



University of  
**Strathclyde**  
Glasgow



# Scotland's Budget Report 2024

Fraser of Allander Institute

# Executive summary

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Despite the increases in funding that have come as a result of the UK Government's Budget on 30<sup>th</sup> October, the settlement for 2025-26 is still tricky for Shona Robison as she presents her Budget for 2025-26 next week, and she will have limited room for manoeuvre.

Significant consequentialia have been generated from Rachel Reeves' announcements – £1.5bn in 2024-25 (of which £1.4bn is resource) and £3.4billion in 2025-26 (of which £2.8bn is resource).

The Scottish Government have said that the funding provided in this year (2024-25) is already largely committed. If this is the case, the uplift in 2025-26 is under more pressure than it would appear. On the resource side, this would mean an uplift of £1.4 bn in 2024-25 is being followed by a further uplift of £1.4bn in 2025-26.

Public sector pay makes up over half of the Scottish Government's resource budget, and therefore the decisions made on pay will have significant bearing on the overall budget position. Obviously, pay recurs every year, and current and future 2024-25 pay decisions will have a big impact on the overall budgetary decisions.

The fact that public sector workers are, on average, paid more in Scotland, will mean that the challenges are even more acute (given a much larger public sector). The decisions on this, and on areas like social security, have put additional pressure on the Scottish Government's budget.

Figuring out the funding position for next year has been much more challenging than usual. The lack of a Medium-Term Financial Strategy this year has made calculating this near-impossible, but we have set out the various pressures that the budget is likely to be under – including pay, the cost of employer National Insurance, the effect of non-recurring spending cuts, deferrals of spending into future years and higher block grant adjustments for tax.

We have included analysis of the impact of employer National Insurance rises on the Scottish Government's Budget, and analysis of the cost to the Scottish Government of replicating the 40% retail, hospitality and leisure relief (RHL) announced by Rachel Reeves in Scotland.

This year's report includes significant analysis of what Scotland spends its money on, to understand more about the discretionary power the government has to prioritise its budgetary decisions. We are grateful to the Joseph Rowntree Foundation for funding this strand of work, although the analysis was undertaken independently by the Fraser of Allander Institute.

This spending analysis highlights the fact that health spending, all other pay, social security and grants to local government makes up £7 in every £8 the Scottish Government spends day-to-day, which seriously limits their room for manoeuvre in changing the overall shape of the Budget.

Our analysis also finds that although spending on reducing child poverty – stated by successive Scottish First Ministers as one of the main, if not their utmost priority – has grown significantly since 2018-19, it would not be fair to say that it has become a large part of the Scottish Budget. It remains under 3% of all discretionary resource funding, and capital spending on child poverty reduction through the provision of affordable housing and urban regeneration has actually fallen by 13% in real terms since 2019-20.

Fraser of Allander Institute, University of Strathclyde

29 November 2024

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# 1. The fiscal outlook

## 1.1 The evolution of Scottish Government's 2024-25 net financial position

2024-25 has been a financial year of tribulations in terms of the Scottish Government's ability to adhere to its legally binding requirement to balance its resource budget. When we presented our [2023 Budget Report](#), we highlighted the challenges that were likely to come in the year ahead, and the Budget bill included some increases in tax, as well as cuts to a number of programmes.

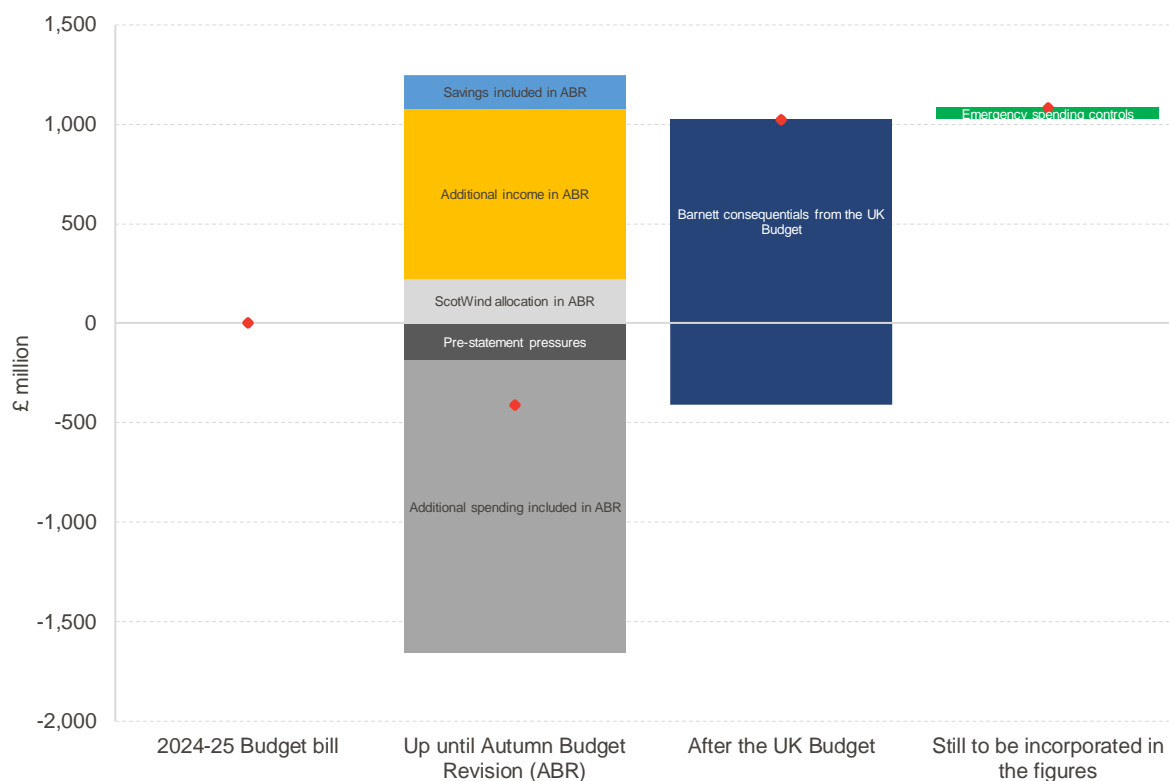
We have not had a medium-term financial strategy (MTFS) this year – it was first delayed due to the election of a new First Minister, and then due to the UK General Election. The Finance Secretary then [wrote](#) to the Finance and Public Administration Committee (FPAC) indicating the 2024-25 edition of the MTFS would be cancelled, and instead one would be presented after the conclusion of the UK Government's Spending Review in the Spring. But on the basis of the last published MTFS, pressures would seem to be growing year-on-year, which was exactly the backdrop that made this such a challenging year.

On 13 August, The Times broke a [story](#) on emergency spending controls imposed by the Scottish Government, which were confirmed in a [statement](#) to Parliament on 3 September. This is the third year in a row in which there has been an emergency budget review. As we [mentioned at the time](#), some of the reasons for this were to do with the fact that the Chancellor of the Exchequer chose (at the time) to fund some of the pay awards out of existing budgets, a significant part of the story was the lack of contingency built in for higher pay awards in Scotland when the 2024-25 Budget bill was passed, which left the Scottish Government at the mercy of labour market conditions. The Minister for Public Finance [admitted as much](#) in a recent FPAC session.

Despite this, the ABR did include significantly higher spending. The Scottish Government set out in its [Autumn Budget Revision](#) (ABR) how it would spend a significantly higher level of funding from Barnett consequentials from the Spring Budget, and which came too late to be included in the Budget bill. These amounted to £731 million, although about £437 million were to do with additional spending on pension contributions and therefore are not really discretionary spending. But this still left about £293 million in additional spending power.

The Scottish Government also announced plans to draw down an extra £162 million from the reserve and it incorporated £224 million of ScotWind proceeds to cover the budget shortfall. This is below the £460 million announced by the Finance Secretary on 3 September and reflects its announced intention of keeping usage of not using all ScotWind proceeds if possible.

Chart 1.1: Evolution of the Scottish Government resource net funding position in 2024-25



Source: Scottish Government, FAI analysis

The ABR included nearly all of the itemised savings from the 3 September statement plus significant additional income, although not the impact of the emergency spending controls. But it also showed even greater levels of spending additions, which totalled £1.5 billion. Given that the ABR didn't specifically make allowances for the higher pay settlements that were being negotiated apart from teachers and social care workers, this would appear to imply that those pay pressures would be additional – and so we'll come back to those later.

For now, a reading of the ABR would imply that even after these itemised savings, there would still be around a £400 million shortfall in funding to cover the spending plans budgeted for.

Some pay deals have been announced already and incorporated into the ABR. This included £242 million for the teachers' pay award and £230 million for the pay uplift for social care workers. Both of these are actually paid out by local government, and so this funding has been put through into higher grants to local authorities.

The additional funding has been necessary because these awards exceeded the planning assumption included by the Scottish Government, which – if we go by the announced pay policy, itself only published on [30 May](#) – was only 2% from 1 April and another 1% from 1 January, which means an effective 2.3% increase for the full year.

