

Boileau, Bee et al.

**Research Report**

## The IFS Scottish Budget Report: 2024-2025

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**Institute for Fiscal Studies**

**IFS Report R300**

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Kate Ogden  
David Phillips  
Sam Ray-Chaudhuri  
Madeline Thomas  
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# Preface

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# 1. Introduction

The Scottish Government's Budget for 2024–25 takes place at a time of particular uncertainty about the future funding environment. UK government spending plans both for the coming year and for later years seem likely to be topped up, but when and by how much is unclear. The current UK government wants to announce tax cuts before the upcoming general election, but history tells us that we should not be surprised if taxes were to rise post-election. And the performance of Scotland's devolved tax revenues – in particular given recent and planned tax policy changes – is uncertain. Taken together, these factors make the task of planning Scottish tax and spending decisions particularly challenging – an issue discussed in an IFS comment published alongside this report (Phillips, 2024).

At the time the Budget Bill was presented to the Scottish Parliament, the funding available for day-to-day (resource) spending in 2024–25 was set to be 2.2% higher in real terms than originally budgeted for in 2023–24. However, accounting for in-year top-ups to budgets in the current financial year – most notably for health, justice and local government – currently planned public service resource spending is set to be 0.6% *lower* in real terms in 2024–25 than in the current financial year. As the Scottish Government has previously argued, next year's plans are likely to be topped up too, but they have not yet been. And as parliamentarians and other stakeholders work out how next year's plans should be amended if more funding becomes available (or, indeed, if it does not), the best starting point for debate is the latest picture for changes in funding.

Additional UK government funding and much stronger forecasts for the net contribution of Scotland's devolved taxes (and particularly income tax) to the budget mean that public service resource funding in 2024–25 is set to be 6.7% higher in cash terms than the initial plans set out in the May 2022 Resource Spending Review. However, higher-than-expected inflation has offset nearly all of this increase in cash budgets: public service resource funding is set to be just 0.7% higher in real terms than expected in May 2022. That it has increased at all is thanks to the forecast improvements in Scotland's net income tax revenue position – the top-ups to UK government funding have lagged behind inflation. The rest of the UK, which has not seen a boost to public spending as a result of improved income tax revenue performance, will see budgets in 2024–25 that are *lower* in real terms than expected two years ago.

Looking further ahead, further forecast improvements in Scotland's net income tax revenue position are set to boost funding, particularly in 2025–26. But UK government funding is likely to be constrained, which means that after a 2.2% real-terms increase in 2025–26, current

projections imply increases in public service resource funding averaging just 0.6% per year in the following three years. There is significant uncertainty around these projections, and the eventual picture could turn out somewhat more or less challenging – but the Scottish Government will almost certainly face tricky trade-offs as it allocates funding between different services.

The rest of this report proceeds as follows.

Chapter 2 looks at the outlook for tax and spending in 2024–25, considering both changes in underlying forecasts and the policy choices made by the Scottish Government. It finds that, compared with plans set out in the 2022 Spending Review, all major areas of spending are set to receive more in cash terms, driven by a combination of higher UK government funding and stronger devolved tax revenue performance (only a small part of which relates to tax policy changes). However, the impact of inflation staying higher for longer means that, in real terms, funding for health and social care is set to be lower next year than expected back in May 2022. Current plans also imply that health and social care spending in the coming year will be lower than the latest plans for 2023–24.

Chapter 3 turns to the medium-term funding outlook, and the tricky choices facing the Scottish Government from 2025–26. It shows that while current projections suggest that year should provide a decent real-terms boost to funding, the following three years could be very tight, necessitating cuts to many services. The chapter also illustrates how uncertain the medium-term funding outlook facing the Scottish Government is, driven both by uncertainty about UK government funding and by difficulty in forecasting Scotland’s devolved tax revenues. In this context, it may make sense to align Scotland’s medium-term spending planning timelines with the UK government’s Spending Review timelines, as is done in Wales.

Chapter 4 looks at Scottish healthcare spending, staffing and activity. It shows that Scotland’s health spending grew by less than England’s in the 2000s and 2010s, and that although currently budgeted spending in 2024–25 is set to be higher per person than in England, it is set to be lower than in Wales (a reversal of the picture for the first two decades of the 21<sup>st</sup> century). It also shows that while NHS staffing has substantially increased since prior to the pandemic, the number of patients being treated remains lower. Unless it is reversed, this seeming fall in productivity – which has also been seen in the English NHS – poses major challenges in tackling growing waiting lists, improving health, and funding the Scottish NHS in coming years.

Chapter 5 then looks at the Scottish higher education funding system. Increases in the amount students can borrow to fund living costs will meet the Scottish Government’s commitment to provide a total package of support ‘the equivalent of the Living Wage’. And it will do so at no cost to the Scottish Government’s main budget: students will repay most of the extra loans and

the share written off will be funded by the UK government. However, addressing the real-terms decline in funding for teaching seen over the last 10 years will be more challenging under Scotland's model of free tuition. Moving away from this model would see the costs faced by students themselves increase significantly, and could come at the risk of the UK government deciding the cost of student loans is not comparable to that in England's system, and so refusing to cover it.

Chapter 6 offers some brief concluding remarks.

## Reference

Phillips, D., 2024. Top-ups to the Scottish Budget for 2024–25 are likely – but huge uncertainty on their scale. IFS Comment, <https://ifs.org.uk/articles/top-ups-scottish-budget-2024-25-are-likely-huge-uncertainty-their-scale>.



## 2. Tax and spending in 2024–25

Bee Boileau, David Phillips, Tom Waters and Tom Wernham

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.<sup>1</sup>

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).

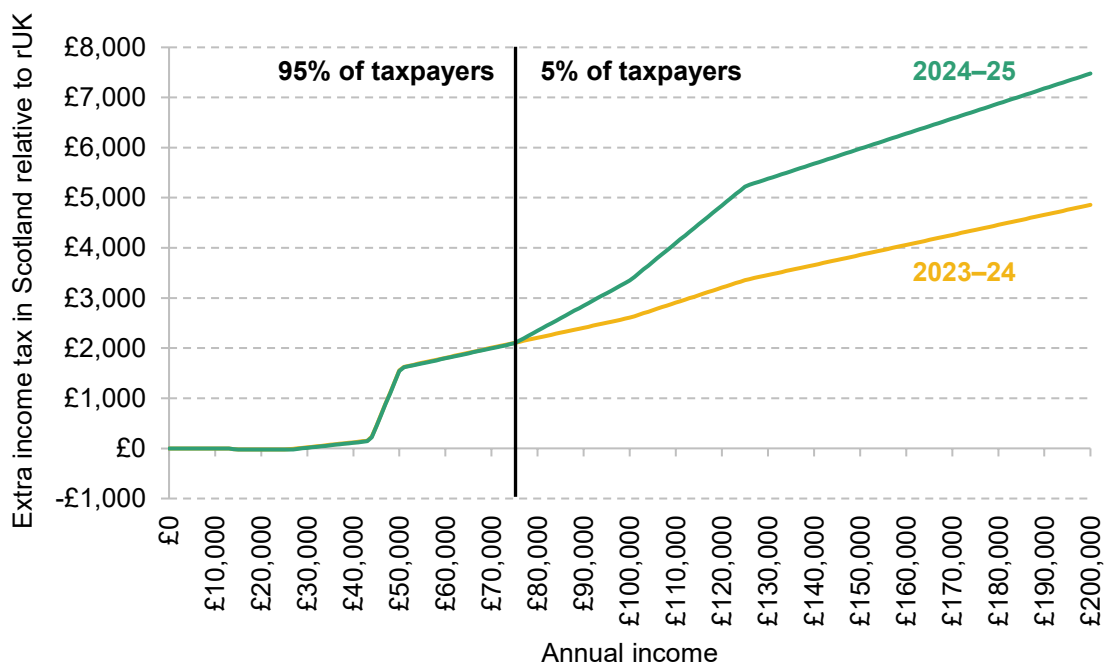
<sup>1</sup> The Scottish Government had the power to vary the basic rate of income tax by up to 3p in the pound from its creation in 1999, and from April 2016 retained revenues from 10 percentage points of each tax band and could raise or lower all rates in lockstep. However, these powers were never 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).<sup>2</sup> 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.

<sup>2</sup> 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.

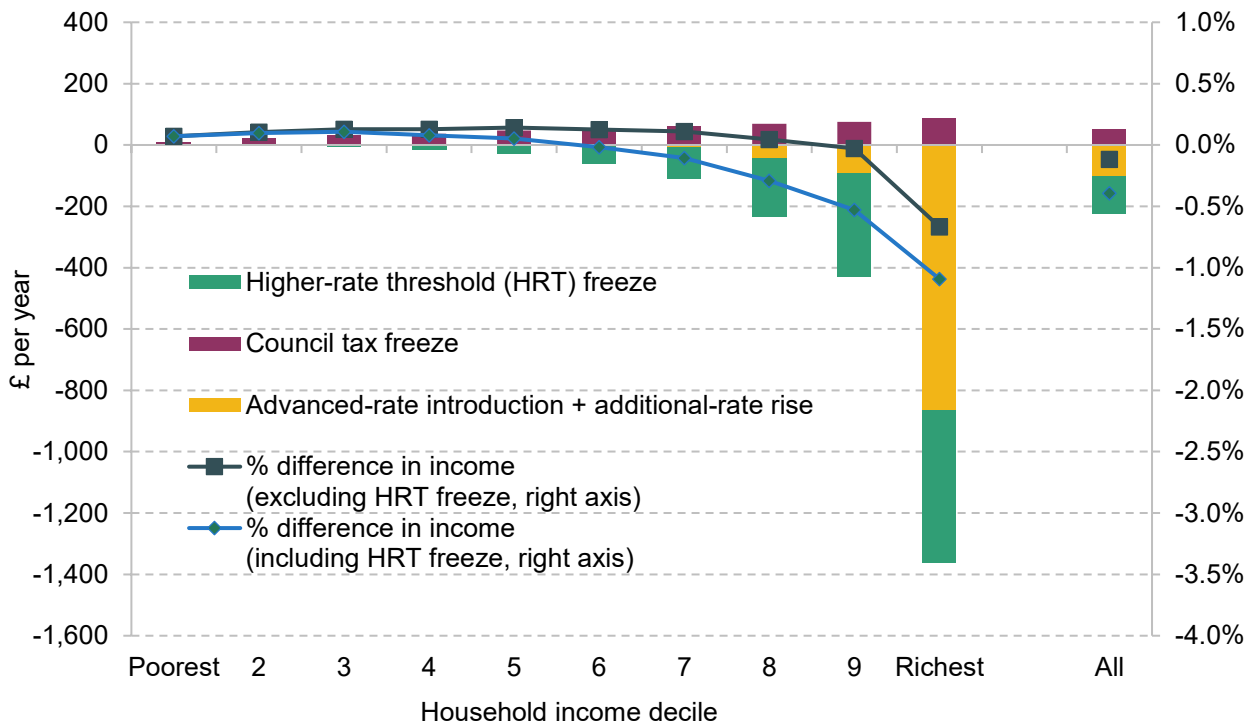
### Distributional effects

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.

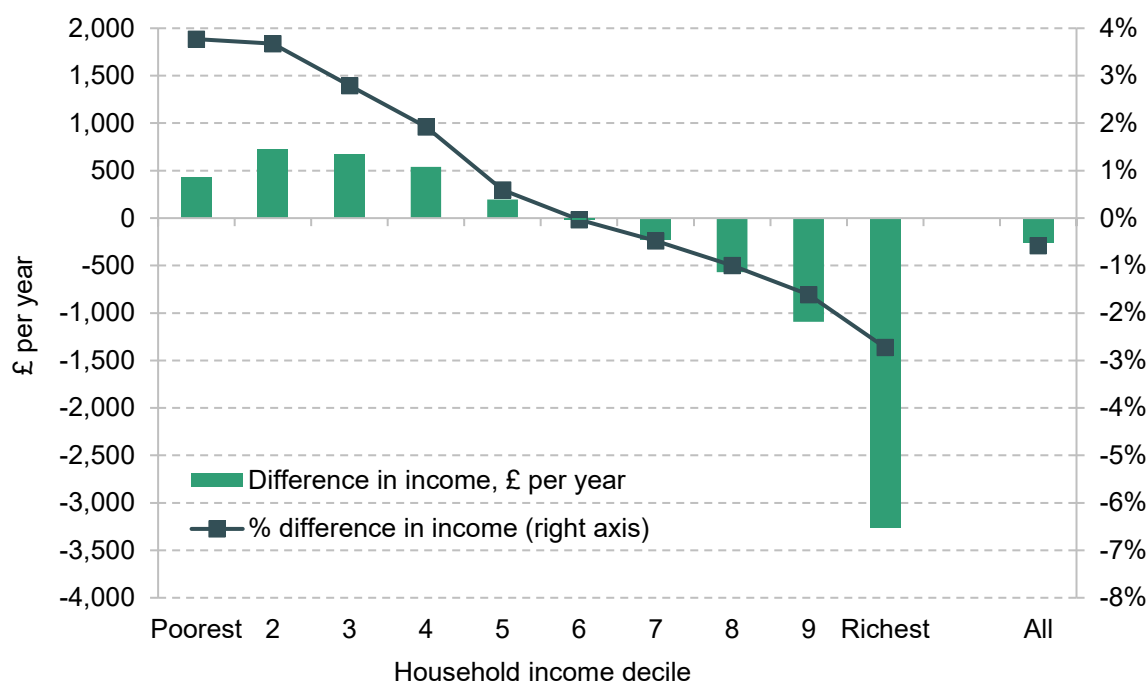
These measures therefore represent a continuation of trends: the Scottish Government has used devolved policy levers to increase progressivity in the Scottish tax and benefit system.

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.<sup>3</sup> 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

<sup>3</sup> 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.

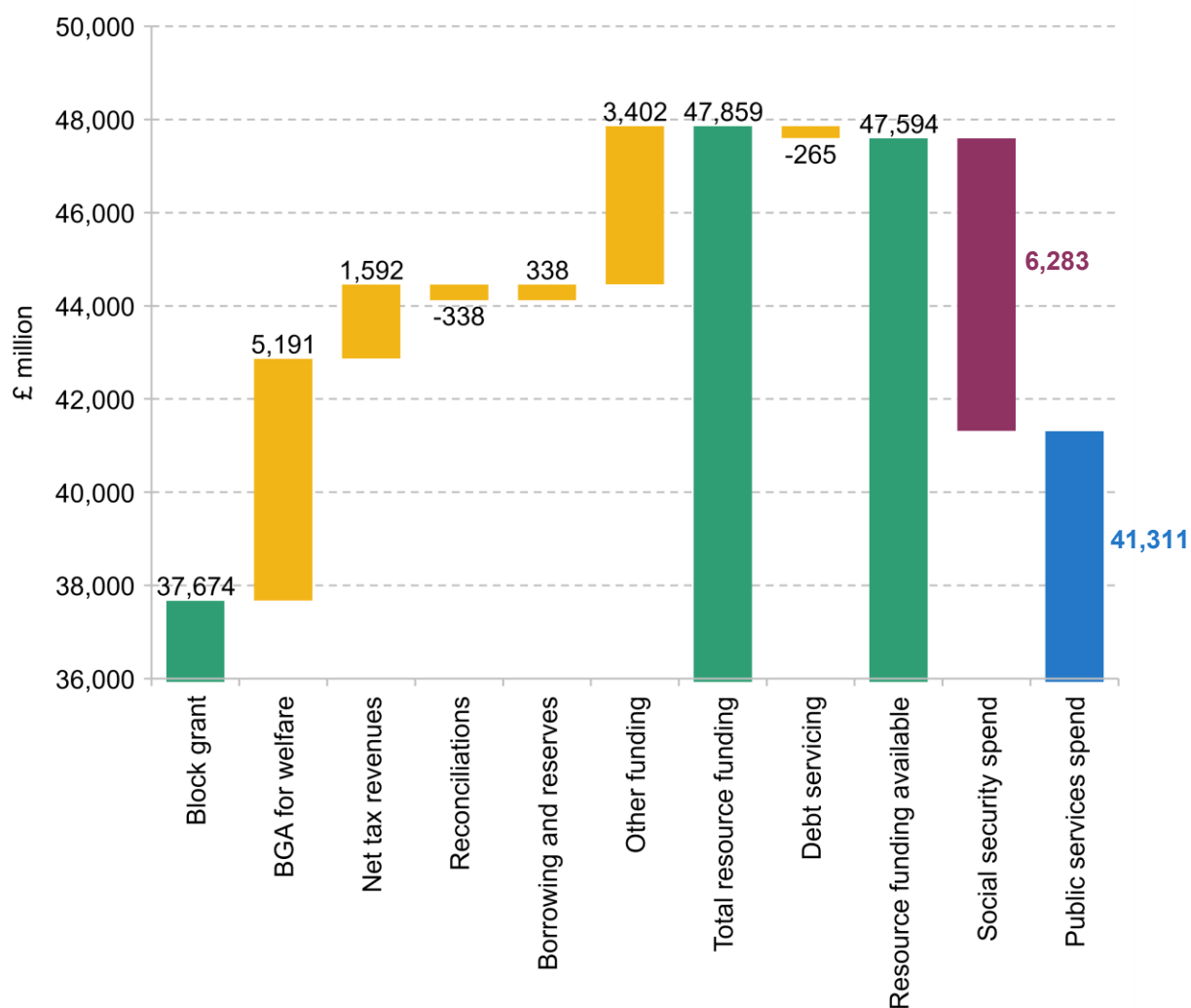
### Resource funding

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.<sup>4</sup> ‘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.

<sup>4</sup> 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.<sup>5</sup>

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
<i>Of which:</i>				
<i>BGA for welfare</i>	4,360	4,405	5,191	1.9ppt
<i>Social security spending</i>	–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
<b>Available for public services</b>	<b>39,747</b>	<b>40,784</b>	<b>41,311</b>	<b>1.3ppt</b>

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

Source: Scottish Fiscal Commission, 2023c.

<sup>5</sup> 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.

## 22 Tax and spending in 2024–25

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.

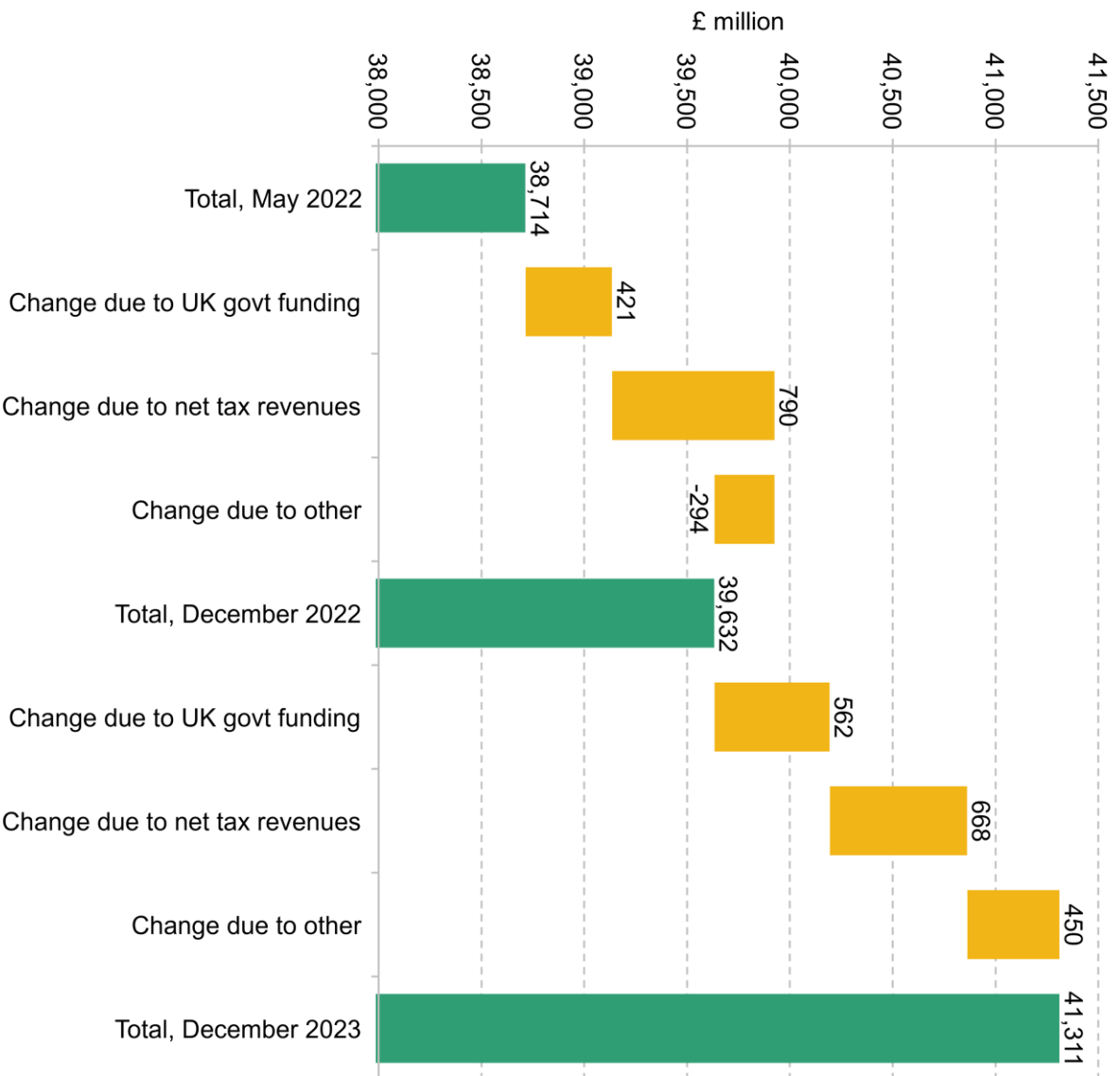
In addition, while the BGA for social security spending is increasing by around £790 million (18%) in cash terms, spending on Scotland’s devolved social security benefits is forecast to increase by around £980 million. This reflects both an expected increase in disability benefit claims as Scotland’s 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 billion 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 consequential on top of the block grant determined in the UK government’s Autumn 2021 Spending Review. These additional Barnett consequential 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.

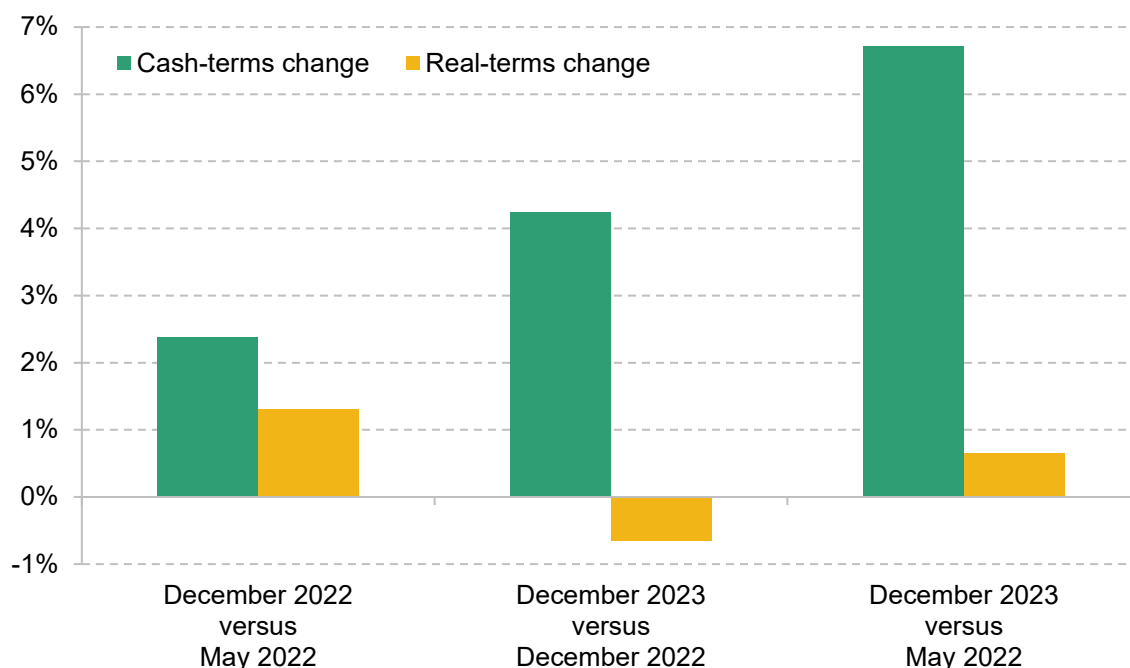
More important, though, in driving the upwards revisions to forecast funding, have been changes in the net tax revenues expected. In May 2022, net tax revenues were expected to be around £130 million; this rose to around £920 million in December 2022 and £1.6 billion in December 2023. Within this, increases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

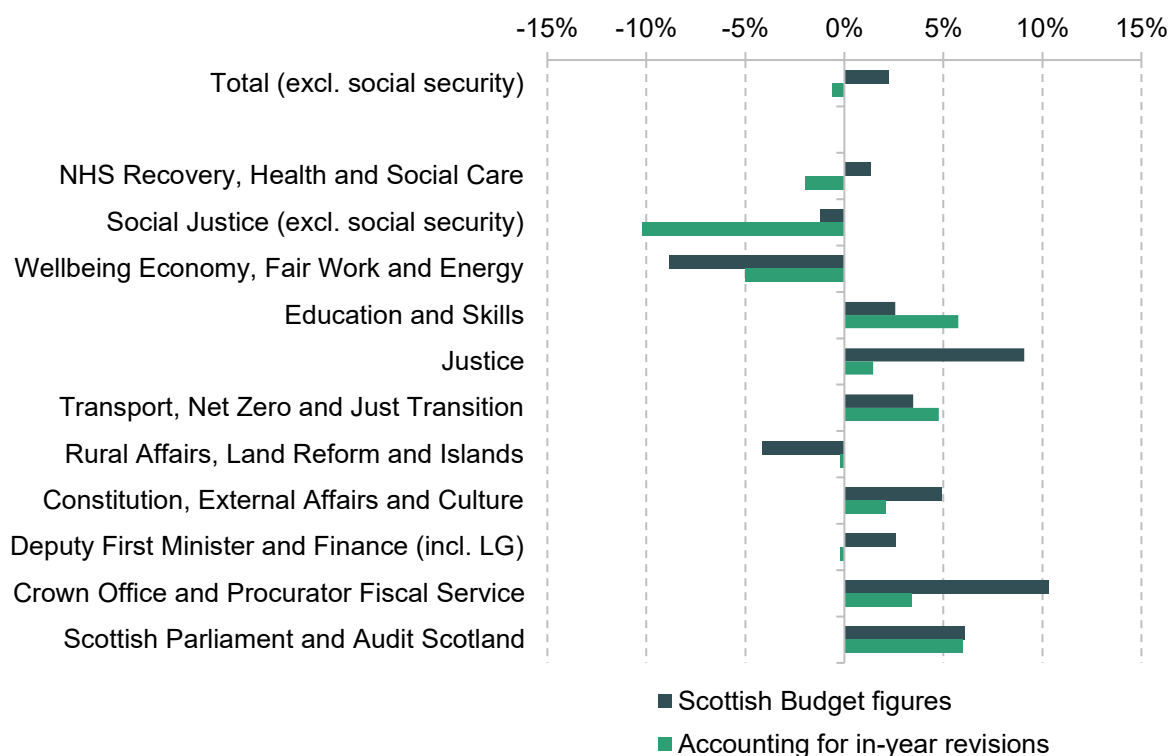
## 2.3 Spending by service

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.<sup>6</sup> 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,

<sup>6</sup> 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,<sup>7</sup> 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.<sup>8</sup> 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 Barnett 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.

