



Kenneth Gibson MSP
Convener
Finance and Public Administration Committee
Scottish Parliament
Edinburgh
EH99 1SP

11 August 2023

Dear Convener,

I am writing in response to the Committee's inquiry on the sustainability of Scotland's finances.

The Scottish Fiscal Commission, as Scotland's official economic and fiscal forecaster, has a role to play in evaluating the sustainability of Scotland's devolved public finances in both the short and long term. We address the former in our regular publication Scotland's Economic and Fiscal Forecasts (SEFF), and the latter in our recent Fiscal Sustainability Report (FSR).

Our FSR found that devolved public spending is likely to grow more quickly than available funding over the next 50 years. It is not our role to suggest solutions to pressure on devolved public finances, nor assess proposals from others. However, the trends and projections that we identified and described in our FSR may be of some value to the committee in order to shape your own consideration of this subject. I set these out below.

Our report showed that over the next 50 years spending on public services will increase because of pressures from rising costs of delivery and an ageing population. Spending on health is projected to grow more quickly than that on other services, increasing from around a third of total devolved spending at present to about half in 50 years' time. The increased spending on public services will run ahead of the likely increases in the funding available to the Scottish Government from the UK Government's Block Grant and from the revenue from devolved income tax and other taxes.

Under current Scottish and UK fiscal policies, if public services in Scotland are to continue to be delivered as they are today, we project that Scottish Government spending over the next 50 years will exceed the estimated funding available by an average of 1.7 per cent each year.

Devolved funding is broadly split equally between the Net Block Grant, after taking account of the Block Grant Adjustment, and Scottish tax revenues. That means that around half of all



funding is determined by public spending in the rest of the UK. Any assessment of Scotland's devolved public finances must also consider fiscal sustainability across the UK, and how that may influence the size and relative influence of the Block Grant in the future.

The OBR produces regular reports on fiscal sustainability for the UK. In their central scenario for the UK the OBR conclude that, combined with their projections for tax revenue, their projections for UK Government spending are not sustainable. The UK Government would need to consider addressing this through either raising more revenue or through reducing spending to stop public debt taking an unsustainable path.

Based on the OBR's suggested paths for reducing the projected UK Government deficit, we have modelled a scenario where the fiscal tightening is applied evenly across all areas of UK Government spending and taxation, including devolved areas. In this case, devolved spending will exceed estimated funding available by an average of 10.1 per cent each year.

The effects of fiscal sustainability will have different implications for particular portfolios and spending commitments. In our FSR, and to keep our modelling assumptions transparent, we considered all devolved spending and did not distinguish between levels of government. We assessed the combined position of local authorities and the Scottish Government. Of course, spending by local authorities complying with their statutory duties is also influenced by long term trends in demographics and costs.

We also assumed that funding and spending on capital investment would grow or fall in line with resource spending. In reality, pressure on the capital budget will have different characteristics to that on resource spending. For example, capital funding is forecast to be 14 per cent smaller in real terms in 2028-29 than in 2023-24, while resource funding is set to increase by 8 per cent

Demographic pressures will add to health costs in the coming decade, but our FSR took into account additional pressures that have been identified in health provision which are not explained by demographic change. They have been attributed to the additional costs associated with new treatments and the increasing prevalence of long-term health conditions. A key conclusion of this is the need for a greater long term strategy for managing rising costs in delivering health care. However, any action taken now to mitigate these long term challenges may have implications for short term budget pressures.

These sustainability challenges are common across the UK, with the OBR projecting similar increases in health spending UK-wide. There are similar trends in other countries, with other fiscal institutions identifying rising costs in healthcare and demographic change as putting pressure on public finances. They would occur under any constitutional settlement or fiscal framework.



The recent agreement by the Scottish and UK Governments on the Scottish Government's fiscal framework makes the existing arrangements for calculating the block adjustments permanent. It therefore would not change the results of our FSR published in March.

We welcome the acknowledgement from both Governments in the Joint Communiqué on the Fiscal Framework Review on the importance of independent scrutiny of the Scottish Government's finances. We also note their support for the Committee's request we move to a two or three year publication cycle for fiscal sustainability reports as set out in your letter of May 2023. We will continue to develop our work on fiscal sustainability. In response to the request from the Committee we are publishing a paper at the end of August exploring how changes to productivity growth would affect our long term projections.

I have set out below where in our publications you may find additional information.

Yours sincerely

Professor Graeme Roy

Health spending FSR, page 26 ([link](#))

The Block Grant and the Fiscal Framework FSR, pages 11, 38, 45 ([link](#))

UK Government response to debt FSR, page 48 ([link](#))

Demographics FSR, Chapter 2 ([link](#))

Local Authority population change FSR, page 19 ([link](#))

Capital SEFF, page 18 ([link](#))