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## Finance and Public Administration Committee

# Budget Scrutiny 2024-25

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# Contents

# Finance and Public Administration Committee

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(a) any report or other document containing proposals for, or budgets of, public revenue or expenditure or proposals for the making of a Scottish rate resolution, taking into account any report or recommendations concerning such documents made by any other committee with power to consider such documents or any part of them;

(b) any report made by a committee setting out proposals concerning public revenue or expenditure;

(c) Budget Bills; and

(d) any other matter relating to or affecting the revenue or expenditure of the Scottish Administration or other monies payable into or expenditure payable out of the Scottish Consolidated Fund.
(e) matters relating to public service reform and the National Performance Framework within the responsibilities of the Deputy First Minister and public administration.

2. The Committee may also consider and, where it sees fit, report to the Parliament on the timetable for the Stages of Budget Bills and on the handling of financial business.

3. In these Rules, “public expenditure” means expenditure of the Scottish Administration, other expenditure payable out of the Scottish Consolidated Fund and any other expenditure met out of taxes, charges and other public revenue.

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# Introduction

1. The Scottish Budget 2024-25 [1] was published on 19 December 2023 and sets out the Scottish Government's proposed tax and spending plans for the next financial year. It is accompanied by the Scottish Fiscal Commission's (SFC's) latest set of forecasts [2] for the economy, tax revenues, and social security spending which, alongside forecasts from the Office for Budget Responsibility (OBR) [3] , informs the overall size of the Budget for 2024-25.

2. For 2024-25, the SFC forecasts slow and fragile growth in both GDP[i] and real disposable income, with interest rate rises expected to continue to affect households and the economy, and inflation likely to stay higher than previously expected. Indeed, latest data from the Office for National Statistics (ONS) [4] shows unexpected inflation[ii] rises of 4% in the 12 months to December 2023, the first time the rate has increased since February 2023.

3. This report sets out the Finance and Public Administration Committee's findings from our scrutiny of the Scottish Budget 2024-25. Our starting point is our Pre-Budget 2024-25 Report on the Sustainability of Scotland's Public Finances [5] , which outlined the Committee's concerns regarding the Scottish Government's lack of long-term financial planning, affordability of spending decisions, and the absence of an overall strategic purpose and objectives for its public service reform programme. The evidence we have gathered during our budget scrutiny this year shows little sign of progress in these areas. The Committee also remains to be convinced that the Scottish Government has taken a strategic approach to targeting spend towards its three key Missions of Equality, Opportunity and Community as intended. This report provides further details of our thinking on these issues.

4. The report also reflects our consideration of the Scottish Parliamentary Corporate Body's (SPCB's) Proposal for 2024-25, as required under the Session 6 Agreement between the Committee and the SPCB [6] .

5. The Committee was supported in our scrutiny of the Scottish Budget 2024-25 by our adviser, Professor Mairi Spowage, and by the Financial Scrutiny Unit in the Scottish Parliament's Information Centre (SPICe). We thank them for their support. We also appreciate our witnesses taking the time to provide valuable evidence, which has helped shape our findings and recommendations.

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i Gross Domestic Product.

ii Consumer price index (CPI) inflation.

# Economic conditions

6. The economic context for this Scottish Budget is a story of essentially no growth over the course of 2023. The latest data for Scotland published in October 2023 [7] shows zero growth from January to October 2023 compared to 2022 levels, and the expectation was that this would persist for the remaining months of that year. On a more positive note, many analysts this time last year were expecting that Scotland would experience a technical recession during 2023, which has not materialised.

7. Inflation has remained higher for longer than was expected at the start of the year, although the UK Government's target to halve inflation by the end of 2023 was met. However, as noted above, the latest data confounded expectations to show a slight inflationary rise, from 3.9% to 4.0%. This uptick has been driven by increases in alcohol and tobacco prices, transport (particularly car repairs) and concert and event prices. This is offset by decreases in food price inflation, although this is still running at 8%.

8. Importantly, from the perspective of the impact on interest rates, services inflation remains higher than the headline rate, linked to historically high earnings growth. Both of these factors, along with disruption to international trade flows over the past couple of months, may, our Budget Adviser suggests, lead the Bank of England to be more cautious than many analysts are hoping on interest rate cuts. However, there is still an expectation that rates have peaked and that they will start to come down over the course of 2024.

9. Consumer sentiment, as measured by the Scottish Consumer Sentiment Indicator [8], while weak compared to pre-pandemic levels, has improved for the third quarter in a row. Our Budget Adviser notes that, despite the severe cost-of-living crisis still impacting most households, this slow but persistent movement towards positive territory for household finance and spending measures is an encouraging sign for the year ahead. Business sentiment is, she further notes, also improving, with most businesses expecting that there will be an increase in activity over the first half of 2024.

# UK context

## Office for Budget Responsibility's Economic and Fiscal Outlook: November 2023

10. The OBR published its Economic and fiscal outlook: November 2023 [3] alongside the UK Autumn Statement [9] . These five-year forecasts highlight that—

- The economy recovered more fully from the pandemic and weathered the energy price shock better than anticipated.
- Inflation is expected to remain higher for longer, taking until the second quarter of 2025 to return to the 2% Bank of England target, more than a year later than forecast in March.
- This domestically driven inflation increases nominal tax revenues compared to the OBR's March 2023 forecasts, however "it also raises the cost of welfare benefits, and higher interest rates raise the cost of servicing the Government's debts".
- The Chancellor meets his target to deliver debt falling as a share of GDP in five years' time "by an enhanced margin of £13 billion, but mainly thanks to the rolling nature of the rule giving him an extra year to get there".
- The tax burden rises in each of the next five years to a post-war high of 38% of GDP.
- The OBR has revised down its estimate of the medium-term potential growth rate of the economy to 1.6% from 1.8% in March, "largely driven by a weaker forecast for average hours per worker, which we now expect to fall in the medium term, rather than holding flat".
- Unemployment is forecast to rise to 1.6 million people (4.6% of the labour force) in the second quarter of 2025, around 85,000 people higher, and a year later, than expected in March.
- Living standards[iii] are forecast to be 3% lower in 2024-25 than their pre-pandemic level.

## UK Government's Autumn Statement

11. The Chancellor of the Exchequer, The Rt Hon Jeremy Hunt MP, labelled his Autumn Statement on 22 November 2023 [9] as an "autumn statement for growth", suggesting that the package includes "110 growth measures". The Chancellor explained his announcements are focused on five areas: "reducing debt; cutting tax and rewarding hard work; backing British business; building domestic and

iii As measured by real household disposable income (RHDI) per person.

sustainable energy; and delivering world-class education". He indicated that, due to "difficult decisions we have taken in the last year", the fiscal situation now allowed him to deliver a package of tax cuts to support growth.

12. Key tax measures announced include reduced national insurance contributions, permanent full expensing of plant and machinery investment costs[iv], extending business rates relief for retail, hospitality and leisure sectors in England, an alcohol duty freeze until 1 August 2024, and tobacco duty increases. The Chancellor's spending announcements include increases to universal credit in line with inflation (September 2023 figures) and the state pension in April 2024 by 8.5% in line with annual earnings growth for May to July 2023. He is also increasing the national living wage from 1 April 2024 by 9.8% to £11.44 an hour for eligible workers across the UK aged 21 and over and announced £80 million for the expansion of the Levelling Up Partnership programme to Scotland[v].

13. The Chancellor reaffirmed the UK Government's commitment set out in the Spring Budget 2023 that, from 2025-26, planned departmental resource spending will continue to grow at 1% a year on average and that public sector capital spending will be frozen in cash terms. The House of Lords Library states in its briefing on the Autumn Statement [10] that these spending targets "imply real terms spending reductions for 'unprotected' departments" from 2025-26 onwards. It highlights OBR estimates that the spending of unprotected departments would need to fall by 2.3% a year in real terms from 2025-26, increasing to 4.1% a year, should the UK Government continue with its ambition to increase defence spending to 2.5% of GDP and return overseas development assistance to its 0.7% of gross national income target.

14. According to the Chancellor, the Scottish Government is receiving £545 million in additional funding "as a result of decisions at the Autumn Statement".

15. During evidence on 12 December 2023 [11] , the OBR noted that the "real spending power of Government departments in England goes down by about £19 billion over the forecast period" due to the Chancellor leaving public service spending plans unchanged in cash terms, despite a higher forecast for inflation". The implication for Scotland, he suggested, is that "if those spending plans are sustained, there will be fewer real increases in Barnett consequentials for Scottish departments because in practice less is being spent in real terms on health, education, transport and other areas where spending is devolved here in Scotland".

16. On the UK Government's decision to freeze total capital spending, the OBR stated that "the Government has not set any detailed spending plans beyond next year [and so] it is not really possible for us to say what the implications are for public investment in the UK". He went on to say that "capital spending has increased as a share of GDP over the past few years, but it is expected to fall back down again over the forecast period if it is frozen in cash terms", adding "if such freezes were to

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iv This was due to end in April 2026.

v For Na h-Eileanan an Iar, Argyll and Bute, Dundee, and the Scottish Borders. The Chancellor stated that the UK Government will consider how to extend this programme further and will work in partnership with the Scottish Government "with the intention of delivering an extension to the Investment Zones programme in Scotland".

be maintained over a long period, we would expect that to have a negative impact on economic growth over the longer term".

17. The Chancellor has recently announced that the UK Spring Budget will take place on Wednesday 6 March 2024 [12] .

# Scottish Fiscal Commission's Economic and Fiscal Forecasts – December 2023

18. The SFC's Economic and Fiscal Forecasts – December 2023 [2] were published alongside the Scottish Government's Budget 2024-25 on 19 December 2023. The outlook for the Scottish economy is largely unchanged since its December 2022 and May 2023 Forecasts, "with a slightly less negative picture for 2023-24 compared to a year ago". It has revised up its forecast of real disposable income per person, however, the drop in living standards of 2.7% between 2021-22 and 2023-24 is "the largest reduction in living standards since Scottish records began in 1998". The SFC forecasts "slow and fragile growth in GDP and real disposable income per person, as the recent rises in interest rates continue to weigh on household incomes and the economy, with inflation also likely to stay higher for longer than we assumed previously".

