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Tax and spending in 2024–25

Economic and Social Research Council

2. Tax and spending in 2024–25

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This chapter of our second annual Budget Report looks at Scottish tax policy and revenue, the overall amount of funding available for Scottish public services, and planned spending on different individual services in the coming financial year, 2024–25. In several important respects, the Scottish Government's 2024–25 Budget represents a continuation of trends seen in recent years. On the tax side, as with the current year, increases to income tax on those on higher incomes are set to raise a modest amount, but much more important have been significant upwards revisions to forecast underlying tax revenues. Combined with (more modest) increases in block grant funding from the UK government, this means that in cash terms, funding for public services in the coming year will be £1.7 billion higher than expected this time last year, and fully £2.6 billion more than expected in the May 2022 Scottish Resource Spending Review. Notwithstanding the recent sharp drop, inflation has still proved higher and more stubborn than expected back in May 2022. This almost fully offsets the boost to cash budgets. In addition, the boosts to spending that have been much highlighted by the Scottish Government again overstate the increase in resources available for public services next year – by ignoring top-ups made to the current year's budgets since the Budget Bill was initially passed.

Key findings

1. The headline tax policy measures in the 2024–25 Budget are an increase in income tax rates for taxpayers with annual incomes over £75,000 and a freeze in council tax bills. The former is estimated to raise £82 million after accounting for behavioural responses, while the latter is being funded by the Scottish Government at a cost of £144 million – roughly what councils could have raised from 5% increases in council tax rates. The combined effect of these two measures – at a giveaway of just over £60 million or just over 0.1% of the Scottish budget – is therefore to slightly reduce the funding available for devolved public services and social security spending in Scotland.

2. Taken together, the planned changes to income tax and council tax freeze will be progressive. Low- and middle-income households are not directly affected by the income tax rises and will benefit from the council tax freeze – although this only amounts to around a 0.1% boost to disposable income on average. In contrast, the

highest-income tenth of households will in many cases see a much bigger increase in income tax bills than they will save in council tax, reducing their net income by an average of 0.7%. When combined with the freeze in the income tax higher-rate threshold (which was already built into tax revenue forecasts but only officially confirmed by the Scottish Government in the Budget), the hit to incomes will amount to an average 1.1% for households in the top tenth of the income distribution, 0.5% for the next-highest tenth, and an average of 0.4% across all households.

3. While the latest increase in income tax rates has added £82 million to tax revenue forecasts in 2024–25, the Scottish Fiscal Commission's (SFC's) latest forecasts for the net contribution of income tax to the Scottish Government's budget next year have been revised up by a much larger £712 million compared with its December 2022 forecasts. This reflects final out-turn data on Scottish income tax revenues in 2021–22 and on earnings, as well as the latest estimates of PAYE tax receipts, in 2022–23 and 2023–24 – where Scotland appears to have been outpacing the rest of the UK, after several years of falling behind.

4. UK government funding in 2024–25 will also be higher than previously assumed. All told, the funding available to the Scottish Government in 2024–25 for day-to-day public service spending is now around £1.7 billion higher than was expected in December 2022, and £2.6 billion higher than was expected in May 2022 when the Scottish Government's multi-year Resource Spending Review was published. Much-higher-than-expected inflation over this period means this cash-terms boost of 6.7% only translates into a real-terms boost of 0.7%.

5. Turning to year-on-year comparisons, figures in the Scottish Budget 2024–25 show day-to-day public service spending rising by 2.2% in real terms compared with the original budget totals for 2023–24. However, the 2023–24 spending plans have been increased since first being set; the SFC's December forecasts suggested that these top-ups amount to around £1.0 billion. Accounting for these would imply that the amount available for public service spending will actually fall by 0.4% in real terms between this year and next. The Scottish Government's 2023–24 Spring Budget Revision, published on 1 February suggests even-bigger-than-expected in-year top-ups, implying a 0.6% real-terms fall in public service spending next year.

6. The funding available for capital spending has not been topped up to the same extent over the last two years, meaning higher inflation has eroded its real-terms value more. Capital funding in 2024–25 will be around 3.3% lower in real terms than expected in May 2022. It will also be 0.7% lower than in 2023–24.

7. As with overall funding for public services, the spending plans for specific service areas ignore in-year top-ups to budgets this year and so typically overstate the increases in spending next year. After adjusting for this, relative winners include the Education and Skills portfolio (up 5.7% in real terms), the Transport, Net Zero and Just Transition portfolio (up 4.8% in real terms) and the Constitution, External Affairs and Culture portfolio (up 2.1% in real terms). Relative losers include the Social Justice portfolio (down 10.2% in real terms), Wellbeing Economy, Fair Work and Energy (down 5.0% in real terms) and Rural Affairs, Land Reform and Islands (down 0.2% in real terms).

8. According to the figures reported in the Budget, funding for the NHS Recovery, Health and Social Care portfolio is, perhaps surprisingly, set to increase by less than average (1.3% in real terms). This figure is, though, affected by classification changes that mean some research and development funding previously classified as resource funding is now classified as capital funding instead. Adjusting for this, on a Budget-to-Budget basis the real-terms rise in funding in 2024–25 is set to be around twice as large (2.6%). However, the NHS Recovery, Health and Social Care budget received significant top-ups in the 2023–24 Spring Budget Revision, totalling £605 million. When accounting for these, even adjusting for the classification changes, health spending is set to fall by 0.7% in real terms between this year and next.

9. The Budget figures suggest councils' day-to-day funding will increase by 7.9% in cash terms (6.2% in real terms) in 2024–25. This gives a seriously misleading picture. It ignores not only sizeable in-year top-ups to councils' funding this year (£310 million), but also the fact that councils could use some of their capital funding (£121 million) for day-to-day spending this year, but that funding is being withdrawn next year, as well as the fact that councils need to fund a series of 'new burdens' from their 2024–25 budgets. After accounting for these factors, and the requirement for councils to freeze council tax in order to receive their full grant funding, we estimate that the funding available to councils will increase by just 3.5% in cash terms (1.8% in real terms) next year.

2.1 Tax policy and revenue

In recent years, powers over and revenues from several taxes have been devolved to the Scottish Government. In particular, stamp duty land tax (a tax on property transactions) and landfill tax (a tax per tonne of refuse disposed in landfill) were fully devolved from 2015–16, joining council tax (a recurrent tax on residential properties) and business rates (a recurrent tax on non-residential properties), which were fully devolved at the outset of the Scottish Parliament in

1999. In addition, powers over rates and bands, and the revenues from income tax on all sources of income except savings and dividends income, were devolved in 2017–18.[1]

In the years since, the Scottish Government has used its powers to raise more revenue and to increase the progressivity of its tax system, in particular by increasing rates of income tax on those on higher incomes (Adam and Phillips, 2021; Waters and Wernham, 2023). Devolved income tax revenues initially disappointed, but have proved more robust than expected in recent years. In this context, what does 2024–25 hold?

Income tax policy changes

Changes to income tax policy continue a trend of slightly reducing tax bills for those with low-to-middle incomes but increasing them substantially for those with higher incomes.

Starting with changes affecting low-to-middle-income taxpayers, the Scottish Government announced increases in the width of the bands of income subject to its 19% starter and 20% basic rates of tax in line with inflation in April 2024. For example, the 19% rate will apply on the first £2,306 of income above the personal allowance of £12,570 (compared with the first £2,162 currently), while the 20% rate will apply on the next £11,685 (compared with £10,956 currently). This leads to a maximum cash-terms saving of just over £10 per year for those with annual incomes between £26,561 and £75,000 compared with a policy of fixing the width of these bands in cash terms at 2023–24 levels.

However, as pointed out by the Fraser of Allander Institute, increasing the band widths by inflation leads to far smaller increases in the upper tax thresholds for these bands than if the thresholds themselves were increased in line with inflation (Spowage, Sousa and Congreve, 2023). This is because each band sits on top of the tax-free personal allowance set by the UK government, which has been frozen in cash terms since April 2021. The new upper thresholds announced by the Scottish Government have been calculated by applying inflation to the difference between the existing thresholds and this frozen personal allowance, not to the overall existing thresholds. Increasing the upper thresholds for these bands (rather than the band widths) by inflation would have cost around £35 million on top of current plans (Spowage et al., 2023) and would have seen taxpayers gain up to £27 per year in cash terms compared with the current year (as opposed to £10).

