as introduce two new benefits: Funeral Support Payment and Best Start Foods. How these new benefits are delivered and advertised will directly affect the level of spending.
- 25 The start dates for these benefits will directly affect how much is spent in the financial year 2019-20; the later the introduction date the lower the spending. In the absence of information on the start dates of the new benefits we have continued to assume a 1 June start date, based on the Scottish Government's commitment to deliver the new benefits by summer 2019.

Tax

- 26 We forecast that £15.9 billion of the Scottish Budget will come from tax revenue in 2020-21. Table 4 shows a summary of our tax forecasts that would

⁴ Scottish Government (December 2018) New baby benefit makes first payments ([link](#))

⁵ Scottish Fiscal Commission (September 2018) Social Security – Best Start Grant (Pregnancy and Baby Grant) – September 2018 ([link](#))

⁶ Scottish Government (2019) Best Start Grant: high level statistics to 28 February 2019 ([link](#))

currently affect the Scottish Budget. Further details on our tax forecasts can be found in Chapter 4.

Table 4: Summary of tax forecasts informing the Scottish Budget

£ million	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Income tax (NSND)	11,005	11,486	11,703	12,332	12,831	13,374	13,985	14,613
Non-Domestic Rates	2,762	2,885	2,803	2,853	3,090	3,301	3,338	3,318
Land & Buildings Transaction Tax	557	553	616	655	691	724	759	794
<i>Residential</i>	258	262	279	310	336	359	382	405
<i>ADS</i>	95	98	126	127	131	134	138	141
<i>Non-Residential</i>	204	193	211	218	224	231	239	248
Scottish Landfill Tax	148	143	109	87	12	14	15	15
Total	14,473	15,067	15,232	15,928	16,624	17,413	18,096	18,739

Source: Scottish Fiscal Commission, Revenue Scotland (2018) Annual Report and Financial Statements for the year ended 31 March 2018 Devolved Taxes Accounts ([link](#)), Scottish Government NDRi returns.

Shaded cells refer to outturn available at time of publication. Figures may not sum because of rounding. Figure for income tax is forecast not outturn data; data for 2017-18 will be available in summer 2019. Further detail can be found in the income tax section.

- 27 In addition, we produce two illustrative forecasts of taxes that may affect the Scottish Budget in the future: assigned VAT and the Scottish share of Air Passenger Duty (APD).

Table 5: Summary of illustrative tax forecasts

£ million	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Assigned VAT	5,361	5,514	5,707	5,879	6,043	6,205	6,369	6,571
Scottish share of Air Passenger Duty	275	286	295	307	320	336	352	369
Total illustrative tax	5,635	5,800	6,002	6,186	6,363	6,541	6,721	6,941

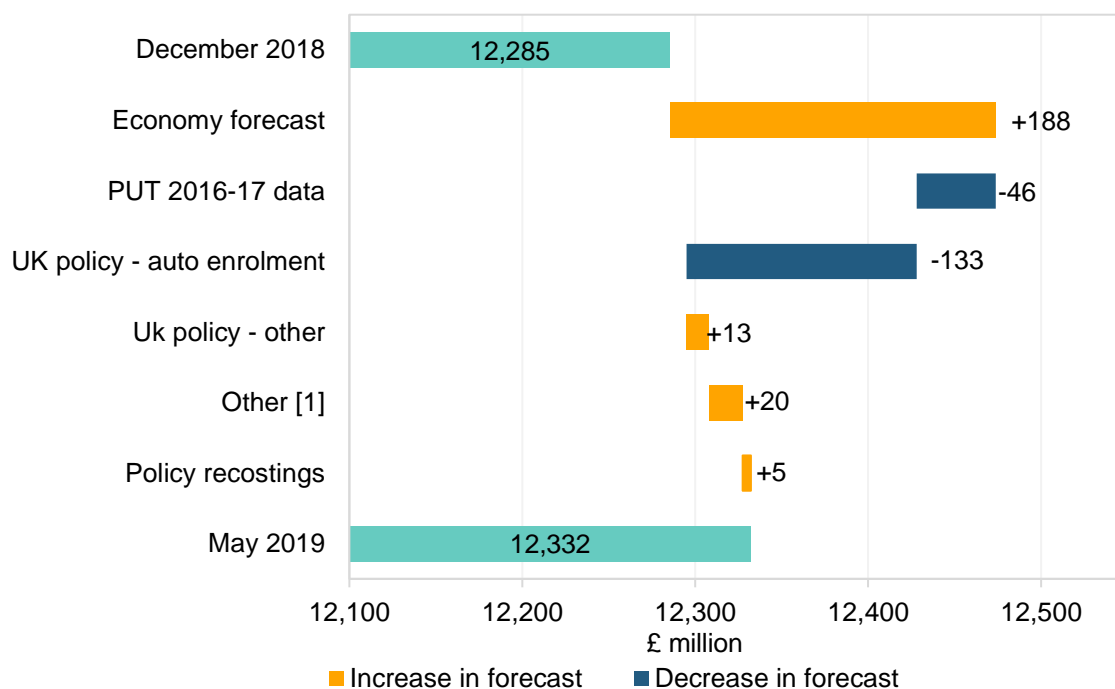
Source: Scottish Fiscal Commission.

Figures may not sum because of rounding.

Income tax

- 28 Figure 2 shows the Commission's latest forecasts of income tax compared to our December 2018 forecast.

Figure 2: Changes in NSND income tax forecast of 2020-21 since December 2018



Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 ([link](#)).

[1] Other includes revisions to OBR triple lock pension forecast, CPI forecasts and HMRC Gift Aid estimates. Further information is provided in Chapter 4.

29 Since December 2018 we have made small upward revisions to our income tax forecast. Upward revisions to our outlook for the economy increase our income tax forecast by around £188 million in 2020-21. This is partially offset by new income tax data for 2016-17 and some adjustments to UK policy costings.

VAT assignment

30 At a meeting of the Finance and Constitution Committee on 8 May 2019 the Cabinet Secretary for Finance, Economy and Fair Work indicated he thought a postponement of the implementation of VAT assignment should be considered until it can be discussed at the time of the fiscal framework review.

31 This means there is a possibility that VAT assignment could be delayed. This is a decision for the Scottish and UK Governments in which we have no role. We will continue to publish illustrative forecasts of VAT assignment and discuss the potential effects on the Scottish Budget were VAT assignment to commence.

32 HMRC estimates VAT assignment for Scotland using a methodology developed by HMRC, HM Treasury and the Scottish Government. In our September 2018 Statement of Data Needs, we asked HMRC, HM Treasury and the Scottish Government to start publishing detailed estimates of VAT

assignment on a regular timetable that was coherent with the timing of Scottish fiscal events.⁷

- 33 Two months in to the 2019-20 transitional year for VAT, there is a limited history of VAT assignment estimates and forecasts available. Our view is that there is a risk to the Scottish Budget from the implementation of VAT assignment because of the limited history of estimates and forecasts. We need an opportunity to analyse VAT assignment estimates, our revenue forecasts, BGA forecasts and likely reconciliations, and this is difficult with the currently available information.
- 34 We ask HMRC, the Scottish Government and HM Treasury to publish more information as soon as possible to enable us to develop our forecasts and gain an understanding of the scale of the risks to the Scottish Budget. We plan to hold further discussions with HMRC, the Scottish Government and HM Treasury and will return to this question when we publish our next Statement of Data Needs in September 2019.

Economy

- 35 Our longer term outlook for the Scottish economy is largely unchanged from our previous forecasts.
- 36 Despite exceptional political uncertainty, the growth rate of the Scottish economy increased over 2017 and 2018. At around 1.3 per cent over the last year, economic growth is higher than the average 1.0 per cent growth experienced since 2010. Unemployment remains at historic lows, and earnings growth has started to increase. A fall in the value of sterling has supported a strong net trade performance.
- 37 All else equal, this nearly two year period of sustained above average growth might have led us to revise up our outlook for the economy. However, in 2019 and 2020, we expect the ongoing uncertainty created by the Brexit negotiation process will limit growth. Business investment fell in 2018, and with business sentiment continuing to fall, we expect business investment to decline for the next two years. We have slightly revised up our outlook for earnings growth in 2019 and 2020 following recently stronger data, but with Brexit uncertainty affecting household confidence, we do not expect significantly higher household consumption in the near term. Balancing these factors, we expect growth of 0.8 per cent in 2019 and 0.9 per cent in 2020.
- 38 From 2021, we expect economic growth to return to our longer term trend rate of growth of around 1.2 per cent.

⁷ Scottish Fiscal Commission (2018) Statement of Data Needs September 2018 ([link](#))

Table 6: Headline economy forecasts, May 2019 and December 2018, per cent growth rates unless otherwise stated

GDP	2018	2019	2020	2021	2022	2023	2024
December 2018	1.4	1.2	1.0	1.0	1.1	1.2	
May 2019	1.3	0.8	0.9	1.1	1.2	1.3	1.3
Average nominal earnings							
December 2018	2.0	2.3	2.5	2.8	3.0	3.1	
May 2019	2.6	2.6	2.7	2.9	3.1	3.3	3.2
Employment (millions)							
December 2018	2.64	2.65	2.65	2.66	2.66	2.66	
May 2019	2.67	2.68	2.68	2.69	2.69	2.69	2.70

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 ([link](#)).

Shaded cells refer to outturn available at time of publication.

Brexit

39 At the time we prepared this report, the Brexit outcome and its implications for Scotland remain unknown. For our forecasts, we assume the UK leaves the EU in October 2019, though other outcomes are possible. The terms on which the UK may leave the EU in October 2019, if at all, are still highly uncertain. We make broad-brush assumptions to capture a range of possible Brexit outcomes in our forecasts, and so our forecasts are robust to a range of possibilities. A no-deal Brexit is not captured in our central assumptions and remains a significant downside risk to our forecasts.

40 Our Brexit assumptions are that:

- The UK leaves the EU in October 2019
- This is followed by a transition period lasting until December 2020
- New trading arrangements with the EU and others slow the pace of import and export growth
- The UK adopts a tighter migration regime than that currently in place.

41 Following these basic assumptions, we capture the effect of Brexit through four main channels:

- Migration – we use the ONS 50 per cent EU migration variant, with projected lower EU migration than in the principal population projection.
- Productivity – we are forecasting slow growth in productivity, in part because of Brexit.

- Trade – using OBR assumptions, we forecast slower growth in Scottish international trade from the end of the transition period.
- Business investment – we expect ongoing Brexit uncertainty to lead to falling business investment in 2019 and 2020.

42 In our previous forecasts, we assumed the UK would leave the EU on 29 March, followed by a transition period. We now assume that the UK will leave the EU in October 2019. This means there is a timing difference between our forecasts and those of the Office for Budget Responsibility (OBR). Given the information available when the OBR published its latest Economic and Fiscal Outlook on 13 March 2019, it assumed that the UK would leave the EU on 29 March 2019.

43 Aside from this timing difference, our Brexit assumptions are still broadly in line with the OBR's, with no significant or fundamental differences in our outlook for the UK and Scotland.

44 The timing difference between our Brexit assumptions and the OBR's has only a small effect on our forecasts. The transition period means that some of the biggest Brexit effects on trade would appear only after the end of the transition period. We both assume the transition period ends in December 2020. Similarly with migration, we do not expect a seven month delay in the UK's departure from the EU to significantly alter the outlook for migration compared to our previous forecasts.



Chapter 1

Introduction

- 1.1 This report presents the official and independent economic and fiscal forecasts created by the Scottish Fiscal Commission to inform the Scottish Government's Medium Term Financial Strategy, published on 30 May 2019.
- 1.2 Alongside our forecasts, the report provides an overview of the main assumptions and judgements made as part of the forecasting process. We also set out what has changed since our last forecasts in December 2019.
- 1.3 The report contains the following chapters:

Summary	Our forecasts and the main stories from this round of forecasts.
Economy Chapter	Our five-year forecasts for the Scottish economy, including the underlying judgements and sensitivity analysis
Fiscal Overview Chapter	Explains the role of our forecasts and the Block Grant Adjustments, discusses the fiscal risks facing the Scottish Budget and assesses the Scottish Government's borrowing projections
Tax Chapter	Our forecasts of the fully and partially devolved taxes within our remit, covering: <ul style="list-style-type: none">○ Non-Savings Non-Dividend Income Tax○ Non-Domestic Rates○ Land and Buildings Transaction Tax○ Scottish Landfill Tax○ Illustrative forecasts of VAT assignment and the Scottish share of Air Passenger Duty

Social Security Chapter	<p>Our forecasts for devolved social security expenditure.</p> <ul style="list-style-type: none"> ○ Carer's Allowance and Carer's Allowance Supplement ○ Discretionary Housing Payments ○ Scottish Welfare Fund ○ Employability Services ○ Funeral Support Payments ○ Healthy Start Vouchers and Best Start Foods ○ Best Start Grant
Annex A: Policy Costings	Our estimates of how much any individual policy will cost or raise, and how the Commission has arrived at that estimate.
Annex B: Policy Recostings	Our revised estimates of policies previously costed. Recostings may be required because of new outturn data or revisions to assumptions and judgements.
Annex C: Materiality and Policy Costings	Our approach to handling policies which have a very small fiscal effect.

The process behind creating our forecasts

- 1.4 The Commission has engaged with the Scottish Government by following the process set out in the agreed and published Protocol between the organisations.⁸
- 1.5 Since formal notification of the date of the Scottish Government's Medium Term Financial Strategy on 7 March, the Commission has had several rounds of meetings to discuss our forecasts. Attendees included the Scottish Government, Revenue Scotland and the Office for Budget Responsibility. In accordance with the Protocol, more detail of timings and attendees is published on our website.⁹
- 1.6 We had to make decisions about when to close aspects of the forecasts. Our Brexit assumptions were finalised on 2 May.
- 1.7 Headline dates of interest are:

⁸ Protocol for engagement between the Scottish Fiscal Commission and the Scottish Government Version 2.0 published March 2018 ([link](#))

⁹ Scottish Fiscal Commission (2018) Scottish Economic and Fiscal Forecasts – May 2019 ([link](#))

18 April	Cabinet Secretary for Finance, Economy and Fair Work wrote to advise the Scottish Government intended to delay publication of its Medium Term Financial Strategy until 30 May 2019
23 April	Dame Susan Rice wrote to the Cabinet Secretary for Finance, Economy and Fair Work to confirm that as the Scottish Fiscal Commission Act requires us to publish our forecasts on the same day as the MTFS we would also postpone publication until 30 May
8 May	The Scottish Government provided the Commission with finalised policy measures. The deadline for the inclusion of new data in the forecasts.
9 May	We closed our economy forecasts for inclusion in the final fiscal forecasts.
10 May	The Commission and the Scottish Government agreed a short extension to the provision of VAT assignment forecasts after HMRC changed their plans for publication of VAT assignment estimates.
13 May	The Commission presented the Scottish Government with final forecasts to allow the finalisation of the Scottish Government's Medium Term Financial Strategy.
15 May	Final VAT assignment forecasts presented to Scottish Government.
17 May	The Commission's near-final report was shared with the Scottish Government.
28 May	Phone call between Dame Susan Rice, Chair of the Commission and Cabinet Secretary for Finance, Economy and Fair Work.
29 May	A pre-release version of the Commission's report was shared with the Cabinet Secretary for Finance, Economy and Fair Work.
30 May	Scotland's Economic and Fiscal Forecasts – May 2019 published.



Chapter 2

Economy

Introduction

- 2.1 This chapter summarises our forecasts of Gross Domestic Product (GDP) and other aspects of the economy such as earnings, employment and household consumption. These feed into our fiscal forecasts, in addition to fulfilling our remit of providing forecasts of onshore GDP growth.
- 2.2 In presenting these, we focus on what has changed since our last forecasts published in December 2018. We have described our approach to forecasting the economy in a series of papers over the last two years.¹⁰ We will publish further papers as our approach develops.
- 2.3 Our economy forecasts were finalised on 9 May 2019, with no new data or information received after this date incorporated in the forecasts.
- 2.4 This chapter starts by providing a summary overview of our economic forecasts, before giving a fuller explanation of each of the component parts.

Forecast summary

- 2.5 Despite exceptional political uncertainty, onshore Scottish economic output has expanded over 2017 and 2018. GDP growth in 2018 was 1.3 per cent, higher than the post-2010 average of 1.0 per cent. This nearly two-year period of sustained growth might have led us to revise up our outlook for the economy.
- 2.6 However, in the coming years, there are a number of significant issues that are likely to slow growth, most of which are related to the ongoing uncertainty created by the Brexit negotiation process. We have considered a number of consumer and business sentiment indicators, as available at the time of writing. These include the Scottish Government's Consumer Sentiment Indicator, the Fraser of Allander Institute (FAI) Scottish Business Monitor, and

¹⁰ Scottish Fiscal Commission (2017) Current Approach to Forecasting ([link](#)), Scottish Fiscal Commission (2018) Forecasting the long-run potential of the Scottish economy ([link](#))

the Royal Bank of Scotland Purchasing Managers Index (RBS PMI).¹¹ These indicators suggest that consumer and business sentiment has recently been falling, and this is likely to limit growth in consumption, investment – other than stockpiling – and earnings. However, net trade has been more positive over the last year following sterling depreciation and government spending will continue to support the economy.

- 2.7 Table 2.1 summarises our economy forecasts. Similar to previous forecasts, we expect overall economic performance to remain below pre-crisis trends over the next five years. Compared to December 2018, we have slightly revised up our outlook for earnings growth. Further detail on our forecasts is provided in supplementary tables on our website.

Table 2.1: Headline economy forecasts, December 2018 and May 2019, per cent growth rates unless otherwise stated

GDP	2018	2019	2020	2021	2022	2023	2024
December 2018	1.4	1.2	1.0	1.0	1.1	1.2	
May 2019	1.3	0.8	0.9	1.1	1.2	1.3	1.3
Trend productivity							
December 2018	0.3	0.7	0.9	1.0	1.1	1.2	
May 2019	0.1	0.7	0.9	1.0	1.1	1.2	1.3
Average nominal earnings							
December 2018	2.0	2.3	2.5	2.8	3.0	3.1	
May 2019	2.6	2.6	2.7	2.9	3.1	3.3	3.2
Average real earnings							
December 2018	-0.3	0.3	0.5	0.6	0.9	1.1	
May 2019	0.2	0.4	0.8	0.9	1.1	1.2	1.2
Employment (millions)							
December 2018	2.64	2.65	2.65	2.66	2.66	2.66	
May 2019	2.67	2.68	2.68	2.69	2.69	2.69	2.70

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 ([link](#)).

Shaded cells refer to outturn available at time of publication.

- 2.8 The fiscal framework provides additional borrowing powers for Scotland in the event of a Scotland-specific economic shock.¹² Our assessment is that a Scotland-specific economic shock, as defined by the fiscal framework, is not

¹¹ Scottish Government (2019) Scottish Consumer Sentiment Indicator – 1st Quarter 2019 ([link](#)), Fraser of Allander Institute (2019) Scottish Business Monitor – Quarter 1 2019 ([link](#)), Royal Bank of Scotland (2019) Royal Bank of Scotland PMI February 2019 ([link](#)), Royal Bank of Scotland (2019) Royal Bank of Scotland PMI March 2019 ([link](#))

¹² The agreement between the Scottish Government and the United Kingdom government on the Scottish Government's fiscal framework ([link](#))

expected to occur. Supplementary Table S2.9 provides a detailed assessment comparing our forecasts to the criteria for a Scotland-specific economic shock.

Households

- 2.9 Since roughly 2008, growth in real household incomes has been near zero or negative, with real earnings lower today than they were a decade ago by most measures. This means that consumption growth has been driven by households reducing their savings. Recent evidence suggests households may be starting to reach the limit of credit-driven consumption. In Scotland the household savings ratio has gradually declined from around 10 per cent in 2010 to around 3 per cent in the most recent data.¹³
- 2.10 Household consumption growth slowed during 2018, with this being offset by stronger growth in net trade and investment. The latest Scottish Government Consumer Sentiment Indicator has reached record lows, and Brexit is likely to be a significant driver of this declining consumer confidence. Weakening sentiment combined with entrenched low real earnings growth and flattening consumer credit growth is likely to mean consumption growth remains low in the coming years.
- 2.11 We have slightly revised up our outlook for earnings growth since our previous forecast. HMRC's Real Time Information (RTI) measure of earnings indicated growth of around 2.6 per cent in 2018, compared to the 1.9 per cent indicated in December 2018 (Table 2.4). Similarly, both the Labour Force Survey (LFS) and Quarterly National Accounts Scotland (QNAS) based estimates of earnings growth in 2018 have been revised up.
- 2.12 Stronger earnings growth is likely to have been driven by a number of factors, including: the higher economic growth over 2017 and 2018 feeding through to higher wages; the very low unemployment rate starting to put upward pressure on wages; increases in the national minimum wage; and Scotland's public sector pay policy.
- 2.13 While earnings growth has risen, we view this within context. We now think earnings growth in 2018 was around 2.6 per cent, which is higher than the 2.0 per cent we estimated in December 2018. This is still below historic values of earnings growth of around 4.5 per cent. With headline CPI inflation of 2.3 per cent in 2018, real earnings growth remains very low but positive, compared to the falling real earnings seen over the past 10 years.
- 2.14 Following a decade of weak real earnings, and with household and business sentiment declining in response to political uncertainty, we continue to expect a slow return to higher real earnings growth over the next five years.

¹³ Scottish Government (2018) Quarterly National Accounts Scotland 2018 Quarter 4 ([link](#))

Business investment

- 2.15 Business investment growth in 2018 was negative both in the UK as a whole and in Scotland, and business investment intentions have declined notably in late 2018 and early 2019.¹⁴ Because of ongoing uncertainty created by Brexit and the evidence from investment intention surveys, we expect business investment to continue to fall in 2019 and 2020, limiting growth in the economy.
- 2.16 There is some evidence that, in the first quarter of 2019, businesses were building up stocks to prepare for a no-deal Brexit at the end of March.¹⁵ While this may have provided some support to business activity and investment in 2019 Q1, the boost is expected to be temporary, and offset in later quarters as businesses run down accumulated inventories.

Net trade

- 2.17 One driver of higher economic growth in 2018 was positive net trade growth, likely driven by sterling's depreciation. At the same time, limited household consumption has also constrained growth in imports. The outlook for net trade following the Brexit process is highly uncertain, with both imports and exports likely to be affected. In addition, global trade has been slowing over the last few quarters. Overall, we don't expect net trade to continue to support economic growth as it has done over the last year, with a slight negative effect on economic growth in 2019 and 2020.

Government

- 2.18 In contrast to the expected weakness in household and business spending, government spending is likely to make relatively large contributions to economic growth over the next five years. UK tax revenues were stronger than expected in 2018, and we expect this to feed through to higher UK Government and Scottish Government spending in Scotland.
- 2.19 Higher economic growth in 2018 has been driven by higher than expected net trade and investment, while earnings and consumption growth have remained low. Since the Scottish Budget includes revenues from income tax, the fact that economic growth may generate relatively less tax growth than it might otherwise have done has important implications for the outlook for Scottish Government spending.

¹⁴ For example, Bank of England (2019) Agents' summary of business conditions – 2019 Q1 ([link](#)), Fraser of Allander Institute (2019) Scottish Business Monitor – Quarter 1 2019 ([link](#)), Federation of Small Businesses (2019) Scottish Small Business Index – Q1 2019 ([link](#))

¹⁵ For example, Scottish Engineering (2019) Scottish Engineering Quarterly Review – March 2019 ([link](#)), Bank of England (2019) Inflation Report – May 2019 ([link](#))

Key Judgements

2.20 Table 2.2 summarises our key judgements.

Table 2.2: Economy forecast key judgements

Issue	May 2019	Change since December 2018
1. Spare capacity	+0.4 per cent in 2018 and +0.3 per cent in 2019	Downward revisions from +0.8 per cent in 2018 and +1.1 per cent in 2019, primarily following revisions to trend GDP growth as a result of changes in our long-run unemployment rate judgement
2. Trend productivity	From growth of 0.1 per cent in 2018 to growth of 1.3 per cent in 2024	No change to outlook from 2019
3. Long-run unemployment rate	4.0 per cent in all years	A downward revision from 4.25 per cent
4. Earnings	Average nominal earnings growth increasing from 2.6 per cent in 2018 to 3.2 per cent in 2024, broadly aligning with productivity growth	Profile revised up, especially in the earlier years of the forecast, following stronger than expected data for 2018
5. Population projections	Office for National Statistics (ONS) 2016-based 50 per cent net EU migration	No change
6. Forecasts of the UK	OBR UK Spring Statement March 2019 forecasts	Updated from OBR UK Budget October 2018 forecasts
7. Brexit	Our Brexit assumptions are that: <ul style="list-style-type: none"> • The UK leaves the EU in October 2019 • This is followed by a transition period lasting until December 2020 • New trading arrangements with the EU and others slow the pace of import and export growth • The UK adopts a tighter migration regime than that currently in place • Slower productivity growth 	Small difference since our last forecast related to the timing of exit. Our judgements remain broadly in line with the OBR's Brexit assumptions used in its March 2019 forecast.
8. Oil & gas	Neutral effect of UK Continental Shelf activity on onshore economy over the forecast horizon	Although oil prices have risen above \$70/barrel, we do not expect significant support to the economy from the oil and gas sector
9. Savings ratio	Broadly flat, picking up slightly in the later years of the forecast	Broadly unchanged
10. Second round effects	The Commission is not including second round economy effects from any policies	No change

Source: Scottish Fiscal Commission.

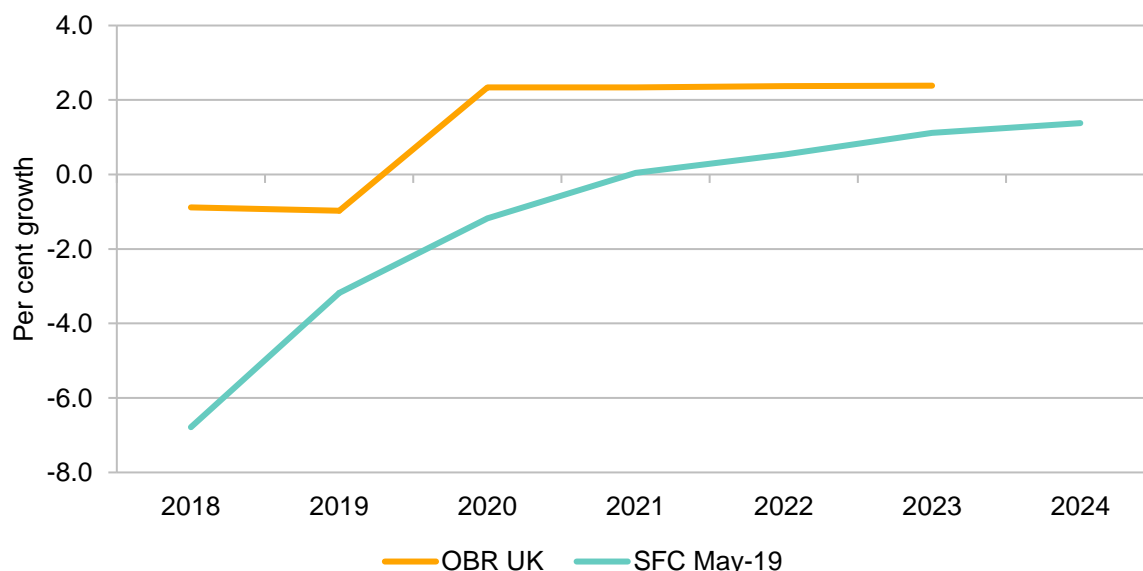
Developments in the Scottish economy

Brexit

- 2.21 In the referendum on 23 June 2016, a majority of votes cast were in favour of the UK leaving the EU. On 29 March 2017, the UK government triggered Article 50 to begin the process of the UK's departure from the EU. This was scheduled to occur on 29 March 2019. In November 2018, the UK government and the EU published a draft Withdrawal Agreement (WA), setting the conditions for the exit of the UK from the EU, and a Political Declaration (PD), outlining the intended nature of post-Brexit UK-EU relationships.
- 2.22 Despite a series of votes since December 2018, the UK parliament did not approve the WA before 29 March, and the EU agreed to delay the UK's departure date until October 2019. This is a flexible extension, and an earlier departure date is possible. The terms on which the UK will leave the EU in October 2019, if at all, are still highly uncertain.
- 2.23 At the time of preparation of this report, the Brexit outcome and its implications for Scotland remain unknown.
- 2.24 The Office for Budget Responsibility (OBR) published its latest Economic and Fiscal Outlook on 13 March 2019. During the same week, the UK parliament voted on the WA. Given the information available at the time, the OBR based its forecast on an assumption that the UK would leave the EU on 29 March 2019, followed by a transition period to December 2020. The OBR left its Brexit assumptions largely unchanged from previous forecasts, making broad-brush assumptions about the effect of Brexit on trade and migration.
- 2.25 In our previous forecasts, our own assumptions about Brexit have been broadly in line with those of the OBR. Because of recent developments, our Brexit assumptions are now different from the OBR's in that we now assume that the UK will leave the EU in October 2019, compared to the OBR's assumption of 29 March 2019.
- 2.26 We think the difference between our Brexit assumptions and the OBR's has only a small effect on our forecast. The transition period means that some of the biggest Brexit effects on trade would only start to occur after the end of the transition period. While we expect the UK to leave the EU seven months later than the OBR assumed, we still expect the transition period to end in December 2020. Similarly with migration, we don't expect a seven month delay in the UK's departure from the EU to significantly alter the outlook for migration compared to our previous forecasts.
- 2.27 The main difference between the Commission's and the OBR's forecasts is about the short-term effect on the economy of Brexit uncertainty. The OBR noted that Brexit uncertainty was weighing on business investment, and this

would likely continue in the near term, but would partly dissipate as the Brexit position was clarified to return to modest growth. Because of ongoing Brexit uncertainty, we have a weaker outlook for business investment in 2019 and 2020 than the OBR, as shown in Figure 2.1.

