

Finance and Public Administration Committee
24th Meeting, 2024 (Session 6)
Tuesday 3 September 2024

Scottish Fiscal Commission’s Fiscal Update, Forecast Evaluation Report and Statement of Data Needs, August 2024

Purpose

1. The Committee is invited to take evidence from the following witnesses from the Scottish Fiscal Commission in relation to its Fiscal Update, Forecast Evaluation Report and Statement of Data Needs, which were all published on 27 August 2024—
 - Professor Graeme Roy, Chair,
 - Professor Francis Breedon, Commissioner, and
 - Claire Murdoch, Head of Fiscal Sustainability and Public Funding.
2. This evidence session is intended to inform the Committee’s Pre-Budget 2025-26 scrutiny ahead of evidence sessions beginning on 10 September.
3. This paper should be read alongside the SPICe briefing on Scottish Fiscal Commission reports.

Overview

4. In his letter to the Committee of 27 August 2024 (Annexe A), Professor Graeme Roy, Chair of the Scottish Fiscal Commission (SFC) explains that its “Fiscal Update has been prepared to assist the Committee with its pre-Budget scrutiny given that we did not publish a forecast in May or June as the Government’s Medium Term Financial Strategy was postponed”. The Cabinet Secretary for Finance and Local Government, in a letter dated 23 August 2024 (Annexe B), confirmed that she “will be looking to bring forward a full update to Parliament in early September” which will “set out in detail the scale of the fiscal pressures that we are facing, in 2024-25 and beyond, and the action the Scottish Government is taking to address this challenge”.
5. Professor Roy states in his letter that the SFC’s—
 - Fiscal Update discusses “the economic and fiscal developments since our last forecasts in December 2023 and how these will affect the Scottish budget for the remainder of 2024-25 and in 2025-26”.
 - Forecast Evaluation Report, which evaluates its December 2022 forecasts for the economy, fully devolved taxes, and social security in 2023-24 and its December 2021 income tax forecast for 2022-23, highlights “a provisional positive reconciliation of £447 million [to be] applied to the 2025-26 Scottish Budget”.

- Statement of Data Needs suggests that “we need more data, and in a more accessible format, to better scrutinise and analyse spending trends and to assess the long-term fiscal implications of climate change”. The Statement, he explains, also makes recommendations to HM Treasury to improve its Block Grant Transparency data.

Fiscal Update, August 2024

UK Government announcements

6. The [SFC’s Fiscal Update](#) highlights a number of announcements made by the UK Government in response to its Spending Audit¹ published on 29 July 2024 which will likely have an impact on the how much funding the Scottish Government receives in 2024-25, including—
 - Higher than expected public sector pay awards of between 5-6% for 2024-25². Assumptions in the UK Government’s 2021 Spending Review were that pay awards would be around 2%. The SFC states that “the implications of this higher spending on public sector pay for departmental budgets in 2024-25, and therefore on the level of Block Grant funding [for the Scottish Government], is currently unclear”. It further suggests that “the UK Government may wait until the publication of the Supplementary Estimates in February 2025 to confirm final impacts on UK departmental budgets.
 - From autumn 2024, the UK Government will pay the Winter Fuel Payment (WFP) only to older people receiving means-tested benefits rather than all people over the state pension age. The Scottish Government has mirrored this announcement in relation to the replacement for WFP in Scotland (Pension Age Winter Heating Payment). This measure is expected to offset the expected reduction in the Block Grant Adjustment of between £140 million and £160 million, as a result of the UK Government’s announcement.
 - Announcements by the UK Government in relation to applying VAT and business rates on private schools are likely to have a limited effect on the Scottish Government’s Budget. However, if the additional funds raised were, as suggested in the Labour Party Manifesto, spent on education, Barnett consequentials would arise.
 - The UK Government’s Budget will be published on 30 October 2024 setting out its spending plans for 2024-25 and 2025-26. The SFC suggests that, given the two fiscal rules³ announced by the UK Government, as well as commitments not to raise income tax, National Insurance, or VAT rates, “it is unclear how much public spending levels in the UK will change from the plans of the previous government”.
 - The next spending review will be published in spring 2025, setting out departmental spending plans to at least 2027-28. The UK Government has

¹ HM Treasury (2024) [Fixing the foundations: public spending audit 2024-25](#)

² The UK Government adopted the recommendations of independent Pay Review Bodies in full.

