Renfrewshire Council

To: Council

On: 27 June 2019

Report by: Director of Finance & Resources

Heading: Scottish Government Fiscal Outlook - Medium Term Financial Strategy

1. **Summary**

1.1 The Scottish Government published its medium term financial strategy (MTFS) on 31 May 2019 (attached as an appendix to this report). The MTFS is informed by the updated economic and fiscal outlook for Scotland, published by the Scottish Fiscal Commission at the same time, and sets out the Scottish Government's view of Scotland's fiscal outlook, future public finances and its planned approach to using the financial powers available under the Scotland Acts 2012 and 2016 over the medium term.

1.2 This is the second iteration of the MTFS following its first publication in 2018 which was in response to a key recommendation of the Scottish Parliament Budget Process Review Group, and which informs the new annual budget cycle. There is now a commitment to continue to update and publish the MTFS document on an annual basis.

1.3 The MTFS this year has shifted focus in comparison to 2018, with an emphasis on outlining the key variables and uncertainties that increasingly underpin the Scottish Government's budget as increased devolution of both tax and spending occurs. As outlined in more detail in the main body of the report, the Scottish Budget is forecast to be subject to a number of downside risks that are expected to develop over the medium term and which if outturn as currently anticipated, will place increasing constraints on the Scottish Government's spending capacity.

1.4 The MTFS provides no material detail in relation to future spending plans of the Government across public services and therefore it remains difficult to draw firm conclusions from this updated plan in respect to the detailed prospects for the local government core grant over the medium term.

1.5 What can be said at this stage, is that the 2018 MTFS set out clearly the Government's spending commitment to key priorities covering the NHS, Police, Education and Early Learning Expansion. Based on the Government's own outlook at that time, there was an expectation that other non priority areas would be subject year on year efficiencies in order to fit within the overall envelop of resources available. Therefore, despite the forecast increase that is expected in the Scottish Budget over the medium term as outlined in the 2019 MTFS, the majority of this growth is likely to be allocated to the protected areas of the budget, in particular the NHS resource budget.

1.6 Consequently, non-protected budgets, including the local government core budget are likely to face reduced settlements in the medium term compared to last year's forecasts. In particular, 2021-22 may be a particularly difficult year, due to the exceptional size of the forecast negative Income Tax reconciliation expected to be applied that year. It is recognised the Scottish Government could look to soften the negative impact on non protected budgets by a combination of use of revenue borrowing powers and use of the Scottish Reserve. This in itself will not be sufficient to offset the negative reconciliation adjustments and therefore the Scottish Government would still be faced with additional decisions in respect to tax increases and or further spending reductions in order to achieve a balanced budget position.

1.7 Overall, the future funding position, based on weaker Income Tax revenues than expected, is an on-going concern and would suggest an increasing risk that such non prioritised areas, such as the local government core grant, may be subject to higher spending reductions over the medium term than that forecast 12 months ago.

2. Recommendations

2.1 Note the Fiscal Outlook published by the Scottish Government and the increasing risks emerging to the national budget, driven principally by lower than forecast growth in tax revenues.

2.2 Note the implications for the Council in terms of an increasing risk of further reductions in grant funding over the medium term.

2.3 Note that an updated financial outlook for the Council will be presented to members in the Autumn of 2019.

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3. Background

3.1 In 2018 the Scottish Government introduced a new approach to setting their budget strategy, with part of this process being the annual publication of a Medium Term Financial Strategy (MTFS). The MTFS is intended to set out expectations and broad financial plans and principles for utilising the devolved financial powers of the Scottish Government; along with scenario plans and projections for at least 5 years ahead. At the same time, the Scottish Fiscal Commission (SFC) also publish revised economic and fiscal forecasts.

3.2 The publication of the MTFS addresses key recommendations of the Scottish Parliament Budget Process Review Group (BPRG) review into the Parliamentary budget process. A materially revised budget process was agreed and implemented in 2018. The review recommended the MTFS should consist of:

- forecast revenue and demand-led spending estimates from SFC and their effect on Scottish public finances;
- broad financial plans for next five years;
- clear policies and principles for using, managing and controlling the new financial powers;
- scenario plans based on economic forecasts and financial information in order to assess potential impact of various scenarios on the budget.

3.3 In line with the new process, the second MTFP was published at the end of May 2019, along with the latest economic and fiscal forecasts of the

SFC. The next step in the budget process will be the publication, in September, of the second annual Fiscal Framework Outturn Report.

4 Medium Term Spending Priorities

4.1 The Government's first MTFS in 2018 outlined the clearest statement of intent by the Scottish Government of its future funding plans and confirmation of the Scottish Government's intended spending priorities:

- Health, with a budget of around £13 billion in 2018-19, but rising to over £14 billion by 2021-22;
- Police, with a budget of around £1 billion which is to be protected in real terms, i.e. growing at the rate of inflation;
- Early Learning and Childcare (ELC) Expansion, with a budget rising to over £500 million by 2021 and which will forms part of the Local Government resource funding;
- Attainment, (i.e. raising attainment levels and closing the attainment gap) via the £750 million Attainment Scotland Fund covering the term of the Parliament;
- Higher Education, with a budget of over £1 billion; and
- Social Security, with a budget that grows to around £3.5 billion by 2021-22, largely due to the phased transfer of responsibilities from the UK Government.

4.2 The 2018 strategy explicitly stated that the level of funding over the medium term that remained after each of these priorities was fully funded, would be available to support spending on non-priority areas – the greatest element of which is the core Local Government budget. At the time of the 2018 strategy, it was forecast that the overall resource budget that would be utilised by the six commitments highlighted above would grow from 56% in 2019-20 to 64% in 2022-23 under the central planning scenario. Due to the six commitments taking up an increasingly greater share of the overall Resource Budget over time, the Government set out a clear direction of travel which would lead to the other areas of the budget being inevitably squeezed.

4.3 As outlined later in this report, the updated 2019 MTFS provides no updated detail of the Government's anticipated spending plans. Equally, there is no detail provided of any change in the commitment to deliver against these priorities over the medium term and therefore it is reasonable to assume such principles and broad outlook for the developing shape of future spending is expected to remain.

5 Scottish Fiscal Commission forecasts

5.1 Concurrently with the Scottish Government issuing the MTFS the SFC issued revised economic and fiscal forecasts. These forecasts have been incorporated in the MTFS assumptions and scenarios.

5.2 A key element of the SFCs report is their outlook for the Scottish economy and devolved tax revenues. The key updates provided by the SFC are summarised below.

- The SFC estimate that GDP in Scotland will grow by 0.8% in 2019, and 0.9% in 2020. Both of these are weaker than the Office of Budget Responsibility (OBR) forecast for the UK as a whole (which are 1.2% in 2019 and 1.4% in 2020).

- On GDP per capita, the gap between the SFC and OBR is smaller at least during the first few years of the forecast horizon.

- Real wage growth in Scotland is also expected to be weak relative to the UK, with growth of 0.5% in 2019 and 0.8% in 2020, compared to around 1.0% in the UK as a whole.

5.3 Such forecasts need to be viewed with a degree of caution given the significant degree of uncertainty that exists, particularly in the context of the ongoing uncertainty in respect to how Brexit will be resolved. The SFC acknowledge that all these forecasts are highly dependent on what happens with regards to Brexit. At present the SFC assumes that the UK leaves the EU in October 2019 with a deal. A no deal Brexit is not captured and remains a significant downside risk to their forecasts.

5.4 As can be seen in the table below, GDP growth and wages continue to lag in Scotland relative to the UK, although they catch up as the forecast progresses. Should such a catch up not come about then further risks, with respect to negative fiscal reconciliations (referred to below), may well emerge for the Scottish Budget.

	2018	2019	2020	2021	2022	2023
GDP Per Capita						
Scotland	0.9	0.5	0.6	0.9	1.0	1.0
UK	0.8	0.6	0.9	1.1	1.1	1.1
Real Hourly Wage Growth						
Scotland	0.4	0.5	0.8	0.9	1.1	1.3
UK	1.1	1.0	1.0	1.1	1.1	1.2
Income Tax Growth						
Scotland	11.5	11.7	12.3	12.8	13.4	14
UK	192	196	208	216	225	234

5.5 Despite slower growth in GDP and wages, forecasts of growth in Scottish income tax revenues over the medium term are still on a par with those seen for the UK (just over 20% in the period to 2023-24). However, this is in part due to the increases in Scottish income tax rates, above those that apply in the rest of the UK, introduced by the Scottish Government.

5.6 In summary, the broad set of economic indicators and forecasts, presents an outlook which anticipates that Scotland's economic position is at risk of continuing to lag that of the UK as a whole. As outlined further in the paper, this presents an increasing risk to the Scottish Government budget through the Fiscal Framework arrangements (ie the block grant adjustment mechanism) that underpin the 2016 Scotland Act fiscal devolution arrangements.

6 Financial Outlook

6.1 As outlined previously to members, as the expansion of fiscal devolution evolves, the Scottish Budget is becoming more complicated and exposed to increasingly greater levels of financial risk and uncertainty. This latest MTFS from the Scottish Government, presents a developing medium term outlook which forecasts a number emerging negative risks and which at present are anticipated will place increased constraint on the Scottish Government's spending capacity over this period.

6.2 As highlighted by the SFC and outlined in the MTFS, a key issue developing is the slow growth rate in income tax per head in Scotland relative to that of the UK as a whole. The impact of this is a growing area of concern and risk for the Scottish budget and is manifesting itself in two key ways:

- Firstly, as underlying growth in devolved Scottish Tax revenues is lagging that of the UK as a whole, the Block Grant adjustment (which replicates what the Scottish budget would have benefited had fiscal devolution not been in place) is expected to grow at a faster rate than devolved taxes. The implication of this is that the Scottish Budget's spending capacity is less than it otherwise would have been under pre-fiscal devolution conditions. It is forecast that the impact of this growing divergence by 2020/21 will almost offset the additional £500 million being raised through devolved tax decisions taken by the Scottish Government over the past two years. Therefore growth in devolved tax revenues for

Scotland as a result of devolved decisions, although growing the absolute spending capacity of the Scottish Government's resources, is expected over the medium term will in effect act as a compensating factor to fill the developing divergence from the faster growing block grant adjustment.

- Secondly, the fiscal devolution framework is underpinned each year by the use of income tax forecasts for that year and a subsequent reconciliation process as finalised outturn tax revenue figures emerge at both a UK and Scottish level. Once completed, this process can result in the flow of funding either to or from the Scottish Government's budget as a reconciliation adjustment. It takes several years for this process to be finalised and 2020/21 represents the year in which the process will begin to take effect with the reconciliation outcome for financial year 2017/18 being finalised. As detailed in the MTFS, based on current forecasts the Scottish budget may be subject to reconciliation adjustments totalling £1billion over 2020/21 – 2022/23.

It's important to note that that this is not to say that the Budget will fall by this amount each year. Instead, whether or not the budget in these years will go up or down will depend upon a variety of factors that have yet to emerge, including further changes in the Barnett block grant which will be influenced by UK level economic performance and UK Government decisions and the actual growth of devolved tax revenues. What can however be said with certainty at this stage, is if these forecasts prove to be accurate, is that the amount of money that the Scottish Government had planned to have at their disposal – all other factors remaining equal – will be smaller.

It should also be noted that the budget in these years will also depend upon how the Scottish Government chooses to respond. The fiscal framework does provide for some borrowing capacity and flexibilities for the Scottish Government to cover this type of eventuality. However, such borrowing powers and flexibilities would not be sufficient to fully offset reconciliation adjustments at this scale. This would imply that the Scottish Government would be required to address this through other means, for example raising additional devolved taxation and or higher than previously planned spending reductions.

6.3 Notwithstanding this outlook, the Scottish Government outline in their medium term plan an expectation of an average annual growth in revenue spending of 3.1% per annum over the next 4 years based on their central planning scenario. However, very limited information is provided this year on forthcoming on spending plans. As outlined earlier in this report, the 2018 MTFS set out some high level information about priority spending commitments. This year's MTFS provides no information on what areas will be prioritised, what the strategy is for non-priority areas, and how spending objectives may be prioritised under different risk scenario. However, in the context of existing commitments and specifically those to the NHS, the Scottish Government have indicated in their plan that "*This means that funding available to other public services in Scotland will continue to be constrained over the coming years."*

6.4 In terms of the implications for the medium term prospects for the local government budget, there is no detail provided beyond this broad statement. However, the potential downside risks that are forecast to emerge over the medium term for the Scottish Budget on revenues, coupled with the Scottish Government's stated spending priorities to the NHS, as well as other areas including Police Scotland, Education and Early Learning Expansion, continues to suggest a material risk that the core local government funding is likely to experience a reduction in both cash and real terms over the medium term.

6.5 As previously reported to members in the February budget report, the Scottish Government has committed to providing local government with a three year funding settlement covering the period 2020/21 – 2022/23, on the proviso the UK Government publishes a new Comprehensive Spending Review (CSR) for the UK in the Autumn. As outlined in the updated MTFP, there is an increasing risk linked to the economic and political uncertainty at a UK level that a CSR in the autumn may not emerge. Within the MTFS document, there would appear to be conflicting statements as to how the Scottish Government would respond to no CSR emerging in the context of its multi year settlement commitment:

"Irrespective of the UK Government's decision about its Spending Review, the Scottish Government therefore plans to undertake reviews of spending beyond 2020-21 in order to ensure we can continue to meet the high standards and deliver the quality public services that people across the country expect."

On the other it also states:

'On resource [spending], we currently plan to publish indicative budgets in December 2019 alongside the Scottish Budget 2020/21, but that may not be possible if we do not have sufficient clarity from the UK Government on its spending plans at that stage'.

6.6 Although the MTFS is lacking in any detail as regards spending plans, the deterioration in the updated medium term forecasts for the Scottish budget coupled with previous spending commitments outlined by the Government, suggest that the outlook for the core local government grant over the medium term has deteriorated somewhat to that which existed 12 months ago. Under the revised budget process the next stage will be the publication in September of the Fiscal Framework Outturn Report which will include audited outturn information in relation to tax revenues, including implications for future financial years. Given the risks around Scotland lagging the UK in this regard, this will continue to be a critical measure.

6.7 It is proposed that an updated Financial Outlook report will be presented to members in the Autumn in advance of the key budget announcements over the second half of 2019.

Implications of the Report

1. **Financial** – the financial strategy outlined by the Scottish Government suggests that local government will continue to receive constrained and potentially declining grant settlements over the medium term. The Council's financial plans will be revised to fully incorporate these potential further reductions in available funding.

2. **HR & Organisational Development** – the financial resources available to the Council will be a key determinant in the future shape and size of the Council workforce.

3. **Community/Council Planning** – none

4. **Legal** - none

5. **Property/Assets** - none

6. **Information Technology** - none

7. **Equality & Human Rights** - the Recommendations contained within this report have been assessed in relation to their impact on equalities and human rights. No negative impacts on equality groups or potential for infringement of individuals' human rights have been identified arising from the recommendations contained in the report. If required following implementation, the actual impact of the recommendations and the mitigating actions will be reviewed and monitored, and the results of the assessment will be published on the Council's website.

8. **Health & Safety** - none

9. **Procurement** – none

10. **Risk** – the future financial position and stability of the Council is a key risk within the Council's risk management plans. The report outlines potential further reductions in funding which could heighten this risk.

11. **Privacy Impact** - none

12. **Cosla Policy Position** – COSLA are actively engaging with the Scottish Government with regards the detail within the MTFS and the potential implications for local government and the services it provides.

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Scotland's Fiscal Outlook

The Scottish Government's Medium-Term Financial Strategy

May 2019

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Foreword by the Cabinet Secretary for Finance, Economy and Fair Work

Strong financial management is vital for both the delivery of public services and for the economy. This Government has a strong track record and in this, our second Medium-Term Financial Strategy, we set out the key financial challenges and opportunities that lie ahead. We also set the context for the forthcoming Spending Review.