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

<sup>8</sup> 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
<b>Total as reported in Budget</b>	<b>12,405</b>	<b>13,389</b>
<i>% change (cash)</i>		7.9%
<i>% change (real)</i>		6.2%
<b>Adjustments</b>		
Capital provided for revenue purposes	121	
Additional in-year funding for pay	265	
Additional funding at Spring Budget Revision	45	
New burdens		–18
<b>Adjusted total</b>	<b>12,835</b>	<b>13,371</b>
<b>Council tax</b>	<b>2,922</b>	<b>2,940</b>
<b>Adjusted total plus council tax</b>	<b>15,757</b>	<b>16,311</b>
<i>% change (cash)</i>		3.5%
<i>% change (real)</i>		1.8%
<b>Memo items: adjusted change since 2022–23</b>		
<i>% change (cash)</i>	4.5%	8.1%
<i>% change (real)</i>	–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 consequentialia 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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# 3. The medium-term outlook and choices

Bee Boileau, David Phillips, Sam Ray-Chaudhuri and Tom Waters

This chapter of our second annual Budget Report looks beyond 2024–25 to the medium-term outlook for the Scottish Government’s funding, and the implications of the funding picture for the choices and trade-offs faced when allocating funding between areas of the budget. The Scottish Government had said it would confront those choices alongside the 2024–25 Budget by publishing an update to 2022’s Resource Spending Review. However, with the Deputy First Minister and Finance Minister, Shona Robison, citing the ‘turbulent economic environment’, a decision has been taken to postpone this until the next set of economic and fiscal forecasts from the Scottish Fiscal Commission (SFC) and the publication of the next Scottish Government Medium-Term Financial Strategy (MTFS), expected in the late spring or early summer. Our analysis, presented below and based on current forecasts for UK government funding and devolved tax revenues, suggests that 2025–26 will see a substantial real-terms increase in Scottish Government resource funding. However, 2026–27 onwards is currently forecast to see much smaller increases in resource funding – that could easily be more than entirely absorbed by the NHS and other priority areas, necessitating cutbacks to many other services. A planned cash-terms freeze to capital funding from the UK government, together with Scotland planning to reduce borrowing used for capital purposes (in an attempt to maintain some headroom against its borrowing limits), is set to see capital funding in Scotland fall significantly in real terms over the second half of the 2020s. More funding than is currently pencilled in might be made available by the UK government for both resource and capital purposes, but risks to net revenues from devolved taxes are likely weighed to the downside. The Scottish Government should not bank on significantly more funding becoming available.

## Key findings

1. The medium-term outlook for Scottish Government funding will depend on both the funding it receives from the UK government and the net revenue it receives from its own devolved taxes and other income sources. Broadly speaking, current plans imply that UK government funding is set to be highly constrained over the period 2025–26 to 2028–29, as efforts are made to start to bring down the debt-to-GDP ratio. On the other hand, forecasts imply that the net contribution of devolved tax revenues to Scottish Government funding is set to increase substantially, driven by income tax.
2. The UK government has pencilled in 0.8% real-terms increases per year in its overall departmental resource spending limits in the four years from 2025–26 to 2028–29. Capital spending limits are set to be frozen in cash terms, implying real-terms cuts averaging 1.7% a year. The Scottish Government's block grant funding will depend on how the UK government allocates funding between departments responsible fully or largely for services that are devolved in Scotland (such as the NHS, housing and justice), versus those responsible fully or largely for UK-wide services (such as defence). In the absence of this information, the Scottish Government assumes block grant funding will change by the same percentage rates as the overall resource and capital spending plans. But, because of the way the Barnett formula operates, Scotland will only get a 0.8% a year real increase in its block grant if UK departments responsible for services that are devolved in Scotland see their budgets increase at a rate faster than this.
3. SFC forecasts for devolved tax revenues and Office for Budget Responsibility (OBR) forecasts for the associated block grant adjustments imply the net contribution of devolved taxes to the Scottish budget will increase by almost 6% a year in real terms between 2024–25 and 2028–29. This is driven by income tax, which is forecast to contribute a net £2.3 billion in 2028–29, up from a forecast £1.4 billion next year. The higher net contribution of income tax reflects the fact that the SFC is forecasting faster earnings growth for Scotland than the OBR is forecasting for the UK as a whole (explaining around £500 million of this increase), and Scotland's generally higher marginal income tax rates, which mean each additional pound of earnings growth generates more revenue (explaining much of the remaining increase).
4. Despite only small increases in UK government funding, the Scottish Government's overall resource funding is set to increase by 2.9% in real terms in 2025–26, with the amount available for devolved public services (after accounting for forecast spending

on devolved social security benefits) increasing by 2.2% in real terms. In part, this reflects forecast year-on-year growth in the net income tax revenue position. But more important is that the SFC now thinks its initial forecasts for Scottish income tax revenue performance in 2022–23 were pessimistic, so is predicting a positive £732 million forecast reconciliation payment in 2025–26 when final revenue out-turn data are available.

5. The picture for 2026–27 onwards is much tougher, despite a slight uptick in growth in funding from the UK government. In part, this reflects a slight slowdown in the improvement in the net income tax position, which will contribute an average of 0.3 percentage points to funding growth each year, down from 0.7 percentage points in 2025–26. However, more important is the fact that reconciliations for past income tax forecast errors drop out of the system (as forecast errors only arise as forecasts are updated after budgets have already been set). As a result, the growth in resource funding available for public services in 2026–27, 2027–28 and 2028–29 is projected to average just 0.6% per year in real terms. To smooth out growth since 2024–25, the Scottish Government could place some of the £732 million that is expected to be received in 2025–26 into reserves for drawdown in these later years.
6. Capital funding is projected to fall by 16% in real terms between 2024–25 and 2028–29. This is a result of the cash freeze in UK government capital funding and a reduction in capital borrowing by the Scottish Government, as it seeks to retain some modest ‘headroom’ against its total debt limits to respond to unexpected cost overruns. The Scottish Government could make additional capital funding available, but only by reducing the amount available for day-to-day (resource) purposes.
7. There is significant uncertainty around these projections. On the one hand, the spending plans pencilled in by the UK government are very tight and, on reasonable assumptions, could see funding for many unprotected areas cut by over 3% a year in real terms. Given this, and the fact that the run-ups to both the 2015 and 2021 multi-year Spending Reviews saw top-ups to spending plans, it might seem more likely than not that block grant funding from the UK government will be higher than currently assumed. On the other hand, the SFC highlights how risks related to net income tax revenues weigh to the downside. This is because its relatively fast earnings growth forecasts for Scotland are likely to reflect, at least to some extent, a different view about UK-wide earnings growth compared with the OBR’s, rather than any Scotland-specific factor. If so, this will either depress tax revenues (if the OBR is correct) or inflate the BGA (if the SFC is correct), both of which would reduce the contribution of income tax revenues to future budgets.

8. Under the SFC and Scottish Government's existing funding projections, if health funding were increased by an average of 2.3% a year in real terms (the rate assumed as needed to maintain existing service standards in the most recent Medium-Term Financial Strategy) and funding for local government held flat in real terms, funding available for other services would be approximately 1% lower in real terms in 2028–29 than in 2024–25. If health funding were increased by an average of 3.3% a year in real terms (in line with estimates from IFS researchers of the cost of the English NHS's long-term staffing plan) and funding for local government increased by 1% a year in real terms, Scotland would see funding for 'unprotected' services fall by 12% in real terms between 2024–25 and 2028–29.
9. If additional UK government funding is forthcoming, these trade-offs would be eased. For example, if an additional £1 billion in UK government funding were made available in 2028–29, then 2.3% real-terms increases in health funding per year and a flat real settlement for local government would be consistent with a 7.5% increase in funding for other services by 2028–29; under 3.3% and 1% real-terms increases for health and local government respectively, the cut to 'unprotected' services would be reduced to 4%.
10. On the other hand, if the net income tax revenue position increases by £1 billion less than expected, the challenges would be substantially tougher. For example, 2.3% real-terms increases in health funding per year and flat funding for local government would imply real-terms cuts of 9% to unprotected services by 2028–29; 3.3% real-terms increases in health funding and 1% real-terms increases in funding for local government per year would entail cuts of 21% in real terms by 2028–29.

### 3.1 The funding outlook

The medium-term outlook for Scottish Government funding will depend on both the funding it receives from the UK government and the net revenue it receives from its own devolved taxes and other income sources. Broadly speaking, current plans imply that UK government funding is set to be highly constrained over the period 2025–26 to 2028–29, as efforts are made to start to reduce the debt-to-GDP ratio. On the other hand, forecasts imply that the net contribution of devolved tax revenues to the Scottish Government is set to increase substantially, growing from 3.4% of resource funding in 2024–25 to 4.4% of resource funding in 2028–29 (with non-domestic rates collected by councils and redistributed by the Scottish Government providing about a further 6.5% in both years). And reconciliations for past forecast errors for income tax revenues are now expected to boost funding in 2025–26 and 2026–27.



## UK government funding

The UK government has not set out detailed departmental spending allocations beyond 2024–25. Instead, it has set provisional resource and capital spending totals each year until 2028–29. Resource spending is set to grow by 0.8% in real terms each year beyond 2024–25, while capital spending is planned to be held flat in nominal terms, implying real-terms cuts.

The implications of these provisional spending totals for the Scottish Government will depend not only on whether these plans are kept to, but also on how funding is allocated between different UK government departments. Funding for departments to pay for services in England (or England and Wales) that are devolved in the case of Scotland will result in additional funding for the Scottish Government via the Barnett formula, while funding for departments to pay for UK-wide responsibilities will not do so. Each UK government department is assigned a ‘comparability factor’, which reflects the proportion of its responsibilities that in Scotland’s case are devolved, and so the share of the funding they receive that leads to additional funding for Scotland via the Barnett formula. Departments for which all responsibilities are devolved to the Scottish Government have a 100% comparability factor: these include the Department for Education and the Department for Levelling Up, Housing and Communities. Those departments for which all responsibilities are UK-wide, and so cover Scotland, have a comparability factor of 0%, and funding for them does not generate any additional funding for the Scottish Government: these include the Cabinet Office and HM Treasury.

The majority of departments have some responsibilities that are devolved and others that are UK-wide, and therefore have a comparability factor between 0% and 100%. This includes departments for which the vast majority of responsibilities are devolved to the Scottish Government, such as Health and Social Care, for which the comparability factor is 99.5%, and the Home Office, for which the comparability factor is 82.5%. It also includes departments where only a few responsibilities are devolved and most responsibilities are UK-wide, such as the Department for Energy Security and Net Zero, for which the comparability factor is 2.6%, and the Department for Science, Innovation and Technology, for which the comparability factor is 6.9%.

In the absence of information on how funding will be allocated between UK government departments in 2025–26 and beyond, the Scottish Government’s medium-term funding projections assume that the block grant will grow at the same percentage rate as overall UK government resource spending limits (0.8% in real terms per year, on average).<sup>1</sup> This would require the funding for the UK government departments delivering services that in Scotland are

<sup>1</sup> Technically, it assumes that block grant funding will grow in line with the Office for Budget Responsibility’s forecast for ‘public sector current expenditure in resource departmental expenditure limits’.

devolved to actually grow at a *faster* percentage rate than overall UK government resource spending. This is because the Barnett formula provides the Scottish Government with the same cash-per-person changes in funding, not the same percentage changes, as are being allocated to departments for England. And with Scottish Government funding per person higher than government funding per person in England, this means an increase in funding of more than 0.8% for England is required to generate a 0.8% increase in the Scottish Government's block grant funding.

As funding for the Department of Health and Social Care is the biggest driver of block grant funding for Scotland, and funding for this department typically grows faster than average, an assumption that 'comparable' funding for England grows faster than overall UK government funding might not seem unreasonable. However, it is far from certain – for example, if cuts are made to other 'comparable' funding for England (such as for policing and justice, or local government) in order to boost health funding. As we discuss further below though, the existing provisional spending totals set out by the UK government are also likely to be revised, introducing further uncertainty into medium-term funding projections; though in this case past behaviour suggests that an upward revision might seem more likely than a downward one.

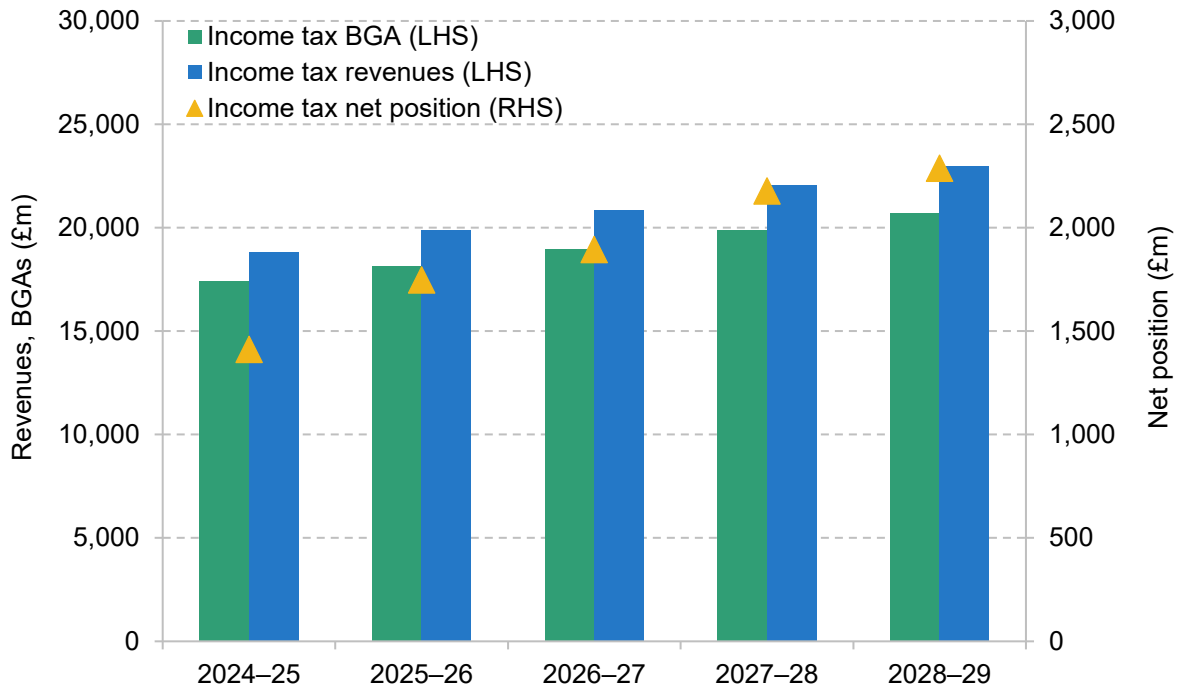
On the capital side of the budget, current UK government plans are for a cash-terms freeze in the four years from 2025–26 to 2028–29, which translates into a real-terms reduction averaging 1.7% per year. Again, block grant funding for capital purposes for the Scottish Government will depend on how funding is allocated between UK government departments, which has not yet been determined. In the absence of this information, the Scottish Government is currently assuming its block grant capital funding will be frozen in cash terms, translating into real-terms reductions averaging 1.7% a year. The Scottish Government also assumes that no more financial transactions capital funding – ring-fenced funding for loan or equity investments in the private sector, such as the Help to Buy scheme – will be provided beyond 2024–25.

### Devolved tax revenues

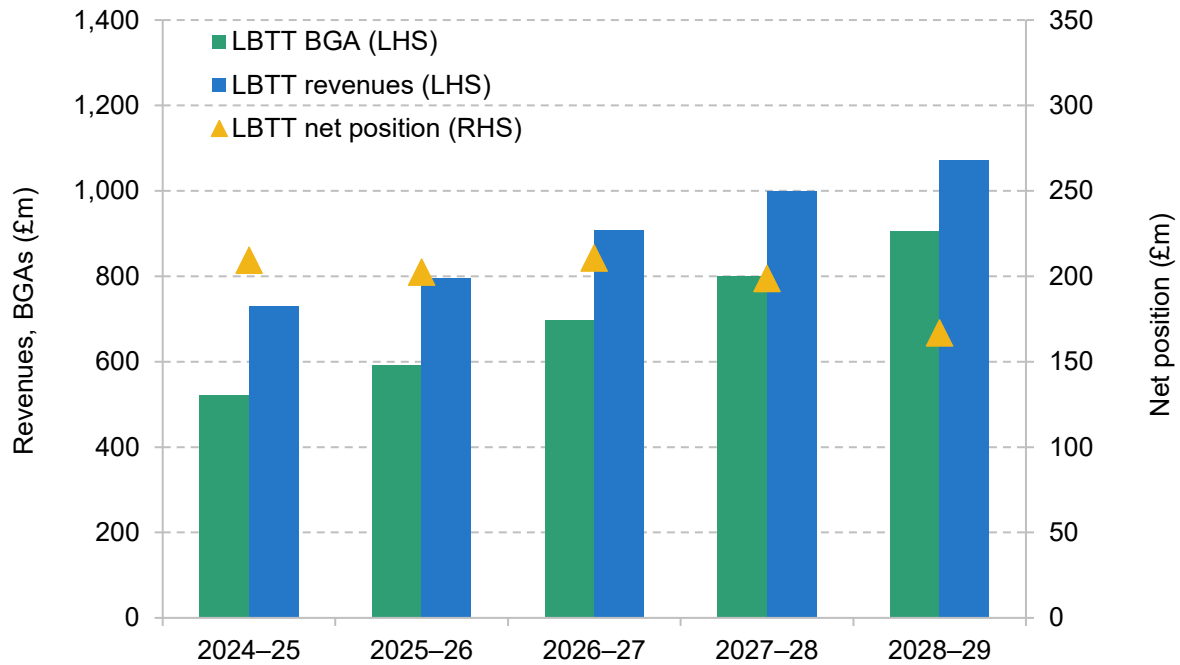
In addition to non-domestic rates, which have been devolved since the creation of the Scottish Parliament in 1999, the Scottish Government now has powers over and retains revenues from income tax, land and buildings transaction tax (LBTT) and Scottish landfill tax (SLFT). The effect of these taxes on funding for the Scottish Budget depends both on the revenues collected within Scotland and on the corresponding block grant adjustments (BGAs) made to the block grant funding received from the UK to account for these new devolved revenues. In turn, these BGAs reflect what would have been raised in Scotland if Scottish revenues per person had grown at the same percentage rate as in the rest of the UK (rUK) since these taxes were first devolved. The 'net position' for each tax captures the difference between the revenues collected and the BGAs, and determines the net contribution of devolved tax revenues to the Scottish Budget (see Figure 3.1).

Figure 3.1. Forecasts for devolved tax BGAs, revenues and net revenue position

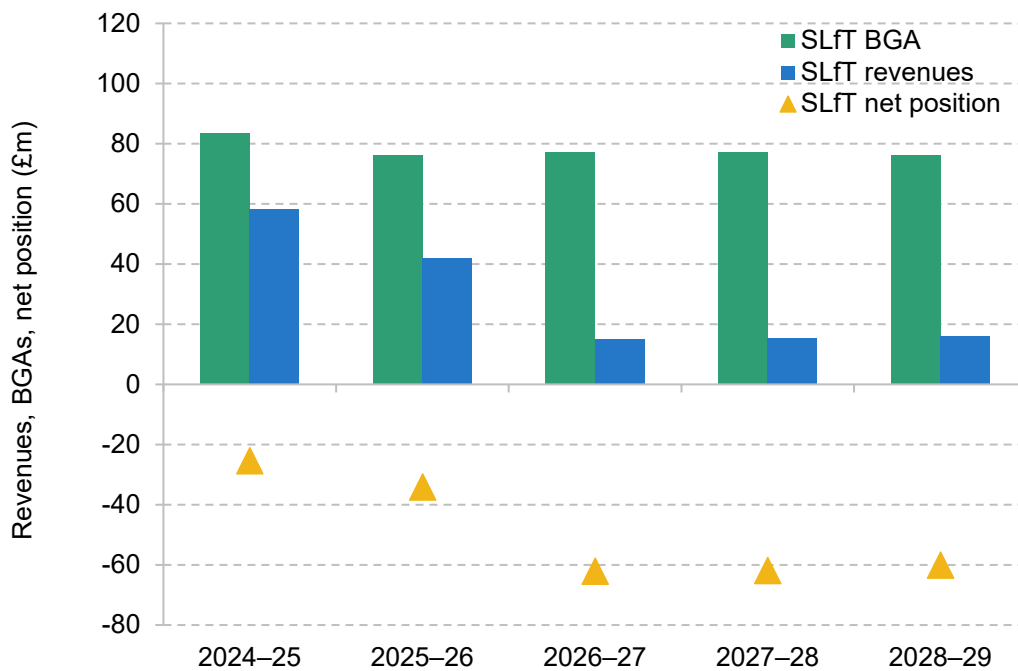
Panel A. Income tax



Panel B. Land and buildings transaction tax



## Panel C. Scottish landfill tax



Source: Scottish Fiscal Commission, 2023.

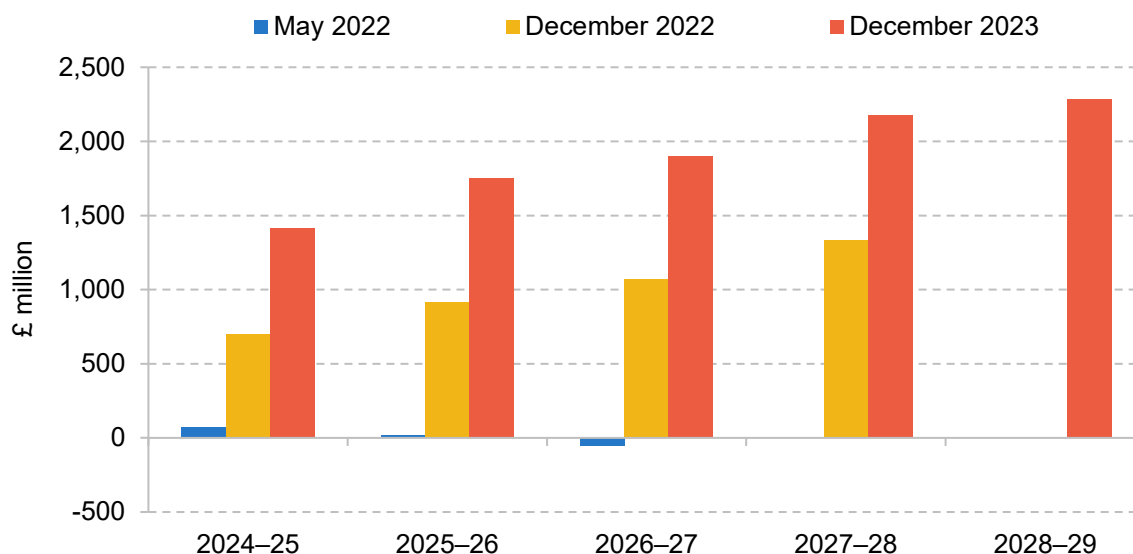
The net position for income tax in particular is set to increase considerably between 2025–26 and 2028–29, growing by 7.5% a year on average in real terms to reach £2.3 billion. Income tax revenues and BGAs are significantly larger than the other taxes devolved to Scotland, so this drives an overall increase in the net tax position of 5.8% in real terms per year, on average, over the period 2025–26 to 2028–29. The growth in the net position for income tax reflects the fact that revenues are forecast to grow by an average of 3.1% in real terms each year, compared with 2.7% for the BGAs. We return to why this is the case below.

The net position for LBTT is set to fall by 7.9% a year on average in real terms between 2025–26 and 2028–29. This is a result of the BGA increasing by more than revenues – although revenues are still forecast to exceed the BGA by almost a fifth (£167 million) in 2028–29. For Scottish landfill tax, the net position is set to further decline to –£60 million in 2028–29, with revenues falling substantially more quickly than the BGA, as the amount of waste sent to landfill falls faster than in England.

### Understanding the income tax net position

The income tax net position in particular now looks higher than was expected in either December 2022 or May 2022, as shown in Figure 3.2. For example, the forecast for the net position for 2026–27 was –£50 million as of May 2022, but had been revised upwards to +£1.1 billion by December 2022 and +£1.9 billion as of the latest forecasts published in December 2023.

Figure 3.2. Forecasts for the income tax net position between 2024–25 and 2028–29, made in May 2022, December 2022 and December 2023



Note: In May 2022, there was no forecast income tax net position for 2027–28 or 2028–29. In December 2022, there was no forecast income tax net position for 2028–29.

Source: Authors' calculations using Scottish Fiscal Commission (2022a, 2022b, 2023).

Table 3.1. SFC and OBR forecasts for employment and earnings growth, 2023–24 to 2028–29

Growth rates	2023–24	2024–25	2025–26	2026–27	2027–28	2028–29
<b>Employment</b>						
OBR	0.1%	0.2%	0.7%	1.0%	0.9%	0.7%
SFC	0.5%	-0.1%	0.1%	0.2%	0.3%	0.3%
<b>Average nominal earnings</b>						
OBR	6.2%	3.3%	1.9%	2.2%	2.6%	2.8%
SFC	6.6%	3.6%	3.0%	2.9%	3.0%	3.1%
<b>Implied growth in employment income</b>						
OBR	6.4%	3.6%	2.6%	3.3%	3.5%	3.6%
SFC	7.1%	3.5%	3.0%	3.1%	3.3%	3.3%

Source: Figure 4.16 of Scottish Fiscal Commission (2023).

This upwards revision has taken place for a variety of reasons. As discussed in the previous chapter, out-turn figures for Scottish income tax revenues in 2021–22 were stronger than expected, as were Real Time Information earnings and PAYE tax data during 2022–23 and so far during 2023–24, with earnings growth in Scotland outpacing that in the rUK. Table 3.1

shows that the Scottish Fiscal Commission's (SFC's) forecasts for average earnings growth in each of the next five fiscal year exceed the Office for Budget Responsibility's (OBR's) forecasts for the UK (which underlie forecasts for the income tax BGAs). This was true to a slightly lesser extent in December 2022, and particularly May 2022. The table also shows that SFC's forecasts for employment growth in Scotland are weaker than the OBR's for the UK as a whole, but much of this relates to slower projected population growth in Scotland, which is adjusted for when calculating the BGAs.

The SFC estimates that each 0.1 percentage point increase in Scottish average earnings growth relative to that in rUK boosts the net tax position by £25 million, and overall that its faster earnings growth forecasts between 2024–25 and 2028–29 explain around £500 million of the forecast £876 million improvement in the income tax net position between 2024–25 and 2028–29. Most of the remainder will reflect the fact that Scotland's more progressive income tax system means that each additional pound of earnings is taxed at a higher marginal rate, on average, and so boosts revenues by more. The SFC estimates that each 1 percentage point of earnings growth generates around £25 million more in revenues than it would under the income tax rates and bands in place in the rUK, for example (and total growth in average earnings is forecast by the SFC to amount to just over 12% in cash terms between 2024–25 and 2028–29).

In addition to boosting forecasts of future income tax revenues, the stronger-than-expected performance of Scottish earnings in 2022–23 and so far in 2023–24 means that the SFC now expects the final out-turn for the net income tax position in those years to be stronger than forecast when the budgets for those years were set. Under the Scottish Fiscal Framework, if this is borne out, the Scottish Government will receive positive reconciliation payments in 2025–26 and 2026–27 for these years. Based on the SFC's latest forecasts, these would be £732 million (roughly 1.5% of the Scottish Government's overall resource budget) and £502 million (roughly 1% of the Scottish Government's overall resource budget) for these two years, respectively.

### Other funding and factors

Several other factors affect the outlook for the Scottish Government's funding, and in particular the amount available for public services:

- The end of drawdowns of existing ScotWind proceeds, which are providing £460 million of funding in the current financial year and a planned £200 million in 2024–25, but no funding thereafter. A new round of windfarm licences for projects designed to reduce the environmental impact of the oil and gas sector has recently been completed, but the revenue from these (up to £262 million) will be lower than from the previous round currently being utilised for public spending.
- Increases in spending on devolved social security benefits that are forecast to outpace increases in the associated BGAs. A small part of this reflects increasing Scotland's new

benefits, such as the Scottish child payment, in line with inflation. Much more important for the years between 2025–26 and 2028–29, though, is the roll-out of Scotland’s new benefits for disabled adults and those with caring responsibilities. Taken together, these are forecast to cost around £680 million more than the associated BGAs, up from £350 million in 2024–25, contributing around 80% of the overall increase in ‘net spending’ on social security benefits (i.e. spending on top of the amount provided by the social security BGAs) over these four years. Box 3.1 discusses this issue in more detail, focusing in particular on adult disability payment (ADP, the Scottish Government’s reformed disability benefit for working-age adults), for which the net cost on top of the associated BGA (based on personal independence payment – or PIP – spending in rUK) is set to increase, but by less than previously forecast.