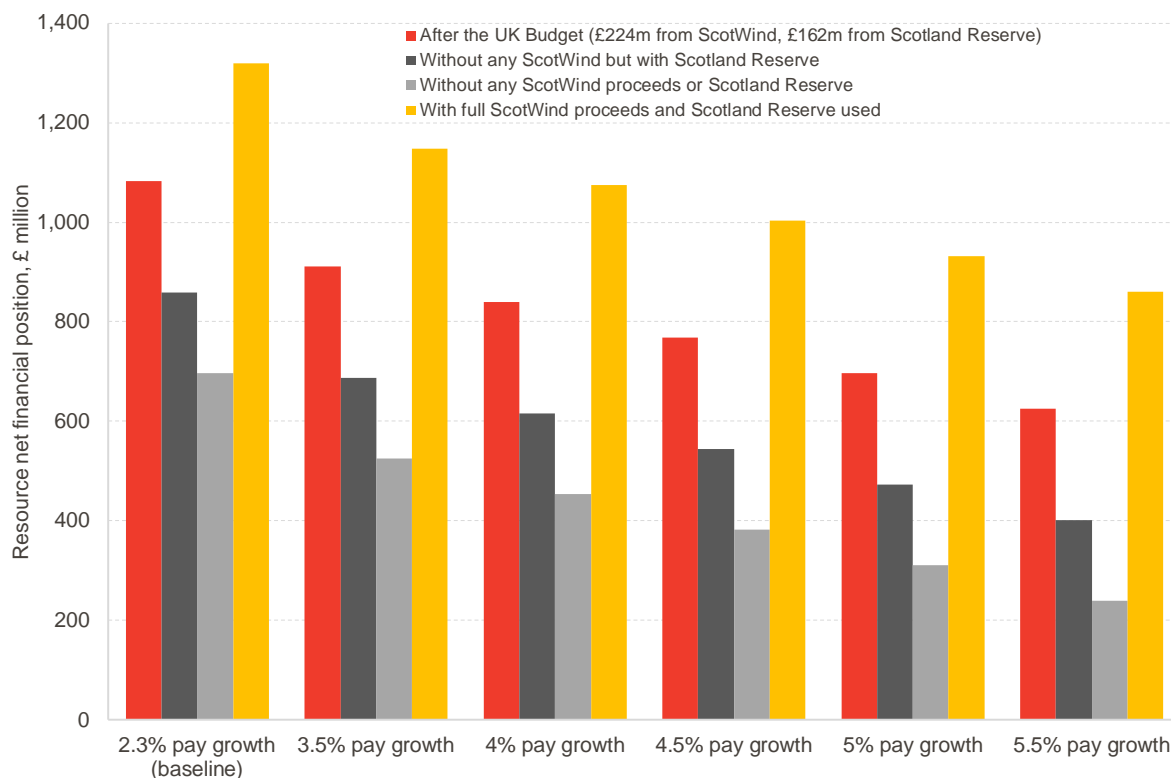
Assuming no changes to total workforce numbers, the 2.3% increase for central government staff only (which includes, among others, civil servants, NHS workers and prison officers) would have meant a cost of £330 million.

Every additional 1 percentage point in pay growth costs the Scottish Government £140 million just for its central government staff. And pay deals (both already agreed and currently under negotiation) are in most cases well in excess of the 2.3% that (again, we think) was budgeted for. For example, the agreed [NHS pay deal](#) is 5.5% and the [proposed Police pay uplift](#) is 4.75%.

We don't yet know for sure what the final pay awards will be in total – and there might yet be some movement in total employment numbers – but an average increase in pay for central Scottish Government staff of 4.5% (which seems fairly plausible, especially given how large a share of employment the NHS constitutes) would cost an additional £315 million.

Will the Scottish Government need to use the ScotWind proceeds and the Scotland Reserve? We can't really know for sure, but the chart below illustrates what the resource net financial position might look like for different scenarios of pay growth and usage of these one-off funds. In all cases, the Scottish Government should be able to balance its resource budget without needing to resort to these extra funding streams – but of course, that would be in the absence of any other pressures.

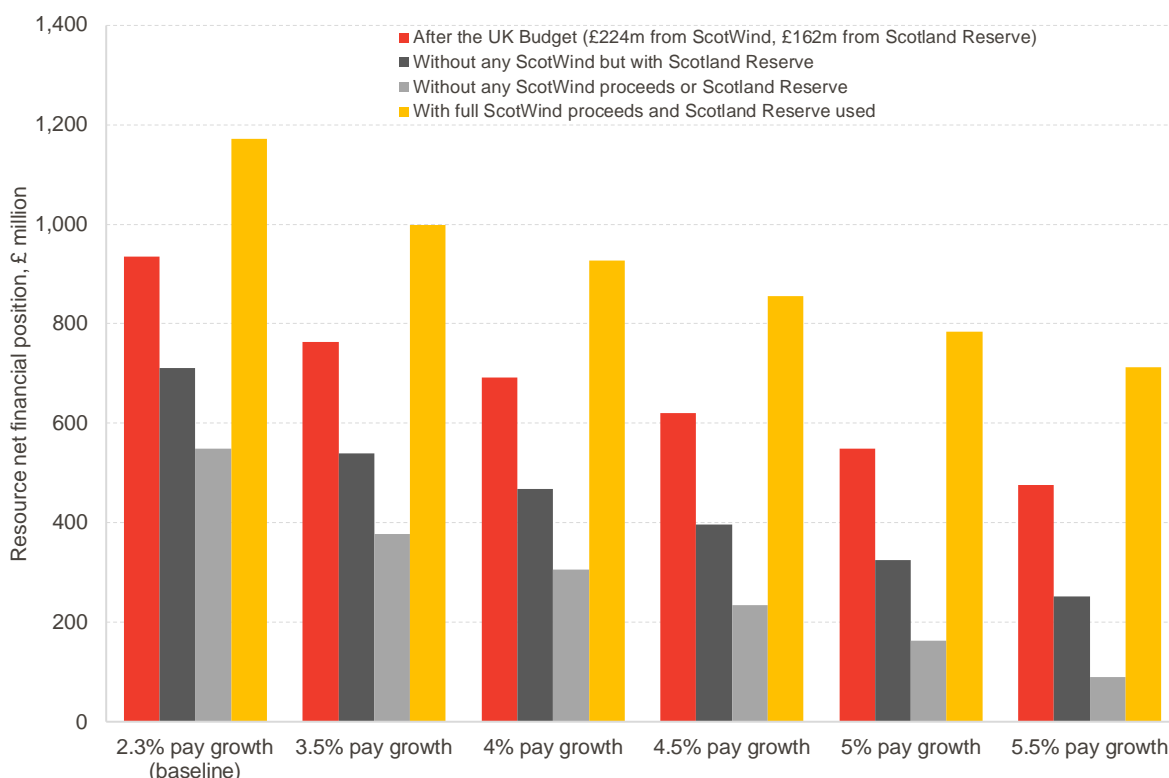
**Chart 1.2: Scenarios for resource net financial position using different pay growth assumptions**



Source: HM Treasury, Scottish Government, FAI analysis

What would the impact be of restoring the universal winter fuel payment? In recent days, there have been suggestions that the Scottish Government might look to reinstate the universality of the Pension Age Winter Heating Payment (PAWHP, the Scottish Government's equivalent of the UK Government's Winter Fuel Payment). How would these scenarios look if we took that into account? Chart 1.3 illustrates this, using the same assumptions for all other spending streams and assuming the cost is the same as the cut to the block grant adjustment (£148 million).

**Chart 1.3: Scenarios for resource net financial position using different pay growth assumptions assuming universal Pension Age Winter Heating Payment is restored**



Source: HM Treasury, Scottish Government, FAI analysis

Of course, there are considerations that the Scottish Government might want to take into account when deciding whether to restore universality of PAWHP other than just whether it is affordable this year – especially in terms of further increasing the size of its DEL-like budget that is demand-driven. So, we await to see where the Scottish Government's balancing of risks and priorities ends up regarding this policy.



## 1.2 The outlook for 2025-26

The MTFS is normally the starting place for any analysis of upcoming years' pressures. It is also accompanied by a full Scottish Fiscal Commission (SFC) forecast, which gives us a better sense of where the data is headed in terms of tax and social security spending forecasts. While the SFC did publish a welcome fiscal update at the end of August, this was understandably not as comprehensive as a full forecast would have been.

This means that we head into the Scottish Budget in a position of knowing less than we ideally would about next year's financial position, especially given (i) how long it has been since the last MTFS and (ii) the significant changes to both spending and funding plans since then, both from the Scottish Government and the UK Government.

The Scottish Government has been given additional resource funding of £1.4 billion in 2024-25 and £2.8 billion in 2025-26 in Barnett consequentials, which will help it deal with the most difficult area for balancing the books.

It is fair to say that this is a significant increase in funding. But the £1.4 billion is baseline funding, and so the additions to the baseline in 2025-26 are only another £1.4 billion. And there are already a number of claims on this number that are likely to cause significant pressures, especially if – as stated by the First Minister – the additional £1.4 billion in 2024-25 is likely to be spent as it has been budgeted for already. This would also mean it will need to be spent next year again, and so further reduces the amount of additional funding for what is a significant set of competing demands already.

The first of those is the effect of the rise in employer National Insurance Contributions (NICs), both through a higher rate (15% compared with the 13.8% previously in place) and through a reduction in the secondary threshold from £9,100 to £6,500. Details are yet to be announced officially, but news reports suggest that Treasury compensation – which is additional to the £2.8 billion – will be in the region of £300 million. Our calculations point to the total public sector cost of the increase in employer NICs in Scotland being around £500 million, and so this would mean an additional £200 million would need to be found by the Scottish Government.