Our economy remains strong, with sustained growth and record low unemployment, but it is clear we face challenges ahead. Global growth remains weak, and for Scotland this weakness is compounded by the continuing uncertainty around Brexit. The Scottish Government is prepared to mitigate some of the negative impacts of Brexit, but it will not be possible to mitigate them all. Brexit is wrong for Scotland, and wrong for the rest of the UK.

Over the medium term, the Scottish Government's Economic Action Plan sets out how we promote inclusive growth and wellbeing in the context of this medium-term fiscal outlook. This includes unlocking investment in our regions, cities, towns and rural economy through City Region and Growth Deals; enhancing opportunities for upskilling and reskilling for those already in work; and maintaining a stable and competitive tax regime.

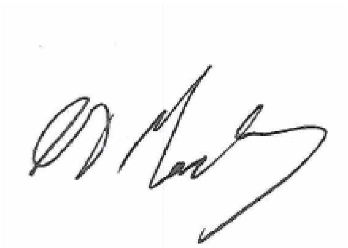
The medium-term funding outlook continues to be dominated by austerity at a UK level. The UK Government's near-decade of austerity has cut funding for some of the most vulnerable people in our society and restricted the resources available for key public services. In Scotland, we have used the limited powers at our disposal to protect key services, despite the £2 billion real-terms reduction to our block grant since 2010.

Austerity is a choice, and not one of Scotland's making. We will continue to make the case to the UK Government that their policy of austerity is both unnecessary and counterproductive. Both the Prime Minister and the Chancellor have claimed that 'austerity is over'. However, the funding outlook for non-Health budgets remains severely constrained.

To demonstrate our prudential approach to financial management, we set out in this Strategy the principles for how the Scottish Government will exercise its borrowing powers and the Scotland Reserve, within the constraints of the Fiscal Framework.

I am taking the opportunity of this publication to outline the framework for our Spending Review. This sets out the criteria that will govern the assessment of budgets, and the process and timetable for the review, reflecting the role of Parliament. It is not yet clear if there will be a UK Spending Review this year. Irrespective of the UK Government's decision, the Scottish Government plans to undertake reviews of spending beyond 2020-21 for both resource and capital budgets.

This Strategy supports this Government's ambitions for Scotland and our people. It will be important in informing how the Spending Review, the Scottish Budget and Programme for Government are developed and scrutinised over the coming year.



DEREK MACKAY MSP

Cabinet Secretary for Finance, Economy and Fair Work

Overview

This is the second Medium-Term Financial Strategy published by the Scottish Government. It sets out the key financial challenges and opportunities that lie ahead and provide the context for the upcoming Spending Review and the Scottish Budget later in the year.

The growth forecasts in Chapter 1 demonstrate that the economic backdrop remains uncertain. The global economy is going through a synchronised period of weakness. For Scotland, this is compounded by the continuing uncertainty around the UK's exit from the EU. The Scottish Government has put in place measures to try to deal with the worst economic and employment impacts. However, no devolved government could fully do so within the existing powers. The chapter sets out the Scottish Government's approach to achieving inclusive growth, including through the Economic Action Plan and infrastructure investment.

Chapter 2 sets out the funding outlook for the medium term, which continues to be determined by austerity at a UK level. The UK Government's macroeconomic policy stance since 2010 has been characterised by austerity – prioritising a reduction of Government debt over most other Government priorities. In Scotland, we have protected key services despite austerity causing a real-terms reduction of £2 billion in the block grant (between 2010-11 and 2019-20).

In Chapter 3 we set out the principles of how the Scottish Government will apply its closely circumscribed fiscal powers on borrowing and the Scotland Reserve in the interest of fiscal sustainability in the medium and long term.

This year, the UK Government has indicated that it plans to publish a three-year Spending Review. As the Budget Process Review Group recognised, the absence of multi-year budgets for devolved public services in recent years has made it more difficult for these services to adopt medium-term priorities and develop plans to address future challenges.

The Scottish Government plans to publish its own Spending Review, following on from the UK Government's Spending Review. In Chapter 4 we publish the framework for our Spending Review. This sets out the criteria that will govern the assessment of budgets and the process and timetable for the review itself. It does not, however, set out detailed spending plans.

Chapter 5 concludes by drawing together the different strands of this Strategy.

The Annexes provide detailed information on the economic and financial modelling, as well as key data on the components of the Fiscal Framework.

PART I – Funding Context

1. Economic Outlook

Overall, 2018 was a positive year for the Scottish economy, with growth relatively broad-based across the economy; the labour market delivering record levels of performance; and further growth in exports.

Alongside this, the most recent data on business research and development trends and inward investment underline the attractiveness of Scotland as a place to do business.

All of this has been achieved against a backdrop of intensifying uncertainty regarding the UK's exit from the EU, as well as continuing structural challenges for particular firms and sectors of the economy.

Scotland's economy grew 1.3 per cent in 2018, continuing a pattern of stronger growth compared to 2015 and 2016. Growth was similar to that of the UK (1.4 per cent). On a per-person basis, however, Scotland's growth rate outpaced the UK by 0.9 per cent to 0.7 per cent, respectively.

Scotland's labour market has continued to perform well in the first quarter of 2019, with unemployment falling to a record low of 3.2 per cent. Alongside this, the number of people in employment has risen by 23,000 over the past year and the employment rate (75.4 per cent) remains close to its record high of 75.8 per cent in 2017.

The continuation of more robust output growth, alongside the strength in the labour market, is reflected in Scotland's productivity performance. Scottish labour productivity grew by 3.8 per cent in 2018, its fastest pace since 2010. Looking at the longer-term picture, Scottish productivity has grown faster than the UK's over the past decade. Since 2007, Scotland's labour productivity has expanded by 10.8 per cent, compared to 2.7 per cent in the UK.

A number of drivers underpinned Scotland's strengthening output growth in 2017 and 2018. Firstly, stronger global economic growth, combined with the depreciation of sterling, provided a boost to Scottish exports. Scottish exports of goods increased by six per cent in 2018, faster than the other UK nations and the UK as a whole which rose by three per cent. Secondly, the rise in the oil price since 2016 and restructuring in the North Sea industry have provided a boost to confidence and activity in the sector.

Scotland remains a highly attractive location for Foreign Direct Investment (FDI). In 2017, there were 116 new foreign direct investment projects in Scotland, up from 108 in 2016. Scotland has maintained its position as the top UK region for FDI, outside London, for five of the past six years. Such investment is key to Scotland's future economic performance, providing an important source of employment, much of which is highly skilled.

However, Scotland continues to face an uncertain outlook as a result of the UK's planned exit from the EU. Whilst leaving the EU without a deal is the worst outcome, even an orderly exit will result in economic loss compared to remaining in the EU. In its report published alongside this Strategy, the Scottish Fiscal Commission (SFC) is clear that uncertainty related to leaving the EU – which, according to a range of surveys, is causing both business and consumer confidence to fall – will have a negative effect on the Scottish economy in the near term. More broadly, there are also some signs that the global economy may be slowing, with the IMF revising down their outlook for growth in 2019.

Against the background of these challenging headwinds, Table 1 sets out the SFC's headline economic forecast. The Commission forecasts that, over the next five years, Scotland's employment will rise further, unemployment will remain at near record lows, and earnings will accelerate.

However, the impact of leaving the EU is clear from the short-term economic forecasts for Scotland, with growth forecast to fall from 1.3 per cent in 2018 to 0.8 per cent in 2019. The SFC relates this anticipated slowdown directly to the ongoing uncertainty created by the UK's EU negotiation process. Indeed, it highlights that this uncertainty has prevented it from revising up its outlook for the Scottish economy.

TABLE 1: HEADLINE ECONOMY FORECASTS

	2018	2019	2020	2021	2022	2023	2024
GDP (per cent growth)	1.3	0.8	0.9	1.1	1.2	1.3	1.3
Employment (millions)	2.67	2.68	2.68	2.69	2.69	2.69	2.70
Unemployment (per cent)	3.9	3.8	4.0	4.0	4.0	4.0	4.0
Real Average Annual Earnings (per cent growth)	0.2	0.4	0.8	0.9	1.1	1.2	1.2

1.1 Achieving Inclusive Growth in Adverse Conditions

Global economic conditions are particularly challenging at present, with the world economy in a 'delicate moment', according to the IMF's chief economist. Not only that, but the UK is poised to leave the EU at the end of October 2019 at the latest.

The Scottish Government's overarching economic ambitions were set out in Scotland's Economic Strategy in 2015. The strategy focuses on the two mutually supportive goals of increasing competitiveness and tackling inequality, through sustainable inclusive growth, fostering innovation, increasing investment, and promoting internationalisation.

Inclusive growth is growth that combines increased prosperity with greater equity; that creates opportunities for all; and that distributes the dividends of increased prosperity fairly. The Scottish approach to inclusive growth centres on both the pace and pattern of growth across the country, and across different groups within our society. Emphasis is placed on building a strong labour market to achieve inclusive growth through the creation of more good-quality jobs, and ensuring people can access these jobs.

To facilitate the delivery of inclusive growth across Scotland, Scotland's Centre for Regional Inclusive Growth (SCRIG) was launched in July 2018. SCRIG will deepen the evidence base on what works in regional inclusive growth, and will promote best practice policy and decision making through Regional Economic Partnerships and other stakeholders.

Economic Action Plan

The Economic Action Plan sets out the actions that will build a strong, vibrant and diverse economy to deliver sustainable, inclusive growth; improve wellbeing; and attract investment across Scotland.

Key elements of the Economic Action Plan include:

- City Region and Growth Deals, which unlock investment in our regions, cities, towns and rural economy. Over £1 billion of investment has so far been committed over the next 10 to 20 years. The aim is to ensure that every part of Scotland benefits through 100 per cent coverage.
- Responding to the rapidly changing skills needs of business and employees, by enhancing the opportunities for upskilling and reskilling for those already in work.
- Maintaining a stable and competitive tax regime, as part of a supportive business environment.
- Setting up the Scottish National Investment Bank, which has the potential to transform Scotland's economy, providing capital for businesses at all stages in their investment lifecycle and important infrastructure projects to catalyse private sector investment.
- The Scottish Growth Scheme, which has already supported over £106 million of investment in 82 companies. We are confident it will support £500 million of investment over the three years to June 2020.
- Establishing an Advanced Manufacturing Challenge Fund of up to £18 million to ensure all parts of Scotland benefit from developments in advanced manufacturing.
- Investing £48 million in a National Manufacturing Institute for Scotland (NMIS) in Renfrewshire, with Strathclyde as anchor university.
- Developing 'A Trading Nation', backed by £20 million of investment, to help boost the value of our overseas exports.

Infrastructure Investment

Investment in infrastructure is vital to supporting and delivering a prosperous and successful Scotland. Evidence from a range of international organisations, including the International Monetary Fund, the World Bank and the European Union, demonstrates a strong positive relationship between infrastructure investment and long-term economic growth.

In the 2018 Programme for Government, the First Minister set out the Scottish Government's commitment to a National Infrastructure Mission (NIM). The adoption of the NIM will provide economic stimulus and boost international competitiveness by raising Scottish infrastructure investment to internationally competitive levels.

The NIM commits the Scottish Government to increase annual infrastructure investment by one per cent of 2017 Scottish GDP by the end of the next parliament in 2025-26, compared to 2019-20. Annual infrastructure investment will therefore be £1.56 billion higher in 2025-26 than the £5.2 billion baseline in 2019-20.

As part of the NIM announcement, the First Minister asked Scottish Futures Trust to "examine new profit sharing schemes such as the Welsh Government's Mutual Investment Model, to help secure both the investment we need and best value for the taxpayer." Scottish Futures Trust (SFT) has now published a report on its recommendations.[1]

It recommends that the Scottish Government adopts a Scottish version of the Mutual Investment Model (MIM). It confirms that the model provides the best value-for-money option which conforms to current Eurostat rules on private sector classification, and that with an appropriate investment pipeline there should be sufficient market interest to invest. SFT notes that, "should greater borrowing powers be made available to the Scottish Government, this would provide a lower cost financing option to deliver additionality." SFT's report assumes that the current borrowing powers remain and examines new investment models over and above the current approaches that would require to be classified to the private sector to count as additional investment.

The Scottish Government has reviewed and agrees with SFT's recommendations. The MIM will be used, alongside a range of other available infrastructure investment tools including capital grant, public borrowing and other forms of revenue finance, to deliver additional infrastructure investment as part of the NIM. These tools currently include using Design, Build, Finance and Maintain (DBFM) contracts through the Hub programme. Whilst these had received a private classification from ONS, Eurostat has concluded a further review and we are not now planning for

[1] https://www.scottishfuturestrust.org.uk/publications

this arrangement to be able to deliver additionality of investment in the future. Consequently, the time is right for a new approach. At this stage, the use of the MIM model will be reserved for central government assets where access to borrowing is more restricted. The intention would be to deploy other levers first, including the use of capital borrowing in line with our fiscal rules and principles.

During 2019-20, the Scottish Government will invest more than £5 billion in infrastructure projects across Scotland, including:

- Over £825 million in the Affordable Housing Supply Programme.
- Progressing our £320 million commitment to construct five new NHS elective care centres in Clydebank, Inverness, Aberdeen, Dundee and Livingston.
- £187 million in City Deals across Scotland.
- £175 million in Early Learning and Childcare facilities.
- Over £145 million funding available through Energy Efficient Scotland.
- £120 million into the precursors of the Scottish National Investment Bank.
- £80 million in active travel to build an Active Nation.
- £50 million for a Town Centre Fund.

The Scottish Government also has a number of significant future capital investment projects including:

- A £600 million programme to deliver 100 per cent coverage in Scotland of superfast broadband (R100 Programme).
- £121 million for Early Learning and Childcare facilities in 2020-21 as part of the Scottish Government’s commitment to invest £476 million between 2017-18 and 2020-21.
- A multi-stage commitment to dual the A9.
- A substantial rolling programme of rail electrification across Scotland, delivering economic, social and environmental benefits.
- Investing £2 billion over 10 years to capitalise the Scottish National Investment Bank.

2. Funding Outlook

Under the Fiscal Framework, three key factors determine the Scottish Budget:

- **UK Government overall fiscal stance** – the block grant from the UK Government remains the single biggest determinant of funding for the Scottish Budget. Changes in the grant are determined by changes in the spending of UK Government Departments through the Barnett formula, so remain entirely outside the control of the Scottish Government;
- **UK Government tax performance** – changes in UK Government tax policy can result in UK Government tax receipts growing at different rates from devolved tax receipts. Through the Block Grant Adjustment process, the Scottish Budget is adjusted for the amount of tax raised per capita in Scotland compared to the rest of the UK. For example, increases in property taxes in England may result in property tax income increasing faster in the rest of the UK than in Scotland, which would increase the Block Grant Adjustment and reduce the size of the Scottish Budget; and
- **Scottish fiscal performance** – if Scottish tax revenue per head for devolved taxes grows faster than in the rest of the UK, through better economic performance, the Scottish budget will increase. If the Scottish Government makes tax policy decisions that increase or decrease tax revenue, these will also have a direct impact on the Scottish Budget.

2.1 UK Fiscal Stance - A Decade of Austerity

This Strategy is being produced at a time of unprecedented austerity. At the end of 2018, UK public spending as a share of national income had fallen for the ninth successive year, the first time that this has happened since the Second World War. Contrary to suggestions that austerity has come to an end, the Office for Budget Responsibility's independent forecasts show that public spending as a share of GDP is forecast to continue to fall further in the coming years.