Figure 2.1: SFC Scottish and OBR UK forecast of business investment growth



Source: Scottish Fiscal Commission, OBR (2019) Economic and Fiscal Outlook – March 2019 ([link](#)).

2.28 Business investment is a small component of GDP. Household consumption appears more robust both in Scotland and the UK, so the effect of weaker business investment on the economy as a whole should not be overstated.

2.29 In summary, our Brexit assumptions are that:

- The UK leaves the EU in October 2019
- This is followed by a transition period lasting until December 2020
- New trading arrangements with the EU and others slow the pace of import and export growth
- The UK adopts a tighter migration regime than that currently in place

2.30 We therefore capture the effect of Brexit through four main channels:

- Migration – we use the ONS 50 per cent EU migration variant, with projected lower EU migration than in the principal population projection.
- Productivity – we forecast slow growth in productivity, in part because of Brexit.
- Trade – using OBR assumptions, we forecast slower growth in Scottish international trade from the end of the transition period.

- Business investment – we expect ongoing Brexit uncertainty to lead to falling business investment in 2019 and 2020.

2.31 Overall our Brexit assumptions remain broadly in line with the OBR's. The difference in the timing of Brexit does not imply significant or fundamental differences in our outlook for the UK and Scotland compared to the OBR's.

Productivity and trend GDP growth

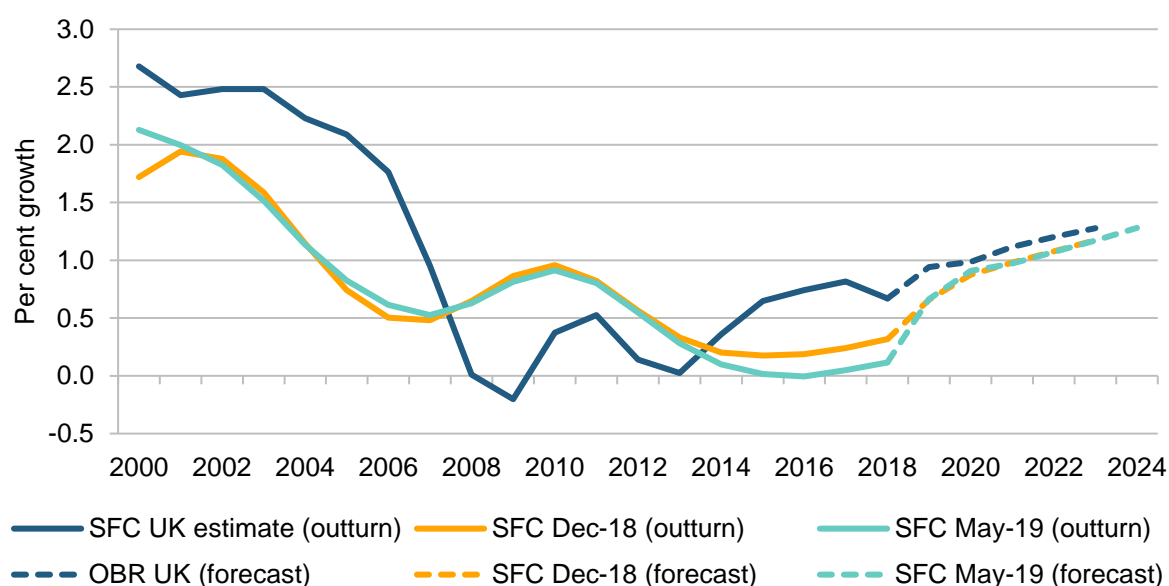
2.32 In this section we provide an update on our outlook for productivity growth and the Commission's judgement regarding long-term trend GDP for Scotland.

Productivity

2.33 The growth rate of productivity appears to have slowed since 2004, with the financial crisis exacerbating this trend. We estimate that trend productivity growth has averaged 0.4 per cent per year since 2008, compared to an average annual growth rate of 1.5 per cent over the 10 years before 2008. Broadly, as in our previous forecasts, we assume that productivity growth gradually increases from the low rates observed in recent years but remains well below its pre-crisis trend over the forecast period.

2.34 As shown in Figure 2.2, estimates of trend productivity growth between 2015 and 2018 have been revised down, by 0.2 percentage points per year on average, compared to our last report. These differences are driven by upward historical revisions to recent outturn data on total hours worked. We still predict a modest recovery in trend productivity growth and we will continue to reflect on the relationship between measured productivity and the performance of the labour market as more evidence becomes available.

Figure 2.2: Trend productivity growth, outturn and forecast, Scotland and the UK



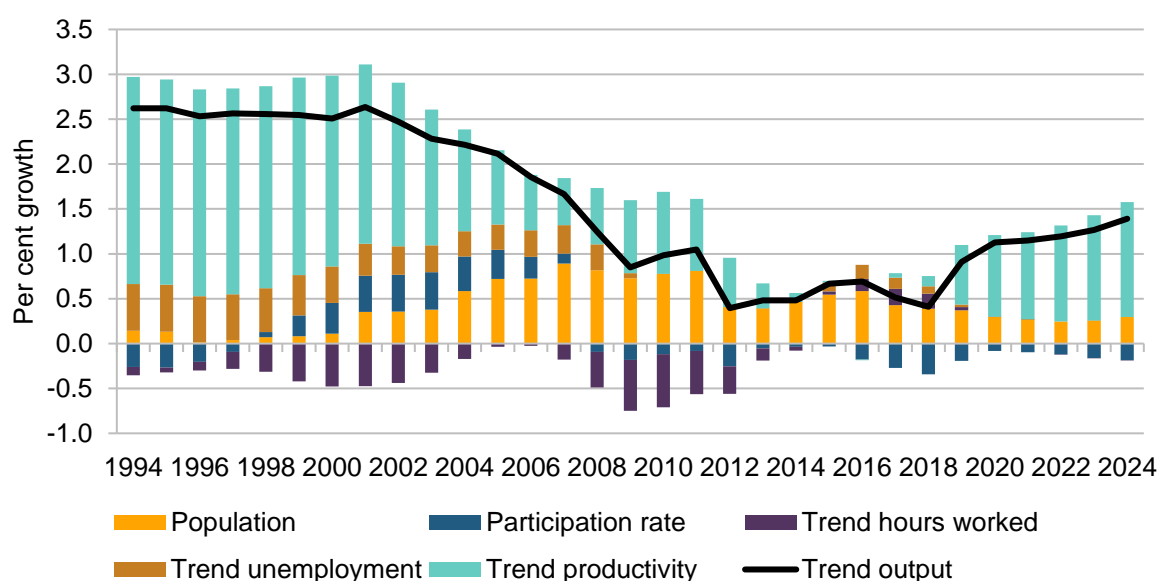
Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 ([link](#)), ONS (2019) Gross Value Added excluding Oil and Gas – March 2019 ([link](#)), ONS (2019) Labour Force Survey: Total actual weekly hours worked (millions) UK ([link](#)), OBR (2019) Economic and Fiscal Outlook March 2019 ([link](#)).

The OBR does not publish a historical series for trend productivity growth. The series we provided is our computed series of UK trend productivity based on ONS data.

Forecast of trend GDP

- 2.35** Our forecast of trend GDP growth is shown in Figure 2.3 and Table 2.3, which include the contribution of each component.
- 2.36** Since December 2018, we have further revised down our assumption for the long-run unemployment rate from 4.25 per cent to 4.0 per cent, in the light of the latest outturn data showing ongoing low levels of unemployment and only modest wage growth. This change slightly increases the trend GDP growth profile across the forecast horizon.

Figure 2.3: Trend GDP growth and contribution of components



Source: Scottish Fiscal Commission.

Table 2.3: Growth of trend GDP and contribution of components (per cent)

	Trend GDP growth	Contribution of components				
		16+ population	16+ participation rate	Long-run unemployment rate	Trend average hours worked	Trend productivity
2017	0.5	0.4	-0.3	0.1	0.2	0.0
2018	0.4	0.4	-0.3	0.1	0.2	0.1
2019	0.9	0.4	-0.2	0.0	0.0	0.7
2020	1.1	0.3	-0.1	0.0	0.0	0.9
2021	1.1	0.3	-0.1	0.0	0.0	1.0
2022	1.2	0.2	-0.1	0.0	0.0	1.1
2023	1.3	0.3	-0.2	0.0	0.0	1.2
2024	1.4	0.3	-0.2	0.0	0.0	1.3

Source: Scottish Fiscal Commission.

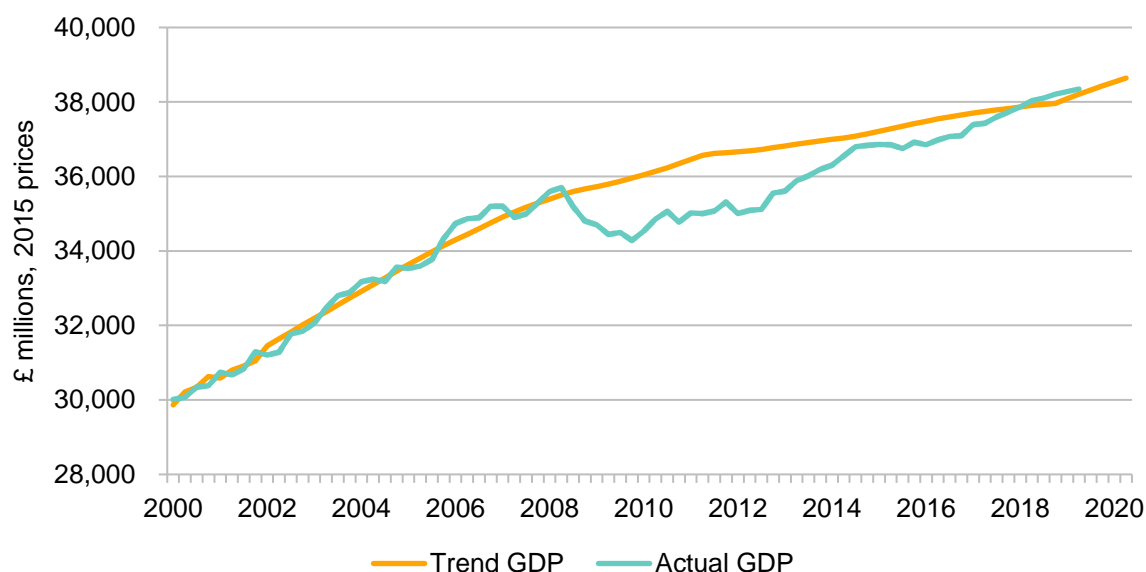
Spare capacity in the economy

2.37 Spare capacity shows the economy's position in relation to its trend. If actual GDP is below trend, there is scope for faster growth in GDP by using the available capacity. If, on the other hand, there is little spare capacity in the economy, this is likely to limit growth. Therefore growth of trend GDP and the amount of spare capacity today are both important factors in our five-year forecast.

2.38 Figure 2.4 shows actual output and our estimates of trend GDP. Our judgement is that, after a period below trend, the economy is now operating

slightly above potential, with our measure of spare capacity at 0.4 per cent in 2018 and 0.3 per cent in 2019.

Figure 2.4: Actual and trend GDP, quarterly

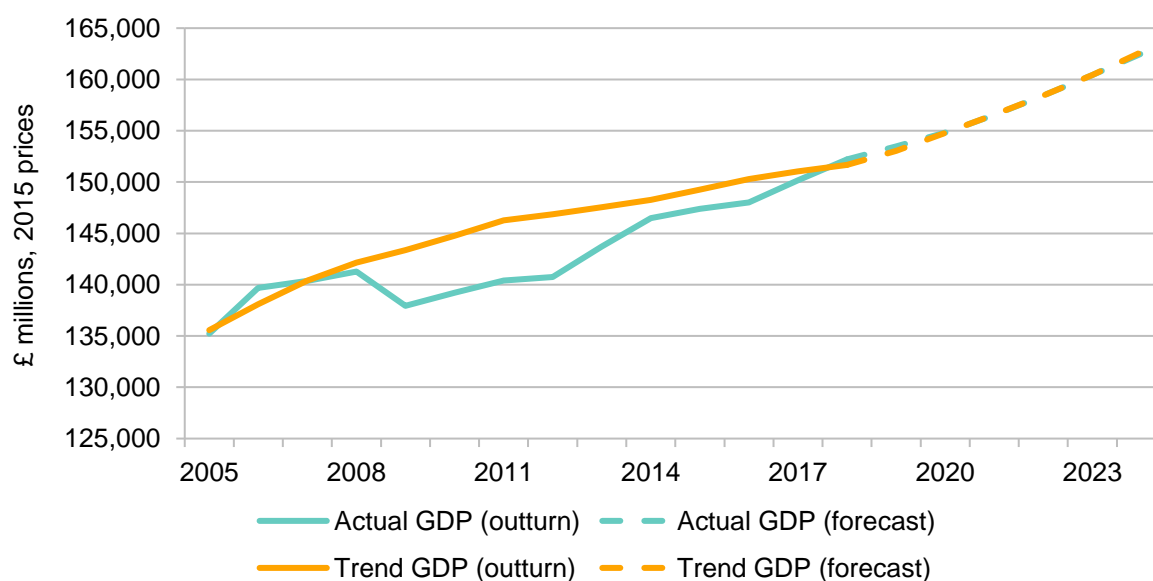


Source: Scottish Fiscal Commission, Scottish Government (2018) Quarterly National Accounts Scotland 2018 Quarter 3 ([link](#)).

Actual GDP series includes Scottish Fiscal Commission short-run GDP forecast.

2.39 As illustrated in Figure 2.5, with the economy already broadly on trend, we forecast GDP growth to return to its long-run growth rate by 2020 and to remain near potential for the rest of the forecast.

Figure 2.5: Trend and actual GDP, outturn and forecast, annual

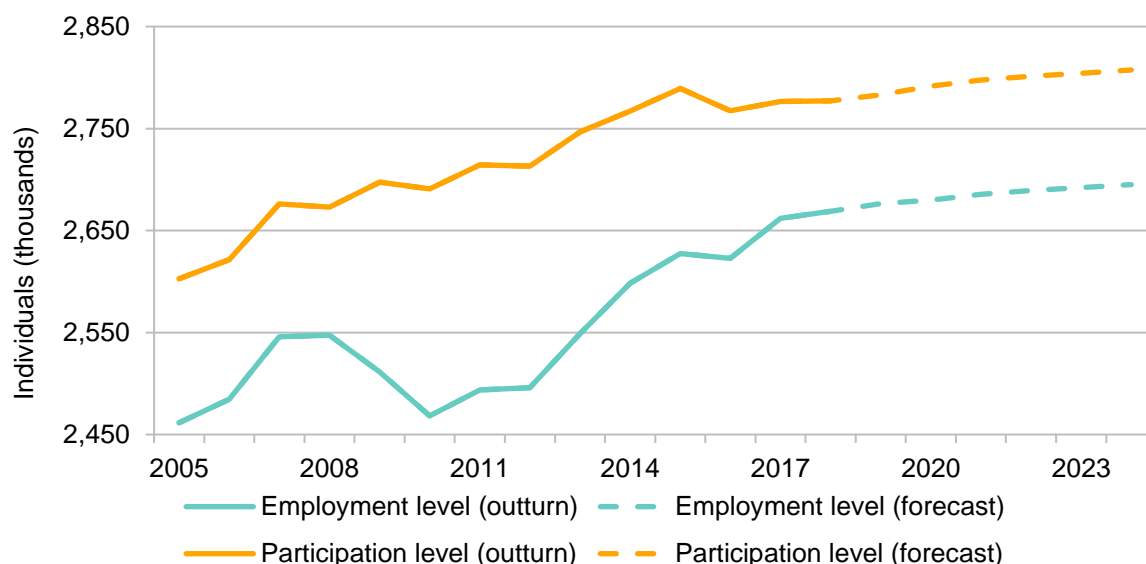


Source: Scottish Fiscal Commission.

Labour market

- 2.40 Employment growth in Scotland has remained robust in recent years, exceeding our December 2018 forecast. Recent surveys show that recruitment difficulties for businesses continue to be a concern in many sectors.¹⁶ Moreover, the unemployment rate in Scotland has continued to decline since our last forecast, reaching 3.5 per cent in the fourth quarter of 2018. Historically low levels of unemployment and continued recruitment difficulties indicate limited spare capacity in the labour market, and are consistent with the view that the economy is operating close to capacity.
- 2.41 Labour market participation levels are expected to continue to gradually increase, and unemployment is expected to remain low. As a result, employment is expected to continue to grow, although at a slower rate than over the last few years.

Figure 2.6: Employment and participation level, outturn and forecast



Source: Scottish Fiscal Commission, ONS (2019) Labour Force Survey – April 2019 ([link](#)), ONS (2019) Regional labour market statistics in the UK: Apr 2019, HI11 ([link](#)).

Earnings and household incomes

- 2.42 Our forecast of earnings balances a recent moderate increase in earnings growth with the longer-term subdued growth in earnings since 2010. As in our previous forecasts, we expect earnings growth to increase gradually in the coming years, although starting from a higher outturn growth estimate for 2018 than we made in December 2018.

¹⁶ Scottish Chamber of Commerce (2019) Quarterly Economic Indicator results for Q1 of 2019 ([link](#))

- 2.43 Table 2.4 presents the latest data on earnings from the available data sources.
- 2.44 HMRC Real Time Information (RTI) figures are a relatively new measure of earnings based on the monitoring of PAYE income tax returns, and not covering self-assessment returns. Because of our focus on income tax, we are placing increasing weight on the RTI earnings information in forming our overall earnings judgement.
- 2.45 Since December 2018, we now have full year data for 2018, and earnings growth has generally been higher than we had expected. Outturn RTI data for 2018 as a whole showed growth of 2.6 per cent. While we don't directly align our earnings forecast to RTI, we have revised up our estimate of 2018 earnings growth to 2.6 per cent.

Table 2.4: Data on average nominal earnings growth in Scotland (per cent)

Data source	Forecast	Average 2010 to 2016	2017	2018
ASHE	Dec-18	1.4	0.9	3.3
	May-19	1.4	0.9	3.3
RTI [1]	Dec-18		2.1	1.9
	May-19		2.1	2.6
LFS	Dec-18	2.1	-1.5	1.4
	May-19	2.1	-1.5	3.8
QNAS COE-based measure [2]	Dec-18	2.3	1.4	0.5
	May-19	2.2	1.1	1.9
Average	Dec-18	1.9	0.7	1.8
	May-19	1.9	0.7	2.9
SFC	Dec-18		1.5	2.0
	May-19		1.0	2.6

Source: Scottish Fiscal Commission, ONS (2018) Annual Survey of Hours and Earnings (ASHE) access via nomisweb ([link](#)), HMRC (2019) UK Real Time Information ([link](#)), ONS (2019) Labour Force Survey Gross weekly earnings of full-time employees by region ([link](#)).

Italics for 2018 are part-year data expressed as annualised growth rate of comparison to previous years. ASHE data are up to April 2018. LFS is average Gross Weekly Earnings.

[1] The average 2010 to 2016 is not available for RTI because these data only exist from April 2014.

[2] QNAS only contain compensation of employees (COE) data for the whole economy. It does not report average annual earnings figures. The data we present in this table are based on SFC calculations applied to QNAS COE data.

- 2.46 We view this upward revision within context. After a decade of slow growth, nominal average earnings growth is still below historic values of around 4.5 per cent. With inflation around 2 per cent in 2018, real earnings growth also remains low.
- 2.47 The moderate rise in earnings growth in 2018 could be explained by a few factors. Employers may be starting to respond to exceptionally low

unemployment, and offering higher wages to attract staff. Higher public sector pay growth and the increase in the national living wage have also contributed. Countering this, productivity growth remains low, and Brexit is likely to continue to weigh on economic activity.

2.48 On balance, we are slightly more positive about the outlook for earnings than we were in December 2018, but our pathway for nominal average earnings growth in Scotland remains weak. With our upwards revision to nominal average earnings growth, we now expect average real earnings to grow in each year of the forecast.

Table 2.5: Average nominal and real earnings growth (per cent)

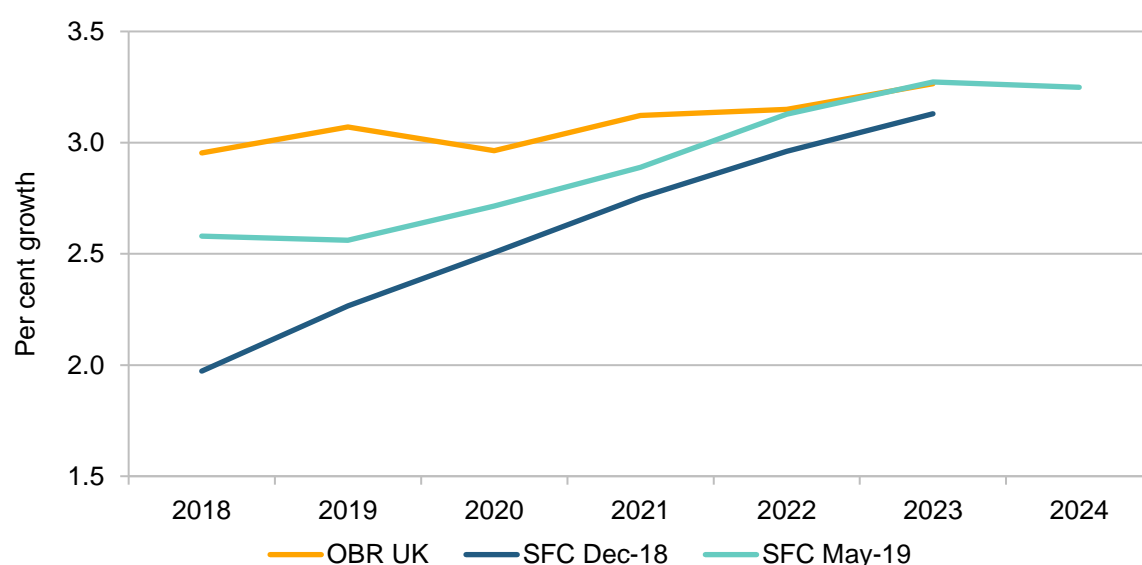
	Forecast	2018	2019	2020	2021	2022	2023	2024
Nominal	Dec-18	2.0	2.3	2.5	2.8	3.0	3.1	
	May-19	2.6	2.6	2.7	2.9	3.1	3.3	3.2
Real	Dec-18	-0.3	0.3	0.5	0.6	0.9	1.1	
	May-19	0.2	0.4	0.8	0.9	1.1	1.2	1.2

Source: Scottish Fiscal Commission.

2.49 These upwards revisions, all else equal, mean greater household disposable income and consumption compared to our December 2018 forecast. This also leads to an upwards revision in our income tax forecast.

2.50 Despite our upwards revision, average nominal earnings growth in Scotland is expected to remain below growth in the UK until 2022 as shown in Figure 2.7.

Figure 2.7: Growth in average nominal earnings, Scotland and UK



Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 ([link](#)), OBR (2019) Economic and Fiscal Outlook – March 2019 ([link](#)).

GDP and the components of expenditure

- 2.51 The Commission forecasts consumption, investment, net trade and government spending separately. These sum to create a pathway for GDP.
- 2.52 Our near-term outlook on these components is set out in the forecast summary section at the opening of the chapter. For the medium to longer term, our view is that:
- After a pick-up in 2019 supported by positive real disposable income growth and a falling savings ratio, household consumption, is expected to remain broadly flat after 2020 as income growth is partly used to rebuild savings.
 - The decline in business investment caused by Brexit uncertainty is expected to end in 2022, followed by a recovery in firms' capital spending in subsequent years. Our forecasts balance the gradual dissipation of political and economic risks about the Brexit outcome with the remaining uncertainty as negotiations over the future trade and migration arrangements continue after Brexit.
 - Scottish net trade will be broadly neutral over the medium to long term, neither adding to nor subtracting from GDP growth from 2021 onwards.
 - Government spending is expected to continue to contribute to GDP growth over the medium to long term. This is discussed in more detail in the section below.

Government

- 2.53 The public sector, including consumption and investment spending, accounts for around a quarter of GDP. General government expenditure in Scotland includes spending by all levels of government: Scottish Government expenditure, expenditure by other UK Government departments in Scotland, and spending by local authorities in Scotland.
- 2.54 For Scottish Government expenditure up to 2023-24, our figures are consistent with the Scottish Government's five-year plans set out in the MTFS 2019. For UK Government and local authority spending in Scotland, we use the latest OBR forecasts from March 2019.
- 2.55 Our Government resource budget forecast is made up of three main components:
- Base resource spending, driven by Scotland's total Block Grant
 - Net Block Grant Adjustments (net BGAs), the net effect of our latest forecasts compared to the latest BGA forecasts

- Reconciliations, reflecting adjustments that we expect to be made to the Scottish Government's budget for differences between the BGA and our forecasts from previous years

2.56 Table 2.6 presents changes in these components since our December 2018 forecast. Reconciliations are discussed in depth in Chapter 3.

Table 2.6: Change in the main components of the Scottish Government's resource budget, and inclusion of income tax reconciliations (£ million)

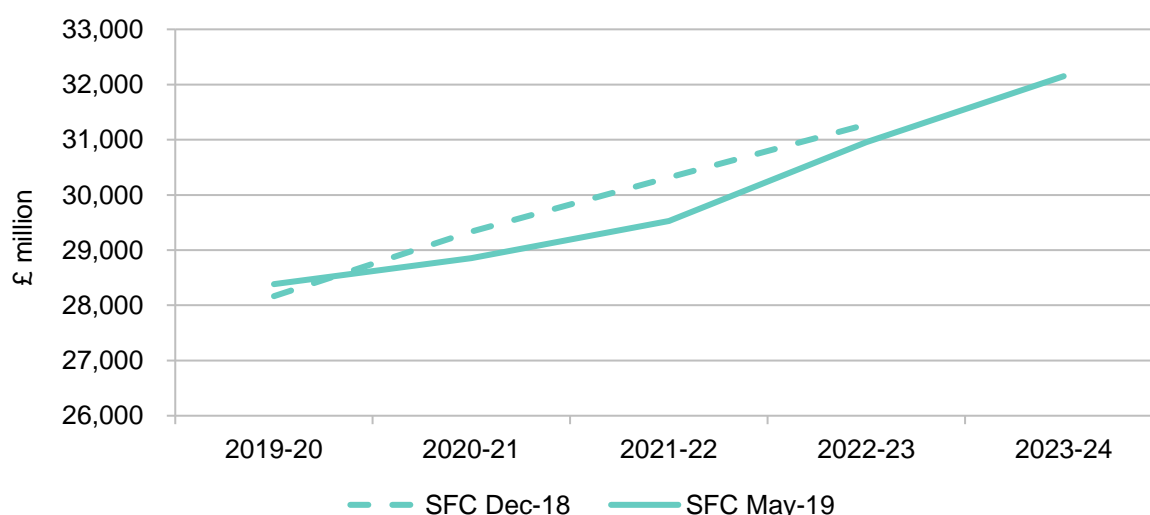
	2019-20	2020-21	2021-22	2022-23	2023-24
Base resource spending limit (block grant)	27,787	28,889	29,752	30,678	31,760
<i>Change since Dec-18</i>	154	67	64	81	129
Net BGA	262	40	5	76	175
<i>Change since Dec-18</i>	0	-242	-279	-235	-153
Income tax reconciliations	0	-229	-608	-188	0

Source: Scottish Fiscal Commission.

The figures in this table are consistent with the MTFS 2019. The Scottish Government's budget is also affected by funding for social security and some non-budget elements.

2.57 Figure 2.8 illustrates the level of the Government's resource spending based on the MTFS 2019 compared to those used in our previous forecast, taking account of all the components in Table 2.6.¹⁷

Figure 2.8: Scottish Government's resource spending plans, Budget 2019-20 and MTFS 2019

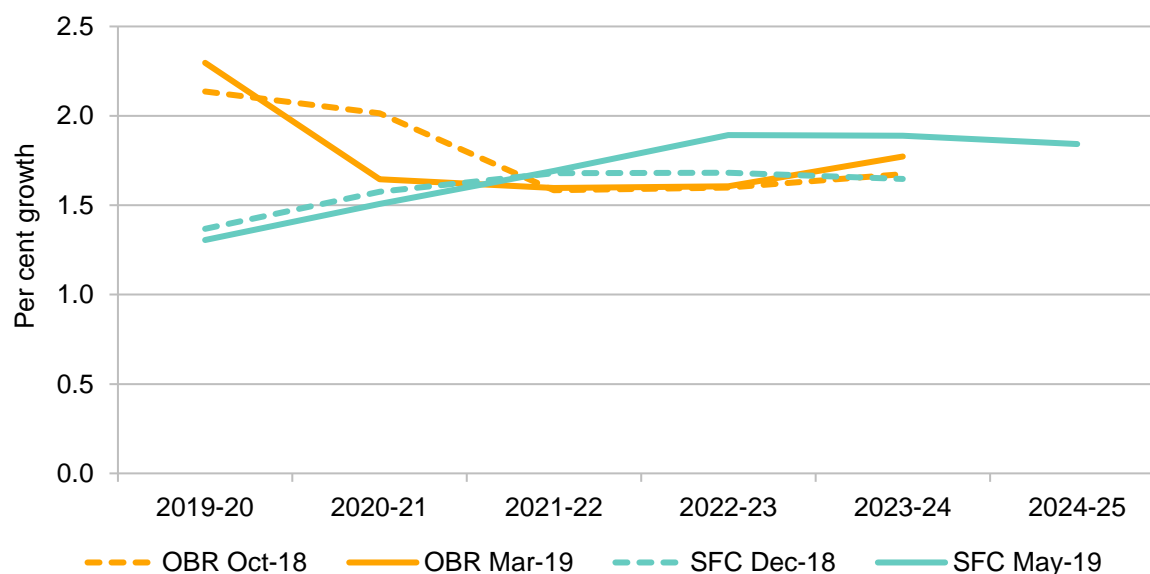


Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 ([link](#)).