Even excluding the effect of the NICs change, the paybill is likely to be a continued source of pressure. Total spending on pay by the Scottish Government was £14.3 billion in 2023-24, and it might plausibly be as high as £15 billion this year. If we add in the local government paybill – largely funded through grants from the Scottish Government – the total paybill rises to £25 billion in 2024-25. That means that if the paybill were to rise by 3% – which would still be lower than in any year since at least 2019-20 – the cost would be around £750 million.

Some of the savings from this year will have knock-on effects next year too. We estimate that nearly half (£90 million) of the savings announced by the Finance Secretary on 3 September are non-recurring, meaning that they will still be additional spending pressures

next year. And if the winter fuel payment's universality is reinstated, then it will cost another £160 million.<sup>1</sup>

There might also be pressures on the budget due to the operation of the Fiscal Framework. Although we won't know for sure until this is combined with the SFC's forecasts, the forecasts from the OBR indicate that the income tax block grant adjustment (BGA) will increase by perhaps as much as £200 million. And though the social security BGA is also likely to increase, we expect the net position will continue to be significantly negative and more so than in 2024-25.

When we put all these pressures together, there is little in the way of additional funding that is not already committed. If pay pressures in particular turn out to be higher than planned – and we certainly hope to see a pay policy published alongside this Budget – and in the absence of further measures, we could very well see the Scottish Government needing to take in-year action again to rectify the fiscal position.

This echoes what Audit Scotland highlighted in their [recent](#) report. The Scottish Government has continually managed to fund pressures on the basis of one-off monies (ScotWind and underspends banked in the Scotland Reserve) and by delaying spending commitments. Eventually a more strategic approach will be needed to ensure sustainability – here's hoping the work starts now.

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<sup>1</sup> Including administration costs of £12 million, according to the 2024-25 ABR.

## 2. Scottish Government spending and funding analysis<sup>2</sup>

### 2.1 The need for analysis by economic category and function of government

This year, as part of Scotland's Budget Report, we have undertaken a project to create a comprehensive way of understanding the Scottish Government's spending and funding that uses administrative data as the starting point.

Understanding how governments allocate and manage their spending is crucial for ensuring public funds are used effectively and transparently. In Scotland, Scottish Government spending plays a huge role in shaping the services and support people rely on every day, from healthcare and education to transport and housing. But understanding exactly how the Scottish Government spends its money and where it comes from can often seem complicated.

To make this clearer, we've taken a fresh look at the Scottish Government's spending and funding. Using detailed data, we've created more comprehensive and transparent way of understanding how money is allocated, spent, and tracked. This approach helps us understand not just the big picture, but also the finer details of how resources are used to meet Scotland's priorities – making it easier to understand not only where the money goes but also how these decisions affect the economy and services in the country.

As part of its routine reporting, the Scottish Government (SG) provides data to the Treasury on its spending in significant amounts of detail. This is done through the [OSCAR II](#) system, which the Treasury uses to collate information across the whole of central government. The OSCAR II data includes a large number of transactions every year, and it is on that basis that the UK Government then prepares a number of publications, including Public Expenditure Statistical Analyses ([PESA](#)), Country and Regional Analysis ([CRA](#)) and the Whole of Government Accounts ([WGA](#)).

The richness of this dataset means that it is worth exploring as a source of further breakdowns than those made available by the Scottish Government. The Scottish Government's presentation of its budget has three main characteristics that make it difficult

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<sup>2</sup> We are grateful to the Joseph Rowntree Foundation for funding this strand of work. The analysis was undertaken independently by the Fraser of Allander Institute, and therefore any remaining errors are ours too.

to get visibility and comparability with other parts of the UK and with public sector finance principles.

The first is that the Scottish Government's presentation tends to focus on **budgets-to-budgets comparisons**, rather than budget against outturn. This is clearly made more difficult by the Scottish Government routinely making very large transfers between portfolios and functions of government midway through the year, meaning that outturn and budgets can differ significantly – often in very predictable ways.<sup>3</sup> Of course, it is within the Scottish Government's gift to set budgets on the basis of where it wants to spend it, and we continue to urge further transparency on this.

In the analysis in this chapter, we focus on outturn data, which is what is reported on OSCAR II. It is also a more meaningful way of looking at spending data, as it reflects actual transactions. The main drawback is that for some areas such as education and social care, large amounts of spending are done at a local government level rather than SG level. There is an inherent tension in the fact that the SG sets out priorities and funding allocations on the basis of particular objectives, but grants to local government are largely not ring-fenced (with some exceptions), which means that the SG has no control over the amounts allocated at local level for different priorities.

The second issue is that the Scottish Government's budget presentation tends to focus on **portfolio and sub-portfolio allocations** (level 2 down to level 4 budgets). While these are clearly meaningful from the perspective of ministerial accountability, they are not the most natural way of looking at data over time. For one, there have been numerous changes in the machinery of government through allocation and reallocation of portfolios, which makes comparability over time quite difficult. It also means that some portfolios have responsibility over multiple areas of government spending, and it can be difficult to gauge whether there has been prioritisation and reprioritisation of different areas by simply looking at the portfolio budgets.

To address this, we have used the classification of functions of government (COFOG), an internationally standardised way of classifying government spending [developed by the Organisation for Economic Co-operation and Development](#) (OECD). This standardised classification is already presented by the Scottish Government, but only in terms of overall spending and with high-level breakdowns. We take advantage of the fact that each of the OSCAR II segment codes has an associated COFOG<sup>4</sup> to get a more granular breakdown, and we then combine with the economic category breakdown used by the Office for National Statistics (ONS) in the Public Sector Finance ([PSF](#)). This is also known as the [PSAT](#) (Public

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<sup>3</sup> For example, every year the Scottish Government includes funding for training of medical professionals in the Health and Social Care portfolio, but then moves it halfway through the year to the Education and Skills portfolio. It also allocates large amounts to adult social care within the Health and Social Care portfolio, coming under social protection in the classification of functions of government, but then moves it to the Finance and Local Government portfolio, where it comes under general public services as grants to local government in this area are largely not ring-fenced. These routine transfers of billions of pounds mean that the budgets set bear little resemblance to the final outturn in a way that hinders transparency significantly.

<sup>4</sup> This is available in the annual OSCAR II data release.

Sector Analytical Tables) breakdown, and contains a much more detailed breakdown of types of spending.

Finally, the SG's budget presentation is generally on a **financing basis** rather than a National Accounts one. This means that it tends to look at spending and funding separately, and to look at how it has to cover the expenditure with its different financing streams. But while that is perfectly logical way of managing funds, it does not match the statistical standards used by governments across the world in terms of recording their effect on economic agents.

It is on that financing basis that the Scottish Government balances its budget every year – but that does not mean that all resources are economically allocated to the particular year in which they have been used to cover expenditure. A National Accounts-like presentation would take into account receipts and spending and the year that transactions are accrued to, so that – for example – if the Scottish Government uses ScotWind proceeds to balance its budget, it is effectively borrowing in that particular financial year from previous years' funds.

## 2.2 Our approach to this analysis

For this piece of analysis, we take the Scottish Government data from OSCAR II and essentially treat it as a separate layer of government. This is analogous to the treatment given to state governments in other countries. Formally, the ONS has deemed devolved administrations to be part of central government, but there is enough detail in the administrative data to apply this separate layer approach.

This means that for the purposes of this analysis, we can get a sense of how Scottish Government revenue and spending flows through to public sector net borrowing, and how funding and spending compare on a year-by-year basis using a National Accounts and Public Sector Finance approach. This is similar to the sub-sector approach in the PSAT tables.

Table 2.1 shows how we have constructed Scottish Government net borrowing. There have been a number of assumptions included in the construction of this from the management information in OSCAR II, and these are signposted in footnotes to the table.

Table 2.1: Conceptual construction of Scottish Government net borrowing estimates

<b>Transactions</b>	
Taxes on income, wealth and production <sup>5</sup>	(A)
Gross operating surplus	(B) = (B1) + (B2)
<i>of which: depreciation</i> <sup>6</sup>	(B1) = (R)-(L2)
<i>of which: public corporations' gross operating surplus</i>	(B2)
Interest and dividends from private sector and rest of the world <sup>7</sup>	(C)
Interest and dividends (net) from public sector	(D)
Rent and other current transfers	(E)
	<b>SGCR = (A) + (B) + (C) + (D) + (E)</b>
<b>Total current receipts</b>	<b>(E)</b>
Current expenditure on goods and services	(H)
<i>of which: pay</i>	(H1)
<i>of which: procurement</i>	(H2)
<i>of which: depreciation</i>	(H3)
Subsidies	(I)
Net social benefits	(J)
Net current grants abroad	(K)
Current grants (net) within general government	(L)
<i>of which: current grants received from Central Government (CG)</i> <sup>8</sup>	(L1)
<i>of which: imputed depreciation grant from CG</i> <sup>9</sup>	(L2) = -(H3)
<i>of which: current grants paid to Local Government (LG)</i>	(L3)
Other current grants	(M)
VAT and GNI based EU contributions <sup>10</sup>	(N)
Interest and dividends paid to private sector and rest of the world	(O)
Adjustment for the change in pension entitlements <sup>11</sup>	(P)
	<b>SGCE = (H) + (I) + (J) + (K) + (L) + (M) + (N) + (O) + (P)</b>
<b>Total current expenditure</b>	<b>(P)</b>
<b>Gross saving</b>	<b>(Q) = SGCR – SGCE</b>
Depreciation	(R) = (H3) = -(L2)
<b>Current budget deficit</b>	<b>SGCBD = -(Q) + (R)</b>
Gross fixed capital formation	(S)

<sup>5</sup> This has been added together as the OSCAR II data has a single tax revenues segment (other than non-domestic rates, which we add separately), but we hope in future to disaggregate it further in the future.

