Finance and Public Administration Committee

14th meeting 2021 (Session 6), Tuesday 14 December 2021

Scrutiny of the Scottish Budget 2022-23

Purpose

1. This paper invites the Committee to take evidence from the following two panels of witnesses in relation to Scotland's Budget 2022-23 and the Scottish Fiscal Commission's 'Scotland's Economic and Fiscal Forecasts December 2021', which were both published on 9 December.

> **Panel 1**: Dame Susan Rice DBE, Chair, Professor Alasdair Smith, Commissioner, Professor Francis Breedon, Commissioner, and John Ireland, Chief Executive, Scottish Fiscal Commission; and
>
> **Panel 2**: David Eiser, Senior Knowledge Exchange Fellow, Fraser of Allander Institute, and Professor Graeme Roy, Dean of External Engagement and Professor in Economics at the University of Glasgow.

Economic and fiscal outlook

2. In 'Scotland's Economic and Fiscal Forecasts December 2021', the SFC sets out its latest forecast for the economy, tax revenues and social security spending to inform the Scottish Government's Budget 2022-23. A summary of the forecasts produced by the SFC is provided at Annexe A.

3. Overall the SFC "expects a strong economic recovery in 2021-22 with Scottish GDP growing by 10.4% and economic activity returning to pre-pandemic levels by the second quarter of 2022". However, it also highlights "some evidence that the Scottish economy has been lagging behind the rest of the UK". The SFC notes that:

- the overall Scottish Budget 2022-23 is 2.6% lower than in 2021-22. After accounting for inflation, the reduction is 5.2%. The 2021-22 Budget included specific funding for Covid-19, however, no specific Covid funding lines are included from 2022-23 onwards.
- after taking account of inflation, the Scottish Budget is expected to increase by 1% in total over the remainder of this Parliament, largely because of increases in UK Government funding.
- inflationary pressures have intensified since its previous forecasts in August. The SFC, in line with the Office for Budget Responsibility (OBR)

and similar to the Bank of England[1], sees annual Consumer Price Inflation (CPI) peaking at 4.4% in 2022 Q2 and gradually returning to the BoE target of 2% in the second half of 2024 “as supply chain issues ease, global demand re-balances and energy prices fall back”. It however also highlights significant risks to the outlook if inflation remains higher for longer, with a disproportionate effect on low-income households.
- the unemployment rate is expected to peak at 4.9 per cent, a significant downward revision from the SFC’s January 2021 forecast, which peaked at 7.6 per cent.
- Scottish income tax revenues have fallen behind the Block Grant Adjustment[2], with a shortfall of £190 million anticipated in 2022-23. This shortfall is expected to reach £417 million by 2026-27, driven by slower growth in employment in Scotland compared to the UK.
- spending on the Scottish Government’s largest social security payments, including new payments, is expected to be £750 million more than the social security funding received as part of the Block Grant by 2024-25, reducing the funding available for other spending priorities.
- its expectation that the Scottish Government explains further how its sources of extra income of £620 million for the resource budget in 2022-23 develop over the course of the financial year as some “are still a matter of negotiation between the Scottish and UK governments”.
- capital funding is expected to fall over the next five years in both cash and inflation adjusted terms, primarily due to reduced UK Government funding. As the Scottish Government moves closer to reaching its capital borrowing limit of £3 billion, borrowing is planned to reduce over the next five years, further reducing capital funding.

4. The SFC’s forecasts, along with those of the OBR determine the size of future reconciliations to the Scottish Budget. The OBR gave evidence to the Committee on its latest forecasts for the UK economy and public finances which accompanied the UK Government’s Autumn Budget and Spending Review 2021 on 27 October. It had also revised up its expectations for growth over the next five years, following stronger than expected growth in the first half of 2021, supported by the vaccine roll-out.

5. The SFC anticipates that “from April 2022 and into the longer term, Covid-19 will become endemic and begin to be managed through guidance and voluntary measures”. Its forecasts were finalised before the emergence of the Omicron variant and, while noting that information on its impact is currently limited, the SFC “broadly think it remains reasonable to assume the effects of Omicron fit within our central assumptions”. There is speculation[3] that interest rates will remain at the same level due to the uncertainty around the impact of the new variant. The Fraser of Allander Institute explained to the Committee during pre-budget scrutiny that Covid-19 has to date largely had similar health and economic impacts across the UK, a scenario

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[1] The Bank of England (BoE), in its Monetary Policy Report[1] of November 2021, set out its expectation that inflation would continue to rise, to 5% by Spring 2022. The BoE’s Monetary Policy Committee will next meet on 16 December to consider whether to raise interest rates, which currently sit at 0.1%.
[2] The BGA is the amount subtracted from the Scottish Budget to account for the devolution of tax revenues.
[3] Bank of England unlikely to raise interest rates this month, say economists | Financial Times (ft.com)

which sees little or no impact on how the fiscal framework operates. However, if these impacts were to disproportionately affect some parts of the UK more than others, the fiscal framework could come under greater strain.

6. In a joint report[4] on the fiscal framework, the Committee's predecessor highlighted some of the risks inherent in forecasting, including:

- the extent of the underlying uncertainty about the economy,
- the availability of relevant and robust data,
- the robustness of the OBR and SFC's respective methodologies and judgments,
- differences in the methodologies used by the OBR and SFC, and
- forecast horizons, i.e. the length of time into the future for which forecasts are prepared.

7. These risks are more acute during periods of economic uncertainty such as the pandemic. In its pre-budget report, this Committee agreed with its predecessor that "the two governments should consider the extent of the risk arising from potential divergence in forecast error between the SFC and the OBR, learning any lessons from the experience of an economic shock being triggered due to a quirk in timings".

8. In evidence on 27 October, Richard Hughes, Chair of the OBR, suggested that there had "been a learning process not only for us but for the Scottish Fiscal Commission" which had helped to reduce forecast error. He also explained that both the OBR and the SFC were now producing a comparison and trying to reconcile where their estimates differ and went on to suggest that "we produce forecasts at different times, which often explains the differences in the expected yields from taxes".[5]

Scottish Budget 2022-23

9. The Cabinet Secretary for Finance and the Economy, in a statement to Parliament on 9 December, announced the Scottish Government's spending priorities in the Scottish Budget 2022-23 as: tackling inequalities, ending Scotland's contribution to climate change, and supporting Scotland's recovery. Specific measures include doubling the Scottish Child Payment to £20 from April 2022 and starting delivery of the new Adult Disability Payment. Funding has also been made available for decarbonisation of homes, buildings, transport and industry, and minimum wage rises to £10.50 an hour for social care staff and those covered by the public sector pay policy.

10. In terms of tax policy, income tax rates remain unchanged, but thresholds increase for some earners. Land and buildings transaction taxes and bands are maintained at current levels, while standard and lower rates of landfill tax are increased. The council tax freeze ends in 2022-23 and so, councils will have flexibility to set the council tax rate for the first time since 2007. There will be a 50%

[4] A joint report with the Social Security Committee and Cabinet Secretary for Finance: Report(2).pdf (parliament.scot)
[5] Official Report (parliament.scot)

rates relief from non-business rates (NDR) for the first three months of 2022-23, capped at £27,500 per ratepayer, and NDR poundage will be 49.8p, a below inflation rise.

11. The Committee published its pre-budget report on 'Scotland's public finances in 2022-23 and the impact of Covid-19'[6] on 5 November. A key theme in the report was the need to balance the short-term demands from the response to, and recovery from, Covid-19, with continuing longer-term pressures such as demography, poverty and inequality. The report also made a number of recommendations aimed at achieving future fiscal sustainability. Under other aspects of the Committee's remit, it has heard in recent weeks about the need to reprioritise a preventative approach, to more closely align the National Performance Framework to budget planning, and to identify how the transition to net zero influences budgetary decisions.

12. The Scottish Government's response to the Committee's pre-budget report received on 9 December is attached at Annexe B. The Committee will be able to question the Cabinet Secretary on this response, as part of its budget scrutiny, on 21 December. A debate expected to be arranged for late January provides further opportunity to discuss these issues.

13. Along with the Scottish Budget 2022-23, the Scottish Government published a Resource Spending Review Framework[7], and a Medium-Term Financial Strategy (MTFS)[8]. The Committee has agreed to undertake a short, focussed inquiry with a view to influencing the resource spending review and to conduct a review of the content of the MTFS to ensure future strategies are fit-for-purpose and best support parliamentary scrutiny.

14. The Budget Bill was also introduced on 9 December, with a Stage 1 deadline expected to be towards the end of January, when a debate on the general principles of the Bill will take place. Stages 2 and 3, where only Ministers can lodge amendments, will follow thereafter.

Next steps

15. The Committee will take evidence from the Scottish Parliamentary Corporate Body and the Cabinet Secretary for Finance and the Economy on the Scottish Budget 2022-23 on 21 December 2021 and is expected to publish its report on the Scottish Budget 2022-23 in mid-January 2022.

Committee clerks
December 2021

[6] Pre-Budget Scrutiny 2022-23: Scotland's Public Finances in 2022-23 and the Impact of COVID-19 (azureedge.net)
[7] The findings of the Resource Spending Review will be published in May 2022, following the Scottish Government's consultation which closes on 27 March 2022.
[8] The next MTFS will be published in May 2022, returning to the usual publication schedule.

Scottish Fiscal Commission

Scotland's Economic and Fiscal Forecasts – Summary

December 2021

fiscalcommission.scot

This publication is available at www.fiscalcommission.scot

Any enquiries regarding this publication should be sent to us at: Scottish Fiscal Commission, Governor's House, Regent Road, Edinburgh EH1 3DE or info@fiscalcommission.scot

Published by the Scottish Fiscal Commission, December 2021

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 revenues and devolved social security spending to inform the Scottish Budget. We also continue to comment on the level of funding available to the Scottish Government and assess its borrowing plans.