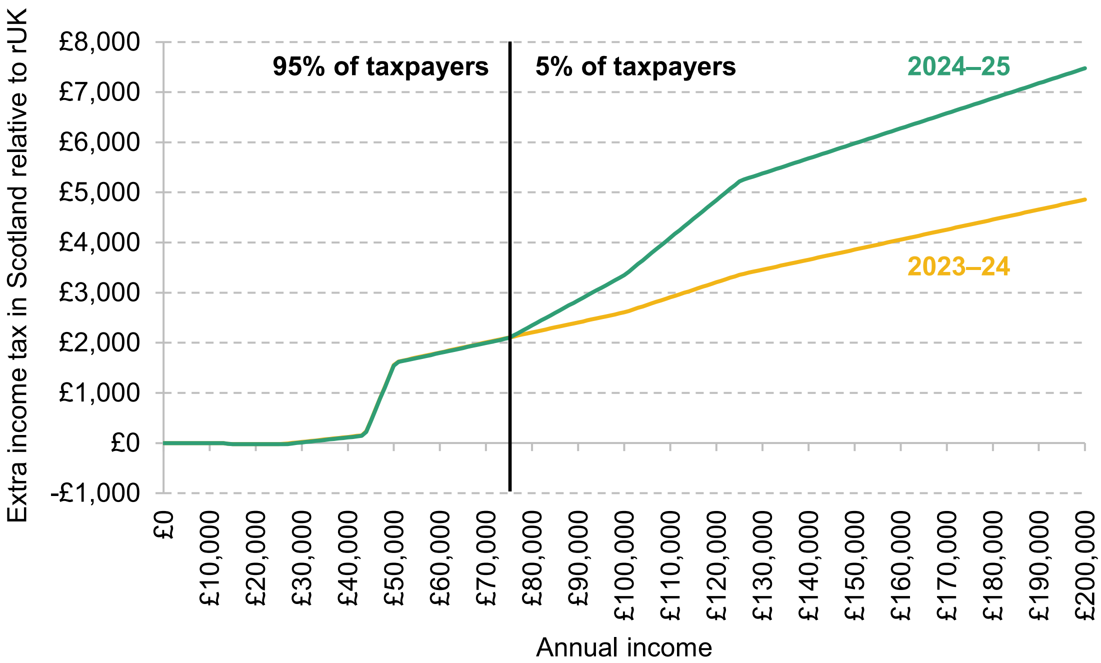
[1] The Scottish Government had the power to vary the basic rate of income tax by up to 3p in the pound from its creation in 1999, and from April 2016 retained revenues from 10 percentage points of each tax band and could raise or lower all rates in lockstep. However, these powers were never utilised.

Turning to higher-income taxpayers, the Scottish Government confirmed a freeze in the higher-rate tax threshold at £43,663. It estimates that this will raise £307 million a year, although it is worth noting that the Scottish Fiscal Commission was already assuming that this would be the case in its tax forecasts, so no additional revenue is scored from this measure. In addition, the policy mirrors a freeze to the higher-rate threshold in the rest of the UK (rUK), albeit at a lower level.

For the 5% of Scottish income tax payers with incomes over £75,000, there are more substantial changes to income tax rates. A new 45% rate of tax (termed the 'advanced rate') will apply on income between £75,001 and £125,140, and the top rate of tax on incomes above £125,140 will be increased from 47% to 48%.

Figure 2.1 shows that these measures will further increase the extent to which those in Scotland with the highest incomes pay more in income tax than those in rUK. From April, a taxpayer on £90,000 will pay £2,846 a year more tax than they would in rUK (up from £2,406), and a taxpayer on £125,000 will pay £5,221 a year more (up from £3,356). For those with an income below £75,000, the difference in tax liabilities between Scotland and rUK will barely change, in part because of the point made above – that starter- and basic-rate band widths, rather than thresholds, were uprated by inflation.

Figure 2.1. Differences in annual income tax liabilities for individuals in Scotland and rUK



Note: Assumes all income is from non-savings, non-dividend sources.

While significant in terms of the changes in tax bills for those affected by the reforms, the estimated revenue effects from these changes are relatively modest, with the new 45% rate estimated to raise £74 million in the coming year, and the increase in the top rate £8 million. To some extent, this reflects the small share of taxpayers subject to these new rates. But it also reflects the fact that the Scottish Fiscal Commission (SFC) assumes that there will be significant behavioural responses to these changes. In particular, a combination of changes in migration, labour supply, and tax avoidance and evasion behaviour is set to reduce the revenue from the 45% rate by around a half, and the increase in the top rate by around 85%. Overall, if there were no behavioural responses, it is estimated that the changes would yield £200 million next year, almost 2.5 times larger than the forecast post-behavioural-response yield.

Other tax policy changes

Council tax

Alongside the increases in income tax for those with incomes of over £75,000, the Budget also confirmed the Scottish Government's intention for a freeze in council tax bills in 2024–25, initially announced at the Scottish National Party's (SNP's) party conference.

It is important to note that the Scottish Government is not actually itself freezing council tax – council tax rates are set by councils. Instead, it is making grant funding equivalent to what could be raised from a 5% increase in council tax rates conditional upon councils' agreeing to freeze their council tax rates – a similar policy to that pursued by the UK coalition government in England in the early 2010s. For councils previously planning an increase in council tax of 5% or less, the choice is relatively straightforward: it is better to have this grant funding than increase council tax by 5%. Councils that had been planning to increase their council tax by more than 5% face a trickier choice: whether to cut back their spending plans somewhat, or forgo this grant funding and put up their council tax by more than 5% in order to boost their spending as planned. If they choose the latter, their residents will in effect have to pay more than £1 extra in council tax for each extra £1 in spending on local services, because of the loss of this conditional grant funding.

The £144 million being provided to councils conditional upon them freezing council tax rates is approximately 1.75 times the amount that is forecast to be raised from the new 45% advanced and increased 48% top rates of income tax. Based on the average council tax rate across Scotland, Table 2.1 shows that a freeze will save those households paying full council tax around £47 a year if they live in a band A property, £71 if they live in a band D property and £174 if they live in a band H property, if we assume council tax would otherwise have increased by 5%. The savings to many households will be lower than these figures though, as a result of discounts (such as the 25% single discount), exemptions (such as for properties occupied solely by students) and the means-tested council tax reduction (CTR) scheme. A full distributional analysis of the freeze can be found later in this chapter.

Table 2.1. Impact of council tax freeze on tax bills, by council tax band

Council tax band	Savings from freeze
A	£47
B	£55
C	£63
D	£71
E	£93
F	£115
G	£139
H	£174

Note: All ‘savings’ are calculated on the basis of the average standard tax bill for properties, before any discounts or premiums.

Source: Authors’ calculations using ‘Council Tax by band 2023–24’, https://www.gov.scot/publications/council-tax-datasets/.

The Scottish Government reaffirmed its commitment to council tax reform, but did not proceed with proposals consulted on last summer to increase the relative tax rates applied to band E to H properties (approximately the quarter most valuable as of 1991).[2] A good reform would include a revaluation to address the fact that council tax bands and hence bills in Scotland (and England) are based on relative property values in April 1991 – a third of a century ago. This means that many (perhaps half) of Scottish properties are now, in effect, in the wrong band. A revaluation could also make changes to the tax rates applied to different bands fairer by ensuring they apply to the ‘right’ properties. The potential impacts of revaluing and of different reforms to council tax in Scotland is an issue that IFS researchers hope to examine over the next year.

Two small changes to council tax will come into effect in 2024–25. First, councils will have the power to set premiums of up to 100% for second homes (Scottish Government, 2023a). Second, new buyers of long-term empty homes will have a six-month grace period to occupy or rent out their property before it is subject to an empty property premium, with councils able to extend this period by up to a further six months.

2 Assuming that councils did not change the band D tax rates they charged as a result of these reforms, and based on the average band D tax rate charged in 2023–24, these reforms would have raised approximately £175 million when fully phased in. Band E bills would have increased by 7.5% (an average of £140) and band H properties by 22.5% (an average of £780). See Phillips (2023) for further details.

Business rates

The Scottish Government mirrored the UK government's policy of freezing business rates for low-value properties, while increasing them in line with inflation for medium- and larger-value properties. In the short term, the biggest beneficiaries of the freeze in rates for low-value properties are likely to be the businesses occupying the properties. However, in the longer term, the biggest beneficiaries are likely to be landlords, as rents increase as a result of increases in demand for these smaller properties (which have lower additional property costs as a result of the reduced rates bill).