19. The SFC notes that UK Government funding through the Block Grant has increased by £318m. Total funding in the 2024-25 Scottish Budget is £1.3bn higher than in 2023-24, a rise of 0.9% in real terms. While resource funding is expected to increase by £1.5bn, capital funding is set to fall by £173m in 2024-25, largely due to the reduced capital budgets applied by the UK Government.

20. The SFC explains that "most of the increase in resource spending is due to the improved income tax net position". This increase of £1.2bn since the SFC's May 2023 Forecasts is explained as being due to inflation and higher earnings growth resulting in increased income tax revenues. The SFC said it has "no strong reasons" to believe that the data it is using is either significantly under or overestimating Scottish tax revenues. However, there are risks and uncertainties, including Real Time Information (RTI) being an "imperfect predictor" of outturn data and a lack of information on self-assessment tax revenues. There are, it notes, similar uncertainties in the OBR's forecasts of UK income tax revenues.

21. The SFC highlights a reduced income tax reconciliation for 2021-22 (to be applied to the 2024-25 Budget). This now stands at -£390m, a reduction from the figure forecast in May 2023 of -£712m. This, the SFC explains, is partly offset by positive reconciliations for the Block Grant Adjustments (BGAs) of other devolved taxes and social security, with the full reconciliation figure at -£338m. In relation to the Scotland Reserve, the SFC notes that the Scottish Government has set the 2024-25 Budget "with no assumed funding from the Scotland Reserve, as it plans to use all the available balance in the current year (2023-24)". Any underspends arising could, it notes, be added to the Reserve and used in future years.

22. The SFC projects large positive reconciliations for years 2022-23 and 2023-24 as a result of revising up its estimates of the income tax net position for those years following higher than expected outturn in 2021-22 and higher than expected relative earnings growth in Scotland in 2022-23, alongside policies to raise additional revenues. As set out in the table below, a positive reconciliation for 2022-23 (to be applied to the 2025-26 budget) of £732m is forecast.

**Figure 1: Outturn and indicative estimates of income tax reconciliations**

| Collection Year | 2021-22 | 2022-23 | 2023-24 |
|---|---|---|---|
| Applies to Budget for | 2024-25 | 2025-26 | 2026-27 |
| Reconciliation (£m) | -390* | 732 | 502 |

Source: SFC

* cell refers to outturn available at time of publication.

23. On public sector pay, the SFC notes that increases "have a significant effect on Scottish Government spending", with 2023-24 pay estimated[vi] to account for over £25bn of resource expenditure across the devolved public sector, including local government (over half of the resource budget). In the absence of the Scottish Government's pay policy for 2024-25, the SFC has assumed average devolved public sector pay growth of 4.5% which, alongside other assumptions it has made, implies a fall in Scotland's public sector employment from 2023-24 onwards.

24. In the medium-term, the SFC expects total funding (resource and capital) to increase by 4% in real terms between 2023-24 and 2028-29, however capital funding is expected to fall by 20% in real terms over the same period. It however highlights that—

> Policymakers need to plan for the potential for funding from 2025-26 onwards to look quite different from the picture presented here. Due to the various funding sources and forecasts used, the outlook for the Scottish Budget is always somewhat uncertain but the high inflation environment is increasing the risk of large changes in funding. We note the current funding outlook from 2025-26 onwards has two particular elements of uncertainty: there is the risk the income tax net position provides a less positive contribution to funding than is currently projected, and at the same time UK Government spending could be higher than currently planned, increasing funding available to the Scottish Government.

vi Estimates from the Scottish Government.

# Scottish Budget 2024-25

## Scottish Government's approach

25. In her foreword to the Scottish Budget 2024-25, the Deputy First Minister explained that “in setting this budget the Scottish Government has adopted a values-based approach focused on our three Missions” for 2026 [1] . These are:

- Equality: Tackling poverty and protecting people from harm,
- Opportunity:A fair, green and growing economy, and
- Community: Prioritising our public services.

26. The Deputy First Minister goes on to say that “we have been compelled to take painful and difficult decisions in order to prioritise funding in the areas which have the greatest impact on the quality of life for the people of Scotland”, adding “we make no apology for deploying the levers available to us to deliver on our values – protecting people and optimising services”.

27. In evidence to the Committee on 16 January 2024 [13] , the Deputy First Minister elaborated on the Scottish Government’s approach to budget-setting for 2024-25—

> Our missions and values of equality, opportunity and community were the guiding principles of the budget, which is a budget to protect people as best we can, to sustain public services, to support a growing and sustainable economy, and to address the climate and nature emergencies. At the heart of the budget is our social contract with the people of Scotland, whereby those who earn more are asked to contribute a bit more, everyone can access universal services and entitlements, and those who need an extra helping hand will receive targeted additional support.

28. The Committee has sought during its scrutiny of the Scottish Budget 2024-25 to establish how the Scottish Government has ensured that its tax and spending plans align with its three Missions.

# Taxation plans

## Income tax proposals

29. As set out in the Scottish Budget 2024-25, the Scottish Government's policy on income tax for 2024-25 is to—

- increase the Starter and Basic rate income tax bands by inflation to £14,876 and £26,561 respectively. These rates, along with intermediate and higher and top rates, will remain unchanged,
- introduce a new 45p Advanced rate band for those earning over £75,000, and
- increase the Top rate of tax from 47p to 48p, paid by those earning more than £125,140.

30. The table below, from the SPICe briefing on the Scottish Budget 2024-25 [14] published on 4 January 2024 sets out the proposed Scottish tax bands and thresholds, 2024-25:

**Figure 2: Proposed Scottish tax bands and thresholds, 2024-25**

| Bands | Band name | Rate (%) |
|---|---|---|
| Over £12,570* - £14,876 | Starter | 19 |
| Over £14,877 - £26,561 | Basic | 20 |
| Over £26,562 - £43,662 | Intermediate | 21 |
| Over £43,663 - £75,000 | Higher | 42 |
| Over £75,001 - £125, 140** | Advanced | 45 |
| Above £125,140 | Top | 48 |

* Assumes individuals are in receipt of the standard UK personal allowance (£12,570 in 2024-25)

** Those earning more than £100,000 will see their personal allowance reduced by £1 for every £2 earned over £100,000

31. The SFC forecasts that the income tax proposals[vii] set out in the Scottish Government's Budget will generate revenues of £18,844m in 2024-25. As noted earlier in this report, its estimates for 2024-25 are £1.2bn higher since its May 2023 Forecasts, due to inflation and higher earnings growth resulting in increased income tax revenues. SPICe notes in its Briefing on the Scottish Budget 2024-25 that the income tax net position[viii] in 2024-25 is expected to be £1.4bn, and this figure is forecast to rise to £2.3bn in 2028-29, although, according to the SFC, the net position is highly sensitive to changes in its own forecasts and those of the OBR.

32. The Budget sets out that "Scottish income tax policy for 2024-25 will continue to build on our progressive approach to taxation, while raising additional revenue to invest in our vital public services". The Scottish Government explains that "we have

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vii Non-savings non-dividend income tax revenues.

viii The amount by which income tax revenues exceed the block grant adjustment for income tax applied to the Scottish Budget to account for devolved income tax decisions.

not taken our decisions on tax lightly and we recognise the challenging economic conditions that many people and businesses are facing", adding "that is why we are asking those who are best able to contribute to pay more for a purpose". The Scottish Government further notes SFC estimates that the decisions it has taken on income tax since 2017-18, including those in the 2024-25 Budget, will add around £1.5 billion of revenue in 2024-25 compared to the rates and bands applicable elsewhere in the UK.

# Income tax: behavioural responses

33. The SFC forecasts that introducing the new Advanced rate and increasing the Top rate of income tax by 1p would raise £82m in 2024-25, after taking account of assumed behavioural changes. Revenues, it notes, would be £118m higher without this behavioural response. The SFC explains that "increased income tax rates may lead to some taxpayers changing their behaviour, for example, increasing contributions into a pension scheme, reducing their working hours, leaving Scotland or more aggressively pursuing tax avoidance or evasion".

34. The SFC suggests that the behavioural modelling it uses, drawing from UK and international literature, is "reasonable and central", though it cautions there will always be some uncertainty. However, the relatively small sums involved means that, even if it had under- or over-estimated the behavioural response by as much as 50%, this would not pose a significant risk to the Budget.

35. Asked about the approach taken by the SFC to modelling behavioural change, the Fraser of Allander Institute (FAI) [15] suggested that "where things will end up is very uncertain, but the forecast is based on what is essentially the best available evidence [and] the SFC has set that out transparently". Professor David Bell from the University of Stirling [15] suggested that if income tax rates were reduced in England in the Spring Budget in March 2024, then the gap in Scotland will widen, risking an increased behavioural response. However, this move would slow the growth in income tax revenues in England, leading to a positive effect for Scotland under the Fiscal Framework.

36. The Scottish Government's response to the Committee's Pre-Budget 2024-25 Report [16] highlighted a policy evaluation of its 2018-19 increases in income tax rates [17] which "showed limited evidence of Scottish taxpayers lowering their taxable income in response to increasing tax rates". The Committee notes, however, that the gap between Scottish and rest of the UK income tax liabilities has widened since 2018-19.

37. The Deputy First Minister later told the Committee [13] that the Scottish Government has "of course, looked very carefully at the assessment from the SFC on any behavioural change, and that is factored into the net gain or benefit from the tax changes", adding that the £82m to be raised from the Advanced rate "is not an insignificant amount". She went on to say that HMRC is producing two separate pieces of analysis which would be available to inform SFC modelling for the 2025-26 Budget—

> The first is a dataset that covers the incomes and locations of UK taxpayers over a 12-year period up to 2021-22. That looks at historic trends of intra-UK migration of taxpayers at different income levels and whether any obvious factors have impacted trends. The second expands on its 2021 empirical study on taxable income elasticities by considering responses in labour market participation and intra-UK migration to the 2018-19 income tax reform. Both pieces of work will make an important contribution to the debate.