¹⁷ In Figure 2.8, the SFC Dec-18 value for 2019-20 is consistent with the Scottish Government's Budget 2019-20. From 2020-21 onwards, the SFC Dec-18 values are the Commission's projections of Scottish Government's expenditure. Further details on these projections can be found in our previous report, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 ([link](#)).

- 2.58 Overall, the Scottish Government's resource spending plans have been revised down since December 2018 from 2020-21 onwards. The base resource spending limit has been slightly revised up since December 2018. This is more than offset by changes in the other two components: the net BGA and reconciliations.
- 2.59 The net BGA and reconciliations are both driven by the relative growth of Scottish and UK tax revenues. In the UK, growth in tax revenues, and particularly income tax, has been more positive than expected over the last two years. When compared to slower growth in Scottish income tax revenues over the last two years, this means negative reconciliations in the years ahead. As well as the direct effect on reconciliations, upwards revisions to the OBR's UK tax forecasts will have been driven in part by the stronger than expected outturn data. Upwards revisions to UK tax forecasts mean upwards revisions to the BGA and a negative effect on the Scottish Government's budget from the net BGA. Further information on the BGA and reconciliations are provided in Chapter 3.
- 2.60 Our December 2018 and May 2019 forecasts of total government consumption expenditure growth in Scotland are shown in Figure 2.9, compared to OBR's forecasts for the UK. The values for Scotland combine UK, Scottish and local government consumption expenditure.
- 2.61 As illustrated in Figure 2.9, growth in government consumption expenditure has been revised up from 2022-23 onwards. Downwards revisions to the level of spending in earlier years as shown in Figure 2.8, before a return towards previous projections of spending, lead to higher growth rates from 2022-23 onwards.

Figure 2.9: Total Government consumption expenditure, Scotland and OBR UK forecasts, constant-price growth rates



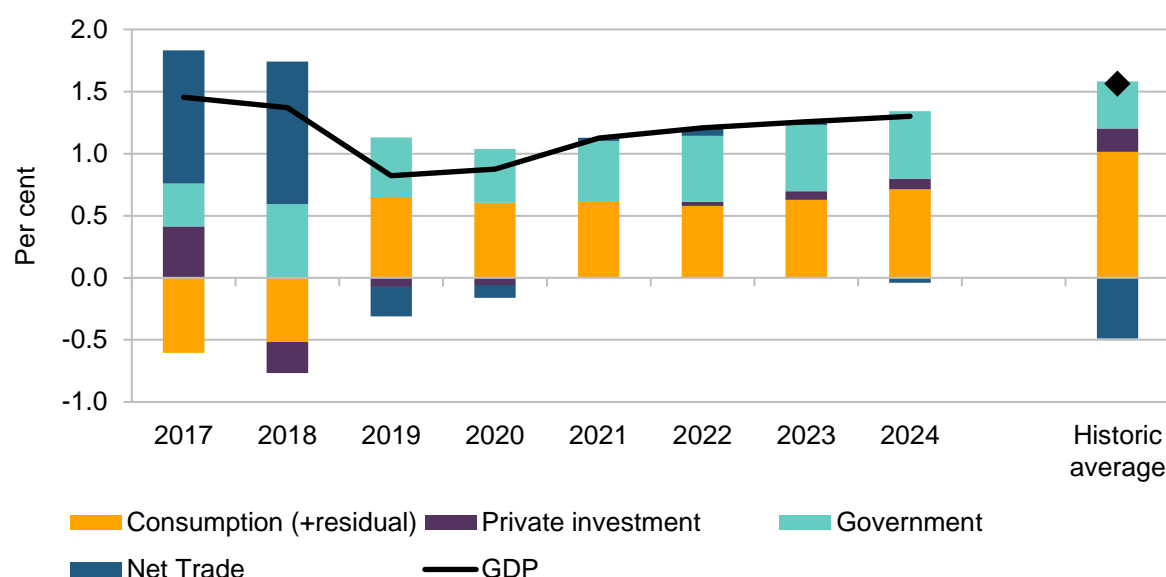
Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 ([link](#)), OBR (2019) Economic and Fiscal Outlook – March 2019 ([link](#)).

2.62 To build our forecast of GDP, we forecast government capital spending as well as government consumption expenditure. The capital spending figures include two main components: the Scottish Government's capital budget for the next five years as set out in its MTFS 2019, and the capital borrowing available under the provision of the Scotland Act 2016. In the MTFS, the Scottish Government has provided specific capital borrowing and repayment plans up to 2020-21, and has set out principles for capital borrowing beyond this point. For the economy forecast from 2021-22 onwards, we adopted the same approach as in our previous forecast in that we assumed the Scottish Government uses the maximum possible capital borrowing based on a 25-year repayment period with equal repayments. Further detail on Scottish Government borrowing is provided in Chapter 3.

GDP growth

2.63 The contribution of each of the components to growth in GDP are shown in Figure 2.10.

Figure 2.10: Contributions by component of expenditure to growth in GDP



Source: Scottish Fiscal Commission.

Historic average is based on growth from 1998 to 2018.

Forecast sensitivities

- 2.64** Forecasts are fundamentally based on assuming recent underlying trends continue, with adjustments made depending on evidence. It is however possible that underlying trends, identified to influence our forecasts, may change within the forecast horizon and alter the outcomes for the economy. We therefore perform additional analysis around our key judgements to illustrate the sensitivity of the forecast to such potential changes.
- 2.65** We focus on sensitivity of GDP, employment and average earnings to variants of three key judgements: migration, long-run unemployment, and productivity. The next paragraphs present our judgements behind the sensitivity analysis and the results are shown in Table 2.7 and Figure 2.11.
- 2.66** These sensitivities are each considered in isolation, that is we show how our forecast would change when adjusting only one variable at a time. We do not explicitly model the effects of interactions between variants.
- 2.67** The Commission's central population forecast is based on the ONS 50 per cent EU migration projection variant. The effect of higher migration is illustrated using the ONS principal projection and similarly the effect of lower migration is illustrated using its low-migration variant.
- 2.68** The variants for the long-run unemployment rate are 3.0 per cent in a low scenario and 4.75 per cent in a high scenario. These variants compare to our current central assumption of 4.0 per cent.

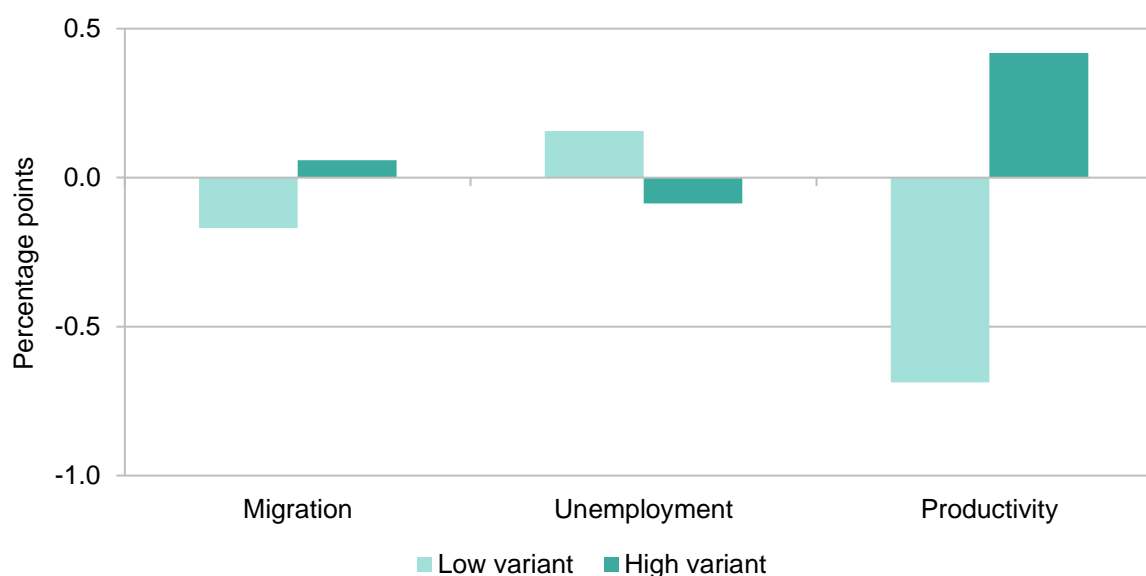
2.69 In the central forecast, productivity is assumed to increase from a growth rate of 0.8 per cent in 2019-20 to 1.3 per cent by 2024-25. In the low-productivity variant, the growth rate of productivity is assumed to reach 0.4 per cent by 2024-25, consistent with average growth seen post-2008. In the high-productivity variant, the growth rate of productivity is assumed to converge to 1.5 per cent by 2024-25, in line with pre-2008 average growth.

Table 2.7: Economic forecast variants, average growth rates of GDP, employment and average earnings from 2019-20 to 2024-25 (per cent)

	Central forecast average		Low variant	High variant
GDP	1.1	Migration	0.9	1.2
		Unemployment	1.3	1.0
		Productivity	0.4	1.5
Employment	0.1	Migration	0.0	0.2
		Unemployment	0.3	0.1
		Productivity	0.1	0.1
Average earnings	3.0	Migration	3.0	3.0
		Unemployment	3.0	3.0
		Productivity	2.3	3.4

Source: Scottish Fiscal Commission.

Figure 2.11: Average deviation from central forecast of annual GDP growth from 2019-20 to 2024-25



Source: Scottish Fiscal Commission.

2.70 Our central forecast is for GDP to grow at an average rate of 1.1 per cent per year from 2019-20 to 2024-25. While migration and unemployment variants have a limited effect on GDP growth, productivity variants have a much larger

effect. The Scottish economy would grow by an annual average of 0.4 percentage points more under the high productivity scenario, while it would grow by about 0.7 percentage points less under the low productivity scenario. GDP growth is considerably more sensitive to changes in productivity assumptions than migration and unemployment.

Comparison to previous forecasts

2.71 Table 2.8 and Figure 2.12 compare the headline variables from our latest forecast to our December 2018 forecast.

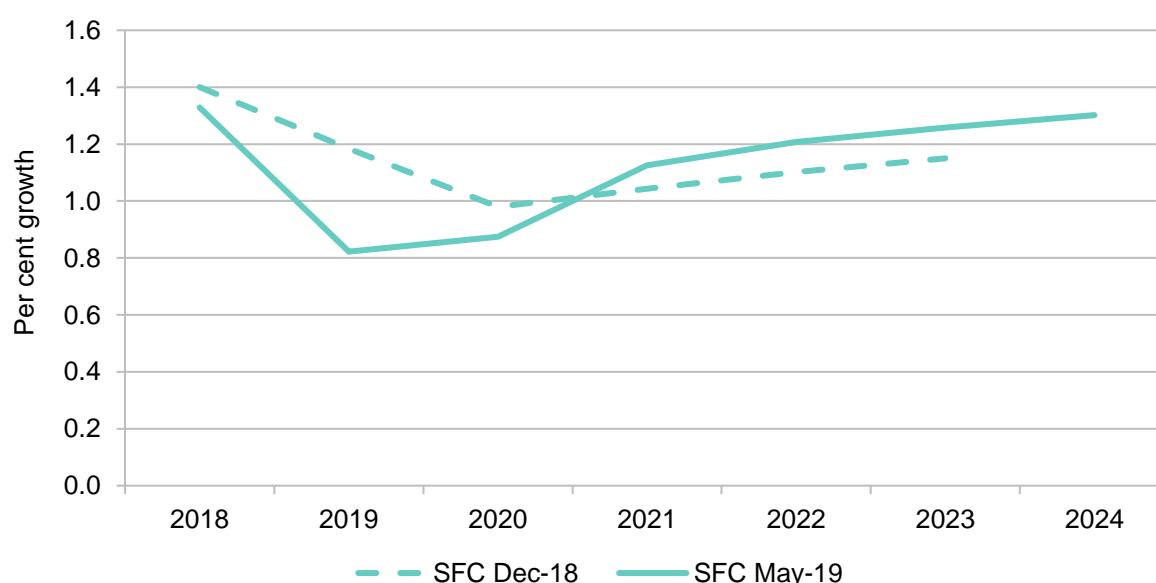
Table 2.8: Comparison between May 2019 and December 2018 economy forecasts, per cent growth rates unless otherwise stated

		2018	2019	2020	2021	2022	2023	2024
GDP	Dec-18	1.4	1.2	1.0	1.0	1.1	1.2	
	May-19	1.3	0.8	0.9	1.1	1.2	1.3	1.3
Employment	Dec-18	0.0	0.2	0.2	0.2	0.1	0.1	
	May-19	0.3	0.3	0.1	0.2	0.1	0.1	0.1
Unemployment (% rate)	Dec-18	4.2	4.3	4.3	4.3	4.3	4.3	
	May-19	3.9	3.8	4.0	4.0	4.0	4.0	4.0
Average nominal annual earnings	Dec-18	2.0	2.3	2.5	2.8	3.0	3.1	
	May-19	2.6	2.6	2.7	2.9	3.1	3.3	3.2
Average real annual earnings	Dec-18	-0.3	0.3	0.5	0.6	0.9	1.1	
	May-19	0.2	0.4	0.8	0.9	1.1	1.2	1.2

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 ([link](#)).

Shaded cells refer to outturn available at time of publication.

Figure 2.12: Forecast comparison, May 2019 and Dec 2018, GDP growth

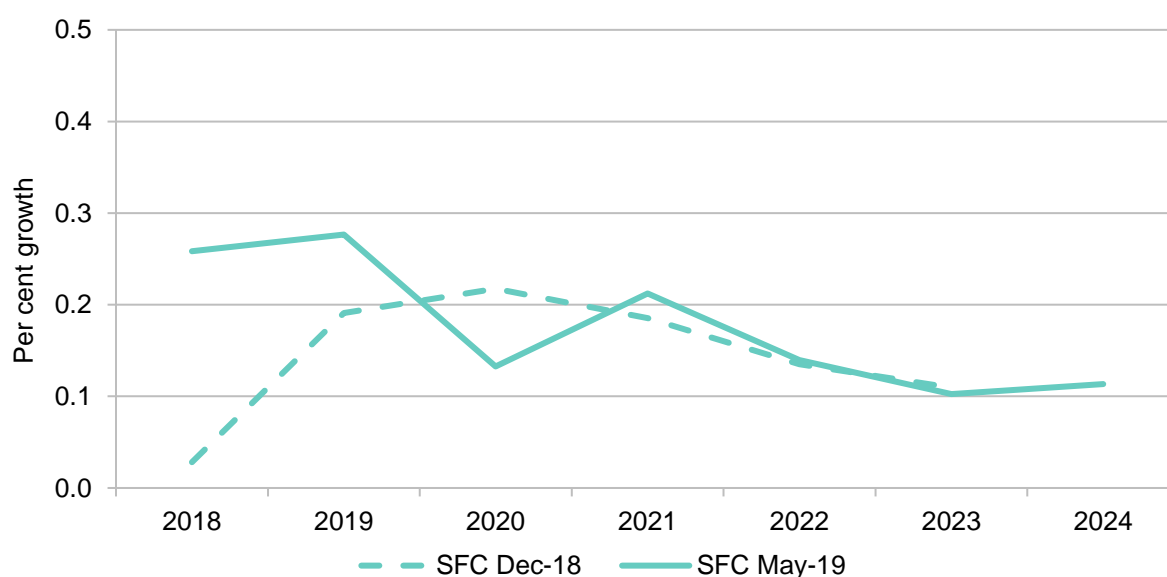


Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 ([link](#)).

2.72 Growth in employment and average earnings are the most important economic determinants in forecasting income tax.

2.73 A comparison of our latest and previous forecasts of employment growth is shown in Figure 2.13. We expect employment to grow at similar rates to our December 2018 forecast in most years. The lower forecast in 2020 reflects the unemployment rate increasing from current low levels to its long-run equilibrium.

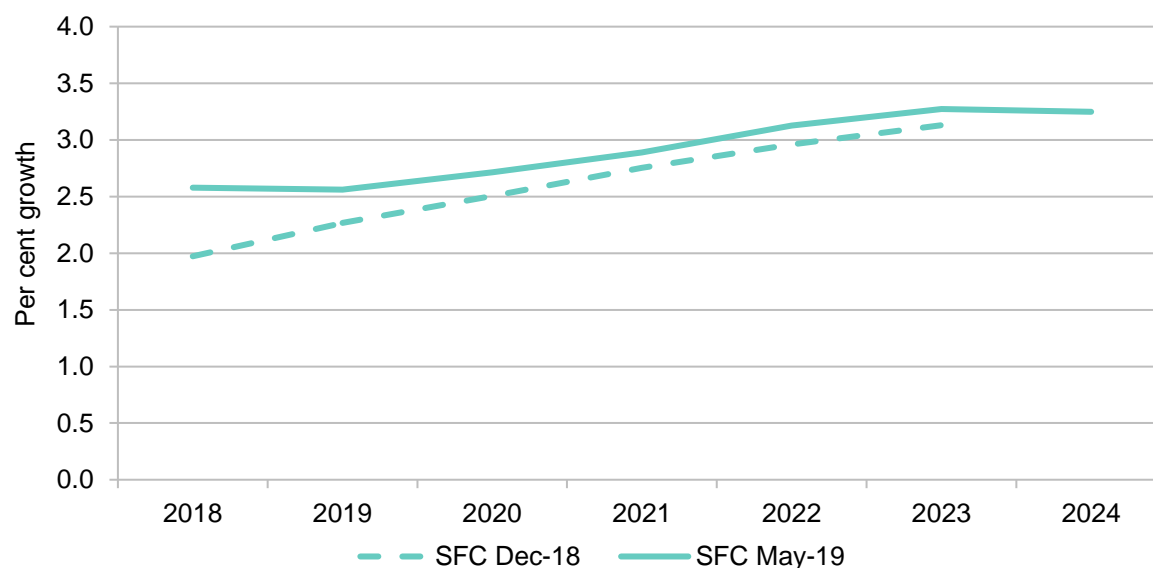
Figure 2.13: Forecast comparison, May 2019 and Dec 2018, employment growth



Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 ([link](#)).

2.74 We have revised up our forecast of average nominal earnings growth, especially in 2018 and 2019. Our outlook for average nominal earnings growth is described in the Earnings and household incomes section. The comparison of average nominal earnings growth from the two forecasts is shown in Figure 2.14.

Figure 2.14: Forecast comparison, May 2019 and Dec 2018, average nominal annual earnings growth



Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 ([link](#)).

Comparison to OBR UK forecasts

- 2.75 This section compares our economic forecasts for Scotland with the OBR's forecasts for the UK.
- 2.76 We are forecasting a weaker economic outlook for Scotland compared to the OBR's forecast for the UK. This is primarily because of slower growth in population and productivity in Scotland than in the UK.
- 2.77 Table 2.9 summarises the forecasts for Scotland and the UK by the Commission and the OBR respectively for five of the main economic determinants: GDP growth, GDP per person growth, employment growth, real hourly wage growth and average nominal annual earnings growth.

Table 2.9: Comparison between SFC May 2019 Scotland with OBR March 2019 UK economy forecasts, per cent growth rates unless otherwise stated

		2018	2019	2020	2021	2022	2023	2024
GDP	OBR Mar-2019	1.4	1.2	1.4	1.6	1.6	1.6	
	SFC May-2019	1.3	0.8	0.9	1.1	1.2	1.3	1.3
GDP per person	OBR Mar-2019	0.8	0.6	0.9	1.1	1.1	1.1	
	SFC May-2019	0.9	0.5	0.6	0.9	1.0	1.0	1.1
Employment	OBR Mar-2019	1.2	0.4	0.5	0.5	0.4	0.3	
	SFC May-2019	0.3	0.3	0.1	0.2	0.1	0.1	0.1
Real hourly wages [1]	OBR Mar-2019	1.1	1.0	1.0	1.1	1.1	1.2	
	SFC May-2019	0.4	0.5	0.8	0.9	1.1	1.3	1.2
Average nominal annual earnings	OBR Mar-2019	3.0	3.1	3.0	3.1	3.1	3.3	
	SFC May-2019	2.6	2.6	2.7	2.9	3.1	3.3	3.2

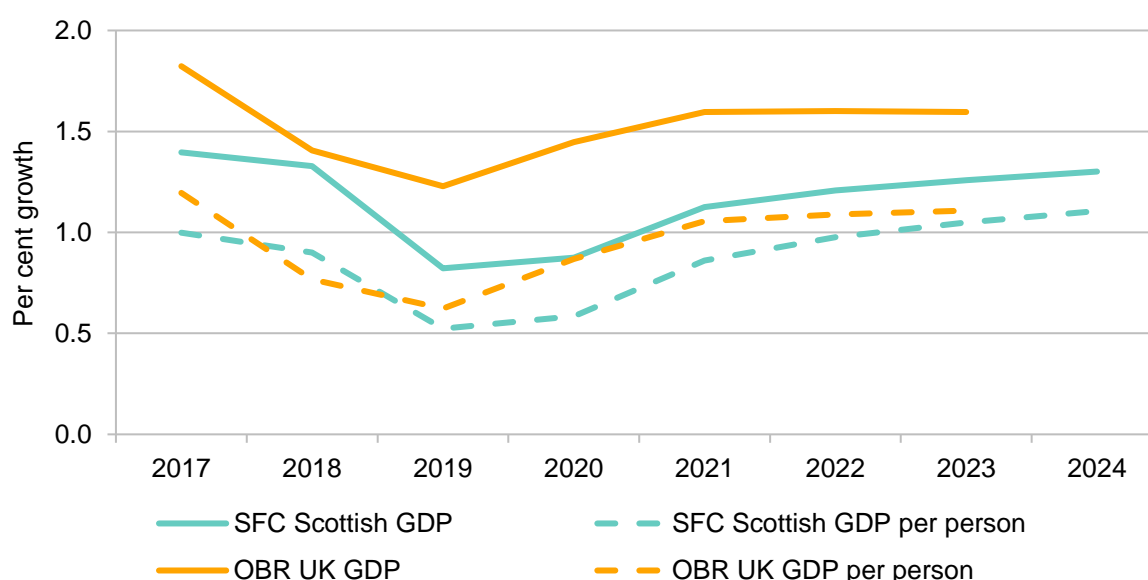
Source: Scottish Fiscal Commission, OBR (2019) Economic and Fiscal Outlook – March 2019 ([link](#)).

Shaded cells refer to outturn available at time of publication.

[1] The OBR does not publish a figure for real hourly wage growth. The figure we provide for “real wages” takes the OBR series for nominal average hourly earnings and deflates this using the Consumer Expenditure Deflator.

2.78 We expect growth in Scottish GDP to be significantly lower than in the UK, primarily because of slower population growth in Scotland. Growth in per person GDP in Scotland is expected to converge with the UK, but will remain lower overall because of slower productivity growth in Scotland. This is shown in Figure 2.15.

Figure 2.15: Forecast comparison, SFC May 2019 Scotland with OBR March 2019 UK, GDP and GDP per person growth

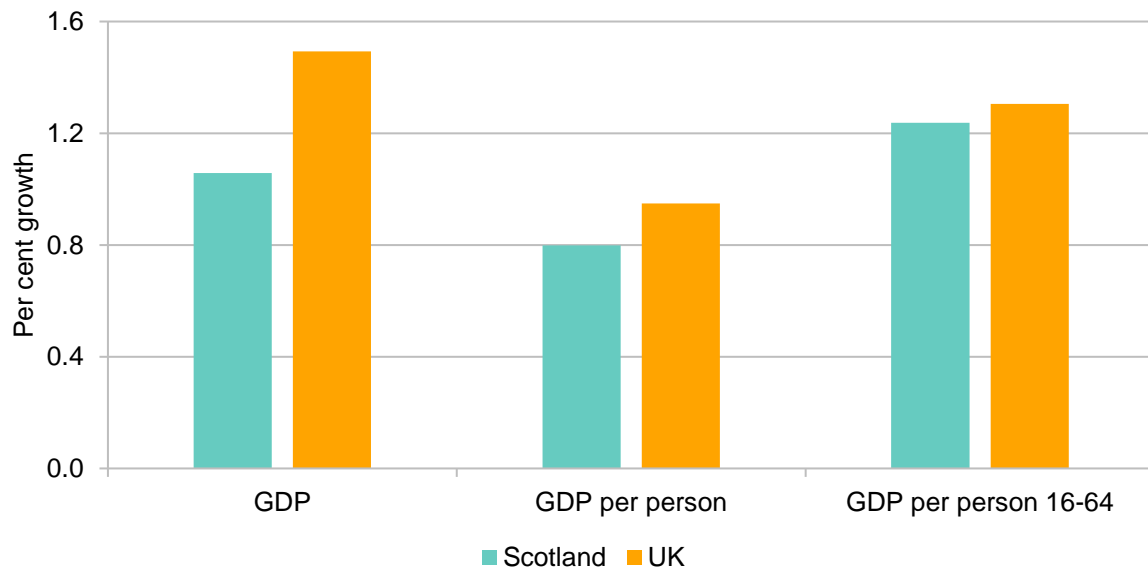


Source: Scottish Fiscal Commission, OBR (2019) Economic and Fiscal Outlook – March 2019 ([link](#)).

2.79 As also shown in Figure 2.16, comparing growth in GDP per person, on average, we still forecast slower growth in Scotland than in the UK, though the

size of the growth gap is significantly reduced. When looking at growth in GDP per person for those aged 16 to 64, our forecasts for Scotland are even closer to the OBR's forecasts for the UK on average.

Figure 2.16: Growth in GDP and GDP per person, Scotland and OBR UK forecasts, average growth rates from 2019 to 2023

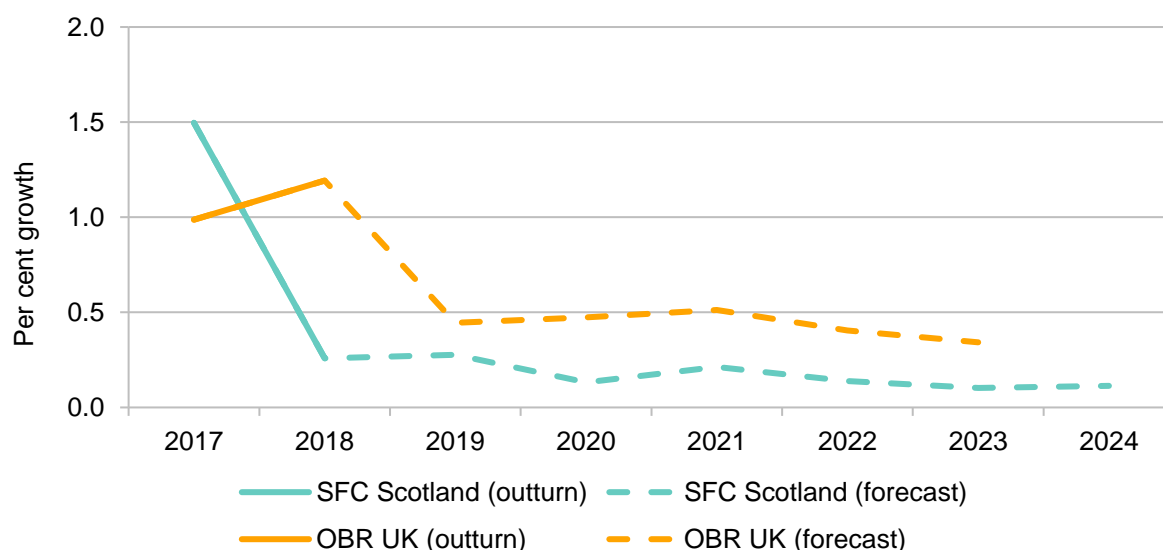


Source: Scottish Fiscal Commission, OBR (2019) Economic and Fiscal Outlook – March 2019 ([link](#)), ONS (2017) 2016-based Population Projections, principal population projections UK ([link](#)).

The OBR does not publish a figure for GDP per person aged 16 to 64. The figure we provide takes the OBR series for real GDP and divides this by the ONS principal projections for 16-64 population.

2.80 As shown in Figure 2.17, the Commission forecasts employment growth in Scotland below the OBR's forecast for the UK. Again, this is mainly because population is forecast to grow faster in the UK.