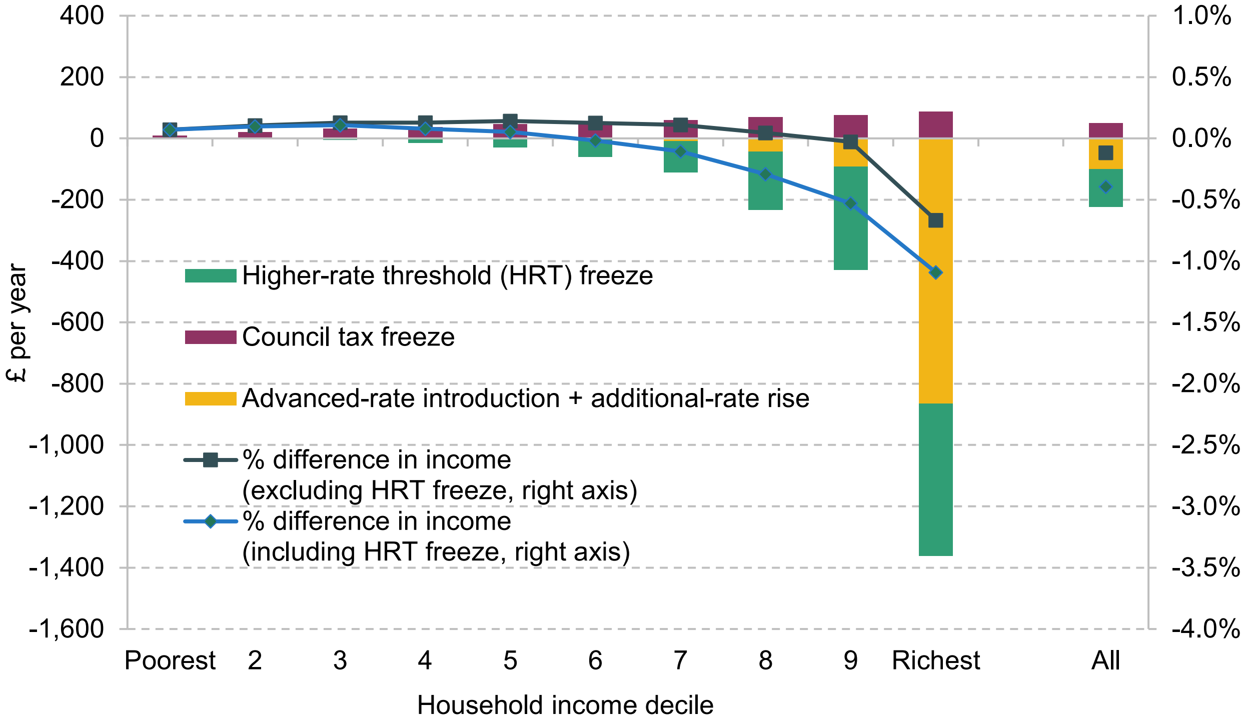
As in the current year, the Scottish Government chose not to replicate the UK government's special reliefs for the retail, hospitality and leisure sectors (which apply in England) on the Scottish mainland. But it did choose to introduce a 100% relief for hospitality properties on the Scottish islands (capped at £110,000 per business per year). In the short term, this new relief will reduce the costs and support the viability of the businesses benefiting from the policy, but if this policy is extended over time (as has been the case several times with policies operating more widely in England), the biggest beneficiaries are likely to be landlords, as rents end up higher than they would have been. It is also possible that businesses could be harmed by the policy if they and their landlords come to believe it is permanent but it is subsequently withdrawn: they could have agreed higher rents in anticipation of having a reduced or zero business rates liability. To avoid this risk, the Scottish Government should be clear about its long-term intentions for this policy.

Distributional effects

The effects of the introduction of the advanced rate, the increase in the additional rate and the freeze in council tax bills will on average offset each other. This is shown in Figure 2.2. On average, these policies will decrease households' disposable incomes by just £52 per year (0.1%), before considering any behavioural responses. However, on top of this, the higher-rate threshold freeze, already included in the SFC baseline, reduces household incomes by a further £123 (0.3%).

There are significant differences across the distribution. The effect of the introduction of the advanced rate and increase in the additional rate of income tax will fall mostly on the richest tenth of households, with modest hits to the incomes of other households in the top half of the income distribution. On the other hand, the 5% freeze in council tax will deliver a broadly similar (and small) proportional boost to incomes across the distribution. As a result, the poorest 80% of households will on average see little change in their disposable incomes as a result of these measures (increasing by £34 a year or 0.1%), whilst the richest tenth will see their incomes fall by £778 a year (0.7%). The freeze to the higher-rate threshold increases tax liabilities more widely across the top half of the income distribution, but with the burden still mostly falling on higher-income households.

Figure 2.2. Combined effects of Scottish income tax changes and council tax freeze 2024–25, by household income decile



Note: Income changes shown are before any behavioural response from households. This is especially important for the increase in the additional rate of income tax, which the SFC expects to generate significant behavioural response (e.g. reducing income or migrating out of Scotland). Household income deciles are defined with respect to the whole population.

Source: Authors' calculations using the Family Resources Survey 2017–19 and TAXBEN, the IFS tax and benefit microsimulation model.

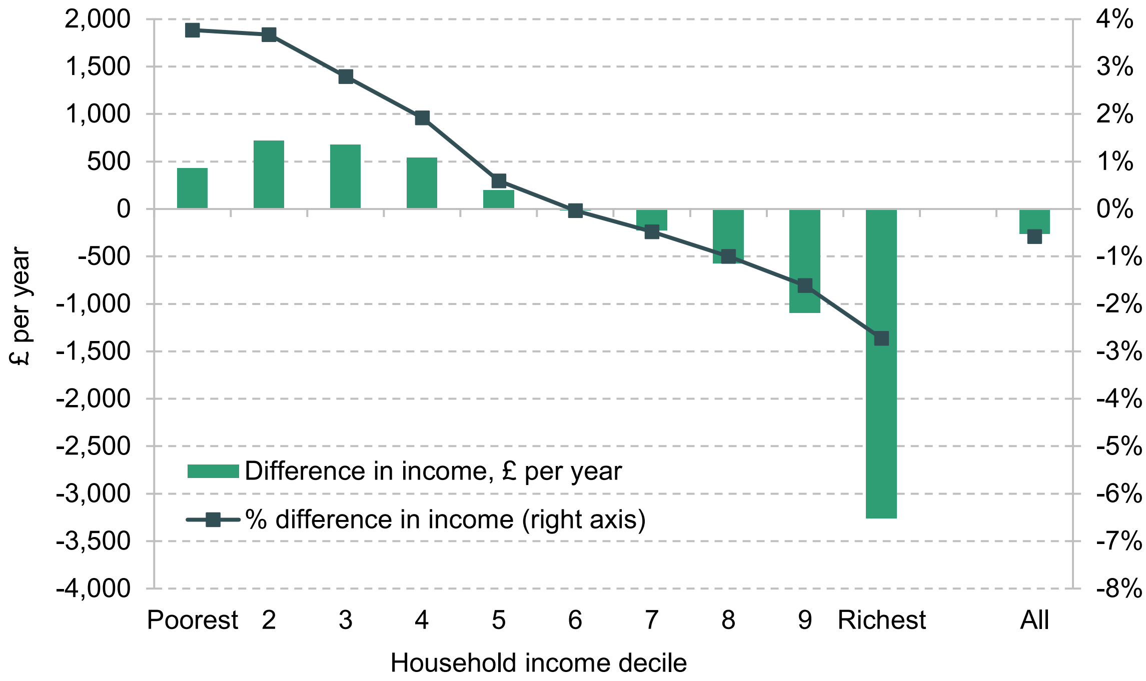
These measures therefore represent a continuation of trends: the Scottish Government has used devolved policy levers to increase progressivity in the Scottish tax and benefit system.

In our Scottish Budget Report last year, we also examined the combined distributional effects of all devolved Scottish income tax and benefit policies compared with those in place in England and Wales (Waters and Wernham, 2023). Figure 2.3 in Box 2.1 updates this analysis.

Box 2.1. The effects of devolved income tax and benefit policy

Figure 2.3 shows the combined effect of the Scottish Government's income tax and benefit policies on Scottish households' incomes, relative to what it would be under the income tax and benefit system in England and Wales. In particular, we model the different income tax rates and bands (including those announced in the 2024–25 Budget), the Scottish child payment and Best Start payments, the carer's allowance supplement, and mitigation of the under-occupancy charge and benefits cap.

Figure 2.3. Household disposable income under the Scottish tax and benefit system, compared with the system in England and Wales, April 2024



Note: Scottish policies modelled include the Scottish income tax system, Scottish child payment and Best Start payments, the carer's allowance supplement, and mitigation of the under-occupancy charge and benefits cap. Differences in council tax relativities are not included. Income changes shown are before any behavioural response from households. This is especially important for the increase in the additional rate of income tax, which the SFC expects to generate significant behavioural response (e.g. reducing income or migrating out of Scotland).

Source: Authors' calculations using the Family Resources Survey 2017–19 and TAXBEN, the IFS tax and benefit microsimulation model.

The figure shows that the measures on average raise revenue, and reduce Scottish households' incomes by £259 or 0.6%, but with a clear redistributive pattern. The poorest half of households have higher disposable incomes under the Scottish system than they would under that in England and Wales, driven almost entirely by more generous benefits for families with children, whereas the richest half have lower disposable incomes as a result of the higher income tax rates they face under the Scottish income tax system.