Our forecasts represent the collective view of the four Commissioners of the Scottish Fiscal Commission who take full responsibility for them. We are very grateful to the staff of the Commission for their ongoing hard work and dedication in producing these forecasts.

Our forecasts rely on data from a range of providers and we are grateful for their support. We would also like to thank officials from the Scottish Government, Revenue Scotland, Social Security Scotland, DWP, HM Treasury, HMRC and the OBR as well as the Scottish Commission on Social Security for their constructive challenge of our judgements and for ensuring that we considered all the available evidence.

Dame Susan Rice DBE

Professor Francis Breedon

Professor Alasdair Smith

Professor David Ulph

9 December 2021

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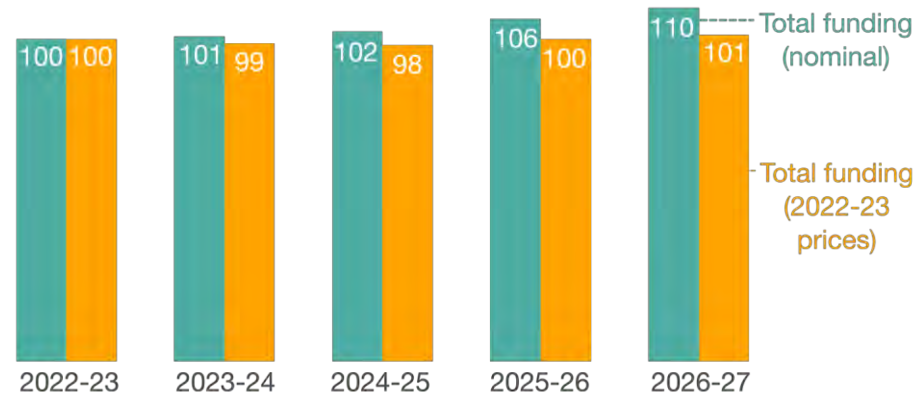
Fiscal Overview

We expect the Scottish Budget to increase by 10 per cent in cash terms between 2022-23 and 2026-27. After adjusting for inflation, this increase is 1 per cent.

Resource funding is expected to increase and capital funding to fall, as a result of changes in funding from the UK Government.

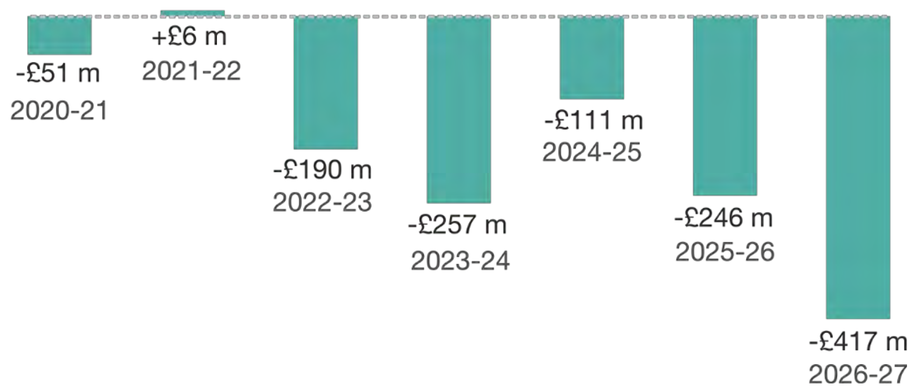
Expected Scottish Budgets flat after inflation



Scottish income tax revenues growing more slowly than the income tax Block Grant Adjustment means a negative net position and funding shortfall of £190 million in 2022-23.

This funding shortfall is expected to continue, reaching £417 million by 2026-27.

Income tax funding shortfalls forecast

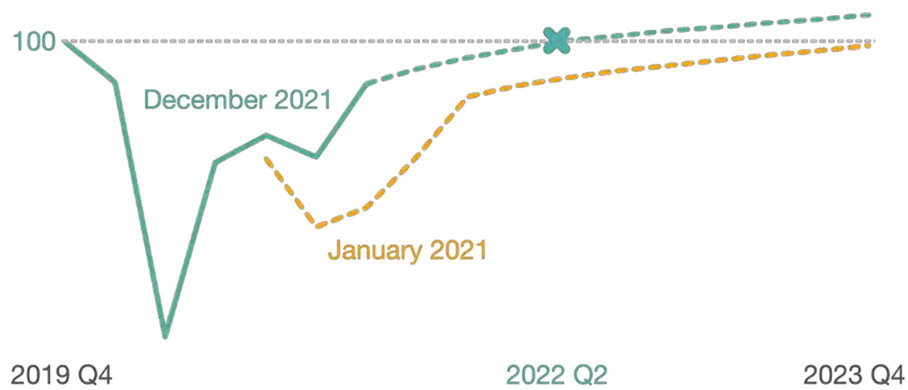


Economy

Since January, the outlook for the economy has improved, with GDP set to return to pre-pandemic levels by 2022 Q2.

This is because restrictions were lifted faster than anticipated and the economy adapted faster to restrictions than expected.

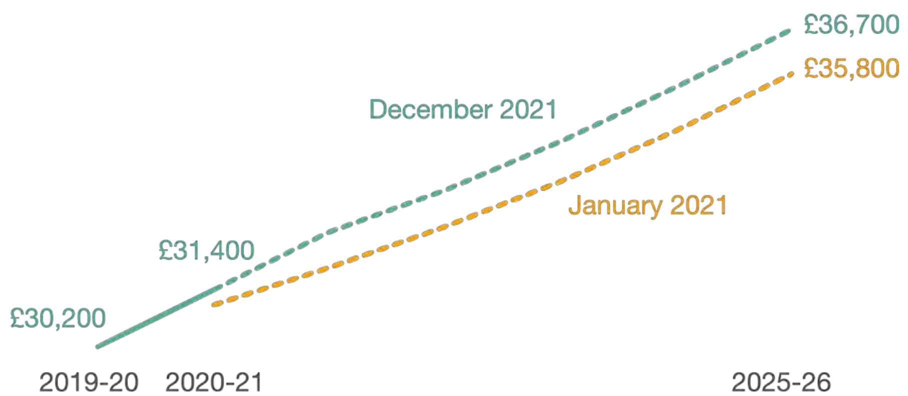
Return to pre-pandemic GDP revised since last Budget



Our December 2021 forecast for nominal average earnings is higher than in January 2021.

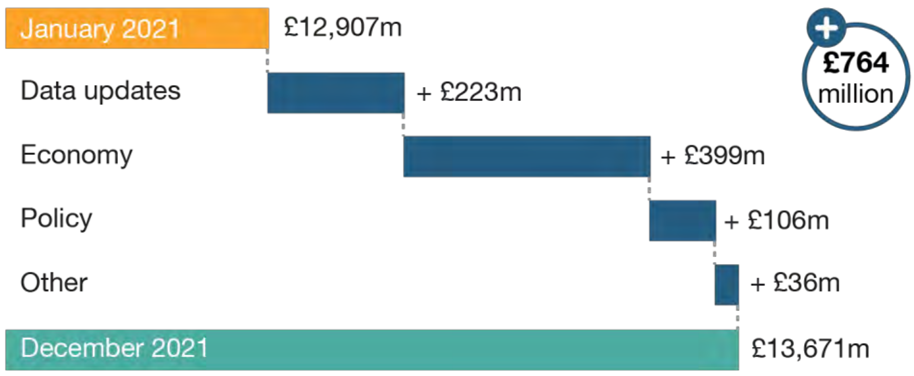
As well as higher inflation, this reflects wage pressures because of labour shortages in particular industries and increases in the minimum wage.

Higher earnings forecast partly driven by inflation



Tax

Income tax forecast for 2022-23 increased since January



Our income tax forecast for 2022-23 has increased by £764 million compared to January 2021 driven by more resilient economic performance.

Freezing the higher rate threshold raises an additional £106 million in revenues in 2022-23.

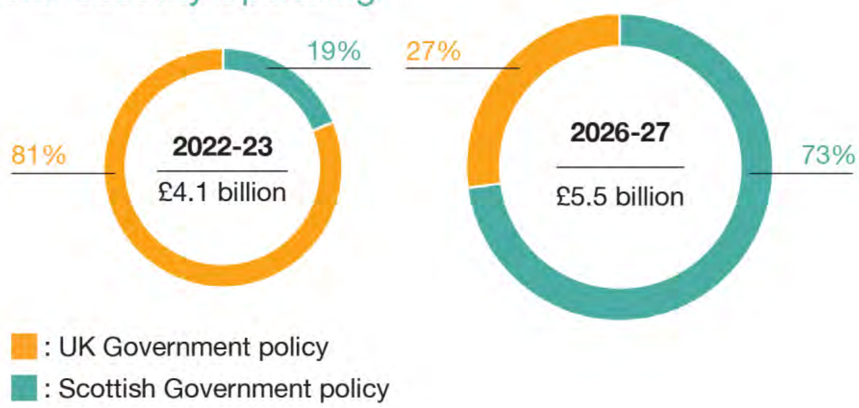
House price forecast revised up in line with income

We expect higher house prices in Scotland than in our previous forecast resulting from increased housing market activity since January 2021, as well as rising inflation feeding through to earnings.

As a result we have revised up our residential LBTT and ADS forecasts.