³ Those rules are for day-to-day spending to match revenues, and for debt to be falling as a share of the economy by the fifth year of the Office for Budget Responsibility’s forecast.

also committed to a more regular cycle of spending reviews which, the SFC suggests, “should mean that Block Grant funding is more certain and that the Scottish Government will therefore be in a better position to provide multi-year spending allocations as part of its Medium-Term Financial Strategy”.

Scottish Government spending

7. The SFC’s Fiscal Update states that “since December 2023 there have been no significant confirmed changes in the Scottish Government’s funding, but the pressure on spending has increased with public sector pay offers in Scotland now coming in higher than the pay policy published in May 2024”, adding “there is significant uncertainty on the level of funding the Scottish Government will receive from the UK Government ahead of the UK Budget” on 30 October 2024.

8. It notes that the Scottish Government is likely to be under pressure to, at least, match the UK Government’s higher-than-expected pay awards. Current offers by the Scottish Government of 4.27% for local authority workers and 5.5% for nurses and NHS workers “are both higher than the 3% set out in the [Scottish] Government’s pay policy published in May” 2024. The SFC highlights that the total public sector pay bill for 2023-24 was around £25 billion, over half of Scottish Government resource spending, and the public sector in Scotland accounts for 22.6% of total Scottish employment compared to 17.6% for the UK overall. The SFC further suggests that—

“If a Budget is set based on pay assumptions which are lower than those that materialise, this creates challenges with in-year management of the Budget, requiring the Government to reduce its planned spending on services. The recent emergency spending controls the Scottish Government has put in place for 2024-25 are the result of those challenges”.

9. In a letter to the Committee of 23 August 2024, the Cabinet Secretary explained that she is “working with my Cabinet colleagues to agree the necessary actions to reduce expenditure and ensure our finances are on a sustainable footing”, adding that “additional measures are now necessary following the UK Treasury’s recent audit of public spending and lack of clarity over whether their decision to deliver Pay Review Body recommendations will be fully funded”. She further notes that “... the Scottish Government has set out that we had no choice but to replicate the UK Government’s decision to restrict eligibility for the Winter Fuel Payment to older people” and “the Scottish Government has also introduced a set of spending controls with the intention of further reducing spend in 2024-25”.

10. The SFC notes that “policy commitments the Scottish Government has made, such as the council tax freeze in 2024-25, social security spending and more generous pay deals in Scotland contribute to the growing pressure on the Scottish Budget”.

11. The SFC further repeats a call made in its December 2023 forecasts for “the Scottish Government to plan its Budget over the short, medium, and long-term”. It also notes that “... the next Scottish election in May 2026 will be in the second

year of a three-year spending review, but we encourage the Scottish Government to set out multi-year spending plans even when these cross into a new parliament to support planning across the public sector.”

Economic and fiscal developments

12. The SFC’s Fiscal Update highlights the following economic and fiscal developments since its December 2023 forecasts—

- The overall economic context for 2024-25, including Gross Domestic Product (GDP) “is broadly in line with our December 2023 forecast”, while Consumer Price Index (CPI) inflation fell back to the 2% target in 2024 Q2, “around a year earlier than we expected in December 2023”.
- Latest Real Time Information data shows that Scotland’s earnings growth in the first part of 2024-25 has slowed and is now similar to the UK average, following a period where “tighter labour market conditions in Scotland” had pushed up Scottish earnings relative to the UK.
- Latest data relating to real disposable income per person show an increase in 2023-24, mainly as a result of lower inflation, following a record fall in 2022-23. The SFC suggests, however, that “the outlook in the near term remains challenging as the downward pressure from higher prices and the recent period of higher interest rates may continue for some time”.
- Statistics showing annual productivity growth in Scotland averaged 0.6% from 2011 to 2023 compared to 1.7% from 1999 to 2010. In December 2023, the SFC forecast annual productivity growth of 1.1 per cent by 2028-29, broadly in line with the OBR’s forecast for the UK, with the underlying assumption that productivity growth in Scotland and the UK “will remain subdued and will not return to the pre-global financial crisis average”.
- An ‘economic performance gap’ in Scottish income tax revenues of £624 million in 2022-23, once taking account of different policy choices in Scotland. The SFC states that, “in addition, the latest data suggests Scottish earnings growth is slowing relative to the UK, meaning the period of catch-up in Scottish income tax revenues may be coming to an end in 2024-25”.