Tax revenue forecasts

These changes in tax policy contribute to revisions to the SFC's tax revenue forecasts. Changes in forecasts for underlying devolved tax revenues, though, are much more significant contributors to improved net revenue forecasts.

The contribution of devolved taxes to the Scottish budget depends on both the revenues from the taxes themselves and the block grant adjustments (BGAs) associated with the taxes – the amount subtracted from the block grant funding received from the UK government to account for the fact Scotland now has its own tax revenues. In turn, the size of the BGAs depends on changes in revenues from the equivalent taxes in rUK. What matters for the Scottish budget, therefore, is not simply the growth in devolved revenues (which will be affected by tax reforms and underlying revenue performance in Scotland), but how that growth compares with growth in comparable revenues in rUK (which will be affected by tax reforms and underlying revenue performance in rUK).

Overall, both devolved tax revenues and BGAs are forecast to be higher in 2024–25 than in the current financial year, and compared with the SFC's forecasts from a year ago. This is a result of an increase in forecast nominal earnings growth in both Scotland and rUK, pushing up income tax liabilities in both. However, forecasts for devolved tax revenues are up by more than forecasts for the BGAs, meaning an increase in the net contribution of devolved taxes to the Scottish budget.

Income tax has driven these changes. For the other taxes devolved to Scotland – the land & buildings transaction tax and the Scottish landfill tax – the forecast net contribution to the budget in 2024–25 has declined compared with what was expected a year ago. These taxes are both smaller shares of devolved tax revenues, meaning the relatively small declines in the net position are outweighed by the large increase in the net position for income tax.

Figure 2.4. Forecasts for income tax block grant adjustment, revenues, and net position in 2024–25, in December 2022 and December 2023

Source: Scottish Fiscal Commission, 2023c.

Figure 2.4 compares the forecasts made in December 2022 and December 2023 for income tax BGAs, devolved revenues, and the income tax net position in 2024–25. As shown, the BGAs have been revised upwards by £1.5 billion. Scottish income tax revenues have been revised upwards by more (£2.2 billion), which results in an overall improvement in the net position from £700 million to £1.4 billion.

Two main factors have driven this upwards revision. First, income tax out-turn data for 2021–22 were stronger than previously expected. The out-turn figures published in July 2023 were around £340 million higher than the final SFC forecasts made in May 2023. Around £260 million of this difference can be attributed to the fact that final PAYE liabilities were higher than what was suggested by the Real Time Information (RTI) data used in the Scottish Fiscal Commission's forecasts. The RTI tax data are a monthly snapshot from the HMRC PAYE system, which is an imperfect guide to final PAYE revenues, although does strongly correlate with them. The remaining £70 million of the difference can largely be attributed to stronger-than-expected growth in self-assessment liabilities among high earners, which are not captured in the RTI data and tend to show significant variability (Scottish Fiscal Commission, 2023b). The out-turn data for 2021–22 are built into the forecast for the net position in 2024–25, and have boosted it by around £320 million.

New RTI data covering 2022–23 and 2023–24 are also stronger than previously expected, with Scottish earnings growth now outpacing rUK after a period of slower growth. And this faster growth in earnings generates more revenues under Scotland's income tax system than it would under the system in place in rUK, because of the higher marginal tax rates applied to higher incomes.[3] All told, the new RTI data for 2022–23 and 2023–24 increase the forecast net position by £350 million.

These latter two trends (faster earnings growth and greater 'fiscal drag') are forecast to continue in 2024–25. The SFC argues that a period of earnings catch-up is reasonable to expect, as a result of various macroeconomic conditions – such as faster growth in the Scottish oil and gas sector and slower growth in London's financial sector.

As with any fiscal forecast, there is significant uncertainty around the SFC forecasts. As the SFC highlights, shifts in forecasts for the BGA or Scottish revenues can lead to large shifts in the net position. Differences in the earnings growth forecasts made by the SFC and the Office for Budget Responsibility represent a significant downside risk to the income tax net position, as we discussed in last year's Scottish Budget chapter (Boileau and Phillips, 2023). If the income tax

[3] The SFC estimates that, for each 1 percentage point of earnings growth, around £25 million more revenue is generated in Scotland than would have been generated with the rUK income tax schedule, as a result of Scotland's more progressive income tax structure (Scottish Fiscal Commission, 2023c).

net position turned out lower than the forecast for the upcoming year, this would generate a reconciliation, where the Scottish Government has to pay back funding to the UK government. This payment would be made three years hence, so a payment for 2024–25 would be made in 2027–28. We return to this issue in the next chapter, where we discuss the medium-term funding outlook and risks.

2.2 Overall funding

In addition to revenue from its devolved taxes, the other main source of funding for the Scottish budget is funding from the UK government, which is largely determined by the Barnett formula. In addition, the Scottish Government has access to borrowing and reserves, with the use of these governed by the Fiscal Framework.

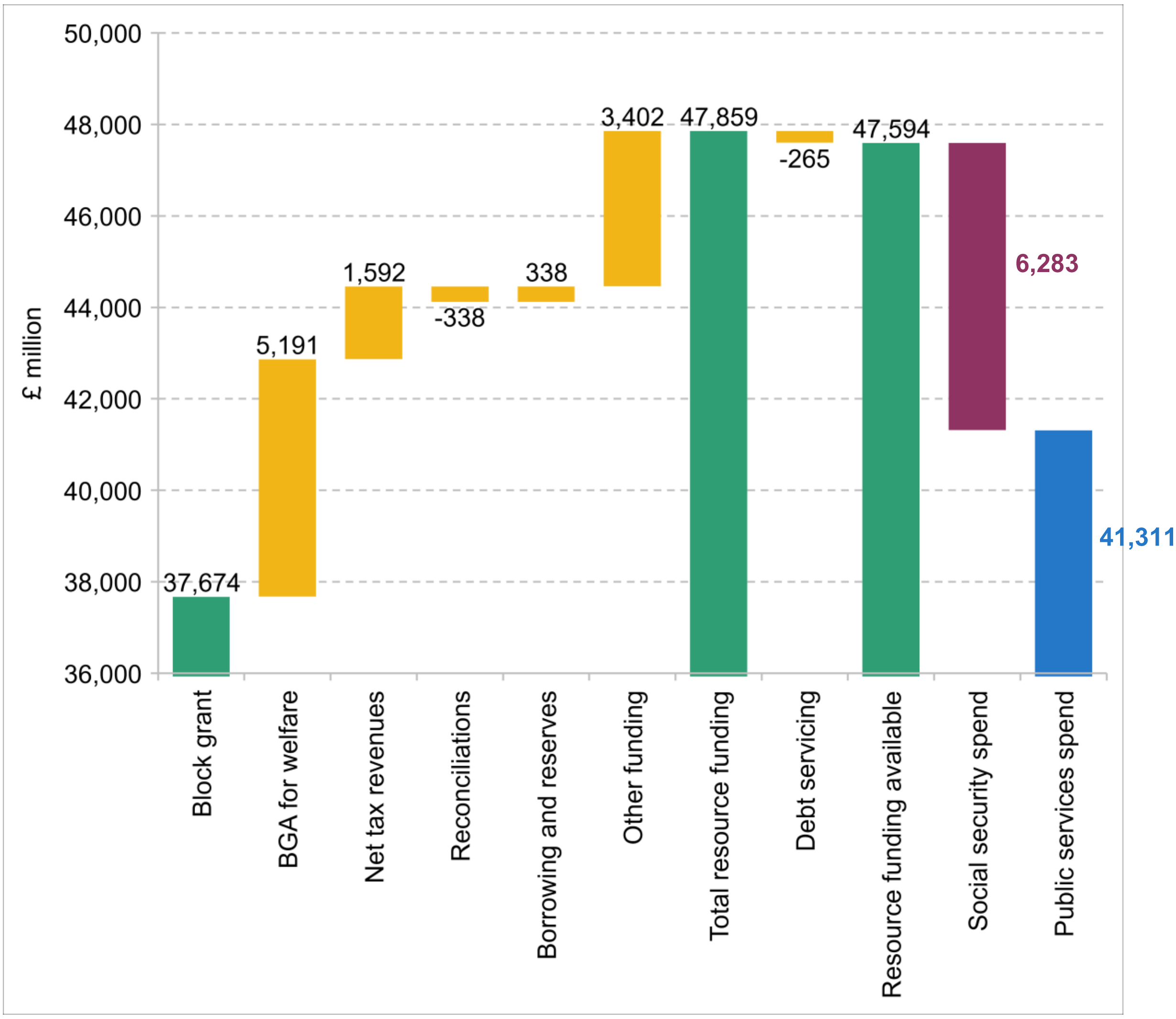
Resource funding

Figure 2.5 shows the contribution of these various sources of funding to the Scottish Government's overall budget for day-to-day (resource) spending in 2024–25. It also shows the amount of funding available for public services after forecast spending on debt servicing costs and devolved social security benefits is deducted.