38. Some witnesses also raised concerns regarding the potential for higher income tax rates to affect Scotland's ability to attract and retain talent. The Scottish Retail Consortium (SRC), for example, suggested in written evidence [18] that "the additional Advanced band and elevated rates for higher earners adds further complexity to existing income tax rules and makes it potentially more expensive and challenging for employers in Scotland to attract and retain the specialist and senior talent they need". There is a risk, it argued, that businesses could seek to locate their highest paid roles and commercial operations outside Scotland, reducing the ability of the private sector to deliver highly paid jobs and the investment needed to grow the economy.

39. The Deputy First Minister was asked whether the Scottish Government was more focused on raising tax from high earners rather than broadening the tax base and, if so, what message that sends to people outside Scotland about it being an attractive place to live, work and invest. In response [13] , she highlighted net migration of on average 7,000 working-age people from the rest of the UK to Scotland, which she suggests adds significantly to Scotland's workforce and is important in growing the economy. She went on to say, however, "we should not be complacent about these matters, and we keep them very much under review".

40. **The Committee recognises the uncertainty around potential behavioural changes arising from increased income tax levels. We therefore welcome the analysis being undertaken by HMRC to identify any behavioural trends in labour market participation and intra-UK migration arising from income tax reforms. We look forward to examining how this analysis informs future forecasts and taxation policy.**

41. **We also seek further information on how the Scottish Government is keeping under review the potential impact on business and the economy of the differential income tax policies in Scotland and the rest of the UK.**

# Interaction of UK and Scottish tax policies

42. The Committee, in its Pre-Budget 2024-25 Report [5] , recommended that "every effort should be made to resolve current anomalies with the UK and Scottish tax systems relating to national insurance and personal allowance" and asked that both governments "seek to mitigate future anomalies through engagement on future tax policy where appropriate". In response [16] , the Scottish Government said it carefully considers the impact of such tax anomalies when determining future tax policy and

suggests that the UK Government has, so far, been unwilling to engage in considering the different tax policies when setting national insurance policy.

43. Professor Bell told the Committee [15] that the interaction between income tax and national insurance is a “massive issue” and suggested that “the UK as a whole should have addressed the bizarre ways in which the rules relating to the different elements of the overall tax structure do not integrate well together”. He suggested that the marginal rate for people earning £110,000 to £125,000 of 69.5% “is possibly the highest … in any OECD country” due to removal of personal allowance, while the FAI has previously highlighted concerns around the £43,000 to £50,000 rate where taxpayers are paying the higher rate of national insurance rather than 2%.

44. While complicated by the devolved systems, Professor Bell suggested there is a case to be made for income tax and national insurance rates to be reviewed together. He further noted decisions in the UK Spring Budget could add to these difficulties.

45. Asked how the Scottish Government takes account of the UK tax system when setting its own income tax rates, the Deputy First Minister acknowledged [13] that “part of the challenge of having a hybrid system and incomplete devolution of tax powers is that anomalies exist”. She added “there are areas that rub up against the UK system in a way that is not ideal” and noted that “this will be brought into sharp focus if further tax changes are made in the Spring Budget”.

46. **The Committee sees little evidence of either government seeking to avoid or resolve the anomalies arising from the way their tax and national insurance policies align, despite this having a significant impact on taxpayers in certain tax brackets in Scotland. We therefore repeat our calls to both governments to work together to mitigate these anomalies.**

# Labour market and earnings

47. The SFC forecasts an increase in Scotland’s unemployment rate from 3.2% in 2022-23 to 3.7% in 2023-24, compared to the OBR’s forecast for the UK of 4.3%. This divergence is due to a tighter labour market in Scotland and is reflected in higher nominal average earnings in Scotland in 2023-24.

48. According to the SFC, strong earnings growth, high inflation and its effects on fiscal drag, and policy changes have all supported a rising income tax net position, as shown in 2021-22 outturn data and this is set to continue into 2024-25. The SFC noted in evidence to the Committee [19] that Scotland’s earnings growth is the highest of any region or nation in the UK. Possible reasons include relatively cheaper labour encouraging businesses to expand employment in Scotland, more activity than expected in the oil and gas sector, protracted slower growth in financial services in London, asymmetric effects of higher interest rates across the UK, or ongoing tightness in the labour market driven in part by Scotland’s demographics.

49. The SFC highlights that, from 2025-26 onwards, the net position continues to rise,

driven partly by Scottish and UK policy divergence, and partly by differing forecasts of earnings growth by the SFC and OBR. There is therefore a risk to the projected income tax net position from 2025-26 if higher earnings growth in Scotland do not materialise. The table below from the SFC Forecasts show the change in income tax net position from 2021-22.

**Figure 3: Income tax net position from 2021-22**

| Year | December 2022: Income tax net position (£m) | December 2023 pre-measures: Income tax net position (£m) | December 2023: change (£m) | December 2023 post-measures: Income tax net position (£m) | December 2023 post-measures change (£m) |
|---|---|---|---|---|---|
| 2021-22 | -256 | 85* | 342* | 85* | 342* |
| 2022-23 | -106 | 542 | 648 | 542 | 648 |
| 2023-24 | 325 | 827 | 502 | 827 | 502 |
| 2024-25 | 700 | 1,330 | 630 | 1,412 | 712 |
| 2025-26 | 915 | 1.661 | 746 | 1,749 | 834 |
| 2026-27 | 1,068 | 1,800 | 732 | 1,896 | 828 |
| 2027-28 | 1,332 | 2,075 | 743 | 2,178 | 846 |
| 2028-29 | | 2,174 | | 2,288 | |

Source: Scottish Fiscal Commission

Figures may not sum because of rounding.

* refers to outturn available at time of publication.

50. The Committee explored projected earnings growth in greater detail during evidence. The FAI indicated [15] that 2021-22 and 2022-23 data gives some indication that earnings in Scotland were growing more quickly but questioned whether that growth would be sustained and highlighted “a real risk” for the 2026-27 budget if the Scottish Government was to face a worse reconciliation than expected. Professor Bell too said [15] , “given we do not know until maybe two years later what the exact figure is, reconciliations have to be made, which can come as very unwelcome surprises”. He further noted that some of the earnings growth was due to public sector pay settlements that had been made in Scotland in advance of England and so the next accurate figures due in April 2024 will “be very interesting to see”.

51. During evidence to the Committee [19] , the SFC suggested that “because Scotland’s tax system is now really quite progressive, for every 1% by which earnings grow faster in Scotland than they do in the rest of the UK, net tax revenue will go up by £250m” and £25m more than in the rest of the UK. This, it explained, “means that we get all the strong effects of both any earnings growth and any differential earnings growth in Scotland compared with the rest of the UK”. It went on to say that “promoting earnings growth is therefore a very powerful way of driving up tax revenue in Scotland”, and so “the more we can get earnings to grow faster in Scotland, the more we can get tax revenues to grow”.

52. However, long-term sickness, the SFC highlights in its Forecasts, continues to be “a large and persistent reason for inactivity” and remains “a downside risk to our projection of the labour force participation rate”. It forecasts trend productivity growth of 0.6% in 2023-24 and 0.8% in 2024-25, rising to 1.1% in 2028-29, which it notes is similar to OBR Forecasts for the UK.

53. The Committee has a continuing interest in ways of increasing productivity,

earnings and labour market participation to support economic growth and grow the tax base. In our Pre-Budget Report, we sought details of progress in delivering actions in the 10-year National Strategy for Economic Transformation, which the Scottish Government has cited as being key to achieving improvements in these areas. The Scottish Government's response identifies the roll-out of certain programmes and refers to its first NSET Annual Progress Report [20], published in June 2023. That Report sets out future priorities including publishing a labour market participation plan, "with action to improve the wider support system for people looking to enter the labour market and stemming the flow of individuals leaving work prematurely".

54. In evidence to the Committee on 12 December 2023 [11], the IFS argued that to address the UK's labour market challenges "first, we need a strategy for getting people who are out of work and are economically inactive into work [and] secondly, we need to know how to help those who are in work to progress, and how we can get the productivity gains that can ultimately deliver wage gains". It commented that "we have done the latter particularly badly during the past 15 years".

55. The IFS went on to highlight that the data on labour market trends "is being exposed as being quite poor", with a substantially lower response rate to the ONS Labour Force Survey (LFS)[ix] leading to inconsistencies between that data and HMRC's Real Time Information (RTI). For example, "based on the LFS, Scotland seems to have had an improvement in its labour force participation and employment relative to the rest of the UK, since before the pandemic …, however, HMRC data shows that Scotland has the lowest increase in employment of any region of the UK—2.7% compared with about 4% in both England and Wales and 6% in Northern Ireland".

56. This issue was also raised by Professor Bell who suggested [15] "there is a question about how representative [the LFS] is and therefore how you have to weight it". The FAI further highlighted [15] that "we have no sub-UK data at the moment being published by the ONS and that is because the survey has such a low response rate as a whole that they can't really rely on it for UK-wide numbers let alone sub-UK results". The FAI suggested therefore that "we don't really know the level of inactivity in Scotland", while Professor Bell advised that "if you want to take effective policy action [on economic inactivity], you must base it on accurate data".

57. The SFC Forecasts note that the "transformed LFS, which is currently being trialled with increased sample size, will be the long-term solution for providing high-quality labour market data for the UK and devolved nations from March 2024".

58. In response to the evidence heard, the Deputy First Minister told the Committee [13] that "average earnings in Scotland are growing faster than in the UK …, we have seen record income tax receipts, with Scottish income tax alone forecast to raise about £18.8bn in 2024-25 to help fund services [and] there are a number of indicators that show, on productivity as well, that the Scottish economy is improving its performance".