Social Security

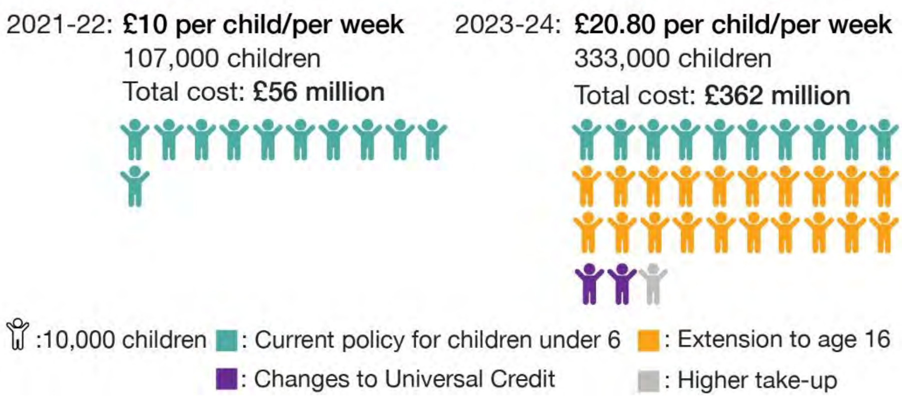
Social Security Spending



Over time Social Security Scotland will administer more payments directly following the introduction of Adult Disability Payment and Child Disability Payment.

Spending on Scottish Government payments also increases as payment rates rise and the Scottish Child Payment extends to children under 16.

Number of children receiving Scottish Child Payment



The number of children receiving Scottish Child Payment will peak in 2023 after the payment extends to children under 16.

We expect changes to Universal Credit will increase the number of eligible children and doubling the payment will encourage more people to apply.

Budget funding, £ million	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
Resource and capital (latest position)	49,637	48,353	48,739	49,414	51,293	52,989
Economy, % growth						
Gross Domestic Product	10.4	2.2	1.2	1.3	1.4	1.4
Consumer Price Index	3.3	3.7	2.3	2.0	2.0	2.0
Nominal Average Earnings	3.8	2.6	3.0	3.2	3.3	3.4
Employment	1.3	1.0	0.1	-0.1	-0.2	-0.2
Tax, £ million						
Income Tax	13,002	13,671	14,313	15,056	15,790	16,445
Non-Domestic Rates	2,083	2,809	3,233	3,167	3,231	3,519
LBTT	720	749	796	839	881	924
Scottish Landfill Tax	123	101	83	85	70	18
Policy announcements						
Freeze 2022-23 higher rate income tax threshold		106	106	111	117	124
2022-23 NDR Retail, hospitality and leisure relief		-56	0	0	0	0
Set NDR poundage to 49.8p in 2022-23		-40	-43	-42	-41	-44
Social Security, £ million						
All devolved social security assistance	3,679	4,065	4,657	4,966	5,230	5,511
Policy announcements						
Adult Disability Payment		38	233	358	458	567
Scottish Child Payment rise to £20		103	184	183	185	186
Other policy announcements	28	37	22	22	22	22

Summary

Introduction

1 Our latest forecasts accompany the Scottish Government's fiscal event presenting both the 2022-23 Scottish Budget and the Medium-Term Financial Strategy to the Scottish Parliament. This Budget is being presented in a context where the resource budget is forecast to face pressure from increasingly negative funding positions for devolved taxes and social security. At the same time the capital budget is falling over the next five years. We focus first on the Scottish Government's plans for 2022-23 before considering the outlook for the economy and Scottish public finances over the next five years.

2 The COVID-19 pandemic continues to affect society, the economy, and the Scottish Budget, but to a lesser extent than we expected when we produced our forecasts for the previous Scottish Budget in January 2021. The success of the vaccination programme has weakened the links between case numbers, hospitalisations and deaths, and the public health response has shifted. In addition many businesses have found ways of adapting to new ways of working. The economic recovery has been faster and smoother than we expected. We anticipate that from April 2022 and into the longer term COVID-19 will become endemic and begin to be managed through guidance and voluntary measures. Our forecasts were finalised before the emergence of the Omicron variant. Current information on the severity and likely implications for restrictions of Omicron is limited, but broadly we think it remains reasonable to assume the effects of Omicron fit within our central assumptions.

3 In our recent reports we have focused on the immediate funding challenges facing the Scottish Government in managing the COVID-19 pandemic. These challenges have not disappeared, but are less pronounced than last winter when the Government was balancing variable spending pressures arising from public health restrictions against an uncertain funding position dependent on UK Government policy.

4 Our focus now is shifting to the fiscal outlook for the next five years. In this report we set out our latest independent forecasts of the Scottish economy, tax, and social security spending as well as the Scottish Budget position.

2022-23 Scottish Budget

5 The Scottish Government has introduced three new tax policies in the 2022-23 Scottish Budget. The income tax higher rate threshold in Scotland is to be frozen at £43,662 in 2022-23 rather than rising in line with inflation, so more income will be taxed at the higher rate of 41 per cent, raising an expected £106 million of additional revenue in 2022-23. The increase is largely offset by two Non-Domestic Rates policies which set the poundage below inflation and extend the retail hospitality and leisure relief at 50 per cent for the first three months of 2022-23, together reducing revenues by £96 million.

6 We expect devolved Scottish taxes to raise £17.3 billion of revenue in 2022-23, a significant upwards revision of £777 million since our January 2021 forecasts. Stronger than expected economic activity combined with higher inflation has led us to revise up our forecasts of nominal household incomes, house prices and GDP, some of the main determinants of our tax forecasts.

The improved economic outlook was also in part due to public health restrictions being lifted more quickly than we anticipated in January.

7 Although our forecast of Scottish income tax revenues has increased since January, we expect revenues in 2022-23 to be £190 million less than the income tax Block Grant Adjustment (BGA) – the amount subtracted from the Scottish Budget to account for the devolution of income tax. We discuss the causes and consequences of this reduction in the budget further below.

8 The Scottish Government is forecast to spend £4.1 billion on social security in 2022-23 including new spending plans announced in the Budget. The Scottish Child Payment will double from £10 to £20 per child per week from April 2022.[1] Our forecast allows for the possibility that the higher payment rate encourages more applications. Low Income Winter Heating Assistance launches in winter 2022 replacing Cold Weather Payments and is forecast to cost £21 million in 2022-23. Our forecasts also include the launch of the largest social security payment, Adult Disability Payment, which will replace Personal Independence Payment.

Figure 1: Additional spending on the Scottish Child Payment

£ million	2022-23	2023-24	2024-25	2025-26	2026-27
SCP increased to £20	103	184	183	185	186

Source: Scottish Fiscal Commission

9 Overall the Scottish Budget in 2022-23 is 2.6 per cent lower than in 2021-22, after accounting for inflation the reduction is 5.2 per cent. The 2021-22 Budget included specific funding for COVID-19. From 2022-23 onwards there are no specific COVID-19 funding lines and any funding previously in this category which has continued is now part of general funding. This reduction is primarily because of the removal of COVID-19 funding and lower capital funding.

10 In developing its Budget the Scottish Government has assumed that it will receive extra income of £620 million for the resource budget in 2022-23 from a number of sources, some of which are still a matter of negotiation between the Scottish and UK Governments. We have reservations about the likelihood and amount of income available from some of these sources, but, considering the possibility of resource underspends materialising in the current financial year, we consider that, on balance across all the sources together, the Scottish Government assumptions are reasonable.

11 We discuss our concerns about some of the assumptions and the associated risks in the Fiscal Overview chapter. The Scottish Government has outlined the potential sources of income and the expected sum they might generate in Annex A of the Budget, and we expect it to explain further how these various sources develop over the coming financial year.[2]

The five-year outlook

Economy

12 We continue to expect a strong economic recovery in 2021-22, with Scottish GDP growing by 10.4 per cent which implies a return to pre-pandemic levels of economic activity by the second quarter of 2022.

[1] The April 2023 inflation increase in the payment rate is brought forward to the same time as the payment is extended to older children, which we expect to be in December 2022 with a payment rate of £20.80.

[2] Scottish Government (2021) Scottish Budget 2022-23 (link)

Figure 2: Scottish GDP growth comparing December 2021 and January 2021 SFC forecasts

Per cent	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
GDP							
January 2021	-12.4	7.5	5.1	1.5	1.7	1.7	
December 2021	-10.3	10.4	2.2	1.2	1.3	1.4	1.4

Source: Scottish Fiscal Commission

13 We assume that with the success of vaccines in weakening the link between case numbers, hospitalisations and deaths, domestic restrictions remain minimal with limited measures in place until April 2022. These assumptions were finalised before the emergence of the Omicron variant. Current information on the severity and likely implications for restrictions of Omicron is limited, but broadly we think it remains reasonable to assume the effects of Omicron fit within our central COVID-19 judgements. More severe effects from Omicron and the emergence of further variants of COVID-19 which are resistant to existing vaccines remain a downside risk to our forecast.

14 Throughout 2020-21 and 2021-22 the labour market has been more resilient than many economic forecasters and commentators, including the Commission, expected. We now expect the unemployment rate to peak at only 4.9 per cent, a significant downward revision from our January 2021 forecast which peaked at 7.6 per cent. Following strong growth in 2021-22, we expect nominal earnings growth to moderate in 2022-23 at 2.6 per cent. Inflationary pressures have intensified since the summer, driven in part by high energy prices. Our central view of inflation, in line with the OBR and similar to that of the Bank of England, sees annual CPI inflation peaking at 4.4 per cent in 2022 Q2 and gradually returning to target in the second half of 2024 as supply chain issues ease, global demand rebalances and energy prices fall back. There are however significant risks to the outlook for inflation. If inflation remains higher for longer, this will have significant implications for the Scottish economy and households.

15 Higher inflation, combined with recent tax rises including the new Health and Social Care Levy, will erode real disposable incomes and household consumption. With inflation outpacing nominal earnings growth in 2022-23, we expect real earnings to fall by 0.8 per cent next year. Low-income households could be disproportionately affected, for example because they spend more of their money on essentials including energy.