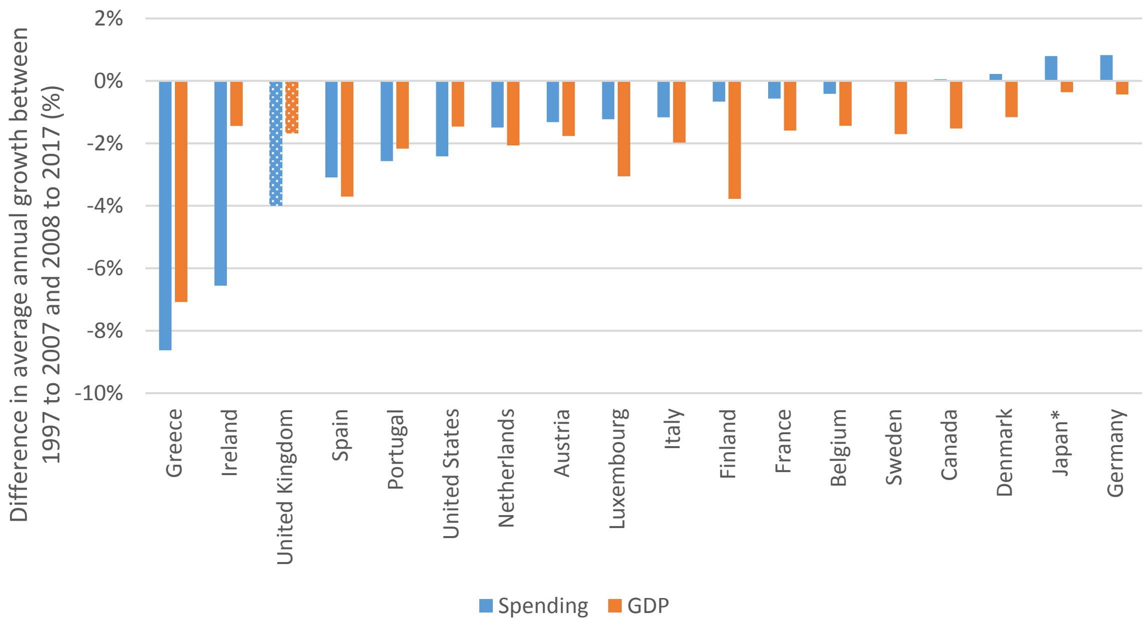
The UK Government's austerity agenda has hurt the poorest and most vulnerable in our society. In particular, the UN Special Rapporteur on Extreme Poverty and Human Rights has argued[2] that the UK Government's policy on austerity was a political choice, and that alternatives to austerity could have transformed the situation of millions of people living in poverty.

The decision to reduce public spending in the UK in 2010 was a response to the financial crisis in 2008. In part, this reflected pressure on governments

[2] https://undocs.org/A/HRC/41/39/Add.1

internationally to reduce the pace of growth in public spending, as the global economy grew more slowly after the financial crisis. However, the reduction of spending in the UK was larger than that in most other similar countries. It was also larger than other countries that saw a similar impact on economic output. This clearly demonstrates the degree to which the scale of public spending reductions seen in the UK since 2010 were a political choice, rather than an economic necessity.

CHART 1: CHANGES IN G7 AND EU15 ECONOMIC GROWTH AND PUBLIC SPENDING SINCE 2008

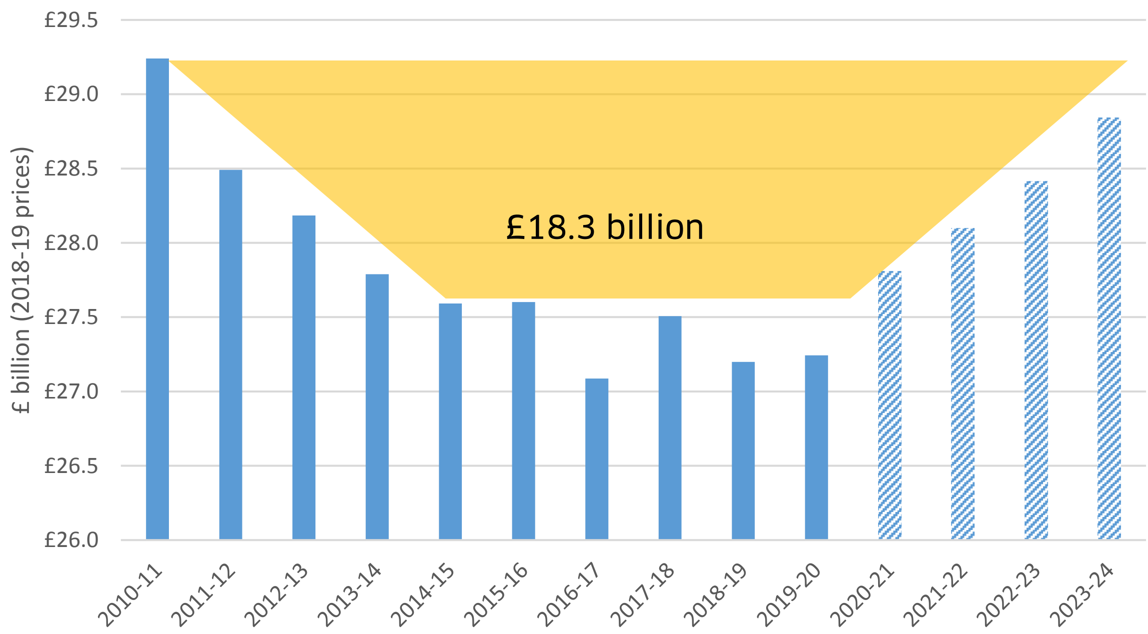


*** Data for Japan only available since 2005; Source: OECD and Scottish Government analysis**

By failing to deliver on the pledge to end austerity, the UK Budget in October 2018 missed the opportunity to provide much-needed direction and leadership for our longer-term finances and the wider economy. The UK Government needs to address this failure and, instead, set out a path for investing in public services. The Office for Budget Responsibility (OBR) has forecast that the Chancellor will have an additional £26.6 billion available in 2020-21 to invest in public services, whilst still meeting his fiscal rules.

Inevitably, Scottish public services have been affected by UK austerity. The resource block grant given to the Scottish Government by the UK Government is currently £2 billion lower in real terms than it was in 2010. The decision to pursue a path of austerity by successive UK Chancellors has meant that over £12 billion less has been invested in Scottish public services over the last nine years. The limited powers afforded to the Scottish Government over devolved taxation are not enough to offset entirely the decisions imposed on our budget from Whitehall. By 2023-24, the Scottish Government expects total resource spending (excluding social security) to have been £18.3 billion less than if spending had remained at 2010-11 levels.

CHART 2: SCOTTISH GOVERNMENT REAL-TERMS RESOURCE FUNDING SINCE 2010-11



Funding for fiscal resource expenditure, excluding social security; source: Scottish Government

2.2 Impact of other UK Government Decisions on the Funding Outlook

In addition to a decade of austerity, and the ongoing uncertainty over the UK's exit from the EU, Scotland's funding outlook has also been affected by a number of UK Government policy decisions that have had a detrimental impact on Scotland's public finances.

Additional Funding to Northern Ireland - Following the General Election in 2017, the Conservative Party agreed a confidence and supply arrangement with the Democratic Unionist Party (DUP), which resulted in a £1 billion allocation to Northern Ireland. Had the well-established arrangement set out in the Statement of Funding Policy been followed, Scotland would have received almost £3 billion of additional funding. This issue is yet to be resolved, and the UK Government has since announced that Northern Ireland has received an additional £140 million for its 2019-20 Budget. These funds were allocated directly to devolved matters, but did not result in additional funding for Scotland or Wales.

Employer Pension Contributions – The UK Government's decision to change the discount rate for public sector pension schemes has resulted in significant increases in employer contributions for the Scottish Government. This creates unsustainable pressures, and proposed levels of funding from HM Treasury do not meet the additional costs for any of the pension schemes, with a total shortfall across Scotland of over £100 million. A large part of this total is NHS pensions, where the UK Government explicitly committed to fund 100 per cent of the cost increases. Failure to fully fund these costs will have a significant and detrimental impact on the delivery of essential front-line services in Scotland.

Police and Fire Services VAT – The change in VAT status for Police and Fire services in Scotland has enabled communities in Scotland to directly benefit from an additional £35 million in spending power for our vital emergency services. However, the settlement did not address the inequitable treatment suffered by Scotland's emergency services between 2013 and 2018, since the £175 million paid to HMRC over that period has not been returned.

2.3 Tax Revenue

Income Tax

Ahead of the 2018-19 Budget, the Scottish Government published an income tax discussion paper exploring options for how Scottish income tax powers could be best used. The Scottish Government subsequently introduced a revised, fairer income tax system for Scotland, using the powers available to us as a lever to counter ongoing UK Government austerity and support sustainability in our public services.

Decisions made in the 2019-20 Budget ensure that Scottish income tax continues to meet the four tests of raising additional revenue; protecting lower earning taxpayers; improving progressivity; and supporting economic growth.

Fifty-five per cent of income taxpayers in Scotland in 2019-20 will continue to pay less than people earning the same income in the rest of the UK, while still raising the revenue needed to support investment in the Scottish economy and public services.

Had we applied UK income tax policy in 2019-20, our own analysis shows that we would have over £500 million less to spend in 2019-20. The additional revenues raised as a result of our policy choices are part of what allows us to sustain our social contract with the people of Scotland and deliver on our key medium-term policy commitments.

Changes to the Income Tax Personal Allowance

The UK Government's decisions to increase the Personal Allowance for 2018-19 and 2019-20 have a relatively larger impact on Scottish income tax liabilities, because Scotland has proportionally more Basic Rate taxpayers than the rest of the UK. As a result, the Scottish income tax base and income tax receipts are reduced proportionately more than the rest of the UK income tax base and the Block Grant Adjustments. The Fiscal Framework contains provision for a compensating transfer where this sort of 'spillover' effect takes place. The Scottish Government has requested that a spillover be considered in relation to these increases.

VAT

The Scotland Act 2016 allows for receipts from half of the VAT raised in Scotland to be assigned to the Scottish Government. However, the power to set VAT rates will remain reserved to the UK Government. With no direct policy levers for the Scottish Government, this is purely assigning a proportion of funds to the Scottish budget with a corresponding Block Grant Adjustment.

UK and Scottish Government officials have worked together to develop the draft VAT assignment model, but significant concerns remain around the potential volatility associated with it and the impact on the Scottish budget. The backdrop of EU exit may create additional uncertainty. Robust VAT forecasts cannot feasibly be constructed in this uncertain environment. This is particularly relevant as, under current plans, the baseline year for VAT receipts coincides with the current timetable for exiting the EU. Additionally, the lack of an actual receipts-based outturn figure means that the accuracy of the estimate-based outturn figure will never be known. Similar concerns have been raised not only by the Scottish Parliament's Finance and Constitution Committee, but also by stakeholders such as Audit Scotland, the Fraser of Allander Institute and the Chartered Institute of Taxation.

In this context, it is only prudent for the Scottish Government to seriously consider postponing the assignment of Scottish VAT and commit to reviewing the position at the time of the Fiscal Framework review.

Air Departure Tax

The Scotland Act 2016 devolved powers over Air Passenger Duty, enabling the Scottish Government to make arrangements for the design and collection of its replacement, Air Departure Tax (ADT).

Following updated advice from the UK Committee on Climate Change – and the new 2045 target for net-zero emissions proposed as a result – the Scottish Government has taken the difficult decision that reducing ADT is no longer compatible with Scotland's new emissions reduction targets.

The Scottish Government remains committed to taking on the power. The UK and Scottish Governments have agreed that introduction of ADT will be deferred beyond April 2020 to ensure that it is not devolved in a defective state. To protect rural communities, a solution has to be found to the Highlands and Islands (H&I) exemption issue before the tax can be taken on.

The Scottish Government will continue to work with the UK Government and the H&I Working Group to find a solution. The UK Government will maintain the application of Air Passenger Duty in Scotland in the interim.

Aggregates Levy

Since the passage of the Scotland Act 2016, the devolution of Aggregates Levy has been prevented by ongoing European and domestic legal questions regarding aspects of the UK levy.

The UK Government recently announced that these questions have been resolved and subsequently published on 13 March a discussion document outlining plans for a review of the UK levy. The Scottish and UK Governments will be discussing the review and its implications for the timing of devolution.

In preparation for the eventual devolution of the levy, the Scottish Government appointed the environmental consultancy Eunomia in 2018 to review, model and analyse options for a Scottish-specific Aggregates Levy.

Tax Forecast

Table 2 shows the forecast net position for each tax, using the latest Scottish Fiscal Commission (SFC) forecasts for Scottish tax revenues and the most recent forecasts for the Block Grant Adjustments from the UK Government's Spring Statement 2019. There are no Block Grant Adjustment forecasts for 2024-25, because the OBR only produced forecasts of corresponding UK Government receipts required for the Block Grant Adjustments up to 2023-24.

TABLE 2: LATEST FORECASTS OF TAX REVENUES AND BLOCK GRANT ADJUSTMENTS

£ million		2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Income Tax	Revenue	11,005	11,486	11,703	12,332	12,831	13,374	13,985	14,613
	BGA	11,127	11,665	11,709	12,380	12,825	13,300	13,805	n/a
	Difference	**-122**	**-179**	**-5**	**-48**	**6**	**74**	**180**	**n/a**
LBTT[1]	Revenue	557	553	616	655	691	724	759	794
	BGA	584	547	535	568	611	651	705	n/a
	Difference	**-27**	**6**	**81**	**88**	**80**	**73**	**54**	**n/a**
SLfT[1]	Revenue	148	143	109	87	12	14	15	15
	BGA	113	105	92	86	92	84	72	n/a
	Difference	**35**	**38**	**17**	**1**	**-80**	**-71**	**-57**	**n/a**
TOTAL	Revenue	11,710	12,182	12,429	13,075	13,534	14,112	14,758	15,421
	BGA	11,824	12,318	12,336	13,034	13,528	14,035	14,582	n/a
	Difference	**-114**	**-136**	**93**	**41**	**7**	**77**	**176**	**n/a**
Estimated income tax reconciliation[2]					**-229**	**-608**	**-188**		

Note 1: The 2017-18 LBTT and SLfT revenue and Block Grant Adjustment are outturn figures.

Note 2: Estimated income tax reconciliations are only available for years when a budget has already been produced. The 2020-21 reconciliation relates to 2017-18 income tax; the 2021-22 figure relates to 2018-19 income tax; the 2022-23 figure relates to 2019-20 income tax. See Annex C for details.

Figures may not sum due to rounding.

The SFC forecasts for income tax have increased in every year from 2018-19 of the forecast period, relative to their forecasts last December. Cumulatively, this is an increase of over £490 million between 2017-18 and 2023-24, driven largely by an improved outlook for earnings.

The latest BGA forecasts made in March have grown faster since the previous forecast in October 2018, when compared with the increase in SFC revenue forecasts between December 2018 and now. This has resulted in a projected reduction in available funding relative to the previous comparable sets of forecasts.

Changes to estimates for tax revenues for 2019-20 do not have any immediate impact on the current budget position.[3] The updated forecasts

[3] As the latest tax and BGA forecasts in Table 2 have no immediate impact on the current and previous years' budgets, the funding outlook continues to use the tax revenue and BGA

for future years provide an indication of the level of revenues that the SFC anticipates, but these figures will not be used to set the 2020-21 budget in December 2019, which will make use of the next set of forecasts that the SFC produces.

Final revenues and Block Grant Adjustments for income tax are recalculated when outturn data is available, around 16 months after the end of the financial year, and a budget adjustment is then agreed for the following budget year. This means that the difference between forecast and outturn income tax for 2017-18, the first year of the current powers, will be accounted for in the 2020-21 Scottish Budget. The expected reconciliation adjustments are shown in Table 2, with details provided in Annex C.

2.4 EU Funding

During the 2014-20 EU budget round, Scotland is estimated to receive over £5 billion in funding from the EU. This supports a wide range of activities across Scotland, delivering infrastructure, sustaining rural communities, providing valuable support for the farming and fishing industries, and delivering research funding for universities.