Block grant funding is currently forecast to total £37.7 billion in 2024–25. In addition to this, the Scottish Government is set to receive £5.2 billion as a BGA for devolved social security responsibilities, and a net £1.6 billion from devolved taxes, with net revenues from income tax representing £1.4 billion of this. Reconciliations for past forecast errors for devolved tax revenues and social security spending mean a £338 million deduction from the Scottish Government's budget, but this is being fully covered by the Scottish Government's borrowing powers.[4] 'Other' funding, finally, represents £3.4 billion: £3.1 billion of this is non-domestic rates revenue, and the further £334 million represents a range of other smaller sources, such as the immigration health surcharge and income from offshore windfarm licences. Taken together, this means total resource funding of £47.9 billion. Not all of this is available for spending on public services, however. Debt servicing costs are forecast to amount to £265 million, meaning total deployable resource funding of £47.6 billion.

[4] Previously, the Scottish Government's resource borrowing powers to address forecast errors were capped at £300 million per year unless a 'Scotland-specific economic shock' had been declared, in which case the limit was increased to £600 million. Following updates to the Fiscal Framework agreed last year (Scottish Government, 2023e), the limit has been increased to £600 million and will be increased in line with inflation going forwards.

Figure 2.5. Sources of Scottish Government resource funding, 2024–25



Note: Y-axis is truncated at 36,000 to show smaller contributions more clearly. Non-domestic rates revenues are included in 'Other funding', rather than in 'Net tax revenues'.

Source: Scottish Fiscal Commission, 2023c.

Spending on devolved social security benefits is forecast to amount to £6.3 billion (around £1.1 billion higher than the BGA received for these purposes). After accounting for this, the amount available for spending on public services is £41.3 billion, equivalent to approximately £7,575 per person in Scotland.

Change compared with the current financial year

Table 2.2 compares the funding available in 2024–25 with both the original budgeted amount, and the SFC's December estimate of the latest position, for the current year. Funding available for public services is set to increase by £1.6 billion, or 3.9%, between the originally budgeted amount for 2023–24 and the amount budgeted for 2024–25. This is a real-terms increase of 2.2% based on forecast inflation as measured by the GDP deflator. However, when taking account of in-year changes to the funding situation in 2023–24, and comparing next year's budget with the SFC's December estimates of the latest position for the current year, the increase is smaller, at £527 million, or 1.3%. This implies a real-terms *cut* of 0.4% to funding for public services next year.[5]

Underlying this are increases in funding from the UK government and devolved tax revenues, which are offset partially by a decline in funding from other sources. In addition, the net cost of Scotland's more generous social security benefits is forecast to rise, boosting household incomes for low-income families with children, and some disabled adults, for example, but reducing the amount of funding available for public services.

Table 2.2. Scottish Government resource funding, 2023–24 and 2024–25 (£ million)

	2023–24 (original amount)	2023–24 (latest position)	2024–25	Contribution of change since 2023–24 latest position to available public service spending (percentage points)
Block grant	36,737	37,055	37,674	1.5ppt
Net tax revenues	557	593	1,592	2.4ppt
Net social security	–884	–894	–1,092	–0.5ppt
Of which:				
BGA for welfare	*4,360*	*4,405*	*5,191*	*1.9ppt*
Social security spending	*–5,244*	*–5,299*	*–6,283*	*–2.4ppt*
Reconciliations	46	46	–338	–0.9ppt
Borrowing and reserves	41	292	338	0.1ppt
Other	3,482	3,910	3,402	–1.2ppt
Debt service	–233	–217	–265	–0.1ppt
Available for public services	**39,747**	**40,784**	**41,311**	**1.3ppt**

Note: 'Other' includes the non-domestic rates distributable amount. 'Latest position' is as of December 2023.

Source: Scottish Fiscal Commission, 2023c.

[5] Note that the Scottish Government's 2023–24 Spring Budget Revision (Scottish Government, 2024) implies a larger in-year top-up than expected by the SFC in December. Accounting for this, the year-on-year real-terms cut in funding for public services in 2024–25 is now 0.6% in real terms.

UK government block grant funding will increase by £619 million between 2023–24 and 2024–25 (based on the latest position for the current year) – a cash-terms increase of 1.7%, but flat in real terms. As shown in Table 2.2, this will contribute 1.5 percentage points to the overall cash-terms increase between this financial year and next.

But more important as a driver of the increase in resource funding between the latest position for 2023–24 and funding for 2024–25, as shown in the table, is the increase in net tax revenues. These will increase by £1.0 billion, almost entirely as a result of improvements in the net position for income tax (as described above). This is a contribution of 2.4 percentage points to the overall cash-terms increase.

This increase in funding from the UK government and devolved tax revenues is being partially offset by three other factors:

- a negative reconciliation payment in 2024–25 for income tax forecast errors in 2021–22, which although covered by borrowing (and lower than expected prior to out-turn figures becoming available), still contrasts with a positive reconciliation payment in 2023–24;
- the planned full drawdown of reserves in 2023–24, which will mean no scope to draw down reserves in 2024–25;
- a reduction in confirmed and assumed levels of funding from other sources, including income from auctions of offshore windfarm licences.

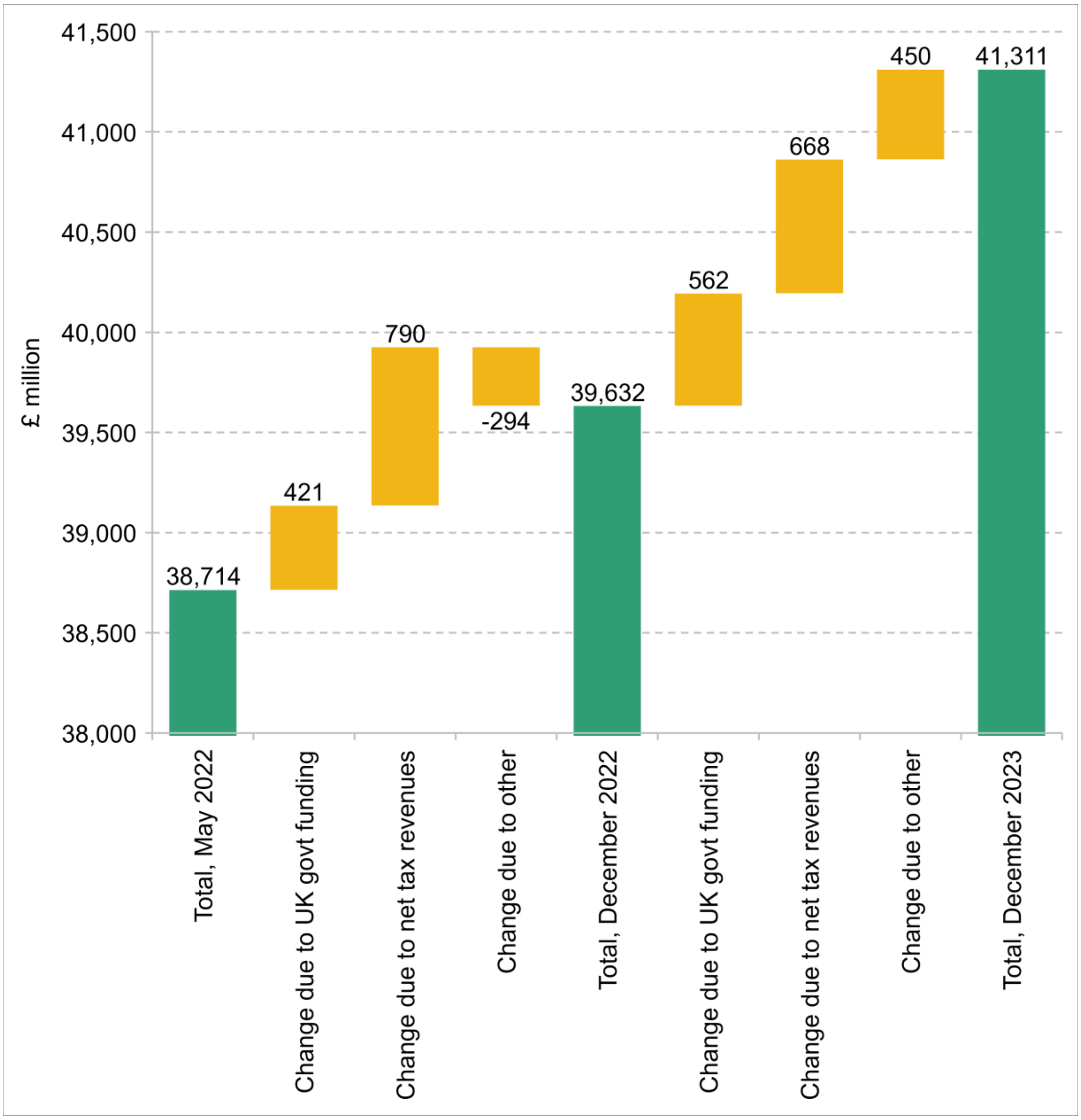
The combined effect of reconciliation payments, borrowing, reserve drawdown and other funding is to reduce total funding for public services by 2.0 percentage points.