Outturn data

13. The SFC’s Fiscal Update comments on the recently published outturn data—

- 2022-23 “was a relatively positive year for growth in Scottish income tax revenues, with the provisional income tax net position reaching £257 million”. As this net funding position is higher than the projected negative £190 million when the 2022-23 Scottish Budget was set, there will be a positive reconciliation of £447 million applied to the 2025-26 Scottish Budget. The SFC explains that this figure “is less positive than the £732 million we expected in December 2023”, and that this reduction is “mostly because of revisions in historical income tax data, which have lowered

Scottish revenues relative to UK Government revenues”. Income tax forecasts from the OBR and SFC (which are published alongside the UK Budget on 30 October 2024) will provide a more complete picture for income tax funding in the 2025-26 Scottish Budget.

- Social security spending in 2023-24 was at £5.3 billion. The SFC estimates that spending exceeded the BGA funding by around £0.9 billion and that this gap will grow to £1.1 billion in 2024-25 and £1.5 billion in 2028-29.

Funding sources and management

14. In relation to other funding sources and management across years, the SFC highlights that—

- The Scottish Government fully used the available Scotland Reserve funding in 2023-24, drawing down £250 million for resource, £32 million for capital, and £44 million for Financial Transactions.
- Provisional outturn data shows underspends of £292 million (£162 million from resource and £130 million from capital). The SFC notes that the Scottish Government now plans to draw down these amounts in full in 2024-25 and expects this to be set out in the Scottish Government’s Autumn Budget Revision.
- The Scottish Government also has a remaining £660 million of ScotWind proceeds available to spend. It had, as at December 2023, planned to use £460 million of ScotWind proceeds in 2023-24 and £200 million in 2024-25. However, none of the £460 million was used in 2023-24.
- The Scottish Government had previously stated that it is considering options to issue bonds in the latter half of the 2025-26 financial year. The SFC states that if the Scottish Government plans to issue bonds during 2025-26, these will need to be set out in the 2025-26 Budget and “we will assess the reasonableness of those borrowing plans” at that time.

Forecast Evaluation Report

15. The SFC’s [Forecast Evaluation Report](#) (FER) published in August 2024 evaluates its December 2022 forecasts for the economy, fully devolved taxes, and social security expenditure in 2023-24, and its December 2021 forecast for Scottish income tax revenue in 2022-23. Key issues highlighted in the FER include—

- An under-forecast of Scottish GDP growth by 1.1 percentage points, which the SFC considers to be “a reasonable forecast error, being close to the UK historical average absolute error, especially given the uncertain and volatile environment in which we produced the forecast”.
- Employment growth was stronger than the SFC had forecast in December 2022, which “partly reflects stronger population growth than assumed” and “also reflects lower unemployment, consistent with the economy remaining stable instead of falling into a shallow recession” (as had been forecast in December 2022).

- The SFC’s December 2021 income tax forecast for 2022-23 was £1,498 million or 11% lower than the outturn figures, with “inflation-driven nominal earnings growth being the largest factor in under-forecasting Scottish income tax revenue”.
- Total outturn revenue from fully devolved taxes, including non-domestic rates, land and buildings transaction tax and Scottish landfill tax “was not significantly different to our December 2022 forecasts for 2023-24”, however, there were “larger errors for each individual tax which offset one another”.
- Total spending on devolved social security in 2023-24 was £5.3 billion, 1% higher than the SFC’s forecasts, which “is a slightly lower level of relative error than in previous years”. The SFC notes that “the largest contribution to our social security forecast error in 2023-24 was higher spending on disability payments associated with higher demand than we forecast, a trend which has also arisen for disability payments in the rest of the UK”. It has also “identified divergences in our assumptions on average award levels, successful new applications, and the outcome of award reviews”.