16 In spite of the pace of the recovery, there is some evidence that the Scottish economy has been lagging behind the UK. Compared to pre-pandemic levels, GDP, employment and earnings have recovered more slowly than in the UK. In part, this can be explained by a divergent sectoral and regional recovery, with areas like finance growing strongly in London. However, some issues pre-date COVID-19: declining North Sea oil and gas activity continues to act as a dampener, and Scotland's demographics are reducing labour market participation relative to the UK. We expect slower growth in earnings and employment in Scotland to continue over the next few years. This has important implications for tax revenues and the Scottish budget.

Contribution of tax to the Scottish Budget

17 The net position for a tax is the difference between the BGA and revenues: a positive net position means revenues are greater than the BGA so making a positive contribution to the budget while a negative net position means revenues are less than the BGA therefore reducing the budget. Over the next five years we expect the net position for Land and Buildings Transaction Tax (LBTT) to be positive, Scottish Landfill Tax (SLfT) has a positive net position until 2025-26. But the income tax

position is forecast to be negative and this is the dominant factor. With the exception of 2024-25, the overall net position for tax is negative for the next five years, as shown in Figure 3.

Figure 3: Tax net positions

£ million	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26	2026-27
Income Tax	148	-51	6	-190	-257	-111	-246	-417
LBTT	64	121	101	86	108	122	128	122
SLfT	20	20	34	18	1	9	1	-60
Total taxes	233	89	140	-86	-148	20	-117	-355

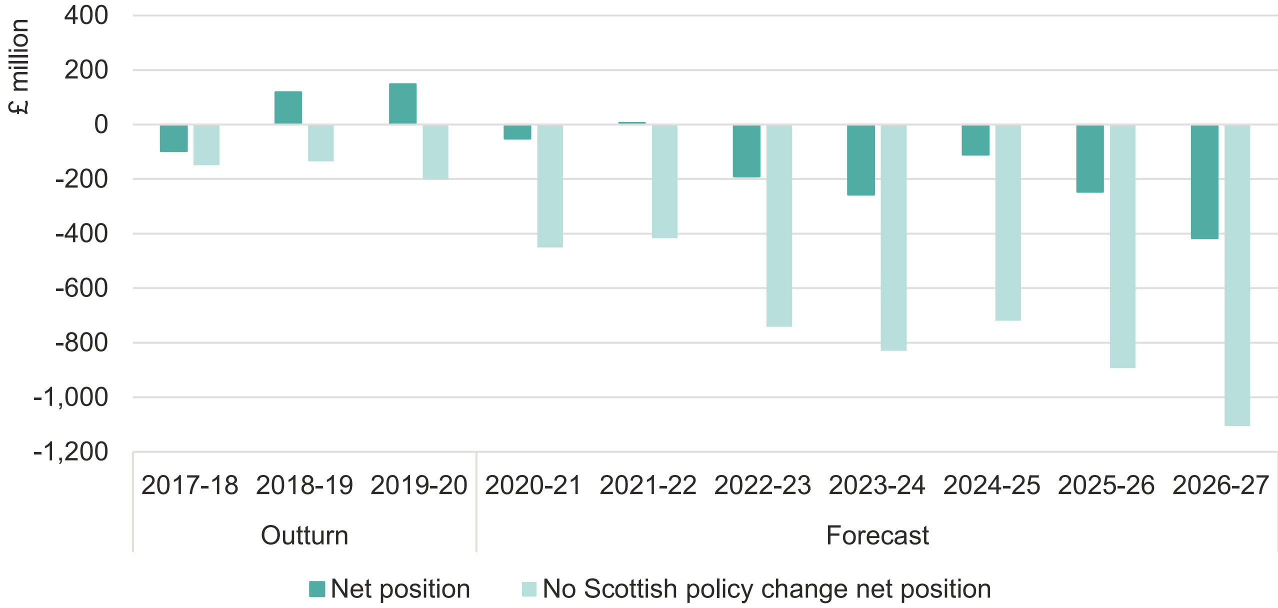
Source: Scottish Fiscal Commission, Scottish Government.
Shaded cells denote outturn.

18 Scottish income tax revenues in 2022-23 are expected to be £190 million less than the income tax Block Grant Adjustment (BGA) – the amount subtracted from the Scottish Budget to account for the devolution of income tax. We expect this shortfall to increase over the next five years, in spite of taxpayers earning over £27,850 paying higher levels of income tax in Scotland than in the rest of the UK.[3]

19 The net position is affected by two main factors: income tax policy differences and relative economic performance, including distributional differences. Since the 2016-17 initial deduction year for the income tax BGA, Scottish employment and earnings have grown more slowly than in the rest of the UK, even after accounting for differences in population growth. All else remaining equal, this would lead to a large negative income tax net position. Successive changes in income tax rates and bands in Scotland to raise additional income tax revenue have so far largely offset these negative economic effects on the income tax net position. Figure 4 shows the income tax net position and an illustrative calculation of what the income tax net position would have been without changes in Scottish income tax policy raising additional revenues. We estimate that in 2022-23, without cumulative Scottish income tax policy changes introduced since 2017-18, the net position would have been -£742 million. This does not factor in changes in UK Government income tax policy, which would have also contributed to the net position via their effect on the BGA.

[3] £27,850 is an illustrative calculation base on 2022-23 income tax rates and bands in Scotland compared to England and Northern Ireland. Individual tax circumstances may vary.

Figure 4: Income tax net position and illustrative position excluding Scottish policy change



Source: Scottish Fiscal Commission

20 From 2022-23, total earnings and employment are expected to continue to grow more slowly in Scotland than in the rest of the UK, and these economic factors are increasingly outweighing the additional income tax revenues from policy changes.

21 The relatively slower earnings and employment growth in Scotland compared to the UK arises from several underlying factors contributing to the emerging negative income tax net position. These include:

- Scotland's changing demographics and a faster growing share of the population among older age groups
- Falling labour market participation of younger age groups
- Slow growth in Scottish average earnings, particularly in North East Scotland relating to oil and gas activity
- More rapid growth in earnings in the UK, driven in part by strong growth in financial services in the UK

22 To move the net position back towards zero or positive values, there would need to be a period of relatively faster growth in income tax revenues per capita in Scotland to catch up with the BGA. Growth could be driven by further policies to raise additional income tax revenues from Scottish taxpayers, or by relatively faster economic growth in Scotland.

23 In addition to the effect on the resource budget of this downward pressure from tax revenues, it is important to note the consequences of increased spending on social security for the Scottish Budget.

Rising social security spending

24 The Scottish Government has introduced significant reforms of devolved social security. Existing payments administered by DWP on behalf of the Scottish Government are being replaced by new Scottish payments administered by Social Security Scotland. As well as reforming the administration

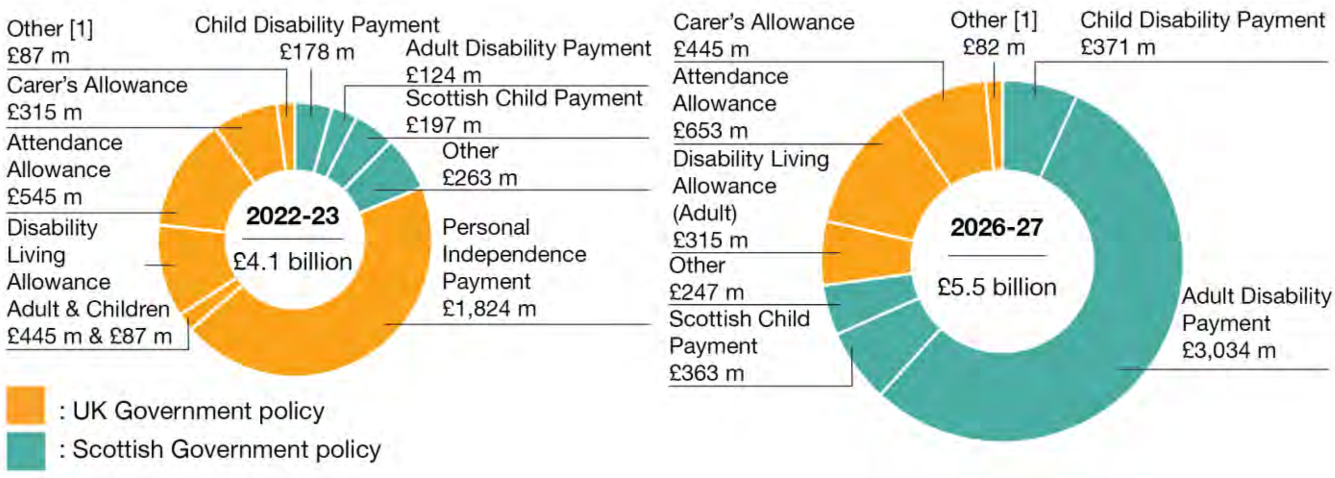
of these payments with an ambition to improve take-up of payments, the Scottish Government has, for many payments, expanded the number of people eligible and increased payment amounts. The largest payment, Adult Disability Payment, launches in 2022. The Scottish Government has also introduced new uniquely Scottish payments, most notably the Scottish Child Payment (SCP) which has been increased in this Budget.

25 We forecast devolved social security spending to increase from £4.1 billion in 2022-23 to £5.5 billion in 2026-27. Overall, our forecast of spending in 2025-26 has increased by £1.0 billion since January 2021. This increase primarily occurs because the Scottish Government plans to launch new payments which are more generous or received by more people. In addition, most payments are uprated by inflation and the higher inflation forecast therefore increases spending. By 2025-26, our forecast is £190 million higher than in January 2021 because of higher inflation.

26 Together these plans see more devolved social security transferring to be based on Scottish Government policy. In 2022-23, most social security spending, over £3 billion, will continue to be administered by the Department for Work and Pensions (DWP) on behalf of the Scottish Government.