In addition, while the BGA for social security spending is increasing by around £790 million (18%) in cash terms, spending on Scotland's devolved social security benefits is forecast to increase by around £980 million. This reflects both an expected increase in disability benefit claims as Scotland's reformed system rolls out, and the impact of inflationary uprating to Scotland's new benefits (such as the Scottish child payment) and more generous benefits (such as the carer's allowance supplement) – both of which will increase household incomes for benefit recipients and push up benefit spending compared with rUK. The net effect of this is to reduce the amount of funding available for public services by around £200 million (0.5 percentage points) in 2024–25 compared with the latest position for 2023–24.

Change compared with previous forecasts for 2024–25

Comparisons of the latest forecasts of funding in 2024–25 with the amount of funding previously expected are also revealing. Figure 2.6 shows that in cash terms, the funding available for public services is now forecast to be £1.7 billion higher than forecast in December 2022, and £2.6 billon higher than forecast in May 2022 at the time of the Resource Spending Review.

Figure 2.6. Changes in projections of 2024–25 resource funding: comparing May 2022, December 2022 and December 2023



Note: Y-axis is truncated at 38,000 to show revisions more clearly.

Source: Scottish Fiscal Commission, 2023c.

Increases in block grant funding have been important in driving these upwards revisions to expected resource funding available for public services, after increases in spending on childcare, schools and the English NHS resulted in higher Barnett consequentials on top of the block grant determined in the UK government's Autumn 2021 Spending Review. These additional Barnett consequentials for 2024–25 were forecast to be £400 million in May 2022, rising to £710 million in December 2022 and £1,380 million in December 2023.

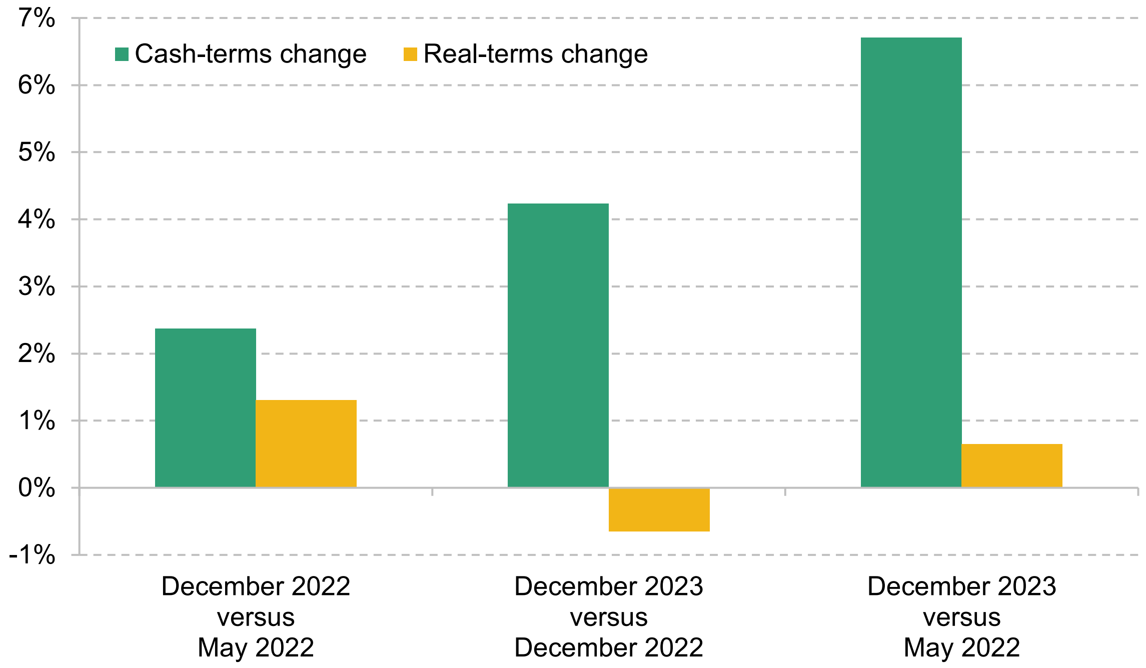
More important, though, in driving the upwards revisions to forecast funding, have been changes in the net tax revenues expected. In May 2022, net tax revenues were expected to be around £130 million; this rose to around £920 million in December 2022 and £1.6 billion in December 2023. Within this, increases in the forecast income tax net position – both between May and December 2022, and between December 2022 and 2023 – have been the drivers.

The expected reconciliation from the original overestimation of the income tax net position in 2021–22, included in the ‘other’ bars in Figure 2.6, has also decreased: in May 2022, this was expected to be £820 million, requiring the government to borrow the maximum then allowed (£300 million) and reduce spending in other areas (by £520 million). In December 2022, the forecast reconciliation had declined slightly to £730 million (reducing the cuts to spending required to £430 million). However, as discussed earlier in this chapter, the out-turn net income tax position in 2021–22, while weaker than assumed when the 2021–22 Budget was set, was notably stronger than subsequent estimates – implying a net reconciliation payment of £338 million next year, as reported in the latest SFC forecasts, which can now be fully covered by the Scottish Government’s enhanced borrowing limit (£610 million) following updates to the Fiscal Framework.

‘Other’ changes also include changes to the forecasts for social security BGAs and spending: both have been revised upwards between May 2022 and December 2023. Social security BGAs have been revised upwards by more than forecasts for social security spending, although the former are still projected to be more than £1 billion lower than the latter.

Despite these consecutive upwards revisions, it is worth noting that inflation has been both higher and more stubborn than expected back in both May and December 2022. This means that the sizeable cash-terms boost to funding for public services in 2024–25 relative to previous expectations is much smaller in real terms. For example, after accounting for increased inflation forecasts, the 2.4% (£0.9 billion) cash-terms increase between May and December 2022 forecasts for funding levels in 2024–25 amounted to just a 1.3% real-terms increase, as shown in Figure 2.7. The even bigger 4.2% (£1.7 billion) boost to forecast funding levels in 2024–25 between December 2022 and December 2023 has actually been more than offset by higher inflation, meaning funding levels in 2024–25 are now forecast to be 0.6% lower in real terms than in December 2022. And if we compare the forecasts for funding available for public services in 2024–25 from May 2022 and December 2023, the 6.7% cash-terms increase is equivalent to just a 0.7% real-terms increase as a result of sharply higher inflation in 2022–23 and 2023–24 than expected two years ago.

Figure 2.7. Cash- and real-terms increases in resource funding available for public services in 2024–25, comparing expectations in May 2022, December 2022 and December 2023



Note: Real-terms changes are calculated using the GDP deflator measure of inflation.

Source: Scottish Fiscal Commission, Scotland's Economic and Fiscal Forecasts (various); GDP deflators from Spring Budget 2022, Autumn Statement 2022 and Autumn Statement 2023.

Capital funding

The Scottish Government's capital funding excluding financial transactions is set to rise slightly in cash terms in 2024–25 compared with its most recent position in 2023–24, by £56 million or 0.9%. This is a fall of 0.7% in real terms. When including financial transactions capital funding (which is ring-fenced for loan or equity-based funding for projects delivered by the private sector, such as 'Help to Buy'), capital funding is set to fall by 2.7% in nominal terms, or by 4.3% in real terms.

These movements are largely driven by funding from the block grant, which underlies most of the Scottish Government's capital funding. The UK is planning to keep capital spending fixed in nominal terms, resulting in large real-terms cuts to capital budgets which feed through to Scottish capital funding. Another factor is a specific one-off transfer to correct an error in the allocation of financial transactions from the UK government received in 2023–24 but not in 2024–25. This can account for all of the nominal fall in capital funding between 2023–24 and 2024–25, but capital funding excluding financial transactions still sees a 0.7% fall in real terms between the two years.

This fall comes despite the fact that in 2023–24 the Scottish Government transferred £60 million from its capital budget to its resource budget, while in 2024–25 it is intending to transfer

£89 million from its resource budget to its capital budget, which should offset declines in capital funding between the two years. A transfer in this direction marks a change from the approach in 2022–23 and 2023–24, where the Scottish Government requested permission to transfer capital funding to its resource budget. It also comes despite the fact that the Scottish Government is intending to borrow the new maximum amount it is allowed for capital spending under the Fiscal Framework in 2024–25, of £458 million.