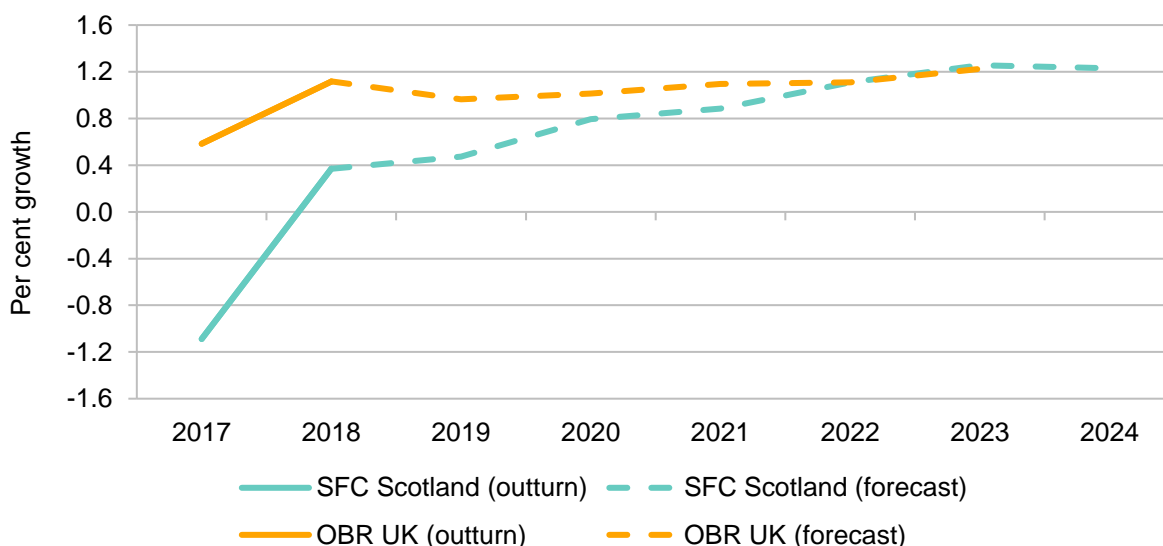
Figure 2.17: Forecast comparison, SFC May 2019 Scotland with OBR March 2019 UK, employment growth



Source: Scottish Fiscal Commission, OBR (2019) Economic and Fiscal Outlook – March 2019 ([link](#)).

2.81 Real wage growth in Scotland was negative or near zero in 2017 and 2018, reflecting weak growth in productivity and nominal wages. It is expected to turn positive in 2019 and be in line with the growth rate in the OBR forecasts of the UK from 2022 onwards. This is shown in Figure 2.18.

Figure 2.18: Forecast comparison, SFC May 2019 Scotland with OBR March 2019 UK, real hourly wage growth



Source: Scottish Fiscal Commission, OBR (2019) Economic and Fiscal Outlook – March 2019 ([link](#)).

The OBR does not publish a figure for real hourly wage growth. The figure we provide for “real wages” takes the OBR series for nominal average hourly earnings and deflates this using the Consumer Expenditure Deflator.

2.82 Forecasts for the UK are an important component in the Commission’s forecasts for Scotland. We will continue to monitor developments in the UK as a whole and reflect on what these mean for the outlook for Scotland.



Chapter 3

Fiscal Overview

Introduction

- 3.1 The Budget is becoming more complex and variable. There are more tax and spending powers being devolved to the Scottish Parliament and they involve significant sums of money. Because the revenue raised from taxes and the amount spent on social security can vary from what we forecast, these elements of the Scottish Budget are uncertain. Adjustments need to be made to account for the differences between the forecasts and the amounts actually raised from tax or spent on social security. Some of these adjustments must be managed in-year while others are spread over time. All these factors expose the Scottish Budget to increasing fiscal risks over time which must be managed using the current powers available.
- 3.2 The Scottish Budget faces two particular fiscal risks next year. The devolution of all remaining social security benefits from April 2020 represents a significant increase in both the size of the Scottish Government's Budget and the potential volatility of future expenditure to which the Budget is exposed. The Scottish Budget next year will include £3.5 billion of spending on devolved social security. In particular the Scottish Government's proposed changes to eligibility for social security payments and the delivery of the benefits introduce significant uncertainty over the future scale of social security spending.
- 3.3 The other new development in 2020-21 is the beginning of the process of income tax reconciliations. When the Scottish Budget is set the income tax component is fixed to our forecast until the actual amount raised (outturn) is available. At this time there is an adjustment to the Scottish Budget to account for differences between the forecasts and outturn data, known as reconciliation. The first ever income tax reconciliation will take place in 2020-21, and our latest forecast suggests a series of large negative reconciliations for income tax in that year and the subsequent two years. These negative reconciliations mean less money for future Scottish Budgets. While the Scottish Government can use borrowing powers and the Scotland Reserve to manage the reconciliations, these will not cover all of the expected

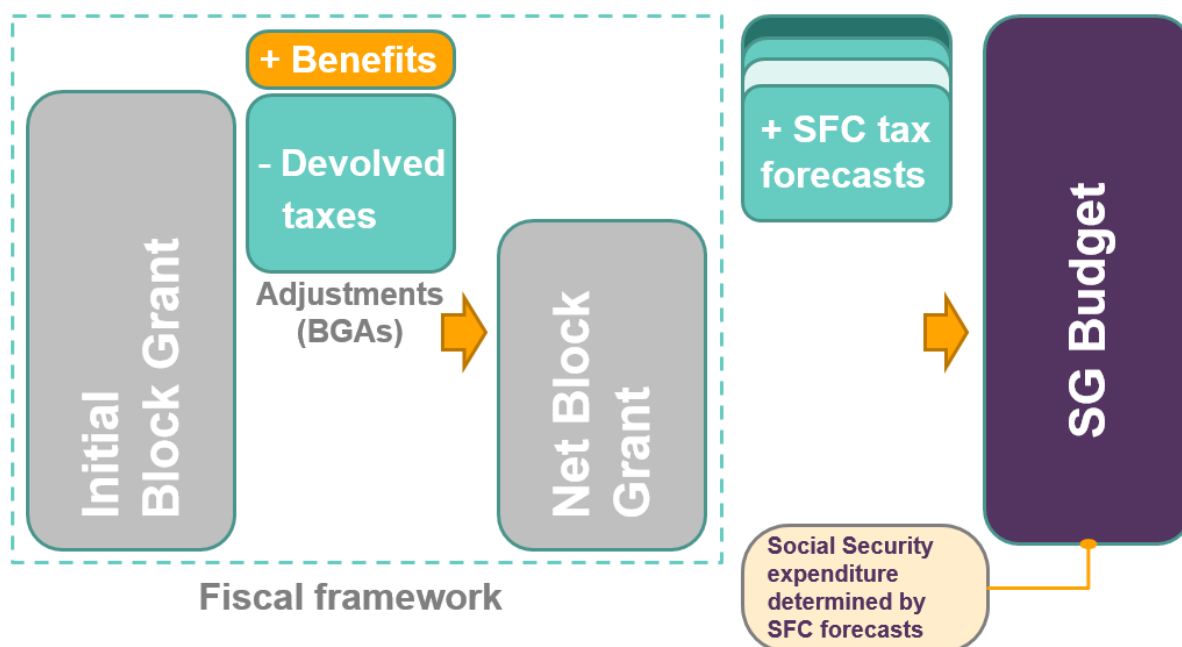
reconciliations. The Scottish Government will need to design and adjust its spending plans to accommodate the expected reconciliations.

- 3.4 This chapter summarises our fiscal forecasts and explains how they fit into the Scottish Budget process along with the Block Grant Adjustments (BGAs). We then consider the reconciliations of forecasts to outturn for both our forecasts of Scottish spending and revenues and the forecasts of the BGAs which will affect future budgets. Finally, we make an assessment of the Scottish Government's borrowing projections.

The Scottish Budget

- 3.5 In Figure 3.1 we present a stylised illustration of how the Scottish Budget is determined. The Scottish Government receives a Block Grant from the UK Government. The initial Block Grant represents the level the Block Grant would have been if there had been no devolution of tax and social security powers to Scotland. It is determined by the UK Government, changing each year to reflect changes to UK Government departmental spending on devolved matters, calculated based on the Barnett formula. For example if health spending in England increases, then the initial Block Grant for Scotland will increase to reflect a Barnett share of that extra spending. This increase is known as a 'consequential'.

Figure 3.1: How is the Scottish Budget determined?



Source: Scottish Fiscal Commission.

- 3.6 The initial Block Grant then needs to be adjusted to account for the devolution of tax and benefit spending powers to Scotland. The UK Government gives additional funding to the Scottish Government for the benefits being devolved and removes funding which is then replaced by revenue from devolved taxes.

These changes to the Block Grant are known as Block Grant Adjustments (BGAs).^{18,19}

- 3.7 The BGAs are based on revenues or spending in Scotland the year before devolution, and then adjusted in line with increases in revenue or spending per head in the rest of the UK.²⁰ The adjustments reflect the hypothetical amount that would have been raised or spent in Scotland if the taxes and benefits had not been devolved.
- 3.8 The UK and Scottish Governments use OBR forecasts of the corresponding UK taxes and benefits and projected population growth in each country to calculate the BGAs.²¹ The arrangements for the BGAs were agreed by the UK and Scottish Governments as part of the fiscal framework accompanying the Scotland Act 2016.²²
- 3.9 The Net Block Grant transferred to the Scottish Government is added to our tax forecasts to determine the funding for the Scottish Budget. This is the amount of money available to the Scottish Government to spend in a year, without considering any borrowing or use of the Scotland Reserve. Our social security forecasts are used to determine how much of the Budget is allocated to social security. The Scottish Government is responsible for allocating the remaining funding to other areas of spending.

Reconciliations

- 3.10 The Scottish Budget is set before the amount raised in tax or spent on social security is known. The Budget is therefore set, in part, based on our forecasts of tax revenues and social security spending in Scotland and the OBR's forecasts for the rest of the UK. Both sets of forecasts will never perfectly match the actual amount spent or raised (the outturn). These errors require reconciliations for the Scottish forecasts and the BGAs.

¹⁸ Non-Domestic Rates (NDR) were devolved before the Scotland Act 2012 and are outwith the fiscal framework. This means there is no Block Grant Adjustment for the equivalent UK Government tax.

¹⁹ Block Grant Additions will be made from 2020-21 onwards for Attendance Allowance, Cold Weather Payments, Disability Living Allowance, Personal Independence Payment, Industrial Injuries Benefits, Severe Disablement Allowance and Winter Fuel Payments. A Block Grant Addition has been applied for Carer's Allowance since 2018-19. Smaller benefits have additions to the Block Grant indexed using the Barnett formula and therefore won't have BGAs; these are Best Start Grant, Funeral Support Payment, Employability Services and Discretionary Housing Payments.

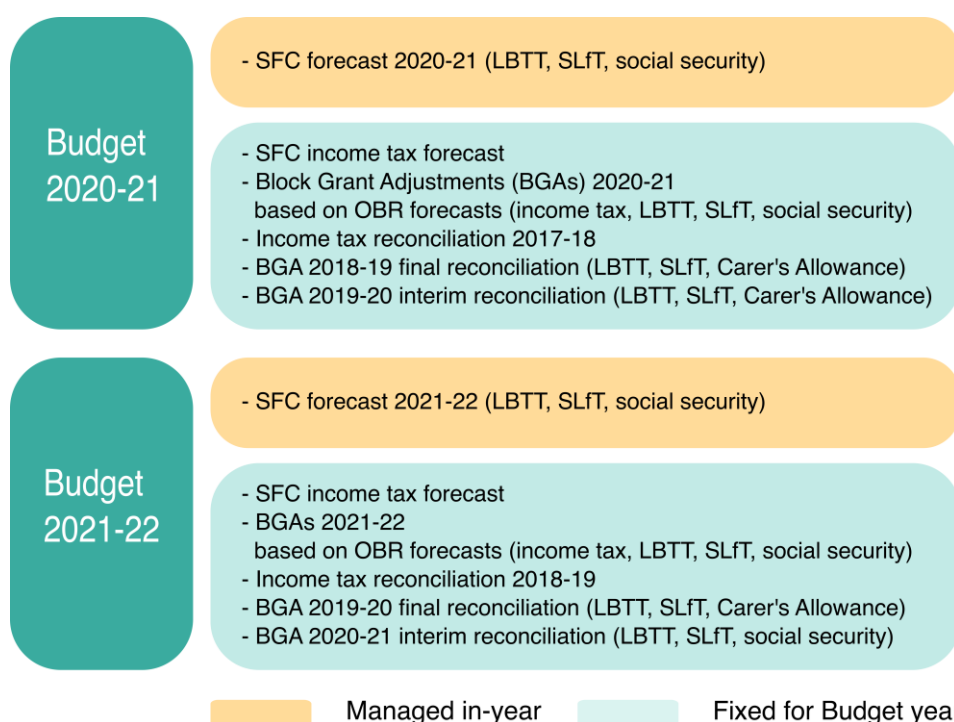
²⁰ The relevant parts of the UK accounted for in UK Government revenues and spending depends on the state of devolution. For example Stamp Duty Land Tax has been devolved to both Scotland and Wales therefore the BGA is calculated based on revenues in England and Northern Ireland. Social security is devolved to Northern Ireland so the BGAs are calculated based on spending in England and Wales.

²¹ The BGAs are not based on the OBR's forecasts of Scottish taxes or benefits, which are separately produced as part of their work to forecast UK-wide public finances.

²² The agreement between the Scottish Government and the United Kingdom government on the Scottish Government's fiscal framework ([link](#))

- 3.11 Social security spending is harder to control than other areas of spending. Spending will be determined by the number of eligible people who apply for the benefit, all of whom must be paid. The Scottish Government will have to meet this expenditure as it arises, even if it differs from the forecast used to set the budget initially.
- 3.12 Our social security forecasts are used to allocate funding to social security as part of the budget process. Any differences between the amount spent and our forecasts must be managed by the Scottish Government within-year. Similarly Land and Buildings Transaction Tax (LBTT) and Scottish Landfill Tax (SLfT) are collected by Revenue Scotland throughout the year and transferred to the Scottish Government. Our forecasts of fully devolved tax revenues are used to set the Budget and any shortfall or surplus must be managed by the Scottish Government within the financial year.
- 3.13 The process for managing Scottish income tax revenues (and in the future, assigned VAT) is different. The forecast of Scottish income tax revenues that we produce for the Scottish Budget determines the amount given to the Scottish Government by the UK Government at the start of the financial year. No adjustments are made until the final outturn data are available, expected around 16 months after the end of the financial year. A reconciliation of the differences between the forecast and outturn will then be applied to the following year's Budget. For example, the outturn data for 2017-18 will be known this summer, and a reconciliation will be applied to the Scottish Budget for 2020-21, three and a half years after the initial forecast was made.
- 3.14 The BGAs are also based on forecasts and must be reconciled once outturn data are available. Typically this is in the summer after the end of the relevant financial year, with the reconciliation applied to the next year's Budget. For the fully devolved taxes and social security there is an interim reconciliation based on updated BGAs from the OBR's forecasts at the UK Autumn Budget. For income tax a single combined reconciliation takes place covering both Scottish revenues and the income tax BGA at the same time.
- 3.15 All this means that, in future years, there are an increasing number of moving parts in the Budget. The Scottish Budget will need to manage in-year any variation in social security spending and fully devolved tax revenues, as well as reconciliations from previous years. Figure 3.2 summarises how Budgets 2020-21 and 2021-22 will be affected by the different forecasts and reconciliations.

Figure 3.2: Forecasts and reconciliations in future budgets



Managed in-year Fixed for Budget year

Source: Scottish

Fiscal Commission.

VAT assignment and reconciliations

- 3.16** VAT assignment is estimated using a methodology that relies heavily on the Living Costs and Foods Survey (LCFS). As with all surveys it is based on a sample and will include some sampling error.²³ This sampling error will introduce some random variation in VAT assignment estimates from year-to-year of an unknown scale and direction.
- 3.17** For both income tax and VAT, over time the Scottish Budget will have to be reconciled for any differences between our forecasts, the BGAs and the eventual outturn estimates. For income tax, reconciliation will be based on full administrative outturn data, and will be driven by, among other things, the performance of the Scottish economy.
- 3.18** The VAT reconciliation will be based on VAT assignment estimates. Differences between our VAT assignment forecasts and VAT assignment estimates could be because the Scottish economy performed differently to what we expected, or it could be because of unobserved random variation generated by the LCFS sample, or any other changes in the VAT assignment model. This would expose the Scottish Budget to an additional sampling error

²³ In statistics, sampling error is the error caused by observing a sample instead of the whole population. The sampling error is the difference between what the sample says about the population and the actual but unknown value.

risk which does not apply for any other taxes or benefits where the actual amount raised or spent is eventually known.

- 3.19 It is difficult to fully understand the sampling error issue when there is limited published information on VAT assignment estimates. We think further data, analysis and discussion is needed to fully understand the risks to the Scottish Budget of VAT assignment and to consider mechanisms for handling sampling error risks.

Borrowing and managing volatility

- 3.20 The calculation of the Scottish Budget has changed significantly since 2015 when the first taxes were devolved and more of the budget is now variable. We are still in the early stages of the operation of the fiscal framework and the Scottish Government's increased fiscal powers. When the Scottish Budget for 2020-21 is set later this year it will be the first time that any reconciliations for income tax have been applied to the Scottish Budget.
- 3.21 Over the coming years, for the reasons outlined above, there will be a greater number of reconciliations applied to each Scottish Budget. These reconciliations create volatility and uncertainty that the Scottish Government has to consider in formulating its spending and borrowing plans for future years. The fiscal framework provides the Scottish Government with two tools to manage this volatility. Firstly, resource borrowing powers allow the Scottish Government to borrow to manage forecast errors. Secondly, the Scotland Reserve is used to manage any savings or surplus fully devolved tax revenues from one year's budget which can be drawn down in future years. The Scottish Government can also plan its spending to manage this volatility, for example reducing spending in years with large negative reconciliations.

Box 3.1: Forecast errors and reconciliations

Forecasting is an inexact science, and there will always be some difference between forecasts and final outturn data, known as forecast error. This is only our fourth set of forecasts produced within a two year period so we have limited outturn data on which to base a judgement of the likely level of forecast error that will give rise to budget reconciliations. The OBR's historic forecast error may be a better benchmark for understanding the likely scale of future forecast errors and reconciliations.

Our December 2018 publication presented analysis based on OBR data suggesting that we might expect an average absolute error in our one year-ahead tax forecasts of around 3.3 per cent, around £530 million in the Scottish context.

In the long run we expect both positive and negative errors, with average forecast errors being zero. Historic UK forecast data suggest that there can be a strong

degree of persistence in forecast errors from one forecast to the next: large positive forecast errors in one year are likely to be followed by a large positive forecast error in the next, and vice versa for negative forecast errors.

As an example, in its December 2013 forecasts the OBR overestimated UK income tax revenues in the year ahead by 2.2 per cent. The OBR continued to overestimate income tax revenues in the year ahead by between 0.9 per cent and 5.6 per cent in its next six forecasts.

The reconciliations for income tax depend on our forecast errors and those of the OBR. The income tax forecast errors will not necessarily always be in the same direction and therefore may not cancel each other out. The persistence seen in the OBR's income tax forecast errors is likely to mean that reconciliations from one year to the next could be of a similar size and direction. That is, a large negative reconciliation in one year is likely to be followed by negative reconciliations over the next few years.

We may already be seeing this in the estimated reconciliations we have for income tax for 2017-18, 2018-19 and 2019-20. We now expect there to be negative reconciliations for three consecutive years. This should not be unexpected, and we may see extended periods of positive reconciliations in the future.

We have also looked at how errors in the forecast on one source of tax revenue relate to those of another tax. Taking income tax and VAT as an example, we might expect similar forecast errors, given that both will be driven to some extent by the economy and in particular by household income and spending. Surprisingly, historic OBR income tax and VAT forecasting errors appear largely independent of each other. This may be because of the large number of non-economic factors that affect these taxes.

Fiscal Forecasts

Tax forecasts

- 3.22** In total we are forecasting £15.9 billion of the Scottish Budget will be raised by tax in 2020-21. These tax revenues reflect the expansion in tax powers over the last four years, with Land and Buildings Transaction Tax (LBTT) and Scottish Landfill Tax (SLfT) devolved from April 2015 and non-savings non-dividend income tax devolved from April 2017. Non-Domestic Rates has been devolved to the Scottish Parliament since its creation.

Table 3.1: Summary of tax forecasts informing the Scottish Budget

£ million	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Income tax (NSND)	11,005	11,486	11,703	12,332	12,831	13,374	13,985	14,613
Non-Domestic Rates	2,762	2,885	2,803	2,853	3,090	3,301	3,338	3,318
Land & Buildings Transaction Tax	557	553	616	655	691	724	759	794
<i>Residential</i>	258	262	279	310	336	359	382	405
<i>ADS</i>	95	98	126	127	131	134	138	141
<i>Non-Residential</i>	204	193	211	218	224	231	239	248
Scottish Landfill Tax	148	143	109	87	12	14	15	15
Total	14,473	15,067	15,232	15,928	16,624	17,413	18,096	18,739

Source: Scottish Fiscal Commission, Revenue Scotland (2018) Annual Report and Financial Statements 2017-18 ([link](#)), Scottish Government NDRi returns.

Figures may not sum because of rounding. Shaded cells refer to outturn available at time of publication. Figure for income tax is forecast not outturn data, data for 2017-18 will be available in summer 2019. Further detail can be found in the income tax section.

3.23 The assignment of a proportion of VAT revenues is expected to begin in April 2020 and would mean £5.9 billion in revenues assigned to the Scottish Budget, with a corresponding BGA reducing the Scottish Budget accordingly in 2020-21. We produce illustrative forecasts of assigned VAT and the Scottish share of Air Passenger Duty, shown in Table 3.2.

Table 3.2: Summary of illustrative tax forecasts

£ million	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Assigned VAT	5,361	5,514	5,707	5,879	6,043	6,205	6,369	6,571
Scottish share of Air Passenger Duty	275	286	295	307	320	336	352	369
Total illustrative tax	5,635	5,800	6,002	6,186	6,363	6,541	6,721	6,941

Source: Scottish Fiscal Commission.

Social security forecasts

3.24 Social security accounts for an increasing proportion of the Scottish Budget. From April 2020 the Scottish Government will become responsible for the payments for all the benefits being devolved. In 2020-21 we estimate £3.5 billion will be spent by the Scottish Government on social security, and this does not include additional expenditure for policy changes that may be introduced. This forecast expenditure should be compared with the £447 million forecast to be spent on social security in 2019-20.²⁴

3.25 The Scottish Government already has responsibility for several social security benefits and has committed to launching several new benefits in 2019. The

²⁴ As shown in Table 3.3, £447 million is the forecast spend on the Scottish Government's social security portfolio. It does not include spending on Healthy Start Vouchers/Best Start Foods or the employability services.

expenditure for these benefits was in the Scottish Government's 2019-20 budget and we produced forecasts for these benefits in our December 2018 publication.²⁵

- 3.26 The Scottish Government launched the Best Start Grant Pregnancy and Baby Payment in December 2018. Take-up of the benefit and resultant spending has been much higher than our initial forecast produced in September 2018. This higher take-up was, in part, a result of the Scottish Government's early promotion of the benefit through social media. These communications encouraged parents to claim the new benefit; including those whose child had been born before the launch. The Pregnancy and Baby Payment received 4,000 applications on the first day it was introduced,²⁶ compared to a forecast of 4,000 payments in the whole of 2018-19.²⁷ There have been 9,770 awards made up to the end of February 2019.²⁸ In our September Forecast Evaluation Report we will compare the final amount spent in 2018-19 to our forecasts.
- 3.27 Based on the evidence we have seen from the introduction of the Pregnancy and Baby Payment we have revised up our forecast of spending on the Best Start Grant in 2019-20 by £8 million to £21 million, a 67 per cent increase. This is discussed in more detail in Chapter 5.

²⁵ Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 ([link](#))

²⁶ Scottish Government (December 2018) New baby benefit makes first payments ([link](#))

²⁷ Scottish Fiscal Commission (September 2018) Social Security – Best Start Grant (Pregnancy and Baby Grant) – September 2018 ([link](#))

²⁸ Scottish Government (2019) Best Start Grant: high level statistics to 28 February 2019 ([link](#))

Table 3.3: Summary of social security forecasts informing the Scottish Budget

£ million	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Carer's Allowance	152	286	304	325	351	371	393
Carer's Allowance Supplement	34	37	40	42	45	48	51
Discretionary Housing Payments	62	64	66	68	69	71	73
Best Start Grant	4	21	16	16	17	17	18
Funeral Support Payment		6	7	7	7	8	8
Scottish Welfare Fund	33	33	33	33	33	33	33
Scottish Government social security portfolio – total expenditure	285	447	466	491	522	548	575
Healthy Start Vouchers / Best Start Foods		5	6	4	4	4	4
Employability Services	19	16	24	23	13	1	0
Total benefit expenditure	304	467	495	518	539	553	578

Source: Scottish Fiscal Commission.

Figures may not sum because of rounding.

3.28 Responsibility for the remaining benefits to be devolved will transfer to the Scottish Parliament by April 2020 at the latest. This means that the Scottish Budget for 2020-21 will include spending for all benefits being devolved.

3.29 The Scottish Government has announced plans to change some of these benefits over the next few years once Social Security Scotland becomes responsible for administering the benefits. As there is not yet sufficient detail available, our forecasts do not include the effect of any of these changes and are therefore likely to underestimate expenditure. Our next forecasts at the time of the Scottish Budget 2020-21 will include policy costings for any changes if sufficient information is available for us to cost them.

Table 3.4: Summary of illustrative social security forecasts

£ million	2020-21	2021-22	2022-23	2023-24	2024-25
Attendance Allowance	530	545	563	584	605
Cold Weather Payments	16	16	16	16	16
Disability Living Allowance	628	591	556	522	499
Industrial Injuries Benefit	82	82	82	82	82
Personal Independence Payment	1,607	1,757	1,914	2,068	2,250
Severe Disablement Allowance	8	7	7	6	6
Winter Fuel Payment	168	170	173	176	180
Total	3,039	3,169	3,310	3,455	3,638

Source: Scottish Fiscal Commission.

Figures may not sum because of rounding.

Table 3.5: Illustrative social security forecasts – number of people expected to receive support

Thousands	2020-21	2021-22	2022-23	2023-24	2024-25
Attendance Allowance	129	129	131	133	135
Cold Weather Payments	649	649	649	649	649
Disability Living Allowance	131	125	109	104	98
Industrial Injuries Benefit	28	27	27	26	26
Personal Independence Payment	267	291	312	332	357
Winter Fuel Payment	963	975	992	1,011	1,031

Source: Scottish Fiscal Commission.

Severe Disablement Allowance is not included within this table as the number of people expected to receive support is below the materiality threshold. Cold Weather Payments is included as number of payments made not number of people.

Fiscal risks of expanding social security responsibilities

3.30 The devolution of social security spending from April next year represents a significant shift in the Scottish Budget, accounting for £3.5 billion in 2020-21. The Scottish Government will become responsible for more social security benefits, some of which will initially be administered by the Department for Work and Pensions (DWP) on the Scottish Government's behalf. The Scottish Government's plans for when Social Security Scotland will accept new claims for each of the benefits are shown in Figure 3.3. The timescales for when existing recipients will transfer to Social Security Scotland is longer and not expected to complete until 2024.

Figure 3.3: Timescales for new claims to Social Security Scotland



Source: Scottish Government (2019) Delivery of devolved Social Security benefits: Stakeholder Toolkit ([link](#))

[1] Winter Heating Assistance for severely disabled children will be introduced as part of Disability Assistance, by the end of 2020.

3.31 These are new areas of responsibility in Scotland and the Scottish Government is proposing major changes to both the benefits themselves and the way the benefits are delivered. It will therefore be a challenge for us to accurately forecast what will be spent in Scotland. The OBR's Welfare Trends report published in January highlighted the difficulties of forecasting changes to disability benefits.²⁹ We are involved in regular discussions with the OBR and will be learning from their experiences. But it is also realistic to expect that forecasts of the cost of policy change will be subject to a higher degree of uncertainty than forecasts where policies are unchanged.

²⁹ OBR (2019) Welfare Trends Report – January 2019 ([link](#))

- 3.32 Part of this uncertainty comes from the operational changes being made and it will be important for us to consider the operational readiness of Social Security Scotland to deliver the benefits. Delays in handing over administrative responsibilities to Social Security Scotland or implementing policy changes are likely to directly affect the amount of money paid out in benefits, and, if these are not considered in our forecasts, may affect the accuracy of our forecasts.
- 3.33 The Scottish Government will need to ensure they can meet the additional costs of any policy commitments. The funding received through the BGAs is based on spending in Scotland in the year before devolution, then grown by increases in spending per head in England and Wales. Any policy change introduced by the Scottish Government which results in additional spending, such as campaigns to increase take-up of benefits, has to be met from within the existing Scottish Government budget, as there will be no additional funding received from the UK Government.