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ix The Labour Force Survey (LFS) is a study of the employment circumstances of the UK population. It is the largest household study in the UK and provides the official measures of employment and unemployment.

59. **The Committee welcomes the improved earnings growth that Scotland is currently experiencing, which is bolstering income tax revenues to support spending in these challenging financial circumstances. We, however, note the risks highlighted by the SFC and other witnesses regarding the implications for the Scottish Budget should higher earnings growth not materialise from 2025-26 onwards. We therefore seek details of how the Scottish Government is planning to mitigate the risks of significant reconciliations in future years as a result.**

60. **The Committee seeks further details of the Scottish Government's plans to produce a labour market participation plan. This should include proposals to reduce economic inactivity and set out how the Scottish Government is engaging with business and the further and higher education sectors to ensure the plan addresses current and future skills challenges. We consider this work to be overdue and therefore ask that development of both the plan and its delivery progress at pace.**

61. **The Committee is concerned at the evidence we heard regarding the unreliability of the ONS Labour Force Survey and a lack of data at devolved nation level, due to reduced sample size. Without accurate data, governments are limited in their ability to put in place effective policy interventions to address labour market participation and economic inactivity. We therefore ask the Scottish Government what steps it is taking to encourage improvements in this area and how it will assure itself that the new survey being trialled is reliable.**

## Non-domestic rates

62. In line with a recommendation from the New Deal for Business [21] , the Scottish Government's Tax Advisory Group (TAG) has been asked to "consider the role of Non-Domestic Rates (NDR) and other taxes in achieving the right balance between sustainable levels of taxation and creating a competitive environment to do business while also supporting communities".

63. In relation to NDR for 2024-25, the Scottish Government has frozen the Basic Property Rate (BPR) charged to properties with a rateable value of up to and including £51,000, at 49.8p, and increased other rates by inflation. NDR reliefs are also maintained, and 100% relief will be offered to island hospitality businesses, capped at £110,000. The SFC forecasts that the cost of freezing the BPR is around £200m per year and that the increases to the intermediate and higher property rates will increase revenues by around £170m a year.

64. The freezing of the BPR was welcomed by the SRC, though it expressed disappointment that the rates freeze was not extended to premises liable for the intermediate and higher property rates.

65. In his Autumn Statement [9] , the Chancellor announced a one-year extension of the UK Government's Retail, Hospitality and Leisure (RHL) relief which provides a 75% discount to businesses occupying eligible retail, hospitality and leisure properties in

England, with a cap of £110,000 per business. The OBR estimated [3] that this announcement generated £230m of Barnett consequentials for the Scottish Budget, however, the FAI has suggested [22] that replicating this relief in Scotland would cost up to £360m "due to there being less concentration in the RHL industries in Scotland, which means relatively fewer businesses affected by the cap".

66. The SRC argued [18] that this decision is a "regrettable omission, more so as … Barnett consequentials were forthcoming" and noted that Scottish businesses had already missed out on 18 months of this relief. The FSB told the Committee on 9 January 2024 [15] that passing on the 75% relief was one of its "big asks". However, given other business reliefs in Scotland not available in England, it recognised that a lower rate might be applied, such as the 40% relief being passed on in Wales.

67. The Deputy First Minister explained to the Committee that freezing the poundage for the sixth year "is not an unsubstantial measure and our small business bonus goes further than anywhere else in these islands". The Scottish Government's targeted relief to islands hospitality businesses "is partly in recognition of the particular challenges that the hospitality sector in those communities has suffered [and] the measure will give us good evidence of the difference that supports make to the hospitality sector". She added that discussions with the hospitality sector are continuing and that she is sympathetic to providing more support should more resources become available.

68. **The Deputy First Minister [13] informed the Committee that "had money been available in a way that did not lead to our having to make hard choices in relation to providing NDR relief and funding the health service, I would have wanted to do more for hospitality, given … challenges for the sector in the post-Covid environment". The Committee notes concerns raised in evidence that the Barnett consequentials relating to retail, hospitality and leisure businesses in England were not passed on to Scottish businesses in full.**

69. **We welcome the Scottish Government's plans to gather evidence on how the relief it has introduced for islands hospitality businesses is making a difference. We seek further details of how it will use this evidence to inform future decisions relating to support for the sector.**

# Council tax

70. The First Minister announced [23] on 17 October 2023 that council tax bills would not increase in 2024-25, bringing "much needed financial relief to those households who are struggling in the face of rising prices". The Scottish Government confirmed in the Scottish Budget 2024-25 that it is providing an additional £144m of funding to enable councils to freeze council tax rates. This, it explained [24] , is based on an above-inflation 5% rise in council tax nationally and that talks with COSLA are ongoing over how this is allocated.

71. Witnesses discussed the extent to which the council tax freeze is a progressive policy, the impact on local authority spend, and whether that revenue could have been better spent on other priorities, such as further increases to the Scottish Child Payment to help meet child poverty targets. On 9 January 2024, the Joseph Rowntree Foundation (JRF) highlighted [15] analysis from the IPPR Scotland [25] that the freeze is "ineffectual" and "will do little to help the poorest households". Professor Bell told the Committee [15] "I find it difficult to justify the freezing of council tax, because, in general, it benefits better-off households".

72. More broadly, the FAI suggested [15] that "a question could reasonably and fairly be asked about whether some of the tax measures, as a whole, have been focused solely on equality", noting that while higher earners are being asked to pay more income tax, people in valuable households are seeing their council tax bills frozen.

73. The FAI also highlighted the impact of the council tax freeze on local authority financing and spending. It explained [15] "the point that we have been making ever since the freeze was announced is that in order to be able to say whether councils have been fully compensated or not, based on their behaviour in previous years, consideration needs to be given to what councils would have done otherwise". Some councils, such as Orkney which raised council tax by 10% the previous year would only be compensated for 5% next year, while some others, which may have increased council tax by a lower amount, would gain from the approach.

74. As in previous years, council tax reform was highlighted as a priority by some witnesses. In response to the Committee's conclusion in our Pre-Budget 2024-25 Report [5] that "like many others, we believe that a more fundamental reform of council tax is now overdue", the Scottish Government said [16] that "the announcement of a freeze recognises the regressive impact of council tax and underlines the importance of reform".

75. The Deputy First Minister explained in evidence to the Committee [13] that the council tax freeze is intended to be "a one-year intervention [and] is designed as a lever to try to help relieve the pressure that household budgets continue to be under", adding that the measure "probably has a larger impact on those on lower-to-medium incomes".

76. Asked about basing the funding of the policy on a 5% increase in council tax, she restated that this is an average of the projected increases in council tax by local authorities and said it would not have been viable to base the funding on the actual amount each local authority had planned to increase council tax. She did, however, recognise that separate structural and distributional issues exist for some local authorities, such as Orkney, and said that the Scottish Government "will need to look at how it can support the council to address these".

77. **The Committee notes that the Scottish Government's decision to freeze council tax for 2024-25 does not expressly target those in poverty. We therefore question how the policy aligns with the Scottish Government's plans to prioritise spending on areas that deliver its three Missions.**

78. **The Committee seeks an update on progress with undertaking a**

**fundamental reform of council tax to ensure fairness and develop a sustainable funding model for local authorities.**

# Other taxes

79. The Scottish Government announced that residential Land and Buildings Transaction Tax (LBTT) rates and bands would be maintained at their current levels, and that first-time buyer relief and the 6% additional dwelling supplement rate would continue. The SFC is forecasting [2] £730m in LBTT revenue in 2024-25, a reduction from £813m in 2023-24, due to a fall in house prices and transactions. It does not anticipate housing prices or transactions returning to their 2022-23 levels until 2026-27. Projected LBTT revenue increases to £1,072m in 2028-29.

80. As noted in the Scottish Budget, the Scottish Government recently introduced legislation [26] to make various amendments to LBTT, including extending timelines related to the additional dwelling supplement, and clarifying measures relating to joint buyers, inherited property and interests. We look forward to considering this statutory instrument in the coming weeks.

81. From 1 April 2024, the standard rate of Scottish Landfill Tax (SLfT) increases to £103.70 per tonne and the lower rate to £3.30 per tonne, in line with planned UK Landfill Tax increases. The SFC forecasts SLfT to raise £58m in 2024-25. As the policy objective of SLfT is to effect behavioural change, revenues are expected to fall over time. The SFC explains that it has seen much lower than expected revenue in the first half of 2023-24 and so it has revised down every year of its forecasts.

82. The Budget refers to the Aggregates Tax and Devolved Taxes Administration (Scotland) Bill [27] , which was introduced in the Parliament in November 2023 and, if enacted, is expected to be introduced as a new Scottish tax on 1 April 2026. Our scrutiny of the Bill starts in February this year.

# Tax Advisory Group

83. In its Pre-Budget 2024-25 Report, the Committee welcomed establishment of the Tax Advisory Group (TAG)[x] as announced by the Scottish Government in its May 2023 Medium-Term Financial Strategy (MTFS) [28] . The Group is intended to “build on the Government’s inclusive approach to tax policymaking and will consider how best to engage with the public and other stakeholders on the future direction of tax policy, including whether a ‘national conversation’ on tax is required”. The Scottish Government’s response to the Committee’s Pre-Budget 2024-25 Report [16] notes that its Strategy for Tax in Scotland which will be published alongside the 2024 MTFS “will build on the core tax principles published in the Framework for Tax in 2021 [29] , as well as setting out how we will further develop our evidence and evaluation of the tax system to support sound tax policy-making”.

84. Both the MTFS and the June 2023 announcement [30] on the role and membership of the TAG stated that "the outcomes of this engagement will feed into the Budget 2024-25 and the development of the Government's longer-term tax strategy". However, the budget document does not mention any input from the TAG to the tax policy decisions made by the Scottish Government for 2024-25. The Committee therefore sought clarification from the Deputy First Minister on this issue. She explained to the Committee [13] that the Group was "never intended to provide an input to each budget" and was instead looking beyond year-to-year budget horizons and at the long-term strategy for taxation.