As a result of the UK Government's chosen route for exiting the EU, the UK will pull out of large elements of this funding without consultation and without setting out clear alternatives. UK Government commitments on successor arrangements are still not defined.

In their post-EU exit spending forecasts, the OBR has assumed that any reductions in contributions to the EU will be recycled into substitute spending by the UK Government[4]. However, how that will translate into allocations under Barnett to the Scottish Budget is still unclear.

The amount of future funding that Scotland will receive beyond EU exit and any transition period will therefore be dependent on the outcomes both of the UK Government's future spending plans, and any discussions between the UK Government and devolved administrations on future financial settlements to reflect EU exit.

In the absence of firm commitments to the amounts that will be provided under alternative arrangements, we cannot yet quantify levels of funding in the future and any impact this will have on the Scottish Budget.

However, the Scottish Government has been clear that, given Scotland voted overwhelmingly against leaving the EU, funding levels should not be reduced as a result of the UK's exit. All lost EU funding must be replaced in full, so that the benefits that EU funding has provided to many sectors across Scotland can be maintained.

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forecasts that determined the budget in each of these years. Please see Table A.1 in Annex A for the tax revenue and BGA figures used to inform the funding outlook.

[4] https://cdn.obr.uk/March-2019_EFO_Web-Accessible.pdf

2.5 Medium-Term Funding Paths

Modelling Scottish Government funding scenarios is challenging, as the Fiscal Framework is still relatively new and there is limited information available on the performance of forecasts relative to outturn data. In addition, under the current UK Government Spending Review, the UK Government has not yet set budgets for UK Departments and devolved administrations beyond 2019-20 (2020-21 for capital), but has indicated an intention to undertake a Spending Review in summer 2019.

Table 3 shows how each funding component is projected to change over the next five years in the Scottish Government's central scenario.

TABLE 3: FUNDING COMPONENTS (NOMINAL)

£ million	2018-19	2023-24	Average annual growth
Total cash budget	32,049	41,508	5.3%
Resource budget[1]	27,624	32,151	3.1%
New social security spending	178	3,876	85.0%
Capital budget limit	3,596	4,971	6.7%
Financial Transactions	401	519	5.3%
Capital borrowing	250	n/a[2]	n/a

Note 1: Resource budget: Fiscal Resource Budget limit and the net Block Grant Adjustment and reconciliations; updated for Supplementary Estimates; including additional adjustments for NDR, Scotland Act Implementation, Migrant Surcharge, Queen's and Lord Treasurer's Remembrancer (QLTR), Rail Resource Grant. Social security funding is not included and is shown separately.

Note 2: Chapter 3 sets out the Scottish Government's policy for capital borrowing. The funding outlook includes planned borrowing of £450m in 2019-20 and £350m in 2020-21. Over the remaining period of the National Infrastructure Mission, our policy is to borrow between £250 million and £450 million annually to ensure that investment increases overall year-on-year but this is not included in this modelling.

Table 4 provides a breakdown of projected Scottish Budget funding out to 2023-24 for the central scenario, as well as upper and lower ranges.

The central scenario analysis suggests that, by 2023-24, the Scottish Budget (excluding non-cash and Annually Managed Expenditure) could be around £41.5 billion. However, this remains uncertain, and the scenario modelling indicates that the size of the Budget could range between £39.2 billion and £43.8 billion. This reflects the uncertainty around the block grant and Scottish devolved tax income, and the impact of economic uncertainty, such as the UK's exit from the EU.

This uncertainty translates into very different outlooks for growth in the Scottish Budget between 2018-19 and 2023-24, with growth projected to be between £7.2 billion and £11.7 billion (in cash terms). In the central scenario, the budget is projected to grow by £9.5 billion over the five-year period, of which £3.7 billion relates to the transfer of additional Social Security powers, and around £2.3 billion derives from Health consequentials.

The funding trajectory shows significant growth mainly because of the devolution of Social Security powers to Scotland. As this additional funding is accompanied by new Social Security responsibilities for the Scottish Government, the change does not increase spending power. Social Security-directed funding will increase from 2019-20 onwards, with a particularly large increase in 2020-21 when the remaining powers will be devolved to Scotland.

Ten of the eleven benefits being devolved to Scotland are demand-led: spend is driven by the number of people who have a claim as set in legislation, rather than by the amount allocated in a budget. Budgets for these benefits are based on Scottish Fiscal Commission forecasts, rather than spending limits. The Scottish Government will need to manage any differential between the Scottish Fiscal Commission's forecasts and actual benefit expenditure.

The capital outlook assumes that the maximum amount of capital borrowing (£450 million) will be undertaken in 2019-20 and £350 million in 2020-21. As set out in chapter 3, our policy is then to borrow between £250 million and £450 million over the remaining period of the National Infrastructure Mission, but this is not included in modelling of the capital outlook. Final decisions are always taken within the relevant budget year, depending on circumstances.

CHART 3: OUTLOOK FOR RESOURCE AND CAPITAL SCOTTISH BUDGET (NOMINAL, INCLUDING SOCIAL SECURITY)

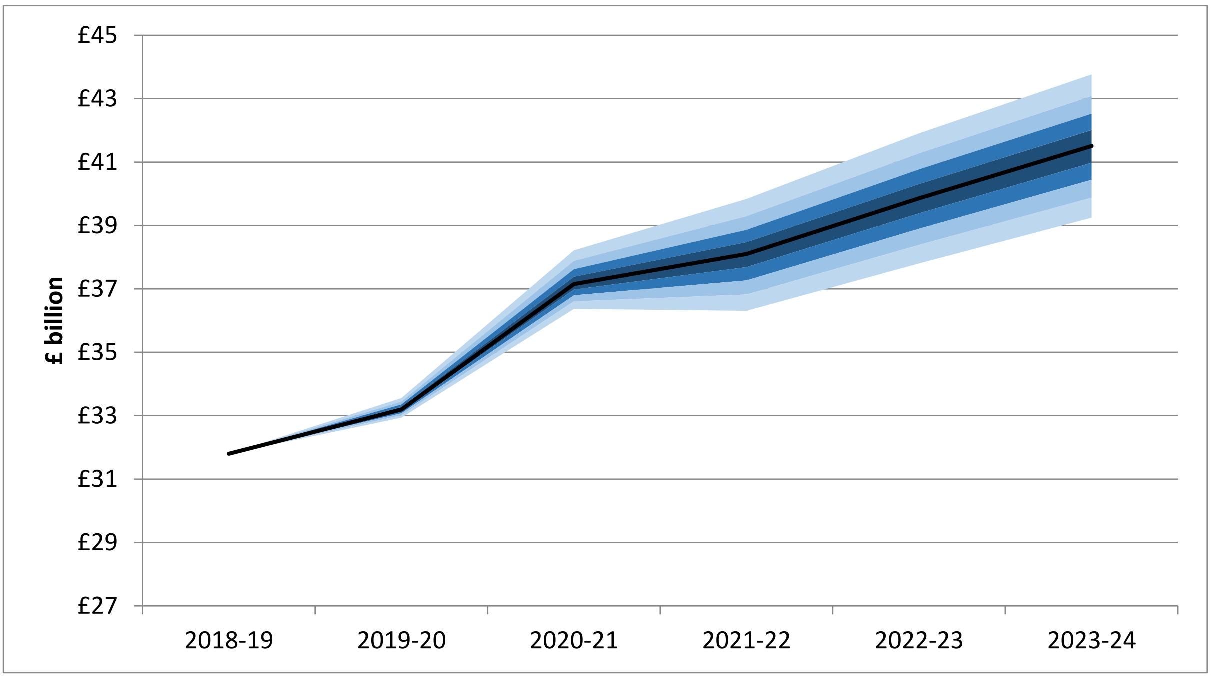
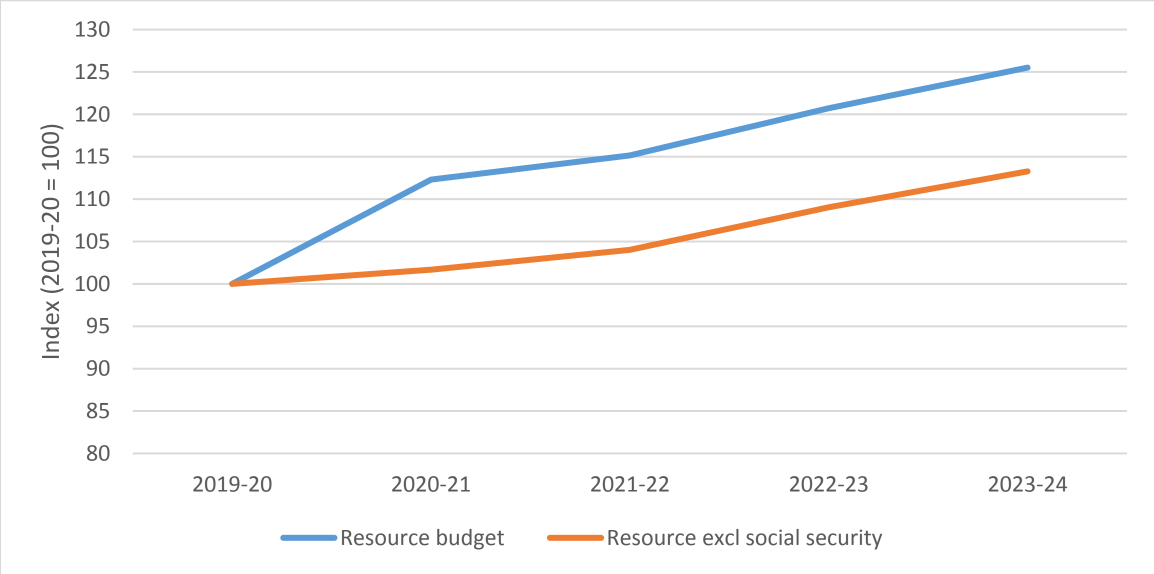


Chart 3 shows how the range around the central projection evolves over time. In 2023-24, the variability amounts to around ±5 per cent of the overall budget. It also highlights how differences can cumulate over a relatively short period. The single largest source of future variations in the Scottish Budget is likely to be the Block Grant Adjustment, although Barnett consequentials will remain a significant source of uncertainty. Further detail is provided in Annex A.

While the Scottish Government budget is increasing in nominal terms, the outlook for Scottish Government spending remains constrained by UK Government fiscal policies. The UK Government has failed to deliver its pledge to end austerity, with the OBR forecasting that public spending as a share of national income will continue to fall.

CHART 4: GROWTH IN RESOURCE SPENDING (NOMINAL)

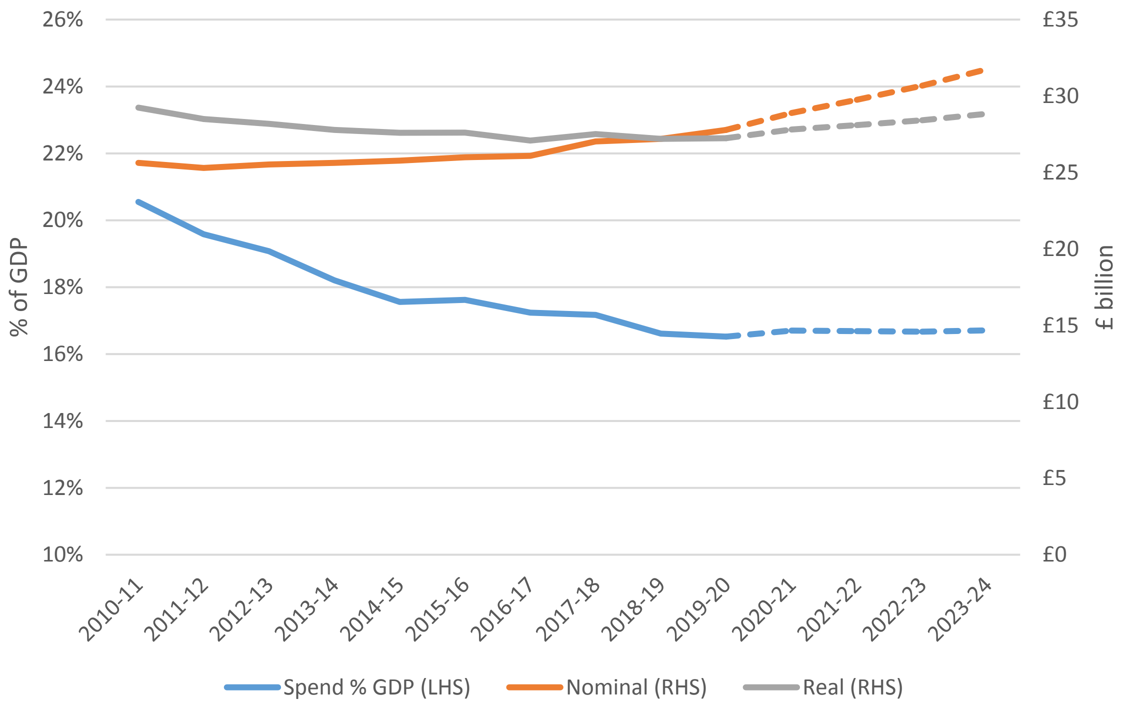


In Scotland over the next five years, the budget for resource spending on day-to-day public services (after excluding the transfer of new social security powers) is expected to grow by 3.1 per cent a year in nominal terms but only 1.1 per cent a year in real terms.

Despite the measures introduced by the Scottish Government to support public services, decisions by the UK Government will mean that austerity will continue in Scotland. The Chancellor's spending plans imply continued real-terms cuts to public spending outside health, as the Institute for Fiscal Studies has highlighted.[5] This means that funding available to other public services in Scotland will continue to be constrained over the coming years.

[5] https://www.ifs.org.uk/publications/13855

CHART 5: OUTLOOK FOR RESOURCE SPENDING (EXCLUDING SOCIAL SECURITY)



As shown Chart 5, Scottish Government resource spending (excluding social security) has fallen from 20.5 per cent of GDP in 2010-11 to 16.5 per cent today and is expected to remain around this level until at least 2023-24.

TABLE 4: SUMMARY OUTLOOK FOR THE MEDIUM-TERM FINANCIAL STRATEGY

£ million (nominal)	2018-19 (outturn)	2019-20	2020-21	2021-22	2022-23	2023-24	Average annual growth[3]
Overall budget[1]							
Upper range		34,007	38,568	39,839	41,909	43,767	6.4%
Central scenario	32,049	33,644	37,503	38,099	39,857	41,508	5.3%
Lower range		33,388	36,720	36,311	37,803	39,247	4.1%
Resource budget[2]							
Upper range		28,582	29,366	30,342	31,962	33,326	3.8%
Central scenario	27,624	28,384	28,857	29,526	30,952	32,151	3.1%
Lower range		28,186	28,348	28,709	29,942	30,976	2.3%
New social security							
Upper range		318	3,489	3,715	3,935	4,150	87.7%
Central scenario	178	313	3,370	3,521	3,694	3,867	85.0%
Lower range		309	3,251	3,326	3,453	3,584	82.3%
Capital budget limit							
Upper range		4,032	4,475	4,792	4,976	5,254	7.9%
Central scenario	3,596	3,978	4,320	4,534	4,693	4,971	6.7%
Lower range		3,924	4,165	4,276	4,409	4,687	5.4%
Financial Transactions							
Upper range		625	888	989	1,036	1,036	20.9%
Central scenario	401	519	606	519	519	519	5.3%
Lower range		519	606	0	0	0	n/a
Capital borrowing							
Upper range		450	350	n/a	n/a	n/a	n/a
Central scenario	250	450	350	n/a	n/a	n/a	n/a
Lower range		450	350	n/a	n/a	n/a	n/a

Note 1 Overall budget: Total Scottish Government funding excluding non-cash elements.