<sup>6</sup> PSCR depreciation is netted off with an imputed grant to from the UK Government to account for the fact that it is funded by the UK Government.

<sup>7</sup> ScotWind revenues are included at the time of signing of contracts, which are assumed to be the point of accrual, so most of them come in 2022-23 (first auction contracts were signed in April 2022).

<sup>8</sup> Grants from central government subtracted as they are funding netted off expenditure.

<sup>9</sup> Grants from central government subtracted as they are funding netted off expenditure.

<sup>10</sup> Included conceptually but set to zero as the Scottish Government does not have responsibility for EU VAT and GNI-based contributions – and this is set to zero post EU exit as well.

<sup>11</sup> Included conceptually but set to zero as the Scottish Government does not have responsibility for funded pensions.

less Depreciation <sup>12</sup>	(T) = -(R)
Increase in inventories and valuables <sup>13</sup>	(U)
Capital grants (net) within public sector	(V)
<i>of which: capital grants received from CG</i> <sup>14</sup>	(V1)
<i>of which: capital grants received paid to CG</i>	(V2)
<i>of which: capital grants paid to LG</i>	(V3)
<i>of which: capital grants paid to public corporations</i>	(V4)
Capital grants to/from private sector	(W)
<i>of which: capital grants paid to private sector</i>	(W1)
<i>of which: capital grants received from private sector</i> <sup>15</sup>	(W2)
<b>Total net investment</b>	<b>SGNI = (S) + (T) + (U) + (V) + (W)</b>
<b>Total gross investment</b>	<b>SGGI = SGNI – (T)</b>
<b>Net borrowing</b>	<b>SGNB = SGCE + SGGI - SGCR</b>

This table can be replicated for each COFOG breakdown, which is what we have done to structure the data for the subsequent analysis. We have included an auxiliary function (which we call funding) for the grants received from the UK Government and tax receipts.

<sup>12</sup> Subtracted to obtain net investment.

<sup>13</sup> Included conceptually but assumed to be zero. This is generally small in the National Accounts at public sector level and in sub-sectors as well.

<sup>14</sup> Grants from central government subtracted as they are funding netted off expenditure.

<sup>15</sup> Grants from private sector subtracted as they are funding netted off expenditure.

## 2.3 Trends in Scottish Government expenditure and funding

Using the approach outlined, we can start to dig into the different ways in which Scottish Government spending has evolved over the past few years. This analysis covers 2018-19 to 2023-24 – the final full year for which data is available, and covers only ‘fiscal’ elements – that is, it excludes financial transactions<sup>16</sup> (borrowing or lending by the Scottish Government) which do not affect either revenues (public sector current receipts) or spending (total managed expenditure).

### 2.3.1 Scottish Government current expenditure

We can see from table 2.2 that total Scottish Government current expenditure has grown in real terms by 4.3% a year since 2018-19. But this period of time coincides with a substantial increase in social security devolution, which has grown in real terms from £192 million to £5.1 billion by 2023-24.

Table 2.2: Scottish Government current expenditure by economic category in real terms

Current expenditure <sup>17</sup> , £ million (2023-24 prices)	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	CAGR <sup>18</sup>
Pay	12,610	12,717	12,672	13,501	14,285	14,327	2.6%
Procurement	8,929	9,580	13,010	13,118	10,114	10,215	2.7%
Subsidies	1,543	1,538	2,207	1,950	1,365	1,287	-3.6%
Net social benefits	192	404	434	4,105	4,375	5,128	93.0%
Grants to local government	11,915	12,025	15,456	14,520	13,476	12,960	1.7%
Other current spending	2,861	2,626	3,527	3,344	3,496	3,094	1.6%
<b>Total current expenditure</b>	<b>38,050</b>	<b>38,891</b>	<b>47,305</b>	<b>50,538</b>	<b>47,111</b>	<b>47,010</b>	<b>4.3%</b>

Source: HM Treasury, Scottish Government, FAI analysis

Subsidies have fallen relative to the start of the period, largely as a result of the Scottish Government bringing ScotRail into public ownership from 1 April 2022. That nearly eliminated rail subsidies to the private sector in the accounts, but does mean that the Scottish Government is directly paying staffing costs and capital investment into ScotRail.

The remaining categories have grown in real terms, but at a lower rate than the headline figures would suggest. Pay and procurement have both grown at just above 2.5% in real terms year-on-year, which represents relatively strong growth in the context of the last 15 years. Paybill growth was particularly high in 2021-22 and 2022-23 (6.5% and 5.8% in real terms), though the latter is inflated by the bringing of ScotRail's paybill into the accounts

<sup>16</sup> An example of this would be lending through the Scottish National Investment Bank.

<sup>17</sup> This excludes grants from the UK Government, which in the full version of this table would be netted off expenditure. However, including them here would show artificially reduced government expenditure, and so they have been excluded.

<sup>18</sup> Compound annual growth rate.



instead of the subsidisation of the operator. Growth excluding the ScotRail effect would have been 3.4% in real terms – still a remarkable figure in one year.

Table 2.3 shows the evolution of the paybill across different functions of government. The 2021-22 paybill growth was spread mostly across health, public order and safety, and general public services. Public order and safety paybill increases were concentrated in the Crown Office, Courts and Tribunal Service, and police. And general public services – which incorporates the Scottish Civil Service, Scottish Parliament and other central functions such as committees and other voted bodies, also rose very strongly.

**Table 2.3: Scottish Government paybill by function of government in real terms**

<b>Paybill by function, £ million (2023-24 prices)</b>	<b>2018-19</b>	<b>2019-20</b>	<b>2020-21</b>	<b>2021-22</b>	<b>2022-23</b>	<b>2023-24</b>	<b>CAGR</b>
Health	8,459	8,296	8,245	8,520	8,859	8,936	1.1%
Public order and safety	2,438	2,555	2,474	2,689	2,750	2,635	1.6%
Education <sup>19</sup>	769	785	772	791	717	703	-1.8%
Economic affairs	319	202	203	202	524	588	13.0%
General public services	323	591	736	880	930	941	23.8%
Social protection <sup>20</sup>	52	78	53	166	248	260	38.2%
Other functions	251	210	188	253	257	263	1.0%
<b>Total</b>	<b>12,610</b>	<b>12,717</b>	<b>12,672</b>	<b>13,501</b>	<b>14,285</b>	<b>14,327</b>	<b>2.6%</b>

*Source: HM Treasury, Scottish Government, FAI analysis*

### 2.3.2 Scottish Government capital spending (gross investment)

On the investment side, there has been a marked real-terms increase in all forms of capital expenditure other than grants to the private sector – although a lot of this has been to do with the nationalisation of ScotRail. This has meant that a larger proportion of the capital formation taking place through the Scottish Government has been either in directly formation or acquisition of new assets rather than giving the private sector grants to acquire those assets. They also become publicly owned assets in this case, which would not have been the case under the previous model.

<sup>19</sup> This includes Scottish Government and arms-length bodies' employment, but not state-school staff (including teachers), who are paid by local government.

<sup>20</sup> This includes the administration of Social Security Scotland, but not the social care paybill, which is paid by local government.

Table 2.4: Scottish Government gross investment<sup>21</sup> by economic category in real terms

<b>Gross investment, £ million (2023-24 prices)</b>	<b>2018-19</b>	<b>2019-20</b>	<b>2020-21</b>	<b>2021-22</b>	<b>2022-23</b>	<b>2023-24</b>	<b>CAGR</b>
Gross capital formation	1,161	1,273	1,327	1,567	2,588	2,245	14.1%
Grants to Network Rail	411	429	742	617	1,043	959	18.4%
Grants to local government	1,062	1,297	1,138	1,014	1,194	1,344	4.8%
Grants to public corporations	16	73	102	88	96	86	39.4%
Grants to private sector	1,614	2,008	2,471	2,412	1,886	1,564	-0.6%
<b>Total gross investment</b>	<b>4,264</b>	<b>5,080</b>	<b>5,779</b>	<b>5,698</b>	<b>6,806</b>	<b>6,198</b>	<b>7.8%</b>

*Source: HM Treasury, Scottish Government, FAI analysis*

The rate of change between gross capital formation and grants to local government has been particularly stark. From a position where they were near enough equal in size in 2018-19, gross capital formation has grown by 14.1% a year in real terms, but even abstracting from the ScotRail change, it would still have grown at around 10% a year on average in real terms. Grants to local government – of which housing and economic development are the largest components – have grown much more slowly, at just under 5% a year, or roughly half the rate of direct SG capital formation on a comparable basis.

In terms of functions of government, health is the largest component of direct fixed capital formation by the Scottish Government. It has also seen a marked increase in spending, of the order of 10% a year on average since 2018-19. Public order and safety investment has also grown strongly relative to 2018-19, although it has dropped back somewhat since the pandemic.

Economic affairs (which includes transport, economic development, science and technology and agriculture, fisheries and forestry) had a large spike in 2022-23 to do with capital spending on rail as part of the nationalisation of ScotRail, but has otherwise remained steady. The remaining functions have been increasing steadily, with one of the big reasons being the setup and increase in scope of devolved functions like Social Security Scotland.