85. **The Committee seeks clarity regarding the Deputy First Minister's comments that the Tax Advisory Group was never intended to provide input to each budget, when previous Scottish Government announcements were clear that the outcomes from this work would feed into the Scottish Budget 2024-25.**

86. **We also request an update on the TAG's work and confirmation that the new Strategy for Taxation is on course to be published in May 2024 as planned, particularly given our previous recommendation that "it is imperative that this work progresses at pace".**

x Information on the Group and its membership can be found here: Advisory group on tax strategy - gov.scot (www.gov.scot).

# Spending plans

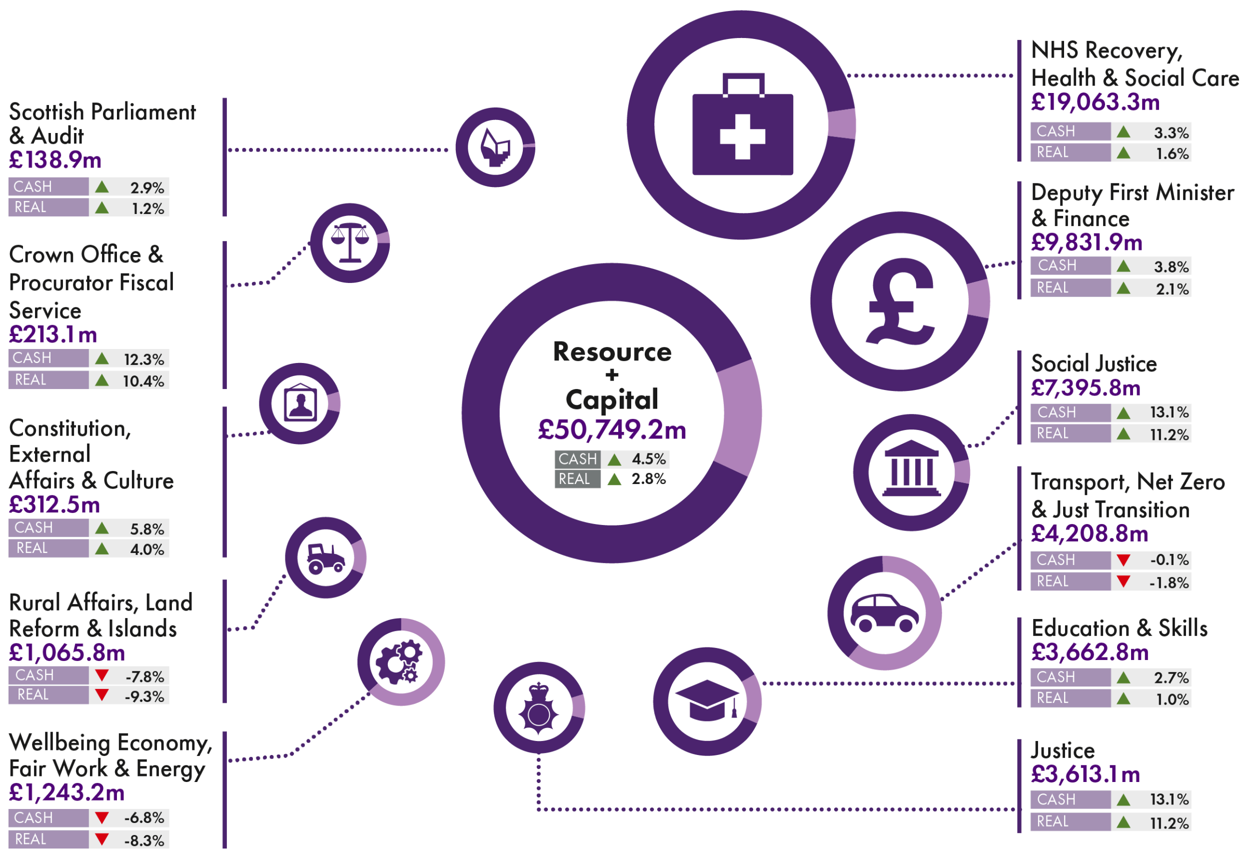
## Spending plans: overview

87. As noted in the SPICe briefing on the Scottish Budget 2024-25 [14] , eight portfolios increase in both cash and real terms, with the largest real terms percentage increases in Social Justice (which includes social security spending) and Justice – both see increases of 11.2% in real terms. The NHS, Health and Social Care portfolio benefit from an increase of 1.6% in real terms on 2023-24 figures.

88. The Wellbeing Economy, Fair Work and Energy (WEFWE), the Rural Affairs, Land Reform and Islands (RALRI), and Transport, Net Zero and Just Transition (TNZJT) portfolios see real terms spending reductions, with RALRI facing the largest percentage fall of 9.3% in real terms.

89. The SPICe briefing includes the Figure below showing fiscal resource and capital, including financial transactions, by portfolio for 2024-25 compared with the Budget agreed in the Budget Bill for 2023-24.

**Figure 4: Fiscal resource and capital, including financial transactions, by portfolio for 2024-25 compared with Scottish Budget 2023-24 as presented**




Source: Scottish Government

# Social Security spending

90. The Scottish Government announced that it is providing £6.3bn for social security payments, an increase of almost £1bn on 2023-24 figures. This includes increasing the Scottish Child Payment in line with inflation. The Scottish Budget 2024-25 [1] states that the Scottish Government is—

> … committed to delivering new Scottish Government social security benefits, including Pension Age Disability Payment and Pension Age Winter Heating Payment, in addition to the 14 new benefits already being delivered by Social Security Scotland, while progressing the national roll-out of Carer Support Payment, and ensuring people receiving benefits are treated with dignity, fairness and respect.

91. The SFC told the Committee [19] that it is expecting spending on social security to rise from £6.3 billion in 2024-25 to £8 billion at the end of the forecast period (2028-29). It expects social security spend to be £1.1 billion above the Block Grant Adjustment (BGA)[xi] next year and to rise to £1.5 billion more than the BGA by the end of the forecast period. The SFC explains that around half of the difference by 2028-29 is from new payments and the other half is from "what we think are changes in behaviours and the different type of system that is running ahead of the equivalent system that exists in England and Wales". The SFC, in its Fiscal Sustainability Report [31] published in March 2023, projects that social security spending will reach £13bn in 2072-73, when there is a projected budget gap of £1.5bn.

92. The impact of this significant planned uplift in social security spend on other areas of the resource budget was explored by witnesses. The JRF [15] favours the Scottish Government's approach to welfare over that of the UK Government and welcomed the protection of schemes such as the Scottish Child Payment, while the SFC [19] noted that the Scottish Government has limited ability to make changes to the level of social security spend each year until and unless it reforms its policy.

93. The Committee explored the sustainability of the Scottish Government's social security polices with witnesses. We heard from Professor Bell [15] that "social security is a valid priority [however], it comes with financial consequences" and the Scottish Government "will have to be upfront about what it is that it will cut in order to fund the additional social security payments". The SFC [19] suggested that "there is little space for new spending once we take account of pressures such as the ongoing consequences of changes to devolved social security payments and the linking of payment rates to inflation", while the FAI [15] further highlighted that prioritisation of social security (as well as health spending) "has come at a cost [and] it is for the Scottish Government and Scottish Parliament to assess whether that is a worthwhile cost".

94. The Deputy First Minister told the Committee [13] that social security "has now

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xi The difference between funding received by the Scottish Government for social security through the Block Grant Adjustment and spending on the corresponding payments.

become a key pillar of spend by the Scottish Government and, it will undoubtedly help to support the most vulnerable", adding that she views the increase in Scottish Child Payment "as an investment in people that has arisen from a conscious and political choice". She further recognised "it is the right investment for the right reasons, but we are very aware of the need to ensure … that the investment in social security is sustainable".

95. **The Committee asks the Scottish Government how it will continue to assess the long-term affordability and sustainability of its social security policies and their impact on other areas of spend, particularly in light of the demographic challenges highlighted by the Scottish Fiscal Commission in its 2023 Fiscal Sustainability Report.**

## Developing and retaining the workforce

96. The need to retain, and attract skills to, Scotland as a key element of growing the economy was raised during both Pre-Budget and Budget scrutiny. We previously sought information from the Scottish Government on the steps it is taking to ensure that Scotland can retain the graduates it educates. In response, the Scottish Government referred to talent attraction and retention as forming a key strand of its ambitions to establish Scotland as a rapidly growing start-up economy and provided examples of showcasing Scottish companies around the world, which it states has been successful in increasing interest in Scotland from investors and entrepreneurs [16] . It further noted that the 2024-25 Budget provides scope to expand the Techscaler network, "delivering world class incubation and commercial education to Scottish start-ups". The Scottish Government later announced £9m to expand its Techscaler programme as part of the Scottish Budget 2024-25.

97. However, Professor David Bell [15] argued that this is "not a great budget in terms of [the Scottish Government's 'Opportunity' Mission and "ostensibly it doesn't look like the budget particularly favours economic growth", a view shared by the FAI. They both suggested that reduced budgets for the Scottish Funding Council, Employability, the Scottish National Investment Bank (SNIB) and enterprise agencies, as well as the reduced capital budget, could impact on inward investment, business growth, and the ability to develop skills in 'green' and high-wage jobs and to retrain people to return to the workplace. Potential impacts on delivery of the NSET are also unclear.

98. Cuts to the Scottish Funding Council budget were noted as an area of particular concern by witnesses. The FAI [15] said it was surprised by this decision given "training people for highly-skilled occupations and green jobs in the future growing economy should be a priority", while Professor Bell [15] suggested that "we are not good at retraining people who have become inactive, for whatever reason, to re-join the labour market [and] colleges can play a hugely positive role in that respect". According to Colleges Scotland [15] , the college sector has seen the equivalent of a 5% cut in its budget, yet the sector delivers on all three of the Scottish Government's priority Missions. It went on say that "colleges provide the fabric to support the economy, our communities and the people in them [and … give] people

opportunities, as well as hope, skills and work".