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### **Box 3.1. SFC disability benefit forecasts and trends in disability benefit claims**

While the eligibility criteria and amounts payable for ADP are the same as for rUK counterpart PIP, differences in the application and review processes mean that spending on ADP per person is expected to be higher. The application process for ADP is designed to lessen the burden on the applicant – for example, by requiring fewer face-to-face medical assessments. This is expected to lead more people to take up the benefit. Those receiving ADP will also have their award reviewed less frequently and in a ‘light touch’ manner, reducing the likelihood that they will lose their benefits. This combination of factors means that spending on ADP is expected to outstrip the BGA funding associated with PIP.

In its latest forecasts, the SFC has revised up its predictions for spending on ADP between 2024–25 and 2027–28 (Scottish Fiscal Commission, 2023). This is due to increases in forecast inflation (raising the amount by which benefits are uprated), and the continued increases in the number of new claims each month, something seen across the UK as we show below. However, the upward revision to ADP spending is less than that to (rUK) PIP spending, meaning that less additional spending is required by the Scottish Government, as the BGA funding covers a greater proportion. Because of this, the difference between devolved social security spending and spending on social security benefits with BGAs is now forecast to be £590 million in 2027–28, down from £775 million forecast last year.

The key reason for this decline relates to the SFC’s view that part of the reason for the bump in PIP/ADP applications is the cost-of-living crisis and resulting pressure on households’ budgets. This has led it to revise down its expectations of the size of the ADP caseload relative to the OBR’s forecast for PIP.

While both the SFC and the OBR account for the effect of the cost-of-living crisis in their modelling of PIP/ADP spending, assuming that as inflation eases the number of applications will ease too, the SFC has informed us that it believes that the cost-of-living crisis will also limit the impact of the introduction of ADP on benefit take-up. Its assumption is that the cost-of-living crisis has reduced the

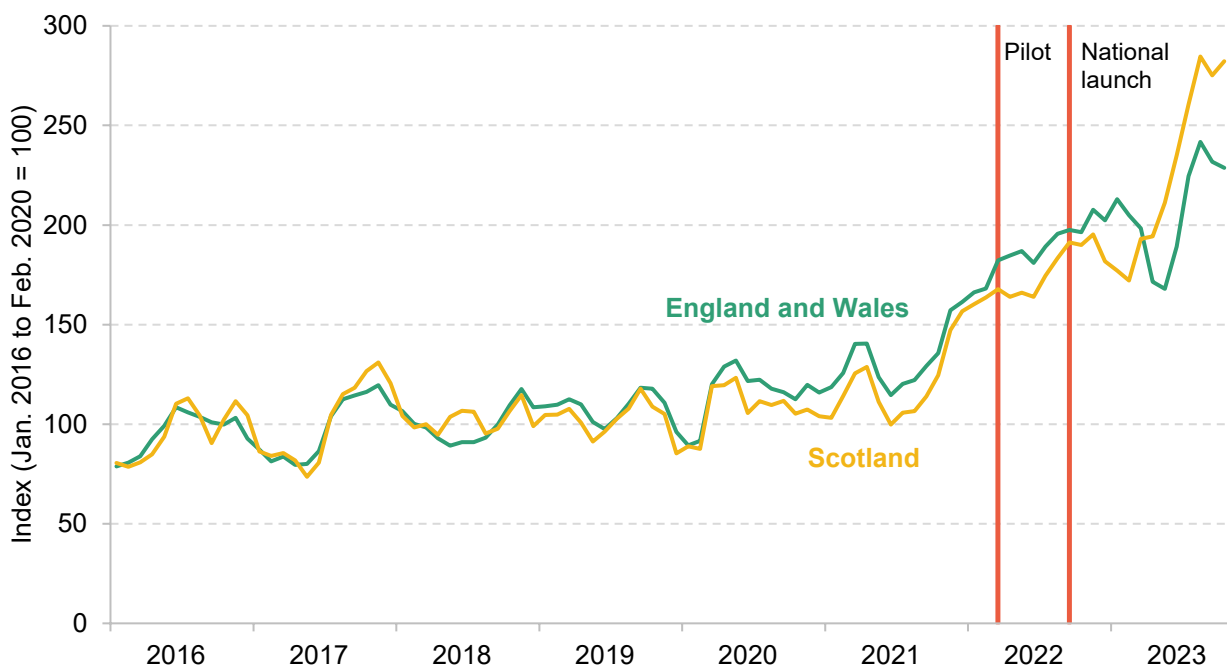
pool of people induced to apply to ADP because of its less onerous approach, since rising prices would have led them to apply to PIP even if ADP were not introduced.

If the SFC is correct, then this will mean less additional spending required. But if instead it was assumed that the effect of the cost-of-living crisis and the easier application process for ADP were independent factors affecting the probability of application, then we might not expect this to reduce the number of additional ADP claimants compared with PIP. This is because, under this assumption, there would be some people induced to apply only because of the combination of ADP's introduction and the cost-of-living crisis. The SFC is assuming that the two effects interact in a way that means this latter group is small.

There is limited evidence with which to assess the validity of this position: it is largely a judgement call. As a result, when combined with uncertainty about just how big a difference Scotland's application, assessment and reassessment systems will make to claim numbers and durations, there remains significant uncertainty about how the cost of ADP will evolve compared with the BGA funding.

However, we can use the evidence on ADP claims so far to offer some insight. Figure 3.3 shows an index of the number of monthly new PIP or ADP awards in Scotland, and in England and Wales.

**Figure 3.3. Monthly new PIP or ADP awards (three-month rolling average; index, January 2016 to February 2020 = 100)**



Note: Up to October 2023. ADP data only include initial awards, so underestimate the true number of awards. PIP data include new awards from mandatory reassessments or appeals. Neither series includes disability living allowance reassessments.

Source: Authors' calculations using Stat-Xplore, Department for Work and Pensions; Social Security Scotland.



We see that from mid 2021, the number of monthly new awards increased sharply in both Scotland and England and Wales, with the increase in England and Wales slightly greater than the increase in Scotland. This was still the case in February 2022, just before ADP began to be rolled out for new applicants. Since then, the increase in new ADP awards has been much greater, so that by October 2023 new awards in Scotland are 72% higher than in February 2022 (7,100 compared with 4,100), whereas new awards in England and Wales are 36% higher (41,900 compared with 30,800). It is difficult, though, to reach any firm conclusions based on the data currently available. The SFC assumes that there will be an initial spike of ADP awards following the roll-out, which could explain this difference, but it may also be that the reform will lead to a longer-term increase in inflows. The data do not yet allow us to distinguish between the two, highlighting the continued uncertainty around disability benefit spending.

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### Capital borrowing

On the capital side of its budget, in addition to real-terms falls in block grant funding from the UK government, the Scottish Government currently plans to reduce its own devolved borrowing from £458 million in 2024–25 to £250 million in 2025–26 and beyond. This would lead to a particularly sharp reduction in capital funding in 2025–26.

The Scottish Government will have some modest headroom against its overall capital debt limit which, following a review of Scotland’s Fiscal Framework, is now being increased in line with inflation. For example, under these plans, outstanding borrowing is set to equal 91% of the debt limit in 2025–26 and 93% in 2028–29. However, borrowing the maximum £466 million allowed in 2025–26 would see outstanding borrowing reach 98% of the total debt limit, and borrowing would need to be cut back in 2026–27, meaning cuts to capital spending could only be delayed by a year. Moreover, having some headroom makes sense as it would allow the Scottish Government space to respond to unanticipated cost overruns by borrowing, if necessary.

If the Scottish Government wanted to continue to borrow more for capital purposes, it could choose to borrow for shorter durations than the current 15 years: quicker repayment of outstanding borrowing would allow more new borrowing, although it would mean more resource funding would need to be allocated for debt repayment rather than day-to-day spending on public services or social security benefits. An alternative – but effectively quite similar – approach to support capital funding would be to transfer funding from its resource budget to its capital budget. As we discuss below, this may be an option in 2025–26, but would be much more difficult in 2026–27 to 2028–29, when resource funding looks to be highly constrained.

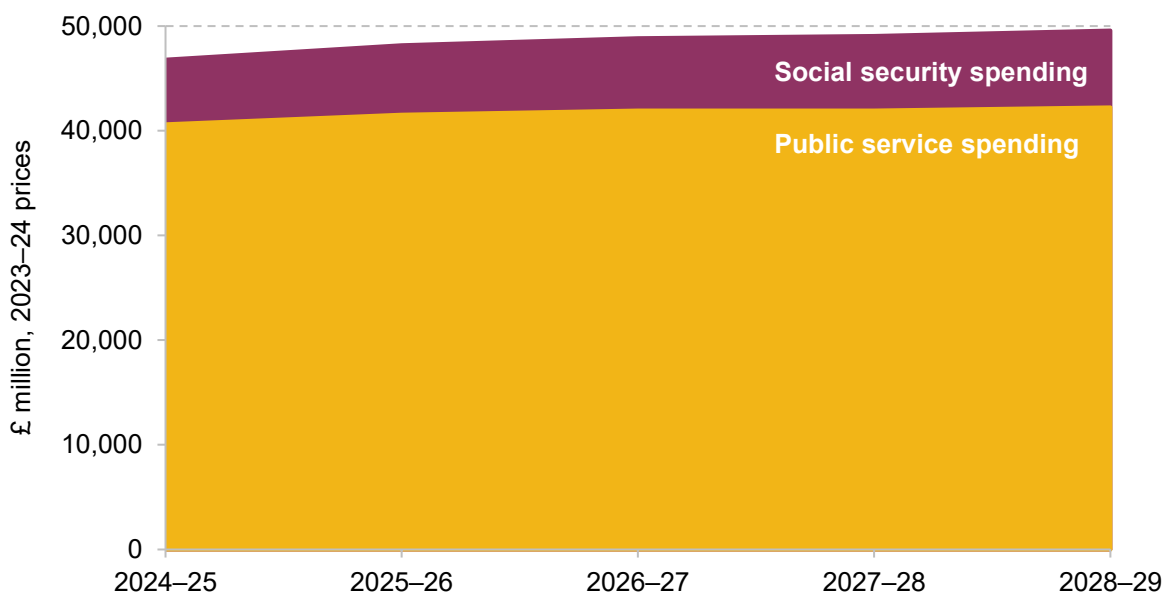
The Budget also confirmed that the Scottish Government is considering borrowing via issuing its own bonds, rather than asking the UK government to borrow on its behalf, from the second half of 2025–26. This bond-financed borrowing will still be subject to the same limits, and is likely to be slightly more expensive due to investors requiring higher interest rates to lend to a new

borrower for bonds that will be less liquid than the UK’s established and large public debt market (Scottish Government, 2023b). However, the Scottish Government argues that this approach will raise Scotland’s profile with international and institutional investors and help develop Scotland’s public finance institutions – which, if true, could be helpful if the current Scottish Government’s aim of independence were achieved.

## Overall funding projections

Figure 3.4 brings together the various sources of funding for day-to-day (resource) expenditure. It shows the overall amount available, splitting it into the amount allocated to spending on social security benefits (in purple) and the amount available for public services (in yellow), for the next five fiscal years, expressed in 2023–24 prices. It shows relatively large increases in funding in 2025–26, followed by much smaller annual average increases in funding in the subsequent three years.

**Figure 3.4. Projected Scottish Government resource funding (2023–24 prices)**



Source: Scottish Fiscal Commission (2023); November 2023 GDP deflators.

## The resource funding outlook for 2025–26

Overall resource funding is projected to grow by 2.9% in real terms in 2025–26, with the amount available for public service spending increasing by 2.2%. The difference between these two figures reflects bigger increases in devolved social security spending than in the associated BGAs from the UK government, as Scotland’s reformed benefits for carers and disabled adults lead to more successful and longer claims.

The 2.2% real-terms increase in the amount available for public services is substantially higher than the real-terms increase in block grant funding assumed by the Scottish Government – which averages 0.8% in real terms in the four years from 2025–26 to 2028–29, but is just 0.5% in real terms in 2025–26. In addition, existing ScotWind proceeds are expected to have been fully drawn down, which will reduce funding by the equivalent of around 0.5%, roughly offsetting the real-terms increase in block grant funding. This means the projected real-terms increase in resource funding in 2025–26 is almost entirely driven by devolved tax revenues, and particularly devolved income tax revenues.

The forecast of year-on-year increases in the net income tax revenue position discussed earlier – driven by the SFC’s assumption of faster earnings growth than the OBR assumes and greater fiscal drag under Scotland’s more progressive income tax system – explains a relatively small part of it: the £300 million real-terms increase in the net income tax position is equivalent to around a 0.7% boost to resource funding for public services. More important, though, is the SFC’s forecast that stronger-than-previously-expected earnings growth and hence income tax revenue growth in Scotland relative to rUK in 2022–23 will lead to a positive reconciliation payment of £732 million in 2025–26. This is equivalent to a 1.8% boost to the amount of resource funding available for public services. The performance of Scottish income tax revenues relative to rUK income tax revenues in 2022–23 will therefore be a key determinant of the Scottish Government’s budget choices and challenges in 2025–26. Even though around eight months had passed between the end of the 2022–23 tax year and the SFC’s latest forecasts for revenues in that year, and hence the size of any reconciliation payments, there is still significant uncertainty, not least because self-assessment tax returns and payments were only due at the end of January 2024. And the reconciliation payment for the previous year, 2021–22 was notably different from the forecast made at the same point: –£390 million as opposed to a forecast –£732 million, a difference equivalent to 0.8% of overall resource funding available for public service spending. As we discuss further below, this means not only future but also past income tax revenue performance creates uncertainty for the Scottish Government’s future budget.

### The resource funding outlook for 2026–27 to 2028–29

In 2026–27 and beyond, the outlook for resource funding is much tougher. This is in spite of the fact that UK government block grant funding is currently projected to increase by more (1.0% a year in real terms) than in 2025–26 – although this is still much slower than over the period between 2019–20 and 2024–25 and, as we discuss below, would likely necessitate cuts to a range of service areas.

Overall resource funding is projected to increase by 1.4%, 0.4% and 1.0% in real terms in 2026–27, 2027–28 and 2028–29, respectively. After accounting for growing expenditure on devolved social security benefits (forecast to increase by 3.4% in real terms per year as Scotland’s new

disability and carers' benefits roll out), the amount available for public services is projected to grow by 1.0%, 0.0% and 0.7% in real terms in the same respective years.

The slowdown in funding growth is driven partly by slowdown in the growth of the income tax net revenue position in these years – with the boost to overall resource funding available for public services equivalent to just over 0.3% (down from 0.7% in 2025–26). More important, though, is the decline and then cessation of forecast positive reconciliation payments for past underestimates of Scotland's net income tax revenue position. For example, while the SFC now forecasts that the net income tax position in the current financial year, 2023–24, will be stronger than when this year's budget was set, generating a positive reconciliation payment in 2026–27, it forecasts that this will be smaller (£502 million) than the payment for 2022–23 made in 2025–26 (forecast to be £732 million). This fall in the reconciliation payment is a drag on the growth in overall resource funding.

Any reconciliation payment in 2027–28 would be because of under- or over-forecasting the net income tax revenue position in 2024–25. As the figures assumed in the Scottish Budget for the 2024–25 net income tax position are the SFC's latest forecasts, there is currently no anticipated 'forecast error' and hence the implied reconciliation payment in 2027–28 is zero. The impact of moving from a £502 million reconciliation payment in 2026–27 to zero in 2027–28 is equivalent to a reduction in overall resource funding available for public services of 1.1 percentage points. Alongside growing net expenditure on devolved social security benefits, this would almost exactly offset assumed growth in block grant funding from the UK government and forecast year-on-year increases in the net income tax revenue position in 2027–28.

Based on current projections for block grant funding, forecasts for devolved tax revenues and social security spending, and forecasts for reconciliation payments, 2027–28 therefore looks as if it will be a particularly tough year. But as we show in Section 3.2, each of the years between 2026–27 and 2028–29 will entail very difficult trade-offs between service areas based on current funding projections.

### The capital funding outlook

The combination of cash-flat block grant funding from the UK government and a reduction in assumed borrowing (to maintain headroom against overall capital debt limits) means a large fall in capital funding between 2024–25 and 2028–29: around 16% in real terms, including funding for capital transactions (loans or equity investments to the private sector). The biggest year-on-year fall is in 2025–26 (around 11% in real terms), as this is when the Scottish Government assumes capital transactions funding will come to an end, and when it plans to reduce capital borrowing. Cuts on this scale would require significant reductions in investment in infrastructure, facilities and equipment – especially if construction inflation continues to outpace overall economy-wide inflation.

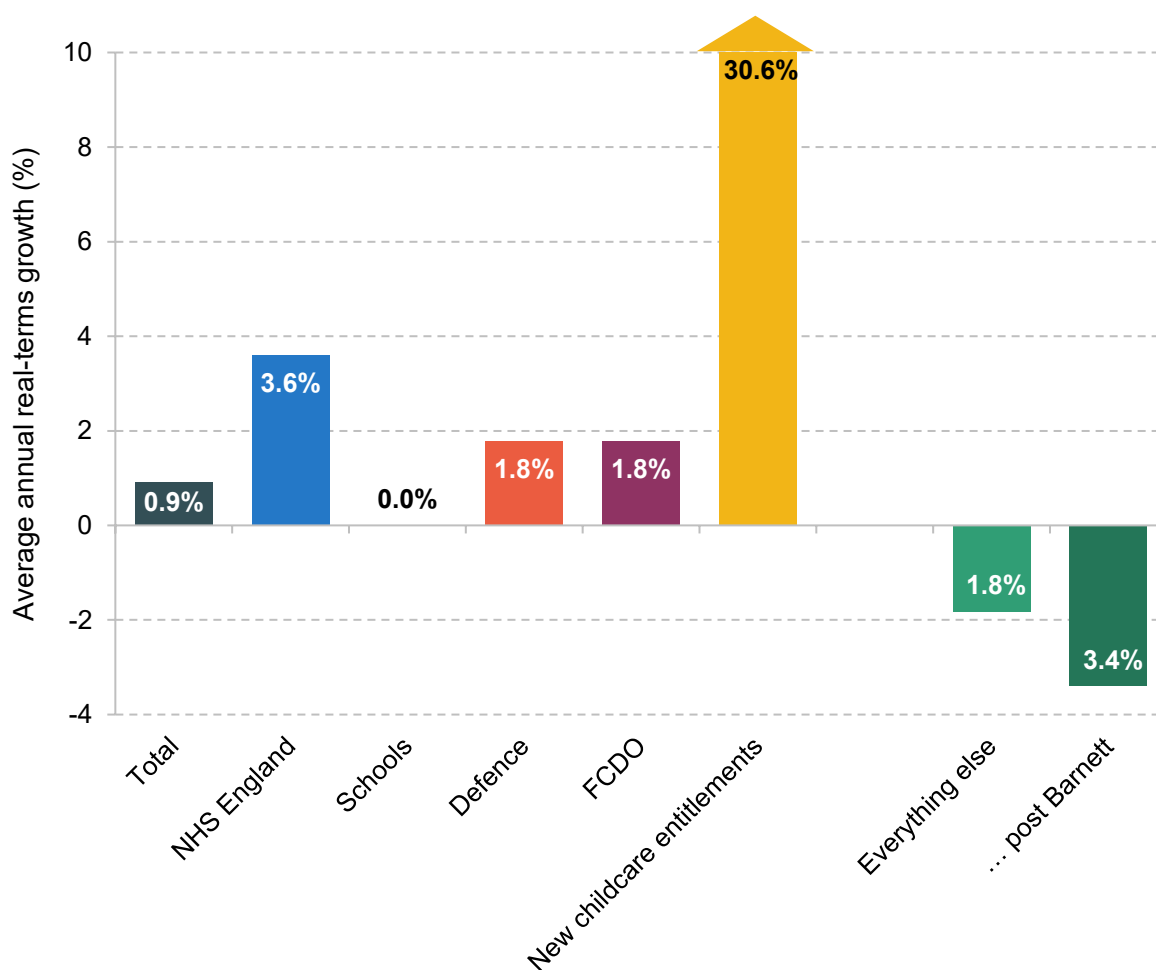
## Upside and downside risks

The medium-term funding projections discussed above are subject to significant uncertainty. The two biggest areas of uncertainty – given their scale and importance to the Scottish Government’s overall budget – are the levels of block grant funding that will be received from the UK government, and devolved income tax revenue performance.

### Key upside risk: UK government funding

We have already discussed uncertainty related to how the UK government chooses to divide up its funding between departments in the next Spending Review period – which will determine how much Scotland receives via the Barnett formula. A more important source of uncertainty, though, is the total funding envelopes pencilled in by the UK government – which could be changed significantly in future Spending Review(s) – and indeed in subsequent UK Budgets.

**Figure 3.5. Illustrative changes in UK government resource funding implied by Autumn Statement 2023 plans, 2024–25 to 2028–29**



Source: Figure 5 in Emmerson et al. (2024).

The current envelopes imply difficult trade-offs for the UK government, with tight spending settlements for many areas of UK government spending. This is illustrated in Figure 3.5, which looks at the implications of a range of plausible assumptions for particular services for ‘unprotected’ services. The figure assumes that NHS funding grows at a rate of 3.6% in real terms, which is below its long-run average growth rate, but which is what would be required to deliver the English NHS workforce plan (Warner and Zaranko, 2023). It also assumes that defence and overseas aid spending are maintained as a proportion of national income, and that schools funding is frozen in real terms (allowing small increases per pupil given falling school rolls in England). It also assumes that new English childcare spending is increased in line with commitments made in the Spring Budget 2023 (note that this is a relatively small area of overall spending).

Given these assumptions, funding for all other areas would need to be reduced by an average of 1.8% a year in real terms in the four years 2025–26 to 2028–29. And after accounting for funding for Scotland, Wales and Northern Ireland that is determined by the Barnett formula (and which would be boosted by increases in funding for the NHS and childcare), the cuts to unprotected departments serving England or the UK as a whole would average 3.4% a year.

This ‘unprotected’ category includes funding for local government, criminal courts and prisons, the police and fire services, further and higher education, culture and sport, rural affairs and environmental protection, energy and climate change, and transport. Many of these faced substantial cuts in the last round of austerity in the 2010s and are facing evident strain and cost pressures. When the prospect of laying out these cuts in detail, through setting out departmental spending allocations, is confronted at the next Spending Review, budgets may be topped up. A top-up to overall envelopes at this point would be in line with recent experience: since 2010, at Spending Reviews, departmental spending totals have been topped up by £14.3 billion per year on average (Atkins and Lanskey, 2023).

This means that it is possible (and perhaps probable) that the existing indicative UK government spending limits will be topped up, which would generate more block grant funding for the Scottish Government (and other devolved governments) than is currently assumed. However, high levels of public debt, which is set to rise further over the next few years and barely fall in 2028–29, mean the Chancellor’s fiscal rules are barely being met – indeed, recent IFS research shows that cutting these high levels of debt appears to be harder than at any time since the 1950s on one key measure (Emmerson et al., 2024). As a result, it seems unlikely that spending plans will be increased to such an extent as to avoid difficult budgetary trade-offs both in Westminster and in Edinburgh.

### Key downside risk: devolved tax revenues

The second key area of uncertainty for the Scottish Budget is the performance of devolved tax revenues, and in particular income tax. In this case, the risks are weighted to the downside, as highlighted by the SFC in its recent forecasts (Scottish Fiscal Commission, 2023).

This is because the increasingly positive net income tax revenue position forecast reflects to a large extent differences in earnings forecasts between the SFC (which forecasts devolved tax revenues) and the OBR (whose forecasts for rUK revenues underlie forecasts of the BGAs). The SFC highlights that there are factors that might mean the continuation of trends over the last 18 months or so for earnings in Scotland to outpace those in rUK – such as improved North Sea oil and gas activity, and reduced bonuses in the City of London in a higher-interest-rate environment. But the differences in forecasts may also reflect different degrees of overall optimism between the SFC and the OBR, rather than optimism about Scottish earnings specifically. For example, the SFC highlights that its earnings forecasts are more in line with the average of independent forecasters for the UK as a whole than the OBR's are. If it turns out that earnings growth across the UK is more in line with the SFC's more optimistic forecasts, then the income tax BGA will increase by more than currently forecast, meaning less of an improvement in the net income tax position. On the other hand, if it turns out that the OBR's relatively more pessimistic figures are borne out, Scottish revenues will underperform the SFC's forecasts, again reducing the net income tax position. Thus, in both cases, the scale of the improvement in the net income tax position would be less than currently forecast.

If, rather than growing by a cumulative 2.6 percentage points more between 2024–25 and 2028–29 as current SFC and OBR forecasts imply, Scottish earnings instead grew at the same rate as in rUK, the net income tax position in 2028–29 would be around £500 million lower – equivalent to a 1 percentage point reduction in overall resource funding. Each 0.1 percentage point reduction in Scottish earnings growth relative to rUK earnings growth per year would reduce the net income tax position and hence available funding by £100 million in 2028–29.

### Other uncertainties – reconciliations and social security forecasts

There is also the potential for final reconciliation payments for 2022–23 and 2023–24 to differ from current forecasts. It is less clear that these risks are weighted to the downside (given that they are based on observed Real Time Information on earnings and PAYE income tax collections). But after positive surprises in relation to reconciliations for 2020–21 and 2021–22, it is important not to discount the risk of negative surprises going forwards.

Another area of uncertainty where it is unclear which way risks are weighted is the net social security spending position. In particular, overall trends in disability benefit claims are uncertain – with the SFC and the OBR seeming to take slightly different views on the extent to which recent big increases in rates of new claims are a permanent or partially temporary issue. And the

extent to which Scotland’s reformed system for applying for, assessing and reassessing disability benefit claims will lead to more and longer successful claims is uncertain – and will likely remain so for some time until the system has been in place longer, so that trends in applications, success rates and benefit durations can be observed. This means the next few years could see big upward or downward revisions to net disability benefit spending, with knock-on effects for the amount of funding available for other areas of Scottish Government spending.

## 3.2 Spending choices and trade-offs

The constrained environment set out above implies difficult budgetary trade-offs for the Scottish Government for both its resource and capital budgets. To illustrate this, we carry out similar analysis to Figure 3.5 for Scotland, by examining the implications for ‘unprotected’ service areas of particular assumptions about health and core local government funding<sup>2</sup> – the two largest and perhaps most politically salient areas of the Scottish Government’s budget.<sup>3</sup> Figure 3.6 shows the implications for these other departments (including funding for the courts, the fire, police and prison services, further and higher education, rural affairs and environmental protection, economic development, transport and actions to tackle climate change), given the SFC’s medium-term funding projections, and three scenarios for health and local government funding:

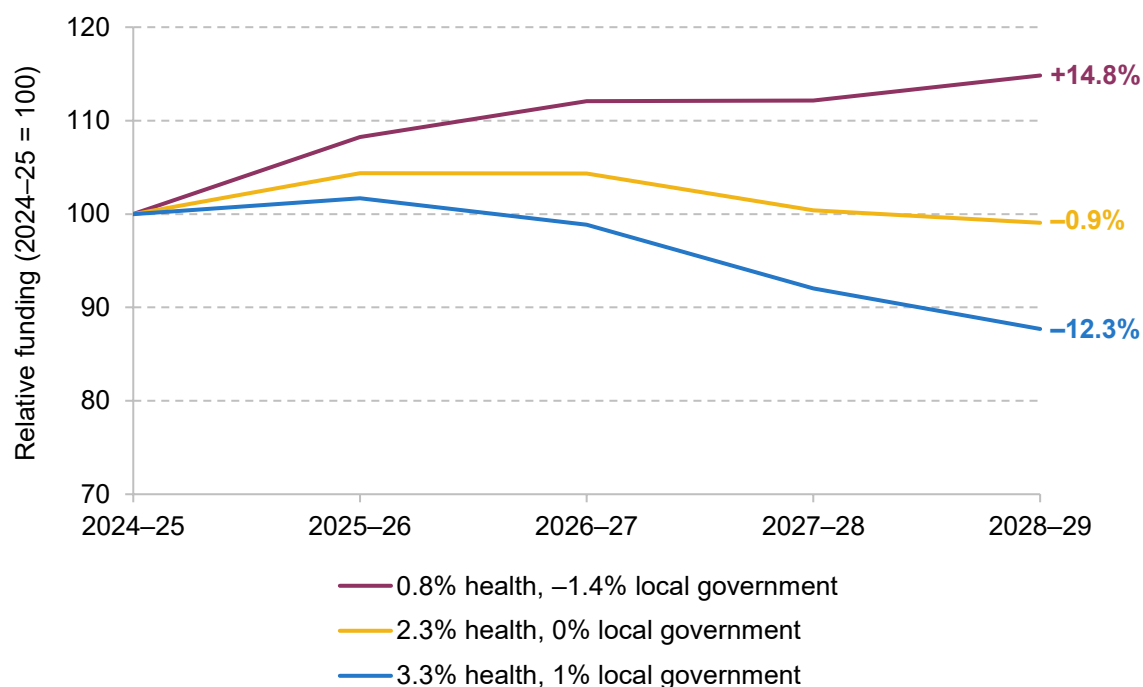
- 1 Health and core local government funding change in line with the real-terms plans set out for the period 2024–25 to 2026–27 in the May 2022 Resource Spending Review. These were for funding for the then-named Health and Social Care portfolio to increase by an average of 0.8% a year in real terms, and for core funding for local government to be cut by 1.4% a year in real terms.
- 2 Health funding to increase by 2.3% a year in real terms, in line with assumptions underlying spending need projections in the Scottish Government’s May 2023 Medium-Term Financial Strategy, and core funding for local government to be flat in real terms.
- 3 Health funding to increase by 3.3% a year in real terms, which would provide the same increase per person in Scotland as IFS researchers estimate is needed to meet the NHS’s long-term staffing plan in England, and core funding for local government to increase by 1.0% a year in real terms.