27 By 2026-27, Social Security Scotland will administer more payments directly. Spending is also increasing as payment rates increase and the SCP is rolled out to all children aged under 16. As shown in Figure 5, our current forecasts estimate that 73 per cent of spending in 2026-27 will be administered by Social Security Scotland and be based on Scottish Government policy. We expect this percentage to increase in our future forecasts as we have not yet incorporated any changes in spending arising from the Scottish Government's replacement payments for Carer's Allowance, Attendance Allowance, Industrial Injuries Scheme, and Winter Fuel Payments which the Scottish Government aims to launch by the end of 2025. Any changes to these payments which further increase spending will also need to be met from the wider Scottish Budget.

Figure 5: Social security spending in 2022-23 and 2026-27



Source: Scottish Fiscal Commission
Scottish Government policy includes Best Start Foods, the three payments of Best Start Grant, Carer's Allowance Supplement, Child Winter Heating Assistance, Low Income Winter Heating Assistance, Funeral Support Payment, Discretionary Housing Payments, Fair Start Scotland, Self-Isolation Support Grant and Scottish Welfare Fund.
This figure does not include Winter Fuel Payment as it has not yet been devolved.
[1] "Other" includes Industrial Injures Disablement Scheme and Severe Disablement Allowance

28 Adult Disability Payment will become the largest component of social security, replacing Personal Independence Payment. People qualify for ADP on the basis of a disability or health condition, and their eligibility is not affected by their income or employment status. This means spending on ADP is

not related to economic performance, and instead is primarily related to demographics. Older people are more likely to receive ADP and therefore a combination of an aging population and increases in the state pension age mean we expect the number of people receiving ADP to increase over the next five years. Changes the Scottish Government is making to devolved social security have long-term spending implications, as once people are deemed to be eligible, they can continue to receive a payment for many years.

29 For the largest payments, the Scottish Government receives Block Grant Adjustment (BGA) funding from the UK Government based on spending on the original DWP payments. Spending above the BGAs for social security must be met from the wider Scottish Budget. The Scottish Government has introduced new payments that do not receive any funding from the UK Government and the costs must be met entirely from the Scottish Budget. Combining completely new payments and payments with BGA funding, we expect that by 2026-27 spending on the Scottish Government's social security benefits will be £760 million more than the corresponding funding received, reducing the funding available for other parts of the Scottish Budget.

Figure 6: Social security net position and new payments

£ million	2022-23	2023-24	2024-25	2025-26	2026-27
Social security net position [1]	-38	-176	-253	-255	-252
Social security new payments [2]	-322	-493	-496	-503	-512
Total	-361	-669	-749	-758	-764

Source: Scottish Fiscal Commission

[1] This includes Adult Disability Payment (covered by the Personal Independence Payment BGA), Child Disability Payment (covered by the Disability Living Allowance BGA along with DLA Adult spending), Attendance Allowance, Carer's Allowance, Industrial Injuries Disablement Scheme, Low Income Winter Heating Assistance (covered by the Cold Weather Payment BGA), and Severe Disablement Allowance.

[2] New payments includes: Carer's Allowance Supplement, Scottish Child Payment, Child Winter Heating Assistance, Best Start Grant Early Learning Payment and Best Start Grant School Age Payment. We also include spending on bedroom tax mitigation through Discretionary Housing Payments.

Fiscal Overview

30 Overall we expect the Scottish Budget in cash terms to increase by 10 per cent between 2022-23 and 2026-27, largely because of increases in UK Government funding. Behind this headline increase are several different elements. Increased resource funding is partially offset by a shrinking capital budget and anticipated shortfalls between tax revenues and Block Grant Adjustments (BGA). The Scottish Government also plans social security spending above the corresponding BGA funding. This creates pressures over the next five years and the Scottish Government will need to balance its spending plans against the available budget.

31 After taking account of inflation the overall increase in the Scottish Budget over the next five years is expected to be 1 per cent, with the first three years of funding being flat before increasing in the subsequent two years. The UK Government's recent Spending Review set out the funding the Scottish Government should expect for the next three financial years, and the Scottish Government has made assumptions about expected growth in the Block Grant beyond that period. We consider these assumptions reasonable.

Resource outlook

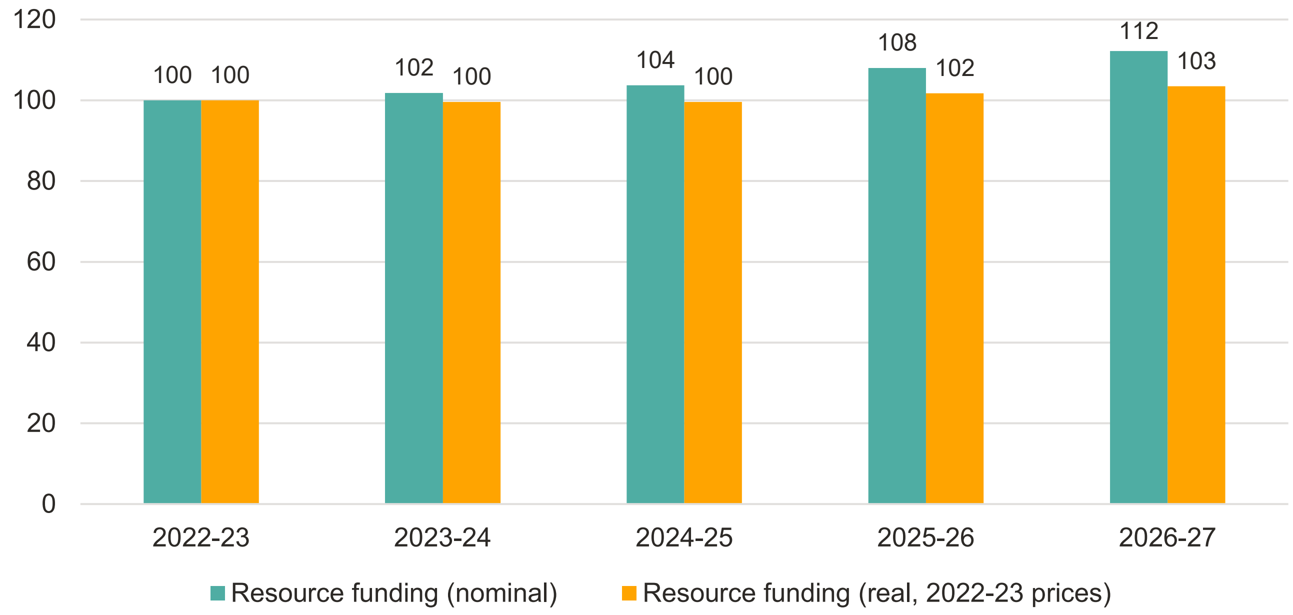
32 Resource funding makes up most of the Scottish Budget and is for spending on current costs such as public sector wages, spending on goods and services, grants and subsidies, and social security spending. For the period covered by the UK Government's Spending Review, 2022-23 to 2024-25,

resource funding increases in nominal terms but remains flat after adjusting for inflation. Thereafter it is assumed UK Government funding increases again.

33 Scottish tax revenues are forecast to increase by 20 per cent between 2022-23 and 2026-27, but the net effect on the budget is forecast to be negative in every year with the exception of 2024-25. Negative Block Grant Adjustments (BGA) reflect tax revenues in the rest of the UK, and these are forecast to outweigh the positive contribution from Scottish tax revenues. This difference is primarily driven by income tax because of lower earnings growth and lower labour market participation rates in Scotland.

34 The overall effect is that the resource budget increases by 12 per cent in nominal terms between 2022-23 and 2026-27, and by 3 per cent after adjusting for inflation.

Figure 7: Medium term outlook for resource funding, indexed to 2022-23



Source: Scottish Fiscal Commission, Scottish Government
Figures in 2022-23 prices calculated using year-on-year growth GDP deflators from Table 1.7 of the OBR's supplementary economy tables. Figures rebased so 2022-23 = 100. Office for Budget Responsibility (2021) Economic and fiscal outlook – October 2021 – supplementary economy tables (link)

35 The Scottish Government will need to balance its spending plans against the resource budget available. The resource management tools available to the Scottish Government give it a limited ability to transfer funding between financial years but cannot be used to manage longer term divergences in funding and spending plans.

Resource management tools

36 The Scottish Government is required to maintain a broadly balanced budget, matching its spending to available funding each year. As the Scottish Government cannot overspend its budget, outturn spending must come in below the allocated budget and this results in underspends, as a normal outcome of budget management. The Scottish Government can use the Scotland Reserve to transfer unspent funds from one financial year to the next. Following the devolution of tax and social security powers, the Scottish Government also has resource borrowing powers which can be used to manage forecast errors.

37 The Scottish Budget is set in advance of each financial year, based on forecasts of revenue and spending. For LBTT, SLfT and social security any differences between our forecasts and outturn

data are managed in-year. For income tax both our forecast of Scottish income tax revenue and the BGA based on OBR forecasts are fixed from when the Scottish Budget is set until outturn data become available. The outturns for revenue and the BGA only become known two years later and differences between forecasts and outturns give rise to a reconciliation in the subsequent budget.

38 In January 2021 the forecast 2021-22 BGA was £475 million lower than our forecast of Scottish income tax revenues. We cautioned that this difference could not be explained by economic or tax policy differences and seemed to reflect the considerable uncertainty surrounding COVID-19 and the fast-paced change of the COVID-19 outlook at the time. Since January 2021, both our and the OBR's forecasts have been revised up following stronger than expected earnings growth in 2021. However, the OBR forecasts have been revised up by significantly more than our forecasts, leading to a reduction in the net position. Our latest forecasts are for Scottish tax revenues to be just £6 million greater than the BGA in 2021-22, and we therefore expect a negative £469 million reconciliation to be applied in 2024-25. The actual reconciliation in 2024-25 will depend on the outturns which will be reported in 2023.