99. In its written submission [32] , Universities Scotland (US) highlighted cuts of £28.5m (resource) to the university sector and called for additional funding to be found "to protect the university teaching grant as far as possible in the interests of Scottish students". It goes on to highlight that the Scottish Government is expecting additional savings to be made in the higher education sector including from reducing first-year university places. Universities Scotland suggest that savings of around £4-5m from removing the temporary additional funded places created to address the consequence of teacher-assessed Highers during the Covid pandemic should be "reinvested in the unit of teaching resource for other home students". It also highlighted a "misconception" that universities can "make up for chronic underinvestment in the level of resource per Scottish student because of an ability to cross-subsidise from international student fees". US went on to say that not all universities have a high proportion of international students, although those that do may be affected by "major headwinds affecting international recruitment".

100. Professor Bell suggested [15] that the Scottish Government needs to "concentrate more on arguing the case on how the budget supports growth", for example, increases in the health budget and disability payments may help people return to work or contribute to the community in other ways.

101. The Deputy First Minister told the Committee [13] that "growth is a priority" and reiterated "we have had to make some very difficult decisions on where we make the investments", adding for example, "we need our enterprise agencies to focus on the key priorities, so there will be things that they are not able to do". On employability, she argued that "where employability funding has been reduced, whether it is through the in-year savings this year or last year, that has been an unfortunate consequence of the pressure on Scottish Government budgets". She explained in relation to university places that discussions are ongoing around what the university sector will deliver and are not yet concluded and confirmed that the Scottish Government is unable to sustain the funding of the 1,200 additional places that arose during the Covid pandemic. It is understood that this accounts for approximately £5m of the £28.5m reduction to the universities budget.

102. **The Committee is unclear, in light of spending cuts to further and higher education, enterprise agencies and employability, how the Scottish Government has, as intended, prioritised its spending towards supporting the delivery of a fair green and growing economy .**

103. **The Committee also notes from the Deputy First Minister's evidence that bodies, such as enterprise agencies, will be expected to focus their efforts on key priorities. We therefore seek further details of how the Scottish Government is assessing the impact on economic growth of the withdrawal of some of their services and support.**

104. Professor Bell [15] highlighted that the fall in agricultural support (of £33.2m) poses particular challenges for crofters who receive a higher proportion of their income from the state. The Deputy First Minister was asked [13] about the impact on rural areas of this reduction in funding, along with cuts of £3.5m to the land reform

budget, £33.6m to forestry budget and £6.9m to the overall marine budget. She responded that "it is a tough budget but we have tried to prioritise the sector's priorities within that" and "we will continue to support people who are farming and crofting in our most remote and fragile areas through £65m for the less favoured areas scheme in 2024-25—we are the only country in the UK to provide that vital support".

# Capital budget

105. The SFC forecasts that capital spending is set to fall by 4% in real terms between 2023-24 and 2024-25, and by 20% in real terms between 2023-24 and 2028-29. The Scottish Government plans to make full use of its increased capital borrowing powers (of £458m) under the updated Fiscal Framework to support capital investment in 2024-25[xii] and will consider accessing alternative sources of capital borrowing in future. The SFC explained to the Committee on 20 December [19] that "the key factor that drives the fall in capital is the block grant", and while the Scottish Government "might do some borrowing around the edges, … the big money comes mostly from the block grant".

106. In its 2023 MTFS [28] , the Scottish Government stated that as part of a prioritisation exercise in advance of the 2024-25 Budget, "we will prioritise capital spending which supports employment and the economy through the Scottish Government's infrastructure plans, and which has greatest impact on realising our three Missions".

107. The Scottish Government's Budget 2024-25 [1] highlights that, while its £6.25bn capital budget will "continue to be invested across a range of high priority areas to help maintain high-quality public services and achieve a just transition to a net zero economy …, delivering on our medium-term capital ambitions will not be easy". This is a larger cut than it had modelled for and "means that it will take longer to deliver all our planned capital projects and programmes – unless the UK Government changes course and increases its investment in capital programmes".

108. Professor Bell agreed [15] that the extent of the reductions to the capital budget announced in the UK Government's Autumn Statement "came as a surprise" and argued that both governments "should be increasing capital spending on public infrastructure" to support business and incomes. The SFC [19] made a similar point—

> Speaking as economists, we feel that, if capital investment is spent wisely, it can have a huge impact on the economy. It connects communities and means that businesses can become more productive and that connectivity both within the UK and outside it can be better. Therefore, all the evidence points to capital investment being a really important part of economic growth in the long run.

109. The FAI [15] also expressed concerns regarding the impact of low investment on growth, suggesting that "investment and capital per worker is one of the big drivers of economic growth in the long run". It, however, acknowledged that the Scottish

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xii The £450 million annual capital borrowing limit is now uprated annually in line with the forecast GDP deflator (1.7% for 2024-25).

Government is limited within its current framework, other than to decide how to allocate the capital budget it has been given.

110. The Deputy First Minister responded [13] to the evidence heard by saying “our capital investment is geared to try to use public capital in a strategic way that levers in private investment” critical to economic performance.

111. **The Committee is disappointed that reductions in capital funding available to the Scottish Government continue. We urge a change in policy in the UK Spring Budget to enable more investment in infrastructure to stimulate economic growth.**

112. **We also seek further information from the Scottish Government on the steps it is taking to use the limited capital spend it has in a strategic way that levers in private investment, as highlighted by the Deputy First Minister in evidence, and how it will measure success in this area.**

113. The SPICe briefing on the Scottish Budget 2024-25 [14] states that—

> The wider reductions to the capital budget are … seen in the Affordable Housing Supply Programme (AHSP) budget. This is being reduced by 27% in real terms in 2024-25. It is unclear how this will affect the Scottish Government's commitment to complete 110,000 affordable homes by 2032 and to invest £3.5 billion in the AHSP this parliamentary term.

114. A number of witnesses highlighted specific concerns regarding the impact of these cuts, including the JRF [15] , which suggested the reduction “is brutal in the context of the housing situation in this country”. It went on to say that there is a significant risk that the Budget could lead to a rise in poverty, particularly due to the cuts in the affordable housing budget and highlighted “no joined-up thinking” overall—"it feels as though the affordable housing budget was cut because something had to be cut”.

115. The FAI [15] further argued it is “hard to see how the cuts to the house-building budget and affordable housing supply budget square with the Scottish Government’s stated priority to increase the housing supply”. It acknowledged other types of housing and investment but argued that affordable housing “will have more impact, as it will allow affordability to perpetuate through the system”.

116. Asked why the Scottish Government had prioritised capital spend in the Police Scotland and digital connectivity budgets over affordable housing, the Deputy First Minister explained [13] that required projects are being funded. She went on to explain that the housing budget has traditionally been the recipient of financial transactions, which have dramatically reduced, and “we have had to deploy the £176m of financial transactions that we do have to the Scottish National Investment Bank (SNIB), in order to maintain its capability”.

117. The Deputy First Minister indicated that this was one of the most difficult decisions taken in this Budget and that, if the availability of capital funding changes, the housing budget would be her number one priority. Asked about the impact on the Scottish Government’s target of having in place 110,000 affordable homes by 2032,

the Deputy First Minister said that 14% of the target had been delivered so far, the profiling of the target would need to change, and private investment will be required to deliver the target. She also confirmed that there is “a clear appetite to invest”, particularly in mid-market rental properties.

118. **The Committee draws the Scottish Government’s attention to the significant concerns expressed by witnesses regarding its decision to cut the affordable housing budget in view of reductions to available capital. We seek further information on the impact of this decision on its target to build 110,000 homes by 2032.**

119. **We also ask the Scottish Government to demonstrate how this decision aligns with its own spending prioritisation criteria and whether it has fully assessed the potential impact on tackling poverty and growth.**

120. The SPICe briefing [14] notes that the SNIB’s financial transactions budget reduces from £238m to £174m (net of repayments), which “is the lowest budget settlement since 2019-20 when the SNIB was launched”. Concerns were raised by witnesses regarding the impact of these cuts on various investments, including net zero. Professor Bell suggested [15] that “in of itself, the bank cannot push us directly towards net zero—we need private sector investment—and with the directive that it has to support investments in that policy area, the bank can support that kind of investment”. He went on to suggest that “the cut might slow down more speculative investments in new technologies that could accelerate the move towards net zero”, adding “perhaps there are alternative funding mechanisms, but thus far the SNIB seems to be the one institution that is very clearly aimed at that particular issue”. The FSB [15] had called for an increase in the investment that the SNIB makes in small businesses to encourage growth, and indicated “obviously, a cut in the budget for the Bank this year gives us a concern about whether it will be able to do that”.

121. NatureScot, however, said [15] it could see “some positives in the budget settlement in the pivot towards supporting the nature and climate crisis”, including future statutory targets in relation to nature degradation linked to climate change.

122. On net zero, the Deputy First Minister was asked [13] about the £69m funding for the offshore wind supply chain, including £32.9m of capital funding, which forms part of the Scottish Government’s recent commitment to spend £500m in this area. She explained that the investment was recommended by the Scottish Government’s Investor Panel, “which said that sector is the one key investment that [it] can make that will have a substantial return for the Scottish economy”. The Deputy First Minister went on to quote figures from the FAI’s The Economic Impact of Scotland’s Renewable Sector – 2023 Update [33] published on 18 December 2023 showing that “Scotland is seen as a good place to invest because of that certainty of objective”. This Update also found that Scotland’s renewable energy industry and its supply chain supported more than 42,000 jobs and generated over £10.1bn of output in 2021.