Reconciliations

Fully devolved taxes and benefits

- 3.34 The fully devolved taxes are the two taxes collected by Revenue Scotland, Land and Buildings Transaction Tax (LBTT) and Scottish Landfill Tax (SLfT). Devolved benefits covers all spending by Social Security Scotland including the benefits administered by DWP on behalf of the Scottish Government. Any differences between the amount collected or spent and our forecasts must be managed in-year by the Scottish Government.
- 3.35 The funding received from the UK Government for social security spending, and the amount deducted from the Block Grant for the fully devolved taxes, the Block Grant Adjustments (BGAs), are initially based on forecasts and then updated twice. An interim reconciliation follows the UK Autumn Budget, based on updated OBR forecasts and applied to the follow year's Budget. A final reconciliation occurs once the UK Government's outturn data are available in the summer after the end of the financial year.
- 3.36 As shown in Table 3.6, the interim BGA reconciliation for 2017-18 was a £31 million deduction from the Scottish Government's Block Grant for Budget 2018-19. This deduction occurred because the LBTT BGA had increased (more tax was expected to be raised in the rest of the UK than originally forecast). The final BGA reconciliation for 2017-18 resulted in the Scottish Government receiving £2 million less in its Block Grant for Budget 2019-20.

Table 3.6: LBTT and SLfT forecast and outturn BGAs for 2017-18 (£ million)

BGA 2017-18		LBTT	SLfT	Total
Forecast BGA	At Budget 2017-18 (Dec-16)	545	119	
Updated BGA	At Budget 2018-19 (Dec-17)	591	104	
<i>Interim reconciliation</i>	<i>Applied to Block Grant for Budget 2018-19</i>	-46	15	-31
Outturn BGA		584	113	
<i>Final reconciliation</i>	<i>Applied to Block Grant for Budget 2019-20</i>	+7	-9	-2

Source: Scottish Fiscal Commission, Scottish Government, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 ([link](#)), Scottish Government (2018) Fiscal Framework Outturn Report ([link](#)).

Figures may not sum because of rounding.

3.37 For the 2018-19 LBTT and SLfT BGAs, the interim BGA reconciliations applied to the Scottish Budget were £54 million for LBTT and minus £9 million for SLfT. This means that £45 million was added to the Block Grant for Budget 2019-20 – at the same time as the £2 million deduction for the 2017-18 reconciliations. The final BGA reconciliations will be known this summer 2019 and will be applied to the Block Grant for Budget 2020-21, as shown in Figure 3.2.

3.38 The latest forecasts of the BGAs shown in Table 3.7 are based on the OBR's March forecasts and have no immediate effect on the Scottish Budget, but they give an indication of the likely scale of future reconciliations. The increase in the BGAs for Scottish Landfill Tax is because the introduction of the Scottish Government's landfill ban for biodegradable municipal waste from January 2021 is expected to result in waste being landfilled in England rather than Scotland, thus increasing English landfill tax revenues.³⁰

Table 3.7: Latest block grant adjustment forecasts

£ million	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
LBTT							
Latest forecast of BGA	584	547	535	568	611	651	705
Change since December	0	1	-32	-28	-22	-16	-17
SLfT							
Latest forecast of BGA	113	105	92	86	92	84	72
Change since December	0	1	1	4	11	11	10

Source: Scottish Government.

Shaded cells refer to outturn available at time of publication.

3.39 The first social security BGA was added to the Scottish Budget in 2018-19 for Carer's Allowance, the benefit having been devolved part-way through 2018-19. In the summer the final BGA figure will be known and a final reconciliation

³⁰ OBR (2019) Devolved tax and spending forecasts ([link](#)).

applied to the Budget 2020-21. Since December 2018, the Carer's Allowance BGA forecast has been reduced by £3 million for 2019-20. The next reconciliation will be based on the Autumn Budget 2019 forecasts and applied to the Budget 2020-21 suggesting a reduction of £3 million to the Block Grant next year.

Table 3.8: Latest Carer's Allowance block grant adjustment forecasts

£ million	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Carer's Allowance						
Latest forecast of BGA	157	287	304	325	355	385
Change since December	0	-3	-3	-3	7	26

Source: Scottish Government

- 3.40** From April 2020 £3 billion of social security spending will be included in the Scottish Budget with associated BGAs. The process of forecasting spending and BGAs and then reconciling these figures will affect the budget in all future years.

Income tax

- 3.41** There is a single reconciliation for income tax which occurs once the final outturn data are available for both Scottish income tax revenues and the BGA. The first income tax reconciliation will be applied to the Scottish Budget 2020-21 for income tax revenues in 2017-18.
- 3.42** The latest estimates of the income tax reconciliations are shown in Table 3.9. These have no immediate effect on the Budget but signal that when the reconciliations occur they are likely to reduce the size of the Net Block Grant. The latest estimates are that the reconciliations would result in the Scottish Government receiving £229 million less in its Block Grant for 2020-21, £608 million less in its Block Grant for 2021-22, and £188 million less in its Block Grant for 2022-23.
- 3.43** The final scale of the reconciliations for 2017-18 and 2018-19 will be known when outturn data become available in summer 2019 and summer 2020, respectively, and applied to the following year's budget. The reconciliation for 2019-20 will not be available until summer 2021 and will affect the 2022-23 Budget.

Table 3.9: Latest income tax forecasts compared with the forecasts used in the 2017-18, 2018-19 and 2019-20 Budget

£ million	Revenue	BGA	Difference	Forecast reconciliation
2017-18 Budget				
Forecasts used in Budget	11,857	11,750	107	
Latest forecast of outturn	11,005	11,127	-122	-229
Change	-852	-623		
2018-19 Budget				
Forecast used in Budget	12,177	11,749	428	
Latest forecast of outturn	11,486	11,665	-179	-608
Change	-692	-84		
2019-20 Budget				
Forecast used in Budget	11,684	11,501	182	
Latest forecast of outturn	11,703	11,709	-5	-188
Change	20	208		

Source: Scottish Fiscal Commission, Scottish Government, Scottish Government (2017) Draft Budget 2017-18: Updated Income Tax Policy Forecasts ([link](#)), Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts Supplementary Publication Updated Income Tax Forecasts ([link](#)), Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 ([link](#)).

Figures may not sum because of rounding.

3.44 The difference between the BGA and revenue shown in Table 3.9 determines the net funding the Scottish Government received when the Budget was set. The final difference once outturn data are available will show the net amount the Government should have received. Comparing the latest estimate of the difference to the position at the time of the relevant Budget gives a forecast of the size of the reconciliation.

3.45 For the 2017-18 and 2018-19 budgets, both our revenue forecasts and the BGA have been revised down. This was because of new income tax outturn data for 2016-17 published in summer 2018, that showed income tax revenue in Scotland was around £550 million lower than we had previously estimated. As 2016-17 was the initial deduction year for income tax, the new data affected both our revenue forecast and the BGA. Overall, our revenue forecasts have been revised down by more than the BGA for these years, and so negative reconciliations are expected. These mean the Scottish Government will receive £229 million less in 2020-21, £608 million less in 2021-22, and £188 million less in 2022-23.

3.46 For the 2019-20 budget, since publication in December 2018 both our revenue forecast and the forecast of the BGAs for income tax have increased in line with some positive economic data for both Scotland and the UK. However, the BGA has been revised up by substantially more driven in part by stronger than expected outturn data for UK income tax revenues. Table 3.10

shows the changes in our income tax forecast and the BGA since December 2018.

Table 3.10: Latest income tax block grant adjustment forecasts compared to December 2018

£ million	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Income Tax							
Latest forecast of BGA	11,127	11,665	11,709	12,380	12,825	13,300	13,805
Change since December 2018	82	170	208	291	347	346	312
Latest forecast of outturn	11,005	11,486	11,703	12,332	12,831	13,374	13,985
Change since December 2018	-3	34	20	47	84	132	180

Source: Scottish Fiscal Commission, Scottish Government.

3.47 In 2019-20, the £208 million upward revision to the BGA compared to the £20 million upward revision in our forecast leads to an expected negative reconciliation of £188 million.³¹

Borrowing

3.48 The Commission is required to assess the reasonableness of the Scottish Government's projections of its borrowing.

3.49 We fulfil this role by assessing any borrowing which Ministers can project in advance. We are not currently forecasting a Scotland-specific economic shock that would allow the Scottish Government increased borrowing powers.

3.50 Our assessment of reasonableness considers the level of borrowing relative to the statutory caps set out in the Scotland Act 2016 and the associated fiscal framework.

3.51 Where appropriate, we also consider how broader fiscal factors may affect the resources available to the Scottish Government.³² This includes our assessment of the likely scale of reconciliations to be applied to the Scottish Budget.

³¹ The reconciliations for 2017-18 and 2018-19 cannot be calculated from Table 3.10 as the latest forecasts must be compared to the BGA forecasts from the relevant budget year. These comparisons are available in Table 3.9.

³² Fiscal factors are defined in the Scottish Fiscal Commission Act 2016 ([link](#)) as: "anything which the Scottish Ministers use to ascertain the amount of resources likely to be available for the purposes of sections 1 to 3 of the Public Finance and Accountability (Scotland) Act 2000" ([link](#))

Resource Borrowing

- 3.52 The Scottish Government has the power to borrow for resource spending up to an overall limit of £1.75 billion for the following reasons: ^{33,34}
- Forecast error in relation to devolved and assigned taxes and devolved social security expenditure arising from forecasts of Scottish revenues/expenditure and corresponding UK forecasts for the Block Grant Adjustments with an annual limit of £300 million.
 - Any observed or forecast shortfall in devolved or assigned tax revenues or devolved social security expenditure incurred where there is, or is forecast to be, a Scotland-specific economic shock. In this scenario the annual limit increases to £600 million.
- 3.53 Resource borrowing is funded from the National Loans Fund (NLF) and Scottish Ministers can decide on a repayment period of between three and five years.
- 3.54 The Scottish Government has confirmed it has not used resource borrowing powers to date and that there are no plans for resource borrowing in 2019-20.
- 3.55 We are not forecasting an economic shock to allow access to the additional resource borrowing.

Scotland Reserve

- 3.56 The Scotland Reserve came into effect in 2017-18 and replaced both the Scotland Act 2012 cash reserve and the Budget Exchange Mechanism. Our May 2018 publication contains more information on the historic use of the Budget Exchange Mechanism. ³⁵
- 3.57 The Scotland Reserve provides the Scottish Government with a cash reserve to build up funds when devolved revenues are higher than forecast and draw down funds when devolved revenues are lower than forecast. It also allows the Scottish Government to carry forward any underspends in both resource and capital budgets.

³³ Scotland Act 2016, Part 2 Borrowing ([link](#))

³⁴ The agreement between the Scottish Government and the United Kingdom government on the Scottish Government's fiscal framework ([link](#)).

³⁵ Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – May 2018 ([link](#))

- 3.58 The Scotland Reserve is comprised of both resource and capital reserves. Financial transactions form part of the capital reserve.³⁶
- 3.59 The current provisions for payments into and drawdowns from the Scotland Reserve are:
- For drawdowns, an annual limit of £250 million for the resource reserve and of £100 million for the capital reserve, both waived in the face of Scotland-specific economic shock.
 - No annual limits for payments into the Reserve.
 - An aggregate cap to the Reserve balance of £700 million.
- 3.60 Table 3.11 summarises the Scottish Government's use of the Reserve during the second year of full operation in 2018-19. These figures, provided by Scottish Government, are the in-year figures reported to the Scottish Parliament in March.³⁷ These will not be updated until the Scottish Government provisional outturn figures are released in June.

Table 3.11: Use of the Scotland Reserve in 2018-19

£ million	Resource	Capital	Financial transactions	Total
2018-19 opening balance	440	87	11	538
2018-19 in-year Reserve drawdown	-250			-250
2018-19 additions to the Reserve	84	13	115	212
2018-19 closing balance	274	100	126	500
Additions to the resource reserve were made up of:				
General	70	13	115	198
Devolved taxes forecast surplus revenues	11			11
Guarantee fee income	2			2

Source: Scottish Government.

Figures may not sum because of rounding. The drawdown from the resource reserve is used to support planned expenditure.

- 3.61 The opening balance of the Reserve at the start of 2018-19 was £538 million.
- 3.62 The Scottish Government estimates that £250 million was to be drawn down from the resource reserve in 2018-19 to support planned resource

³⁶ Financial Transactions are a form of capital budget allocated by HM Treasury to the Scottish Government which can only be used for the provision of loans or equity investment beyond the public sector and cannot be used to fund public services. Financial Transactions facilities have to be repaid to HM Treasury in future years.

³⁷ Scottish Government brief guide to the 2018-19 Spring Budget Revision (SBR) included in Finance and Constitution Committee meeting papers for Wednesday 13 March 2019. Page 54 and 55 ([link](#))

expenditure. This is in line with the figure provided by the Scottish Government and reported in December 2018.

- 3.63 In December 2018, we also reported the Scottish Government estimated £85 million was to be drawn down from the capital reserve in 2018-19. Based on the latest information, no drawdown was made from the capital reserve in 2018-19.
- 3.64 The Scottish Government's latest in-year estimates are that £212 million will be paid into the Reserve in 2018-19 and the closing balance of the Reserve is forecast to be £500 million.
- 3.65 The Scottish Government has provided the following information on its planned use of the Reserve in 2019-20:
- £128 million will be drawn down in resource, £24 million in capital and £48 million in financial transactions. The resource and capital estimates are both revised down from the Scottish Government's previous figures, provided in December 2018, of £220 million for resource and £46 million for capital. The total planned drawdown from the capital reserve, including financial transactions, is now £72 million.³⁸
 - These drawdown estimates have changed because the 2019-20 resource and capital spending plans are now expected to be funded in part from other sources, for example, additional budget consequentials deferred from 2018-19 as well as by drawing down from the Reserve.
- 3.66 For our assessment of the Scotland Reserve we note:
- The Reserve balance is expected to fall from £538 million at the start of 2018-19 to £500 million at the start of 2019-20. The balance on the capital reserve has increased by £128 million (including financial transactions) and the balance on the resource reserve has fallen by £166 million.
 - The Government has revised down its planned drawdowns for 2019-20. Current drawdown estimates, of £128 million from the resource reserve and £72 million from the capital reserve, remain under the annual limits set out in the fiscal framework.
- 3.67 The Scottish Government estimate the balance of the Scotland Reserve will be £300 million at the end of 2019-20, plus any underspends which are carried forward. Of this only £146 million could be drawn down in 2020-21 for resource spending, and this is not sufficient to manage the £229 million income tax reconciliation in 2020-21. Unless additional underspends are paid into the reserve, this would not provide the Scottish Government with any

³⁸ Financial transactions count towards the capital drawdown limit.

funds in the reserve for the following year, when the forecast income tax reconciliation is much larger.

- 3.68 The negative income tax reconciliations mean less money will be available for future Scottish Budgets. The Scottish Government could choose to manage some of this through resource borrowing or use of the Scotland Reserve. However, the borrowing powers available to the Scottish Government and the level of funds in the Scotland Reserve combined with rules about withdrawing funds from the Reserve will not cover all of the expected reconciliations. All else equal, this will mean the Scottish Government having to adjust its spending plans or increase taxes, and this should be borne in mind when developing current policy and spending plans.
- 3.69 We will continue to monitor tax and social security reconciliations, and any use of resource borrowing, as more years of outturn data on revenue and spending and BGA forecast differences become available.

Capital Borrowing

- 3.70 Capital borrowing can be funded from the NLF, commercial loans or the issue of bonds.³⁹
- 3.71 The Scottish Government's borrowing powers are:
- Statutory aggregate capital borrowing limit of £3 billion
 - Annual limit of 15 per cent of the overall borrowing cap, equivalent to £450 million a year
- 3.72 The Scottish Government's historic borrowing and borrowing plans, along with repayment schedules and cumulative stock of debt are shown in Table 3.12.

³⁹ Scotland Act 2012, Part 3 Borrowing ([link](#))

Table 3.12: Scottish Government capital borrowing

£ million	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
	Outturn		Planned [1]		Borrowing plans not set			
Borrowing	450	250	450	350				
Agreed repayment period (years) [2]	25	10	25	25				
Interest rate	1.9	0.95	2.5	2.5				
Total repayments for borrowing from 2015-16 to 2020-21								
Principal	20.5	27.6	46.8	65.7	78.1	84.2	85.4	86.5
Interest	0.0	7.7	10.4	20.1	28.5	28.6	27.3	26.2
Debt stock								
Start of year	607	1,036	1,258	1,662	1,946	1,868	1,784	1,698
End of year	1,036	1,258	1,662	1,946	1,868	1,784	1,698	1,612
Percentage (%) of debt cap at end of year [3]	35	42	55	65	62	59	57	54

Source: Scottish Government.

Figures may not sum because of rounding.

[1] Interest rates for these years are based on the Scottish Government's borrowing projections. The Scottish Government believes these interest rates are prudent in comparison to recent rates of around 1.5 per cent.

[2] The term of any loan is normally 10 years, but where the lives of the assets being purchased through the loan justify longer or shorter terms, these can be agreed.

[3] Debt cap is £3 billion.

3.73 At the time of our borrowing assessment in December 2018, the Scottish Government was planning to borrow £450 million in 2018-19 over 25 years. In 2018-19, the Scottish Government only borrowed £250 million. This was drawn down on 21 March 2019, and will be paid back over 10 years which is the standard term of capital loans in the fiscal framework, but shorter than the 25 years agreed for all previous borrowing.

3.74 Capital spending can be difficult to predict and the Scottish Government draws down capital borrowing towards the end of the financial year once the spending levels become apparent. In 2018-19 the Scottish Government planned to borrow the maximum £450 million but the actual borrowing level was £250 million. This illustrates how the actual capital borrowing levels may be lower than projected in future years if capital spending is lower than predicted.

3.75 The following information on the borrowing plans up to 2020-21 has been provided by the Scottish Government:

- The Scottish Government plans to borrow £450 million in 2019-20 and £350 million in 2020-21. These numbers may change as actual capital spending within each financial year becomes apparent.
- The Scottish Government has assumed an annual interest rate of 2.5 per cent for both 2019-20 and 2020-21 in its affordability modelling

- Borrowing in 2019-20 and 2020-21 is expected to be repaid over a 25 year time horizon.

3.76 The Scottish Government has set out principles for capital borrowing beyond 2020-21 in the Medium Term Financial Strategy.⁴⁰ In line with these principles, the Government plan to borrow between £250 million and £450 million a year from 2020-21 onwards but the specific borrowing plans for this period have not yet been set.

3.77 For our borrowing assessment we note:

- The Government borrowed £450 million in 2017-18, the maximum allowed under the fiscal framework rules, and £250 million in 2018-19.
- The Government plans to borrow £450 million in 2019-20 and £350 million 2020-21.
- The Government's projections of capital borrowing comply with the terms set out in the fiscal framework.

3.78 We also note that the Government will have borrowed 65 per cent of the total statutory borrowing cap by the end of 2020-21, four years after the expansion in capital borrowing limits.

3.79 The Scottish Government will be able to continue to borrow the maximum amount per year until it reaches the statutory cap of £3 billion. Beyond this point the annual amount available to borrow will be limited. The exact profile of principal repayments and the amount available for the Scottish Government to borrow will depend on the repayment period and the interest rate offered by the NLF at the point of agreement.⁴¹

3.80 If, from 2021-22 onwards, the Scottish Government borrowed £450 million a year at recent NLF rates repaid over 25 years then the current cap of £3 billion would be reached in 2023-24.⁴² If the Scottish Government borrowed £250 million a year repaid over 10 years then only 80 per cent of the cap would be reached in 2023-24.

⁴⁰ Scottish Government (2019) Medium Term Financial Strategy

⁴¹ Current NLF lending rates from the UK Debt Management Office are updated daily and are available at their website. ([link](#))

⁴² Recent NLF rates assumed in this illustrative example are likely to differ from those available at the time of borrowing. The Scottish Government chose to use higher rates in its affordability modelling.



Chapter 4

Tax

Income Tax

Forecast

Table 4.1: Non-Savings Non-Dividend income tax forecast

£ million	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
	10,719	11,005	11,486	11,703	12,332	12,831	13,374	13,985	14,613

Source: HMRC (2018) Technical note: Scottish income tax ([link](#)), Scottish Fiscal Commission.

Shaded cells refer to outturn available at time of publication.

Background

- 4.1 The Scotland Act 2016 transferred new tax powers to the Scottish Parliament. From 2017-18, the Scottish Parliament took full responsibility for non-savings and non-dividend (NSND) income tax rates and thresholds.
- 4.2 Income tax is partially devolved. The responsibility for defining the income tax base, including setting or changing income tax reliefs and the personal allowance, continues to rest with the UK Government. HMRC remains responsible for the collection and management of Scottish income tax. HMRC is also responsible for deciding who is a Scottish taxpayer as defined in legislation. The Scotland Act 2012 defines a Scottish taxpayer as someone who is a UK taxpayer and has their main place of residence in Scotland.⁴³

Scottish Government policy changes

- 4.3 The Scottish Government has implemented income tax policy changes for 2017-18, 2018-19 and 2019-20. The most significant of these changes were in the Scottish Budget 2018-19, where a new five band income tax policy was introduced. We estimate that by 2020-21, these policies will in total raise an

⁴³ Scotland Act 2012 ([link](#))

additional £370 million. Table 4.2 provides details on the policy changes, and the corresponding revenue expected to be raised.⁴⁴

Table 4.2: Overview of previous income tax policy changes

Tax year	Policy	Additional revenue in 2020-21 (£ million)
2017-18	Freeze the higher rate threshold at £43,000	78
2018-19	New five band income tax system	220
2019-20	Freeze the higher rate threshold at £43,430	72

Source: Scottish Fiscal Commission.

4.4 The tax thresholds and rates for 2019-20 are shown in Table 4.3.

Table 4.3: NSND income tax thresholds for 2019-20

Tax band range	Band name	Tax rate (%)
Over £12,500 - £14,549 [1]	Starter	19
Over £14,549 - £24,944	Basic	20
Over £24,944 - £43,430	Intermediate	21
Over £43,430 - £150,000 [2]	Higher	41
Above £150,000	Top	46

Source: Scottish Fiscal Commission.

[1] Assuming individuals are in receipt of the Standard UK Personal Allowance.

[2] Those earning more than £100,000 will see their Personal Allowance reduced by £1 for every £2 earned over £100,000.

4.5 The Scottish Government has not yet announced its policy intentions for the 2020-21 tax year. Our assumptions about future rates and bands are consistent with our previous forecast. The precise rates and bands we assume can be found in supplementary table S4.2.

Changes since our last forecast

4.6 Income tax outturn data are available up to 2016-17, and so we forecast income tax from 2017-18 onwards. Our approach to creating the income tax forecast was set out in our 'Current Approach to Forecasting' publication.⁴⁵ We provide additional information in our tax supplementary tables on the economic determinants and income tax rates and bands in our forecast. In addition the supplementary tables contain the latest distribution of taxpayers by income and revenue.

⁴⁴ Our forecast is based on when income tax liabilities accrue during each tax year, and not when HMRC receive the cash receipts. For simplicity of language we sometimes refer to liabilities as revenue.

⁴⁵ Scottish Fiscal Commission (2017) Current Approach to Forecasting – September 2017 ([link](#))

4.7 Our NSND income tax forecast has been revised up from 2018-19 onwards based on developments since December, the changes are shown in Table 4.4.

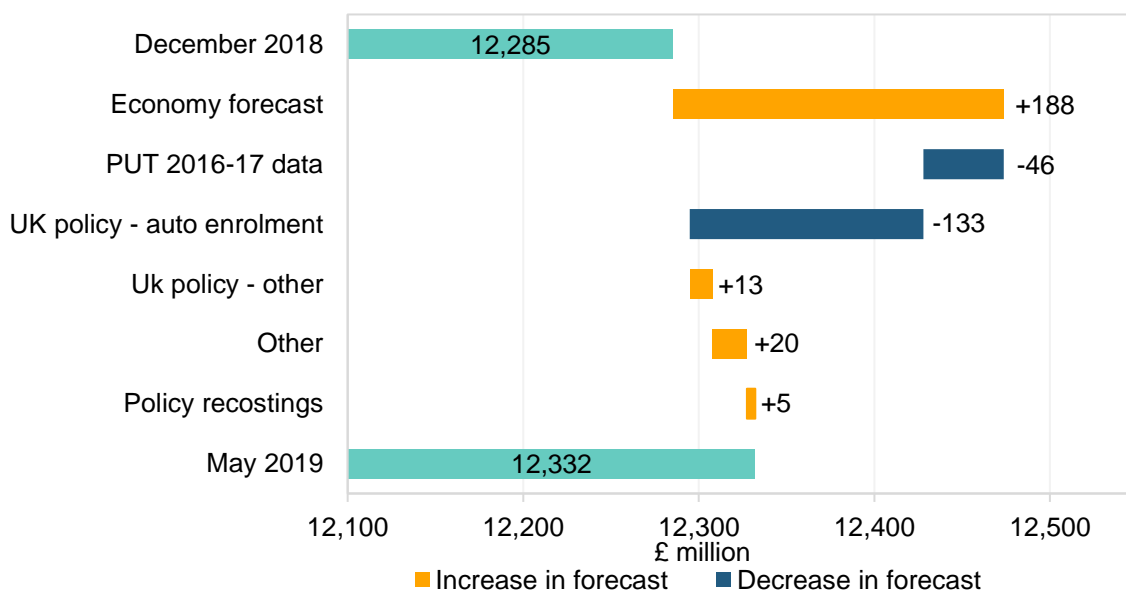
Table 4.4: Changes in NSND income tax forecast since December 2018

£ million	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
December 2018	11,008	11,452	11,684	12,285	12,746	13,242	13,805
Economy earnings	3	118	150	188	225	276	322
Economy employment	2	4	1	1	4	6	7
PUT 2016-17 data	-9	-19	-30	-46	-60	-76	-91
UK policy – auto enrolment	-17	-88	-127	-133	-139	-146	-153
UK policy – other	11	9	10	13	10	11	13
Other	7	10	14	20	41	52	71
Policy recostings	-1	0	2	5	3	9	12
May 2019	11,005	11,486	11,703	12,332	12,831	13,374	13,985
Change from December 2018	-3	34	20	47	84	132	180

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 ([link](#)).

Figures may not sum because of rounding.

Figure 4.1: Changes to 2020-21 NSND income tax forecast since December 2018



Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 ([link](#)).

Figures may not sum because of rounding.

4.8 The increase in the earnings forecast is the main reason our forecast has been revised upwards. This offsets downward movements in our forecast

because of the UK auto enrolment policy adjustment, and the new 2016-17 Public Use Tape (PUT) dataset.⁴⁶ The effect on the forecast is shown in Figure 4.1.

Economy forecast

- 4.9 Chapter 2 discusses revisions to our economy forecast. Two of these are significant for our NSND income tax forecast: the number of people in employment and earnings growth.
- 4.10 The forecast for earnings growth has the largest effect on our forecast. Updates to our forecast of the number of people in employment have a very small effect on our forecast.

PUT data

- 4.11 On 10 April 2019 we received the 2016-17 PUT data from HMRC. Because we align our forecast to the 2016-17 outturn, the new PUT does not significantly change our headline forecast. The new data does change the earnings distribution, which leads to a downward revision to the forecast in all years.
- 4.12 Outturn data for 2017-18 will be published by HMRC in July 2019. In our next forecast we will align the 2016-17 PUT with the 2017-18 outturn. We will also consider how best to use the Real Time Information (RTI) liabilities data. Box 4.1 describes in more detail how we plan to use the data released in the summer.

Box 4.1: New HMRC Scottish income tax publication

HMRC have informed us they intend to publish a separate Scottish income tax outturn document in the summer. The publication will contain:

- The Scottish Non-Savings, Non-Dividend income final outturn figure for 2017-18 (with 2016-17 restated).
- The rUK NSND income final outturn figure for 2017-18 (with 2016-17 restated).
- The number of Scottish taxpayers by marginal tax rate for 2017-18 (with 2016-17 restated).

HMRC also intends for this document to include the RTI estimates of PAYE liabilities for Scotland that HMRC currently provides to the Scottish Fiscal Commission and the Scottish Government on a monthly basis.

⁴⁶ The PUT is an anonymised version of HMRC's Survey of Personal Incomes. More information about the Survey of Personal Incomes can be found in HMRC (2019) Personal incomes statistics ([link](#)).

HMRC has been working closely with us, and colleagues in the OBR and Scottish Government since the publication of the 2016-17 outturn data to develop this document and will continue to do so as it finalises the format and content.

We are continuing to consider how to best use RTI tax liabilities data in our forecast. After HMRC's summer publication, we will have three years of RTI liabilities information available, and two years of outturn. We will then be able to analyse how closely RTI reflects outturn data, which will inform our judgement of how to use RTI in December. We will provide more detailed analysis of income tax data in our September 2019 Forecast Evaluation Report.