If we compare capital funding in 2024–25 with expectations in May 2022, the cash-terms figure is 2.5% higher, but the real-terms figure is 3.3% lower, given higher-than-expected inflation in 2022–23 and 2023–24. If we also include financial transactions in capital funding, the latest forecasts for 2024–25 are actually 0.9% lower in cash terms than forecasts in May 2022 and December 2022. This translates into a real-terms reduction of 6.5%.

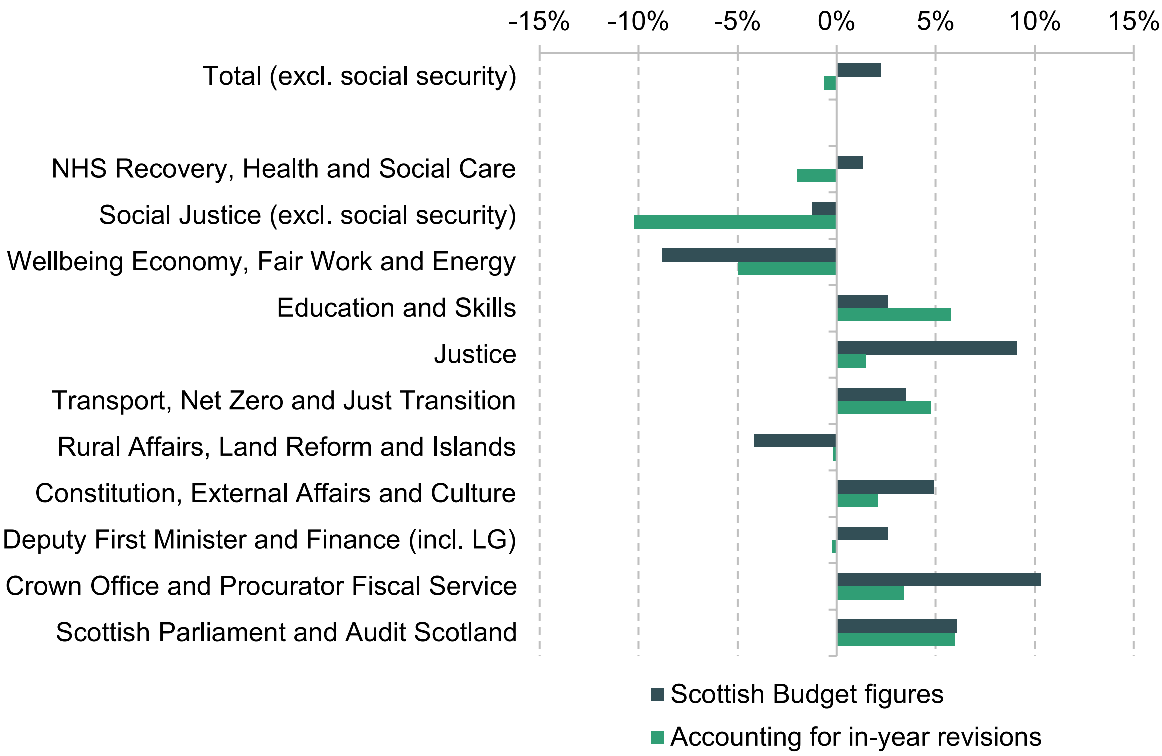
2.3 Spending by service

In the Budget published by the Scottish Government, spending plans for 2024–25 were compared with original plans for 2023–24. These figures suggest that, excluding spending on social security assistance, day-to-day spending is set to increase by 2.2% in real terms in the current year.

This 2.2% real-terms increase is, of course, not spread equally between different portfolios, as shown in Figure 2.8. Justice is a particular winner, seeing a 9.1% real-terms increase in day-to-day funding, with notable increases for prisons (just over 6% in real terms), courts (just under 6% in real terms), and the police and fire services (around 4% in real terms), but the biggest increases for police and fire pensions costs (around 45% in real terms). Funding for the Crown Office and Procurator Fiscal Service (up 10.3%) and for the Scottish Parliament (up 6.1%) is also set to increase substantially, although these are very small parts of overall funding.

Spending on the NHS Recovery, Health and Social Care budget is reported to grow by 1.3% according to the Scottish Government's figures – less than the average for all public services. Spending on the Social Justice budget, excluding social security payments, is set to fall by 1.2%, driven by the end of the Fuel Insecurity Fund, which provides grants to charities to support families unable to afford energy. Another area where real-terms cuts are apparent is the Wellbeing Economy, Fair Work and Energy portfolio, set to fall by 8.8% in real terms, driven in part by the end of the 'Fair Start Scotland' employability programme (which provides intense 12–18 months of support to those seeking work) and a reduction in regional development funding administration costs as legacy EU programmes wind down.

Figure 2.8. Planned real-terms changes in resource spending, 2023–24 to 2024–25, by portfolio



Note: LG = local government. Figures adjusted for inflation using Office for Budget Responsibility GDP deflator forecasts (November 2023). We here subtract social security from the Social Justice portfolio, and add non-domestic rates to the Deputy First Minister and Finance portfolio. The figures for health here do not account for changes in the timing of reclassifying health research funding as capital (as opposed to resource) spending, as described in the 'Health services' subsection below.

Source: Authors' calculations using Scottish Government (2023b, 2023c, 2023d and 2024).

These figures, though, exclude the more than £300 million topping up resource spending totals for 2023–24 confirmed in the Scottish Government's 2023 Autumn Budget Revision and the £835 million confirmed in the 2024 Spring Budget Revision. Taking account of these in-year top-ups to public service spending plans implies a real-terms cut of 0.6% between the latest position for this year and next year's spending plans.

Taking account of the top-ups allocated in the Autumn and Spring Budget Revisions, funding for Justice and for Local Government looks less generous, and cuts to non-social-security Social Justice look sharper, as Figure 2.8 shows.

Spending on the non-social-security elements of the Social Justice portfolio is now set to fall by more than 10% in real terms between this year and next, and spending on the Justice portfolio is now set to rise by just 1.5% in real terms (compared with the 9.1% implied by Budget figures). This is largely due to big in-year top-ups to funding for police and fire pensions (as well as smaller in-year top-ups to the prison, police and fire services' operating costs. Spending on the

Crown Office and Procurator Fiscal Service looks less generous next year, increasing by 3.4% in real terms compared with the 10.3% implied in the Budget (although this is a small area of spending).

The Rural Affairs, Land Reform and Islands budget now looks to see less dramatic real-terms cuts next year, with spending falling by 0.2% compared with the 4.2% when comparing 2024–25 plans with this portfolio's original budget for 2023–24. Similarly, while spending on the Wellbeing Economy, Fair Work and Energy portfolio is still facing real-terms cuts of 5.0% next year, this is less severe than the 8.8% real-terms cuts implied by Budget-to-Budget comparisons. The Education and Skills budget now looks to be rising by 5.7% in real terms next year, compared with the 2.6% in the Budget.

Comparisons with the 2022 Resource Spending Review

It is instructive to compare budgets for 2024–25 with what the Scottish Government initially set out in May 2022's Resource Spending Review. In this Spending Review, the government planned spending from 2023–24 until 2026–27. Some portfolios were redesigned in 2023 though, meaning that for some portfolios it is difficult to compare current plans with plans set out in the Resource Spending Review. In addition, between 2021–22 and 2024–25, a series of accounting changes were applied to Budget figures, creating further difficulty in comparing spending plans set out in different fiscal events.[6] We can adjust for these accounting changes, however, and look at areas of portfolios where comparisons can be made.

Spending for 2024–25 for most comparable portfolios has received cash-terms top-ups since May 2022. Day-to-day health and social care spending has been topped up by 4.5%, the Education and Skills portfolio has been topped up by 7.2%, and the Justice portfolio has been topped up by 16.1%. Funding for the Crown Office and Procurator Fiscal Service and for the Scottish Parliament (both smaller areas of spending) has also been topped up, by 19.6% and 12.3% respectively.

Higher inflation forecasts since May 2022, though, make these cash-terms top-ups look less generous. Comparing plans for 2024–25 in 2021–22 prices at the time plans were made, health and social care spending is in fact 1.4% lower in real terms than was planned in May 2022. Education and Skills spending has increased in real terms by just 1.1%, while plans for Justice, the Crown Office and Procurator Fiscal Service, and the Scottish Parliament all look less generous. Justice spending is set to be 9.6% higher in real terms – still a considerable boost,

6 These changes are the result of the adoption of a new accounting standard relating to leases, the International Financial Reporting Standards 16, which results in increases in capital funding and reductions in resource funding.

albeit mostly for police and fire pensions rather than operating costs – while the latter two areas of spending are set to be 12.8% higher and 5.9% higher respectively.

Health services

Funding for NHS Recovery, Health and Social Care day-to-day spending is, as described above, reported to be increasing by 1.3% in real terms between 2023–24 and 2024–25 according to figures presented in official Budget documentation.