Note 2 Resource budget: Fiscal Resource Budget limit and the net Block Grant Adjustment including forecast reconciliations; updated for Supplementary Estimates; including additional adjustments for NDR, Scotland Act Implementation, Migrant Surcharge, Queen's and Lord Treasurer's Remembrancer (QLTR), Rail Resource Grant. Social security funding is not included and is shown separately.

Note 3: The expected average annual inflation rate (GDP deflator) over the five years is 1.9 per cent.

3. Fiscal Principles and Policies

Despite the current challenging economic climate, the Scottish Government has maintained a strong record of fiscal discipline, balancing its budget every year since 2007. As this climate persists, and as we progress with the implementation of the powers from the Fiscal Framework, the Scottish Budget will be subject to greater levels of uncertainty and volatility than ever before.

In this context, the Scottish Government recognises the importance of setting out the principles and policies to guide the use of its fiscal powers, to manage budget volatility, to enhance budget flexibility and to borrow to support capital investment.

3.1 Overarching Principles

The use of our powers will depend on a number of factors, including the economic and fiscal circumstances at the time. While a greater proportion of the Scottish Government budget now comes from devolved revenues, more than half is still determined by UK Government spending decisions. This means that the circumstances in which we use our powers will often depend on decisions that are outwith our control. In view of this uncertainty, and the constraints of the existing Fiscal Framework, the Scottish Government considers a principles-based approach to be appropriate to support the effective use of the Scottish Government's reserve and borrowing powers.

The following principles will guide decisions on the use of our fiscal powers:

- **Sustainability** – Sovereign countries generally seek to achieve this by having a broadly balanced budget position over the economic cycle. Under the current constitutional setting, the Scottish Government is constrained to a stricter standard of achieving a balanced budget annually, with only limited ability to borrow and use a reserve. Within its limited borrowing and reserve powers the Scottish Government will achieve sustainability through:
    - **Stability** – Use of the powers will be taken with a view to achieving steady funding and expenditure trajectories.
    - **Budget flexibility** – The powers will be applied in a manner that ensures flexibility for future budgets and the ability to respond to unforeseen events.
- **Intergenerational fairness** – The Scottish Government will seek to use these powers in a way that ensures future taxpayers only bear the cost of spending that benefits them.
- **Value for money** – Borrowing and other sources of revenue-finance investment will achieve value for money for the taxpayer.
- **Transparency** – The Scottish Government will set out clearly its planned and actual use of these powers.

3.2 Application of the Principles to the Reserve and to Borrowing

Scotland Reserve

The Scotland Reserve allows the Scottish Government to smooth spending within and between years, and assists in the management of tax volatility. The Reserve is capped in aggregate at £700 million, or only 2.1 per cent of the Scottish Budget in 2019-20, falling to 1.7 per cent in 2023-24, based on the central projection in this document. Annual drawdowns from the Reserve are limited to £250 million for resource and £100 million for capital. This severely restricts the Scottish Government's ability to build up a medium-term reserve and draw down from it.

The Scotland Reserve will be used in a way that balances the principles of Flexibility, Stability and Value for Money.

- Even with tight financial management, it is important to retain flexibility. Managing expenditure across financial years often uses up a substantial proportion of the £250 million resource and £100 million capital limits.
- Within these limitations, the Scottish Government intends to build up the balance in the Scotland Reserve over time, as resources allow, in order to have a financial cushion available, while ensuring that the Reserve retains sufficient capacity to have the flexibility to manage any underspend across financial years.
- We will use the Scotland Reserve as far as possible to smooth resource funding over time, including in relation to potential reconciliations for Income Tax under the Fiscal Framework, and to achieve a stable spending trajectory.
- We will seek to use the Scotland Reserve in a manner that keeps the economic cost of revenue-funded investment and resource borrowing as low as possible, to achieve value for money.
- We will operate this policy within the limitations on the overall size of the Reserve and the drawdown limits which severely restrict the scope to use the Scotland Reserve to smooth the funding trajectory.

Annex C sets out information on use of the Scotland Reserve in 2018-19 and 2019-20.

Resource Borrowing

The Scottish Government can borrow to support resourcing costs only in very specific circumstances: for in-year cash management; and for forecast error on devolved and assigned taxes and on devolved social security expenditure (and on corresponding UK forecasts for the Block Grant Adjustments). The borrowing is subject to annual limits for each scenario, and an aggregate annual limit of £600 million within a statutory overall limit for resource borrowing of £1.75 billion. [6]

The resource borrowing powers will be used in a way that balances the principles of Flexibility, Stability and Value for Money:

- Resource borrowing is an important tool to help achieve stable funding and spending trajectories, in order to ensure macroeconomic stability. Repayment terms would be as short as possible, to minimise servicing costs, subject to the need to smooth resource spending over time.
- In the context of the constraints outlined above, the scope for reductions in spending and/or use of any funds held in the Scotland Reserve would generally be considered first, before any decision is taken on resource borrowing.

No resource borrowing has been undertaken to date and none is planned in 2019-20.

Capital Borrowing

The capital grant funds the majority of direct capital investment by the Scottish Government. In addition to the capital block grant, the Scottish Government can increase capital expenditure through borrowing up to £450 million per year up to a maximum total of £3 billion. While these powers enable the Scottish Government to support the capital investment programme and promote economic growth in Scotland, there are limitations to their use.

The capital borrowing powers will be used in a way which balances the principles of Flexibility, Stability, Value for Money and Intergenerational Fairness and supports the delivery of the National Infrastructure Mission:

- The 2019-20 Budget sets out the baseline for the National Infrastructure Mission (NIM) in 2019-20 of £5.2 billion, which will increase by £1.56 billion by the end of the next parliament in 2025-26. In order to achieve this increase in investment, capital borrowing will be required as part of a combination of funding sources that also include capital grant, financial transactions and alternative revenue-finance models, including private finance.

[6] Where there is, or is forecast to be, a Scotland-specific shock, the borrowing limit for forecast error is extended but is still subject to the aggregate annual limit and statutory overall limit. A Scotland-specific 'economic shock' is defined as when onshore Scottish real GDP growth is below 1 per cent in absolute terms on a rolling 4 quarter basis, and 1 percentage point below UK real GDP growth over the same period. It is important to note that if an 'economic shock' occurs it is not possible for the Scottish Government to apply resource borrowing to provide an economic stimulus. It can only be used where there is a forecast error in relation to devolved and assigned taxes, and on devolved social security expenditure, (and on the corresponding UK forecasts for the Block Grant Adjustments).

- Capital borrowing from the National Loans Fund is a lower-cost alternative to privately financed investment, so this source of borrowing can help achieve value for money. However, there is both an annual limit and an overall cap on use of this borrowing.
- The term structure of borrowing will be chosen to strike the right balance between flexibility (requiring shorter term lengths), value for money (requiring shorter term lengths), and stability (suggesting longer term lengths) and intergenerational fairness (term length corresponds to asset life).
- A contingency reserve of £300 million of the capital borrowing limit will be left unused, to provide the flexibility to undertake capital borrowing if an unforeseen need arises to stabilise the spending trajectory, recognising that we do not yet have capital budgets beyond 2020-21. The annual £450 million drawdown limit would still apply, potentially limiting the immediate use of the contingency borrowing.
- Over the period of the NIM, our policy is to borrow between £250 million and £450 million annually to ensure that there is sufficient investment planned to support economic growth, and that investment increases overall year-on-year. The decision on the term would be taken at the appropriate time in each year, dependent on factors prevailing at the time such as interest rates and the impact on the resource budget. Borrowing of £450 million is expected to be required in 2019-20 and £350 million in 2020-21.

Scenario modelling of borrowing options is set out in Annex B. This indicates that a range of options could be undertaken over the course of the next parliament, leaving the £300 million contingency reserve and remaining within the five per cent resource limit. These options include borrowing between £250 million and £450 million each year until 2025-26. The modelling also demonstrates that there is less sensitivity to interest rate movements than to the term of loan or amount borrowed. Annex B also sets out borrowing that has been undertaken to date, as well as planned borrowing in 2019-20 and 2020-21.

Revenue-Finance Investment

The Scottish Government uses revenue finance to deliver additional high-value infrastructure projects, which could not be delivered with capital grant alone. Previous tools used have included the Non-Profit Distributing (NPD) model; the revenue-finance Hub programmes, tax incremental financing and growth accelerator; and guarantees such as the Rental Income Guarantee Scheme. Some of these projects may also have had some capital grant-funded element. Such infrastructure projects are financed through annual payments or increased tax revenue, typically over a 25- to 30-year period.

Within this framework, the affordability and sustainability of all Scottish Government long-term revenue commitments, including repayment of debt stock, are assessed as part of the Budget process and are kept within a maximum of five per cent of the *resource* Budget available (excluding social security). This was tightened at Budget 2019-20 from the previous limit of five per cent of the *total* Scottish Budget.

The commitments included in the five per cent calculation are the Scottish Government's share of the ongoing costs of: previous Public Private Partnership (PPP) contracts that are now operational; Non-Profit Distributing (NPD) and Hub programmes; growth accelerator; and cost of borrowing. This self-imposed limit ensures that we do not overly constrain our budget choices in future years. Annex B sets out more detail on the funding of infrastructure in the National Infrastructure Mission.

3.3 Review of the Fiscal Framework

The Fiscal Framework will be reviewed by the Scottish and UK Governments following an independent report produced by the end of 2021. This Review will ensure that the Framework is 'fair, effective and transparent', in line with the Smith Commission's principles. Whilst the scope of the Review is undefined, apart from the need to agree a Block Grant Adjustment mechanism, a broad Review should be undertaken using these guiding principles. It should also focus, as a minimum, on the issues below:

Fairness – The Review should examine whether the current Block Grant Adjustment mechanism accurately reflects the loss in revenues to the UK Government of devolving Scotland Act 2012 and 2016 tax powers, as intended through the 'no detriment' principle. The Personal Allowance issue, highlighted in Chapter 2, is an example of the drawbacks of indexing the Block Grant Adjustments to the rest of the UK tax base and VAT Assignment.

Effectiveness – Chapter 3 shows the very limited flexibilities that the current Framework provides to the Scottish Government to manage budget volatility and support investment in Scotland. The Review should re-evaluate the current limits and once again examine the merits of a prudential borrowing regime as recommended by the Commission.

Transparency – Chapter 2 highlights the uncertainty of basing VAT assignment on a methodology-generated, rather than receipts-based, outturn figure. The Review should consider whether there are more transparent ways of assigning VAT revenues to Scotland. The Commission also recommended a more productive, robust, visible and transparent relationship between the UK and Scottish Governments. The additional funding to Northern Ireland shows the continuing lack of transparency around UK Government decisions on funding issues. The Review should also consider whether current governance structures allow for transparent and consensual decision-making on all aspects of the Fiscal Framework.

Part II – Spending Outlook

This part of the Medium-Term Financial Strategy provides the high-level framework for a Scottish Government Spending Review.

This is the first time that such a framework has been published. It follows a recommendation from the Budget Process Review Group and is part of a subsequent agreement between the Scottish Government and the Finance and Constitution Committee of the Scottish Parliament:

- "There is a presumption that the Scottish Government will carry out a Spending Review, linked to the equivalent UK Spending Review. Where the Scottish Government plans to diverge from linking a Spending Review to the UK equivalent then it will write to the Finance and Constitution Committee setting out the reasons for doing so.
- At a Spending Review, the Scottish Government will publish a framework document setting out the economic and political context, the criteria which will govern the assessment of budgets and the process and timetable for review. The framework document will be published prior to Summer recess in order to allow sufficient time for parliamentary scrutiny and input into the Spending Review.
- The Parliament's committees should undertake a constructive dialogue with Ministers, public bodies and stakeholders once the framework document is published in order to influence the outcome of the Spending Review."

At the UK Spring Statement on 13 March 2019, the Chancellor confirmed that a UK Spending Review would conclude alongside the UK Budget if an EU exit deal was agreed. Given the "flextension" to 31 October 2019 for an EU exit deal to be agreed and the impending change of Prime Minister, arrangements for any UK Spending Review are not yet clear.

4. Spending Review Framework

Scottish Ministers are clear that sustainable public finances are a priority given continued UK austerity and growing demand on public services.

Irrespective of the UK Government's decision about its Spending Review, the Scottish Government therefore plans to undertake reviews of spending beyond 2020-21 in order to ensure we can continue to meet the high standards and deliver the quality public services that people across the country expect.

We will also begin work to fulfil the Budget 2019-20 commitment to bring forward a three-year settlement for local government from 2020-21.

Our aim is that where possible we will provide certainty for the years ahead. On resource, we currently plan to publish indicative budgets in

December 2019 alongside the Scottish Budget 2020-21, but that may not be possible if we do not have sufficient clarity from the UK Government on its spending plans at that stage.

On capital, we will take account of the Infrastructure Commission's findings to be reported at the end of December 2019 and the Scottish Government's next Infrastructure Investment Plan which will be informed by the Commission's advice meaning future budgets will be published by June 2020.

4.1 Our Approach to the Resource Budget.

Our ambition is to allocate budgets to meet the changing needs of Scotland's people and the challenges of our times, whilst considering more systematically the links between budgets and what those budgets deliver.

We will expect all spending proposals to be focused on outcomes and to evidence as far as possible the impact (positive or negative) of spend on:

- Wellbeing – driven by Scotland's National Performance Framework;
- sustainable and inclusive economic growth;
- tackling child poverty; and
- tackling climate change.

Fiscal sustainability will underpin our approach, and we will seek greater collaboration across portfolios and public bodies to improve outcomes, and better evidencing of external factors that drive spending (such as adverse UK Government policies or demographic changes). As part of this work we will continue our efforts to adopt a more outcomes-focused approach to budgeting.

Our Timeline

The proposed timeline for the resource budget is set out below:

- May: Medium-Term Financial Strategy and Spending Review Framework published as well as Scotland's Wellbeing: Delivering the National Outcomes.
- June-September: Proposals developed in line with Spending Review Framework.
- October: Ministerial discussions take place on proposals provided.
- November: Budgets are reviewed in light of UK Autumn Budget / Spending Review.
- December: Budget / Spending Review (to be confirmed once UK Government position is clear) published including a three-year resource settlement for local government, and Budget Bill for 2020-21 introduced.

Pre-Budget scrutiny by the Scottish Parliament's Committees will take place across this period. In publishing this framework, even with the uncertainty that exists over a UK Spending Review and EU exit, our aim is to help inform this pre-Budget scrutiny and maximise the opportunity for others to influence the Scottish Budget through it.

4.2 Our Approach to the Capital Budget

The Capital Spending Review framework will be set in the context of the National Infrastructure Mission set out in the 2018 Programme for Government. This will steadily increase annual investment, rising by 1 per cent of current (2017) GDP by the end of the next parliament, 2025-26, compared to 2019-20.

In January 2019 we established an Infrastructure Commission for Scotland (the Commission) to provide long-term strategic advice on national infrastructure priorities, based on evidence and good practice, and to align investment with long-term inclusive economic growth and low-carbon objectives. The work of the Commission will help inform investment priorities over the 30 years ahead, and also in the more immediate period covered by the National Infrastructure Mission.[7]

The six overarching objectives of the Commission's remit are informed by the Scottish Government's National Performance Framework, Economic Strategy and Economic Action Plan. These are:

- Delivering sustainable and inclusive growth across Scotland.
- Managing the transition to a more resource efficient, lower carbon economy.
- Supporting delivery of efficient, high quality, modern public services.
- Increasing industry competitiveness, whilst tackling inequality.
- Enhancing societal living conditions now and in the future.
- Ensuring alignment with the new National Planning Framework.

The Commission will also consider the following key drivers to inform their work and these will also be considered by the Scottish Government through the Spending Review process:

- Securing Scotland's international competitiveness.
- The markets and connections that Scotland requires for goods, services and people.
- How to prioritise investment to deliver inclusive economic growth and low carbon objectives.
- Demographic and other social change factors.
- Place-making.
- Technological change and innovation.