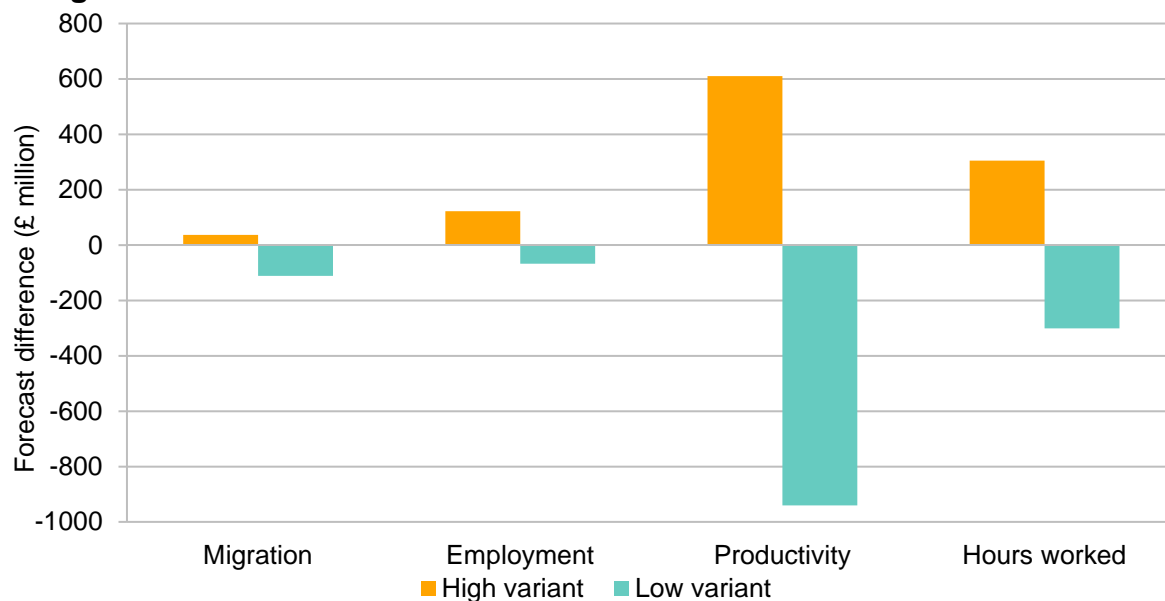
UK government policies

- 4.13 As some aspects of income tax are reserved to the UK, we need to take account of UK government policy measures affecting Scottish income tax. To do this we are reliant on the OBR's publicly available policy costing database. This only includes policies as they were costed at the time of introduction.
- 4.14 We work closely with the OBR to ensure we are including the effect of UK policies on Scottish income tax as fully as possible. Following further discussions with the OBR since our last forecast, we have revised the way we capture pensions auto-enrolment in our forecasts. This revision reduces our forecast by £133 million in 2020-21.
- 4.15 Recostings of other historic UK policies results in a small upward revision to our forecast, of around £10 million in each year of the forecast.

Forecast uncertainty

- 4.16 We assess the sensitivity of our income tax forecast to the alternative economy scenarios considered in Chapter 2. The effect on our forecast of adjustments to our economic inputs are shown in Figure 4.2. The effects result from changing only one variable at a time. We do not explicitly model the effects of interactions between variants. As Figure 4.2 shows, our forecast is most sensitive to changes in our assumption about productivity growth.

Figure 4.2: Difference from central NSND income tax forecast in 2024-25



Source: Scottish Fiscal Commission.

4.17 Our forecast is also sensitive to our assumptions on the scale of behavioural changes. Table 4.5 shows how our estimates of behavioural responses change when we assume different taxable income elasticities. The elasticities used to obtain our central estimate are outlined in our March 2018 publication on behavioural responses to income tax.⁴⁷ The high and low variants are obtained by increasing or decreasing the central elasticity by 50 per cent.

Table 4.5: Sensitivity of behavioural responses in 2020-21

£ million	High variant	Central estimate	Low variant
2017-18 Policy costing	-11	-7	-4
2018-19 Policy costing	-82	-55	-27
2019-20 Policy costing	-10	-7	-3
Behavioural response to 2019-20 UK policy [1]	-17	-11	-5
Total change to revenue	-119	-80	-39

Source: Scottish Fiscal Commission.

Figures may not sum because of rounding.

[1] Includes the three behavioural responses that were incorporated in our December 2018 forecast. Further details can be found in supplementary table S4.8.

4.18 One additional source of uncertainty is Brexit. Our income tax forecast is based on the Brexit assumptions set out in Chapter 2. A no-deal Brexit is a downside risk to our economy and income tax forecasts.

⁴⁷ Scottish Fiscal Commission (2018) How we forecast behavioural responses to income tax policy – March 2018 ([link](#))

Comparison to OBR forecast

4.19 As part of their role as UK-level fiscal forecaster, the OBR also produces a forecast of Scottish income tax revenues. Table 4.6 compares our latest forecast with the OBR forecast published in March 2019.

Table 4.6: SFC and OBR Scottish NSND income tax forecast comparison

£ million	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
SFC May 2019	11,005	11,486	11,703	12,332	12,831	13,374	13,985
OBR March 2019	11,077	11,828	12,037	12,708	13,190	13,679	14,197
Difference	-71	-342	-334	-375	-359	-305	-212

Source: OBR (2019) Devolved Tax and Spending Forecasts – March 2019 ([link](#)), Scottish Fiscal Commission. Figures may not sum because of rounding.

4.20 Our forecast is consistently lower than the OBR's forecast, with an average difference of -£286 million over the forecast horizon. There are a few reasons for these differences:

- **Modelling differences:** In our forecasts we use a bottom-up micro simulation forecast based on our detailed taxpayer model. This allows the Commission to develop an income tax model which takes account of Scottish demographics and the distribution of income of Scottish taxpayers. The OBR takes a 'top-down' approach by first producing a forecast of the NSND income tax for the whole UK and then estimating a Scottish share which is applied to this forecast.
- **Data and economic determinants:** Our forecasts are based on the 2016-17 PUT, and are projected forward using Scottish-specific economic determinants which we produce as part of our economy forecasts. The OBR forecast of future earnings growth is based on UK economic determinants. This means that our forecast reflects Scotland-specific factors, such as our assessment that wage growth will be lower in Scotland than in the rest of the UK, while the OBR's forecast does not account for these factors. Moreover, in creating its forecast, the OBR also uses data available from HMRC covering the whole of the UK, whereas our forecasts mainly use Scottish-specific data.
- **Policy costing:** Both forecasts include costings of the Scottish Government's 2019-20 policy to set the higher rate threshold at £43,430. There are small differences in the judgement of behavioural effects, but this does not lead to large differences in the policy costing. Further information can be found in our March 2018 paper.⁴⁸

⁴⁸ Scottish Fiscal Commission (2018) How we forecast behavioural responses to income tax policy – March 2018 ([link](#))

Non-Domestic Rates

Forecast

Table 4.7: Non-Domestic Rates forecast

£ million	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
	2,762	2,885	2,803	2,853	3,090	3,301	3,338	3,318

Source: Scottish Fiscal Commission, Scottish Government NDRi returns.

Shaded cells refer to outturn available at time of publication.

4.21 Revenues from Non-Domestic Rates (NDR) are forecast to increase by £515 million from 2019-20 to 2024-25. The main reasons are an increase in gross income and a decrease in the amount of income lost because of appeals.

Background

4.22 NDR is paid by the owner, tenant or occupier of non-domestic properties. The amount of tax paid is dependent on the rateable value (RV) of the property, the tax rate (also known as poundage) and any reliefs or exemptions for which the property is eligible.⁴⁹ While NDR is collected and ultimately spent by local authorities, the Scottish Government retains control over the policy framework of the tax. This includes control over decisions such as the poundage, the system of reliefs available to ratepayers, and the date at which a revaluation of properties will take effect.⁵⁰

Box 4.2: Our role in the NDR bill costing process

The Scottish Government has introduced a bill making a number of changes to NDR. The bill covers:

- The administration and enforcement of Non-Domestic Rates. These amendments include: the removal of charity relief from mainstream independent schools, changes to the appeals process and to the duration of the revaluation cycle.
- Information-gathering powers for assessors and local authorities. These include additional powers given to assessors and local authorities to issue written notices requiring ratepayers to provide certain types of information.

⁴⁹ Rateable value is defined in the Valuation and Rating (Scotland) Act 1956 ([link](#)).

⁵⁰ Though local authorities do have the power to introduce their own locally funded reliefs under the Community Empowerment (Scotland) Act 2015 ([link](#)).

- The regulatory powers available to Scottish Ministers to tackle the avoidance of NDR.

As part of our statutory duty to provide independent and official forecasts of NDR revenues we may produce forecasts to accompany primary or secondary legislation. Where we have already costed policies to accompany the Scottish Budget or the Medium Term Financial Strategy we would not typically expect to provide updated costings to accompany the introduction of legislation. Similarly in order for us to provide a costing there needs to be sufficient detail on the policies. The majority of the provisions in the NDR bill are enabling legislation and the specific details will be set out in future secondary legislation. Once the details are clearer we will incorporate these in our forecasts.

There are two policies in the bill where there is sufficient detail. These account for 0.3 per cent of NDR revenues. Although we choose not to cost these to accompany the bill, we believe there is sufficient policy information to incorporate these in our central forecasts at this stage. Should there be any changes made to these policies as the bill progresses through the Scottish Parliament we will incorporate them in our next forecasts at the time of the Scottish Budget.

Scottish Government policy changes

- 4.23 The Scottish Government has introduced a bill to implement a number of recommendations from the 2017 Barclay Review of Non-Domestic Rates. Of those that might fall into our remit to cost, we have sufficient detail to make an assessment of the effect on NDR income of two.
- 4.24 As of 1 April 2020 mainstream independent schools will not be eligible to claim charity relief, increasing NDR income by £7 million in 2020-21. Special independent schools and specialist independent music schools will continue to be eligible. As of the start of the next revaluation cycle on 1 April 2022, the Scottish Government will remove the exemption from NDR for non-domestic buildings, for example cafes or bowling greens, on certain local authority parks. In addition, those parks which do not allow free and unrestricted access will themselves no longer be exempt. We expect this to increase NDR income by £2 million in 2022-23.

Changes since our last forecast

Table 4.8: Change in NDR forecast since December 2018

£ million	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
December 2018	2,827	2,785	2,887	3,087	3,295	3,332
Data updates	55	15	-43	-7	-7	-6
Methodology changes	3	3	3	3	3	3
May 2019 Pre-measures	2,885	2,803	2,846	3,083	3,291	3,329
Policy costings	0	0	7	7	9	9
May 2019 Post-measures	2,885	2,803	2,853	3,090	3,301	3,338

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 ([link](#)).

Figures may not sum because of rounding.

- 4.25** The main change since December is to our forecast for appeals losses. Data for the second and third quarters of 2018-19 reported lower losses than we expected. As we have not changed our view on the total RV ultimately lost to 2017 revaluation cycle appeals, the effect is to raise NDR income in 2018-19 and 2019-20 and lower our forecast in 2020-21 and 2021-22. Updated estimates of telecoms appeals losses relating to the 2005 and 2010 revaluation cycles raises our forecast by £8 million in 2019-20.
- 4.26** The inclusion of the Scottish Government's policy changes raises our forecast by £9 million by 2023-24. We have made one methodological update to our forecast to align the local authority mid-year estimate for gross income with separately reported data on RV lost to appeals. This raises our forecast by an average £3 million per year.

Box 4.3: The NDR pool

We forecast what is known as the 'contributable amount', the NDR revenue collected by local authorities and contributed into the central 'pool'. The 'distributable amount' is the amount of NDR revenue the Scottish Government distribute back to local authorities. In December our forecasts were used by the Scottish Government as a basis for setting the 'distributable amount' in 2019-20. The Government can distribute more or less than the forecast contributable amount in any given year, as long as the total amount collected is subsequently distributed back to local government.

The NDR rating account, or pool, is used to manage the difference between the contributable and distributable amounts. The position of the NDR pool in any given year depends on the contributable amount as estimated by local authorities at the start of the financial year, known as the 'provisional contributable amount', the distributable amount and any adjustments from previous years to account for differences between the 'provisional contributable amount' and the NDR revenues

actually collected by local authorities. Further information on the NDR rating account can be found in our previous reports.⁵¹

Table 4.9 sets out the balance of the NDR pool from the previous three years, and the projected balance for 2019-20. The provisional contributable amount is based on local authorities estimates of NDR revenues not on our own forecasts. At the time of publication the Provisional Contributable Amount (PCA) figures were not available and the most appropriate position of the pool remains the estimate from December 2018. We will provide updated information on the projected balance of the pool in our next forecast publication.

Table 4.9: Projected balance of the Non-Domestic Rating Account as at December 2018

£ million	2016-17	2017-18	2018-19	2019-20
Provisional contributable amount (A) [1]	2,754	2,844	2,883	2,785
Net effect of prior year adjustments (B) [2]	6	-23	-82	-56
Distributable amount (C)	2,769	2,666	2,636	2,853
Annual balance (D) (A + B - C)	-8	155	165	-124
Cumulative balance (E) (E from year before + D)	-297	-141	24	-100

Source: Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts December 2018 ([link](#)), Scottish Government (2018) Non-Domestic Rating Account 2017 to 2018 ([link](#)).

Figures may not sum because of rounding. Shaded cells indicate outturn. The presentation differs slightly to that in the published audit of the NDR rating account, mainly due to the presentation of line B – 'net prior year adjustments'.

[1] Provisional contributable amount is reported by local authorities to the Scottish Government after the start of the financial year and determines level of contributions to the pool.

[2] Differences between the provisional contributable amount and final audited figures from the previous year are reflected in this line.

Forecast uncertainty

4.27 Our forecast for NDR is subject to several uncertainties. The most significant of these concerns our assumption about the amount of RV expected to be lost to appeal. The effect this has on NDR income is determined by both the size and timing of appeals losses. As revaluation appeals are backdated to the effective date of the property, the later an appeal is resolved in the cycle the greater the effect it has on NDR income.⁵²

⁵¹ Scottish Fiscal Commission (2018) Forecast Evaluation Report ([link](#)) and Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 ([link](#)).

⁵² The effective date refers to the first day on which an entry in the valuation roll has effect for rate charging purpose.

Land and Buildings Transaction Tax

Forecast

Table 4.10: LBTT revenue forecasts

£ million	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Total LBTT revenue	557	553	616	655	691	724	759	794
of which:								
Residential (excluding ADS)	258	262	279	310	336	359	382	405
Additional Dwelling Supplement	95	98	126	127	131	134	138	141
Non-residential	204	193	211	218	224	231	239	248

Source: Scottish Fiscal Commission, Revenue Scotland (2018) Annual Report and Financial Statements 2017-18 ([link](#)).

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

Background

4.28 Land and Buildings Transaction Tax (LBTT) is payable upon the purchase of residential land or property, the purchase or lease of a non-residential land or property, or upon the purchase of an additional property.

4.29 We forecast the tax collected and published as part of Revenue Scotland's Annual Accounts.⁵³ These data will not exactly match the monthly statistics published on Revenue Scotland's website which are collated on a different basis from the Annual Accounts.⁵⁴

Residential LBTT

Table 4.11: LBTT residential forecast (excluding ADS)

£ million	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
	258	262	279	310	336	359	382	405

Source: Scottish Fiscal Commission, Revenue Scotland (2018) Annual Report and Financial Statements 2017-18 ([link](#)).

Shaded cells refer to outturn available at time of publication.

⁵³ Revenue Scotland (2018) Annual Report and Financial Statement 2017-18 ([link](#)).

⁵⁴ For further detail see: Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 ([link](#)) and Appendix B of Revenue Scotland (2018) Annual Summary of Trends in the Devolved Taxes 2017/18 ([link](#)).

Background

- 4.30 Residential LBTT is paid on land or residential property purchases over £145,000. LBTT was introduced on 1 April 2015 and replaced Stamp Duty Land Tax (SDLT) in Scotland.
- 4.31 The rates and bands for residential LBTT only apply to the portion of the purchase price that falls within the band, and are as follows:
- 0 per cent on transactions up to £145,000
 - 2 per cent on the portion above £145,000 up to £250,000
 - 5 per cent on the portion above £250,000 up to £325,000
 - 10 per cent on the portion above £325,000 up to £750,000
 - 12 per cent on the portion above £750,000
- 4.32 From the end of June 2018, First Time Buyers (FTB) of residential properties have paid no tax on the value of the property they have purchased up to £175,000.

Changes since our last forecast

Table 4.12: Changes to residential LBTT revenue forecast (excluding ADS) since December 2018

£ million	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
December 2018	258	267	296	324	349	373	398
Prices		-7	-26	-24	-25	-28	-31
Transactions		4	10	11	12	13	14
FTB recosting		1	0	0	0	0	0
Fiscal drag		0	1	1	1	2	2
Other		-3	-1	-1	-1	-1	-1
May 2019	258	262	279	310	336	359	382
Change from December 2018		-5	-16	-14	-14	-15	-17

Source: Scottish Fiscal Commission, Revenue Scotland (2018) Annual Report and Financial Statements 2017-18 ([link](#)).

Shaded cells refer to outturn available at time of publication.

- 4.33 In December, we noted a slowdown in house price growth during the first half of 2018-19 and a fall in the number of transactions. At that time we expected price growth to return to the long-run average by the end of 2019-20 with transactions continuing to fall before growing modestly from 2020-21 onwards.
- 4.34 Since December, house price growth is lower than we expected with prices dropping by 0.4 per cent in the last quarter of 2018-19. This drop occurred at

the same time as the introduction of the new higher rate of ADS and, combined with the uncertainty around Brexit, may have contributed to the drop in prices. We have revised our near-term forecast for house price growth down in line with the recent data, but our longer term price growth remains broadly unchanged.⁵⁵

- 4.35 There has been renewed growth in transactions in the second half of 2018-19, rather than the continued fall that we previously expected. Some of this has, in part, been affected by forestalling behaviour because of the increase in the rate of ADS on 25 January 2019. Our latest forecast assumes the volume of transactions will remain unchanged in 2019-20, and will moderately grow afterwards.
- 4.36 Revenue Scotland has provided data on the value of FTB relief claimed up to February 2019. This has reduced our estimate of the cost of the policy by £1 million in 2018-19. At this point, we have not revised the costing for subsequent years, as there is insufficient data to justify a longer term adjustment.
- 4.37 As a result of the lower price growth forecast, we expect that the effects of home buyer behaviour because of fiscal drag will be weaker than we assumed in December. This increases our revenue forecast by an additional £2 million by 2023-24.⁵⁶

Forecast uncertainties

- 4.38 Our revenue forecast is driven by three determinants: mean prices, median prices and transactions. Forecast errors in any of these will produce errors in our revenue forecast. Further information on the sensitivity of the model to each determinant can be found in our December 2018 publication.⁵⁷
- 4.39 The potential effect of Brexit on Scotland remains highly uncertain. We assume a relatively smooth and orderly Brexit process at the end of October and our forecast for prices and transactions are consistent with current market trends.
- 4.40 The Scottish Government has announced a new scheme targeted at FTBs, which has some similarities to existing Help to Buy equity loan schemes.⁵⁸ This Scottish Government scheme will offer FTBs a loan of up to £25,000 toward their deposit. The loan is repayable in full when the house is sold, or in

⁵⁵ Registers of Scotland (2019) Monthly House Price Statistics – March 2019 ([link](#)), Registers of Scotland (2019) Quarter 4: January – March 2019 ([link](#)).

⁵⁶ Buyers may respond to changes in prices and consequently changes in taxes by either lowering their offer to accommodate the higher tax bill, or by not purchasing a property at all.

⁵⁷ Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 ([link](#)).

⁵⁸ Scottish Government (2019) Building a fairer housing market ([link](#)).

full at any time, but no monthly payments are needed. We will assess any effect on either our house price or our transactions forecasts once sufficient detail about the policy is available.

Comparison with the OBR

Table 4.13: SFC and OBR LBTT (excluding ADS) forecast comparison

£ million	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
SFC May 2019	262	279	310	336	359	382
OBR March 2019	263	252	285	330	375	428
Difference	-2	28	25	5	-16	-46

Source: Scottish Fiscal Commission, OBR (2019) Economic and Fiscal Outlook – March 2019 ([link](#)).
Figures may not sum because of rounding.

- 4.41 The difference between the OBR and the Commission's forecasts are because the OBR has a lower price and transactions forecast in 2019-20, and higher price and transactions growth forecasts thereafter.
- 4.42 The OBR's forecast of the UK House Price Index is for growth of 0.2 per cent in 2019-20. This is partly influenced by a fall in prices in London and the South East of England. The OBR forecast increases thereafter, rising up to 4.2 per cent in 2023-24, which is 2 percentage points higher than our long-term average for Scotland. The OBR forecasts a 1.2 per cent drop in transactions in 2019-20, and a 5.7 per cent rebound in 2020-21.

Additional Dwelling Supplement (ADS)

Table 4.14: Additional Dwelling Supplement forecast

£ million	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
	95	98	126	127	131	134	138	141

Source: Scottish Fiscal Commission, Revenue Scotland (2018) Annual Report and Financial Statement 2017-18 ([link](#)).

Shaded cells refer to outturn available at time of publication.

Background

- 4.43 The Additional Dwelling Supplement (ADS) was introduced on 1 April 2016 and applies to additional residential property transactions worth £40,000 or more. The rate was increased from 3 to 4 per cent on 25 January 2019. The tax is charged on the full value of the property purchased.
- 4.44 The buyer has up to five years following the ADS transaction to reclaim the ADS paid, if their previous residence is sold within 18 months of purchasing the new property.

Changes since our last forecast

Table 4.15: Changes to Additional Dwelling Supplement forecast since December 2018

£ million	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
December 2018	95	94	122	123	127	130	134
Prices		0	-1	-1	-1	-2	-2
Transactions		2	4	4	4	4	4
ADS recosting		2	0	0	0	0	0
Other		1	1	1	1	1	1
May 2019	95	98	126	127	131	134	138
Change from December 2018		4	4	4	4	4	4

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 ([link](#)), Revenue Scotland (2018) Annual Report and Financial Statements 2017-18 ([link](#)).

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

4.45 The price and transactions growth projections that we use in the ADS forecast are the same as those used in the residential LBTT model. Our ADS forecast therefore follows a similar pattern to the residential forecast.

4.46 The net ADS forecast has increased by £4 million in 2019-20 as a result of the higher transactions growth forecast. These changes are partly offset by changes in our lower price forecast.

4.47 Our December 2018 model, used to cost the introduction of the new 4 per cent rate on 25 January 2019, contained a minor coding error. Correcting this has increased our 2018-19 forecast by £2 million.⁵⁹

Comparison with the OBR

Table 4.16: OBR and SFC Additional Dwelling Supplement forecast comparison

£ million	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
SFC May 2019	98	126	127	131	134	138
OBR March 2019	97	125	129	138	147	157
Difference	1	1	-2	-6	-12	-19

Source: Scottish Fiscal Commission, OBR (2019) Economic and Fiscal Outlook – March 2019 ([link](#)).

Figures may not sum because of rounding.

⁵⁹ Our policy costing model previously contained a coding error for 2018-19 Q4, which meant we were incorrectly applying the 3 per cent rate rather than the 4 per cent rate in one month of the quarter. This did not significantly affect our forecast and did not have budgetary implications. The response aligns with the categorisation of such an error as described by the Commission's voluntary compliance with best practice set out in the Office for Statistics Regulation's Code of Practice for Statistics ([link](#)).

- 4.48 The OBR published its latest ADS forecast in March 2019. Our forecast is £1 million higher than the OBR's in 2019-20 but lower in the subsequent years. As in the residential forecast, this is mainly because of the different price and transactions growth rates used.
- 4.49 We also forecast a repayment rate that accounts for 21 months after the purchase of the additional property, while the OBR's repayment rate is based on the first 18 months.

Non-residential LBTT

Table 4.17: Non-residential LBTT forecast

£ million	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
	204	193	211	218	224	231	239	248

Source: Scottish Fiscal Commission, Revenue Scotland (2018) Annual Report and Financial Statements 2017-18 ([link](#)).

Shaded cells refer to outturn available at time of publication.

Background

- 4.50 Non-residential LBTT applies to purchases or leases of commercial land and property. This includes shops or offices, agricultural land, forests or any other transaction where the main subject matter of the transaction consists of, or includes, an interest on land that is non-residential.
- 4.51 The Scottish Government introduced a new set of tax rates and bands for non-residential transactions on 25 January 2019. These changes only affected conveyances and the premium element of leases. All other elements of the existing non-residential LBTT policy remain unchanged.
- 4.52 The current rates and bands for non-residential LBTT transactions are:
- 0 per cent on transactions up to £150,000
 - 1 per cent on the portion above £150,000 up to £250,000
 - 5 per cent on the portion above £250,000

Changes since our last forecast

Table 4.18: Changes to non-residential LBTT forecast since December 2018

£ million	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
December 2018	204	208	226	233	240	247	255
Prices			1	1	1	1	2
Transactions			-1	-1	-1	-1	-1
Lease factor			-4	-4	-4	-4	-4
Outturn data		-15	-11	-11	-11	-12	-12
Policy recosting & other		0	0	0	-1	0	-1
May 2019	204	193	211	218	224	231	239
Change from December 2018		-15	-15	-15	-16	-16	-16

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 ([link](#)), Revenue Scotland (2018) Annual Report and Financial Statements 2017-18 ([link](#)).

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

4.53 The outturn revenue in the second half of 2018-19 has been lower than we previously expected, and we have revised our in-year forecast down by £15 million.⁶⁰ Our forecast for future years starts from the average of the distribution of prices and transactions over the last three years. Incorporating data for 2018-19 has reduced our revenue forecast by an average £11 million from 2019-20 onwards.

4.54 We have revised our price and transactions forecast models. Previously we used a statistical model for forecasting the first two years of the forecast before growing in line with economic activity. We now use our economic forecast throughout. Transactions are grown in line with growth in real economic activity and we use our GDP deflator forecast for prices. This aligns our non-residential forecast on prices and transactions with the Commission's economy forecasts and Brexit assumptions. This has a small effect on the forecast.

4.55 We forecast the revenue raised from leases as a percentage of the non-residential conveyances revenue. This percentage has been downgraded from 15 per cent to 13 per cent, after incorporating the most recent in-year outturn data. This reduces the forecast by £4 million each year after 2018-19.

4.56 The costing of the introduction of the new tax schedule has been updated to reflect the new price and transactions forecasts. We have estimated that the new rates and bands increase non-residential LBTT revenue by an average of £14 million per year from 2019-20 onwards, approximately £0.5 million less

⁶⁰ The in-year forecast is based on the effective date data up to February 2019 and March 2019 cash data.

than previously forecast. This costing will be reviewed as more outturn data become available.

Comparison with the OBR

Table 4.19: OBR and SFC non-residential LBTT forecast comparison

£ million	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
SFC May 2019	193	211	218	224	231	239
OBR March 2019	206	215	217	225	233	241
Difference	-12	-4	1	0	-2	-2

Source: Scottish Fiscal Commission, OBR (2019) Economic and Fiscal Outlook – March 2019 ([link](#)).

Figures may not sum because of rounding.

- 4.57** The Commission's forecast is £12 million lower in 2018-19 than the OBR's as we incorporated more recent revenue outturn data, not available to the OBR in March. In the following years the small differences are because the OBR uses UK price and transactions growth rates, while we use Scotland-specific growth rates linked to our economy forecast.

Scottish Landfill Tax

Forecast

Table 4.20: Scottish Landfill Tax forecast

£ million	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
	148	143	109	87	12	14	15	15

Source: Scottish Fiscal Commission, Revenue Scotland Annual Report and Financial Statements 2017-18 ([link](#)).
Shaded cells refer to outturn available at time of publication.

- 4.58 Scottish Landfill Tax revenues are forecast to fall to £12 million in 2021-22, before rising to £15 million in 2024-25. This reduction is because new waste incineration capacity diverts waste from landfill to incineration and the Scottish Government's ban on the landfilling of biodegradable municipal waste (BMW) comes into force in January 2021.

Background

- 4.59 Scottish Landfill Tax (SLfT) is a tax on the disposal of waste to landfill, with the amount of tax payable determined by the weight of waste being disposed and the type of waste. In 2019-20 the standard rate of tax has been set at £91.35 per tonne, with a lower rate of £2.90 per tonne for certain inert materials such as rocks and soils.
- 4.60 SLfT is an environmental tax, aimed at reducing the amount of waste landfilled and the associated environmental damage. From 1 January 2021, the Scottish Government will implement a ban on the landfill of BMW.⁶¹

Scottish Government policy changes

- 4.61 The ban on the landfilling of BMW applies from 2021 onwards and is being written into permits issued by the Scottish Environment Protection Agency (SEPA) to landfill sites allowing them to operate. The ban affects local authorities who manage large amounts of BMW through the kerb-side collection of landfill waste, as well as commercial waste operators.
- 4.62 Our December 2018 forecast set out a number of important developments in relation to the ban.⁶² Since then, the Scottish Government published its waste markets study to clarify the ways in which this diversion of waste from landfill can be achieved.⁶³ The report identified four options for diverting waste from landfill in Scotland: landfill sites in northern England, incinerators in England, exports to Europe and the construction of new Scottish incinerator facilities.

⁶¹ Scottish Government (2012) The Waste (Scotland) Regulations 2012, Regulation 4 ([link](#))

⁶² Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 ([link](#))

⁶³ Scottish Government (2019) Waste Markets Study – Full Report ([link](#))

Changes since our last forecast

Table 4.21: Change in Scottish Landfill Tax forecast since December 2018

£ million	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
December 2018	136	104	83	13	13	14
Data updates	5	3	3	0	1	1
Methodology changes	2	2	2	0	0	0
May 2019	143	109	87	12	14	15

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 ([link](#)).

Figures may not sum because of rounding.

4.63 The main change to the early years of the forecast have been the inclusion of the most recent published data from Revenue Scotland for the third quarter of 2018-19 and more up-to-date information from SEPA on the status of operation of several incineration sites. This has increased the forecast by approximately £5 million in 2018-19 and by £3 million in 2019-20.