16. Commenting on the forecast errors highlighted in the FER, the SFC highlights that its forecasts for 2023-24 “were produced during a period of high inflation driven by the Russian invasion of Ukraine and interest rates rising to levels we had not seen since before the 2008-09 global financial crisis, contributing to high levels of uncertainty and leading to greater volatility”. The SFC indicates that, given these factors, it is satisfied with the performance of its forecasts for the economy, devolved taxes, and social security in 2023-24.

17. Its December 2021 forecast for income tax in 2022-23 was produced while there was ongoing uncertainty about the recovery from the COVID-19 pandemic and before the invasion of Ukraine and its subsequent consequences were known. Therefore, while “a large portion of this error could not have been foreseen, ... there remain lessons to be learnt”.

18. The FER further includes a table (figure 2.5 setting out historical forecast performance in relation to GDP). The SFC states that “at this stage, we have not identified any systemic concerns with the way we produce our forecasts”, adding that—

“Over time, as we publish more forecasts and undertake more evaluations, we will be able to make a more comprehensive analysis of our forecast performance and draw conclusions on areas of development.”

Statement of Data Needs

19. The SFC's [Statement of Data Needs](#) published in August 2024 highlights areas for improvement which would help it produce and evaluate its forecasts. Chapter 5 provides a summary of recommendations, noting that the SFC will evaluate progress on each of these in its next Statement of Data Needs which it expects to publish in 2026. Most of the recommendations are for the Scottish Government. This includes requesting more detailed Classification of Functions of Government (COFOG) information which would allow more comparisons across financial years and from budget to outturn, unrounded figures in all budgetary documents, and publication of its planned net zero assessment. The SFC also asks for further improvements to be made to the Climate Change Assessment of the Scottish Budget, including showing if spend supports mitigation, adaptation, or both. The Scottish Government is further asked "to supply, where possible, consistent projections of basic pay awards, average pay bills, total pay bill, and workforce for the devolved public sector in sufficient time for the SFC to consider for its forecasts alongside the Scottish Budget and MTFs".
20. The SFC further recommends that both HM Treasury and the Scottish Government ensure timely publication of Barnett funding data, and that the UK Government provides statutory access to the relevant information from its departments and public bodies. The Office for National Statistics is asked to publish a timetable for the labour market survey/transformed labour market survey and annual population survey reweighting exercise and wider developments, and improvements are also sought in relation to availability of Scottish labour market estimates. Finally, Social Security Scotland is asked to provide more detailed statistics in a number of areas with a view to improving forecasts.
21. The Statement of Data Needs also includes a table (figure A.1) setting out progress against past recommendations, with most closed or in progress.

Next steps

22. The Committee will begin taking evidence in relation to its pre-Budget 2025-26 scrutiny on 10 September 2024.

Committee Clerking Team
August 2024

Letter from Professor Graeme Roy, Chair of the Scottish Fiscal Commission, in relation to its August 2024 publications

Dear Convener,

Today the Scottish Fiscal Commission has published three reports. Our Fiscal Update has been prepared to assist the Committee with its pre-Budget scrutiny given that we did not publish a forecast in May or June as the Government's Medium Term Financial Strategy was postponed. We discuss the economic and fiscal developments since our last forecasts in December 2023 and how these will affect the Scottish budget for the remainder of 2024-25 and in 2025-26.

In our Forecast Evaluation Report we evaluate our December 2022 forecasts for the economy, fully devolved taxes, and social security in 2023-24 and our December 2021 income tax forecast for 2022-23. For Scottish income tax revenues 2022-23 was a relatively positive year for growth, with the income tax net position reaching £257 million. As this net funding position is higher than when the 2022-23 Scottish Budget was set, there will be a provisional positive reconciliation of £447 million applied to the 2025-26 Scottish Budget.