<sup>2</sup> More precisely, we vary assumptions about funding for the NHS Recovery, Health and Social Care portfolio and the funding provided to councils via the Deputy First Minister and Finance portfolio (which provides the main general-purpose grant funding to councils).

<sup>3</sup> Moreover, unlike in England, most spending on schools and childcare is paid for from general-purpose local government funding, rather than separate funding streams.



**Figure 3.6. Implication of differing degrees of prioritisation of the NHS Recovery, Health & Social Care and Local Government portfolios for other public service spending**



Source: Authors' calculations using Scottish Fiscal Commission (2023) and Scottish Government (2023a).

Figure 3.6 shows that under the first scenario, funding for unprotected services could be increased by approximately 15% in real terms over the period between 2024–25 and 2028–29, in contrast to the cuts set out in the May 2022 Resource Spending Review. This reflects the fact that while tight, the projected funding outlook is less dire than the Scottish Government was assuming when it last set out medium-term funding plans. In turn, this is because of substantial upwards revisions to the forecast trajectory for the net income tax position (which SFC and OBR forecasts in May 2022 implied would progressively worsen, but is now set to improve). But it also reflects the fact that whereas in May 2022 the Scottish Government assumed that its UK government block funding would grow by 1% *less* than overall UK government funding resource spending limits in order to be 'cautious', it is now assuming its block grant funding will grow in line with those overall limits.

Such small increases in health funding alongside cuts to local government are arguably unrealistic given the evident pressure on the NHS and on adults' and children's social care services, in particular. At the very least, they would likely entail a continued worsening of access to and quality of these services.

The second scenario arguably represents a minimum needed to maintain existing health service standards, and would allow for councils' overall funding to be increased by around 0.8% per year in real terms if council tax were increased by 5% (in cash terms) a year. This would enable

increases in social care spending of about 2.3% per year in real terms (in line with health spending) if increases in other local government spending (including on education) was held roughly flat in real terms. Under this scenario, funding for all other services could increase by 4.4% in real terms in 2025–26 (when, as previously discussed, the Scottish Government’s funding is projected to increase at a reasonable rate). But it would be flat in 2026–27 and fall by 3.8% in real terms in 2027–28 and 1.3% in 2028–29, by which point it would be 0.9% lower in real terms than in 2024–25.

The third scenario would allow for substantial increases in Scottish NHS employment and activity in line with what the English NHS’s long-term workforce plan implies south of the border. Real-terms increases of 1% in Scottish Government funding for councils would, together with council tax increases of 5% a year, provide roughly 1.5% per year overall real-terms increases in council funding. That would enable social care spending to grow by 3.3% per year (in line with health spending) and increases in spending on other council services (including education) averaging around 0.5% per year in real terms. Under this scenario, there would still be sufficient funding for an average increase in funding for other ‘unprotected’ services of 1.7% in 2025–26. But funding for these ‘unprotected’ services would need to be reduced by an average of 2.8%, 6.9% and 4.7% in real terms in 2026–27, 2027–28 and 2028–29, making the second half of the 2020s extremely difficult for a whole raft of Scottish public services. Their funding would be, on average, 12.3% lower in real terms in 2028–29 than in 2024–25.

In reality, if its overall funding followed the path implied by current SFC forecasts and assumptions about block grant funding, the Scottish Government would likely give priority areas, such as the health service, bigger increases in funding in 2025–26 and smaller increases thereafter, so that funding for other services did not rise and then fall in a way that could likely cause inefficiencies in spending and service delivery. But these scenarios illustrate that even simply standing still with healthcare and social care, let alone aiming for improvements, would entail difficult decisions for many other services in the second half of the 2020s.

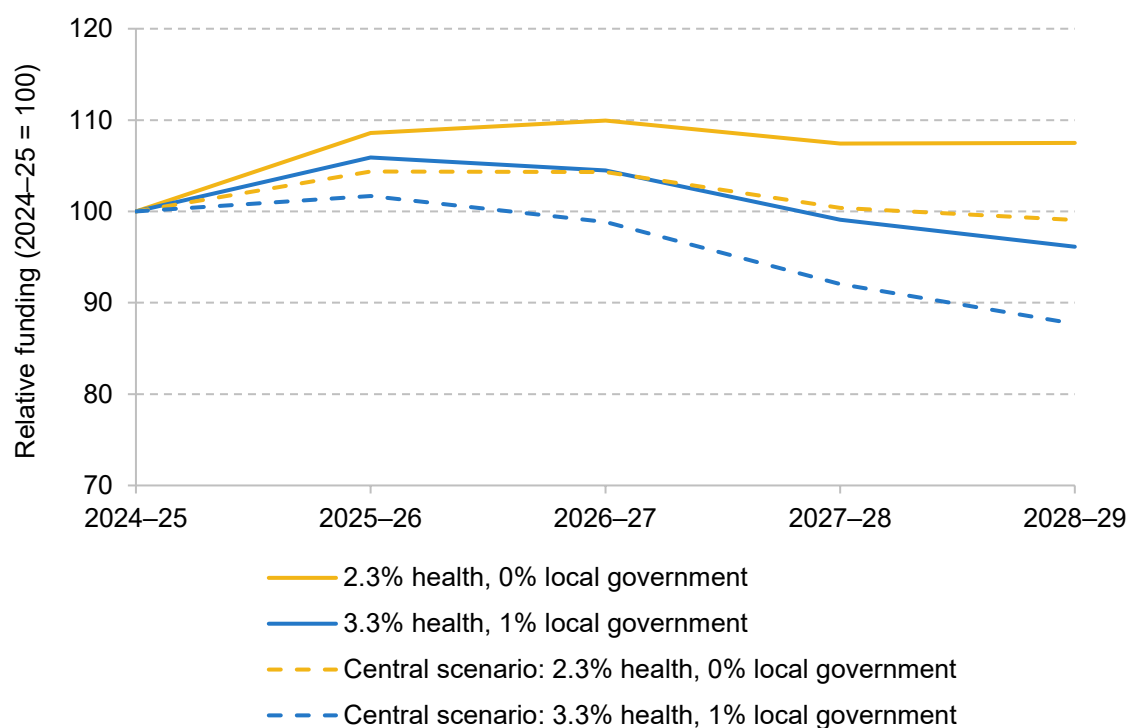
### How would trade-offs change if overall funding were higher or lower?

As described earlier, it is likely that funding will not follow the exact path set out in the SFC’s December forecast report. On the one hand, it seems plausible – at least given past behaviour – that whoever is in office in Westminster come the next UK Spending Review will top up spending plans. On the other hand, risks around Scotland’s devolved tax revenues are weighted to the downside. We now turn to what such upside and downside scenarios could mean for the budgetary trade-offs facing the Scottish Government.

### Upside scenario: additional funding found by the UK government

In our upside scenario, we assume that UK government resource spending plans are topped up by £15 billion (in real terms) in 2028–29. The precise number is arbitrary, but is chosen to be similar in magnitude to that seen on average across Spending Reviews since 2010 (Atkins and Lanskey (2023) estimate this at £14.3 billion). We assume that real-terms increases are more front-loaded<sup>4</sup> and amount to £7.5 billion in 2025–26, £10 billion in 2026–27 and £12.5 billion in 2027–28. We also assume that two-thirds of these increases give rise to extra funding for Scotland under the Barnett formula.<sup>5</sup> The implied increases in block grant funding on top of those assumed in the SFC’s projections are around £480 million in 2025–26, rising to £1 billion by 2028–29.

**Figure 3.7. Implication of differing degrees of prioritisation of the NHS Recovery, Health & Social Care and Local Government portfolios for other public service spending: upside scenario**



Source: Authors’ calculations using Scottish Fiscal Commission (2023) and Scottish Government (2023a).

<sup>4</sup> We make this assumption for two reasons. First is because of the evident short-term pressures on services such as the NHS and councils. Second is that current spending envelopes assume that the UK government will allow special non-domestic rates reliefs for the retail, hospitality and leisure sectors to expire at the end of March 2025, which seems unlikely given it has rolled over these ‘temporary’ reliefs each year since the COVID-19 pandemic; a bigger boost to funding that year will allow the reliefs to be rolled over again without significantly squeezing funding for public services in that year.

<sup>5</sup> Unlike the Scottish Government’s approach for projecting UK government funding, this approach allows us to account for the fact that the Barnett formula provides the same cash-per-person increase in funding as in England rather than the same percentage increase.

Figure 3.7 shows that under this scenario, 2.3% real-terms increases in funding per year for health and a flat real-terms settlement for local government would allow funding for other services to be around 7.5% higher in real terms in 2028–29 than in 2024–25, although all that increase would take place in 2025–26. In reality, as discussed earlier, it is likely that funding increases for all services, including health, would be front-loaded, to avoid this ‘feast’ then ‘famine’ for certain services. Nevertheless, this scenario illustrates that top-ups to block grant funding by the UK government could notably ease the budgetary trade-offs facing the Scottish Government.

However, there will still likely be challenges. For example, 3.3% real-terms increases for the NHS and 1% for local government would see funding for ‘unprotected’ services be 4% lower in real terms in 2028–29 than in 2024–25. In other words, providing funding to the NHS that could help address current performance issues, and modest increases in central government funding for councils, would require cuts to many areas of spending, even if the UK government loosens its purse strings to the tune of £15 billion per year by 2028–29 in real terms.

### Downside scenario: a weaker net income tax revenue position

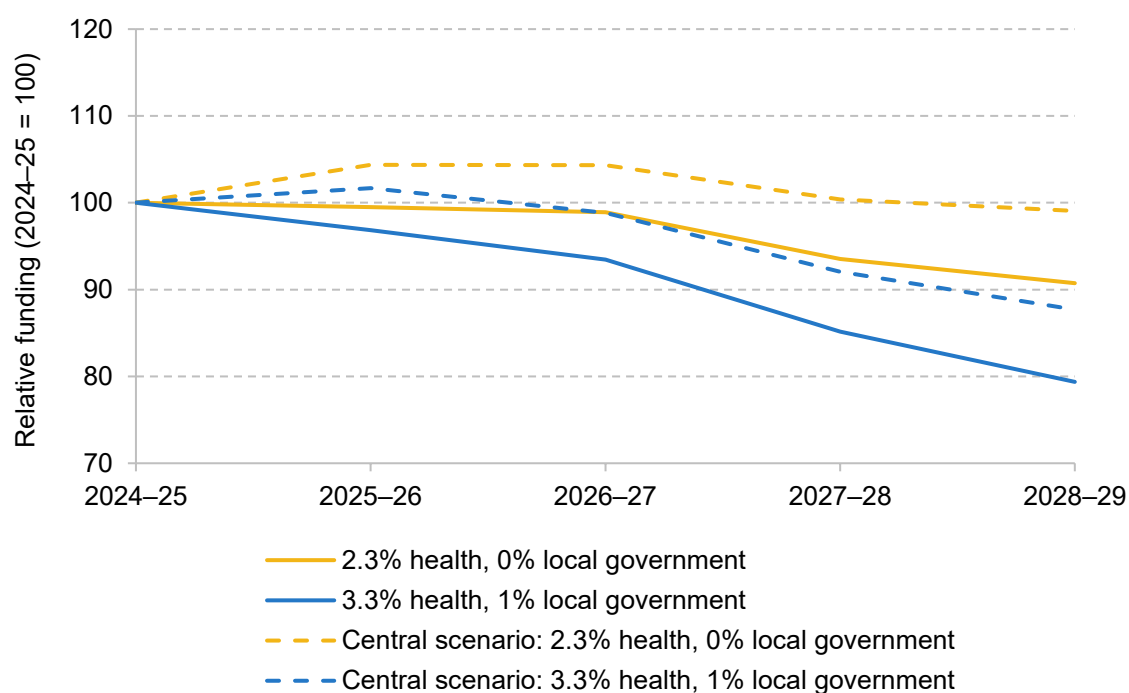
The key downside risk relates to Scotland’s net income tax position – which in turn depends on how strongly Scottish earnings grow in Scotland relative to rUK. As highlighted earlier, the SFC’s forecasts for Scottish earnings are higher than the OBR’s for the UK as a whole – a cumulative 12.5% between 2024–25 and 2028–29, compared with 9.8% – contributing around £500 million to the increased net income tax position in 2028–29. In addition, the SFC reports that each 0.1 percentage point change in earnings growth relative to rUK changes the net tax position by around £25 million.

In our downside funding scenario we therefore assume that not only do Scottish earnings not outpace rUK earnings, but they instead grow by a cumulative 1 percentage point less between 2024–25 and 2028–29. Most obviously, this could arise if Scottish earnings grow by less than the SFC forecast or if rUK earnings grow by more than the OBR’s forecast – but it could also reflect earnings in Scotland and rUK outpacing their associated forecasts, but the latter by more. Based on the SFC’s estimates, this would reduce the net tax position by £750 million in 2028–29. A 1 percentage point decline in earnings growth in Scotland over four years would be a relatively modest change over such a period: over the four years between 2014–15 and 2018–19, the decline was around 4 percentage points, whereas between 2006–07 and 2010–11, the increase was around 3 percentage points. This scenario should therefore not be seen as a ‘lower bound’ on the impact of relative earnings growth on the net tax position.

In addition to these changes to earnings growth assumptions, in our downside scenario we also assume that the positive reconciliations for income tax forecast errors in 2022–23 (affecting the 2025–26 budget) and 2023–24 (affecting the 2026–27 budget) are only half as large as currently

forecast, at £366 million and £251 million, respectively. This scale of change is roughly of the same magnitude (although in the opposite direction) to the ‘positive’ surprise for the 2021–22 reconciliation (which affects the 2024–25 budget). Such a situation could arise if PAYE tax revenues are weaker than suggested by Real Time Information that is already available (which is a good but imperfect guide to PAYE revenues) and/or Scottish self-assessment revenues fall back after particularly strong growth in 2021–22. We also assume that these effects persist, and further reduce the net income tax position in 2027–28 and 2028–29 by £250 million. All told, this means that relative to the projections set out in the SFC’s latest forecast report, resource funding would be around £550 million lower in 2025–26, with the difference growing to £1 billion by 2028–29. In that final year, the net tax position would be around £1.3 billion, compared with £1.2 billion in 2024–25 and £0.6 billion in 2023–24 (after accounting for changes in assumptions about forecast errors and reconciliations discussed above).

**Figure 3.8. Implication of differing degrees of prioritisation of the NHS Recovery, Health & Social Care and Local Government portfolios for other public service spending: downside scenario**



Source: Authors’ calculations using Scottish Fiscal Commission (2023) and Scottish Government (2023a).

Figure 3.8 shows the implications of this for the budgetary trade-offs facing the Scottish Government. It shows that under spending scenario 2 – with 2.3% real-terms increases in funding for health and flat real-terms funding for local government – and this ‘downside’ scenario for funding, the amount of funding available for ‘unprotected’ services would decline in every year (albeit only slightly in 2025–26) and would be over 9% lower in real terms by 2028–29. This shows that in the absence of an improving net income tax position, even providing the

minimum needed for the NHS and requiring councils to rely on council tax for any real-terms increases in funding would necessitate significant cuts to other service areas.

If health funding were instead increased by 3.3% in real terms per year and local government funding by 1% in real terms per year, the cuts to unprotected services would be even larger – a cumulative 20% in real terms by 2028–29. Such cuts, having come on top of cuts to many such areas in the 2010s, would probably be undeliverable, without stopping certain types of spending and services entirely.

## The challenge of medium-term budgeting in Scotland

The differences in the budgetary trade-offs that the Scottish Government would face in the downside, central and upside funding scenarios presented above illustrate the difficulties the Scottish Government has in making medium-term spending plans. Uncertainty about UK government funding, the future net contribution of devolved tax revenues and the impacts of disability and carers' benefits reforms on caseloads and spending, when combined with the limited borrowing powers available to the Scottish Government, mean it is more difficult for the Scottish Government to make firm plans than it is for the UK government.

The Scottish Government has already postponed when it intends to publish updated medium-term spending plans until its next Medium-Term Financial Strategy, expected this summer. Given the potential for substantial changes in UK government spending plans for 2025–26 and beyond, which are unlikely to become clear before the upcoming general election, and the fact that more data on the roll-out of Scotland's reformed benefits will become available during the course of next year, it may make sense to push these plans back again. Going forwards, it may then make sense to align Scottish Spending Reviews with UK Spending Reviews, as is the case in Wales. At the very least, those planning and managing the budgets of particular spending portfolios (and Scottish councils) should treat any spending plans set out in a pre-election Scottish Spending Review as potentially subject to significant revision.

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# 4. Healthcare spending, staffing and activity

David Phillips and Max Warner<sup>1</sup>

Health is the largest single area of Scottish Government spending, making up 35% of the Scottish Government's total discretionary budget in 2024–25 and 39% of its non-benefit budget.<sup>2</sup> Its share of spending has grown significantly over time, driven by large increases in health spending in the 2000s and cutbacks to other areas of spending in the 2010s. This trend is set to continue with the Scottish Fiscal Commission (SFC) projecting that to keep up with the demands of an ageing, less healthy population, and medical advancements, Scottish health spending would need to grow by around 3% in real terms per year in the late 2020s and 2030s, compared with around 2% for all Scottish Government spending. More urgently, there is clear evidence that the NHS in Scotland, as in the rest of the UK, is struggling to recover from the COVID-19 pandemic, despite record levels of spending and staffing.

In this chapter of our second Scottish Budget Report, we therefore look at long-run trends in healthcare spending in Scotland and how these compare with trends in England and Wales, before examining recent trends in NHS staffing, activity, productivity and performance in Scotland. We conclude with a discussion about future funding and staffing.

## Key findings

1. Scottish health spending per person has grown considerably in real terms over time, from £1,659 per person in 1999–2000 to £3,073 in 2022–23 (in 2022–23 prices). Spending grew rapidly in the first decade after devolution, with average real growth of 5.0% per year between 1999–2000 and 2009–10, but at a much slower rate of 0.4%

<sup>1</sup> The authors thank Carl Emmerson for helpful comments, Andrew Mooney for advice on data sources and Bee Boileau for assistance with Scottish Budget numbers. All opinions and any errors or omissions are those of the authors alone.

<sup>2</sup> These figures relate to spending categorised as 'Health' under the COFOG classification (Classification of the Functions of Government), expressed as a percentage of total resource and capital departmental expenditure limits (DEL) plus non-domestic rates, either including or excluding social security spending. The NHS Recovery, Health and Social Care portfolio accounts for 35.4% and 40.0% of the Budget but also includes spending on sports, food standards, and elements of social care.



per year between 2009–10 and 2019–20. Spending rose rapidly during the COVID-19 pandemic, and although it has since fallen, spending per person remained 10% higher in 2022–23 than in 2019–20.

2. Spending per person on health was higher in Scotland than in either England or Wales at the start of devolution, but this gap has fallen over time. In 1999–2000, Scotland spent 22% more per person on health than England, but by 2019–20 this had fallen to 3% more per person. Under current plans, Scotland will spend around 3% more than England per person in 2024–25. In both 2018–19 and 2019–20, Wales spent more on health per person than Scotland, a trend that is set to continue under the current budgets of the devolved governments of both countries.
3. The number of staff working in the Scottish NHS has increased substantially since the start of the pandemic. In July–September 2023, the NHS employed 11% more consultants, 16% more junior doctors and 8% more nurses than pre-pandemic.
4. Measured hospital activity fell rapidly during the COVID-19 pandemic and has still failed to recover fully. In April–June 2023, the Scottish NHS treated 8% fewer elective day-case patients, handled 8% fewer emergency admissions and 8% fewer outpatient appointments and treated 21% fewer elective inpatient admissions than pre-pandemic.
5. Higher funding and staffing than pre-pandemic but lower hospital activity points to a large fall in measured NHS hospital productivity in Scotland. This fall is particularly concerning given the challenging fiscal situation the Scottish Government continues to face.
6. The number of patients on the elective waiting list in Scotland has grown by 87% since the start of the pandemic. The percentages of patients waiting less than 18 weeks for elective treatment and less than four hours in A&E departments have also fallen substantially since the start of the pandemic. Until the NHS can deliver more hospital activity than pre-pandemic, it is likely waiting lists and waiting times will continue to rise.
7. The apparent fall in hospital productivity in Scotland is similar in magnitude to that observed in the English NHS. But England has increased staff by more than Scotland, so the recovery in hospital activity has been much greater.
8. The elective waiting list has grown by less in England than in Scotland since the start of the pandemic, although definitions of included activity differ. Elective and A&E waiting times performance has been worse in England post-pandemic than in

Scotland. By these measures of performance, neither country's system is performing better across the board.

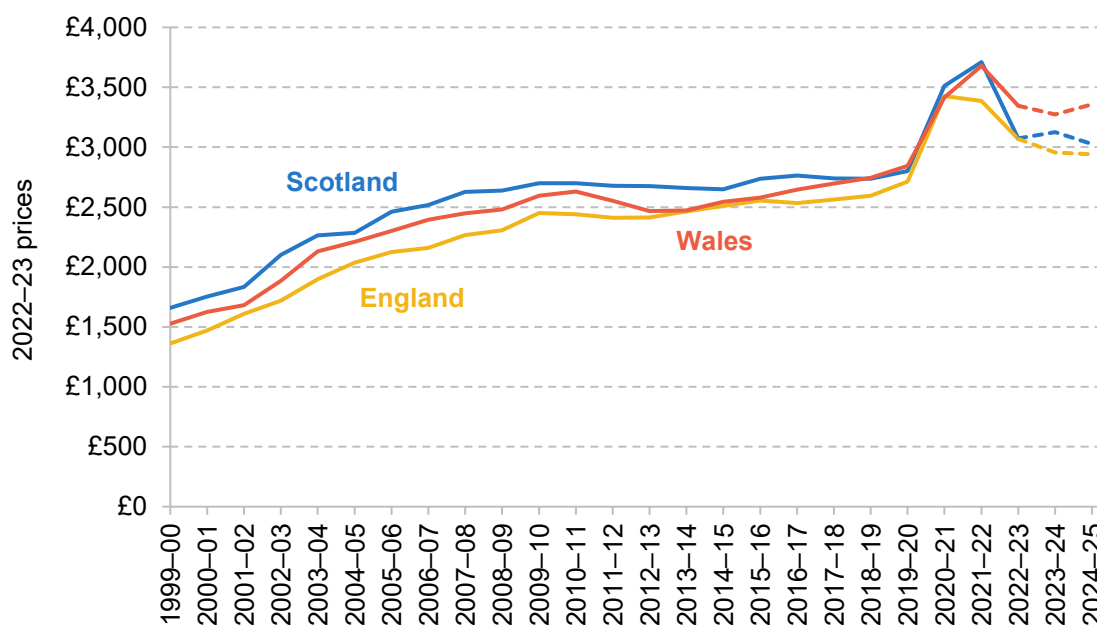
9. Demographic and cost pressures mean that health spending would need to increase in Scotland over time to provide the same level of service. The Scottish Fiscal Commission projects that Scottish health spending will need to grow by around 3% in real terms per year in the late 2020s and 2030s, compared with around 2% for all Scottish Government spending.
10. Much of this increase in spending will go towards increased staffing. However, the Scottish Government's health and social care workforce plan only aims to increase NHS staffing by 1% over the five years from 2022. The English NHS workforce plan implies a 20–21% growth in NHS staff in England over the same period. This suggests that Scotland is likely to need to either increase staffing numbers and spending by more than planned increases, find ways to boost productivity significantly faster than is being planned in England, or live with a relative deterioration in NHS service quality.

## 4.1 Long-run trends in health spending

Health spending and policy has been devolved to Scotland since the advent of devolution in 1999. The basic principles of the healthcare system remain similar in Scotland to those in the rest of the UK, with (most) medical care and treatment provided free at the point of use, and funding allocated between localities within Scotland on the basis of assessed population healthcare needs. However, some different decisions on how much to spend and on how to organise and deliver healthcare services can and have been made. For example, prescription medication is free for all in Scotland (as well as in Northern Ireland and Wales), in contrast to England, where the majority of the working-age population is subject to prescription charges. And there has generally been lower use of private providers and less emphasis on patient choice in the Scottish healthcare system, and a greater emphasis on the integration of different parts of the health and social care system (although recent changes in England have also promoted integration).

Focusing first on long-run trends in health spending, Figure 4.1 shows real-terms spending per person on health in Scotland (the blue line), England (the yellow line) and Wales (the red line) between 1999–2000 and 2022–23 as estimated in HM Treasury's Country and Regional Analysis data series. The dashed lines then show our estimates of the planned levels of spending for 2023–24 and 2024–25 based on the Scottish, UK and Welsh budgets. These planned levels of spending should not be taken as final, since in all parts of the UK NHS funding is often topped up.

Figure 4.1. Real spending per person on health in Scotland, England and Wales



Note: Populations from 2022–23 onwards estimated using ONS population growth rate projections applied to 2021–22 population estimates. Planned funding for 2023–24 and 2024–25 estimated using the planned growth rates in the NHS Recovery, Health and Social Care portfolio for Scotland, the Department of Health and Social Care (DHSC) budget for England, and the health and social care main expenditure group for Wales.

Source: HM Treasury, Country and Regional Analysis (various),

<https://www.gov.uk/government/collections/country-and-regional-analysis>; Office for National Statistics, Estimates of the population for the UK, England, Wales, Scotland and Northern Ireland (various), <https://www.ons.gov.uk/peoplepopulationandcommunity/populationandmigration/populationestimates/datasets/populationestimatesforukenglandandwalesscotlandandnorthernireland>; Office for National Statistics, 2020-based interim national population projections: year ending June 2022 estimated international migration variant, <https://www.ons.gov.uk/peoplepopulationandcommunity/populationandmigration/populationprojections/datasets/2020basedinterimnationalpopulationprojectionsyearendingjune2022estimatedinternationalmigrationvariant>; HM Treasury, Autumn Statement 2023, <https://www.gov.uk/government/publications/autumn-statement-2023>; Welsh Government, Draft Budget 2024 to 2025, <https://www.gov.wales/draft-budget-2024-2025>; Welsh Government, Update on 2023–2024 financial position: summary of main changes, <https://www.gov.wales/update-on-2023-2024-financial-position-summary-of-main-changes>; Scottish Government, Scottish Budget: 2024 to 2025, <https://www.gov.scot/publications/scottish-budget-2024-25/>; Scottish Government, Scottish Budget 2023 to 2024: Spring Budget Revision, <https://www.gov.scot/publications/spring-budget-revision-2023-24/>.

We first consider the trends in Scotland. Health spending per person has risen considerably over time in Scotland, from £1,659 per person in 1999–2000 to £2,801 per person in 2019–20 (in 2022–23 prices). Most of the increase took place in the 2000s, with spending per person growing by an average of 5.0% per year in real terms between 1999–2000 and 2009–10. But from 2010–11, health spending per person fell in real terms for some years (2010–11 to 2014–15 and 2017–18 to 2018–19). Between 2009–10 and 2019–20, health spending per person overall therefore grew on average by just 0.4% per year in real terms, far slower than during the previous decade.

The Scottish Government has long committed to pass on NHS Barnett consequential to the Scottish NHS. However, the data do not allow us to assess this, as the definition of health spending differs from the NHS spending that this commitment is based on.