123. **The Committee recognises that overall reductions to the Scottish**

**Government's capital budget impacts on its ability to target funds towards achieving net zero. We seek further details of how it is mitigating these challenges, including attracting private investment, to make greater progress towards delivering a fair, green and growing economy.**

124. The Scottish Government, in its 2023 MTFS [28] , stated that "to help to address the difference between the capital funding and spending outlook, we plan to publish a reset of the project pipeline … alongside the 2024-25 Budget – providing transparency over which projects may now be delivered over a longer timescale". Its Infrastructure Investment Plan (IIP) and Capital Spending Review were both also extended by one year to 2026-27. The Committee previously committed to consider this information as part of budget scrutiny.

125. The updated pipeline was not published alongside the Scottish Budget 2024-25. Audit Scotland told the Committee [15] that the Scottish Government is planning to undertake work on "understanding better or mapping out, how it intends to prioritise its infrastructure spending", adding "we can say that it cannot afford to do what it originally planned to do".

126. The Deputy First Minister confirmed [13] that the Scottish Government would provide an update on the capital delivery of existing infrastructure at the end of January and the updated IIP would be published in the Spring following the UK Spring Budget. She added "it will be important to see what [the Spring Budget] looks like before we introduce the IIP revisions as the budget could end up impacting positively or negatively on capital".

127. **The Committee is not convinced of the need to wait until after the UK Spring Budget before publishing the updated infrastructure project pipeline. Regardless, the Scottish Government should have been upfront about the delay and the reasons behind it.**

128. **We seek publication of the updated project pipeline and Infrastructure Investment Plan by Easter 2024.**

129. In 2022-23, the Crown Estate Scotland concluded the first round of the ScotWind offshore wind leasing process which enabled developers to apply for seabed rights to plan and build windfarms in Scottish waters. This round generated over £756m. The SFC highlights [2] that the Scottish Government has a remaining £660m of ScotWind proceeds available to spend. The Scottish Government had planned to use £310m in 2023-24 and £350m in 2024-25 but has now decided to use £150m less in the 2024-25 Budget and deployed this funding in 2023-24. The Scottish Government will therefore have used all the income from ScotWind between 2022-23 and 2024-25.

130. Professor Bell argued [15] that the ScotWind funds should be regarded as equivalent to a sovereign wealth fund which should be used to support future generations. He explained that "to be equitable, it should not be spent only on the generation that has been lucky enough to have that revenue gathered" and agreed with the

suggestion that fiscal rules should be applied to protect the funds.

131. The Deputy First Minister, in response to this suggestion, said [13] that "in an ideal world, where there would be no need to plug gaps in day-to-day spend, I can see the appeal of building a sovereign wealth fund with money from ScotWind". She argued, however, that the Scottish Government had "no option but to use all the tools at our disposal", including Scotwind revenues, in order to sustain public services. She said the Scottish Government would continue to consider the setting of fiscal rules, but "the difficulty is that, if I was sitting here with £350m unallocated in a certain fund, I imagine that there would, understandably, be calls for that money to be deployed in order to avoid some difficult decisions".

132. **The Committee seeks further information regarding the strategic parameters of the fiscal rules applied to ScotWind. The Committee is attracted by the concept of funding generated from sources such as ScotWind being placed in an investment fund for future generations. While we understand the challenges facing the Scottish Government in meeting day-to-day financial pressures, this is a question of long-term strategic financial planning. We, therefore, ask that the Scottish Government gives consideration to these suggestions for future leasing rounds.**

# Medium and long-term planning

133. In its 2023 MTFS [28] , the Scottish Government committed to publishing refreshed multi-year spending envelopes alongside the 2024-25 Budget. In our Pre-Budget 2024-25 Report [5] , we recommended that these should include sufficient detail to enable meaningful parliamentary scrutiny and to allow public bodies to plan ahead.

134. The Scottish Government has only published single-year spending plans for 2024-25. It explains [1] that this is because “the nature of the Autumn Statement and the OBR’s forecasts make future prospects more volatile, and it could be misleading to plan too far ahead across the board”. It plans to “revisit the multi-year outlook” in its next MTFS in May 2024. The SFC notes [19] “the Scottish Government’s argument would be that, while there is uncertainty about the net tax position and about what the UK Government might do, it can do a budget for only one year”, however, “as the independent fiscal institution, we find that disappointing and think that the Scottish Government should set out multi-year spending plans”. It went on to say that “in our role as the independent fiscal institution for Scotland we encourage the Scottish Government to plan its budgets over both the short, medium and long term”, an approach it suggests is even more important against a backdrop of uncertainty.

135. Witnesses told the Committee [15] about the impact on their organisations of having single-year spending plans. The SCVO argued that this presents significant challenges for planning the delivery of services, staffing levels and, in some cases, can threaten the viability of voluntary organisations. Colleges Scotland said that multi-year budgets provide an ability to plan and to make much better decisions. GCC however argued that having certainty around budgets is more important than having a longer-term view and NatureScot argued that some certainty in the medium-term would help to support relationships with its partners and those bodies it funds.

136. While acknowledging it is difficult for the Scottish Government to produce multi-year plans in these uncertain times, the FAI suggested [15] “it would be helpful to have multi-year plans that show what the [budget] gap is going forward … so that a better conversation can be had across Scottish society about what decisions will have to be made”.

137. **The Committee notes that the Scottish Government only receives funding for one year. Nevertheless, we agree with the Scottish Fiscal Commission that the Scottish Government should set out multi-year spending plans to support planning and scrutiny. Despite the uncertainties ahead, we believe that it was possible for the Scottish Government to provide some indicative figures for future years alongside the Scottish Budget 2024-25 as intended.**

138. **We seek assurances and certainty that it will publish multi-year spending plans with the next Medium-Term Financial Strategy in May 2024.**

139. The Committee strongly recommended in our Pre-Budget 2024-25 Report that the

Scottish Government produces a full response to the SFC's Fiscal Sustainability Report setting out the actions it will take to start addressing the longer-term challenges ahead. The Scottish Government's response is silent on this recommendation. Asked when the Committee can expect to see this response to the report, the Deputy First Minister said [13] —

> I will be happy to furnish the committee with that longer-term plan after the Spring Budget. The MTFS in May will be a key point at which I can set out what the medium term looks like … The point that you are looking at goes a bit beyond that, into the longer term, and … I will try to furnish the committee with as much information as possible on that at the earliest opportunity.

140. Concerns were raised regarding an overall lack of strategic longer-term planning. Professor Bell for example told the Committee [15] that neither the UK Autumn Statement nor the Scottish Budget were "fiscal events for future generations". He went on to highlight that the view should be long term, in particular to have plans in place to deal with sudden shocks such reconciliations, citing they "could easily cost us £1bn". He suggested, while the latest MTFS pointed to there being a significant budget gap, decisions to address this appeared to be taken at the last minute, rather than approaching them in a more considered way. The FAI had a similar view [15] , highlighting that, while the Autumn Statement took place only a few weeks before the Scottish Budget, the projected shortfall was set out in May and so decisions could have been taken earlier.

141. **The Committee remains concerned that the Scottish Government still appears to be primarily occupied with resolving immediate funding issues, with little focus on medium to long-term planning.**

142. **We are also disappointed that the Scottish Government did not respond to our strong recommendation that it produces a full response to the Scottish Fiscal Commission's Fiscal Sustainability Report. This was a missed opportunity to demonstrate a long-term planning approach and to start to address the significant challenges ahead.**

143. **We note the assurances from the Deputy First Minister that she will provide a "longer-term plan" after the UK Spring Budget. We restate our expectation that this includes a full response to the significant future challenges set out in the SFC's report.**

144. **We also request an update on when the Scottish Government will seek to schedule a parliamentary debate on this important report, as committed to in its response to our Pre-Budget 2024-25 Report.**

# Transparency

## Budget comparisons

145. The Committee is focused on enhancing the transparency of budget documentation and welcomes the engagement it has had with the Scottish Government on these issues to date. We note the Scottish Government's favourable response to the Committee's recommendation that, to support transparency, it should adopt a similar approach to that of the UK Government and the SFC in comparing its Budget plans for spending with the latest estimates or outturns from the previous year's spend.

146. While this information is not provided within the budget document itself, the Scottish Government has advised [16] that it "recognises the need to provide this information and will set out the requested detail in an additional on-line publication in January 2024". The Committee believes this data will provide a more accurate comparison of changes to budget lines year on year, a view supported by some witnesses we heard from during this budget process. At the time of writing, this information has not been published and could therefore not be considered as part of our budget scrutiny.

147. **The Committee welcomes the engagement we have had with the Scottish Government to date on enhancing the transparency of budgetary information and we look forward to continuing our discussions on additional improvements that can be made.**

148. **We ask that in future years the comparison of its spending plans with the latest estimates or outturns from the previous year's spend is published alongside the Scottish Budget, to support transparency and maximise opportunities for scrutiny.**

149. The Scottish Government also accepted our previous recommendation, and that of the SFC, to produce budgetary information by Classification of the Functions of Government (COFOG), such as health, education, and social protection, allowing comparisons over time. This year, COFOG data was published alongside the Scottish Budget on 19 December 2023 [1] .

150. On 23 January 2024, the SFC published Spending trends in the 2024-25 Budget [34] , which provides new analysis of the Scottish Government's spending plans between 2022-23 and 2024-25 using COFOG and additional detailed data provided by the Scottish Government. The analysis shows "a steady and rapid growth in spending on the category of social protection, as a result of UK-wide trends for rising demand for disability benefits, as well as Scottish Government policy choices". Spending on health has not kept up with inflation, mainly due to cuts in capital funding. The SFC further notes "spending as the year evolves can be significant", highlighting provisional outturn data for 2022-23 showing that spending was almost £1bn higher than expected when the budget was set. It therefore suggests that, as 2024-25 progresses, health spending may increase if additional

funding arises or if there are reprioritisations within the Scottish Budget.