Most of the requests in our Statement of Data Needs relate to funding and spending information. We welcome the improvements made by the Scottish Government since our last Statement of Data Needs in 2022. But we need more data, and in a more accessible format, to better scrutinise and analyse spending trends and to assess the long-term fiscal implications of climate change. We also make recommendations to HM Treasury to improve its Block Grant Transparency data.

I would be happy to answer any questions you have on these reports and look forward to giving evidence to the Committee on Tuesday 3 September.

Yours sincerely,

Professor Graeme Roy
Chair, Scottish Fiscal Commission

Letter from Cabinet Secretary for Finance and Local Government dated 23 August 2024

Dear Kenneth

I am writing to set out an update on key issues ahead of our meeting on 29 August.

The Scottish Government, along with government and public sector bodies across the UK, faces a very challenging environment as we manage our finances through the current financial year and set our budget for 2025-26.

I am working with my Cabinet colleagues to agree the necessary actions to reduce expenditure and ensure our finances are on a sustainable footing. Further to this, additional measures are now necessary following the UK Treasury's recent audit of public spending and lack of clarity over whether their decision to deliver Pay Review Body recommendations will be fully funded.

Over the last few weeks, the Scottish Government has set out that we had no choice but to replicate the UK Government's decision to restrict eligibility for the Winter Fuel Payment to older people.

The Scottish Government has also introduced a set of spending controls with the intention of further reducing spend in 2024-25. In addition, I am working closely with my counterparts in Wales and Northern Ireland, along with the UK Chancellor of the Exchequer and the UK Chief Secretary to the Treasury, to ensure that all avenues are explored to navigate the financial challenges we face in the months and years ahead.

Subject to the agreement of the Parliamentary Bureau, I will be looking to bring forward a full update to Parliament in early September. During this statement, I will set out in detail the scale of the fiscal pressures that we are facing, in 2024-25 and beyond, and the action the Scottish Government is taking to address this challenge.

Fiscal Update

I welcomed the Committee's engagement on publishing a Medium Term Financial Strategy in 2024, given the timing of the UK General Election and uncertainty over the timing of the Autumn Statement. My update in September will provide further information to Parliament on the medium-term position to support pre-Budget scrutiny.

Given the announcement of a UK Government multi-year Spending Review, due to conclude in the Spring, it is my intention not to publish an MTFS alongside the 2025-26 Budget. Publishing an MTFS shortly before the UK Government Spending Review would risk the information provided becoming quickly out of date in the Spring. It is instead my intention to return to the usual schedule for the MTFS and publish a full MTFS in good time ahead of Budget 2026-27; recognising the precise

timing will depend on the timing of the UK's multi-year Spending Review which we expect to hear more about in the UK Autumn Statement on 30 October. In the meantime, I am keen to explore what medium-term information could be included in the Scottish Budget documentation, alongside the Tax Strategy. I would welcome the Committee's views on where there are particular gaps that can reasonably be addressed prior to the UK's multi-year CSR and 2025 MTFS.

Budget Date

The early confirmation of the UK Autumn Statement supports early planning of the 2025-26 Scottish Budget, and I am mindful of the interests of the Committee in securing an early Budget, along with the time necessary for Ministers and officials to work with the Scottish Fiscal Commission and to finalise policy, tax and spending plans. It would be very helpful if we could reach an early consensus on the Budget date to support our planning and to allow early notification to the Scottish Fiscal Commission.

Tax Strategy

The Tax Strategy will publish as a final document alongside the 2025-26 Scottish Budget later this year. My officials are in discussion with the Committee Clerks to confirm the best way to ensure the Committee has adequate time to feed in further views on this important piece of work. I believe there will be an opportunity to discuss this with you on 29 August.

I hope this information is helpful and I look forward to meeting with you and Committee members on 29 August for further discussion.

I have copied this letter to Professor Graeme Roy, Chair of the Scottish Fiscal Commission for information.

Kind regards

Shona Robison MSP
Cabinet Secretary for Finance and Local Government