<sup>21</sup> This includes only capital transactions for which there is either the formation of an asset to be owned by the Scottish Government (capital formation) or the payment of a grant to a different part of the public or the private sector. It therefore excludes financial transactions such as lending of funds to third parties, because the making of funds available does not constitute capital formation in and of itself – only when it is disbursed to purchase or create an asset does it correspond to investment.

Table 2.5: Scottish Government gross fixed capital formation (GFCF) by function of government in real terms

<b>GFCF by function, £ million (2023-24 prices)</b>	<b>2018-19</b>	<b>2019-20</b>	<b>2020-21</b>	<b>2021-22</b>	<b>2022-23</b>	<b>2023-24</b>	<b>CAGR</b>
Health	577	601	540	699	956	941	10.3%
Economic affairs	376	363	333	328	936	352	-1.3%
Public order and safety	137	149	190	211	223	192	7.0%
Other functions	70	159	263	330	472	759	61.0%
<b>Total</b>	<b>1,161</b>	<b>1,273</b>	<b>1,327</b>	<b>1,567</b>	<b>2,588</b>	<b>2,245</b>	<b>14.1%</b>

Source: HM Treasury, Scottish Government, FAI analysis

### 2.3.3 Scottish Government revenues (current receipts and grants from the UK Government)

In terms of how SG revenues have evolved, we can also discern some interesting trends regarding the Scottish Government's funding.

Tax and other current receipts have been on an upward trajectory throughout this period, with only a small blip during the pandemic – which was to be expected. Scottish Government receipts have grown at an average of 0.7% a year in real terms

Table 2.6: Scottish Government revenues by stream in real terms

<b>Funding, £m (2023-24 prices)</b>	<b>2018-19</b>	<b>2019-20</b>	<b>2020-21</b>	<b>2021-22</b>	<b>2022-23</b>	<b>2023-24</b>	<b>CAGR</b>
Tax and other receipts	18,895	18,294	15,751	17,451	18,920	19,551	0.7%
Discretionary fiscal UK Government grants	18,273	20,003	33,721	32,121	26,404	26,347	7.6%
Ring-fenced resource UK Government grants (depreciation)	1,060	865	861	963	1,256	1,212	2.7%
Capital fiscal UK Government grants <sup>22</sup>	4,391	4,847	5,587	5,818	5,972	5,581	4.9%
<b>Total funding</b>	<b>42,620</b>	<b>44,009</b>	<b>55,920</b>	<b>56,354</b>	<b>52,551</b>	<b>52,691</b>	<b>4.3%</b>
<b>Discretionary fiscal resource funding</b>	<b>37,168</b>	<b>38,297</b>	<b>49,472</b>	<b>49,572</b>	<b>45,324</b>	<b>45,898</b>	<b>4.3%</b>
<b>Capital fiscal funding</b>	<b>4,391</b>	<b>4,847</b>	<b>5,587</b>	<b>5,818</b>	<b>5,972</b>	<b>5,581</b>	<b>4.9%</b>
<b>Total discretionary fiscal funding</b>	<b>41,560</b>	<b>43,144</b>	<b>55,059</b>	<b>55,390</b>	<b>51,295</b>	<b>51,479</b>	<b>4.4%</b>

Source: HM Treasury, Scottish Government, FAI analysis

<sup>22</sup> Includes a downward adjustment to account for the cost of IFRS 16 leases, which increased funding but has no corresponding expenditure – and therefore no fiscal consequences.

Even stronger has been the real-terms growth in discretionary fiscal UK Government grants, at 7.6% a year. This is in large part due to the devolution of some social security payments, which have been accompanied by a block grant adjustment reflecting the movements in analogous England and Wales welfare payments.

When combined, tax and other receipts and discretionary fiscal UK Government grants make up total discretionary fiscal resource funding available for the Scottish Government. This was £46 billion in 2023-24, and has been growing at a significant 4.3% a year in real terms since 2018-19.

On the capital side, fiscal UK Government grants have also grown by around 4.9% a year on average, though in this case the growth has nearly all happened up to 2020-21. In fact, capital grants were 0.1% lower in real terms in 2023-24 than in 2020-21, and 6.5% lower than in 2022-23 – a steep fall in a single year.

A final note in this section about the ring-fenced resource grant that the Scottish Government receives. This covers depreciation – which is an economically meaningful accounting for the loss of value of capital over time, but which has no spending power consequences for the Scottish Government. That is why we include it in the totals but do not devote much time to discussing it.

This approach also gives us an answer to an oft-asked question, which is the size of the Scottish Budget. This approach abstracts from items which the Scottish Government formally manages but that are entirely funded by the UK Government, such as public sector pensions. Therefore, we can say that the Scottish Government's discretionary spending power in 2023-24 was £51.5 billion – 26% of Scottish onshore GDP.

### 2.3.4 The overall fiscal balance of the Scottish Government

With this in mind, we can then put together the overall fiscal balance – or net borrowing when written with the opposite and more common sign in the public sector accounts – for the Scottish Government. This aligns with the PSAT presentation shown in table 2.1, and shows that in 2023-24 the Scottish Government ran a small resource surplus (about £100 million). On the capital side, it invested around £600 million in excess of grants, and therefore its net borrowing was £550 million.

Table 2.7: Scottish Government net borrowing in 2023-24 from a PSAT perspective

Transactions	2023-24 (£m)
Taxes on income, wealth and production <sup>23</sup>	19,297
Gross operating surplus	0
<i>of which: depreciation<sup>24</sup></i>	<i>0</i>
<i>of which: public corporations' gross operating surplus</i>	<i>0</i>
Interest and dividends from private sector and rest of the world	38
Interest and dividends (net) from public sector	115
Rent and other current transfers	101
<b>Total current receipts</b>	<b>19,551</b>
Current expenditure on goods and services	25,753
<i>of which: pay</i>	<i>14,327</i>
<i>of which: procurement</i>	<i>10,215</i>
<i>of which: depreciation</i>	<i>1,212</i>
Subsidies	1,287
Net social benefits	5,128
Net current grants abroad	-85
Current grants (net) within general government	-14,599
<i>of which: current grants received from Central Government (CG)</i>	<i>-26,347</i>
<i>of which: imputed depreciation grant from CG</i>	<i>-1,212</i>
<i>of which: current grants paid to Local Government (LG)</i>	<i>12,960</i>
Other current grants	1,784
VAT and GNI based EU contributions	0
Interest and dividends paid to private sector and rest of the world	184
Adjustment for the change in pension entitlements	0
<b>Total current expenditure</b>	<b>19,451</b>
<b>Gross saving</b>	<b>99</b>
Depreciation	1,212
<b>Current budget deficit</b>	<b>1,112</b>
Gross fixed capital formation	2,245
less Depreciation	-1,212
Increase in inventories and valuables	0
Capital grants (net) within public sector	-3,192
<i>of which: capital grants received from CG</i>	<i>-5,581</i>
<i>of which: capital grants received paid to CG</i>	<i>959</i>
<i>of which: capital grants paid to LG</i>	<i>1,344</i>
<i>of which: capital grants paid to public corporations</i>	<i>86</i>
Capital grants to/from private sector	1,595
<i>of which: capital grants paid to private sector</i>	<i>1,615</i>

<sup>23</sup> Excludes council tax as that is a local government receipt.

<sup>24</sup> PSCR depreciation is netted off with an imputed grant to from the UK Government to account for the fact that it is funded by the UK Government.

<i>of which: capital grants received from private sector</i>	-20
<b>Total net investment</b>	<b>-564</b>
<b>Total gross investment</b>	<b>648</b>
<b>Net borrowing</b>	<b>548</b>

*Source: HMT Treasury, Scottish Government, Office for National Statistics, FAI analysis*

This presentation allows us to state a number of figures on a comparable basis with what is used for the UK Government in terms of share of GDP.

In 2023-24, Scottish Government current receipts – that is, taxes<sup>25</sup> plus interest and dividend receipts and other current receipts – were £19.5 billion, equating to 9.7% of GDP.<sup>26</sup> Fiscal grants from the UK Government – current, capital and ring-fenced depreciation – were £33.1 billion, or 16.5% of GDP.

Current expenditure by the Scottish Government (excluding UK Government grants) was £47.0 billion, or 23.4% of GDP. Gross investment (excluding UK Government grants received) was £6.2 billion, or 3.1% of GDP. When put together, this means that Scottish Government net borrowing was £0.5 billion, or 0.3% of GDP.

<sup>25</sup> This includes Scottish income tax, land and buildings transactions tax and Scottish landfill tax, as well as non-domestic rates.

<sup>26</sup> For the purposes of this, GDP is taken to mean Scottish onshore GDP, which was £201.3 billion in 2023-24.

## 2.4 Deep dive 1: How has Scottish health spending evolved over the last few years?

Health is quite possibly the most important area that the Scottish Government has responsibility for. It [regularly tops polling](#) in terms of areas of concern for Scottish residents, and health or the NHS were mentioned no fewer than 18 times by the Finance Secretary in the last budget speech. And the NHS was the major frontline during the pandemic, underlining its critical importance.