[7] More detail on the Commission can be found at https://infrastructurecommission.scot/

- Considerations around development, ownership and financing of infrastructure, including Fair Work.

By the end of 2019 the Commission will provide its 30-year vision for infrastructure in Scotland together with strategic advice on prioritisation for the first five years.

As the Commission's recommendations will be a critical input to the next Scottish Government Infrastructure Investment Plan and associated capital budget, the Scottish Government's aim is to publish a new Infrastructure Investment Plan and the capital Spending Review by June 2020.

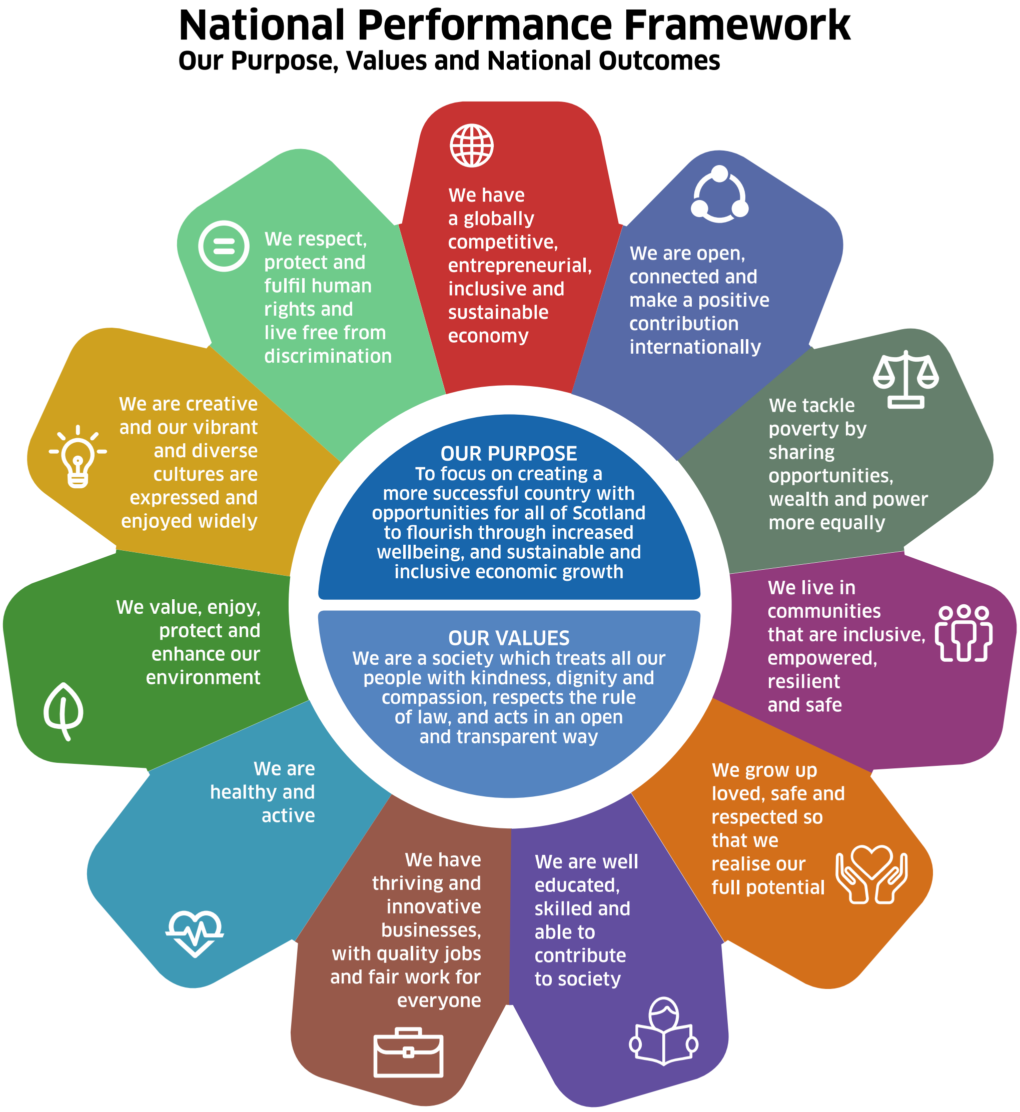
Our Timeline

The proposed timeline for the capital budget is set out below:

- May: Medium-Term Financial Strategy and Spending Review Framework published.
- June: Spending Review process begins.
- End June/July – Infrastructure Commission interim findings available
- November: Budgets are reviewed in light of UK Autumn Statement / Spending Review.
- December: Budget published and Budget Bill for 2020-21 introduced.
- End-December: Infrastructure Commission final report published.
- March-Summer 2020: Infrastructure Investment Plan finalised, building on Infrastructure Commission report.
- Summer 2020: Capital future years budgets set out.

4.3 Opportunities and Challenges

Our actions to tackle some of the big challenges of our time, including getting our economy fit for the future, preparing for demographic change and tackling inequality, are united by the Purpose for Scotland at the heart of the National Performance Framework: to focus on creating a more successful country with opportunities for all of Scotland to flourish through increased wellbeing, and sustainable and inclusive economic growth.



Scotland's National Performance Framework was updated in 2018 with a refreshed Purpose and National Outcomes. The framework has a simple yet ambitious purpose at its heart that everyone in Scotland can get behind to create a more successful country.

Our commitments to giving every child the best start in life and our social contract with the people of Scotland to invest in early learning and childcare, housing, health, justice and education remain a priority. This is underpinned by placing our strategic focus on addressing Scotland's long-term challenges, notably climate change and child poverty, at the core of the spending review.

We have seen significant improvements since devolution showing how people's lives have improved for the better, including lower premature mortality, people feeling more positive about where they live and the skills profile of our population.

We know challenges remain and inequality is holding Scotland back from reaching its full potential. The places where people live and grow up shape the opportunities they have and can influence their life chances. A place-based approach, focused on maximising the impact of the combined assets and investment available, can help us tackle inequality and improve outcomes locally. We will continue to have due regard to the Public Sector Equality Duty and Fairer Scotland Duty when shaping strategic policy and legislative and budgetary decisions, aiming to advance equality and progressively realise human rights.

Financial and Economic Context

The financial and economic context for the Spending Review is clearly set out in this Medium-Term Financial Strategy. It includes a decade of austerity, the ongoing uncertainty over the UK's exit from the EU and its impact, the impact of UK policies on our most vulnerable and the significant restrictions on our fiscal powers to borrow or use the Scotland Reserve.

Public Sector Pay Policy

The Scottish Government remains committed to providing fair and affordable pay rises for public sector employees. A sustainable approach to public sector pay is crucial given the number of public sector workers it applies to and the scale of associated spending. Public sector pay, at an estimated £16.7 billion in 2019-20, accounts for well over half of the Scottish Government resource budget.

Table 5 illustrates the cumulative additional cost of various increases to the 2019-20 public sector pay bill for the Scottish Government, the 44 public bodies covered by the pay policy, the NHS, teachers, police, fire and further education. It excludes other local authority pay costs.

TABLE 5: ILLUSTRATIVE ADDITIONAL PAY BILL COSTS (INCLUDING ON-COSTS)

£ million	2020-21	2021-22	2022-23	Total
1%	130	131	132	393
2%	260	265	270	794
3%	389	401	413	1,204

5. Conclusion

This is the second Medium-Term Financial Strategy published by the Scottish Government. It is designed, as recommended by the Budget Process Review Group, to allow a medium-term perspective on the public finances to be maintained throughout each parliamentary session.

The document does not set out any new decisions or spending commitments but instead seeks to explore and explain the key financial challenges and opportunities faced by the Scottish Government and its public services over the next five years.

Irrespective of the UK Government's decision about its Spending Review, the Scottish Government plans to hold a multi-year review of spending and this document sets out the framework for that.

The figures and modelling within the document are based on the data available as of its publication in May 2019 and will be subject to change as new and updated data become available.

If you have comments on the content or the presentation of this document, we would be delighted to have them. Please contact the Finance Co-ordination Mailbox (finance.co-ordination@gov.scot).

Annex A – Methodology for Calculating the Funding Outlook

The modelling looks at each component of the Scottish Government budget in turn, and projects these individually. The main focus of the projection is on the cash budget limits provided by HM Treasury. These are then supplemented with projections of:

- Income from devolved taxes;
- Block Grant Adjustments;
- Social Security funding; and
- Capital borrowing.

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TABLE A.1: TAX REVENUES AND BLOCK GRANT ADJUSTMENTS FOR FUNDING OUTLOOK

£ million		2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Income Tax	Revenue	11,857	12,177	11,684	12,332	12,831	13,374	13,985
	BGA[1]	11,750	11,749	11,501	12,380	12,825	13,300	13,805
	Difference	**107**	**428**	**182**	**-48**	**6**	**74**	**180**
LBTT	Revenue	507	588	643	655	691	724	759
	BGA[1]	545	600	567	568	611	651	705
	Difference	**-38**	**-12**	**76**	**88**	**80**	**73**	**54**
SLfT	Revenue	149	106	104	87	12	14	15
	BGA[1]	119	94	91	86	92	84	72
	Difference	**30**	**12**	**13**	**1**	**-80**	**-71**	**-57**
Total taxes	Revenue	12,513	12,872	12,430	13,075	13,534	14,112	14,758
	BGA[1]	12,414	12,444	12,159	13,034	13,528	14,035	14,582
	Difference	**99**	**428**	**271**	**41**	**7**	**77**	**176**
Estimated income tax reconciliation					**-229**	**-608**	**-188**	
Other Adjustments[2]		**-4**	**-4**	**-9**	**-2**	**-**	**-**	**-**
OVERALL	**Net budget impact**	**95**	**424**	**262**	**-190**	**-601**	**-111**	**176**

Note 1: The BGAs shown are calculated using the Indexed Per Capita (IPC) indexation method. This method in practice determines the BGAs applied to the budget.

Note 2: This includes the net impact of non-tax income (fines, forfeitures and fixed penalties & proceeds of crime) reconciliations for fully devolved taxes on the budget.

Figures may not sum due to rounding.

For revenue and Block Grant Adjustments, we use the figures that determined the Scottish Budget positions for each Budget Act for the years up to and including 2019-20. We use these figures because they informed the funding outlook for each of these years.

For 2020-21 onwards, we use the May 2019 Scottish Fiscal Commission forecast for each devolved tax. The Block Grant Adjustments are from the UK Government's 2019 Spring Statement.

The uncertainty which is captured in the forecast derives from two key factors: uncertainty relating to forecasts of the devolved Scottish taxes and the resulting net block grant position, and uncertainty around the future budget limits from HM Treasury.

Uncertainty Relating to Devolved Tax Forecasts

It is still too soon to have a clear understanding of the uncertainty around Scottish-specific forecasts. The Scottish Fiscal Commission (SFC) published its first evaluation of its forecasts in September 2018, which highlighted the challenges of evaluating forecasts with such limited data. In its latest May forecast, the SFC suggests that it might expect an average error in its one-year ahead tax forecasts of around 3.3 per cent, or around £530 million.

As with last year's publication, the approach to modelling uncertainty is to look at the historical variations in per-person income tax growth rates in Scotland and the rest of the UK. These are used to estimate their probability of further differences over time, and their impact on the Scottish Budget. By way of comparison, this approach results in a one-year ahead forecast uncertainty of 2.3 per cent around the devolved taxes forecast, increasing to 6.4 per cent by 2023-24.

Uncertainty Relating to Future Budget Limits

Uncertainty around budget limits is based on analysis of changes to previous budgets as a result of Barnett consequentials at previous fiscal events. Consequentials for resource, capital and financial transactions are calculated separately. In addition, a further adjustment is made for uncertainty around future budget limits related to social security. As this funding is still very new, no time series of changes to it exist. Instead, work is based on analysis of Office for Budget Responsibility (OBR) uncertainty, which suggests that social security spending forecasts are twice as uncertain as departmental spending forecasts.

Presentation of Results

Rather than present a small number of funding scenarios, the uncertainty from all sources is combined to illustrate a range of possible future paths that the Scottish Government budget may take. Differences from the central projection could occur for a broad range of reasons, such as changes to economic performance, UK Government policy, or changes in labour market behaviour. This range is presented as a fan chart.

Limitations to the Projections

There are a number of risks to the Scottish Budget which have not yet been captured within this modelling and scenario development, such as the assignment of VAT. It is expected that further information will be built into modelling in future years as information and understanding increases, including future UK Government funding once a new Spending Review is undertaken.

The modelling assumes that the current Fiscal Framework methodology (indexed deduction per capita) is used across the entire five-year period.

Further uncertainty in the funding outlook is introduced through the forecast process itself and through divergence in economic performance. Risks around Scottish Government income differing from forecast can be twofold:

- Scottish devolved tax is different from forecast; or
- the rest of UK tax is different from forecast.

Tax forecasts are often linked to economic forecasts. Economic variables such as employment and incomes will be important in determining decisions such as whether households purchase a house, or whether businesses choose to invest. For example, the income tax forecast can be affected by a range of potential factors including:

- employment growth;
- wage growth;
- changes in income distribution in Scotland and the rest of the UK; and
- impact of policy changes.

To this extent, the tax forecasts are often viewed as being closely linked to the economy forecast, with the overall business cycle effects on employment and wage growth likely to be key drivers in the short term, although other factors such as the distribution of incomes and policy choices also play a role. Towards the end of the five-year period, longer term underlying trends such as productivity, demographics and labour market participation may also begin to affect the forecast.

Annex B – Detail on Capital Investment

Table B.1 shows the 2019-20 baseline as set out in the 2019-20 Budget updated for revised capital grant and borrowing assumptions. The capital grant figures are based on the modelled central scenarios in this document until 2023-24; thereafter, they have been kept level. We will continue to develop our approach to revenue-finance investment which can be used to provide additionality beyond what is possible from capital grant and our limited borrowing powers.

TABLE B.1: NATIONAL INFRASTRUCTURE MISSION BASELINE

£ million	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Capital Grant*	4,020.3	4,320	4,534	4,693	4,971	4,971	4,971
Borrowing	450.0	350	n/a	n/a	n/a	n/a	n/a
Financial Transactions	635.5	505	505	505	505	505	505
NPD/Hub Investment	60.0	40	n/a	n/a	n/a	n/a	n/a
Innovative Finance	30.0	25	25	35	20	2	3
Total	5,195.8	4,890	5,064	5,233	5,496	5,478	5,479

*Note: For 2019-20 this includes £42m from the reserve in addition to the capital grant central scenario.

Matching Projects to Financing Methods

The Scottish Government aims to secure best use of all of the funding and financing approaches available within devolved powers, ensuring it can deliver the National Infrastructure Mission (NIM) and value for money. In general, the Scottish Government can generate most investment overall by drawing for each body on those funding methods which offer lowest cost of funds or lowest opportunity cost. This section summarises the various approaches deployed within Scotland and how their cost compares.

Capital Grant and Capital Borrowing - Capital grant is determined by the allocation provided to the Scottish Government by HM Treasury. Capital grant can be used for any new infrastructure investment and for the acquisition of financial assets. Under the provisions of the Scotland Act 2016, the Scottish Government also has the ability to annually borrow up to £450 million, up to a maximum of £3 billion, to fund further capital investment.

Growth Accelerator - Growth Accelerator is an innovative form of revenue finance where local authorities invest in infrastructure to stimulate local economic development. Where local authorities meet agreed outcomes such as generating a set number of additional jobs from low-income areas, the Scottish Government pays a grant to the local authority equivalent to the investment (including financing costs) over a set time period (typically 25 years). Where targets are not met, the local authority is paid a percentage of the grant depending on how close it was to achieving the target.