During the COVID-19 pandemic, health spending rose substantially in Scotland and peaked at £3,710 per person in 2021–22 before falling to £3,073 in 2022–23.<sup>3</sup> This includes specific pandemic spending, such as vaccination and contact tracing (Test & Protect). Although much lower than during the peak of the COVID-19 pandemic, real health spending per person was still 10% higher in 2022–23 than in 2019–20.

We estimate that the Scottish Budget implies that health spending per person will reach around £3,026 in 2024–25, still below its peak level in 2021–22, and lower than in 2022–23 and 2023–24. It is also possible, indeed probable, that the Scottish Government will announce top-ups to Scottish health spending in 2024–25: as discussed in Chapter 2, following in-year top-ups to the 2023–24 health budget, spending is now set to fall in real terms next year.

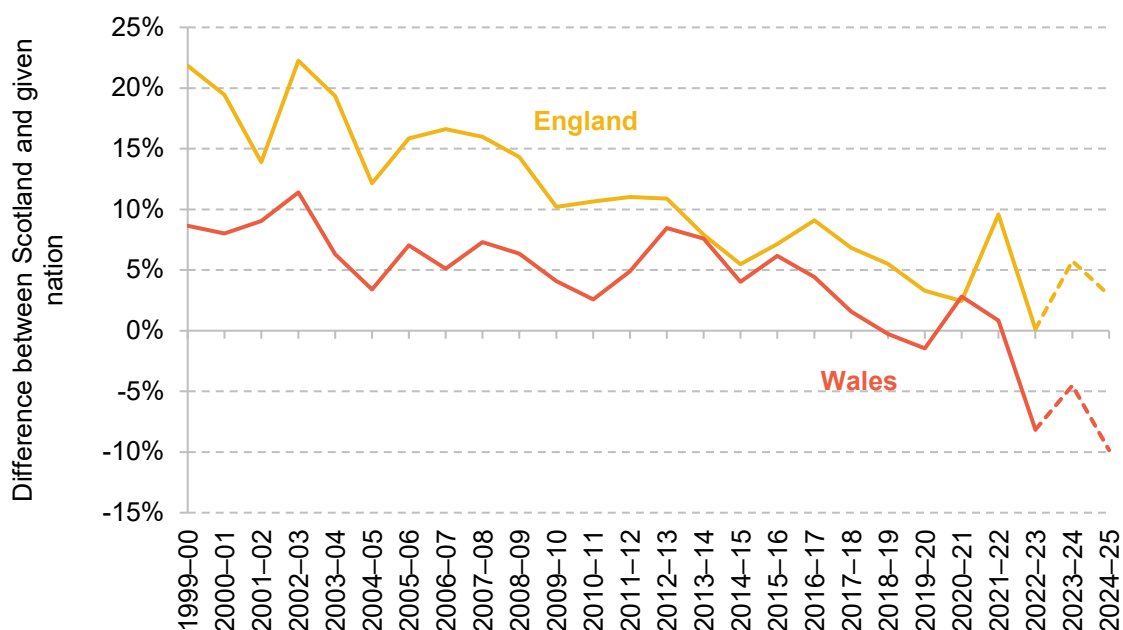
## Comparisons with England and Wales

At the outset of devolution, Scottish health spending per person was approximately 22% higher than health spending in England (Figure 4.2), equivalent to an extra £297 per person in Scotland. In the 25 years since, Scotland has continued to spend more on health per person than England, but this gap has fallen over time, and by 2022–23 England and Scotland spent almost the same on health per person.

Between 1999–2000 and 2009–10, health spending per person grew by 6.0% in England, compared with 5.0% per year in Scotland. This 1 percentage point faster annual growth in England meant that by 2009–10, Scotland spent 10% more per person on health than England, compared with 22% a decade before. Between 2009–10 and 2019–20, health spending per person grew at a slower rate in both countries, but was still faster in England, at 1.0% per year compared with 0.4% per year in Scotland. This meant that by 2019–20, Scotland spent just 3% more per person on health than England.

<sup>3</sup> Note that the fallback in estimated expenditure for both Scotland and the rest of the UK (rUK) in 2022–23 in HM Treasury’s Country and Regional Analysis data series is greater than in the Scottish Government’s ‘Government Expenditure and Revenue Scotland’ (GERS) data series (Scottish Government, 2023a). The reason for this discrepancy is not clear to us and should be investigated. Unfortunately, GERS does not separate rUK expenditure by country, so we must use the Country and Regional Analysis data series to make cross-UK comparisons.

Figure 4.2. Difference between health spending per person in Scotland and other nations



Source: See source to Figure 4.1.

During the COVID-19 pandemic, the gap between Scotland and England's health spending oscillated, falling in 2020–21 and growing in 2021–22. But the sharpest change was in 2022–23, when health spending per person fell by 9% in England and 17% in Scotland relative to the previous year. As a result, official estimates from HM Treasury suggest both countries spent a very similar amount on health per person in 2022–23. Although consistent with the long-run trend of a declining gap in health spending, this near-equality of spending in 2022–23 appears to be driven by fluctuations in health spending during the pandemic, rather than by a permanent shift in health spending patterns.<sup>4</sup>

Under Scottish and UK government plans, we estimate that the gap in spending will reopen a little, with Scotland spending 3% more than England per person on health in 2024–25. However, this should be treated with caution. It is likely that NHS funding plans in both countries will be topped up – as is almost always the case in England (Zaranko, 2021) – and so this gap may end up rather different.

Scotland has also tended to spend more on health per person than Wales, but this pattern has reversed in recent years. At the outset of Scottish devolution, Scotland spent 9% (£132) more per person on health than Wales. But by 2009–10, this had fallen to 4% (£106) more. In 2018–19 and 2019–20, Wales slightly overtook Scotland, with Scotland spending 1% less per person than

<sup>4</sup> Note that the Scottish Government's GERS publication suggests spending in Scotland was just under 2% above the average for the UK as a whole in 2022–23, and hence potentially around 2% higher than in England.

Wales in 2019–20. During the first two years of the COVID-19 pandemic, Scotland once again spent more than Wales, but this reversed in 2022–23, with Scotland spending an estimated 8% (£273) less than Wales per person. Under the current plans of the two devolved governments, we estimate that Scotland will continue to spend less than Wales in 2023–24 and 2024–25, spending 10% less per person than Wales in 2024–25.

Smaller increases in health spending in Scotland than in England in the 2000s may have reflected, to some extent, smaller overall increases in funding as a result of the ‘Barnett squeeze’ (whereby Scotland’s higher starting level of funding means the Barnett formula provides smaller percentage increases). However, during the 2010s, the Scottish Government’s overall funding was cut by less than funding for comparable services in England (Phillips, 2021). The smaller increases in health spending therefore allowed the Scottish Government to cut other areas by less (or increase them by more) than the UK government. For example, education spending per person was reduced by 5% in real terms during the 2010s in Scotland, compared with 22% in England (Farquharson, Phillips and Zaranko, 2021).

Scotland spends substantially more on adult social care than England. In 2022–23, Scotland spent £591 per person on adult social care compared with £403 per person in England (and £582 in Wales). This greater spending on adult social care in Scotland is at least in part due to the introduction of free personal care for the elderly in Scotland in 2002 and its extension to working-age adults in 2019. The gap in social care spending per person between England and Scotland has fluctuated over time, but Scotland has consistently spent more per person than England since the start of devolution. In 1999–2000, Scotland spent 27% more per person than England, rising to 34% more in 2019–20 and 47% more in 2022–23.

Although Scotland spent more than England in 2022–23 on adult social care, and this gap has been growing over time, this does not offset the large decline in Scottish health spending relative to England. Scotland spent 23% more per person on health and adult social care together than England in 1999–2000 and 13% more in 2009–10. In 2022–23, total spending on health and adult social care was an estimated 6% higher in Scotland than in England (£3,664 per person in Scotland versus £3,472 per person in England) according to official HM Treasury estimates. As with health spending, Wales still spends more than both Scotland and England when we include adult social care spending (£3,928 per person).

## 4.2 Trends in staffing, activity and performance

The last section showed that there has been a convergence in Scottish and English health funding since the advent of devolution. The last four years have seen healthcare systems across the UK

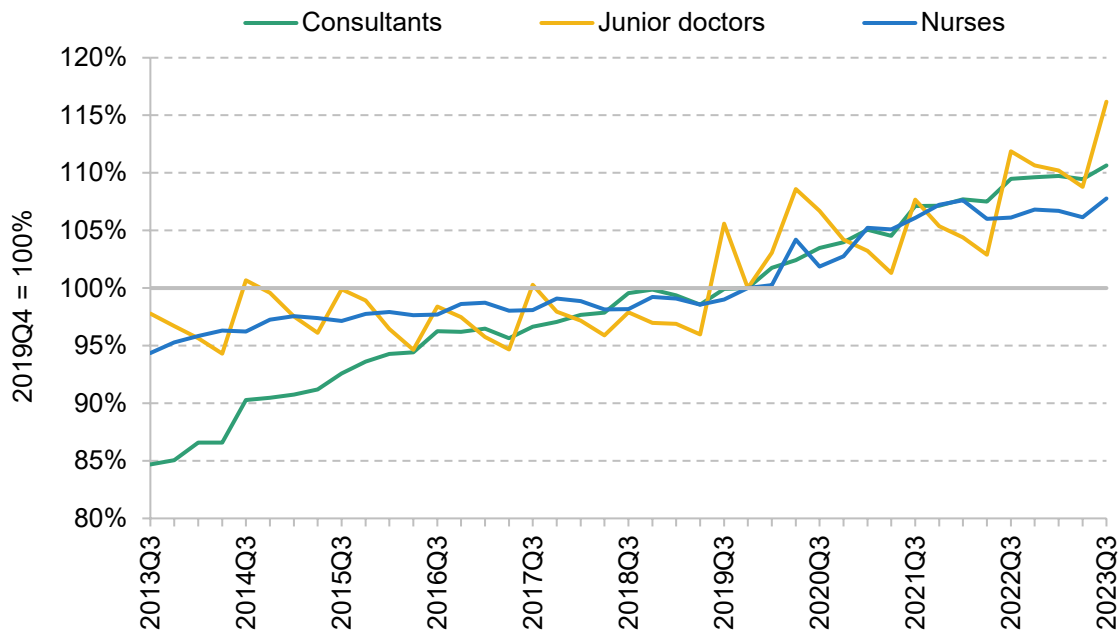
(and indeed the world) first have to respond to an unprecedented pandemic, and then attempt to recover and deliver services to a population that is growing older and less healthy. As a result, health spending in Scotland (and England) rose rapidly during the worst of the pandemic, and although spending has since fallen, it is planned to remain substantially above pre-pandemic levels.

Funding is important, but on its own it does not tell us how well a healthcare system is performing. In this section, we therefore examine trends in NHS staffing, activity and performance in Scotland. We consider how the NHS has changed since the start of the pandemic and, where data allow, we examine trends since the early 2010s. Where possible, we draw tentative comparisons with England, although these should always be treated with caution due to differences in data collection and definitions.

### Staffing

Staff – both clinical and non-clinical – are the largest area of NHS spending in Scotland. In 2019, 46% of its NHS Recovery, Health and Social Care budget was spent on staff costs, rising to 56% in 2023 (Scottish Government, 2023b). In this subsection, we examine how the number of staff working in the NHS has changed over time.

**Figure 4.3. Full-time-equivalent staff employed relative to 2019Q4: Scotland**



Note: ‘Nurses’ includes health visitors.

Source: TURAS Data Intelligence, 2023.

Figure 4.3 shows the number of full-time-equivalent (FTE) staff employed by NHS Scotland in three key staff groups relative to October–December 2019, the final quarter before the start of the COVID-19 pandemic. These data cover staff directly employed by the NHS – such as those working in NHS hospitals – but do not include many staff working in GP practices.

The number of consultants – the most senior doctors working in the NHS – has grown consistently since 2013. The NHS employed 4,670 full-time-equivalent consultants in July–September 2013 and 5,510 in October–December 2019 on the eve of the COVID-19 pandemic. In the latest available data, for July–September 2023, the NHS employed 6,100 consultants. This is 590 more than pre-pandemic, an increase of 11%.

The number of junior doctors – doctors who are still in training – has had a very different trajectory from the number of consultants, remaining approximately constant between 2013 and 2019 at an average of around 5,760. The number of junior doctors rose rapidly from July–September 2019, reaching 6,890 in July–September 2023, 16% higher than the pre-pandemic level. This increase in junior doctor numbers was likely driven by changes in the number of medical school places funded by the Scottish Government in the preceding years (Lewis, 2023).

The number of nurses has also risen consistently since 2013, though at a slower rate than the number of consultants. The NHS employed 54,390 nurses in July–September 2013 and 57,640 in October–December 2019. As with doctors, the number of nurses rose rapidly during the COVID-19 pandemic. In July–September 2023, the NHS employed 62,120 nurses, 8% more than pre-pandemic.

The NHS in Scotland therefore employs substantially more consultants, junior doctors and nurses than it did either in 2013 or prior to the COVID-19 pandemic in 2019. For nurses and junior doctors, the rate of growth in staff numbers has been much faster since the start of the pandemic. Some of this reflects that the NHS has substantially higher funding than it did pre-pandemic. But some of this is also driven by an increased share of the NHS budget going towards staffing – from 46% in 2019 to 56% in 2023 (Scottish Government, 2023b).

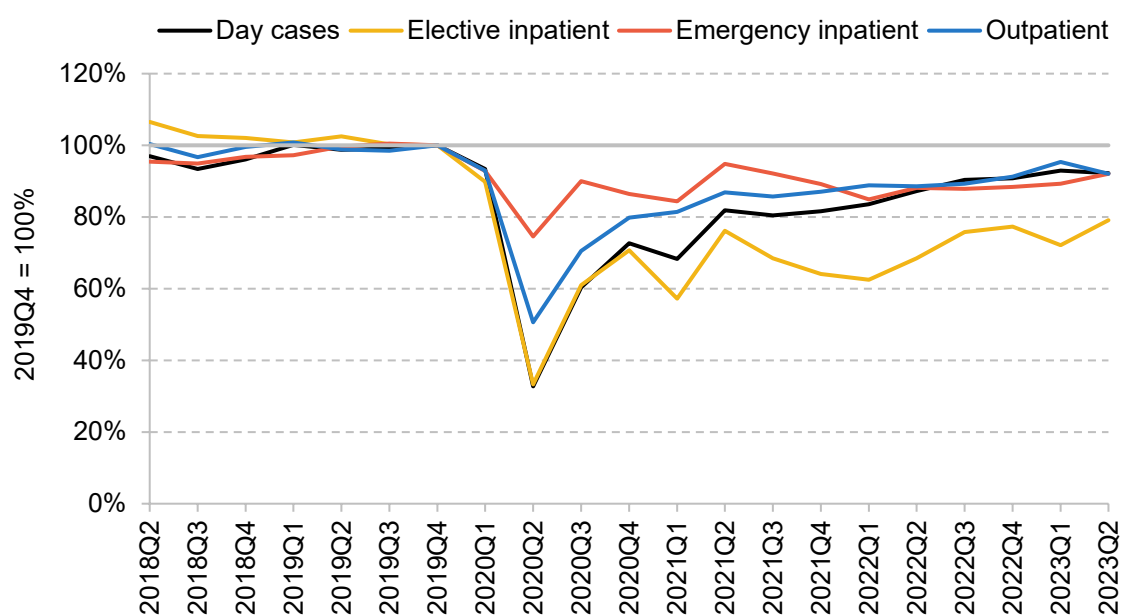
Although the number of staff has substantially increased since the start of the pandemic, there is still evidence of substantial workforce challenges. The turnover rate for all NHS staff has increased from 6.3% in 2019–20 to 9.4% in 2022–23. Over the same period, agency spending for medical and dental staff has risen by 16% and bank and agency spending for nurses and midwives has more than doubled (a rise of 111%, from £212 million to £447 million; TURAS Data Intelligence, 2023). In part because of these challenges, in 2022 the Scottish Government published National Workforce Strategy for Health and Social Care, which we will discuss in Section 4.3.



## Activity

With higher levels of funding and a larger number of staff, we would normally expect the NHS to deliver more and higher-quality care. But these increases in funding and staffing have occurred in the context of the COVID-19 pandemic, which put huge pressure on healthcare systems during 2020 and 2021, and continues to exert a large impact. We therefore now examine how NHS activity has changed over time, both pre- and post-pandemic. We focus on hospital activity as this is an important part of NHS activity and has the best recorded data.

**Figure 4.4. Treatment volumes relative to 2019Q4: Scotland**



Source: Public Health Scotland, 2023a.

Figure 4.4 shows how the number of patients treated in different types of care have changed relative to October–December 2019, the final data period before the start of the COVID-19 pandemic. The black line shows the number of day cases, pre-planned hospital treatment that does not require an overnight stay. The yellow line shows the number of elective inpatient admissions, pre-planned treatment that requires a stay in hospital. Together, these two categories make up elective, or pre-planned, hospital care. The red line shows the number of emergency inpatient admissions, emergency treatment that requires a stay in hospital. The blue line shows the number of outpatient appointments, treatment or consultation that is delivered without a stay in hospital.

Although we only have one-and-a-half years of pre-pandemic data, they suggest that the number of emergency admissions and day cases was rising, the number of outpatient appointments was approximately flat, and the number of elective admissions was falling. A falling number of

elective admissions is not necessarily a bad thing – it may reflect improvements that mean the same care can now be delivered as day cases.

At the start of the pandemic, all forms of hospital activity fell rapidly, particularly elective day cases and inpatient admissions. Although patient volumes for all four types of care have risen from their 2020 levels, they remained substantially below their pre-pandemic levels in 2023. In April–June 2023 (the latest available data), day cases, emergency inpatient admissions and outpatient appointments were all 8% below their pre-pandemic levels. Elective inpatient admissions were even lower, at 21% below their pre-pandemic levels.

Although data collection is still in development, the data that are available suggest that activity in primary care has also not returned to pre-pandemic levels. Between January and October 2023, there were 6% fewer direct interactions with GPs than over the same period in 2019, and 3% fewer direct interactions with other primary care professionals (Public Health Scotland, 2023b).

The NHS has therefore not yet managed to recover its activity to pre-pandemic levels. This is already a low baseline to compare activity with, because without the pandemic we would have expected most types of activity to have grown over time – in particular given the big increase in the number of consultants, junior doctors and nurses since the pandemic. Although hospital activity has increased over the last year of data, this has been slow. At the current rate of recovery, it would take several more years for the NHS just to return to pre-pandemic activity levels.

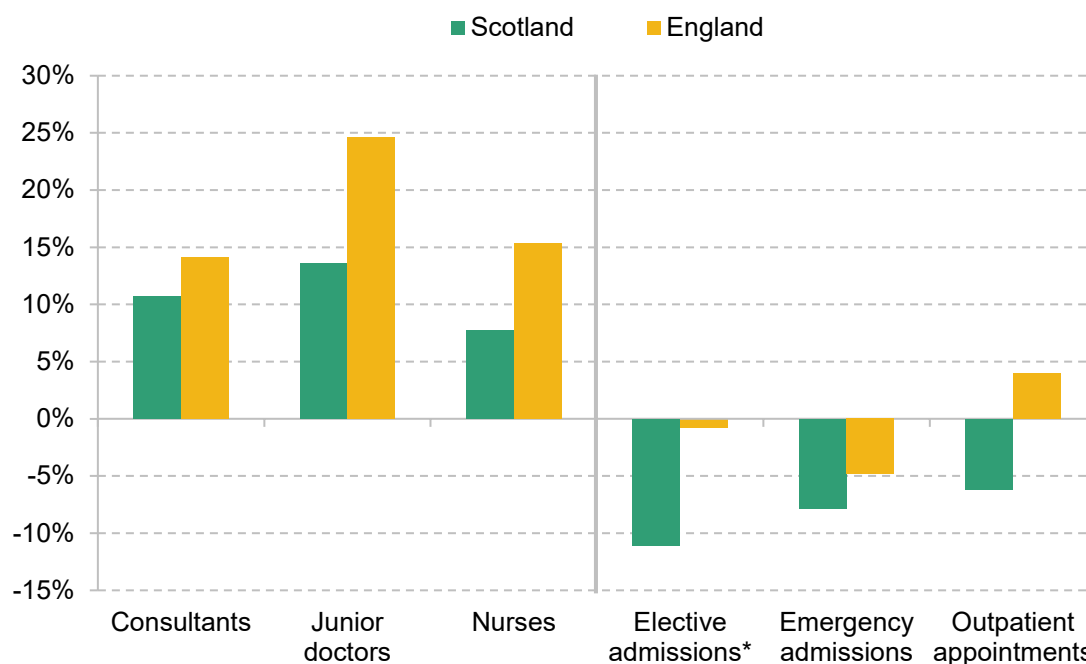
### Productivity

In the previous sections, we have shown three key trends: NHS funding and hospital staffing are substantially above their pre-pandemic levels, but hospital activity remains substantially below pre-pandemic levels. We now explore this potential fall in hospital productivity, how it compares with that in England, and potential explanations.

To summarise the changes, Figure 4.5 shows how the number of staff and hospital activity have changed between 2019 and 2023 separately for Scotland (the green bars) and England (the yellow bars). The data for each country are collected and defined in slightly different ways, so caution should be taken when comparing exact numbers, but the broad trends are illustrative.

Starting first with Scotland, as we showed earlier, staff in all three major clinical groups – consultants, junior doctors and nurses – are substantially above their 2019 levels. Over the same period, the numbers of elective admissions (day cases and elective inpatient admissions combined), emergency admissions and outpatient appointments are lower than their 2019 levels.

Figure 4.5. NHS inputs and outputs in January–June 2023 relative to 2019



Note: These are not the latest data for England, but chosen to be comparable to the data for Scotland. For closer comparability to England, elective admissions combine day cases and elective inpatient admissions for Scotland. \* Elective admissions for England also include maternity and other admissions.

Source: TURAS Data Intelligence, 2023; Public Health Scotland, 2023a.

This points to a large reduction in hospital productivity in Scotland, in the sense that more staff are treating fewer patients – a crude measure of labour productivity.<sup>5</sup> Lower productivity means the NHS can deliver less care for the same level of funding, or requires larger increases in funding to achieve increases in activity. When productivity appears to be going down in a public service that is as large and as important as the NHS, it is particularly concerning and especially so given the challenging fiscal situation the Scottish Government faces, as discussed in Chapter 3 of this report.

Turning to England, there was a much larger increase in NHS staffing over the same period. For example, the number of full-time-equivalent nurses was 8% higher than pre-pandemic levels in Scotland but 15% higher in England. The English NHS also had a smaller reduction in admitted patient volumes over this period, and outpatient volumes were above pre-pandemic levels. Note that this is not the most up-to-date data for England, since Scottish data are produced with a greater lag. More recent English data on patient activity are even higher (Warner and Zaranko, 2023a).

<sup>5</sup> See Warner and Zaranko (2023a) for a discussion of the limitations of this approach to measuring productivity in the context of the English NHS.

Taken together, the data suggest that NHS productivity has fallen by broadly the same amount in both Scotland and England. England has increased staffing by more than Scotland, but also has correspondingly higher treatment volumes – consistent with broadly the same reduction in activity per staff member.

NHS productivity has been widely discussed in England (Warner and Zaranko, 2022 and 2023a; Freedman and Wolf, 2023). This has in part led the Chancellor, Jeremy Hunt, to launch a review of public sector productivity more broadly. Many potential explanations for the observed fall in productivity have been proposed, but as yet there is no conclusive evidence of what the primary reasons are.

One likely explanation for part of the fall in productivity is that although staffing has increased substantially, other inputs have not increased to the same extent. In both Scotland and England, staffing has increased by far more than the number of hospital beds. In April–June 2023, NHS Scotland had 1.9% fewer hospital beds than pre-pandemic (Public Health Scotland, 2023a), compared with 8–14% more staff in the three key clinical staff groups. It seems plausible that additional staff are less effective at increasing activity if there are not additional hospital beds and other inputs for them to use, particularly if there is little spare capacity. This suggests that other inputs should be prioritised rather than just increasing staffing further.

Another potential explanation is that patients now have more severe and complex health conditions than pre-pandemic. If each hospital admission or outpatient appointment requires more healthcare to be delivered, this could explain why more staff are delivering a smaller number of admissions and appointments. In this case, productivity may not have fallen, because the actual level of healthcare being delivered may not have fallen, even though measured activity has. However, the change in severity would have to be substantial to fully explain the fall in measured NHS productivity in either Scotland or England. Evidence from England suggests that although there has been an increase in severity, the increase is in line with pre-pandemic trends (Mooney et al., 2023).

Hospitals are also still treating a non-trivial number of patients with COVID-19, and this may reduce hospital productivity. Evidence from England finds that COVID patients on average spent 8.6 more days in hospital than non-COVID emergency admissions in 2022, adjusting for age and clinical complexity (Mooney et al., 2023). These longer stays reduce the number of other patients that can be treated. Indirectly, measures to prevent the spread of COVID-19 within hospitals, such as the use of PPE and testing those with COVID-like symptoms, may also hinder the ability of staff to treat non-COVID patients.

Difficulties in discharging patients, and more generally issues in patient flow, may also be reducing NHS productivity. If beds are occupied by patients who no longer need to be in

hospital, this will reduce the number of patients that the NHS is able to treat. In November 2023, there were 1,910 people delayed in Scottish hospitals, 28% more than in November 2019 (Public Health Scotland, 2023c).

Overall, the available evidence suggests that NHS hospital productivity in Scotland has fallen: despite large increases in staffing and funding, the NHS is treating fewer patients than pre-pandemic. This fall is similar to the observed fall in hospital productivity in England. There are many potential explanations, but as yet little conclusive evidence for the relative importance of each factor. Nonetheless, improving hospital productivity should be a major policy focus. Unless the causes can be diagnosed and effectively treated, the risk is that the NHS will go on providing less care with the same (or additional) resources.

## Waiting times and waiting lists

In the previous subsections, we have focused on hospital activity, i.e. the quantity of care provided. But the quality of hospital activity also matters.<sup>6</sup> There are a number of different aspects of quality, including clinical effectiveness and patient experience. Here, we focus on another relevant aspect of quality, the length of time that people must wait for treatment. This is another way of measuring how well the NHS in Scotland is performing.

We first consider waiting lists for pre-planned (elective) treatment from NHS hospitals. Figure 4.6 shows the size of the waiting list for NHS treatment since December 2012, separately for inpatient admissions / day cases and new outpatient appointments.

Both the inpatient and outpatient waiting lists had risen substantially pre-pandemic. In December 2012, there were 45,500 waiting for inpatient treatment and 209,100 waiting for outpatient appointments. In December 2019, this had risen to 80,000 waiting for inpatient treatment and 281,700 waiting for outpatient appointments, increases of 76% and 35% respectively. The inpatient waiting list had risen consistently between 2012 and 2019, while the outpatient waiting list had remained relatively constant after its peak in 2017.

Waiting lists fell slightly at the start of the COVID-19 pandemic, as the number of referrals fell rapidly in the first half of 2020. Waiting lists then started to grow much faster than before the pandemic as referrals overtook treatment volumes. In September 2023, the latest available data, there were 151,100 waiting for inpatient treatment and 525,700 waiting for outpatient appointments. These are both up by almost 90% compared with pre-pandemic levels. Although

<sup>6</sup> Measures of productivity should also account for the quality of healthcare provided, which our simple analysis of hospital productivity above does not do. However, in all the cases examined in this subsection, quality has fallen, suggesting quality-adjusted hospital productivity may have fallen even further than our analysis in the previous subsection suggested.