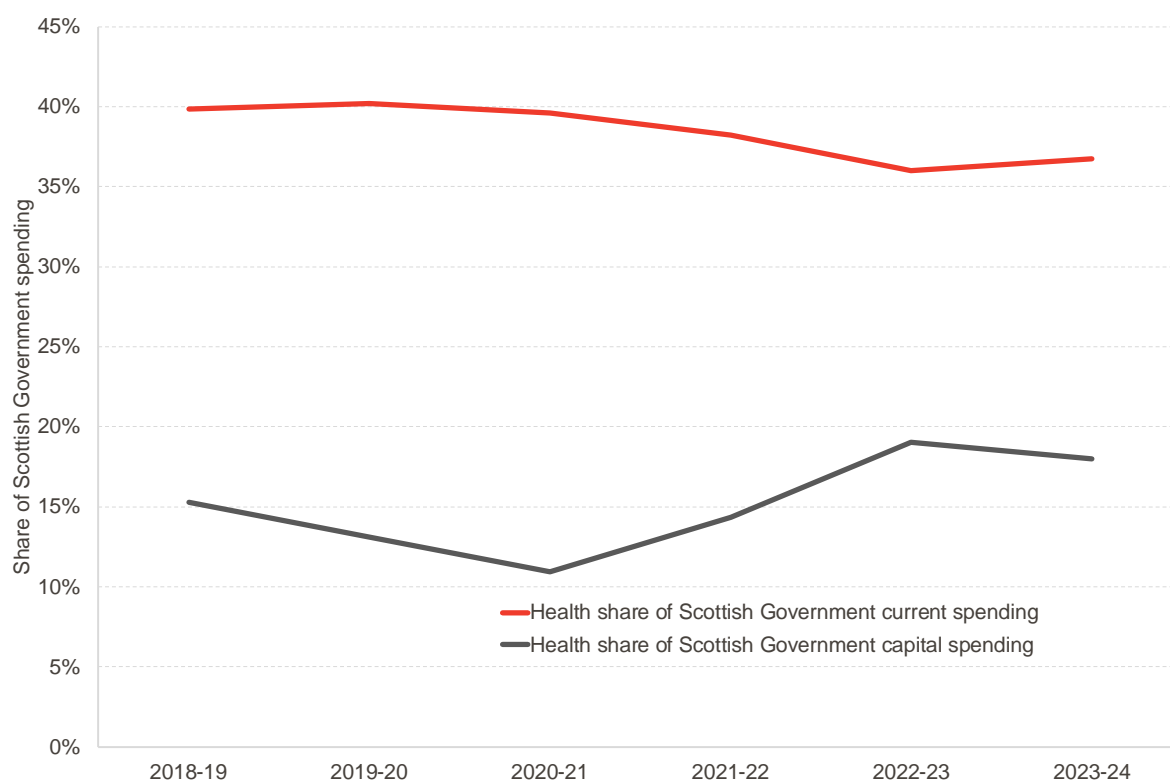
It's no surprise then that we'd be interested in looking at how spending in health care has evolved over the last few years. On top of the major pandemic interventions of 2020-21 and 2021-22, and which included the creation of a large and unexpected programme in the form of Test and Protect programme, the health service is also dealing with large waiting lists and the consequences of an ageing population putting greater pressures on health care demand.

To conduct this analysis, we used the same approach as outlined in sections 2.1 and 2.2, which go through the methodology in detail.

Of course health is an important part of government spending, but it still bears stating the figures. In 2023-24, the Scottish Government (SG) spent £18.7 billion on health, which accounted for 36% of its spending.

Most of this was current spending – £17.7 billion, or 38% of all SG current spending – but it is also a significant proportion of capital spending (£940 million, or 18% of all SG capital spending). While the current spending share has remained relatively stable, the capital share has increased significantly in the last couple of years.

Chart 2.1: Health spending as a share of total Scottish Government spending



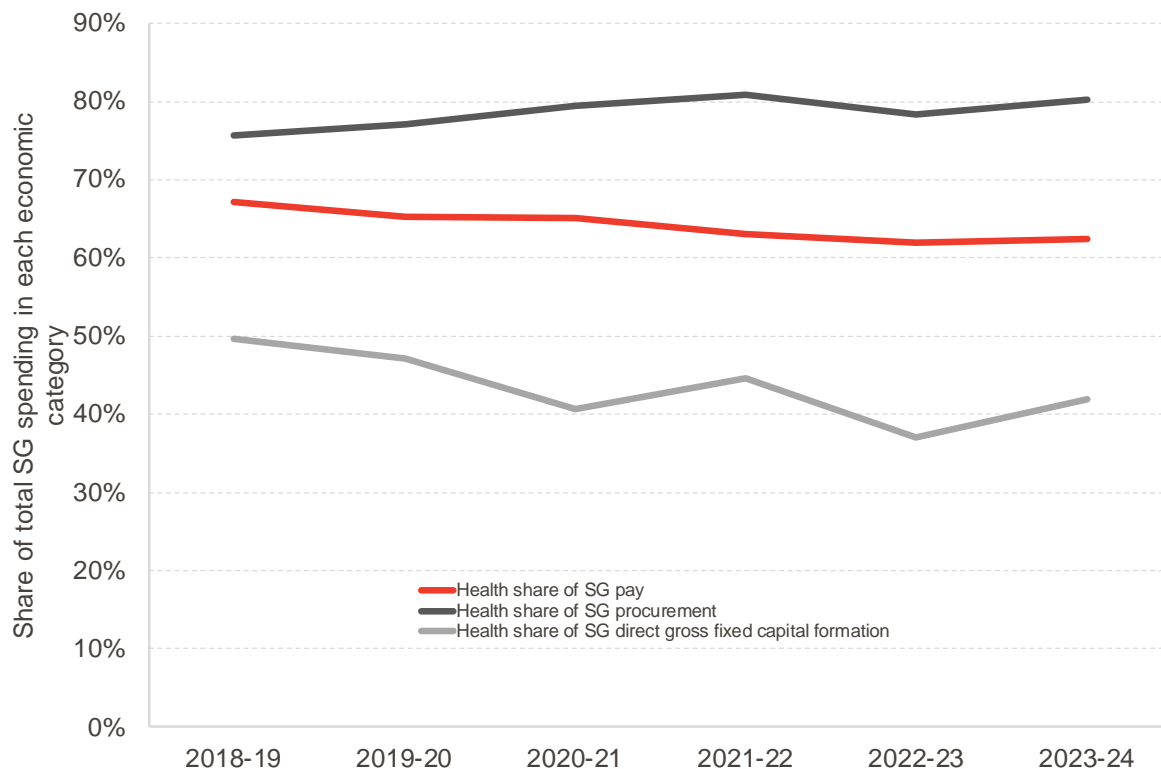
Source: HM Treasury, FAI analysis

The size of health spending is even larger with respect to direct provision of goods and services and direct capital investment. The proportion of total spending on pay that goes on health is just under two-thirds, even if that has declined somewhat recently. Half of direct capital formation is in health as well.

But the most noteworthy number is in terms of procurement. This is a category that includes a number of things, including contracted out services (GPs, but also agency staff) as well as supplies and medicines. Health accounts for a huge and growing share of SG procurement: £4 of every £5 spent in procurement goes on the health service.



Chart 2.2: Health spending as a share of total Scottish Government in selected economic categories



Source: HM Treasury, FAI analysis

When we delve into real-terms growth in the different types of spending, a surprising picture emerges. Since 2018-19, the total health paybill has only grown by an average of 1.1% a year in real terms – well below the 2.1% rate of growth in current health spending in real terms.

Instead, growth in procurement – which includes supplies as well as agency staff – has far outstripped that of pay. It has grown at an annual average of 3.9% in real terms from 2018-19 to 2023-24, and it is now close to parity with spending on pay. If these growth rates were to be maintained, procurement spending in the health service would overtake pay by 2027-28.

Capital spending has grown strongly, by an average of 10% a year – significantly higher than the growth in overall capital spending for the SG as whole, which has averaged 6.3% a year in real terms.

Table 2.8: Health spending by economic category in real terms since 2018-19

<b>Economic category (£bn, 2023-24 prices)</b>	<b>2018-19</b>	<b>2019-20</b>	<b>2020-21</b>	<b>2021-22</b>	<b>2022-23</b>	<b>2023-24</b>	<b>CAGR</b>
Pay	8.5	8.3	8.2	8.5	8.9	8.9	1.1%
Procurement	6.8	7.4	10.3	10.6	7.9	8.2	3.9%
Gross capital formation	0.6	0.6	0.5	0.7	1.0	0.9	10.3%
Other current spending	0.7	0.6	0.6	0.6	0.6	0.6	-4.5%
<b>Total health spending</b>	<b>16.5</b>	<b>16.9</b>	<b>19.7</b>	<b>20.4</b>	<b>18.3</b>	<b>18.6</b>	<b>2.5%</b>
<b>Of which current</b>	<b>15.9</b>	<b>16.3</b>	<b>19.2</b>	<b>19.7</b>	<b>17.4</b>	<b>17.7</b>	<b>2.1%</b>
<b>Of which capital<sup>27</sup></b>	<b>0.6</b>	<b>0.6</b>	<b>0.5</b>	<b>0.7</b>	<b>1.0</b>	<b>0.9</b>	<b>9.8%</b>

Source: HM Treasury, FAI analysis

<sup>27</sup> Includes some minimal other forms of spending through grants to the private sector, hence the difference relative to gross capital formation.

## 2.5 Deep dive 2: How has spending on child poverty evolved relative to overall Scottish Government funding?

The Scottish Government has four targets for reducing child poverty: [relative poverty](#), [absolute poverty](#), [low income and material deprivation and persistent poverty](#). These are set in legislation, and there are statutory 2030 targets in addition to interim 2023-24 targets. On top of this, [successive First Ministers](#) have highlighted reducing child poverty as one the biggest, if not the utmost priority for their governments.