Outcomes Finance – This is an innovation building on Growth Accelerator revenue finance and is currently being developed. The aim is to identify the outcomes that local authorities would need to meet to receive a dedicated payment from Scottish Government. Currently a form of Outcomes Finance is under discussion with COSLA to explore how it might more cost-effectively finance the new schools programme.

Tax Incremental Financing (TIF) – In TIF, local authorities invest in enabling infrastructure to deliver economic growth. They are then allowed to retain future increases Non Domestic Rates Income arising as a result of their investment which they can use to finance it.

Mutual Investment Model (MIM) - MIM is a profit sharing form of public-private revenue finance which has been developed by the Welsh Government. Under MIM, a delivery company is established to undertake specific infrastructure investment. The delivery company finances infrastructure investment through a mixture of bank debt, bonds and risk capital from the public and private sector. To pay for the cost of the infrastructure investment, the delivery company receives a unitary charge from the Scottish Government (typically over a 25-year period). Under the MIM model, profits arising from the delivery of infrastructure are shared between the public and private sector investors.

Hub - Hub is a public-private partnership delivery vehicle developed by Scottish Futures Trust but will no longer be used for design, build, finance and maintain (DBFM) contracts. HubCos can and do also provide assets directly funded by Councils and others, who draw on the HubCo procurement and construction expertise. 'Hub' is a term used both to describe the revenue-finance model and the procurement route."

Financial Transactions (FTs) - FTs are a form of finance allocated to the Scottish Government by HM Treasury. FTs can only be used to make loans or equity investments in private sector entities, e.g. universities, or individuals. FTs need to be repaid to the Scottish Government for onward repayment to HM Treasury.

Guarantees - The Scottish Government has the ability to issue "guarantees". For example, the Scottish Government may agree to fund the gap between expected and actual income. Guarantees are designed for investment projects where there are clear policy benefits but little current appetite in financial markets for support.

Matching Finance to Projects

Increasing SG Cost of Capital

Public Sector **Central Government** e.g. roads, rail, digital projects, justice, colleges, health.	**Public Sector** **Local Government** e.g. schools, housing and local economic development.	**Notes** (The cost of finance presented below in this table was estimated by Scottish Future Trust, more detail can be found at https://www.scottishfuturestrust.org.uk/publications)
	Tax Incremental Finance (TIF)	Council finances the asset through loans from Public Works Loans Board (PWLB) and is incentivised by extra tax revenues. TIF cost-neutral to SG if Non-Domestic Rates displacement arising from the new asset is accurate.
Capital Grant Capital Borrowing	Capital Grant Capital Borrowing	Capital grant block grant is provided by HM Treasury. The PWLB interest cost for borrowing is estimated at 1.4 to 2.1 times the capital value or cost of asset.
	Growth Accelerator (GA) Outcomes Finance (OF)	Local Authority borrows from PWLB and is incentivised by SG resource grant subject to meeting pre-agreed outcomes. Council Prudential Borrowing and SG affordability limits the use of GA. As above, the PWLB interest cost for borrowing is estimated at 1.4 to 2.1 times the capital value or cost of asset.
Mutual Investment Model (MIM)		Finance cost is estimated at 1.9 to 2.8 times the capital value or cost of asset.

*The total 25-year cost of maintenance is estimated to be 0.5 times the capital value or cost of the asset.

Increasing SG Opportunity Cost of Capital

Private Sector Universities, SMEs, Housing Associations, GPs, individuals	Notes
UK Guarantees Scheme (UKGS)	A UK wide £40bn fund for nationally significant infrastructure projects is available and open until at least 2026. UKG guarantees up to 100% of the principal and interest payments on infrastructure debt issued by the borrower to banks or investors. All guarantees are issued on a commercial basis. UKG is the guarantor; SG faces no risk. UKGS therefore represents lowest opportunity cost of financing private sector in Scotland.
Financial Transactions (FTs)	FTs can only be used for private sector loans or equity investments. SG receives FTs from HM Treasury, currently around £0.5bn p.a. SG must repay 80% to HMT and any bad debts beyond that must be met from SG capital grant.
Scottish Guarantees	Scottish Government can issue its own guarantees similar to UKGS. Any guarantee over £1m must be approved by the Finance Committee. Capital budget is required to meet any calls on guarantees therefore the risk and potential call on capital must be calculated and provided for before issuing.
Capital Grant	Capital grant should be prioritised for public sector projects which cannot be funded through other means.

Capital Borrowing Modelling

Three scenarios were selected to illustrate the impact of different capital borrowing decisions:

- deployment of remaining borrowing capacity on a steadily reducing profile over the NIM period;
- using borrowing to keep capital spending broadly level from 2021-22 (based on the MTFS central scenario to 2023-24);
- maximising borrowing until we can only borrow what we repay.

Each scenario was modelled on the basis of 10- and 25-year repayment terms and with interest rates of 2 per cent and 4 per cent.

In addition, one further scenario was modelled showing borrowing between £250 million and £450 million in each year of the National Infrastructure Mission, leaving a "reserve" of at least 10 per cent (£300 million). In this scenario the modelled borrowing terms that were applied were varied according to the amount borrowed:

- £450 million – 25 years
- £350 million – 25 years
- £300 million – 20 years
- £250 million – 10 years

Borrowing was only modelled for the period of the National Infrastructure Mission to 2025-26. The borrowing profile of the scenarios is as follows:

TABLE B.2: BORROWING PROFILES

Scenario (£ million)	19-20	20-21	21-22	22-23	23-24	24-25	25-26
1) Gradually reducing over NIM period	450	350	350	300	250	250	250
2) Borrow to keep capital level	450	350	450	300	50	50	50
3) Maximise borrowing	450	450	450	450	340-450	117-450	123-344
4) Between £250m- £450m over NIM period	450	350	350	300	300	250	250

Assumptions

The central scenario resource budget (excluding social security) has been used as the basis of the 5 per cent calculation.

Repayments are based on the equal instalment repayment (annuity) method.

Future capital grant and Financial Transactions funding is only confirmed until 2020-21. The central scenario numbers are used from 2021-22 to 2023-24 and thereafter level cash has been assumed.

The capital borrowing modelling has been undertaken in the context of the National Infrastructure Mission commitment to steadily increase infrastructure investment until it is £1.56 billion higher in 2025-26 than it was in 2019-20. It has been assumed that revenue finance will be used to bridge the gap between capital grant, FTs and borrowing to steadily increase investment and from 2026-27 keep investment at 2025-26 levels. This means the amount of investment funded through revenue finance will change as the borrowing profile changes.

For the purpose of cautious modelling assumptions, the most expensive form of revenue finance, private finance, has been modelled. The interest rate for this has been kept constant for all scenarios. However, revenue finance is broader than just private finance and, for example, the growth accelerator model is a form of revenue finance which makes use of Public Works Loans Board (PWLB) borrowing, not private finance.

Conclusions

The modelled scenarios only show borrowing utilised until the end of the next parliament and the end point of the National Infrastructure Mission target – 2025-26. Table B.3 below shows the remaining borrowing headroom for each of the scenarios and, with the exception of the scenarios that maximise borrowing in each year, all have borrowing headroom of greater than £300 million, 10 per cent of the aggregate borrowing limit.

As repayments are made but no further borrowing is modelled, the headroom will increase reflecting that there are choices that can be made in later years.

TABLE B.3: BORROWING HEADROOM							
Scenario (£ million)	**19-20**	**20-21**	**21-22**	**22-23**	**23-24**	**24-25**	**25-26**
1) Borrowing reducing over NIM period 25 years 2%	1,338	1,062	797	594	451	318	194
2) Borrowing reducing over NIM period 25 years 4%	1,338	1,058	788	577	424	280	144
3) Borrowing reducing over NIM period 10 years 2%	1,338	1,089	872	740	687	661	661
4)Borrowing reducing over NIM period 10 years 4%	1,338	1,085	863	723	663	629	622
5) Level cash 25 years 2%	1,338	1,112	888	819	835	855	878
6) Level cash 25 years 4%	1,338	1,108	879	801	807	817	830
7) Level cash 10 years 2%	1,338	1,139	963	971	1,084	1,205	1,334
8)Level cash 10 years 4%	1,338	1,135	954	953	1,057	1,172	1,297
9) Maximise borrowing 25 years 2%	1,338	962	600	253	0	0	0
10) Maximise borrowing 25 years 4%	1,338	958	590	234	0	0	0
11) Maximise borrowing 10 years 2%	1,338	989	681	417	197	41	53
12) Maximise borrowing 10 years 4%	1,338	985	671	398	168	0	0
13) Borrow between £250m-£450m over life of NIM at 2% but different terms - 10-25 years depending on amount	1,338	1,066	809	618	495	397	324

Table B.4 below shows the impact of each of the scenarios on the 5 per cent revenue finance affordability limit.

TABLE B.4: IMPACT ON 5% AFFORDABILITY LIMIT							
Scenario	**19-20**	**20-21**	**21-22**	**22-23**	**23-24**	**24-25**	**25-26**
1) Borrowing reducing over NIM period 25 years 2%	3.27%	3.42%	3.50%	3.47%	3.57%	3.66%	3.78%
2) Borrowing reducing over NIM period 25 years 4%	3.27%	3.44%	3.54%	3.52%	3.63%	3.73%	3.85%
3) Borrowing reducing over NIM period 10 years 2%	3.27%	3.52%	3.66%	3.69%	3.84%	3.97%	4.11%
4) Borrowing reducing over NIM period 10 years 4%	3.27%	3.53%	3.69%	3.74%	3.89%	4.03%	4.18%
5) Level cash 25 years 2%	3.27%	3.42%	3.50%	3.49%	3.56%	3.63%	3.77%
6) Level cash 25 years 4%	3.27%	3.44%	3.54%	3.54%	3.62%	3.71%	3.85%
7) Level cash 10 years 2%	3.27%	3.52%	3.66%	3.73%	3.85%	3.92%	4.05%
8) Level cash 10 years 4%	3.27%	3.53%	3.69%	3.78%	3.90%	3.99%	4.12%
9) Maximise borrowing 25 years 2%	3.27%	3.42%	3.52%	3.48%	3.57%	3.64%	3.71%
10) Maximise borrowing 25 years 4%	3.27%	3.44%	3.56%	3.53%	3.64%	3.73%	3.80%
11) Maximise borrowing 10 years 2%	3.27%	3.52%	3.70%	3.74%	3.91%	4.05%	4.21%
12) Maximise borrowing 10 years 4%	3.27%	3.53%	3.74%	3.79%	3.97%	4.13%	4.29%
13) Borrow between £250m-£450m over life of NIM at 2% but different terms - 10-25 years depending on amount	3.27%	3.44%	3.53%	3.51%	3.63%	3.73%	3.88%

None of the scenarios breach the 5 per cent limit, with the closest being scenario 12 in 2025-26 at 4.29 per cent (maximising borrowing over 10 years at 4 per cent). A change in interest rate had minimal impact compared to a change in the repayment term.

The scenario that maximised borrowing to the limit to the extent that we borrow only what is repaid has a positive impact on the 5 per cent because the amount of investment financed by more expensive private finance is reduced.

Annex C – Fiscal Framework Update

This Annex shows changes in the net position of the Scottish Budget following the latest Scottish Fiscal Commission (SFC) forecasts and Block Grant Adjustment (BGA) estimates informed by Office for Budget Responsibility (OBR) forecasts, as well as the latest capital borrowing and Scotland Reserve balances.

Tax

Table C.1 shows the latest forecasts for tax revenues from the SFC and BGA estimates from the UK Government's Spring Statement in March 2019.

TABLE C.1: LATEST FORECASTS OF TAX REVENUES AND BLOCK GRANT ADJUSTMENTS

£ million		2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Income Tax	Revenue	11,005	11,486	11,703	12,332	12,831	13,374	13,985	14,613
	BGA[1]	11,127	11,665	11,709	12,380	12,825	13,300	13,805	N/A
	Difference	**-122**	**-179**	**-5**	**-48**	**6**	**74**	**180**	**N/A**
LBTT[2]	Revenue	557	553	616	655	691	724	759	794
	BGA[1]	584	547	535	568	611	651	705	N/A
	Difference	**-27**	**6**	**81**	**88**	**80**	**73**	**54**	**N/A**
SLfT[2]	Revenue	148	143	109	87	12	14	15	15
	BGA[1]	113	105	92	86	92	84	72	N/A
	Difference	**35**	**38**	**17**	**1**	**-80**	**-71**	**-57**	**N/A**
TOTAL	Revenue	11,710	12,182	12,429	13,075	13,534	14,112	14,758	15,421
	BGA[1]	11,824	12,318	12,336	13,034	13,528	14,035	14,582	N/A
	Difference	**-114**	**-136**	**93**	**41**	**7**	**77**	**176**	**N/A**

Note 1: The BGAs shown are calculated using the Indexed Per Capita (IPC) indexation method. This method in practice determines the BGAs applied to the budget. Figures may not sum due to rounding.

Note 2: The 2017-18 LBTT and SLfT revenue and Block Grant Adjustment are outturn figures.

Figures may not sum due to rounding.

These revised estimates for income tax revenues and Block Grant Adjustments for 2017-18, 2018-19 and 2019-20 do not have any immediate impact on the Scottish Budget. Under the Fiscal Framework, BGAs for income tax are fixed for a financial year based on the forecast at the previous fiscal event.

The updated forecasts for future years provide an indication of the level of revenues that the SFC anticipates, but these figures will not be used to set the 2020-21 Budget in December 2019, as that will make use of the next set of forecasts that the SFC produces.

Future Reconciliations

The forecasts for both Scottish tax revenues and corresponding BGAs are based on the latest available information at the time of the Budget. Once the outturn data is available for the Scottish tax revenues and the BGAs, reconciliations will be carried out.

Income Tax

For Scottish income tax, outturn data is available around 16 months after the end of the financial year. For example, 2017-18 income tax outturn data will be available in summer 2019 and a reconciliation will be applied to the 2020-21 Budget to both forecast revenues and the BGA.

The potential scale of the reconciliations required are shown below for the 2020-21, 2021-22 and 2022-23 Budgets using the latest forecasts.

TABLE C.2: INCOME TAX RECONCILIATION TO 2020-21 BUDGET (£ MILLION)

2017-18 INCOME TAX	Revenues	BGA	Net Position	Forecast Reconciliation
Budget 2017-18	11,857	11,750	+107	
Latest forecast	11,005	11,127	-122	
Change	-852	-623		-229

TABLE C.3: INCOME TAX RECONCILIATION TO 2021-22 BUDGET (£ MILLION)

2018-19 INCOME TAX	Revenues	BGA	Net Position	Forecast Reconciliation
Budget 2018-19	12,177	11,749	+428	
Latest forecast	11,486	11,665	-179	
Change	-692	-84		-608

TABLE C.4: INCOME TAX RECONCILIATION TO 2022-23 BUDGET (£ MILLION)

2019-20 INCOME TAX	Revenues	BGA	Net Position	Forecast Reconciliation
Budget 2019-20	11,684	11,501	+182	
Latest forecast	11,703	11,709	-5	
Change	20	208		-188

Figures may not sum due to rounding.

Since the 2017-18 Budget, the forecast updates have shown a deterioration in the net budget position, which - if proved correct in the outturn - would lead to negative reconciliation requirements in future Budgets.

However, these forecast positions are not certain and will not be known for sure until outturn receipts are available for 2017-18 in summer 2019, for 2018-19 in summer 2020 and for 2019-20 in summer 2021.

It is also worth noting that 2017-18 and 2018-19 revenue and BGA forecasts for income tax were based on a forecast 2016-17 baseline. Income tax outturn data for 2016-17 has now been published, and will be used from now on as the baseline value for the income tax revenue forecasts and BGA. This figure is £806 million lower than the 2016-17 forecast used at the 2017-18 Scottish Budget and £495 million lower than the one used at the 2018-19 Scottish Budget.