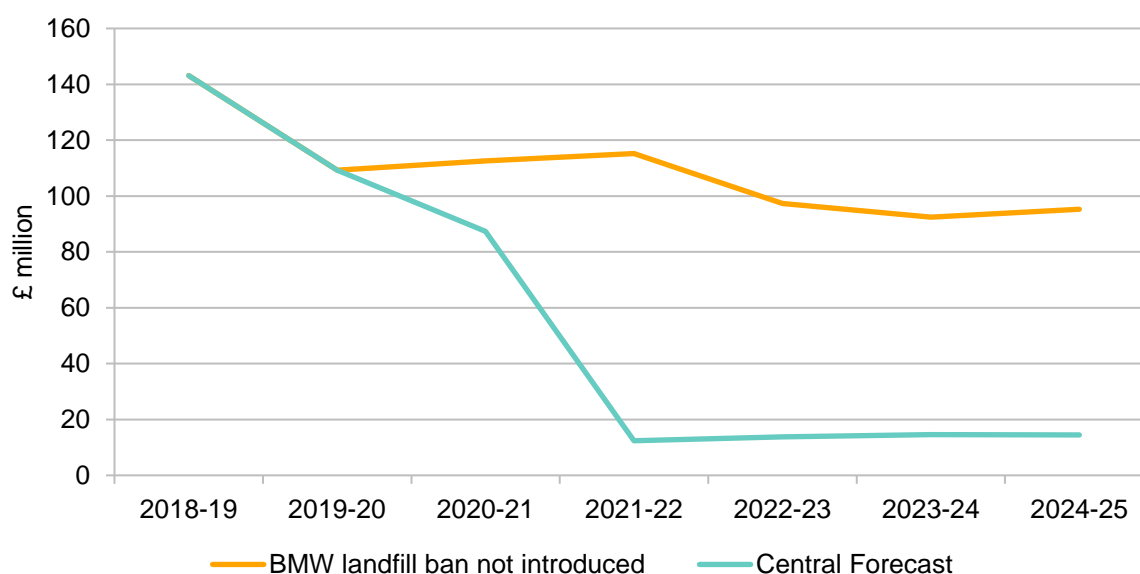
4.64 The factor affecting the later years of our forecast is the inclusion of the effect of the BMW landfill ban in our central revenue forecast. Figure 4.3 demonstrates the effect of the ban on our forecast. Relative to a projection in which the ban is not implemented, this lowers revenue in 2020-21 by £25 million and by £103 million in 2021-22. This aspect of our forecast will be regularly reviewed as the evidence base continues to develop and the timing of diversion from landfill becomes clearer.

4.65 Aside from the implementation of the BMW ban, our assumption on the timing of new incineration capacity becoming operational is the major driver of our forecast. New capacity has two effects on the forecast. The first is to reduce SLfT revenue by reducing the volume of waste landfilled. The second is to increase revenue because residue from incineration will go to landfill and therefore be eligible for SLfT. In 2018-19 four new incinerator sites began operation. Small delays to these sites since our December publication have resulted in increases in the 2018-19 forecast of SLfT revenues. Our forecast includes two further sites, which we assume become operational in 2022.

Forecast uncertainty

4.66 Our forecast is highly sensitive to the BMW ban. The ban results in a significant reduction in SLfT revenues – in 2021-22 forecast revenues are £12 million. Figure 4.3 shows SLfT revenue from the level of waste we expect would be landfilled before accounting for the ban from January 2021 onwards – the orange line. We estimate revenues in 2021-22 would be £115 million without the ban, £103 million higher than revenues with the ban. We will continue to consider new information on factors such as the development of waste infrastructure in Scotland, alongside updates to the plans of local authorities and waste management companies.

Figure 4.3: Effect of the BMW ban on the SLfT forecast



Source: Scottish Fiscal Commission.

4.67 The other factor driving the forecast is the timing and size of additional incineration capacity. These are large complex construction projects that can encounter significant delays for a variety of reasons.

Comparison with OBR forecasts

Table 4.22: SFC and OBR Scottish Landfill tax forecast comparison

£ million	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
SFC May 2019	143	109	87	12	14	15
OBR March 2019	146	111	90	20	21	22
Difference	-3	-2	-3	-8	-7	-7

Source: Scottish Fiscal Commission, Office for Budget Responsibility (2019) Devolved tax and spending forecasts – March 2019 ([link](#)).

Figures may not sum because of rounding.

4.68 The OBR published a forecast of SLfT revenues in March 2019.⁶⁴ Our forecast is lower than the OBR's for two main reasons. First, the OBR has assumed new incineration capacity comes online more slowly. Second, the OBR has assumed there will be a degree of non-compliance with the BMW ban.⁶⁵ On the basis of insufficient evidence available for Scotland, we do not make an equivalent adjustment to our forecast.

⁶⁴ OBR (2019) Devolved tax and spending forecasts – March 2019 ([link](#))

⁶⁵ The OBR's assumption is based on HMRC's estimate of the tax gap for Landfill Tax in the rest of the UK. Further detail can be found in OBR (2019) Devolved tax and spending forecasts – March 2019 paragraph 4.9 ([link](#)).

VAT

Table 4.23: VAT receipts assigned to Scotland forecast

£ million	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
	5,012	5,361	5,514	5,707	5,879	6,043	6,205	6,369	6,571

Source: Scottish Fiscal Commission, HM Treasury, HMRC and Scottish Government.

Shaded cells refer to outturn available at time of publication.

Outturn in this context refers to a provisional estimate of the Scottish share of VAT, applied to outturn UK VAT receipts.

Background

4.69 The Scotland Act 2016 states that half of VAT raised in Scotland will be assigned to the Scottish Government.⁶⁶ 2019-20 is a transitional year for VAT assignment, when estimates and forecasts of VAT assignment are being calculated, but do not have any effect on the Scottish Budget. Ahead of this transitional year, we started publishing illustrative forecasts of VAT assignment in December 2018. VAT assignment was expected to be part of the Scottish Budget from 2020-21 onwards.

4.70 At a session with the Finance and Constitution Committee on 8 May 2019 the Cabinet Secretary for Finance, Economy and Fair Work indicated that he thought a postponement of the implementation of VAT assignment should be considered until it can be discussed at the time of the fiscal framework review.

4.71 This means there is a possibility that VAT assignment could be delayed. This is a decision for the Scottish and UK Governments, in which we have no role. We will continue to publish illustrative forecasts of VAT assignment and discuss the potential effects on the Scottish Budget were VAT assignment to commence.

4.72 VAT being assigned rather than devolved means the Scottish Government will not have any direct policy control. VAT will continue to be collected by HMRC at the UK level and it will not be possible to calculate VAT raised in Scotland from tax returns.

4.73 We published a paper on our approach to creating forecasts of assigned VAT in September 2018.⁶⁷

VAT assignment outturn data

4.74 HMRC estimates VAT assignment for Scotland using a methodology developed by HMRC, HM Treasury and the Scottish Government. We have

⁶⁶ Scotland Act 2016 Part 2 Section 16 ([link](#)). The Scotland Act 2016 legislated to assign 10p of the standard rate and 2.5p of the reduced rate to the Scottish Budget. This represents half of the current VAT rates.

⁶⁷ Scottish Fiscal Commission (2018) Approach to forecasting VAT assignment ([link](#))

been in regular discussion with HMRC over the last few months about VAT assignment work and we appreciate their engagement. Details on the VAT assignment methodology have been published by HM Treasury.⁶⁸

- 4.75 In our September 2018 Statement of Data Needs, we asked HMRC, HM Treasury and the Scottish Government to start publishing detailed estimates from its VAT assignment model on a regular timetable that was coherent with the timing of Scottish fiscal events.⁶⁹
- 4.76 HMRC published its first VAT assignment estimates for the period 2011 to 2016 on 30 May 2019, the same day as this report. While HMRC had announced it would also publish a provisional estimate for 2017 VAT assignment in its 30 May publication, it has decided to delay the 2017 provisional estimate to ensure the required level of quality assurance for Official Statistics.⁷⁰ HMRC has announced it will publish the provisional estimate for 2017 in August 2019 and has set out a publication timetable for further information in its statistical publication.
- 4.77 We are now two months into the 2019-20 transitional year of VAT assignment. We have published two forecasts of VAT assignment based on data up to 2016, and HMRC has now published estimates of VAT assignment from 2011 to 2016 for the first time.
- 4.78 The transitional year was intended to be an opportunity to review VAT assignment estimates and forecasts, and understand the potential effects on the Scottish Budget. We need to analyse VAT assignment estimates, our revenue forecasts, BGA forecasts and likely reconciliations. This is difficult with the information currently available. Therefore, our view is that there is a risk to the Scottish Budget from the implementation of VAT assignment because of the limited history of estimates and forecasts available.
- 4.79 We ask HMRC, the Scottish Government and HM Treasury to publish more information as soon as possible to enable us to develop our forecasts and gain an appreciation of the scale of the risks to the Scottish Budget. We plan to hold further discussions with HMRC, the Scottish Government and HM Treasury and will return to this question when we publish our next Statement of Data Needs in September 2019.

Changes since last forecast

- 4.80 Our forecast incorporates small revisions to historic VAT assignment outturn estimates. These revisions were shared with us in advance of their publication to allow us to include them in our forecast. The forecast also reflects the latest

⁶⁸ HM Treasury (2018) Scottish VAT assignment – Summary of VAT assignment model ([link](#))

⁶⁹ Scottish Fiscal Commission (2018) Statement of Data Needs September 2018 ([link](#))

⁷⁰ HMRC (2019) HMRC Announcements – January 2019 to May 2019 ([link](#))

economic determinants and UK data. Table 4.24 presents a breakdown of the effect of these changes.

Table 4.24: Changes to our forecast since December 2018

£ million	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
December 2018	5,033	5,383	5,631	5,801	5,966	6,122	6,279	6,434
Revised outturn	-21	-19	-19	-25	-29	-30	-30	-29
UK determinants	0	-3	-85	-68	-59	-53	-52	-51
Economic determinants	0	0	-13	-1	1	4	9	16
May 2019	5,012	5,361	5,514	5,707	5,879	6,043	6,205	6,369
Change from December 2018	-21	-23	-117	-94	-87	-79	-73	-65

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 ([link](#)).

4.81 We describe the main sources of differences from our December 2018 forecast in more detail below.

Revisions to VAT assignment outturn data

4.82 Minor revisions to the VAT assignment outturn data published by HMRC reduced the forecast by between £19 million and £30 million.

UK data updates

4.83 Because of the lack of Scottish-specific data for VAT, the Commission assumes that certain determinants of VAT raised in Scotland will follow the same patterns as VAT raised in the rest of the UK. The effect of changes in these determinants on our forecast are shown in Table 4.25.

Table 4.25: Changes since December 2018 because of changes in UK determinants

£ million	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
VAT receipts	0	-75	-71	-67	-67	-68	-72
Household standard rated share	-3	-10	3	9	13	17	20
Total UK determinants	-3	-85	-68	-59	-53	-52	-51

Source: Scottish Fiscal Commission.

4.84 The OBR's March 2019 UK VAT receipts forecast has been revised down by around £1.1 billion in total.⁷¹ We assume VAT assignment in Scotland follows a similar pattern, reducing our forecast by between £67 million and £75 million in each year.

⁷¹ OBR (2019) Economic and Fiscal Outlook – March 2019 ([link](#)).

- 4.85 The household standard rated share refers to household expenditure liable to VAT converted to a standard-rated equivalent, as a proportion of total household expenditure. We assume the Scottish proportion grows in the same way as in the UK as a whole. Using the latest UK forecast slightly decreases our forecast in 2017-18 and 2018-19 and slightly increases it throughout the rest of the forecast period.

Economy forecast

- 4.86 Changes to our economy forecast affect the expenditure liable for VAT. Overall, the economic determinants lead to the forecast decreasing slightly over the period 2017-18 to 2019-20 and increasing slightly in later years.

Comparison with OBR forecasts

Table 4.26: SFC and OBR VAT assignment forecast comparison

£ million	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
SFC May 2019	5,012	5,361	5,514	5,707	5,879	6,043	6,205	6,369
OBR March 2019	5,123	5,269	5,486	5,679	5,869	6,054	6,231	6,410
Difference	-111	91	27	28	10	-11	-25	-41

Source: Scottish Fiscal Commission, OBR (2019) Economic and Fiscal Outlook – March 2019 ([link](#)).

- 4.87 Differences between the Commission's forecasts for Scotland and those made by the OBR are shown in Table 4.26. These are a result of differences in approach to forecasting VAT assignment, and data available at the time of the forecast.

- In their March publication, the OBR produced an illustrative projection rather a fully considered forecast.⁷² This approach uses the UK forecast and applies a constant share to Scotland with a minor adjustment for population.
- OBR did not have access to the revised outturn data published by HMRC for their forecast. We have used these data in our forecast.

⁷² Scottish Fiscal Commission, OBR (2019) Economic and Fiscal Outlook – March 2019 ([link](#)).

Air Passenger Duty

Forecast

Table 4.27: Forecast Scottish share of Air Passenger Duty

£ million	2017-18 [1]	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
	275	286	295	307	320	336	352	369

Source: Scottish Fiscal Commission

[1] Figure for Air Passenger Duty is not classed as outturn data. It is an estimate of the Scottish share of tax revenues.

4.88 Air Departure Tax (ADT) was due to replace UK Air Passenger Duty (APD) in Scotland from April 2018. The introduction of ADT in Scotland has been deferred until the state-aid issue raised in relation to the Highlands and Islands exemption has been resolved.⁷³ We continue to produce illustrative forecasts of APD paid in Scotland.

Background

4.89 APD is a tax paid on eligible passengers on flights departing from UK airports. The amount of tax paid depends on the passenger's class of travel (for example business or economy) and their final destination. Destinations fall into two bands based on flight distance from London. The higher band applies to countries whose capital city is further than 2,000 miles from London. The reduced rate applies where passengers are travelling in the lowest class available. The standard rate applies to passengers travelling in any other class of travel and the higher rate applies to private jets.⁷⁴

4.90 APD tax forms are returned on a company-by-company basis, with one tax return for all their business in the UK. There are therefore no historical data on APD revenues or passengers paying APD in Scotland. Further details on our approach to forecasting Scottish APD can be found in our December 2018 publication.⁷⁵

⁷³ Parliamentary Question – 23 April 2019 ([link](#)), Letter from the Minister for Public Finance and Digital Economy to the Convener of the Finance and Constitution Committee 23 April 2019 ([link](#)).

⁷⁴ HMRC (2018) Guidance: Rates for Air Passenger Duty ([link](#)).

⁷⁵ Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 ([link](#)).

Changes since our last forecast

Table 4.28: Change in Air Passenger Duty forecast since December 2018

£ million	2017-18 [1]	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
December 2018	277	302	312	322	336	349	364
CAA Survey	4	6	6	6	7	7	8
Methodology change and data updates	-5	-21	-23	-21	-22	-21	-20
May 2019	275	286	295	307	320	336	352
Change since December 2018	-2	-16	-17	-15	-15	-14	-12

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 ([link](#)).

Figures may not sum because of rounding.

[1] Figure for Air Passenger Duty is not classed as outturn data. It is an estimate of the Scottish share of tax revenues.

4.91 The inclusion of the 2018 Civil Aviation Authority (CAA) Passenger Survey has increased the forecast by £6 million in 2019-20. This is because the survey allocates a greater number of passengers into the higher band.

4.92 Updated CAA monthly passenger figures and OBR UK GDP and inflation forecasts have been included. There have also been methodology updates to our forecast model for Scottish passenger numbers including a change to correct a coding error in our model for passenger numbers.⁷⁶ The combined data and modelling updates have resulted in an average decrease of £22 million per year in our APD forecast.

Forecast uncertainty

4.93 The current estimates of Scottish APD revenues are based on a combination of administrative and survey data. The accuracy of the estimates will only be known once the tax is devolved and separately collected for Scotland.

4.94 While we have judged that the 2018 CAA Passenger Survey is of sufficient quality to include in our forecasts, we have not as yet carried out a full investigation of the data. This includes investigating whether the new questions in the survey might lead us to revise our estimates of the share of passengers in each tax band. We will review the survey data over the summer and include more detailed analysis in a future publication.

⁷⁶ Our forecast model previously contained an error which meant we were producing a skewed Scottish passenger number forecast. This did not significantly affect our forecast and did not have budgetary implications. The response aligns with the categorisation of such an error as described by the Commission's voluntary compliance with best practice set out in the Office for Statistics Regulation's Code of Practice for Statistics ([link](#)).

Comparison with OBR forecasts

Table 4.29: SFC and OBR Air Passenger Duty forecast comparison

£ million	2017-18 [1]	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
SFC May 2019	275	286	295	307	320	336	352
OBR March 2019	299	319	334	347	361	378	396
Difference	-24	-33	-39	-40	-41	-42	-44

Source: Scottish Fiscal Commission, OBR (2019) Devolved tax and spending forecasts – March 2019 ([link](#)).

Figures may not sum because of rounding.

[1] Figure for Air Passenger Duty is not classed as outturn data. It is an estimate of the Scottish share of tax revenues.

4.95 The main source of difference between the OBR's forecast and ours is difference in the estimates of revenue in 2017-18 as the baseline for the forecasts.⁷⁷ The OBR uses the mid-point between the HMRC and Scottish Government estimates of the Scottish share of UK APD revenues to produce its central forecast, resulting in a higher estimate. Our approach uses the CAA Passenger Survey, which includes domestic travel and is therefore less likely to overestimate the share of the higher band passengers. HMRC use the International Passenger Survey to estimate the Scottish share of APD.⁷⁸ We will work closely with the OBR to review methodologies, with a view to making further improvements to estimates of the Scottish share of APD.

⁷⁷ Based on 2017-18 data, the OBR estimate the Scottish share of UK APD revenues to be 8.9 per cent compared with our estimate of 8.5 per cent. For further information see Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts May 2018 ([link](#)).

⁷⁸ Most recent published CAA Surveys by airport: Glasgow, Edinburgh and Aberdeen 2018 and Prestwick 2009. Travel trends 2017 using IPS data covering Scottish Airports was last released by ONS in August 2017 ([link](#)).



Chapter 5

Social Security

Carer's Allowance and Carer's Allowance Supplement

Forecast

Table 5.1: Forecast expenditure on Carer's Allowance and Carer's Allowance Supplement

£ million	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Carer's Allowance	152	286	304	325	351	371	393
Carer's Allowance Supplement	34	37	40	42	45	48	51
Total expenditure	186	323	344	367	396	420	444

Source: Scottish Fiscal Commission, 2018-19 provisional outturn expenditure from Social Security Scotland and is subject to audit.

Figures may not sum because of rounding.

Carer's Allowance was devolved to the Scottish Parliament on 3 September 2018, the expenditure for 2018-19 is proportioned accordingly.

- 5.1** Annual expenditure on Carer's Allowance (CA) and the Carer's Allowance Supplement (CAS) is forecast to increase by £121 million between 2019-20 and 2024-25. Spending rises each year because the number of people receiving CA, also referred to as the caseload, increases and the payment amounts increase each year by inflation.

Background

- 5.2** CA was devolved to the Scottish Parliament on 3 September 2018. The Department for Work and Pensions (DWP) will continue to administer the payments on behalf of the Scottish Government until Social Security Scotland takes over delivery.

- 5.3 The Scottish Government started paying CAS in 2018 to ‘top up’ the amount paid to carers in Scotland. CAS is paid in two lump sums each financial year to everyone in receipt of CA in Scotland on qualifying dates.⁷⁹

Changes since our last forecast

Table 5.2: Change in CA and CAS forecast expenditure

£ million	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
December 2018	191	320	345	367	389	412
2018-19 outturn	-5					
Data and assumption updates	0	3	4	5	7	8
Universal Credit adjustment	0	0	-5	-5	0	0
May 2019	186	323	344	367	396	420
Change from December 2018	-5	3	-1	0	7	8

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 ([link](#)).

Figures may not sum because of rounding.

- 5.4 The inclusion of new data has increased our forecast. This was because of more individuals receiving CA than expected in our last forecast, and slightly higher inflation forecasts from the OBR.
- 5.5 Our forecasts contain an adjustment to account for expected changes to CA expenditure as a result of the roll-out of Universal Credit. The OBR has updated the adjustment to their Great Britain forecast as there are delays to the Universal Credit roll-out. This reduces our CA forecast for 2020-21 and 2021-22.
- 5.6 The roll-out of Universal Credit may affect CA in two ways. First, before Universal Credit, some disability benefit recipients could receive severe disability premiums, which topped up their benefit. These people would lose their premiums if their carer claimed CA. Universal Credit does not have severe disability premiums, which removes a barrier to claiming and potentially increases the CA caseload.⁸⁰
- 5.7 Second, Universal Credit contains a carer's element with similar qualifying criteria to CA. Some individuals may choose to claim the Universal Credit carer's element and not apply for CA, potentially lowering the CA caseload.

⁷⁹ The qualifying dates for 2019-20 are 15 April 2019 and 14 October 2019. Scottish Government (2019) Carer's Allowance Supplement Guide ([link](#)).

⁸⁰ Severe disability premiums/additions can be included in Income Support, Income-Based Jobseeker's Allowance, Income-related Employment and Support Allowance, Pension Credit or Housing Benefit.

Caseload forecast

5.8 In recent years the CA caseload has increased. We expect this to continue over the next five years, as shown in Table 5.3. Increases in the state pension age have increased the caseload because once people become eligible for their State Pension they can no longer receive CA. The female state pension age has gone up from 60 to 65 and now the male and female state pension age is increasing to 66 over the period March 2019 to October 2020. There are also more people receiving a disability benefit which makes their carer eligible for CA.⁸¹ This increases the number of people who could potentially have someone caring for them and claiming CA.

Table 5.3: Forecast number of individuals expected to receive CA

Thousands	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
	79	83	87	91	96	100	103

Source: Scottish Fiscal Commission.

Payment amount forecast

5.9 CA and CAS payments will be increased by inflation each year, also referred to as uprating. Table 5.4 shows our forecasts for CA and CAS payments.

Table 5.4: Forecast CA and CAS payments

£	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
CA (weekly)	66.15	67.55	68.85	70.25	71.65	73.10
CAS (twice-yearly)	226.20	230.10	234.00	237.90	243.10	247.00

Source: Scottish Fiscal Commission, UK Government (2018) Benefit and pension rates for 2019 to 2020 ([link](#)), Scottish Government (2019) Carer's Allowance Supplement Guide ([link](#)).

The Scottish Government is applying the same CA rates set by the UK Government for 2019-20. Shaded cells refer to outturn available at time of publication.

Forecast uncertainty

5.10 The number of individuals who will receive Carer's Allowance is closely linked to the number of individuals receiving disability benefits and Universal Credit. There is uncertainty in the forecasts for these associated benefits as the UK welfare system is in a period of significant reform. This is one of the main risks to our CA forecast and we will closely monitor trends in these benefits.

Comparison with OBR forecasts

5.11 The OBR published a forecast of CA expenditure in Scotland in their March 2019 devolved tax and spending publication.⁸² The OBR assumes spending

⁸¹ To receive CA both the care giver and care recipient must meet qualifying criteria. Full eligibility details can be found on the UK Government's website ([link](#))

⁸² OBR (2019) Devolved tax and spending forecasts – March 2019 ([link](#))

on CA in Scotland will follow the same profile as in England and Wales, with a small adjustment to account for slower growth in Scotland's working-age population relative to England and Wales.

- 5.12 Our forecasts are broadly similar for the next few years and diverge towards the end of the forecast period. The OBR's forecast is closely linked to their forecast for disability spending. As we further develop our forecasting approach for disability benefits in advance of our next publication, we will be considering any potential effects on CA expenditure.

Table 5.5: Forecast comparison (excluding CAS)

£ million	2019-20	2020-21	2021-22	2022-23	2023-24
SFC May 2019	286	304	325	351	371
OBR March 2019	287	305	326	355	385
Difference	-1	-1	-1	-5	-14

Source: Scottish Fiscal Commission, OBR (2019) Devolved tax and spending forecasts – March 2019 – charts and tables ([link](#)).

Figures may not sum because of rounding.

Discretionary Housing Payments

Forecast

Table 5.6: Expenditure on Discretionary Housing Payments

£ million	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Forecast							
Bedroom tax mitigation [1]	51	53	55	57	58	60	62
Scottish Government funding plans							
Other DHPs [2]	11	11	11	11	11	11	11
Total	62	64	66	68	69	71	73

Source: Scottish Fiscal Commission.

Figures may not sum because of rounding.

[1] Also known as the 'removal of spare room subsidy', the bedroom tax is the reduction in housing support for individuals living in social housing, and deemed to have one or more spare rooms.

[2] This represents the Scottish Government's announced funding plans, not a forecast of need or demand.

5.13 We forecast total expenditure on Discretionary Housing Payments (DHPs) to rise from £62 million in 2018-19 to £73 million in 2024-25. Mitigating the bedroom tax – the reduction in housing support for individuals living in social housing, and deemed to have one or more spare bedrooms – becomes more costly over the period as we expect an increase both in the number of social homes and in the rents for these properties.

Background

5.14 DHPs are grants awarded by local authorities to people in receipt of certain benefits who need financial assistance with housing costs. The Scottish Government provides funding to local authorities who pay the grants on a discretionary basis.

5.15 The budget for DHPs is split into two parts. The first is to mitigate the bedroom tax. The second is a discretionary fund for all other DHP claims.

5.16 The Scottish Government has set the 2019-20 budget for the discretionary fund at £11 million. We have not been informed of any plans to change the level of funding for the discretionary fund over the forecast period. We do not assess the demand for the discretionary fund and whether the funding from the Scottish Government is reasonable.

5.17 The rest of this section considers our forecast of expenditure to mitigate the bedroom tax.

Changes since our last forecast

Table 5.7: Change in forecast expenditure to mitigate the bedroom tax

£ million	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
December 2018	50	52	54	55	57	58
Assumption updates	0	1	1	1	2	2
May 2019	51	53	55	57	58	60

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 ([link](#)).

Figures may not sum because of rounding.

- 5.18** We have used information about planned rent increases for 2018-19 from the Scottish Housing Regulator to update our assumption for social housing rents.⁸³ This has increased our forecast. Higher rents mean that the amount a household loses to the bedroom tax is greater, and the Scottish Government will spend more on mitigation.

Forecast uncertainty

- 5.19** DHPs will be used to mitigate the bedroom tax until at least May 2020.⁸⁴ There is uncertainty around the date when the bedroom tax will be mitigated at source through Universal Credit. We assume that the Scottish Government will use DHPs to mitigate the bedroom tax for the entire forecast period.
- 5.20** The Scottish Government has committed to increase the stock of social housing in Scotland through the Affordable Housing Supply Programme and this increases our forecast.⁸⁵ If the total number of social housing units rises by less than we expect, then we would expect fewer households to be subject to the bedroom tax and expenditure would be lower than forecast.
- 5.21** We assume that all households entitled to support from the Scottish Government to mitigate the bedroom tax take up that support. We understand there may be differences across local authorities because of the roll-out of Universal Credit. We will review this assumption when we receive further outturn data at a local authority level from the Scottish Government.

⁸³ Scottish Housing Regulator (2018) Charter indicators and data by outcomes and standards ([link](#))

⁸⁴ Scottish Government (2018) Letter from Minister for Social Security to Convener on 'bedroom tax' – 3 April 2018 ([link](#))

⁸⁵ Scottish Government Affordable Housing Supply Programme ([link](#))

Best Start Grant

Forecast

Table 5.8: Forecast expenditure on Best Start Grant

£ million	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Pregnancy and Baby Payment	4	6	6	6	7	7	7
Early Learning Payment		10	5	5	5	5	5
School Age Payment		5	5	5	5	5	5
Total	4	21	16	16	17	17	18

Source: Scottish Fiscal Commission, 2018-19 provisional outturn expenditure from Social Security Scotland and is subject to audit.

Figures may not sum because of rounding.

5.22 We have revised our forecast for Best Start Grant (BSG) in 2019-20 to £21 million, an increase of £8 million from our December 2018 publication. The changes we have made to the forecast reflect the high number of applications and successful awards paid for the Pregnancy and Baby Payment in the first few months. We assume this continues for the other BSG payments and in future years.

Background

5.23 BSG is a series of one-off payments to help low income households with the costs associated with having a child. Support available includes a Pregnancy and Baby Payment, an Early Learning Payment and a School Age Payment. The Pregnancy and Baby Payment was introduced on 10 December 2018, with the other payments following in 2019.

Changes since our last forecast

Table 5.9: Change in BSG forecast expenditure

£ million	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
December 2018	2	12	13	13	14	15
Expenditure data	3					
Data updates		1	0	0	0	0
Take-up assumption		3	3	3	2	2
First year eligibility		4				
May 2019	4	21	16	16	17	17
Change since December 2018	3	8	4	3	2	2

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 ([link](#)), 2018-19 provisional outturn expenditure from Social Security Scotland and is subject to audit.

Figures may not sum because of rounding.

5.24 The Scottish Government published information on the first three months of Pregnancy and Baby Payments.⁸⁶ We have used information from this publication to revise our take-up assumptions.