Whether those targets are met or not is of course a matter for other publications, and that is an outcomes issue rather than being solely based on inputs. The latest data was released in March, covering 2022-23; at the time, we [concluded](#) that it looked unlikely that the interim targets would be met.

But though inputs are no guarantee of success, they are certainly heavily correlated. So what can we say about how spending on child poverty over the past few years has compared with Scottish Government funding?

To do this, we bring together two sources of data. One is the functional and economic category spending data that we have compiled for the report, and which allows us to do a more detailed breakdown of where Scottish Government spending goes – what it buys, and which form that takes.

The other is data on child poverty spending, based on successive Child Poverty Annual Progress reports. Every year since 2018-19, the Scottish Government has published an update that looks at how much is spent on child poverty, which can be categorised in two ways:

- **Targeted spending on child poverty**, that is, programmes for which all of its spending is directed at low-income households with children. These include direct transfers like the Scottish Child Payment, but also grants to local authorities to administer school-based programmes such as the School Clothing Grant, and provision of free school meals. A full list of those programmes is available in section 3 of the [2023-24 Child Poverty Annual Progress Report](#).
- **Indirect spending on child poverty**, that is, programmes that are aimed at low-income households but not necessarily with children. For these, an estimated proportion of spending that goes on households with children is provided by the Scottish Government on a programme-by-programme basis. These include, for example, carer's allowance, the affordable homes programme, council tax reduction, employability support, and the Scottish Welfare Fund.

The Scottish Government data shows that targeted spending has been increasing strongly, at an average of 21% year-on-year in real terms. The biggest source of increases in recent years has been the introduction and increase in the Scottish Child Payment, which represented £427 million (45%) of all target child poverty spending in 2023-24. Spending on school meals has also grown significantly since 2018-19, and by 2023-24 accounted for

another 18% of target spending. So these two programmes together are nearly two-thirds of the £954 million shown in table 2.9.

**Table 2.9: Scottish Government child poverty spending in real terms since 2018-19**

<b>Child poverty spending, £m (2023-24 prices)</b>	<b>2018-19</b>	<b>2019-20</b>	<b>2020-21</b>	<b>2021-22</b>	<b>2022-23</b>	<b>2023-24</b>	<b>CAGR</b>
Targeted spending	366	382	517	704	857	954	21.1%
Indirect spending	274	415	584	548	475	425	9.2%
<i>of which resource</i>	128	216	376	341	303	253	14.6%
<i>of which capital</i>	146	199	208	207	172	173	3.5%
<b>Total spending</b>	<b>640</b>	<b>797</b>	<b>1,101</b>	<b>1,252</b>	<b>1,332</b>	<b>1,380</b>	<b>16.6%</b>

*Source: Scottish Government, FAI analysis*

Direct spending is all in resource spending, whereas some of the indirect spending is on capital through the affordable homes and regeneration strategy programmes.<sup>28</sup> Our calculations indicate that indirect resource spending has grown at a slower rate than targeted spending (15% year-on-year in real terms), but that both have eclipsed the growth rate of indirect capital spending. In fact, a lower share of the capital budget went on low-income households with children in 2023-24 than in 2018-19 (3.1% and 3.3%, respectively) and spending on capital linked to child poverty has fallen by 13% in real terms since 2019-20.

**Table 2.10: Scottish Government spending as a share of discretionary fiscal funding since 2018-19**

<b>Child poverty spending, % of discretionary funding</b>	<b>2018-19</b>	<b>2019-20</b>	<b>2020-21</b>	<b>2021-22</b>	<b>2022-23</b>	<b>2023-24</b>
Resource spending	1.3%	1.6%	1.8%	2.1%	2.6%	2.6%
<i>of which targeted</i>	1.0%	1.0%	1.0%	1.4%	1.9%	2.1%
<i>of which indirect</i>	0.3%	0.6%	0.8%	0.7%	0.7%	0.6%
Capital spending	3.3%	4.1%	3.7%	3.6%	2.9%	3.1%
<b>Total spending</b>	<b>1.5%</b>	<b>1.8%</b>	<b>2.0%</b>	<b>2.3%</b>	<b>2.6%</b>	<b>2.7%</b>

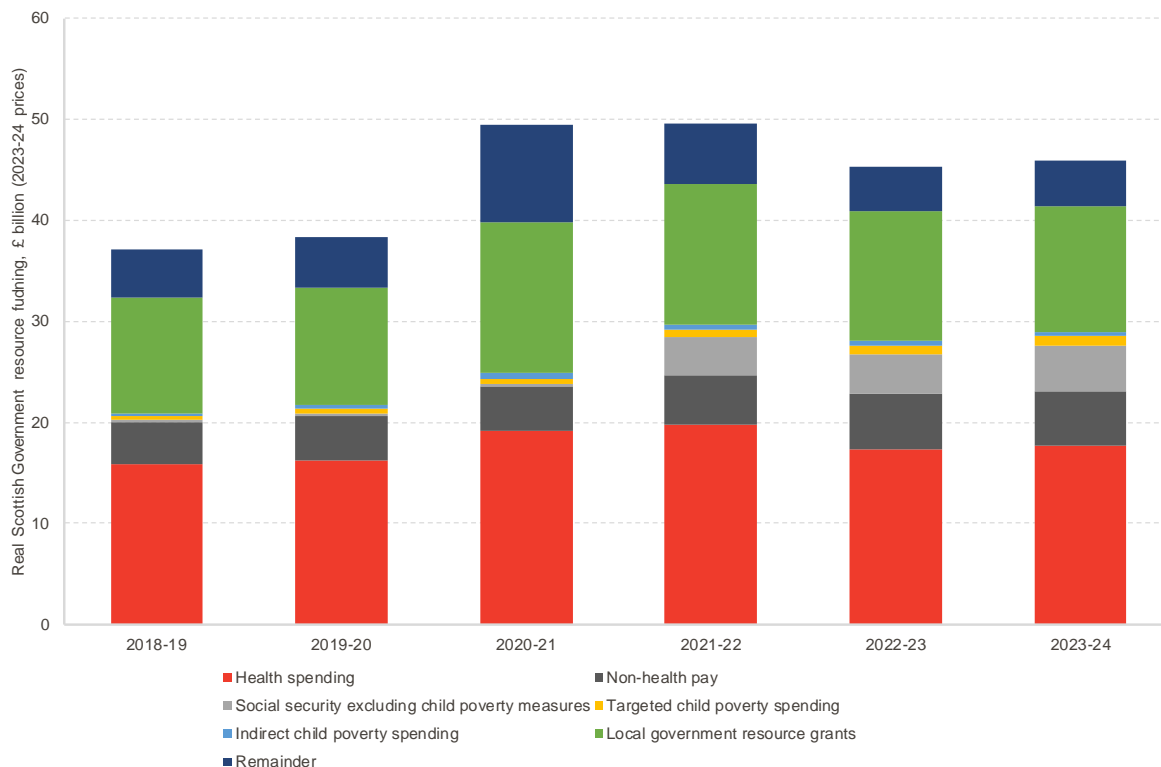
*Source: Scottish Government, HM Treasury, FAI analysis*

Since 2018-19, discretionary funding for the Scottish Government has grown from around £37 billion to £46 billion. But though this has grown significantly, and despite the increase in child poverty spending since then, it would not be fair to say that it has become a large part of the Scottish Budget – it remains under 3% of all discretionary resource funding. Health

<sup>28</sup> Note that we have assumed these are all spent on fiscal capital, that is, not on financial transactions. There is not enough detail in the Child Poverty Progress report to determine whether that is the case, but if it were to include financial transactions, then less of the capital resources would be going on indirect spending on child poverty.

spending, non-health pay, grants to local government and now social security excluding child poverty measures far outweigh it.

**Chart 2.3: Comparison between real-terms Scottish Government discretionary resource funding and selected categories of expenditure**



Source: HM Treasury, Scottish Government, FAI analysis

In fact, those four categories – health, non-health pay, social security excluding child poverty and local government grants – account for £7 in every £8 of Scottish Government resource funding. Once we include child poverty spending, this also highlights the challenge going forward for the Scottish Budget: all other programmes of day-to-day spending must be funded from just 10% of overall funding. With social security spending projected to continue outweighing the block grant adjustments and continued pay pressures, it becomes clear why the Scottish Government has and is likely to continue finding the path of public spending challenging. That is not to say that these are not perfectly reasonable political choices – it is a government’s choice how to disburse its funds, after all – but they come with real trade-offs.

## 3. Tax policy options and consequences

### 3.1 What might the Scottish Government do on non-domestic rates?

In the Budget, the Chancellor announced that Retail, Hospitality and Leisure (RHL) businesses would receive 40% rates relief in England next year, following a 75% relief in the current year.

RHL businesses in Scotland have had no such relief since 2021-22, which (as you can imagine) has led to many businesses saying they are at a disadvantage to their counterparts South of the Border. Given this extension in relief in England, businesses in the RHL sector are likely to be calling on the Scottish Government to follow suit.

Such a decision by the Chancellor does generate Barnett consequential for the Scottish Government, because the UK Government compensated English councils for the lost revenue. Business rates are devolved to all three devolved nations, and there is no obligation for any of the devolved governments to replicate measures in their jurisdiction.