39 The Scottish Government has limited tools to manage this reconciliation, and has stated it plans to use resource borrowing to manage income tax reconciliations. The Scottish Government will be able to borrow £300 million to manage the reconciliation, effectively passing the repayment forward to future years. The remaining £169 million of the expected £469 million reconciliation will reduce funding in 2024-25. The Scotland Reserve is the other tool available to the Scottish Government, which in principle could prepare for a negative reconciliation by deliberate underspends to build up the Reserve. However, the Reserve has an overall size limit and an annual drawdown limit and, given the existing need for the Scottish Government to use the Reserve to manage underspends, the scope for it to help prepare for negative reconciliations is very limited.

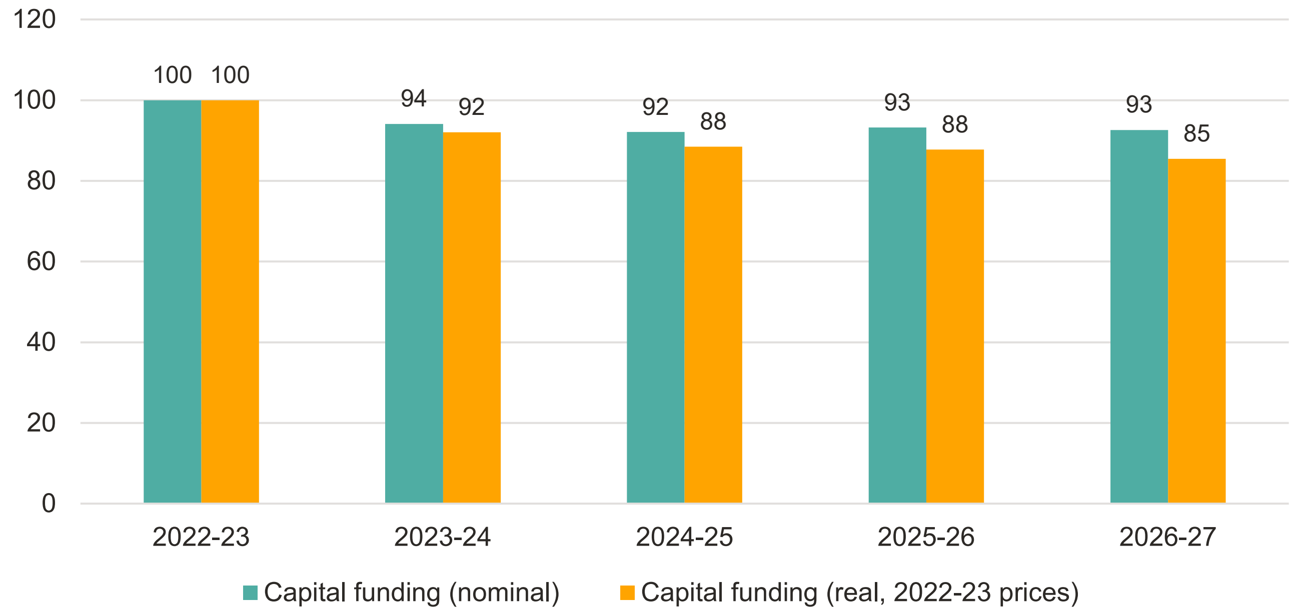
40 Currently the Scottish Government has enhanced borrowing powers and greater flexibility to use the Scotland Reserve because our January 2021 forecasts triggered a "Scotland-specific economic shock". These flexibilities expire after 2023-24 and are therefore not available to the Scottish Government to manage the large income tax reconciliation expected in 2024-25. As a result, the Scottish Government would need to consider adjustments to spending to manage the reconciliations. With the Scottish budget steadily increasing in size (both through inflation and real increases) this situation is likely to become increasingly common while the limits remain fixed.

Capital funding

41 Capital funding accounts for 13 per cent of the Scottish Budget. It is used for long-term investment such as hospitals, roads, and research and development. Financial transactions are a subsection of capital funding and can be used to make loans to, or equity investments in, private sector entities.

42 Over the next five years we expect capital funding to fall in both cash and inflation adjusted terms, primarily because of reduced UK Government funding. The Scottish Government is moving closer to reaching its capital borrowing limit of £3 billion, with a self-imposed rule to ensure a contingency of £300 million remains available in 2026-27. To stay within these limits, borrowing is planned to reduce over the next five years, further reducing capital funding.

Figure 8: Medium term outlook for capital funding, indexed to 2022-23



Source: Scottish Fiscal Commission, Scottish Government
Figures in 2022-23 prices calculated using year-on-year growth GDP deflators from Table 1.7 of the OBR's supplementary economy tables. Figures rebased so 2022-23 = 100. Office for Budget Responsibility (2021) Economic and fiscal outlook – October 2021 – supplementary economy tables (link)

43 The Scottish Government plans to borrow the annual maximum of £450 million in 2022-23. However, in the past, where underspends have arisen during the year, it has typically reduced planned borrowing in-year to ensure there is not a large underspend which reaches the Scotland Reserve limit. We therefore consider the Scottish Government's planned borrowing reasonable, but note both the likelihood that borrowing will turn out to be less than planned in each year, and that over the next five years it is likely the Scottish Government will be close to the overall borrowing limit.

Additional Information

Abbreviations

ADP	Adult Disability Payment
BGA	Block Grant Adjustment
COVID-19	Coronavirus
CPI	Consumer Price Index
DWP	Department for Work and Pensions
GDP	Gross Domestic Product
OBR	Office for Budget Responsibility
OECD	Organisation for Economic Cooperation and Development
PIP	Personal Independence Payment
SCP	Scottish Child Payment

A full glossary of terms is available on our website:

https://www.fiscalcommission.scot/explainers/glossary/

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The Commission is committed to fulfilling our role as an Independent Fiscal Institution, in line with the principles set out by the Organisation for Economic Cooperation and Development (OECD).[4]

The Commission also seeks to adhere to the highest possible standards for analysis. While we do not produce official statistics, we voluntarily comply as far as possible with the UK Statistic Authority's Code of Practice for Statistics. Further details and our statement of voluntary compliance can be found on our website.[5]

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

Correspondence and enquiries

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All charts and tables in this publication have also been made available in spreadsheet form on our website. For technical enquiries about the analysis and data presented in this paper please contact the responsible analyst:

Economy	Silvia Palombi
Public funding	Claire Murdoch
Taxes	David Stone
Social security	Francisco Forner

This publication is available at www.fiscalcommission.scot

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Scottish Government's response to the Finance and Public Administration Committee's pre-budget report

Dear Kenneth

Pre-Budget Scrutiny Report 2022-23

Thank you to the Committee for your pre-budget scrutiny report ahead of the 2022-23 Scottish Budget. I have carefully considered the points raised by the Committee and a detailed response is set out in the annex to this letter.

Given the enormity of the economic and fiscal challenges the Scottish Government is facing in preparing its Budget, I welcome the Committee's acknowledgment of the UK and Scottish economic outlooks, and the impact of having no COVID funding guarantee in 2021-22. I recognise the Committee's views on the need for effective intergovernmental relations, greater transparency and scrutiny, and improving public awareness and understanding of the budget process. The Scottish Government will continue to work together with the Parliament to meet these challenges, to ensure that we take effective action to support economic recovery and manage the risks around the public finances.

I welcome the Committee's ongoing input into the forthcoming review of the Fiscal Framework, and its recommendations and support for the issues that need to be considered. I view contributions from parliamentary committees and wider stakeholders as an integral part of the review process, which is why I am pleased to have agreed with the Chief Secretary to the Treasury that input will be sought at both the report and review stages of the process. I welcome views from the Committee on how best to obtain its input and engage throughout the process, while acknowledging that the review is a joint undertaking with UK Government.

On the independent report, my officials continue to work with HM Treasury counterparts to finalise the terms of reference and to consider potential authorship options. I will keep the Committee updated on progress, which I hope can be made swiftly, to enable commencement of the review as early in 2022 as possible.

Personal Allowance Spillover Dispute

I would also like to provide you with an update on the outstanding dispute with the UK Government in relation to their increases to the income tax personal allowance (PA), and the disproportionate impact these have on Scottish revenues through the operation of the Fiscal Framework. At official level, both governments have signed off a joint analytical framework which agrees that a direct spillover effect arises from the UK Government's changes to the PA, and so a transfer of funding from the UK Government to the Scottish Government is due. However, our Governments are disagreed on the size of the spillover effect.

The period covered by the dispute dates back to 2017-18 and is depriving the Scottish Budget of a material level of funding while it remains unresolved. I am therefore seeking to resolve the dispute without further delay. On that basis, the Scottish Budget 2022-23, published today, includes a funding assumption relating to several different funding sources, one of which is a funding transfer relating to this dispute. This does not pre-judge the outcome of the dispute resolution process. The Scottish Government will continue to engage with that process in good faith, with an expectation of reaching a swift resolution in 2022. I have therefore written to the CST today to request a discussion early in the new year to consider this dispute and to discuss next steps, with a view to progressing the matter to an agreeable resolution.

I hope that the Committee finds this information helpful. I will keep the Committee updated once an agreement is reached with the CST.