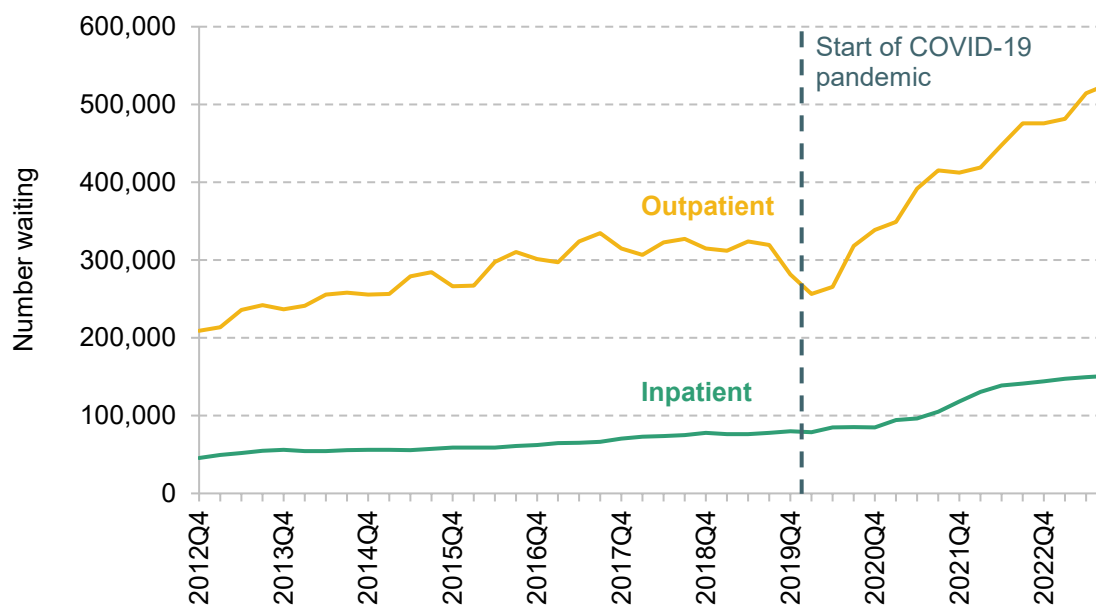
not directly comparable because different definitions are used for which activity is included, the elective waiting list in England grew by 70% over the same period.

Waiting lists therefore grew rapidly from the middle of 2020, and likely by more in Scotland than in England. This is perhaps not surprising given that funding and staffing are further above pre-pandemic levels in England than in Scotland, and Scotland has had a slower recovery in hospital activity. While elective hospital activity continues to be below pre-pandemic levels (Figure 4.4), waiting lists are likely to continue rising. And even returning to pre-pandemic levels of activity will likely not be enough, because waiting lists were already rising before the pandemic.

As waiting lists have risen, so has the average length of time that people wait for pre-planned treatment. For example, in September 2023, the median wait of someone on the waiting list for day-case or inpatient treatment was 166 days, compared with 54 days in December 2019.

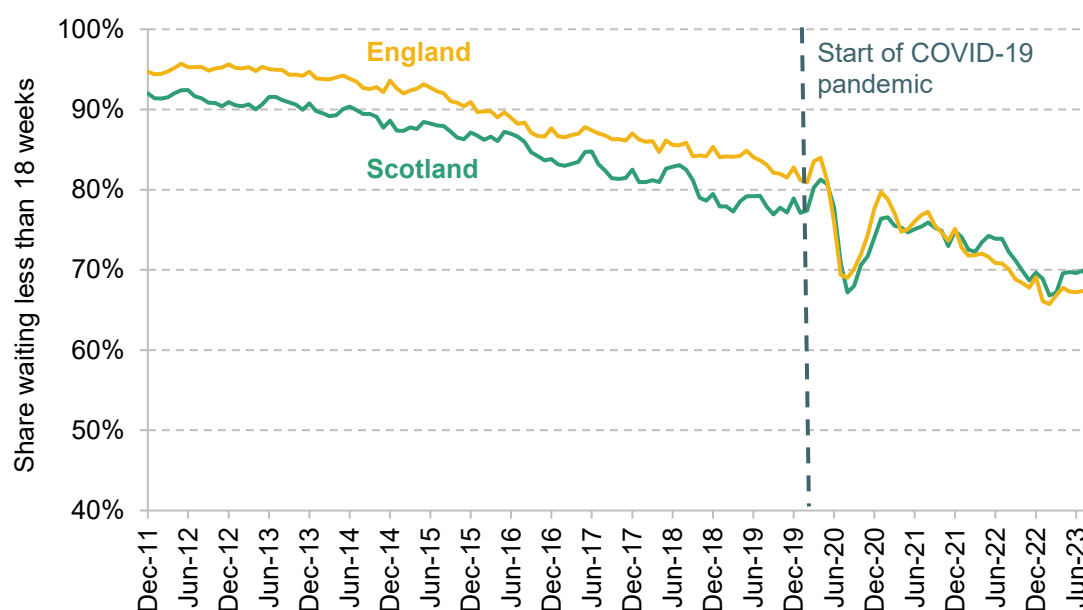
The Scottish NHS has a target that 90% of patients should be treated within 18 weeks of referral. Figure 4.7 shows the percentage of treated patients waiting less than 18 weeks in both Scotland and England. Note again that Scotland's and England's data are not perfectly comparable, but the trends are still informative about relative performance of the two healthcare systems.

**Figure 4.6. Waiting lists for NHS treatment in Scotland**



Source: Public Health Scotland, 2023d.

Figure 4.7. Percentage of patients waiting less than 18 weeks



Note: Scottish figures exclude NHS Tayside July to December 2017 and NHS Grampian March 2020 to June 2022. English figures are adjusted for missing data.

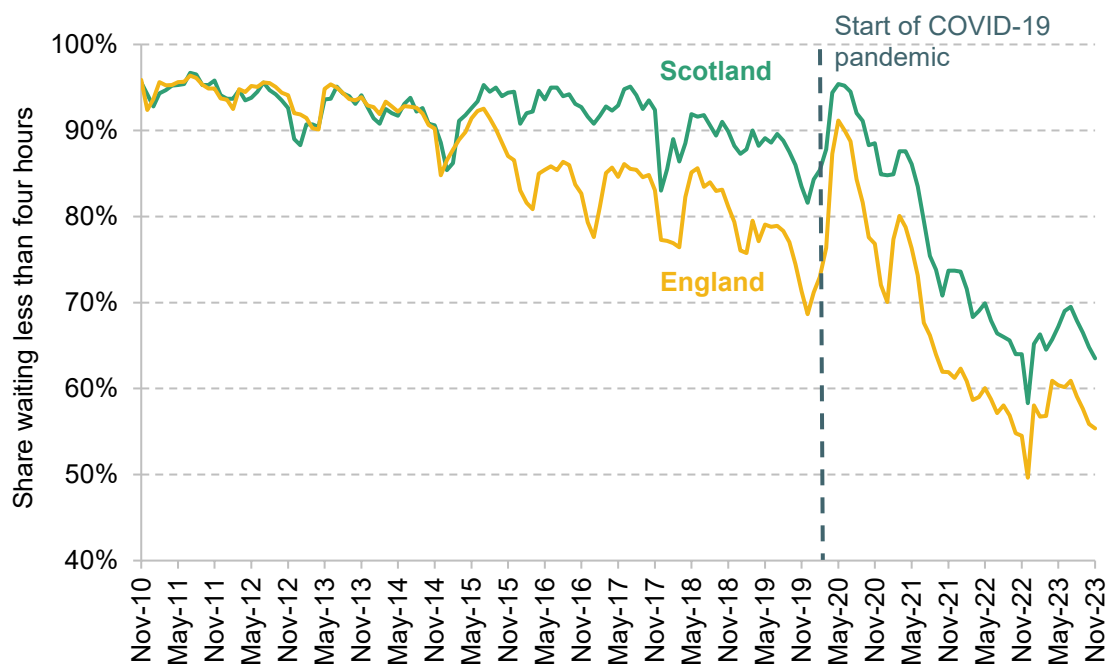
Source: Public Health Scotland, 2023e; NHS England, 2023a.

For both Scotland and England, waiting time performance was declining pre-pandemic. In Scotland, 92% of patients were treated within 18 weeks in December 2011, falling to 79% in December 2019. Performance declined steeply during the pandemic, before partially but not fully recovering. In the latest available data, for September 2023, 68% of patients were treated within 18 weeks in Scotland.

Waiting time performance has therefore declined substantially in Scotland since the start of the COVID-19 pandemic. As with the total size of the waiting list, this is unlikely to improve until hospital activity increases significantly above pre-pandemic levels. Although the total waiting list has grown by a smaller amount in England and elective treatment volumes are higher, Figure 4.7 suggests that waiting time performance has declined by more in England than in Scotland.

It may seem surprising that waiting times have worsened more in England, despite Scotland having a slower recovery in elective activity and, if anything, a larger increase in the total size of the waiting list. However, the relationship between the size of the waiting list and the distribution of waiting times is complex. It is possible for the waiting list to rise and the share waiting less than 18 weeks to either rise, fall or stay the same. Much depends on which types of patients are prioritised to receive treatment. Both health systems have introduced targets to eliminate the longest waits first. This is an important objective, but on its own will not improve performance against the 18-week target.

Figure 4.8. Percentage of patients waiting less than four hours in A&amp;E departments



Note: Only includes major 'type 1' A&E departments.

Source: Public Health Scotland, 2023f; NHS England, 2023b.

Finally, we consider the times that individuals have to wait to receive emergency healthcare in Accident and Emergency (A&E) departments. The Scottish NHS has a target that 95% of people attending A&E should be treated within four hours. Figure 4.8 shows the percentage of patients waiting less than four hours in major A&E departments in both Scotland and England.

As with elective waiting times, A&E waiting time performance was declining in both Scotland and England pre-pandemic, but by more in England. In February 2020, 85% of A&E attendances in Scotland waited less than four hours, while the figure was 73% in England.

Since the start of the COVID-19 pandemic, A&E waiting time performance has decreased further in both countries. In November 2023, 64% of patients waited less than four hours in Scotland, and 55% waited less than four hours in England. A&E waiting time performance was therefore worse in England than in Scotland. But Scotland started from a much higher pre-pandemic baseline, and so the decline in performance since the start of the pandemic was substantially greater in Scotland.

This section has shown that NHS performance, as measured by waiting times and waiting lists, has declined substantially in Scotland since the start of the pandemic. While hospital treatment volumes remain below pre-pandemic levels, it is likely that the elective waiting list will continue to grow. England has seen a smaller increase in the elective waiting list than Scotland since the



start of the COVID-19 pandemic, but elective and A&E waiting times are somewhat better in Scotland than in England. This suggests that neither healthcare system is obviously performing better than the other, while all indicators consistently point to both healthcare systems doing much worse than pre-pandemic despite an increase in resources.

### 4.3 The outlook

In this section, we consider the outlook for Scottish healthcare spending and workforce in the coming years. We have long known that an ageing population, as well as pressures on the costs of providing services, will mean health spending would have to increase over time to maintain the same service provision. Our medium-term analysis of the funding outlook for Scotland contained in Chapter 3 of this report shows that health is set to squeeze the funding available for other services, even under relatively modest assumptions about growth in healthcare spending over the next four years.

Over the very long term, the Scottish Fiscal Commission (2023) projects that health spending will grow from 35% of the Scottish Government budget in 2027–28 to 50% by 2072–73. This is equivalent to an average 2.6% a year real-terms growth in funding. These increases are mainly driven by higher real wages paid to healthcare staff and other cost pressures, although demographic pressures are also projected to increase costs in the 2030s and 2040s.

Last year, the UK government set out its NHS long-term workforce plan for England, covering 2021–22 to 2036–37. For the first time, this set out official estimates of how large the government thinks the NHS should be over time (as opposed to fiscal watchdogs' estimated spending pressures). The plan aims to increase the number of staff employed by the English NHS from 1.5 million in 2021–22 to between 2.3 and 2.4 million in 2036–37. This is a 58–64% total increase in staffing, equivalent to an annual increase of between 3.1% and 3.4% per year. Warner and Zaranko (2023b) estimate that under a central set of assumptions, this implies an average real-terms spending increase of 3.6% per year.

The Scottish Government set out its own National Workforce Strategy for Health and Social Care in Scotland in 2022. This included far less modelling than the English plan, but set out an objective to grow the NHS workforce in Scotland by 1% over five years. Over the same period, the English plan implies a workforce growth of 20–21%. Recently, the Scottish Cabinet Secretary for NHS Recovery, Health and Social Care said that he did 'not anticipate any significant workforce growth over the medium term', in part given the large increases in workforce since the start of the pandemic (Scottish Government, 2023b).

There is therefore a striking difference in NHS workforce plans between the Scottish and UK governments – the English plan wants to increase the NHS workforce by around 20% over five

years, while the Scottish plan wants to increase it by 1%. Some of this may be explained by the English NHS having larger unmet need for staffing than Scotland, but the Scottish workforce also has rising agency and bank staffing costs.

It is likely that the Scottish Government will face pressure to increase NHS staffing in the coming years. On the available metrics, the post-pandemic performance of the Scottish NHS is close to England's, and the post-pandemic recovery of hospital activity is still lagging behind England. This suggests that Scotland is likely to need to either up its planned increases in staffing and spending, find ways to boost productivity significantly faster than is being planned in England, or live with a relative deterioration in NHS service quality. But lower hospital productivity since the start of the pandemic also suggests that Scotland should ensure there is sufficient investment in capital and other inputs, alongside additional staffing.

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# 5. Higher education spending

Kate Ogden and Madeline Thomas<sup>1</sup>

Education is a ‘devolved matter’ in the UK, and there has been growing divergence in education policies among the four parts of the UK since 1999. The Scottish Government has made starkly different policy decisions on how higher education should be funded, and how the costs should be shared between graduates and taxpayers, in part reflecting different priorities and objectives. Indeed, higher education is one area where Scotland’s public service provision has long appeared more generous than that in England, with students who choose to stay in Scotland for university not required to pay any tuition fees. Instead, the costs of their teaching are all met by the Scottish Government, at a cost of around £900 million each year. In addition, Scotland still provides the poorest students with non-repayable bursaries of up to £2,000 per year towards their living costs, alongside income-contingent loans of at least £6,000 per year.

Recently announced changes will see the system become *more* generous for students and graduates next year. First, students will be eligible for larger living costs loans, delivering on a 2021 commitment to provide a total package of student support ‘the equivalent of the Living Wage’ by 2024–25. Second, the loan repayment threshold (above which graduates make repayments on their loans) will increase from £27,660 to £31,395 in April 2024, reducing monthly repayments for many graduates. Importantly, under current funding arrangements, the UK government provides up-front funding for loans issued to Scottish students, and ring-fenced funding for any eventual loan write-offs. This means increases in generosity through the loan system do not impact the amount the Scottish Government has to spend on competing policy priorities, as determined at the Scottish Budget each year.

But under the current system of free tuition, the Scottish Government does cover the full costs of teaching for Scottish undergraduates who study in Scotland. The Scottish Government controls these tuition costs in two ways: through control of per-student funding and by restricting the number of funded places. Per-student funding has been gradually eroded over the last decade, with further funding cuts announced in the 2024–25 Budget, implying cuts to the number of funded places.

<sup>1</sup> The authors thank Carl Emmerson and David Phillips for helpful comments, and Ben Waltmann for his work developing the IFS Student Finance Calculator for England, upon which the IFS Scotland Student Finance Calculator has been built. All opinions and any errors or omissions are those of the authors alone.

In this chapter of our second annual Scottish Budget Report, we explain how higher education is funded for Scottish students who stay in Scotland to study. We consider issues related to living cost support (for which the Scottish Government has provided much additional support in the Budget) and issues around funding for teaching that remain unresolved. We draw on new modelling of student loan repayments to examine the distributional consequences of the current funding model, and to consider potential policy options in light of the pressures on the Scottish Budget highlighted in Chapter 3.

## Key findings

1. The Scottish Government spends around £900 million each year on teaching Scottish undergraduates, through the main teaching grant and a notional tuition fee which is paid on behalf of Scottish students who stay in Scotland for their studies. Unlike in the rest of the UK (where students are charged tuition fees), the Scottish Government meets the whole costs of teaching, and has controlled these costs in recent years by controlling the number of places for Scottish students and freezing per-student resources. Funding per student per year of study has fallen by 19% in real terms since 2013–14 and, as a result, Scottish universities are increasingly reliant on international student fees.
2. A cut to higher education resource funding (the budget line that includes the main teaching grant) was announced at the Scottish Budget for 2024–25. This is a cash-terms cut of 6.0% compared with initial planned spending in 2023–24, or of 3.6% year-on-year accounting for in-year savings that had already been made this year since the 2023–24 budget was initially set out. This implies that funding for home students will fall, with the Scottish Funding Council (which allocates funding to universities) trading off a further squeeze on per-student resources with potential cuts to the number of funded places.
3. Around £600 million is provided in the form of living cost support to students each year, the vast majority in the form of living cost loans (£500 million), alongside non-repayable bursaries of up to £2,000 per year for the poorest students. Living cost support has become less generous over time, with total support for the poorest students declining in real terms by 16% (£1,600 per year) between 2013–14 and 2022–23, and further implicit cuts due to the freezing of the household income thresholds that determine entitlements.

4. A £900 cash increase in loan entitlements this academic year, in response to cost of living pressures, was the first real-terms increase in support since at least 2013–14. A much bigger increase of £2,400 per year is planned for next academic year. This delivers the Scottish Government’s commitment to provide a total package of student support ‘the equivalent of the Living Wage’ by 2024–25. The earnings threshold above which Scottish borrowers make student loan repayments is also set to increase in April 2024, from £27,660 to £31,395. If there was full take-up of living cost support, these changes would *increase* average lifetime loan repayments in real terms by around £5,000, and increase average loan write-offs by around £3,400 per student.
5. Importantly, the costs of issuing loans to Scottish students, and of any eventual loan write-offs, are currently met by the UK government. Increases in generosity of support or in repayment terms for Scottish borrowers of the type planned for 2024–25 come at no cost to the Scottish Government’s main budget so long as this funding arrangement continues.
6. Given the system applying in 2024 (and assuming full take-up of living cost support) and the Office for Budget Responsibility’s assumptions about inflation and earnings growth, we expect around two-thirds of Scottish borrowers to repay their loans in full. The highest-earning half of graduates will repay approximately what they borrowed in real terms (£34,000), with much lower average lifetime repayments (£4,900) amongst the lowest tenth of graduates by lifetime earnings.
7. This system costs the Scottish Government around £850 million more per cohort (£28,700 more per student) than the English system would. From this spending, Scottish graduates on average gain £23,800 (largely through lower borrowing and loan repayments), and the UK taxpayer gains £4,900 per student in the form of lower loan write-offs.
8. Under the current ‘free tuition’ system, increased teaching resources for home undergraduates can come only through additional cash expenditure from the Scottish Government. Requiring some contribution from students towards the costs of their tuition could deliver a significant boost to teaching resources, or ease pressure on the Scottish budget. But this would increase lifetime contributions from Scottish graduates or mean much higher loan write-offs, potentially risking the arrangement under which the cost of these write-offs is met by the UK government.

## 5.1 How is Scottish higher education funded?

In this section, we describe how higher education in Scotland is funded currently, focusing on the vast majority of undergraduate students who stay in Scotland to study.<sup>2</sup> We examine recent trends in funding for teaching and living cost support, changes planned for the 2024–25 academic year, and how this spending affects the Scottish Government’s main budget.

### Teaching costs

The most striking feature of how higher education is funded in Scotland is the absence of tuition fees for most Scottish students. For those who choose to stay in Scotland for their studies, the full costs of undergraduate teaching are met by the Scottish Government.

Technically, Scottish universities charge ‘home fee’ students a tuition fee of £1,820 per year. However, the Student Awards Agency Scotland (SAAS), an executive agency of the Scottish Government, pays these tuition fees on behalf of most Scottish undergraduate students working towards their first degree. In 2022–23, SAAS paid tuition fees for 117,000 full-time undergraduate students, at a total cost of £200 million. In addition, the Scottish Government also provides funding to the Scottish Funding Council, which distributes this to universities (much as the Office for Students does in England). The main teaching grant was worth £700 million (or just under £5,800 per student) in both 2022–23 and 2023–24.

Together, Scottish universities received direct public funding of around £900 million for teaching home undergraduate students in academic year 2023–24, or £7,610 per student. Figure 5.1 shows that this was around 19% less in real terms per student than in 2013–14, as the tuition fee has been fixed in cash terms at £1,820 since 2009–10 and the main teaching grant per student has risen by less than inflation.

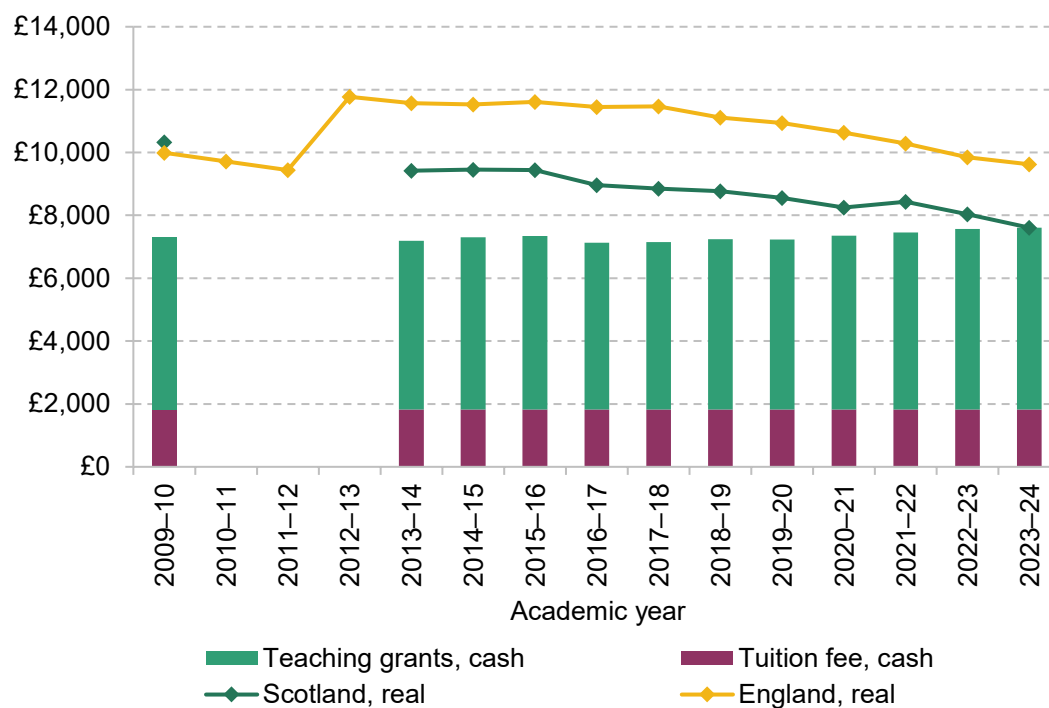
This is also around £2,020 (21%) lower than the per-year resources available for an English university teaching an England-domiciled undergraduate in 2023–24.<sup>3</sup> Annual resources for undergraduate teaching were similar north and south of the border in 2009–10, before the increase in tuition fees charged by English universities from 2012–13 injected additional funding. Since then, the trends – a gradual erosion of resources, with fees frozen and below-inflation increases in grants – have been similar.

<sup>2</sup> Of the 115,000 Scotland-domiciled full-time undergraduates studying for their first degree at a university in the UK in 2021–22, 96% were studying in Scotland.

<sup>3</sup> Although note that the typical undergraduate degree lasts for four years in Scotland, compared with three years in the rest of the UK. Resources over the course of a typical degree are more similar, at around £30,000. See Ogden and Phillips (2023).



Figure 5.1. Up-front per-student resources for teaching per year



Note: Tuition fee for 'home fee' full-time first degree student from SAAS, plus main teaching grant divided by the number of 'funded' places. Data not available for years 2010–11 to 2012–13. Real-terms figures based on financial year GDP deflator. Figures for England reflect Office for Students grants, the tuition fee cap and estimated bursaries and fee waivers funded by English universities (which reduce resources available for teaching).

Source: Scottish Funding Council's university final funding allocations (various years); Drayton et al. (2023); <https://www.gov.uk/government/statistics/gdp-deflators-at-market-prices-and-money-gdp-november-2023-autumn-statement>.

Importantly, the Scottish Funding Council allocates each university a number of 'funded places' for eligible Scottish students, which attract funding from the main teaching grant. Universities are able to recruit up to 10% above this number, receiving only around a quarter of the average per-student funding for them, and then face financial penalties for recruitment beyond this.<sup>4</sup> This restricts the number of Scotland-domiciled students Scottish universities can recruit, controlling the costs of teaching for the Scottish Government – which is especially important given all of these costs are met by the government, rather than through loans. No such caps exist in England or Wales.

In contrast, universities in Scotland can charge students from the rest of the UK (rUK) tuition fees of up to £9,250 per year, and international students much more, and face no caps on

<sup>4</sup> According to the conditions of funding (Scottish Funding Council, 2023), once a university exceeds its student numbers beyond a specific tolerance, a portion of its main teaching grant is withdrawn which is equivalent to the estimated tuition fee income generated by the excess number of students. Recruiting an additional student therefore leads to no net change in total university funding.

numbers.<sup>5</sup> At the margin, a Scottish university receives much more funding for teaching an additional rUK or international student than an additional Scottish student. This means Scottish universities have a financial incentive to expand provision, but not for Scottish students.<sup>6</sup>

As per-student resources for teaching home students have been eroded over time, international student fees have become increasingly important for the finances of many Scottish universities. Fees for teaching students from outside Scotland were worth around £1,413 million to Scottish universities in the 2021–22 academic year, accounting for around 30% of their total income.<sup>7</sup>

The ability of Scottish universities to attract international students has so far allowed their fees to cross-subsidise the teaching of home undergraduates. This has also been the case at many English universities, such that the UK government now faces an acute trade-off between funding for English universities and reducing headline net migration figures (Emmerson et al., 2024).<sup>8</sup> The sustainability of the university funding model in Scotland also depends partly on the UK's immigration policy, over which the Scottish Government does not have control.

### Planned changes in 2024–25

The tuition fee for home fee students is expected to remain at £1,820 in 2024–25 (a slight real-terms cut). The size of the main teaching grant and the number of funded places are yet to be confirmed. However, the main teaching grant sits within the Scottish Government's 'HE Resource' budget, and movements in this budget line provide a good indication of what might happen to teaching funding next academic year.<sup>9</sup>

Planned HE Resource spending at the 2023–24 Budget was £809 million for the 2023–24 fiscal year, £20 million more in cash terms than the budget for 2022–23 (Scottish Government, 2023a). However, the 2023–24 spending plans have been reduced since they were first set; in May 2023, the Scottish Funding Council confirmed that this extra £20 million had been identified as a

<sup>5</sup> For medicine, the intake target for each university, and the unofficial numbers cap, include all home fee, rUK and Republic of Ireland entrants. For subjects that are expensive to teach, universities are compensated by the Scottish Funding Council for the difference between the tuition fee cap for rUK students and the assumed cost of teaching.

<sup>6</sup> Including undergraduate and postgraduate students, and both part- and full-time students, 39% of those enrolled at Scottish providers in the 2021–22 academic year were not Scotland-domiciled, compared with 34% in 2014–15. ([HESA student enrolments](#), DT051 table 1.)

<sup>7</sup> This varied substantially by university: from around 2% at the University of the Highlands and Islands, to as high as 39% at St Andrews and 48% at Heriot-Watt. Around 80% of non-Scottish fees were from students from outside the UK and the EU. ([HESA finance statistics](#), DT031 tables 1 and 6.)

<sup>8</sup> Tuition fees from non-UK students accounted for 22% of the total income of English universities in 2021–22.

<sup>9</sup> Planned HE resource spending at the 2023–24 Budget was £809 million for the 2023–24 fiscal year, compared with main teaching grant of around £700 million in both 2022–23 and 2023–24 academic years. Funding for tuition fees paid on behalf of students is recorded elsewhere in the budget ('Student Support and Tuition Fee Payments').

necessary in-year saving by the Scottish Government and would not be distributed to universities.<sup>10</sup> This leaves planned HE Resource spending in 2023–24 at £789 million.

Figures in the Scottish Budget 2024–25 show the budget for HE Resource falling further to £761 million in 2024–25. This is a cash-terms fall of 6.0% compared with the original budget for 2023–24, or (as is a better indicator of the change in resources from one year to the next) of 3.6% year-to-year accounting for in-year cuts.

A further squeeze on real-terms per-student funding is likely, and the supporting documents to the 2024–25 Budget mention reductions in first-year university places. Exactly how the planned savings will be shared between these two – reductions in funding per place and in the number of places – will be confirmed in university funding allocations, with indicative allocations typically published in April.

### Living cost support

Students can also access financial support towards their living costs while they study – through a combination of loans and non-repayable bursaries from SAAS.<sup>11</sup> In 2023–24, those classed as Young Students (broadly someone under the age of 25 who has not supported themselves financially for three years, is not married and does not have dependent children) are entitled to borrow either £6,000 or £7,000 per year of study. Those with low household incomes (typically parental incomes) are also entitled to non-repayable bursaries of between £500 and £2,000 per year.