However, this figure includes a line for 'Other Board Services and Miscellaneous Income' funding, set to be £60 million in 2023–24 and –£334 million in 2024–25. This has a significant effect on the overall funding changes. After discussions with the Scottish Government, around £235 million of the change in 2024–25 is a result of recategorisation of research and development (R&D) spending from resource to capital,[7] without material effects on what is actually available for day-to-day health spending. Adjusting for this transfer would imply that rather than growing by 1.3% in real terms, the NHS Recovery, Health and Social Care budget is set to grow by 2.6% in real terms in 2024–25, compared with the original budget set for 2023–24.

The NHS Recovery, Health and Social Care budget received no significant top-ups in the Autumn Budget Revision, but did see significant top-ups in the Spring Budget Revision published on 1 February (Scottish Government, 2024). Top-ups to this portfolio's resource budget totalled £605 million in the spring revision, implying that, based on the latest plans and adjusting for the recategorisation of R&D spending, Scottish Government funding for health and social care will fall by 0.7% in real terms between 2023–24 and 2024–25.[8] Given the evident difficulties the NHS is having in recovering from the COVID-19 pandemic (which are discussed more in Chapter 4 of this report), and upwards pressure on both wage and non-wage costs, such a cut in funding would likely see a further degradation in service quality and necessitate cuts in staffing.

This means it is highly likely that there will again need to be in-year top-ups to the NHS Recovery, Health and Social Care portfolio in 2024–25. If more funding becomes available in 2024–25 – for example, from additional funding via the Barnet formula if the UK government tops up its Department of Health and Social Care's budget – such top-ups would be easier to deliver. If further funding does not become available (or is insufficient), the Scottish Government may instead have to redistribute funding from other portfolios to the health and social care budget next year.

[7] This reclassification has traditionally happened at Autumn or Spring Budget Revisions but is being made up front in the 2024–25 Budget.

[8] Excluding the recategorisation of R&D spending, health and social care funding is currently set to fall by around 2% in real terms in 2024–25 compared with the latest position for 2023–24.

It is worth noting that the approach taken in regards to health and social care funding by the Scottish Government differs significantly from that of the Welsh Government. After making significant in-year top-ups to the Welsh health and social care budget in 2023–24, the Welsh Government chose to significantly top up its 2024–25 spending plans too. This means that even compared with the latest position for 2023–24, the Welsh health and social care budget is set to increase by 2.7% in real terms in 2024–25. In order to deliver this increase in health funding, the Welsh Government has had to make cutbacks to a range of other services.

The aim of the Welsh Government's approach was to avoid the need for in-year top-ups to health and social care spending and cuts to other areas of spending in 2024–25: in other words, to pre-empt the inevitable pressures on its health and social care budget. Whether the Scottish Government's or Welsh Government's approach is better will depend on whether further funding becomes available later in 2024–25, on how difficult managers of health services find dealing with funding uncertainty compared with managers of other services, and on whether managers of other services find late increases or decreases in funding more difficult to cope with.

Local government

Funding for local government services comes from multiple Scottish Government portfolios. General-purpose resource funding is provided from the 'Deputy First Minister and Finance' portfolio in the form of the General Revenue Grant and redistributed non-domestic rates revenues, which together are set to total just under £11.5 billion in 2024–25, up from an originally budgeted £11.1 billion in 2023–24 and £10.7 billion in 2022–23. In addition, councils are set to receive £144 million of additional general-purpose revenue grant if they all agree to freeze council tax, as well as £239 million in specific revenue grants from the 'Deputy First Minister and Finance' portfolio. And just over £1.5 billion is set to be provided from other portfolios for revenue spending purposes – including £372 million for health, social care and mental health, £242 million for teachers' pay, £230 million for increases in the 'Real Living Wage' and £145.5 million for commitments on the size of the school workforce. Taken together, as illustrated in Table 2.3, this means revenue funding for councils of £13.4 billion in 2024–25, up from £12.4 billion in 2023–24. In cash terms, this represents an increase of 7.9% which, after adjusting for forecast inflation using the GDP deflator, translates into a real-terms increase of 6.2%.

However, this gives a seriously misleading impression of the change in funding that will be available for Scottish councils in the coming year. There are four key reasons for this.

First, a portion of the grant funding is conditional upon councils freezing council tax – rather than additional spending power for Scottish councils, it is instead of an approximately 1.1% increase in their overall funding that a 5% rise in council tax rates would have generated.

Table 2.3. Scottish local government funding, 2023–24 and 2024–25

Funding source	2023–24	2024–25
General Revenue Grant	8,085	8,404
Non-domestic rates	3,047	3,068
Council tax freeze grant	0	144
Specific revenue grants	230	239
Grants from other portfolios	1,043	1,534
Total as reported in Budget	**12,405**	**13,389**
% change (cash)		*7.9%*
% change (real)		*6.2%*
Adjustments		
Capital provided for revenue purposes	121	
Additional in-year funding for pay	265	
Additional funding at Spring Budget Revision	45	
New burdens		–18
Adjusted total	**12,835**	**13,371**
Council tax	**2,922**	**2,940**
Adjusted total plus council tax	**15,757**	**16,311**
% change (cash)		*3.5%*
% change (real)		*1.8%*
Memo items: adjusted change since 2022–23		
% change (cash)	*4.5%*	*8.1%*
% change (real)	*–1.5%*	*0.3%*

Note: 'New burdens' based on authors' assessment of what represents genuinely additional provision as opposed to an area of provision where costs are rising.

Source: Scottish Government, 2023b, 2023c, 2023d and 2024.

Second, it ignores the fact that councils were able to utilise £120.6 million of capital funding provided in 2022–23 and 2023–24 for revenue purposes. This top-up to capital funding has been withdrawn for 2024–25. Accounting for this reduces the increase by a further 0.9 percentage points.

Third, councils have received significant top-ups to their General Revenue Grant since the 2023–24 Budget Bill was passed – most of which was announced at the time of the third reading of the

Budget Bill but not actually included in it. All told, £264.5 million extra was provided for pay costs in the Autumn Budget Revision. Another £45 million was provided for emergency financial assistance after the floods, and for Ukrainian resettlement in the Spring Budget Revision. This has boosted funding in the current financial year by 2.5%, reducing the increase in 2024–25 by a similar magnitude.

Finally, some of the funding for 2024–25 is for 'new burdens' – new or expanded service provision requirements, most notably related to the continued roll-out of free school meals and personal & nursing care. Together these amount to just over 0.1% of funding being provided.

After adjusting for these factors, the funding available to councils (including from council tax) for revenue purposes is set to increase by 3.5% (not 7.9%) in cash terms and by 1.8% (not 6.2%) in real terms after adjusting for forecast inflation as measured by the GDP deflator.

The GDP deflator (1.7%) is likely to understate the cost pressures facing councils. For example, the National Living Wage is set to increase by almost 10% in April, and the SFC assumes that average public sector pay will increase by 4.5% in 2024–25 as a result of pay awards and pay drift (i.e. an increase in the average position of workers on pay spines). In addition, inflation can have a lagged effect on councils' costs: contracts for services commissioned from external private and voluntary sector organisations (such as large parts of social care spending) are often adjusted using inflation from the prior autumn. In the case of 2024–25, that means Autumn 2023, when inflation was higher than is forecast for the coming year (e.g. CPI inflation was 6.7% in September 2023 and 4.6% in October 2023). Moreover, evidence from England suggests that costs for a number of key services – such as specialist children's placements, home-to-school transport, and temporary accommodation for homeless families – are outpacing general inflation (Local Government Association, 2023). Based on inflation as faced by councils rather than the GDP deflator, 2024–25 could therefore easily be a year of cuts rather than increases.

Even based on the GDP deflator measure of inflation, after adjusting for in-year top-ups to funding in 2022–23 and 2023–24, and 'new burdens' that councils are facing, funding in 2024–25 is set to be just 0.3% higher in real terms in 2024–25 than in 2022–23. This is in contrast to the headline Budget-to-Budget comparison set out in the Scottish Government's Budget documentation, which suggests a 4% real-terms increase over these two years.

It also contrasts significantly with the situation in England, where the combined figure for 'core spending power' for local government and schools (the most comparable measure to Scottish local government funding including council tax) is set to have increased by 5.6% in real terms between 2022–23 and 2024–25 – substantially less than anticipated as of December 2022 as a result of higher-than-forecast inflation, but still a sizeable real-terms increase.

It is worth noting that the situation for local government could improve next year if more funding is found – for example, if additional Barnett consequentials are provided by the UK government, or if the Scottish Government does not draw down its reserves entirely in the current financial year as planned and can therefore utilise them next year instead. However, as it stands, the picture for local government funding is far less rosy than that painted by the Scottish Government.

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