Yours sincerely,

Kate Forbes

ANNEX – DETAILED SCOTTISH GOVERNMENT RESPONSE

Para	Comment/Recommendation	Response
35.	As we turn our attention to recovery from the pandemic, the Committee understands that it may become more challenging to identify and track the flow of Covid-19 spend. However, the Committee asks the Scottish Government to commit to providing transparent and timely information on all Covid-19 allocations to allow proper scrutiny of where, and how effectively, the money has been spent, so that any lessons can be learned for the future.	The Scottish Government understands the importance of this information and will continue to provide transparent information on all Covid-19 funding allocations through timely provision of information to the Committee and through the formal budget revision process.
38-39.	The Committee acknowledges that the minimum funding guarantee of 2020-21 provided welcome certainty for the Scottish Government to announce policies and spending to support those most affected by the pandemic. We note that, despite the pandemic's ongoing impact, no such guarantee was in place in 2021-22, which has made budget management more challenging. Our predecessor Committee's recommendation was that the UK Government should, if the fiscal position rapidly evolves, commit to providing a similar funding guarantee. Longer-term, we believe that there would be merit in both governments reviewing whether this type of guarantee could provide greater certainty for devolved budget planning in the future.	Scottish Ministers recognise the benefit of this guarantee and have continued to seek a formal guarantee of Covid funding for 2021-22. The Government will take forward the possibility of securing similar guarantee arrangements in future.
42-44.	The Committee welcomes the recent announcement that the Cabinet Secretary for Finance and the Economy and the Chief Secretary to the Treasury have agreed to commission an "independent report on the Block Grant Adjustment arrangements, including a call for stakeholder input, prior to a broader review of the Fiscal Framework". We note the Cabinet Secretary's plans to undertake a programme of analysis to inform the broader fiscal framework review, building on the independent report and other key publications and evidence, including last session's joint report. We request regular updates on the commissioning and progress of this independent report. The Committee further recommends that the independent report should be presented to both the UK and Scottish parliaments, as well as the two governments, as recommended in the Legacy	Scottish Government officials are continuing to work with HM Treasury officials to finalise the terms of reference and consider the potential authorship for the report, to enable us to swiftly commission and complete the report, and commence the review as early in 2022 as possible. Once the arrangements are finalised, we will confirm the authorship and publish the terms of reference. We will keep the Committee updated. The Committee's recommendations on the presentation of the report are noted. As the Committee will be aware, the arrangements for the independent report are subject to joint agreement with HMT. We would welcome the opportunity to

	Expert Panel report 23 to our predecessor committee at the end of last session.	present the report and its findings to both Parliaments as well as both Governments.

Para	Comment/Recommendation	Response
48-49.	The Committee concludes that the fiscal framework broadly worked as intended during the pandemic, though this was more by accident than design. Whether this remains the case in relation to Scotland's recovery from the pandemic is something that the Committee will want to return to in future budget scrutiny. We recommend that the review of the fiscal framework should look at how it can be strengthened to withstand the risk from any future health or economic shocks that could disproportionately affect one part of the UK.	The Scottish Government agrees that the Fiscal Framework review must reflect on the experience of COVID-19 and the operation of the framework to date, to ensure that it is robust to future shocks and provides the Scottish Government with the necessary powers and flexibilities to manage associated risks. This should include consideration of the potential for future shocks to disproportionately impact Scotland through the operation of the Fiscal Framework, for example, on account of differences in the sectoral composition of the two economies. The review must consider solutions to address this potential issue.
53-54.	The Committee believes that the fiscal framework review presents an opportunity to consider how communication and transparency between the UK and Scottish governments can be improved, to allow more effective management of public finances in Scotland. We also seek an update from both governments on progress with the ongoing review of intergovernmental relations, the timetable for concluding this work, and how its outcomes will impact on the fiscal framework review.	The intergovernmental relations (IGR) review proposals deliver many elements of what the Scottish and Welsh Governments set out to achieve from the review and offer the prospect of improvements to current processes. The First Minister has written back to the UK Government to indicate she is content to use the proposals detailed in the review as the basis for engagement but that these must be kept under review. It has also been made clear that procedural improvements alone are not enough to reset the relationship. The Fiscal Framework review will provide the opportunity for both governments to embed the IGR principles for collaborative working and reflect on the findings of the IGR review, considering what improvements can be made to support better intergovernmental engagement, coordination and dispute avoidance and resolution.
57.	The Committee believes that the fiscal framework review should look at ways to simplify, and clarify the workings of, the fiscal framework where possible, to improve public understanding and public accountability. We believe that, as a starting point, both governments should commit to providing transparency and enabling Parliamentary scrutiny of their decision-making at key stages during the review process.	The Scottish Government is committed to a transparent review process, while acknowledging that the review is a joint endeavour undertaken with the UK Government, and some elements of the process will require shared, private space for intergovernmental discussion.

Para	Comment/Recommendation	Response
71-76.	The Committee considers that the Scottish Government should have more flexibility to carry forward and manage its budget across years in normal times. We look forward to exploring this matter further. We believe that the limits on the Scottish Government's resource borrowing powers to cover forecast error and cash management, and the Scotland Reserve, are not currently sufficient. We consider that these should, as a minimum, be linked to inflation. The Committee agrees with our predecessor that the two governments should consider the extent of the risk arising from potential divergence in forecast error between the SFC and the OBR, learning any lessons from the experience of an economic shock being triggered due to a quirk in timings. Recent publication of the UK and Scottish government budgets has followed a different timeline than was envisioned when the fiscal framework was agreed, which has created additional volatility and uncertainty for the budget process. We believe that greater co-ordination regarding the two governments' budget timings is needed. Noting recommendations from both the Smith Commission and our predecessor committee, as well as evidence gathered during our inquiry, we consider that it is now time to revisit the merits of a prudential borrowing scheme for capital borrowing. The Committee recommends that these issues are considered as part of the upcoming fiscal framework review.	The Government welcomes the Committee's views and support on these issues. As the Committee's report identifies, there is emerging consensus in Scotland around the inadequacy of the current borrowing and reserve powers compared to the volatility and risks to which the Scottish Budget is exposed. The Fiscal Framework review must consider and make changes to these powers, to support sound financial planning and management for future years. In making those changes, the review should reflect on the issues the Committee has identified, including ensuring that the limits are increased over time to reflect growth in tax revenues and the economy, and improving intergovernmental co-operation and co-ordination. We also agree on the need to look again at the case for a prudential borrowing regime for capital. More broadly, we appreciate the part the committee has played in highlighting these issues and illustrating where there are deficiencies in the current arrangements.

Para	Comment/Recommendation	Response
86-89.	The Committee notes that the demographic projections present a double 'whammy' to fiscal sustainability, as the proportion of working age people falls while the number of over 65s continues to grow. The provision of public services and welfare payments would, in this scenario, need to be funded from a smaller and more productive working population. We recognise that reversing these demographic trends will require a focused and sustained approach to policy-making over a number of years. We therefore seek clarification from the Scottish Government as to how this challenge will be addressed in its Budget 2022-23, and its next Medium-Term Financial Strategy, which looks ahead to the next five years. The Committee also notes publication of the Scottish Government's strategy 'A Scotland for the future: opportunities and challenges of Scotland's changing population' in March 2021. We seek an update on progress in delivering its recommendations, including its proposal for a Demographic Commission. The Committee welcomes the Scottish Fiscal Commission's preparatory work to start producing a fiscal sustainability report each session, which would look ahead to the next 30 to 50 years and identify "particular pressures on spending or revenue arising from, for example, population growth". We agree with the SFC that this presents a real opportunity to "consider whether major alterations will be required to adjust for changing circumstances" and we therefore ask the Scottish Government to support the SFC in this important work.	The Scottish Government is conscious of the significant impact that demographic change may have in Scotland, in common with many advanced economies. This was highlighted clearly in the January 2021 Medium-Term Financial Strategy, which also made clear the constraints that the current Fiscal Framework places on our ability to manage these impacts. In October 2021, the Cabinet Secretary for Constitution, External Affairs and Culture chaired the most recent meeting of the Scottish Government's Ministerial Population Taskforce. The Taskforce discussed its cross-portfolio approach to Scotland's demographic challenges ahead, and the arrangements we are putting in place to deliver the initial 36 actions identified in the Population Strategy – across vital areas including talent attraction, migration, housing, and public finance. Exploring a Demographic Commission was one of the Strategy's identified actions, and the Scottish Government will continue to explore this option further into 2022. In the meantime, the Scottish Government's Independent Expert Advisory Group on Population and Migration will continue its work to produce analysis to inform Scottish Government policy development in relation to demographic change in Scotland. The December 2021 MTFS has continued to highlight demographic factors, notably the impact of ageing as a driver of public service expenditure. Scotland's population has increased in past years, and is projected to continue to rise. The largest medium-term trends relate to the significant increase in our older population, and changes in where and in what household size people choose to live. All local authority areas will see an increase in pensioners with implications for services such as health, or the nature

		of housing required. The biggest change is a 71% forecast increase in the number of people aged over 75 in the next 25 years. The Infrastructure Commission for Scotland focused on a range of strategic long term drivers for infrastructure, including how best to optimise the impact of infrastructure in enabling sustainable places. The Scottish Government's response to the Commission, our latest Infrastructure Investment Plan (IIP) for 2021-22 to 2025-26, has building resilient and sustainable places at its heart. The IIP invests in projects and programmes that meet the needs of older people; provide services and homes where people choose to live and regenerate areas of working-age population decline. In addition to this, the Resource Spending Review Framework reflects on the impact that demographic change could have on public finance and need for public services. The Framework highlights changing demographics as one of the key factors which will have a substantial impact on public spending over the Resource Spending Review period – seeking views on this and other trends which the Scottish Government should consider. The demographic outlook will continue to inform decisions made by the Scottish Government. The Scottish Government is fully committed to fiscal sustainability. Accordingly we will support the Scottish Fiscal Commission in the preparation of a fiscal sustainability report, including providing the resources requested, as is reflected in their increased budget allocation.