As shown in Figure 5.2, total support available varies from £6,000 (for anyone with household income over £34,000) to £9,000 per year. Support varies discontinuously based on household income; there are sudden changes in entitlements at specific income thresholds. Someone with a household income of just over £34,000 would receive £1,500 less support per year than someone with a household income of just under £34,000. This creates unfairness and reduces work incentives for those with incomes close to these arbitrary thresholds which, if understood by households, could induce some to reduce their earnings.

Unlike in England and Wales, where a student living away from home receives more funding, and studying in London even more, entitlements for Scottish students do not depend explicitly on where a student lives. Instead, they depend on whether someone is classed as a Young Student (as described above) or an Independent Student. Those in the latter group are typically

<sup>10</sup> This funding was instead ‘redeployed’ to support teachers’ pay pressures (Scottish Government, 2023b, page 6).

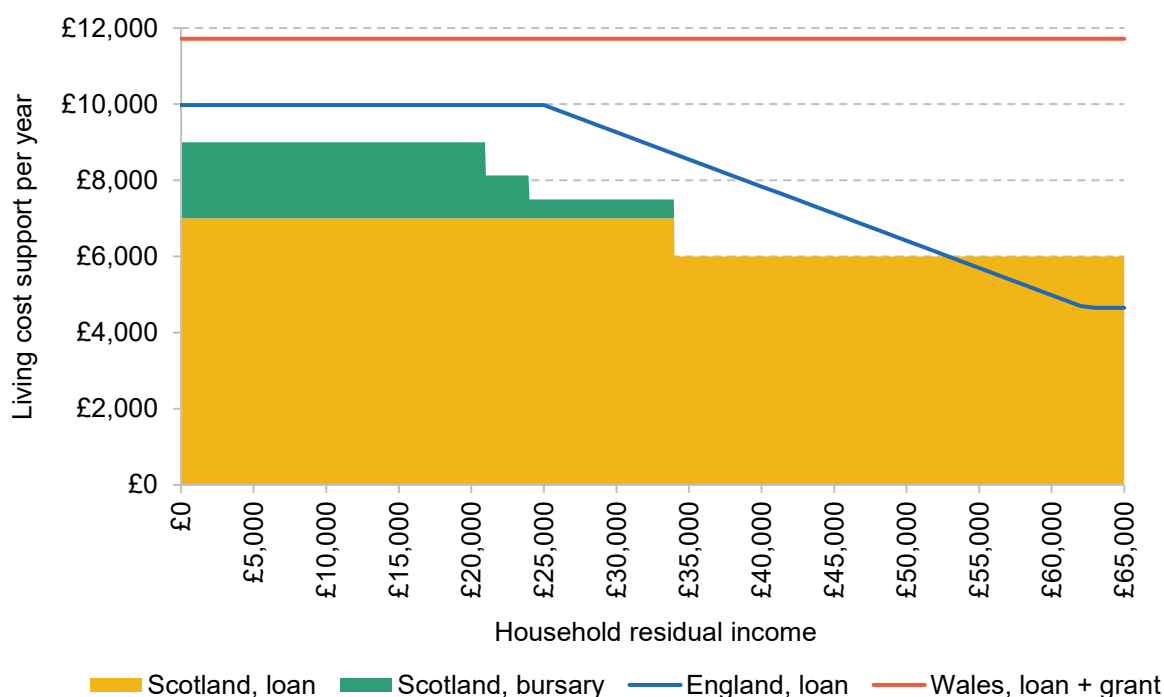
<sup>11</sup> Students apply to the SAAS for both bursaries and loans. The loans are then administered by the UK-wide Student Loans Company.

eligible for the same total level of living cost support, but a greater share of this is provided as loan rather than grant.<sup>12</sup>

The total amount of support available to an equivalent student also varies substantially in different parts of the UK, as shown in Figure 5.2. Many Scottish students in 2023–24 are entitled to less total support than an equivalent English student, although a small portion of the Scottish support would be provided in the form of a grant for some. In Wales, student support is significantly more generous, with all students entitled to total support of £11,720 in 2023–24, and every student entitled to a non-repayable grant of at least £1,000, increasing to £8,100 for the poorest.

A range of other funding is available to Scottish students based on their personal circumstances. For instance, there are grants available for students who have a disability, are carers or are lone parents. Students who are under 25 and permanently estranged from their parents are entitled to an Estranged Students' Bursary of £1,000 and a living cost loan of up to £8,000. Any student who has ever been looked after by a local authority before the age of 18 is eligible for a Care Experienced Students' Bursary of £9,000, instead of a living cost loan or other bursary.

**Figure 5.2. Entitlements to living cost support by household income, academic year 2023–24**



Note: Entitlements for Young Students in Scotland, and for England- and Wales-domiciled students living away from home and not attending a London university.

Source: <https://www.saas.gov.uk/full-time/undergraduates/student-loan-bursary-tuition-fees>; Bolton, 2024.

<sup>12</sup> The exception is students with a household income of between £21,000 and £23,999. In this range, Young Students receive total support of £8,125 and Independent Students £8,000.

As shown in Table 5.1, £511 million of living cost loans were issued to full-time students by SAAS in 2022–23, along with bursaries and grants totalling £85 million. Around two-thirds of students receiving some support from SAAS in 2022–23 (including having tuition fees paid on their behalf) received some living cost loan that academic year. This implies much lower take-up of living cost loans than the take-up of maintenance loans in either England (91%) or Wales (94%), and contributes to lower loan borrowing amongst Scottish students (something we return to in Section 5.2).<sup>13</sup>

**Table 5.1. Living cost support provided to full-time students by SAAS in 2022–23**

	£m	Number of students	% of all students	Average £ per recipient
Living cost loans	511.1	91,425	67.0%	£5,590
Young Students' Bursary	39.5	26,275	19.3%	£1,502
Independent Students' Bursary	14.7	15,670	11.5%	£937
Care Experienced Bursary	13.8	1,840	1.3%	£7,486
Disabled Students' Allowance	11.9	5,555	4.1%	£2,148
Other bursaries and grants	5.4	-	-	-

Note: '% of all students' is as a share of all full-time students receiving any support from SAAS, including tuition fees and fee loans. Includes support provided to postgraduate students, EU-domiciled students and Scotland-domiciled undergraduates studying in the rest of the UK. 'Other bursaries and grants' includes Dependants' Grant, Lone Parents' Grant, Educational Psychology Grant and adhoc payments.

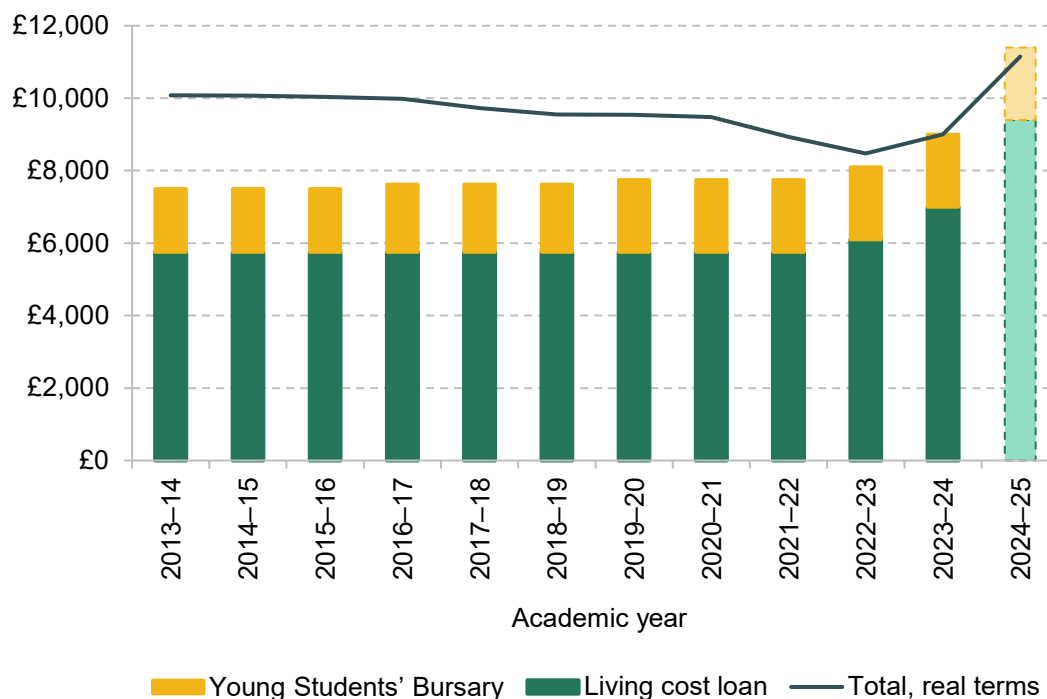
Source: SAAS 'Higher education student support in Scotland 2022–23', tables FT.1 and FT.3, available at <https://www.saas.gov.uk/about-saas/statistics/stats-22-23>.

The system of living cost support for Scottish students has become substantially less generous over time. This is for two reasons. First, the cash value of support has increased little until recently. From 2013–14 until 2021–22, the total living cost support a Young Student with a low household income was eligible for increased from £7,500 to £7,750. By 2022–23, support was worth 16% less in real terms than in 2013–14, a cut of around £1,600 in current (2024 Q1 CPI real) prices, as shown in Figure 5.3. Indeed, a £900 increase this year in the maximum amount all Scottish students can borrow, in response to cost of living pressures, was the first real-terms increase in support since at least 2013–14.<sup>14</sup>

<sup>13</sup> The Student Loans Company publishes statistics on take-up of maintenance and tuition fee loans as a proportion of eligible students in England, Wales and Northern Ireland. See table 3A at <https://www.gov.uk/government/collections/student-support-for-higher-education-he>. No equivalent statistics are publicly available for Scotland.

<sup>14</sup> <https://www.gov.scot/news/increased-support-for-students/>.

**Figure 5.3. Entitlements to living cost support for Scottish Young Students with low household income, by academic year**



Note: Entitlements for Scotland-domiciled full-time undergraduates, classed as Young Students and with the lowest assessed household income. Real-terms figures based on CPI in Q1 of the relevant academic year.

Source: <https://www.saas.gov.uk/about-saas/stats-2022-23/policy-background>; <https://www.saas.gov.uk/full-time/undergraduates>.

As highlighted by Ogden and Phillips (2023), there have also been freezes to the parental earnings thresholds that determine entitlements. Since 2016–17, the lowest parental earnings threshold has increased from £19,000 to £21,000, but the next two thresholds have been frozen in cash terms, despite growth in average earnings of 29% over the same period. This means that some students are eligible for a quarter (£2,120) less in real terms in 2023–24 than a student whose family was in the same position in the earnings distribution would have been entitled to in 2016–17.

### Planned changes in 2024–25

The amount of living cost support for students is set to increase significantly next academic year. In December, the Scottish Government announced that all Scottish students will see their loan entitlement increase by £2,400 in Autumn 2024, taking the maximum living cost support for Young Students from £9,000 to £11,400.<sup>15</sup> This delivers on a commitment in the Programme for

<sup>15</sup> See <https://www.gov.scot/news/increasing-financial-support-for-scottish-students/>.

Government 2021 to provide a total package of student support ‘the equivalent of the Living Wage’ by 2024–25 (Scottish Government, 2021).<sup>16</sup>

Importantly, this calculation has been based on the real living wage of £12 an hour produced by the Living Wage Foundation, which is higher than the National Living Wage (which will rise to £11.44 an hour from April 2024). Accounting for inflation, this represents a real-terms increase of £2,150 (24%) for the poorest, and will restore the real-terms generosity of the 2016–17 system for most. It will bring entitlements for Scottish students with household incomes between around £20,000 and £40,000 roughly in line with their English counterparts, and will be much *more* generous than the English system for those from the poorest and the richest households.

However, the income thresholds that determine eligibility will be frozen in cash terms for another year. Given forecast nominal earnings growth of around 3% in 2024–25, some students may still see their living cost entitlements fall year-on-year as their household income just surpasses a specific threshold for support, even if they have become no better off in relative terms.

## How much is spent overall, and how does this appear in the Scottish Government’s budget?

In 2022–23, around £1.5 billion was spent in total on undergraduate higher education – including teaching and living cost support. Of this, cash expenditure on student support through SAAS (tuition fees paid on behalf of Scottish students, and bursaries) and direct grants provided to universities through the Scottish Funding Council amounted to around £1 billion. This expenditure appeared in the Scottish Government’s main budget as departmental expenditure limit (DEL), coming from Scottish Government ‘Fiscal Resource’, and was explicitly traded off by the Scottish Government against spending on competing policy priorities. In contrast, loans provided to Scottish students – for living costs, and for tuition fees for the minority who studied outside Scotland – were treated as a UK government annually managed expenditure (AME) programme, and so financed by the UK government. Any eventual loan write-offs (or impairment costs) are met through separate ring-fenced funding from HM Treasury (HMT).<sup>17</sup> Around £0.5 billion of loans were issued to Scottish students, and this spending was not subject to the same budget limits.

<sup>16</sup> This is based on the method used to calculate the Minimum Student Income in the 2017 independent review of student financial support in Scotland. This assumed students should receive support equivalent to the Scottish Government’s Living Wage for 950 hours per year: a notional 25 hours of study (out of a typical 35-hour working week, on the basis that they can supplement their income with up to 10 hours of paid work) for 38 weeks per year. The Augar Review instead recommended that an appropriate level of maximum maintenance support for English students would reflect the National Minimum Wage for 1,125 hours per year (37.5 hours per week for 30 weeks).

<sup>17</sup> Technically, write-offs appear in the Scottish budget through the RAB charge and stock charge (see footnote 25) and are met via non-cash DEL.

Of course, the long-run cost to the UK government of providing these loans will be lower than this initial loan outlay as graduates make repayments towards their loans. This funding arrangement – the loan outlay and eventual write-offs being funded by HMT – depends on the Scottish Government higher education funding policy being broadly similar, or having ‘broadly comparable’ costs to the UK government’s policy. We provide estimates of this long-run cost in Section 5.2, and consider one measure of ‘broadly comparable’ costs in Section 5.3.

As highlighted earlier, the Scottish Budget suggests that spending on teaching will fall in 2024–25. Without substantial increases in bursaries and grants – which are not expected – spending on higher education from Scottish Government Fiscal Resource is likely to fall year-on-year. At the same time, increases in entitlements to living cost loans are likely to increase loan outlay, increasing UK-funded AME spending.

## 5.2 How do Scottish students repay their loans?

Students are liable to start repaying their loans from the April after they finish their course. For employees, student loan repayments are deducted automatically from their earnings by their employer through PAYE. How much graduates repay depends on their earnings: graduates make no repayments if they earn below a certain threshold (currently £27,660) and repay 9% of their earnings above that threshold. Any outstanding loan is written off at the end of the repayment period (currently 30 years) with no adverse consequences for graduates.

These loans accrue interest, during study and after graduation, at the same rate. This rate typically changes each September, and is set to be the lower of two things: the Bank of England (BoE) base rate plus 1%, and retail price inflation (RPI) in the year to the previous March. The policy intention behind this is to ensure rates remain low – and this has largely been delivered over the recent period of very low interest rates, with the interest rate remaining below 2% from 2009 until September 2022, as shown in Figure 5.4.

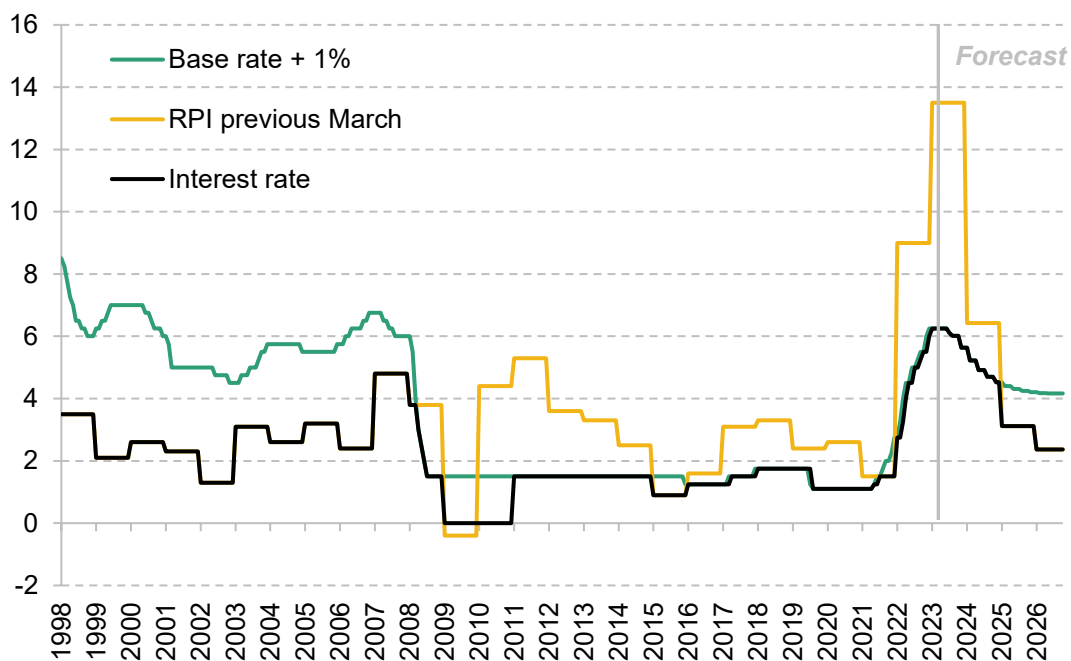
The interest rate has since risen steadily as the Bank of England successively increased the base rate in response to high inflation, and is currently 6.25% (the base rate of 5.25% plus 1 percentage point). Based on market expectations of the path for the base rate, the interest rate in Scotland is expected to fall gradually over the next 18 months, and then to fall more sharply to 3.1% in September 2025 and to 2.4% in September 2026. While the period of high interest rates for Scottish borrowers will be relatively short-lived, the use of a lagged measure of inflation



means it will persist beyond the period of high inflation itself, and this is likely to increase political pressure on the Scottish Government to reduce interest rates.<sup>18</sup>

In broad terms, the loan repayment terms for Scottish borrowers are similar to those for borrowers in other parts of the UK, as shown in Table 5.2. The same interest rate calculation method applies for borrowers in Northern Ireland, although they face a lower repayment threshold and a shorter write-off period. The terms for Scottish borrowers are definitely more generous than the new Plan 5 loan terms, which apply to England-domiciled students who start courses from 2023 onwards. In particular, Scottish borrowers can earn more before making repayments and make lower monthly repayments, repay for fewer years before their loans are written off, and face an interest rate that is the same (RPI) or lower.

**Figure 5.4. Interest rate charged on Plan 4 student loans**



Note: Figures from February 2024 onwards are forecasts.

Source: DfE guidance (<https://www.gov.uk/guidance/how-interest-is-calculated-plan-4>); Office for Budget Responsibility (2023); ONS RPI All Items (<https://www.ons.gov.uk/economy/inflationandpriceindices/timeseries/czbh/mm23>); Bank of England base rate history (<https://www.bankofengland.co.uk/boeapps/database/Bank-Rate.asp>); conditioning assumptions from Bank of England (2024).

<sup>18</sup> In England, we also expect the even higher maximum interest rate (7.6%) to persist after RPI falls (Drayton et al., 2023).

Table 5.2. Student loan repayment terms across the UK

	Scotland (Plan 4)	England (2012–22) and Wales (Plan 2)	England (from 2023) (Plan 5)	Northern Ireland (Plan 1)
Repayment rate	9%	9%	9%	9%
Repayment threshold (from April 2024)	£27,660 (£31,395)	£27,295 (£27,295)	£25,000 (£25,000)	£22,015 (£24,990)
Interest rate (as of February 2024)	Lower of BoE base rate + 1% and RPI (6.25%)	RPI + 3% while studying Then RPI to RPI + 3% depending on income (7.6%)	RPI (7.6%)	Lower of BoE base rate + 1% and RPI (6.25%)
Write-off period	30 years	30 years	40 years	25 years
Average loan balance	£15,430	England: £44,940 Wales: £35,780	-	£24,500

Note: Loan balances on entering repayment are as of 2022–23 financial year, and are averages amongst all borrowers on entry into repayment by government administration that funded the loan. The interest rate applied to Plan 2 loans typically varies with graduates' incomes, but is currently subject to a cap at the Prevailing Market Rate such that the same interest rate applies to all loans.

Source: <https://www.gov.uk/repaying-your-student-loan>; <https://www.gov.uk/government/statistics/uk-comparisons-to-financial-year-2023/uk-comparisons-to-financial-year-2023>.

The biggest difference between parts of the UK is in the average loan balances of home students funded by different government administrations. Those from Scotland have by far the lowest average loan balances on entry into repayment at £15,430, compared with £24,500 in Northern Ireland, £44,940 in England (where around 95% of students take out loans for tuition fees) and £35,780 in Wales (which has the same higher tuition fee cap as England, but provides more living cost support through grants rather than loans). The much lower borrowing of Scottish students is despite typically longer courses, and reflects three main factors: the absence of tuition fees (and so tuition fee loans) for most Scottish students, lower entitlements to living cost loans for many, and lower take-up of living cost loans amongst eligible Scottish students.

Indeed, a typical Scottish student on a four-year course at a Scottish university who took out all the living cost loan they were entitled to might expect to graduate with a loan balance of between £24,000 and £28,000 based on entitlements in 2023–24. Given the planned increase in loan entitlements (and even with no further increases), someone starting a course next academic year could instead expect to borrow between £34,000 and £37,600 over four years.

## How much can Scottish students expect to repay?

The income-contingent nature of student loan repayments means future repayments depend on the future earnings of Scotland's graduates. Forecasting future earnings is a hugely uncertain exercise, reflecting forecasts for average wage growth over the next 35 years, as well as how this is distributed across individuals over the course of their careers, and other changes for individuals (such as changes in hours or periods of unemployment).

The IFS Scotland Student Finance Calculator<sup>19</sup> models the lifetime repayments of a single cohort of Scottish full-time undergraduate students, focusing on those who studied at a university in Scotland.<sup>20</sup> The model makes some key simplifying assumptions: that all undergraduates start courses at age 18 and study for the intended course length; that all students are eligible for living cost support as if they were Young Students or Care Experienced Students, and take up all the support they are entitled to; that borrowers do not make voluntary contributions; and the parameters of the student loans system do not affect graduates' gross earnings.

Under these assumptions, and policies in place in 2023–24, we estimate that students starting in 2023 could expect to borrow £25,900 on average over their courses, and to repay £22,300 on average over their lifetimes, adjusted for inflation.<sup>21</sup> Around three-quarters of students would fully repay their loans, with those having some debt written off after 30 years concentrated in the bottom three deciles of lifetime earnings.<sup>22</sup>

As shown in Figure 5.5, borrowers in the top six deciles of lifetime earnings are expected to repay around £27,000 on average (very slightly more than they borrowed once adjusted for inflation), with those in the lowest decile repaying only £6,500 on average. As a share of lifetime earnings, repayments are highest in the third decile (1.7% on average) and fall to around 0.6% amongst the highest tenth of earners.<sup>23</sup>

<sup>19</sup> <https://ifs.org.uk/calculators/student-finance-calculator-scotland>.

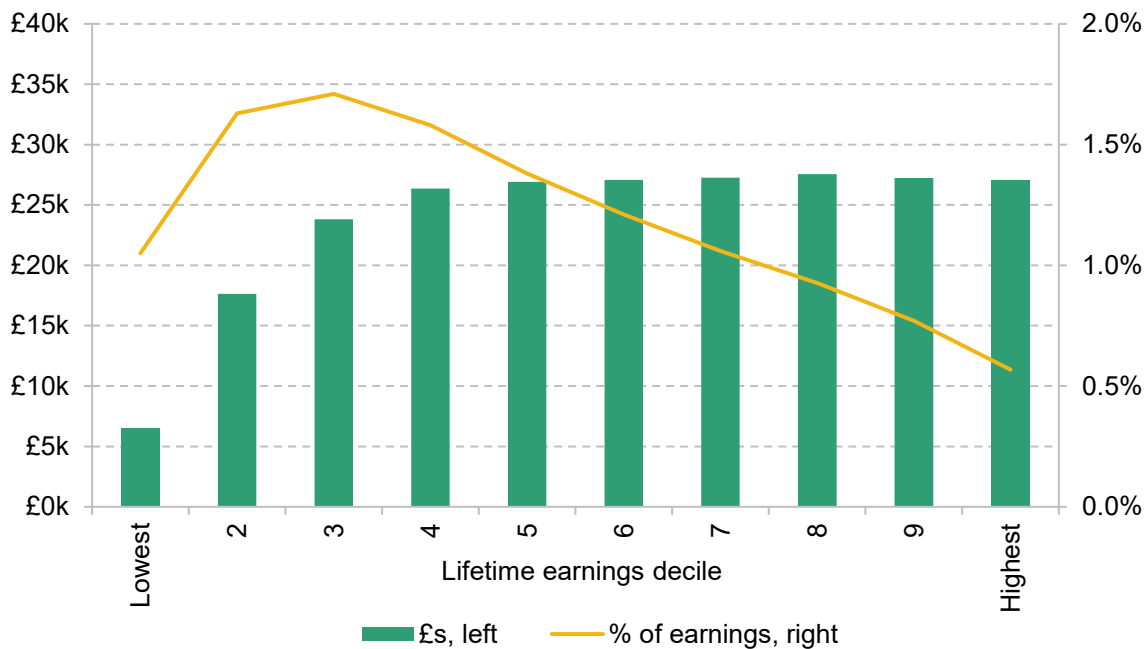
<sup>20</sup> This draws on the simulated lifetime earnings profiles of 20,000 representative graduates, which were estimated using data from the Labour Force Survey (LFS) and the British Household Panel Survey / Understanding Society and are set to match the earnings of those with HE degrees living in Scotland (wherever they were born and wherever they studied for their HE degrees).

<sup>21</sup> Figures relating to loan repayments are inflation-adjusted, and are here presented in RPI real terms, without any further discounting.

<sup>22</sup> Differences in earnings and employment dynamics imply higher average lifetime loan repayments amongst male graduates (£25,200) than female graduates (£20,300), with around 90% of men expected to fully repay their loans compared with around two-thirds of women.

<sup>23</sup> When expressed as a percentage of lifetime earnings, repayments and lifetime earnings are expressed in CPI real terms.

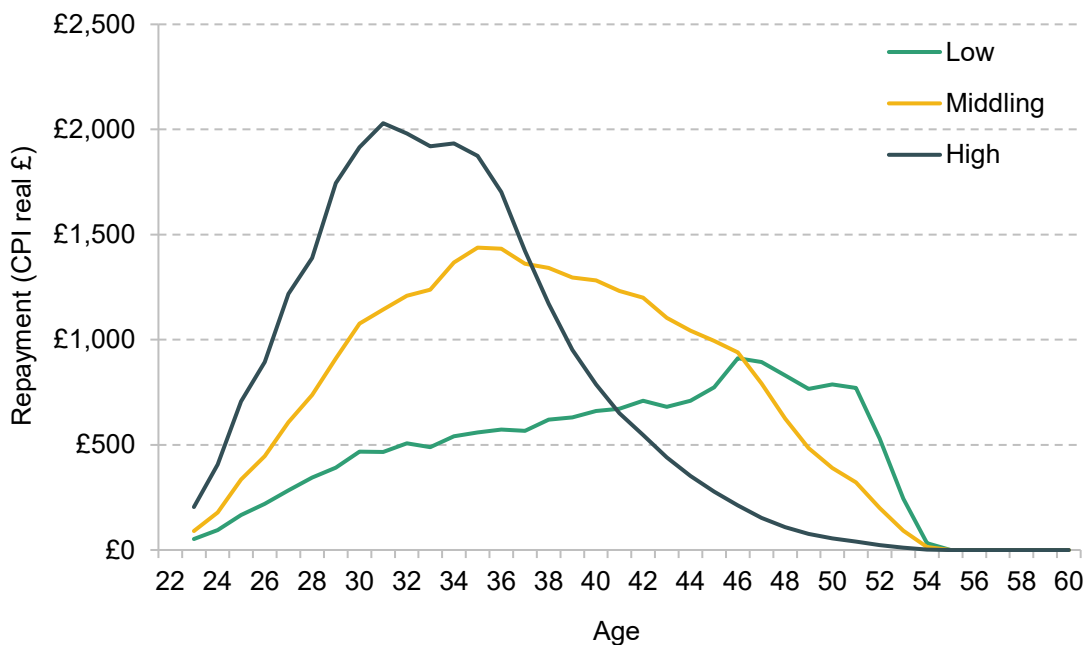
**Figure 5.5. Lifetime loan repayments, £s and as a percentage of lifetime earnings, by lifetime earnings decile**



Note: Expected lifetime repayments for a single cohort under the system applying for the 2023 entry cohort. Repayments and earnings are in undiscounted CPI real terms (2023 prices).