Table 5.10: Take-up assumptions for Best Start Grant

Per cent	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Pregnancy and Baby Payment – first births	43	45	47	49	51	53
Pregnancy and Baby Payment – second and subsequent births	67	69	71	73	75	77
Early Learning and School Age Payments	67	69	71	73	75	77

Source: Scottish Fiscal Commission

5.25 Our assumed take-up rates increase over the forecast period meaning we expect the number of BSG payments made by Social Security Scotland to rise each year, with an initial spike in the first year the benefit launches.

⁸⁶ Scottish Government (April 2019) Best Start Grant: high level statistics to 28 February 2019 ([link](#))

Table 5.11: Forecast number of payments

Thousands	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Pregnancy and Baby Payment	15	15	15	16	17	17
Early Learning Payment	39	19	19	20	20	21
School Age Payment	20	21	21	20	20	21
Total	73	55	55	56	57	59

Source: Scottish Fiscal Commission

5.26 We have revised our approach to estimating the number of people eligible for Early Learning Payments when it launches, increasing spending in 2019-20. More than 11,000 applications for BSG have been received in the week following the launch of the Early Learning Payment.⁸⁷ Our previous forecasts didn't fully capture all children who were eligible on the first day. We now consider eligible children aged between two and three and a half at the launch of the benefit, some of whom have just a short time to apply before the child is too old. We then include eligible children turning two during the financial year.

5.27 A number of minor data updates have been included in our forecast: information on births, population and eligibility.

Forecast uncertainty

5.28 The BSG is a new benefit with limited data available. This leads to uncertainty around our assumptions.

5.29 How benefits are delivered and advertised directly affects take-up. Pending detailed information on the Scottish Government's communications plans for the new payments, we have assumed take-up for these benefits increases based on the response to the introduction of the first payment. The Pregnancy and Baby Payment was actively publicised in advance of its launch date. In comparison, the Early Learning Payment was only announced one day before launch. As our forecasts may not accurately reflect the communications and marketing activity, the risk that spending differs from our forecasts is high.

5.30 We assume the rates of payment for each payment remain constant across the forecast period. BSG is not subject to a mandatory increase by inflation each year, but there is a requirement on the Scottish Government in the Social Security (Scotland) Act to consider the effect of inflation on the benefit and to report to Parliament.⁸⁸ If the Scottish Government chooses to change the rates of payment for BSG, this will affect future spending.

⁸⁷ Cabinet Secretary for Social Security and Older People at the Social Security Committee on 9 May 2019 page 11 of the Official Report ([link](#))

⁸⁸ Chapter 7 Social Security (Scotland) Act ([link](#))

Best Start Foods

Forecast

Table 5.12: Forecast expenditure on Best Start Foods and Healthy Start Vouchers

£ million	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Healthy Start Vouchers	2					
Best Start Foods	3	6	4	4	4	4
Total	5	6	4	4	4	4

Source: Scottish Fiscal Commission.

Figures may not sum because of rounding.

5.31 Expenditure on Best Start Foods (BSF) is forecast to decrease by £2 million between 2020-21 and 2024-25. Spending falls because the number of people we assume to be eligible decreases across the forecast period. This is because eligibility criteria remain fixed while we assume incomes increase.

5.32 The Scottish Government will also incur costs in respect of the equivalent UK benefit, Healthy Start Vouchers (HSV), in 2019-20 until all eligible people are transferred to the new benefit and the old scheme is closed.

Background

5.33 BSF will provide weekly payments worth £4.25 to eligible families where the mother is pregnant or has children aged under three. Families will receive payments pre-loaded onto a smartcard every four weeks, which can be used to purchase a range of healthy foods. The Scottish Government committed to introduce BSF by summer 2019.

Changes since our last forecast

Table 5.13: Change in BSF forecast expenditure

£ million	2019-20	2020-21	2021-22	2022-23	2023-24
December 2018	4	5	4	4	4
Transitional protection	1	1	0	0	0
Data and assumption changes	0	0	0	0	0
May 2019	5	6	4	4	4
Change from December 2018	0	1	0	0	0

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 ([link](#)).

Figures may not sum because of rounding.

5.34 The Scottish Government will provide transitional protection for families with a child aged two and over receiving HSV who successfully transfer to BSF.

These families will receive BSF payments until their child turns four to ensure they are not disadvantaged by the change in the age of eligibility for BSF, which stops payments when a child turns three. Our December 2018 forecast did not include costs for transitional protection.

- 5.35 We have updated our forecast for a number of data releases and revised our take-up rate assumption. The UK Government writes to eligible families to ask them to apply for the HSV scheme. We now understand it is the Scottish Government's intention to do the same with BSF from 2020-21 onwards. As a result we assume lower take up of BSF compared to HSV in 2019-20 and thereafter the take-up rate is the same.

Table 5.14: Take-up assumption for HSV and BSF

Per cent	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Healthy Start Vouchers	68	68	68	68	68	68
Best Start Foods	62	68	68	68	68	68

Source: Scottish Fiscal Commission.

Table 5.15: Number of people forecast to receive support

Thousands	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Healthy Start Vouchers	9					
Best Start Foods	11	21	15	15	14	13
Total	20	21	15	15	14	13

Source: Scottish Fiscal Commission.

This is a forecast of the number of children and mothers supported. It is not a count of households.

Forecast uncertainty

- 5.36 The main uncertainty relates to the take-up rate for BSF. This is a new benefit so we do not know how many people will take up support. We revised our take-up assumption based on the Scottish Government's plans to write to eligible people. Any communications and marketing activity could also increase take-up further. At this stage and pending information on planned activity we have not incorporated an effect from communications activity. This presents a risk that spending differs from our forecasts.
- 5.37 The Scottish Government plans to link BSF and BSG, once BSF is live. Claimants will fill one form to apply for both benefits and receive payments depending on their eligibility. This could increase take-up above our 68 per cent judgement. We will monitor the effect of the new form on take-up.
- 5.38 In December 2018 we assumed BSF would launch on 1 June 2019 based on the Scottish Government's commitment to deliver the new benefits by summer 2019. In the absence of information on the start date we have continued to assume a 1 June 2019 start. Any delays past this date will result in actual expenditure for 2019-20 differing from the forecast presented here.

Funeral Support Payment

Forecast

Table 5.16: Forecast expenditure on Funeral Support Payment

£ million	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
	6	7	7	7	8	8

Source: Scottish Fiscal Commission.

Background

5.39 Funeral Support Payment (FSP) will support individuals on low incomes with funeral costs. The amount paid in FSP is split into two components. The first covers reasonable burial or cremation costs; the second is a flat rate amount for 'other' expenses which will increase in line with inflation. In our previous publication, and in the secondary legislation, this benefit is referred to as Funeral Expense Assistance. The Scottish Government plans to introduce FSP by summer 2019.

Changes since our last forecast

Table 5.17: Change in Funeral Support Payment forecast expenditure

£ million	2019-20	2020-21	2021-22	2022-23	2023-24
December 2018	6	6	7	6	7
Take-up rate update	0	0	1	1	1
May 2019	6	7	7	7	8

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 ([link](#)).

Figures may not sum because of rounding.

5.40 We have updated our take-up rate assumptions for FSP since our last forecast. We have increased our assumption because of the high take-up we have observed for the Best Start Grant Pregnancy and Baby Payment since it was launched in December 2018. We use these as an indication of the likely increase in take-up once Social Security Scotland becomes responsible for the benefit.

Table 5.18: Take-up rates for Funeral Support Payment

Per cent	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
December 2018	53	54	54	55	55	
May 2019	55	57	59	61	63	65

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 ([link](#)).

Table 5.19: Forecast number of people expected to receive Funeral Support Payment

Thousands	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
	4	5	5	5	5	5

Source: Scottish Fiscal Commission.

Forecast uncertainty

- 5.41** The main uncertainty relates to the take-up rate for FSP. The awareness of potential recipients about the policy changes between FSP and the previous UK benefit, Funeral Payments, and their eligibility under the new scheme could have a significant effect on take-up.
- 5.42** The Scottish Government has engaged with stakeholder groups, such as funeral directors, who will play an important role in informing people about the changes. We also expect the Scottish Government will carry out digital advertising and media campaigns but do not have much detail on these plans. As a result our forecasts may not accurately reflect the planned activity and the risk that spending differs from forecasts is high.
- 5.43** In December 2018 we assumed FSP would launch on 1 June 2019 based on the Scottish Government's commitment to deliver the benefit by summer 2019. In the absence of information on the start date we have continued to assume a 1 June 2019 start. Any delays past this date will result in actual expenditure for 2019-20 differing from the forecast presented here.
- 5.44** The average amount paid for the previous UK benefit, Funeral Payment, has changed year on year between minus one percent and plus two percent since 2013-14. If the average payment was to grow at a different rate to our estimate (0.9 percent) this would affect expenditure.

Employability Services

Forecast

Table 5.20: Forecast expenditure on Employability Services

£ million	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Employability services	19	16	24	23	13	1	0

Source: Scottish Fiscal Commission.

- 5.45 Spending on employability services peaks in 2020-21 and 2021-22 as people referred to the service move into and remain in employment for sufficient time such that performance fees are disbursed to service providers.

Background

- 5.46 Our employability forecast includes three services, the largest of which is Fair Start Scotland (FSS). This is a voluntary service designed to help people with disabilities or who are at risk of long-term unemployment find sustained employment. The service launched on 3 April 2018. The other two services were transitional and accepted referrals during 2017-18.
- 5.47 Fair Start Scotland is designed around participants' needs and there are three broad categories of support provided. These are: Core, Advanced and Intense. This segmentation reflects the range of circumstances of the people who volunteer. For most participants, pre-employment support is provided for up to 12 months followed by a further 12 months of support in employment, should the participant agree.
- 5.48 The Scottish Government has contracted external providers to deliver the service, allocating a £96 million budget to accept referrals over three years. Contracts with providers are for five years.
- 5.49 The Commission's employability forecast is produced using the Scottish Government's forecast model. Our role in the process is to provide scrutiny and challenge to the modelling approach and forecasts. This is a different approach to other areas of our forecast, where we build and run the forecast model ourselves. The forecast set-up in the employability case uses a range of performance management information and the Scottish Government's performance monitoring activities, while allowing the Commission to own the final forecasts that are published.

Changes since our last forecast

Table 5.21: Change in Fair Start Scotland forecast expenditure

£ million	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
December 2018	16	19	28	22	9	0
Data and updated forecasts from service providers	-1	-3	-4	1	4	1
May 2019	15	16	24	23	13	1

Source: Scottish Fiscal Commission, Scottish Fiscal Commission (2018) Scotland's Economic and Fiscal Forecasts – December 2018 ([link](#)).

Figures may not sum because of rounding.

5.50 The main change to the forecast has been because of fewer starts during the first year of service (2018-19) than previously expected. This has reduced the forecast by £1 million in 2018-19 and has also lowered the forecasts for 2019-20 and 2020-21. Fewer referrals means that fewer job outcome milestones will be realised within those years and therefore, less will be paid in performance fees than previously anticipated.

5.51 Another factor is a larger than expected proportion of those starting the service being in the Core category. While this reduces our forecast overall, there are two effects to consider. First, the Core category has a higher conversion rate onto job outcomes than does Advanced or Intense. All else equal, this increases the forecast. Second, the performance fee per job outcome in Core is relatively lower than in the other two strands. All else equal, this lowers the forecast.

5.52 Partly offsetting this is an increase in the forecast in the later years. This reflects two factors. First, there will be more referrals than previously forecast in 2019-20 and 2020-21. Second, the corresponding job outcome milestones will be reached later in the life of the service. This raises the forecast by £4 million in 2022-23 and £1 million in 2023-24.

Transitional services

5.53 Our forecasts for the two transitional services, Work First Scotland and Work Able Scotland, are slightly changed from December 2018. These services were introduced in April 2017, taking referrals for one year and with contracts lasting to the end of 2018-19. We expect that 2018-19 spend will be £3.5 million for Work First Scotland and £0.3 million for Work Able Scotland.

Table 5.22: Forecast expenditure on transitional services

£ million	2018-19
Work First Scotland	3.5
Work Able Scotland	0.3

Source: Scottish Fiscal Commission.

Note that there will be no expenditure for Work First Scotland or Work Able Scotland after 2018-19.

Forecast uncertainty

- 5.54** The voluntary nature of the service may lead the eventual number of people being referred and then agreeing to participate being lower than expected. Original assumptions about take-up were based on previous DWP schemes, in particular the New Deal for Disabled People. The evidence base underpinning this was limited, owing to few comparable previous voluntary schemes. We will continue to monitor the evidence on referrals and job outcomes as the life of the service progresses.
- 5.55** The second source of sensitivity for the forecasts is the effectiveness of the service providers at supporting participants into sustained employment. For Fair Start Scotland this forecast risk may be alleviated by a longer service period than for the two transitional services. The monthly performance monitoring system put in place by the Scottish Government will also play a very important role in mitigating this risk. While in the early stages of the service, this risk will more likely affect the profile of spending rather than the total amount spent. As the service progresses the importance of this risk to overall spend increases.
- 5.56** Our employability forecasts will always be reliant, to an extent, on information from the Scottish Government on how they expect expenditure on the services to develop. The service is delivered by contracted providers and monitored by the Scottish Government. The Scottish Government has some levers to influence the performance of providers, and therefore the level of expenditure. This has a more direct effect on expenditure than we see for social security benefits, where, for example, the Government may or may not be successful with a strategy to increase take-up of benefits.
- 5.57** We will continue to monitor expenditure on the service, in particular the assumptions around the risks identified. The current forecast of FSS expenditure will continue to be considered alongside the monthly performance and financial information being provided by the Scottish Government. The forecast may also be affected by any unanticipated effects that the changing UK-EU relationship might have on the Scottish labour market. We will continue to work closely with the Scottish Government to further develop the FSS expenditure forecast as the service matures.

Scottish Welfare Fund

Scottish Government's funding plans

Table 5.23: Funding plans for the Scottish Welfare Fund

£ million	2018-20	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
	33	33	33	33	33	33	33

Source: Scottish Government.

- 5.58** The Scottish Welfare Fund (SWF) helps people on a low income who are in crisis because of a disaster or emergency and helps vulnerable people set up home or continue to live independently in their community. The Scottish Government provides funding to local authorities who then award the discretionary payments.
- 5.59** The Scottish Government has set the 2019-20 budget for SWF at £33 million. The fund has stayed constant at £33 million since 2013-14.
- 5.60** The Scottish Government has not informed us of any plan to change the level of funding for the SWF over the forecast period. We present the Scottish Government's funding plans in Table 5.23. We do not assess the demand for the SWF or whether the funding provided to local authorities is reasonable.



Annex A

Policy Costings

Introduction

- A.1 Annex A sets out the methodology we used to produce the costings of new policies included in our forecasts. It shows the different steps and judgements taken to arrive at our costings of new Government policy proposals. As ever, we welcome discussion about the approaches and judgements we have taken.

Previous policy costings

- A.2 Our December 2018 publication included costings for policies announced by the Scottish Government at Budget 2019-20.
- A.3 Annex A only provides costings for policy changes where we have not previously provided a policy costing. Where we have previously provided a policy costing, any further changes will be captured in Annex B on policy recostings.
- A.4 Annex C sets out our approach to handling policies with a very small fiscal effect and we do not consider to be material in cost. It also sets out the Scottish Government's policy on the Young Carer's Grant and explains why we have not produced a costing for this policy.

New policy costings

- A.5 Table A.1 provides a summary of new policy costings included in our forecasts. The positive figures in the table indicate gains to the Scottish Budget.

Table A.1: Policy costings to accompany the Medium Term Financial Strategy 2019

£ million	2020-21	2021-22	2022-23	2023-24	2024-25
NDR					
Commercial activity in currently exempt parks			2	2	2
Mainstream independent schools no longer eligible for charitable relief	7	7	7	8	8
Overall effect of new policy	7	7	9	9	9

Source: Scottish Fiscal Commission.

Figures may not sum because of rounding.

Non-Domestic Rates (NDR)

Title of measure

Commercial activity on current exempt parks and Council land vested in recreation will no longer be exempt from Non-Domestic Rates

Measure description

- A.6 Currently parks under the control of, or vested in, a local authority are not included in the valuation roll, unless the local authority derives a net profit from the park. Parks under the control of, or vested in, a Minister of the Crown, government department or other body exercising Crown functions are not included in the valuation roll, provided the public has free and unrestricted access to the park. Non-domestic properties located within such parks are not included in the valuation roll. No rates are payable in respect of parks or non-domestic properties which are not entered in the roll.
- A.7 The policy change requires non-domestic properties within such parks to be entered in the valuation roll and therefore pay tax.⁸⁹ In addition, the policy change requires exempt parks which do not have free and unrestricted public access to be entered in the roll.
- A.8 Affected properties will be brought onto the valuation roll in time for the next non-domestic rates revaluation on 1 April 2022 and rates will therefore be payable in respect of such properties from 2022-23 onwards.

The cost base

- A.9 The cost base is non-domestic properties within identified parks currently not on the valuation roll.

The costing

- A.10 There is no information on non-domestic properties in public parks that are not on the valuation roll. These properties have not been assigned a rateable value (RV) by Assessors. The costing therefore follows the methodology set out in the Barclay Review.⁹⁰
- A.11 The costing assumes that there is an average five non-domestic properties in each of Scotland's 32 local authorities that will be brought onto the valuation roll. As per the Barclay Review, we assume that each property has an average rateable value of £20,000. We apply our forecast of the poundage to the average RV to calculate the average NDR paid by each of these

⁸⁹ Non-Domestic Rates (Scotland) Bill ([link](#))

⁹⁰ Barclay Review of Non-Domestic Rates (2017) ([link](#))

properties.⁹¹ Finally, we multiply the average NDR paid by the total number of properties we assume are affected. Given the timing of the introduction of the new policy, the first year of our costing is 2022-23.

Table A.2: Costing for commercial activity in currently exempt parks

£ million	2022-23	2023-24	2024-25
May 2019	1.7	1.7	1.7

Source: Scottish Fiscal Commission.

Uncertainties around the costing

- A.12** This costing carries a very high degree of uncertainty. The main problem is in identifying the cost base. As these properties are not on the valuation roll, we do not know either how many of them there are, nor what their rateable value is. Therefore we do not have a reliable estimate of the amount of NDR these properties might pay. Nor do we know whether they may be eligible for any reliefs after being brought onto the roll, for example through the Small Business Bonus Scheme.
- A.13** Should relevant information arise before the implementation of the policy or after the process of identifying and valuing these properties is complete, we will revisit our costing of this policy change.

⁹¹ This is the one area of difference between our approach and that used by the Scottish Government in the financial memorandum that accompanied the introduction of the Non-Domestic Rates (Scotland) Bill ([link](#)). While our forecast for the poundage is driven by the OBR's March 2019 forecast for inflation, these forecasts were not available to the Scottish Government at the time of producing their costing. This only leads to very small differences in our respective costings.

Title of measure

Mainstream independent schools no longer eligible to claim charity relief

Measure description

A.14 As part of the NDR Bill, the Scottish Government is changing the eligibility of mainstream independent schools to claim charity relief.⁹² Independent schools that are registered charities are currently able to claim up to 100 per cent relief – 80 per cent mandatory relief with a further 20 per cent relief left to the discretion of local authorities. The policy change means that mainstream independent schools will no longer be eligible for any charity relief. Independent special schools which offer enhanced provision for children who have additional support needs, as well as specialist independent music schools, will retain their eligibility for charity relief. The policy change takes effect on 1 April 2020.

The cost base

A.15 The cost base is all mainstream independent schools in Scotland.

The costing

A.16 The costing uses data from a data source called the billing system, which contains a record of entries on the valuation roll claiming relief at a set point in time. We also use a list of independent schools provided by the Scottish Council of Independent Schools to identify which schools will be affected by the policy change.⁹³

A.17 We calculate an estimate of the total amount of charity relief claimed by the mainstream independent schools in 2018-19. We grow this estimate using our forecast for the poundage.⁹⁴ This produces a forecast for the NDR income gained as a result of schools no longer claiming the relief from 2020-21 onwards. Table A.3 shows our costing of £7 million in 2020-21, rising to £8 million in 2024-25.

⁹² Non-Domestic Rates (Scotland) Bill ([link](#))

⁹³ Scottish Council of Independent Schools ([link](#))

⁹⁴ This is the one area of difference between our approach and that used by the Scottish Government in the financial memorandum that accompanied the introduction of the Non-Domestic Rates (Scotland) Bill ([link](#)). While our forecast for the poundage is driven by the OBR's March 2019 forecast for inflation, these forecasts were not available to the Scottish Government at the time of producing their costing. This only leads to very small differences in our respective costings.

Table A.3: Costing for mainstream independent schools no longer eligible to claim charity relief

£ million	2020-21	2021-22	2022-23	2023-24	2024-25
May 2019	7	7	7	8	8

Source: Scottish Fiscal Commission.

Uncertainties around the costing

A.18 We attached a reasonably high degree of certainty to this costing as we have some information on the properties likely to be affected. There are two sources of uncertainty around the costing. The first is our forecast for the poundage. This relies on the OBR's forecast for CPI inflation and Scottish Government policy. Should either of these change, our forecast would change accordingly. Second is whether we have identified all of the mainstream independent schools correctly. We will continue to monitor the policy as it comes into effect and revise our costing as appropriate.



Annex B

Policy Recostings

Introduction

- B.1** A policy recosting is a revised estimate of a policy that has been previously costed. There are two main reasons why we may recost previously announced or implemented policies.
- The outturn administrative data that includes the effects of the policy change is not yet available. For example, the 2017-18 income tax higher rate threshold policy will not be present in the outturn data until summer 2019.
 - We revise judgements or assumptions relating to our previous policy costings – particular in response to new evidence.
- B.2** This Annex sets out the latest policy recosting estimates and how they have changed from the previous costing. We publish this Annex twice a year as part of our Scotland's Economic Fiscal Forecast (SEFF) series.

Table B.1: Latest policy recostings

£ million	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Income Tax [1]								
2017-18 policy	52	56	84	78	85	96	106	116
2018-19 five band policy, of which		204	208	220	232	244	259	273
Introduction of starter rate		-48	-48	-51	-52	-54	-56	-58
Introduction of intermediate rate		130	131	140	147	155	163	171
Higher rate threshold adjustment		51	53	56	59	63	67	68
Increase in higher rate		66	68	71	74	78	82	88
Introduction of top rate		3	3	3	4	4	4	5
2019-20 policy			69	72	76	81	86	91
NDR [2]								
Business Growth Accelerator and Empty New Build relief		-24	-28	-29	-30	-31	-32	-32
LBTT								
Relief for first time buyers, of which		-4	-7	-7	-7	-7	-7	-7
Residential component		-4	-6	-6	-7	-7	-7	-7
ADS component		0	0	0	0	0	0	0
ADS rate change, of which		4	26	24	25	26	26	27
Residential component		0	-2	-2	-2	-2	-2	-2
ADS component [3]		4	27	26	27	28	28	29
Non-residential rate change		2	13	13	14	14	15	15

Source: Scottish Fiscal Commission.

Figures may not sum because of rounding.

[1] These recostings are not a direct comparison to the rUK income tax policy. For the 2017-18 Higher rate threshold policy, the baseline assumed is statutory CPI indexation. For 2017-18, the UK Government increased the higher rate threshold greater than statutory indexation to £45,000. The full static costing, behavioural reduction and post-behavioural income tax costing breakdowns can be found in Scottish Fiscal Commission (2018) Supplementary tables S4.5, S4.6 and S3.7 May 2019 ([link](#))

[2] Our recosting has estimated the cost of these together because in many cases the award of one will be linked to the other. Some properties will start claiming empty new build relief before transitioning to business growth accelerator as they become occupied.

[3] Effect on net ADS revenue

Table B.2: Change from previous costing

£ million	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Income Tax							
2017-18 policy	-0.5	0.1	0.4	2.6	-0.3	3.7	5.4
2018-19 five band policy, of which		0.1	1.0	1.3	2.5	3.8	4.8
Introduction of starter rate		-0.1	0.0	0.0	-0.2	-0.3	-0.5
Introduction of intermediate rate		-1.5	-1.2	-1.1	-0.5	0.1	0.7
Higher rate threshold adjustment		0.2	0.6	0.8	1.2	1.4	1.5
Increase in higher rate		0.3	0.4	0.5	0.9	1.4	1.9
Introduction of top rate		1.2	1.2	1.1	1.1	1.2	1.3
2019-20 policy			0.7	0.9	0.9	1.3	1.8
NDR							
Business Growth Accelerator and Empty New Build relief		0.0	0.1	0.0	-0.1	-0.1	0.0
Continuation of transitional relief		0.0	0.0	-0.1	0.0	0.1	0.1
LBTT							
Relief for first time buyers, of which		1.0	-0.3	-0.2	-0.2	-0.2	-0.2
Residential component		0.9	-0.3	-0.3	-0.2	-0.2	-0.2
ADS component		0.1	0.0	0.0	0.0	0.0	0.0
ADS rate change, of which		1.8	0.1	0.0	0.1	0.2	0.3
Residential component		0.1	0.1	-0.5	-0.3	-0.1	0.1
ADS component [1]		1.8	0.0	0.5	0.4	0.3	0.2
Non-residential rate change		-0.3	-0.6	-0.7	-0.7	-0.7	-0.7

Source: Scottish Fiscal Commission.

Figures may not sum because of rounding.

[1] Effect on net ADS revenue



Annex C

Materiality and policy costings

Introduction

- C.1** The Commission produces policy costings alongside our forecasts to show the effect changes made by the Scottish Government have on tax revenues and social security expenditure. We produce forecasts to accompany the Scottish Budget, and cost policies announced at these fiscal events.
- C.2** Annex A of our report sets out the costings for policies announced since our last publication, which we have not already costed. Annex B provides information on revised estimates of previously costed policies, known as recostings.
- C.3** The tax revenues devolved and assigned to Scotland will amount to over £20 billion a year, once fully implemented. The social security expenditure being devolved to Scotland equates to around £3.5 billion a year. Some policies announced by the Scottish Government will have a very small fiscal effect. This annex sets out our approach to handling policies we do not consider to be material in cost.

Materiality Policy

- C.4** The Commission has set thresholds under which policies will be deemed to be immaterial and therefore will not be costed.
- C.5** Where a policy is estimated to cost less than £0.5 million per year it is considered negligible and therefore will not be costed. For policies with an estimated cost of £2 million or lower per year, a decision will be made whether to cost the policy or not.
- C.6** Our decision as to whether or not to cost a policy require some, or all, of the following criteria to be met:
- High degree of confidence that the cost of the policy is low, even if there is a high degree of uncertainty as to the precise cost.

- The cumulative changes being made do not push the policy above the materiality threshold.
- Limited risk of significant behavioural response.

C.7 The Commission's approach to corrections and revisions published in our statement of compliance with the code of practice for statistics categorises errors based on material/not material and important/not important.⁹⁵ This policy of materiality will also be applied in those circumstances.

C.8 Details of any policies the Commission has decided not to cost will be included in this Annex in subsequent publications. We will keep under review both our materiality policy, and the policies we have previously not costed to ensure that none of these are now above the thresholds.

⁹⁵ Scottish Fiscal Commission (2018) Compliance with the Code of Practice for Official Statistics ([link](#))



Abbreviations

ADS	Additional Dwelling Supplement
ADT	Air Departure Tax
APD	Air Passenger Duty
ASHE	Annual Survey of Hours and Earnings
BGA	Block Grant Adjustment
BMW	Biodegradable Municipal Waste
BSF	Best Start Foods
BSG	Best Start Grant
CA	Carer's Allowance
CAS	Carer's Allowance Supplement
CAA	Civil Aviation Authority
COE	Compensation of Employees
CPI	Consumer Price Index
DHP	Discretionary Housing Payment
DWP	Department for Work and Pensions
EU	European Union
FAI	Fraser of Allander Institute
FSS	Fair Start Scotland
FTB	First Time Buyers
FSP	Funeral Support Payment
GDP	Gross Domestic Product
HM	Her Majesty's
HMRC	Her Majesty's Revenue and Customs
HSV	Healthy Start Vouchers
LBTT	Land and Buildings Transaction Tax
LCFS	Living Costs and Food Survey
LFS	Labour Force Survey
MTFS	Medium Term Financial Strategy
NDR	Non-Domestic Rates
NSND	Non-Savings and Non-Dividends
OBR	Office for Budget Responsibility
ONS	Office for National Statistics
PAYE	Pay As You Earn
PCA	Provisional Contributable Amount
PD	Political Declaration
PMI	Purchasing Managers' Index
PUT	Public Use Tape

QNAS	Quarterly National Accounts Scotland
RBS	Royal Bank of Scotland
RTI	Real Time Information
RV	Rateable Value
SDLT	Stamp Duty Land Tax
SEFF	Scotland's Economic and Fiscal Forecasts
SEPA	Scottish Environmental Protection Agency
SFC	Scottish Fiscal Commission
SG	The Scottish Government
SLfT	Scottish Landfill Tax
SWF	Scottish Welfare Fund
VAT	Value Added Tax
WA	Withdrawal Agreement

A full glossary of terms is available on our website:

<http://www.fiscalcommission.scot/about-us/glossary-of-terms/>

Voluntary compliance with the Code of Practice for Statistics

The Commission seeks to adhere to the highest standards for analysis possible. While we do not produce official statistics (we produce forecasts), the Commission and our work voluntarily complies as much as possible with the UK Statistic Authority's Code of Practice for Statistics. Further details and our statement of voluntary compliance can be found on our website.

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