Para	Comment/Recommendation	Response
93-94.	We believe that more efficiency can be achieved by streamlining and linking up the various strategies and plans which have an impact on growing the economy and fiscal sustainability as we move out of the pandemic. We ask the Scottish Government to outline how it will make progress on this matter. The Committee considers that the upcoming statutory review of national outcomes provides an opportunity to reposition the National Performance Framework at the heart of government planning, from which all priorities and plans should flow. We also ask the Scottish Government to consider how the NPF could be more closely linked to budget planning.	The Scottish Government recognises the importance of streamlining and linking up various strategies and plans impacting on growing the economy and fiscal sustainability. The Scottish Government recognises the opportunity that the upcoming Review of the National Outcomes presents to further embed the National Performance Framework (NPF) in government planning and will work to ensure that progress is made on positioning the NPF at the heart of government. The Review is planned to commence in 2022.
100-101.	The Committee believes that multi-year budgets are crucial to securing certainty for Scottish public finances, including for local government, the third sector, and other key bodies. We acknowledge that it can be more challenging to deliver this approach in situations where the Scottish Government does not have confirmed multi-year block grant funding from the UK Government. We therefore recommend that both governments consider how multi-year budgets can be achieved more routinely as part of the fiscal framework review. The Committee asks the Scottish Government to set out in its framework document due in December further details of its resource spending review and how this might bring more certainty and efficiency to budgeting arrangements in the future.	The Scottish Government agrees with the Committee that multi-year budgets offer greater certainty and stability for the Scottish public finances, and would encourage the UK Government to provide substantially greater clarity than it has in the past. I will continue to press for this in my regular meetings with my devolved counterparts and HM Treasury. As noted in response to the recommendation at paragraph 49, the Scottish Government agrees that the review of the Fiscal Framework must reflect on the experience of COVID-19 and the operation of the framework to date, to ensure that it is robust to future shocks and provides the Scottish Government with the necessary powers and flexibilities to manage the associated risks. The Scottish Government's Resource Spending Review Framework, published alongside Budget 2022-23, provides more detailed information on the context, objectives and process of the multi-year Resource Spending Review.

Para	Comment/Recommendation	Response
110-113.	The Committee understands that public finances will be under significant pressure in the next few years and that the Scottish Government faces difficult decisions on how it prioritises spend and raises revenue. We further realise that it will not be possible to address the consequences of Covid-19 within the short planning horizon of just one budget round. We therefore recommend that the Scottish Government explores within its next resource spending review and Medium-Term Financial Strategy, which policy interventions would have the greatest impact on cross-cutting issues such as addressing inequalities and poverty. We can see real economic and societal benefits in prioritising spend for preventative measures, whether that be to protect the environment or the health of the nation in future years. We believe that the resource spending review provides an opportunity to introduce bold preventative measures to protect funds and create a wellbeing economy for the long-term. Many of our other recommendations in this report are intended to achieve greater fiscal sustainability, which we believe would allow more preventative spend to be identified and allocated in future years. The Committee asks the Scottish Government to set out in the Scottish Budget 2022-23 and Medium-Term Financial Strategy how it intends to manage the economy to meet its net zero commitments by 2045. Examining the finances behind the net zero targets is an issue we intend to return to in early course. This may also be an area which the Scottish Fiscal Commission will wish to consider as part of future fiscal sustainability reports.	The Scottish Government's Resource Spending Review Framework identifies an outcomes focus as one of the key principles underpinning the spending review process. The focus of the review is to ensure that public spending delivers the best outcomes for our citizens. As part of the Resource Spending Review, three priorities have been identified; • To support progress towards meeting our Child Poverty targets. • To address climate change. • To secure a stronger, fairer and greener economy. These three key, cross-government priorities will inform the assessment and development of future spending plans as the process progresses. The Medium Term Financial Strategy focused on longer-term sustainability. It sets out the economic and fiscal outlook, and the Scottish Government's approach to managing fiscal volatility and risk.

Para	Comment/Recommendation	Response
131-132.	We note that the Scottish Government's Covid Recovery Strategy sets out a range of commitments to reskill and retrain people, as well as support for the creation of jobs. In view of the evidence we received, we believe that the Scottish Government should also look to provide targeted schemes to support older workers into work, to ensure a fair and equal recovery. We recognise that addressing skills shortages is only one half of the challenge; ensuring businesses provide secure, good quality employment is equally important. In line with the Scottish Government's stated priority of building a wellbeing economy, the Committee seeks an update on how it will broaden access (including for older people) to a high standard of employment through its Budget 2022-23 and next Medium-Term Financial Strategy.	The Medium Term Financial Strategy focuses on longer-term sustainability with spending decisions being taken as part of the Scottish Budget and Scottish Government Spending Reviews. In the absence of powers over the employment legislation the Scottish Government will continue to use the levers at our disposal to promote Fair Work principles that improve pay, conditions and opportunities for all workers including older workers. Fair Work First criteria are being applied to public sector grants and procurement and have been expanded this year to include specific promotion of flexible working practices Our Employability in Scotland website brings together information on available employability support schemes. Services such as No One Left Behind, which helps people gain skills and confidence, and Fair Start Scotland, which offers tailored, flexible, person-centred support to find and stay in work, are available to people of all ages. Apprenticeships are another route to supporting people of all ages into sustainable and rewarding careers. Scotland's Modern and Graduate Apprenticeships, of which there are over 100 apprenticeship frameworks available, are accessible to people aged sixteen or older.

Para	Comment/Recommendation	Response
143-144.	The Committee recognises that higher inflation can bring with it increased income tax revenue, but that this must be balanced in the Scottish Budget with higher costs and spend on pay and social security. We ask the Scottish Government if it has assessed the implications for the Scottish Budget of higher inflation rates continuing into the medium-term, particularly given Scotland's demographic position. We would also welcome clarification as to how the Scottish Government intends to reflect the uncertainty of inflation rates in its public sector pay policy.	The Medium Term Financial Strategy economic outlook sets out the outlook for inflation in some depth. The outlook for inflation is also an integral part of SFC forecasts of the fiscal position. The impact of higher inflation on public spending is set out in the Resource Spending Review framework document. The SFC's forecasts also discuss the potential impact of higher inflation on the economy as a whole. The Scottish Government has in recent years stated its preference for an inflation proofed pay uplift, balanced with affordability and value to the public purse. The Scottish Government considers inflation impacts as at September CPI (3.1%) - in line with income tax threshold and pension payment uplifts - in determining headline pay uplifts. The Scottish Government acknowledges the transient nature of inflation and will continue to prioritise progressive, fair pay awards, that provide additional protection to the very lowest paid, where cost of living impacts are felt most profoundly.
157-160.	The Committee recognises the impact of the pandemic on many businesses, including the hospitality, retail, leisure and travel sectors, some of whom have built up significant debt. We ask the Scottish Government to consider how it might best support these sectors to recover, rejuvenate the high street and grow the economy. We recognise that the two non-domestic rates reliefs put in place by the Scottish Government for the year 2020-21 provided much-needed support to those businesses struggling the most. While we appreciate that it may not be sustainable to plan for similar reliefs within the 2022-23 Budget, we welcome the Cabinet Secretary's commitment to be "cognisant of the need to ensure taxation enables businesses to fully recover and fully trade".	The continuing pressures on Scotland's local authorities caused by the pandemic are well known and fully acknowledged. In addition to the additional general support the Scottish Government has provided so far we also provided £249 million last year specifically to compensate councils for the loss of income from sales, fees and charges. This extra funding was included in the additional £1.2 billion in direct COVID-19 support provided during 2020-21 through the local government finance settlement – over and above local authorities' regular grant payments. This was supplemented by another £259 million of general support this year. Decisions on local government budget allocations are subject to the outcome of discussions with COSLA and individual local authorities. These discussions

	The Committee understands the continuing pressures on local government finance, with lost income during the pandemic and additional reliance on reserves expected in 2022-23. The Committee asks the Scottish Government to explore whether greater flexibility can be afforded to councils to respond to local priorities and fund local services in the next budget round. The Committee would welcome regular updates throughout the session on how the local government fiscal framework is progressing.	include asking local authorities what funding flexibilities could be provided to help them fund local services at a time when they are likely to face a very challenging financial settlement. Work to develop a rules based fiscal framework had been delayed at the onset of the pandemic. However Scottish Government and COSLA officials have now recommenced discussions. We still think that it is essential for Local Government to contribute specific proposals to inform these considerations and more substantive work is proposed to be taken forward in the first part of 2022. It can be expected that the development of a fiscal framework will have a direct relevance to the Scottish Government's Resource Spending Review and also have a bearing on the Local Governance Review.
168-169.	The Committee looks forward to exploring evidence from Scottish local authorities on their experiences in relation to the UK Government's replacement for EU funds and to hearing from the Secretary of State for Levelling Up, Housing and Communities on this important matter. In the meantime, we recognise, in line with other findings in this report, that greater communication and sharing of information between the UK and Scottish governments is needed to enable effective public spending in areas where there may be a shared interest.	The Scottish Government welcomes and shares the committee's concerns around the lack of and poor quality of engagement from the UK Government regarding the replacement EU funding and the development of new UK-wide funds being deployed in areas of devolved competence. The UK Government is choosing to use the Internal Market Act powers without the engagement or consent of the Scottish Government and Scottish Parliament. This approach introduces considerable additional uncertainty to future devolved funding settlements, and risks duplication and waste in the delivery of policies and services. Despite years of promises that the UK Spending Review would reveal all about the nature of the replacement for EU Structural Funds – the UK Shared Prosperity Fund – there is still no clarity on Westminster's plans for this Fund. We have had no input into its development, and have seen no evidence that it will

		meet the needs of Scotland's places and people.

Para	Comment/Recommendation	Response
172.	The Committee notes a lack of clarity as to whether the Scottish public sector will incur additional costs as a result of the proposed increase in employer national insurance contributions, under the UK Government's Health and Social Care Levy. We invite the Scottish Government to provide an update on this issue and any consequences for the Scottish public finances following discussions with HM Treasury.	The Scottish Government estimates that the public sector will incur additional costs of around £150m per annum in Scotland as a result of the increase to employer National Insurance Contributions under the Health and Social Care Levy. HM Treasury have confirmed that the Scottish Government is receiving Barnett consequentials on equivalent spend to cover these costs in England, though have yet to provide an exact breakdown.