

Finance and Public Administration Committee

22nd Meeting, 2022 (Session 6), Tuesday 6
September 2022

Scottish Fiscal Commission: August 2022 reports

Purpose

1. The Committee is invited to take evidence in relation to four new reports published by the Scottish Fiscal Commission on 30 August 2022, from:
 - Professor Graeme Roy, Chair,
 - Professor David Ulph, Commissioner,
 - John Ireland, Chief Executive, and
 - Claire Murdoch, Head of Social Security and Public Funding, of the Scottish Fiscal Commission (SFC).
2. The four reports published by the SFC are as follows:
 - [Forecast Evaluation Report](#), in which the SFC reviews its income tax forecast for 2020-21 and its forecasts for other devolved taxes and social security spending for 2021-22, comparing them with recent outturn data.
 - [Approach to Fiscal Sustainability Consultation Paper](#) on the SFC's proposed approach to producing its first full fiscal sustainability report next year.
 - [Trends in Scotland's population and effects on the economy and income tax](#), in preparation for the SFC's 2023 Fiscal Sustainability report.
 - Its fourth [Statement of Data Needs](#), setting out key areas for improvement in the data and information it needs for forecasting.
3. Each of these reports include an introduction, which sets out key points. This paper provides background in relation to these reports to inform the Committee's evidence-taking on 6 September.

Forecast Evaluation Report

4. The SFC explains that the Coronavirus (COVID-19) pandemic has contributed significantly to errors across the forecasts it evaluates in this report, which assesses the accuracy of its forecasts in January 2021 for the economy, fully devolved taxes and social security in 2021-22. For income tax, the SFC evaluates its February 2020 forecast for 2020-21, as this is the latest year for which outturn data are available.
5. The Evaluation Report states that "Scotland's GDP is estimated to have grown by 11.8% in 2021-22, which is 4.2 percentage points higher than our January 2021 forecast of 7.5%". It goes on to explain that "we underestimated GDP growth in 2021

Q1 ... because of two main factors: the lockdown in early 2021 was not as significant as we anticipated, and we underestimated the scale of the economic activity generated by the rollout of the vaccine and associated testing programme". It notes that the labour market in 2021-22 also turned out to be more resilient than anticipated, with employment continuing to grow after the end of the furlough scheme on 30 September 2021.

6. In February 2020, the SFC forecast that the net effect of income tax on the Scottish Budget was £46 million. The outturn data show that the net effect of income tax on the Budget is actually £96 million, which leads to a reconciliation of £50 million. The SFC notes that this is the first positive reconciliation in four under the Fiscal Framework and is expected to be applied to the Scottish Budget in 2023-24.

7. Spending on devolved social security in 2021-22 was £3,754m, 4% higher than the SFC's forecast of £3,618m, similar to last year when it was 3% higher. The SFC highlights, that the Personal Independence Payment (PIP) "again had the largest single error, with spending £115m higher than forecast ..., partly because it is by far the largest devolved benefit". While much of the forecast error was due to the uncertainty of the pandemic or have been accounted for in later forecasts, the May 2022 PIP forecast continues to fall around 2% short of the outturn and "so it is likely that we will need to make a further increase in our next forecast".

8. Total revenues from the fully devolved taxes (Non-Domestic Rates (NDR), Land and Building Transactions Tax (LBTT) and Scottish Landfill Tax (SLFT) in 2021-22 were 8% higher than its forecasts for 2021-22. This was largely down to increases in LBTT revenues of £221m (38%) above the SFC's forecast, which it explains is due to house prices growing faster than expected and the share of residential properties paying the top two tax bands increasing. Provisional SLFT outturn data for 2021-22 was £125 million, 42% higher than forecast in January 2021, which the SFC explains is due to it underestimating how much waste would be produced and charged at the standard rate for SLFT.