Source: Authors' calculations based on [IFS Scotland Student Finance Calculator](#).

**Figure 5.6. Average annual loan repayments, by age and tercile of lifetime earnings**



Note: Smoothed (three-year rolling averages) average annual loan repayments amongst individuals in different terciles of the lifetime earnings distribution, at each age, assuming all students begin courses at age 18. Real-terms figures based on financial year CPI.

Source: Authors' calculations based on [IFS Scotland Student Finance Calculator](#).

The share of graduates making any repayments in a year reaches 40% at age 25, peaks at around 70% at age 31, and then declines steadily until only around 20% are still making repayments in the year before any remaining balance is wiped. As shown in Figure 5.6, amongst those in the top third of graduates by lifetime earnings, average repayments peak at £2,000 a year at age 31 – around 4.5% of their earnings in that year – before falling during their 30s as some people have repaid in full and therefore cease making repayments. Amongst the middle tercile, average repayments peak later, at around £1,500 per year in their mid 30s, but many more repay throughout their 30s and early 40s. For the lowest third of lifetime earners, average repayments are much lower until their early 50s.

### Who bears the costs of HE in the long run?

Under the assumptions described above, and assuming that policy remains as it was in 2023, we estimate the long-run costs of higher education for the cohort of Scottish undergraduates starting courses in 2023 at Scottish universities would be £1,763 million, adjusted for inflation. This would be split as described in Table 5.3. Of the total cost of undergraduate teaching and associated grant- and loan-funded living costs for a single cohort of students, around 56% of the long-run cost would be met by the Scottish Government, 38% by graduates themselves and 6% by the UK government.

**Table 5.3. Long-run costs of higher education for the 2023 cohort, under 2023 policy**

	£ million	£ per student	% of total
Scottish Government cash expenditure	994	8,200	56%
Student loan repayments	664	22,300	38%
Student loan write-offs	105	3,500	6%

Note: All figures are undiscounted, RPI real, in 2023 prices. Assumes full take-up of living cost support. Scottish government cash expenditure includes main teaching grant (£0.7 billion), tuition fees paid on behalf of Scottish students (£0.2 billion) and bursaries towards living costs (£0.1 billion).

Source: Authors' calculations based on [IFS Scotland Student Finance Calculator](#).

One measure of the long-run cost of student loans is the resource accounting and budgeting (RAB) charge, an estimate of the long-run cost of loans issued in the current year, based on future loan write-offs and interest subsidies. Our preferred approach is to estimate the proportion of loan outlay issued each year that is not expected to be repaid, discounting future repayments only to account for inflation. With no real discounting (i.e. with no discounting in addition to adjusting for inflation), we estimate the RAB charge for the 2023 Scotland cohort at +14%, suggesting a cost of around £3,500 on average per student. Intuitively, total student loan write-offs (£105 million) are 14% of the total value of loan write-offs plus loan repayments (£769 million), when both are valued in RPI real 2023 prices.

An alternative measure of the RAB charge used by the UK government instead values future repayments in present terms using the HMT discount rate. This assumed discount rate is meant to capture the opportunity cost of government funds – the cost of funding student loans rather than undertaking other government projects. However, the Treasury uses a negative real discount rate which, counterintuitively, means the same repayment in real terms now counts for more in the RAB charge calculation the further in the future it is made.<sup>24</sup> Under the current system, we estimate the RAB charge for the 2023 Scotland cohort using the UK government preferred discount rate to be *minus* 11% (suggesting the UK government *makes* around £2,800 on average per student).<sup>25</sup>

### Planned changes in 2024–25

As described above, several changes are planned for 2024–25 which will affect the cost of the system. The repayment threshold is set to increase to £31,395 from April 2024. This alone would increase the RAB charge slightly from +14% to +16% (with no real discounting). As shown in Figure 5.7, those in the bottom four deciles of lifetime earnings could expect to repay around £1,500 less over their lifetimes as a result, whereas those in the top half of the income distribution could expect to repay roughly the same over their lifetimes (with lower monthly repayments but made for more years).

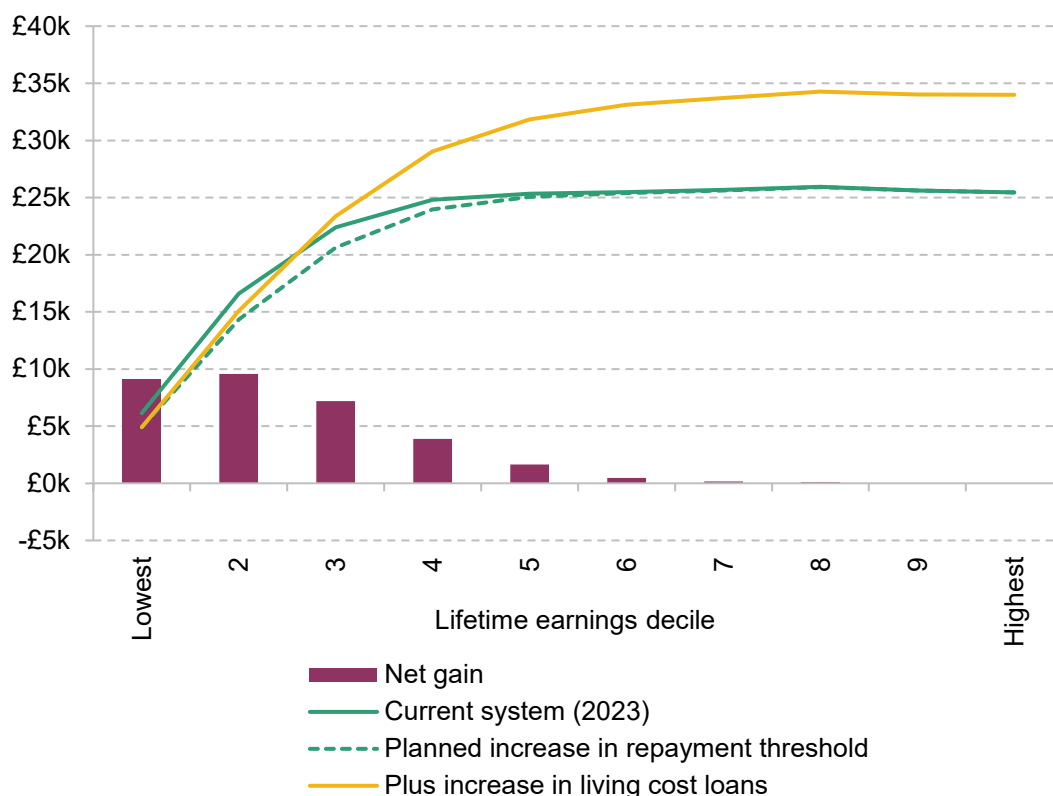
Amongst those taking up the full living cost support they are entitled to, the planned £2,400 increase in living cost loan entitlements will increase total living cost support per student by around 28% (from £29,500 to £37,700<sup>26</sup>), and will also increase both lifetime student loan repayments and write-offs. On average from these two changes, the top half of graduate lifetime earners can expect to repay any additional borrowing in full, although they may still benefit from the ability to borrow more at a time when they are especially likely to be credit-constrained. Those in the bottom half of the income distribution gain more in additional living cost support than the increase in their lifetime loan repayments, as shown in Figure 5.7, with those in the poorest tenth around £9,100 better off on average under the 2024 system.

<sup>24</sup> For further discussion, see <https://ifs.org.uk/education-spending/higher-education>.

<sup>25</sup> The Scottish Government also estimates the ‘stock charge’, which reflects revisions to the ‘fair value’ of loan assets in relation to lending in previous years. Any changes to student loan repayment terms or changes in economic forecasts that affect the expected value of future loan repayments are reflected in this budget line. The IFS model does not calculate the stock charge. It does produce estimates of the ONS accounting write-off, which is another measure of the long-run costs of loans to government, discounting future repayments based on the individual borrowers’ interest rates, rather than the HMT discount rate.

<sup>26</sup> These figures are in 2023 RPI real prices, and include both living cost loans and bursaries.

Figure 5.7. Lifetime loan repayments under different policies, £s, by lifetime earnings decile



Note: Expected lifetime repayments for a single cohort. 'Net gain' measures the increase in up-front living cost support, less the increase in lifetime loan repayments. All figures are in undiscounted RPI real terms (2023 prices). Planned increase in repayment threshold models impact of changing repayment threshold in 2023 to £30,261 (equivalent to £31,395 in 2024 given expected earnings growth). Assumes full take-up of living cost loans under all policies.

Source: Authors' calculations based on [IFS Scotland Student Finance Calculator](#).

Together, these two changes planned for 2024–25 will increase the total government outlay on higher education from £1.8 billion to around £2 billion per cohort. The Scottish Government will meet around half of the long-run costs under the new policy, with an increasing share of costs falling on graduates in the long run (40%) and a near-doubling in the cost of eventual loan write-offs to the UK government (see Table 5.4). We estimate that the RAB charge under 2024 policy will be +20% (with no real discounting).

Table 5.4. Long-run costs of higher education for the 2023 cohort, under 2024 policy

	£ million	£ per student	% of total
Scottish Government cash expenditure	988	8,200	49%
Student loan repayments	812	27,300	40%
Student loan write-offs	205	6,900	10%

Note: See note and source to Table 5.3.

The increased generosity of the living cost support system for Scottish students and the improvement of loan terms for Scottish graduates will be shared between Scottish graduates and the UK government, rather than being a burden on the Scottish Government's main budget. If students took up their full entitlements to living cost support, these changes would substantially increase average lifetime loan repayments amongst Scottish graduates (by around £5,000) and would add around £100 million (£3,400 per student) to the cost of loan write-offs to the UK government.

## 5.3 What could a different funding system look like?

Ogden and Phillips (2023) identified two main challenges facing the Scottish model for higher education funding in the run-up to the 2024–25 Budget: a decline in the generosity of living cost support and real-terms cuts in teaching resources. The first has been at least partially addressed. As already highlighted, the Scottish Government plans to make changes that from 2024–25 will increase the generosity of up-front support for Scottish students and reduce the monthly repayments of graduates. That these changes will only affect loan entitlements and expected repayments means they will be without cost to the Scottish Government's main budget. But further cuts to university funding are planned, and as discussed in Chapter 3, while the Scottish budget situation is better than expected a year ago, it remains very challenging.

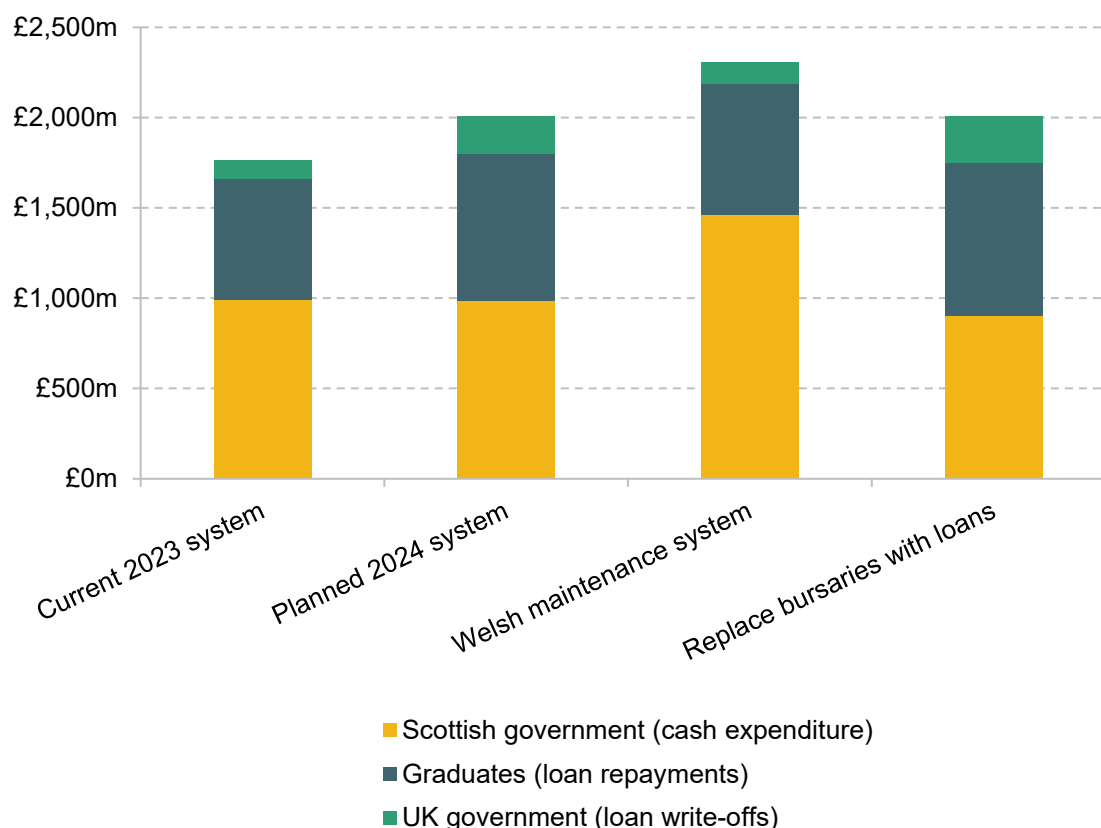
In this section, we use the IFS Scotland Student Finance Calculator to examine the costs and distributional consequences of some further alternative funding models, taking the planned 2024–25 system as the baseline and highlighting the trade-offs between competing objectives.

The Scottish Government could be minded to go further on the generosity of living cost support for students. One potential option would be adopting the maintenance system for Welsh students. This would increase living cost support per student by a further 27% compared with 2024–25 plans. However, much of the additional cost would be in the form of bursaries, at a cost of £473 million to the Scottish Government's main budget. This is unlikely to be an appealing option given budgetary challenges.

Alternatively, the Scottish Government could retain the level of generosity planned from Autumn 2024, but with less impact on the Scottish budget, by providing support through loans rather than bursaries. Replacing the Young Students' Bursary with additional living cost loans would leave total living cost support unchanged, while replacing around £85 million of Scottish Government expenditure with additional loans. Graduates would repay just under half of the additional loan outlay (about £38 million), with the UK government meeting the cost of additional loan write-offs (about £48 million), as shown in Figure 5.8.



Figure 5.8. Long-run cost of higher education borne by different parties, under different policies



Note: Assumes full take-up of living cost loans and bursaries. Cash expenditure falls slightly under planned 2024 system given assumed cash freezes to bursaries and teaching resources.

Source: Authors' calculations based on [IFS Scotland Student Finance Calculator](#).

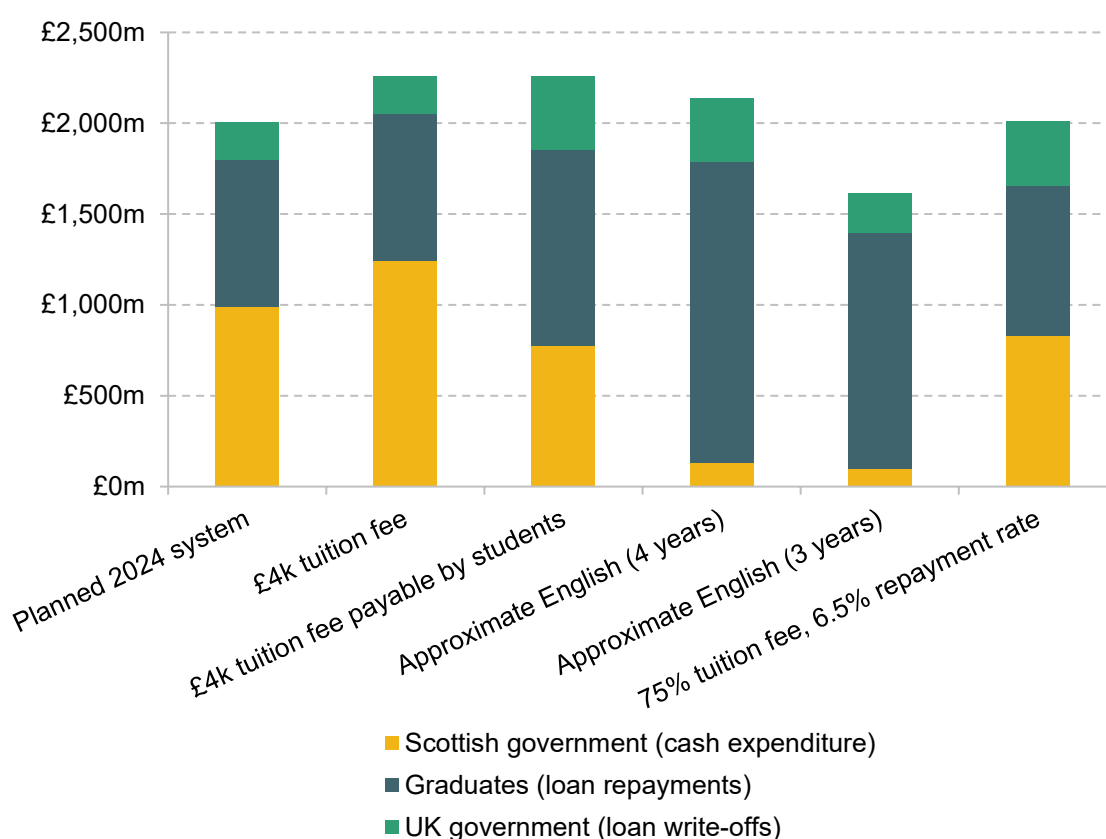
The trade-off on teaching resources is more acute. Under the current 'free tuition' model, any increases in per-student teaching resources for Scottish students would have immediate impacts on the Scottish budget. For instance, increasing the tuition fee from £1,820 to £4,000 would increase the resources available to universities for teaching by around 30%, more than restoring them to the same real value as in 2013–14. If these tuition fees were still paid on students' behalf by SAAS, and there was no change to the number of funded places, this would *add* around £255 million to Scottish Government cash expenditure per cohort.

Another way to deliver the same increase in teaching resources would be to shift towards a funding model with a greater role for tuition fee loans. If this £4,000 per year tuition fee was payable by Scottish students and covered through a tuition fee loan, teaching resources per cohort would still rise by £255 million, but the Scottish Government would spend around £210 million *less* up front than under the 2024 system, as shown in Figure 5.9. Around £470 million of tuition fee loans would be issued to Scottish students, of which they could expect to repay around 57% (£264 million, or £8,900 each), with the remaining £200 million

eventually written off. In this case, every additional £1 of cost to Scottish graduates would save the Scottish Government £1.77 – suggesting there might be ways to compensate Scottish graduates and still reduce demands on the Scottish budget.

Of course, this sharing of costs in the long run depends on this new arrangement still being considered to have ‘broadly comparable’ costs to arrangements in England. When there are changes to Scottish Government policy in this area, HM Treasury comes to a view as to whether costs remain broadly comparable, but there is not a fully formalised process for this. It is not clear exactly what measure of cost is used. The gross loan outlay per student (the AME spending component) may be of interest as this counts towards public sector net debt. In the long run, it is the eventual loan write-off which matters for the public finances, although this will be impacted by the choice of discount rate. Where there are different rates of loan take-up between the devolved administrations, it may matter whether costs are compared per student or per borrower.

**Figure 5.9. Long-run cost of higher education borne by different parties, under different policies**



Note: Assumes full take-up of living cost loans and bursaries. ‘£4k tuition fee’ increases tuition fee to £4,000 per year. ‘Approximate English (4 years)’ matches English teaching resources (including a £9,250 per year tuition fee payable by students) and living cost support and matches Plan 5 loan repayment terms. ‘Approximate English (3 years)’ also reduces the typical degree length to three years.

Source: Authors’ calculations based on [IFS Scotland Student Finance Calculator](#).

As an illustration, we consider the impact if Scotland matched the system for 2023 starters in England in most respects, including the funding of teaching through a £9,250 per year tuition fee, approximately matching English students' entitlements to living cost loans, and Plan 5 loan terms. The costs in this case are shown by the 'Approximate English system (4 years)' bar in Figure 5.9.

The combined effect of the different choices made by the Scottish Government with respect to higher education funding – except for the longer typical length of degrees at Scottish universities – is to increase the cost of educating each cohort of Scottish undergraduates to the Scottish Government by around £850 million (or £28,700 per student). For this, Scottish students receive around £10,900 less spending on their teaching, are entitled to around £6,500 more living cost support on average, and can expect to repay £28,300 less over their lifetimes. While the increase in Scottish Government spending is equivalent to £28,700 per student, graduates on average gain £23,800, and the UK taxpayer gains £4,900 per student in the form of lower write-offs.

If Scotland matched the English system, total loan outlay in this case (assuming full take-up) would be £2.0 billion per cohort, or around £67,500 per student, compared with £1.0 billion (£34,300 per student) under the system planned for Scotland in 2024. Around £350 million (£11,800 per student) would be written off in the long run, compared with around £200 million now.<sup>27</sup> If HM Treasury was using loan outlay or this measure of loan write-offs to determine whether the costs of the Scottish student loan system were 'broadly comparable' – and particularly if it was comparing costs under the two systems for the same number of years of study – there may be some scope for the Scottish Government to increase teaching funding (or reduce pressure on the Scottish budget) without increasing contributions from Scottish graduates.

For instance, if three-quarters of the tuition fee of £1,820 per year were made payable by students (instead of paid on their behalf by SAAS), the Scottish Government would save approximately £150 million per cohort, which could be used to increase university funding or for other spending priorities. This could be combined with a cut in the repayment rate from 9% to 6.5%, reducing monthly repayments for Scottish graduates. Although graduates would make these lower loan repayments for more years, they would repay on average only around £400 more in total over their lifetimes (adjusted for inflation). The Scottish Government saving would be almost entirely paid for by an increase in loan write-offs to £355 million (£11,900 per student). This would be roughly in line with our estimate of the long-run cost to the UK government of Scotland switching to a fully English funding system, suggesting the cost of these loan write-offs may still be met by the UK government.

<sup>27</sup> If the typical degree length was instead three years, as is the case at English universities, loan outlay would be around £1.5 billion (£54,000 per student) and write-offs around £215 million (£7,700 per student).

It is not clear how much scope there would be in practice for the Scottish Government to make such changes without bringing current funding arrangements into question. This is due both to uncertainty over the measure of cost that HM Treasury uses to reach a judgement, and to potential differences in the methodology used to model earnings and future loan repayments, which mean modelling by the UK or Scottish governments may deliver different results from the IFS Scotland Student Finance Calculator.

## 5.4 Conclusion

The Scottish Government plans to increase the generosity of living cost support for Scottish students next year, and to reduce monthly loan repayments from graduates from April. Under current funding arrangements, it can make such changes to loan outlay and eventual write-offs without impacting the Scottish Government budget. Indeed, if students took up their full entitlements to living cost support, the changes planned for 2024 would substantially increase average lifetime loan repayments amongst Scottish graduates (by around £5,000). They would also add around £100 million (£3,400 per student) to the cost of loan write-offs met by the UK government, although the UK government will still spend around £150 million less on loan write-offs for each cohort of Scottish students than if Scotland matched arrangements in England.

The Scottish Government has been less inclined to increase generosity where this would directly impact the resources available to fund competing policy priorities – which, under the current model of free tuition, include funding for undergraduate teaching. As a result, per-student teaching resources have been gradually eroded over time, and numbers of funded places for Scottish students tightly controlled, so that universities in Scotland are increasingly reliant on international student fees. The 2024–25 Scottish Budget suggests this trend is likely to continue next academic year.

There are no easy answers to increasing university funding, without increasing Scottish Government spending on higher education or requiring some contribution from students towards the costs of their tuition. Any attempt to significantly boost teaching resources through tuition fees would lead to significant increases in lifetime contributions from Scottish graduates. And any attempt to increase loan funding but to protect Scottish graduates from higher lifetime repayments could fall foul of HM Treasury’s ‘broadly comparable costs’ test.

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## 6. Conclusions

This report has looked at a number of key budgetary and public service issues for the Scottish Government for the 2024–25 financial year and beyond.

Two years ago, Scotland’s devolved income tax revenues were expected to be a drag on the Scottish Government’s overall funding. This picture has now changed in a rather remarkable way, with SFC and OBR forecasts implying a large and growing positive contribution to the Scottish Government’s budget. For the coming year, this means that while higher-than-expected inflation has eroded the real-terms value of funding provided by the UK government (despite some top-ups), the overall amount available for public services is set to be higher in real terms than expected two years ago. This is not true in the rest of the UK. Looking further ahead, current forecasts imply a further budgetary boost from income tax, particularly in 2025–26, but the Scottish Fiscal Commission highlights how risks are weighted to the downside: it is more likely that the net contribution of income tax will be lower than that it will be higher than currently forecast.

The improvements in the net income tax revenue position are only partially related to tax policy decisions – including the introduction of a new 45% ‘advanced rate’ and increased 48% ‘top rate’ from next April. Much more important are improvements to underlying earnings data and forecasts. Even so, income tax policy changes are a further sizeable step, following a series of previous steps, that have substantially increased taxes on higher earners, increasing both revenues and the degree of redistribution compared with following UK government policy. Plans that would have increased the progressivity (or at least reduced the regressivity) of council tax have instead been put on hold. Rather than kick this issue into the long grass, the time created should be used as an opportunity to consider broader reform, including updating property valuations that are now a third of a century out of date. The tax strategy that the Scottish Government proposes to publish later this year is a chance to think about the design and purpose of each devolved tax in contributing towards overall policy goals, and whether considering the tax system as a whole can enable more efficient revenue-raising and redistribution.

Our analysis of spending plans has, again, shown the stark contrast between the picture that emerges when you compare current plans for 2024–25 with initial budgets for 2023–24 (as the Scottish Government traditionally does) and when you compare them with the latest budgets for 2023–24. In particular, doing the latter shows that health spending is currently set to fall year-on-year and that increases in local government funding are less generous than they initially appear.

Some, including at times the Scottish Government, have argued that comparing initial budgets for the coming year with updated budgets for the current year is misleading: next year's plans can be topped up too. Indeed, they often are. And as an accompanying short briefing published alongside this report shows, it is likely that funding will become available to top up 2024–25 spending plans too (Phillips, 2024). But that funding has not yet been made available to different services, and current plans *are* current plans. As politicians and other stakeholders negotiate and lobby for changes in plans, the latest figures are surely the best place to start.

Health spending may need to be topped up – particularly if productivity (as measured by treatments per staff member) remains depressed compared with pre-pandemic levels. There is also a chasm between future staffing plans in Scotland and in England, with the former planning much smaller workforce growth than the latter, although reality in both countries may look quite different from both sets of plans, as rising demand and a desire to improve services need to be reconciled with fiscal reality.

Higher education funding also poses challenges for the Scottish Government. Increases in living cost loan entitlements from the start of the next academic year will mean Scottish students are entitled to at least as much support as English students. But providing additional funding to universities for teaching costs – which is down substantially in real terms over the last decade, and substantially lower than in England on a per-year basis – will be much harder without moving away from Scotland's model of free tuition.

Just how tough the budgetary challenges the Scottish Government will face in the short and medium terms is uncertain, and will depend on a range of factors including UK government tax and spending decisions, Scottish tax revenue performance and policy decisions, and public service demand, inflation and productivity. This a lot of moving parts, which makes budgetary planning particularly challenging for the Scottish Government, not least because of its constrained borrowing powers. It is important to bear in mind that Scotland already benefits from a higher-than-population share of UK government borrowing, and major expansions of Scotland's borrowing powers risk unfairness to England under current fiscal arrangements (Bell, Eiser and Phillips, 2021). And some uncertainty is an inherent feature of budget processes that are responsive to changing needs and resources. But some additional borrowing flexibility, combined with earlier confirmation of changes to spending plans by the UK government (where possible), and the Scottish Government aligning its Spending Reviews with UK government Spending Reviews, could make planning a little less of a challenge.

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