While the use of this outturn figure causes forecast revenue and BGA figures to be lower, the 2016-17 outturn data has no direct impact on the Scottish Budget. This is because the BGA deducted from the Budget and the forecast tax revenues added to the Budget have been revised down by the same amount to account for the new baseline value.

Fully Devolved Taxes

Revenue Scotland manages and collects LBTT and SLfT and these revenue streams feed in to the Scottish Budget as they are collected. There is no reconciliation required for these revenues; the Scottish Government manages any variance between what was forecast and actual revenues as part of its in-year budget management process. The latest 2019-20 forecasts for LBTT and SLfT are shown in Tables C.5 and C.6.

TABLE C.5: LBTT 2019-20 REVENUE FORECAST (£ MILLION)	
SFC Revenue Forecast – Budget 2019-20	643
SFC Revenue Forecast – MTFS 2019	616
Change	-27

TABLE C.6: SLfT 2019-20 REVENUE FORECAST (£ MILLION)	
SFC Revenue Forecast – Budget 2019-20	104
SFC Revenue Forecast – MTFS 2019	109
Change	+6

The BGAs for these taxes are reconciled twice. The first ‘interim reconciliation’ is made within the financial year at the Autumn Budget, on the basis of the most recent OBR forecasts. The latest forecast interim reconciliation to the 2019-20 LBTT and SLfT BGAs is shown in Tables C.7 and C.8.

TABLE C.7: LBTT 2019-20 FORECAST BGA INTERIM RECONCILIATION (£ MILLION)	
Forecast BGA – UK Autumn Budget 2018	567
Forecast BGA – UK Spring Statement 2019	535
Forecast Reconciliation to 2019-20 Budget	+32

TABLE C.8: SLFT 2019-20 FORECAST BGA INTERIM RECONCILIATION (£ MILLION)	
Forecast BGA – UK Autumn Budget 2018	91
Forecast BGA – UK Spring Statement 2019	92
Forecast Reconciliation to 2019-20 Budget	-1

Once outturn data is available in the following financial year, a final reconciliation is applied to the block grant for the financial year thereafter (i.e. two years after the year to which the revenues relate). Tables C.9 and C.10 show the forecast final reconciliation for 2018-19 LBTT and SLfT BGAs.

TABLE C.9: LBTT 2018-19 FORECAST BGA RECONCILIATION (£ MILLION)	
Forecast BGA - UK Autumn Budget 2018	546
Forecast BGA - UK Spring Statement 2019	547
Forecast Reconciliation to 2020-21 Budget	-1

TABLE C.10: SLfT 2018-19 FORECAST BGA RECONCILIATION (£ MILLION)	
Forecast BGA - UK Autumn Budget 2018	104
Forecast BGA - UK Spring Statement 2019	105
Forecast Reconciliation to 2020-21 Budget	-1

Social Security

Carer's Allowance

For social security benefits, the Block Grant Adjustments are additions rather than deductions. Carer's Allowance is the only social security benefit in current operation that requires a Block Grant Adjustment. Table C.11 shows the SFC's latest expenditure for Carer's Allowance (not including the supplement) and the Block Grant Adjustment estimate provided at the Spring Statement 2019.

TABLE C.11: FORECASTS OF CARER'S ALLOWANCE EXPENDITURE AND BLOCK GRANT ADJUSTMENTS (£ MILLION)

		2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Carer's Allowance	SFC Expenditure Forecast – MTFS 2019	152	286	304	325	351	371	393
	BGA Estimate - UK Spring Statement 2019	157	287	304	325	355	385	N/A
	Difference	5	1	0	0	4	14	N/A

There is no reconciliation required for Carer's Allowance expenditure, as the Scottish Government manages any variance between forecast and actual revenues in-year.

As with the fully devolved taxes, the BGAs for benefits are reconciled twice. The first 'interim reconciliation' is made within the financial year at the Autumn Budget, on the basis of the most recent OBR forecasts. The latest interim reconciliation to the 2019-20 Carer's Allowance BGA is shown in Table C.12.

TABLE C.12: CARER'S ALLOWANCE 2019-20 FORECAST BGA INTERIM RECONCILIATION (£ MILLION)

Forecast BGA - UK Autumn Budget 2018	290
Forecast BGA - UK Spring Statement 2019	287
Forecast Reconciliation to 2019-20 Budget	-3

Once outturn data is available in the following financial year, a final reconciliation is applied to the block grant for the financial year thereafter. There will be a reconciliation to the 2018-19 Carer's Allowance BGA as part of the 2020-21 Budget. Table C.13 shows the forecast final reconciliation.

TABLE C.13: CARER'S ALLOWANCE 2018-19 FORECAST BGA RECONCILIATION (£ MILLION)

Forecast BGA - UK Autumn Budget 2018	157
Forecast BGA - UK Spring Statement 2019	157
Forecast Reconciliation to 2020-21 Budget	0

Discretionary Housing Payments and Best Start Grant

The Scottish Fiscal Commission forecasts expenditure on Best Start Grant and Discretionary Housing Payments (DHPs) and Scottish Government spending plans on DHPs, as shown in Table C.14 below.

TABLE C.14: FORECASTS AND SPENDING PLANS FOR BEST START GRANT AND DISCRETIONARY HOUSING PAYMENT EXPENDITURE (£ MILLION)

		2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Best Start Grant	SFC Expenditure Forecast	4	21	16	16	17	17	18
DHPs – Bedroom Tax Mitigation	SFC Expenditure Forecast	51	53	55	57	58	60	62
DHPs – Other Spend	SG spending plans	11	11	11	11	11	11	11

Best Start Grants and DHPs are not funded through Block Grant Adjustments. They are instead initially funded by ‘Machinery of Government’ transfer payments directly from the Department of Work and Pensions until the end of the Spending Review period. After that, funding for these benefits becomes part of the core resource block grant, or ‘baselined’ into the block grant, and subject to the Barnett formula. This means that there are no BGAs calculated for these benefits and no reconciliation process. Funeral Support Payment, commencing in summer 2019, will also commence through this process. Table C.15 shows the funding transfers that the Scottish Government has agreed before funding becomes part of the core resource block grant.

TABLE C.15: BEST START GRANT AND DISCRETIONARY HOUSING PAYMENT FUNDING TRANSFERS (£ MILLION)

		2018-19	2019-20
Best Start Grant	Funding Transfer	1	2
DHPs	Funding Transfer	20	20

Benefits Yet to Commence

Executive competence for the remaining benefits will commence in April 2020 and, where relevant, Block Grant Adjustments will be agreed at the UK Government’s Autumn Budget 2019.

Capital Borrowing

Table C.16 shows the Scottish Government's current capital borrowing plans.

The Scottish Government has borrowed £250 million in 2018-19 to support capital expenditure. This is less than the £450 million originally planned, largely as a result of additional consequential capital funding received from the UK Government.

In 2019-20, the Scottish Government has announced plans to borrow the annual maximum of £450 million capital intended over a 25-year period. Final decisions on the specific borrowing arrangements for 2019-20 will be taken over the course of the year.

The Scottish Government currently plans to borrow a further £350 million in 2020-21 to support the National Infrastructure Mission. Final decisions on future borrowing levels will be taken as part of the 2020-21 Budget and subsequent budget processes.

Chapter 3 sets out the Scottish Government's policy of borrowing between £250 million and £450 million over the remaining period of the National Infrastructure Mission, but this is not included in table C.16 at this stage. Final decisions are always taken within the relevant budget year, depending on circumstances.

On the basis of existing and planned borrowing included in the table, the Scottish Government will have accumulated £1.66 billion in capital debt by the end of 2019-20, 55 per cent of its overall limit. Details on previous borrowing can be found in the Fiscal Framework Outturn Report published on 20 September 2018.

The capital outlook assumes that the maximum amount of capital borrowing (£450 million) will be undertaken in 2019-20 and £350 million in 2020-21. As set out in chapter 3, our policy is then to borrow between £250 million and £450 million over the remaining period of the National Infrastructure Mission, but this is not included in modelling of the capital outlook. Final decisions are always taken within the relevant budget year, depending on circumstances.

TABLE C.16: CAPITAL BORROWING AND REPAYMENT SCHEDULE

£ million		2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Borrowing		**450**	**250**	**450**	**350**				
Repayment on 2015-16 borrowing	*Capital*	9.43	9.43	9.43	9.43	9.43	9.43	9.43	9.43
	Interest	0	0	0	0	0	0	0	0
Repayment on 2016-17 borrowing	*Capital*	11.1	11.1	11.1	11.1	11.1	11.1	11.1	11.1
	Interest	0	0	0	0	0	0	0	0
Repayment on 2017-18 borrowing	*Capital*		7.07	14.35	14.62	14.90	15.19	15.48	15.77
	Interest		7.72	8.35	8.07	7.80	7.51	7.22	6.93
Repayment on 2018-19 borrowing	*Capital*			11.95	24.06	24.29	24.52	24.76	24.99
	Interest			2.06	2.21	1.98	1.74	1.51	1.27
Repayment on 2019-20 borrowing	*Capital*				6.5	13.3	13.6	14	14.3
	Interest				9.8	11	10.7	10.3	10
Repayment on 2020-21 borrowing	*Capital*					5.1	10.4	10.6	10.9
	Interest					7.7	8.6	8.3	8
Repayment on 2021-22 borrowing	*Capital*								
	Interest								
Repayment on 2022-23 borrowing	*Capital*								
	Interest								
Total Repayments of Principal		**20.53**	**20.53**	**32.48**	**51.10**	**63.22**	**69.06**	**69.89**	**70.73**
Repayment period for borrowing (years)		25	10	25	25				
Interest rate		1.9	0.95	2.5	2.5				
Is interest rate fixed or variable?		Fixed	Fixed	Fixed	Fixed				

Scotland Reserve

Table C.17 shows the 2018-19 Reserve position as reported at Spring Budget Revision and provided to the Scottish Fiscal Commission for its May 2019 forecasts.

TABLE C.17: 2018-19 SCOTLAND RESERVE FORECAST AT 31 JANUARY 2019

£ million		
2018-19 Opening Balance		**(538.0)**
2018-19 Forecast Movements		**38.3**
In-year Reserve Drawdown	250.0	
Forecast Underspends	(211.7)	
2018-19 Forecast Closing Balance		**(499.7)**
2019-20 Expenditure Commitments		**407.5**
Budget Bill (anticipated drawdown)	313.5	
Budget Bill - Stage 2	94.0	
Less: Additional 2019-20 Funding		**(208.0)**
Late budget consequentials carried forward through HMT Reserve	(148.0)	
QLTR Receipts deferred from 2018-19	(60.0)	
2019-20 Planned Reserve Drawdown		**199.5**
2019-20 Forecast Residual Balance		**(300.2)**
Of Which		
Resource	(145.7)	
Capital	(154.5)	

Additional funding commitments for 2019-20 totalling £313.5m were made when the budget was initially published in December 2018, with the full amount of this funding to be met through anticipated drawdown from the reserve. A further £94m of spending was committed at Stage 2 of the Budget Bill giving a total commitment to be funded of £407.5m as shown above. However, the overall funding position had changed by the time the additional spending was committed at Stage 2. Additional Budget consequentials of £148m were provided by the UK government and income from the Queen and Lord Treasurer's Remembrancer account of £60m originally intended for deployment in 2018-19 could now be deferred. These two elements of additional funding have been applied against the total spending commitment of £407.5m reducing the planned drawdown from the reserve in 2019-20 to the £199.5m shown in the table.

Annex D – Transparency on Borrowing Powers and Scotland Reserve

To support understanding and scrutiny of the Scottish Government's decisions in relation to the planned and actual use of its Reserve, borrowing powers and revenue-finance investment, and how these decisions align with our principles and policies, the Scottish Government will provide the information outlined below.

Month	Publication	Information provided on the use of the Reserve, Borrowing and Revenue-Finance Investment
December	Scottish Budget document	Alongside the Scottish Government's tax and spending proposals for the financial year ahead, this document sets out the Scottish Government's capital borrowing plans. Resource borrowing plans would also be covered in this document, although there has been no resource borrowing to date. In relation to revenue-finance investment, the document details the monitoring of the long term investment commitments funded from revenue, and sets out these commitments as a percentage of the resource budget (excluding social security), and when they will peak. The document will also update on progress against the National Infrastructure Mission. Where drawdown from the Reserve will support spending plans for the financial year ahead, detail will also be provided in this document.
May	Medium-Term Financial Strategy	This document sets out a range of possible funding scenarios for the Scottish Budget, the Scottish Government's approach to fiscal principles and policies, and the broad financial plans over the coming five-year period. For borrowing, the document sets out the borrowing undertaken to date, the repayment details, and sets out planned or modelled borrowing for future years, where known. It sets out the broad approach to borrowing, including relevant context and developments: for example, how it will be used to deliver the National Infrastructure Mission. For revenue-finance investment, this document sets out the revenue commitments as a

		percentage of the resource budget (excluding social security) and provides a breakdown of committed and planned projects by category. For the Scotland Reserve, it sets out the closing balance for the previous financial year and the planned use for the current financial year. It also sets out the broad approach to use of the Reserve.
September	Fiscal Framework Outturn Report	This report focuses on the operation of the Fiscal Framework, reporting on the reconciliation process, the Scotland Reserve and borrowing powers and is based on audited information, as far as possible. It sets out the borrowing undertaken during the past financial year, and an assessment of the borrowing against the borrowing limits, as well as the implications of borrowing in terms of the estimated profile of future repayments. For the Scotland Reserve, it outlines the payments into and withdrawals from the Reserve and gives the Reserve balance at the start and end of the previous financial year. It also details the arrangements for borrowing in the current year, where known, and the forecast closing balance on the Reserve for the current year. For revenue-finance investment, the report notes the 5 per cent limit and the commitments that are included within this.

The Scottish Government will also provide updates on the use of the reserve and borrowing powers at a number of points during the financial year. The Scottish Government will also inform the Finance and Constitution Committee directly when it draws down any planned borrowing.

Month	Publication	Information provided on borrowing and the Reserve
October	Autumn Budget Revision	Provides an in-year running balance on the Reserve.
February	Spring Budget Revision	Provides an in-year running balance on the Reserve.
June	Provisional Outturn Statement	For capital borrowing, the statement details the actual amount borrowed in the preceding financial year and shows the aggregate position against the overall borrowing cap. It would detail the same for resource borrowing, should there be any. It shows the updated reserve position after allowing for the provisional underspend position. It shows any planned drawdown in the current year and details the residual balance.

In addition, a number of publications provide further information on the use of our powers, as set out below.

Unitary Charges Publications

We provide funding or part-funding for a number of Non-Profit Distributing (NPD) and Public Private Partnership/Private Finance Initiative (PPP/PFI) projects in Scotland.

We publish three documents annually which provide details of the actual/estimated annual unitary payment charges paid/to be paid by public sector procuring bodies in Scotland to private sector consortiums for services agreed over the length of the contracts:

Three separate publications for unitary charges covering:

- pipeline NPD/Hub projects
- operational PPP/PFI projects
- operational NPD projects pre-November 2010

Publication is generally in March.

Scotland Act Annual Report

This a statutory report that we produce every year, normally in April, to inform Parliament of the operation and implementation work we have done on fiscal powers in the Scotland Acts 2012 and 2016.

This provides information on the operation of the capital and resource borrowing powers since the previous report and any implementation work taken forward in relation to the powers. The report also gives an update on the Reserve balance.

Scotland's Economic and Fiscal Forecasts

In addition to the Scottish Government's key publications, the Scottish Fiscal Commission produces two annual forecasts. Both publications cover five-year forecasts of the Scottish economy, tax receipts and social security expenditure and an assessment of whether the Scottish Government's projections of borrowing are reasonable (including use of the Reserve). The December forecast publication informs the Scottish Budget for the next financial year.

This publication is available at **www.gov.scot**

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