Approach to Fiscal Sustainability Consultation Paper

9. The Legacy Expert Panel's report to this Committee's predecessor recommended inviting the SFC to publish "a long-term fiscal sustainability report at least once during each session of the Parliament". This Committee endorsed the SFC's proposal and approach to producing a fiscal sustainability report (FSR) covering the next 50 years, and the SFC began work on this earlier this year.

10. The Consultation paper describes, and invites feedback on, the SFC's proposed scope and methodology for producing and publishing its FSR in March 2023. It explains that the key aim of an FSR is to highlight how broad trends will affect the public finances over time and that they "use projections of the population and the economy to project government spending and revenues in the long-term". It goes on to state that "long-term projections are more illustrative as there is greater uncertainty regarding policy change as well as how the population and economy may evolve". FSRs also, it suggests "generally assume that revenue-raising and spending policy continue in line with current government policy ... because it is a useful

baseline to project fiscal pressure over a fifty-year horizon, and shows how current decisions could affect the future position”.

11. For its first FSR, the SFC has decided to “investigate the role of demographic change fully and do justice to this important topic”, and states that “we see this as a prerequisite to undertaking more complex analysis in future reports”. Its Trends report discussed below details demographic projections for Scotland over the next 50 years.

12. The Consultation Paper sets out the following topics the SFC has identified as “potentially important to investigate in future FSRs”:

Pressures on fiscal sustainability:

- Effects of climate change
- Population health and health inequalities
- Role of migration (international and from the rest of the UK)

Effects of pressures on fiscal sustainability

- Health spending
- Adult Social Care

Policy Areas (pressures and effects)

- Child Poverty
- Achieving Net Zero

13. The Consultation Paper seeks feedback on these suggestions, order of preference, and any additional topics which the SFC could explore

14. The SFC plans to measure fiscal sustainability for the Scottish Government using a measure it has called the ‘annual budget gap’. It notes that “the Office for Budget Responsibility and most of the FSRs by other Independent Fiscal Institutions which we have reviewed use the ‘fiscal gap’ as their measure of fiscal sustainability”. This refers to “the permanent and immediate change needed in spending or taxation over the projection period to reach a certain debt-to-GDP ratio [and] this is usually expressed as a percentage of GDP”. The SFC concludes that, as the Fiscal Framework requires the Scottish Government to have a broadly balanced budget each year, a debt-based measure cannot be used to assess fiscal sustainability, however, “the balanced-budget requirement does supply us with a condition to assess fiscal sustainability against”. The annual budget gap would show the gap between funding and spending each year. This is one of the areas on which the SFC is consulting.

15. It further asks for responses to a detailed set of questions at Chapter 5 of the report, on the following themes, by 31 October 2022:

- Is our approach to projecting Scottish Government funding appropriate?
- Is our approach to projecting Scottish Government spending appropriate?
- Are our stress tests useful for testing the robustness of the fiscal position?

- Are readers content with our focus on demographics for our first FSR in 2023?
- What topics should we focus on for future FSRs?
- How should we use stress tests to assess Scottish Government fiscal sustainability?
- Is our scope fitting for the aims of our FSR?

Trends in Scotland's population and effects on the economy and income tax

16. The SFC explains that this Trends report is designed to support its work on fiscal sustainability and, in preparation for that work, it sets out demographic projections for Scotland for the next fifty years and considers how these differ from UK-wide projections. It is widely understood that one of the most important factors affecting fiscal sustainability is demographics, as the size and composition of the population affects both spending and funding.

17. The SFC explains that its population projections use Office of National Statistics (ONS) and National Records of Scotland (NRS) data and assumptions and mirror the assumptions applied by the Office for Budget Responsibility (OBR) in its recent 'Fiscal risks and sustainability' report. It has produced these projections on the same basis as the OBR so that its population and economic projections are comparable.

18. In its Trends report, the SFC projects Scotland's population to fall by 900,000, a drop of 16% between 2022 and 2072, with implications for the economy and income tax revenues, as well as government funding and future spending.