Last year, we looked at the 75% relief announcement in England and tried to estimate how much it would cost to replicate. This analysis concluded that it was likely to cost considerably more in Scotland to replicate the relief than was provided through Barnett, because:

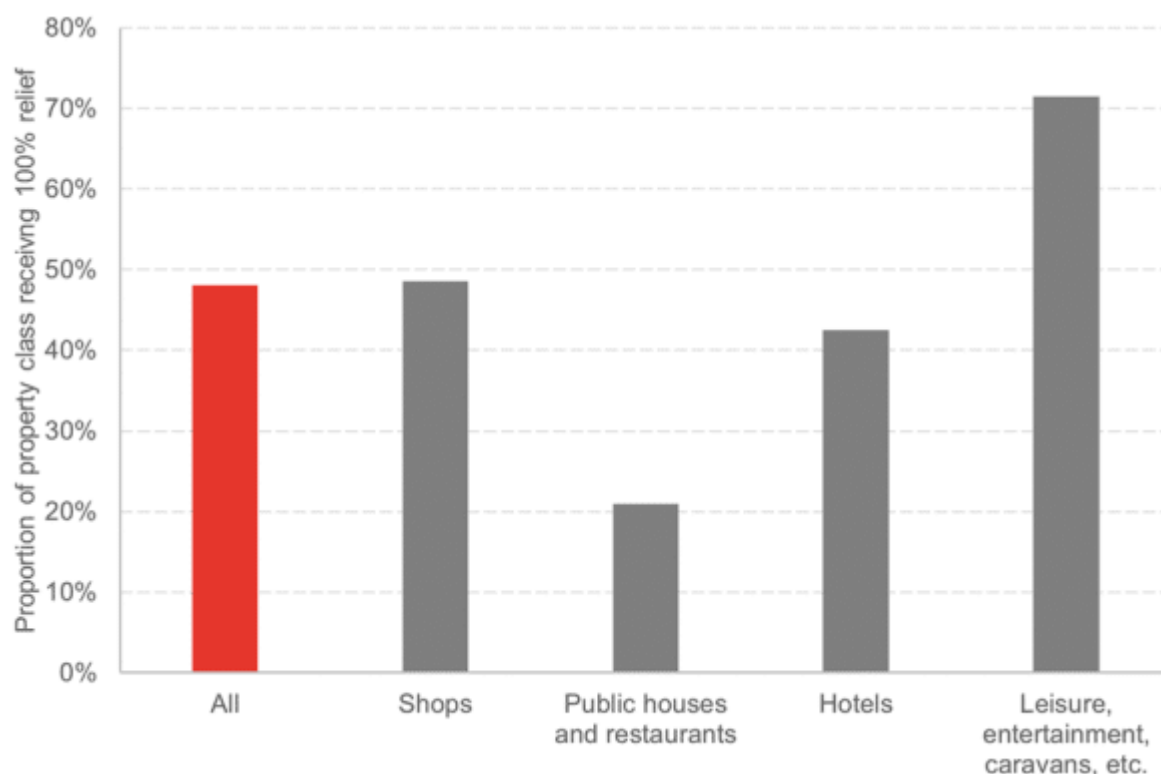
- The business rates system is just differently structured in Scotland; but mainly;
- RHL businesses make up a larger share of the property tax base in Scotland.

As we did last year, we have looked at the data available on the tax base for business rates to try to estimate how much it might cost to replicate the 40% relief in Scotland.

We must emphasise that this is not completely straightforward from the publicly available data. Whilst the Valuation Roll (which lists all properties and their rateable value) is a public document, the extent to which different properties attract reliefs is not on this database, so we have to make some assumptions about the extent to which properties may already be receiving reliefs. Obviously, for example, if a property is already receiving 100% relief (e.g. through the Small Business Bonus Scheme), then they cannot receive any more relief from the 40% measure, even if they are in RHL.

This is important because 100% relief for property is actually quite common: 48% of properties receive this.

Chart 3.1: Proportion of properties that receive 100% relief, selected property classes



Source: Scottish Government

The second challenge is that there is a cap on the amount of relief that an individual company can receive, which limits the amount of relief paid, but requires a property-by-property analysis (and some assumptions about multi-property companies) to understand the impact this has on the overall cost.

All of these assumptions mean our analysis will not be as accurate as a proper costing by the Scottish Fiscal Commission if the Scottish Government were to introduce this measure (given the additional data they have access to): and our attempt to account for multi-property enterprises is likely to be imperfect which might mean we are underestimating the impact of the cap (so slightly overestimating the cost of a new relief).

Having said all that – with all the caveats – our analysis suggests that it will cost roughly £220m to replicate this relief in Scotland, compared to the £147m that was generated by the decision in England through Barnett.<sup>29</sup>

<sup>29</sup> For those who are interested, you will note that this is not a linear reduction on our estimate for the 75% relief. This is because of the cap for each company again: companies are more likely to hit the cap with a higher level of relief so it is not as simple as it appears.

### 3.2 The impact of employer national insurance rise on the public sector in Scotland

Ever since Budget day, there has been an ongoing conversation about the largest tax rise announced by the Chancellor on 30th October. Many sectors of the economy have been calculating the cost of this employer national insurance increase, in many cases warning about the impact this may have on the sustainability of their organisations and perhaps limiting their ability to create new jobs or offer pay increases.

As a reminder, the Chancellor increased both the rate of employer NICS (from 13.8% to 15%) and lowered the threshold at which employers have to start paying NICs from £9,100 to £5,000. IT depends on the level of pay, of course, but for the vast majority of workers the threshold change will have a bigger impact than the rate change.

From the public sector point of view, the UK Government said they would compensate public sector employers “for higher tax costs due to the measure” through higher budgets. It was confirmed by the Treasury on the day of the budget that compensation for the devolved administrations for these increased costs would be in addition to the uplifts in funding already announced. What has not been clear is how the amount of compensation was going to be worked out.

There are a few different ways that this could be approached.

A fair question to ask is why can't the Scottish Government just calculate how much it would cost to change the National Insurance threshold and rate and give this number to the Treasury?

Unfortunately, it is not as simple as this. The Scottish public sector is made up of hundreds of different organisations, and the SG does not have access to the detailed pay bill information of all of these organisations. Perhaps this situation underlines that they should seek to have access to (and why not publish?) this information, but at the moment they do not.

The Scottish Government has collected information from across the Scottish public sector, asking bodies to estimate how much they think this will cost them, and they [published](#) this information last week. This came up with an estimate of around **£550m** in the cost to the public sector in Scotland, which included an estimate provided by COSLA for local government of £265m (more on this below).

Alternatively, we could look at the compensation that the UK Government has set aside, and take a proportionate share of it. The UK Government has set aside £4.7 billion to compensate public sector employers (although we do not know exactly how this was worked out). The size of the Scottish devolved public sector is 547,000, which is 9.2% of all public sector employment in the UK. This would suggest the Scottish share of this money should be **£432m**.



Finally, as was done when the Health and Social care levy was proposed in 2021, the level of funding for the devolved administrations could be worked out through the Barnett formula. So, as compensation is calculated for the Department of Health, Education, Local Government, Defence etc, the amount of funding generated would be linked to the level of funding provided to these departments and the extent to which responsibilities are devolved. The overall share of the compensation that was given in that case in 2021 was 7.7%. If it was something similar the compensation would be around **£362m**. But the devolved/reserved splits are always evolving so it may be that the number would be a bit different now on this basis.

The [BBC had a story](#) over the weekend that the Treasury have told the SG that the compensation would be between £295m and £330m. Given the size of this number, it seems likely that they are taking the Barnett share approach – but we are not sure.

One of the reasons for this large divergence in numbers is due to the larger public sector in Scotland (22% of employment compared to 17% for the UK) and the fact that it is relatively better paid.

We have examined data from the Annual Survey of Hours and Earnings, which is the most comprehensive data source on earnings, and includes a split between the public and private sector in Scotland. Looking at the distribution of earnings in the public sector, and accounting for those people near or below the new and existing threshold, we estimate that the change may cost £931 on average for each worker.

This suggests the following rough costs for each part of the public sector.

**Table 3.1: Breakdown of the cost of the employer NICs rise to the devolved public sector**

<b>Public sector body</b>	<b>Cost estimate (£m)</b>
NHS	173
Civil Service	26
Police and Fire services	25
Further education colleges	11
Other public bodies	21
Local government	244
Public corporations	7
<b>Total devolved public sector</b>	<b>509</b>

These are by no means definitive estimates, **as the actual costs will depend very much on the earnings distribution within each sector**. So, if a sector or organisation have used actual pay bill information to calculate a number, then it will be better than using the approach above.

One of the main differences between our estimate and the SG numbers is driven by the COSLA number. Our understanding, from talking to COSLA, is that they have assumed the rate uplift will apply to the whole paybill (so assuming no one is below the threshold),

although they have used 250,000 as the size impacted by the threshold change, which will account for some of this. We still think the £265m is likely to be an overestimate for 262,000 staff (although see what we're saying about ALEOs below). Note also that our estimates are lower than the figures collected by the SG, so we look forward to getting more information about how these have been calculated.

The boundary of the public sector is also quite tightly defined in the statistics above. The numbers above do not include Arms Length Organisations (or ALEOs) which are strictly in the public sector from a classification point of view but they are not included in these statistics.

There is not a recent source on how many ALEOs there are or how many people are employed in them (which is not ideal and should be addressed), but there are definitely dozens of them (maybe more than 100) employing low tens of thousands of people. The increased cost of these staff will ultimately fall on local government.

Overall though, this has highlighted a real data gap, where even if the Treasury wanted to compensate for the full cost it is very difficult to work it out. This doesn't seem good enough to us, so hopefully more of this data about the paybill can be centrally collected and made available to researchers like us.

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