19. It shows that "Scotland faces similar though more pronounced challenges to other high-income nations and to the UK in terms of ageing population". Those aged 65 and older grow from being 20% of the population in 2022 to 32% in 2072, while those aged between 16 and 64, who are most likely to be working, drop from 64% of the population in 2022 to 56% in 2072. The SFC explains that "the more acute ageing population in Scotland is primarily a result of a low number of births caused by a low fertility rate combined with an already older population", adding that "a decrease in net migration also contributes to this change but to a lesser extent".

20. Overall, the SFC's projections show Scottish GDP growing at an average rate of 0.9% per year between 2028-29 and 2071-72, which is slower than the UK's by half a percentage point per year over the same period. Between the same period, the average growth in GDP per person is 1.3 per cent for Scotland, which is similar to the OBR's projection of 1.4 per cent for the UK for the same period.

21. Slower growth in average earnings in Scotland than the UK over the last five years is also explored in the Report, along with productivity growth, which "has broadly matched the UK since 1998". The SFC plans to explore how these issues impact on fiscal sustainability in its FSR report next year.

Statement of Data Needs

22. This Statement sets out the SFC's data request and recommendations for improvements in the data and information it receives to produce its forecasts and support its work on fiscal sustainability. It argues that "the quality and availability of the data we require directly affects our ability to support parliamentary scrutiny of the Scottish Budget by both producing and then evaluating our forecasts".

23. The SFC reports that several improvements have been made by data providers in response to its previous Statement in 2020. It highlights in particular that it has "established several successful processes with HM Treasury to ensure we have access to information on the effects of UK Government policy changes, which have been set out in a memorandum of understanding published in August 2022". It continues to recommend, however, that it is provided with statutory access to information held by the UK Government and UK bodies.

24. The SFC notes several areas where improvements are required in both the collection and publication of data by Social Security Scotland (SSS). It explains that, "as more new and increasingly complex payments are being introduced, we require more detailed and varied data". It expresses concerns regarding the data currently available for the Child Disability Payment on new applications and clients who are transferred from the Department for Work and Pensions (DWP) to SSS. It further states that it is not receiving the same level of detail in the data provided by SSS as it did from DWP, which it requires to produce its forecasts. It also highlights a "risk that future publications on the Adult Disability Payment have the same issues".

25. There are also concerns that SSS are not collecting certain data that has been collected by DWP historically, which the SFC argues has "long-term implications for data analysis [as] this information is lost and cannot be recovered or published at a later date". This, it notes, could "have potentially significant consequences on the quality of our forecasts over the next few years".

26. The SFC also make a recommendation that in future the Scottish Budget and consolidated accounts present spending allocations and outturn by Classification of Function of Government (COFOG) – for example, setting out spend on Health, Education, Housing, Economy and Environment. This is to aid transparency in budgetary and outturn spending presentation to allow for comparable read across between years, regardless of how individual portfolio definitions change.

27. The SFC also highlights:

- further engagement is needed with the ONS and HMRC on regional earnings data, public sector employment and average earnings,
- the Scottish Government is asked to provide public sector employment data and is "encouraged to consider in more detail the productivity measures in their labour market statistics and provide a clearer definition of average hours worked",
- the lack of regional price indices "for an accurate measure of regional inflation data as part of our economic forecasts",

- it is in discussions with the Scottish Government and HMRC about receiving more timely information on self-assessment liabilities.
- it requires more detailed data on the Scottish Landfill tax, and
- in order to project Scottish Government spending in the future, further clarity is required on the level and classification of current spending as well as spending plans as set out in Scottish Government Budgets or Spending Reviews.

28. It expects to use data from Scotland's Census 2022, including population data at Scotland level, with age and sex breakdowns, alongside NRS population projections. It seeks updated timescales for publication of the census data, including "confidence levels of estimates so that we can incorporate these in our models effectively".

Committee Clerking Team
September 2022