151. A number of technical challenges were identified by the SFC during this analysis, including presentational adjustments and internal transfers. The accompanying letter from the SFC Chair [35] states “we encourage the Scottish Government to publish and share with us spending data that enable more detailed analysis and note that their usefulness would be even greater if some of the complexities relating to their collection and presentation could be resolved”.

152. **The Committee welcomes the new SFC analysis of data by Classification of the Functions of Government, which we consider enhances transparency in the comparison of key areas of spending over time.**

153. **We ask the Scottish Government to consider how it can share additional spending data and resolve the technical difficulties identified to enable the SFC to further develop this analysis. We would also be keen to see the analysis published at an earlier stage in the budget process to enable greater opportunities for committee scrutiny.**

154. Our Pre-Budget 2024-25 Report [5] recommended that the Scottish Government explicitly sets out in the Scottish Budget 2024-25 if there are “any areas of spending it has assessed as not meeting its three missions test and where funding will, as a result, be reduced or ceased entirely”. The Scottish Government’s response [16] states that the published portfolio allocations will reflect where investment has been sustained and prioritised. However, while the figures provided in the Scottish Budget show where funding has been reduced or ended, there is little explanation of why these decisions have been taken.

155. However, witnesses felt that greater transparency and explanation of the Scottish Government’s spending decisions, including why it is prioritising some areas of spend and deprioritising others, would be helpful. The JRF told the Committee [15] that “there is something about being intentional and saying where it will spend money and why”, adding for example, “it should be possible to say, “We don’t have the funds to spend lots of money, but we hear from people all the time about the mental health struggles that they face, so we will prioritise investment in that”. The FAI suggested [15] there is strength in acknowledging the ‘trade-offs’ and bringing decisions together in a coherent way and “how things that might cut across different portfolios come together to form one direction of travel in a particular area”.

156. Witnesses also supported the need for more consistent presentation of budgetary information, for example, for comparative purposes all budget lines should be set out in real or cash terms rather than using these terms interchangeably. The forestry budget was highlighted as an area that saw increases last year and significant reductions this year, which the FAI commented [15] as being “surprising” as “if it was thought to be a priority last year, I cannot see why it would not be this year”.

157. The SCVO and Colleges Scotland both said [15] they are unclear from the figures in the Scottish Budget 2024-25 about the level of funding they can expect to receive, an issue exacerbated by a lack of detail and funds coming from different budget

lines. Asked specifically when the colleges budget would be known, the Deputy First Minister said [13] that the position would be clarified “as quickly as possible” and that the final position would take into account demand-led expenditure “to make sure that the landing position of colleges is what is required for them to deliver the services that they are required to deliver”. She further clarified that the process is no different than in previous years.

158. Other specific issues raised with the Deputy First Minister included the need for more clarity regarding the increases to the budget line for student support to show that much of this money could not be used as it relates to UK funding for student loans as part of Annual Managed Expenditure (AME). An inconsistency in the presentation of spending for public private partnerships across portfolios was also raised.

159. The Committee heard from Dr Alison Cumming from the Scottish Government [13] that “we are aware that there are long-standing inconsistencies in presentation between portfolios”, but “it is difficult for us to make a lot of changes to level 3 budget presentation from one year to the next in a way that would maintain the line of sight”. She went on to say that “it will always be a question of judgment, but we would be happy to work with the Committee on whether we have the right level of disaggregation at levels 3 and 4, and what changes to that disaggregation would enhance Parliament’s scrutiny of the budget”.

160. **The Scottish Government has said that its taxation and spending plans have been prioritised to deliver its three Missions of Equality, Opportunity and Community. However, the Committee is unclear from the information provided that a rounded strategic approach has been taken to assess and prioritise those areas of spend that will make most impact in delivering these Missions. In future years, it would be helpful to see a more detailed explanation of the Scottish Government’s assessment of spend against its overall priorities, along with the trade-offs it has had to make.**

161. **We further ask the Scottish Government to consider how it can resolve inconsistencies in the presentation of budgetary information and provide greater clarity to organisations at an earlier stage about the level of funding they will receive. We would in particular like to see consistency in relation to how public private partnership payments are set out in the budget.**

# Taxonomy approach

162. In its Pre-Budget 2024-25 Report [5], the Committee welcomed that both capital and resource[xiii] would, for the first time, be included in an enhanced taxonomy approach to identify and categorise all spending lines across the Scottish Budget with regards to their climate impact.[xiv] The Scottish Government agreed to provide this information in response to recommendations of the Joint Review of the Budget as it relates to climate [36] and related research from the FAI on Improving emissions assessment of Scottish Government spending decisions and the Scottish Budget [37].

163. The Scottish Government published this Taxonomy data as an Annex to the 2024-25 Budget [1]. This highlights that—

> … around 9% of budget spend is positively aligned with the delivery of the Scottish Government's climate objectives [and] 2% is negatively aligned, primarily delivering road and livestock investments which support emission generating activity. The vast majority of spend, 72%, is neutral delivering on core objectives which generate relatively little emissions domestically but may have higher emissions when evaluated in consumption terms; this is primarily healthcare and social funding. Local government funding (around 16% of the total) is excluded from the taxonomy assessment.

164. The Scottish Government assesses 75% of resource spend as neutral and 51% of capital, with 'negative high' at 1% in resource and 7% in capital. It explains that adopting this taxonomy approach "represents an overall proportional improvement in future budget reporting". It adds however that "because the taxonomy is new and different in approach to previous years, analysis of 2024-25 does not include a comparison to previous years: instead, it aims to set a provisional baseline from which to learn".

165. The SPICe Spotlight Blog on the Scottish Budget 2024-25 [38] notes that "these 'enhancements' do not tackle the big challenges in understanding how this spending will contribute to meeting Scotland's climate targets". It adds that "we do not know what outcomes will be achieved by this spending – do the current allocations of negative spending set Scotland on a path to meet the emission reduction targets, to what degree is 'positive' spending offset by 'negative' [spend], and how will spending decisions in 2024-25 contribute to emissions in future years?". The blog concludes that "unfortunately, this new taxonomy does little to increase the ability of parliament to understand or scrutinise the impact of the Budget on Scotland's climate".

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xiii Previously this information was provided for capital spend only.

xiv Further information on this can be found in this Joint Letter from the Deputy First Minister and Cabinet Secretary for Net Zero, Energy and Transport to the FPA Committee, 18 November 2022.

166. **The Committee welcomes the publication of taxonomy information for both resource and capital this year and notes that this aims to set a provisional baseline from which to learn. We ask the Scottish Government to consider how it can continue to develop this data in future to enable year-on-year comparisons and to better support scrutiny of the impact of budget decisions on climate change.**

# National outcomes

167. The Committee looks forward to leading the Scottish Parliament's scrutiny of the proposals for revised National Outcomes in 2024. In our Pre-Budget 2024-25 Report [5] , we asked the Scottish Government to provide an update on progress towards "developing an approach centred around multi-year programmes, the associated outcomes and the annual spend profiles attached", including an overall timetable for completion of this work. In response, the Scottish Government explained [16] that "this approach is embedded across Scottish Government activity rather than being addressed as a single workstream [and] as such, Scottish Ministers expect all programmes in the Scottish Government to:

- have clear objectives linked to the delivery and achievement of outcomes,
- deliver value for money, and
- have closely tracked spend and regular reporting."

168. The Scottish Budget 2024-25 itself sets out the national outcomes (primary and secondary) to which spend in certain portfolio areas is intended to contribute. The final Annex in the Budget document [1] highlights that the Scottish Government is redesigning its approach to internal performance reporting, drawing on the mandate letters[xv] and strategic delivery plans for each portfolio. This, it states, will "inform the performance reporting and monitoring necessary to align the commitments with the Programme for Government, with the Budget, through to the Prospectus and ultimately the NPF, bringing the data necessary to measure Scottish Government's progress towards the National Outcomes".

169. Witnesses told the Committee it is unclear whether the national outcomes were 'built in' at the outset of developing the Scottish Budget or 'bolted on' at the end of the process. Carnegie UK argued [15] that the national outcomes should be the starting point for considering where spending should be targeted, rather than starting with the priorities and thereafter setting out how they link to the national outcomes. This, it suggested, would allow progress to be better measured.

170. The Deputy First Minister told the Committee [13] that the NPF "remains important for priorities and delivering them", adding that is "overlaid with the First Minster's key missions, which hone in on what is important and on how to focus and prioritise". She went on to say that the starting point to constructing the budget was "how we can prioritise and focus on the things that really matter", given there is less money to go around.

171. **The Committee believes that the forthcoming statutory review of the national outcomes is an important opportunity to turn the ambitions of the National Performance Framework into action, including ensuring that the**

xv The First Minister's mandate letters to all Cabinet Secretaries set out his expectations around outcomes they are expected to achieve in the short term and by 2026.

**outcomes drive spending decisions.**

172. **The Committee is interested in how the Scottish Government's redesign of its approach to internal performance reporting will support the measurement of progress against delivery of the national outcomes, as suggested. We therefore seek further details of this work, including a timeline for when the agreed approach will be implemented.**

# Public service reform

## Overview

173. Recommendations from the Committee's inquiry into the Scottish Government's Public Service Reform Programme were included in our Pre-Budget 2024-25 Report [5] . This Report set out the Committee's concerns "that the focus of the Scottish Government's public service reform programme has, since May 2022, changed multiple times, as have the timescales for publishing further detail on what the programme will entail". We therefore made recommendations aimed "to bring much needed impetus, focus and direction to the Scottish Government's Reform Programme to ensure successful outcomes can be achieved at a much quicker pace".

174. The Scottish Government committed in its 2023 MTFS [28] to providing six-monthly updates to the Committee on the Programme to coincide with the Scottish Budget (usually published in December) and the MTFS in May each year. The Committee asked that the Scottish Government's first six-monthly update to the Committee includes the following information—

- a clear vision and strategic purpose for what it wants to achieve with the programme, including how it will provide leadership and oversight to support public bodies to deliver on this vision,
- the financial strategy to accompany the reform programme that was committed to by the then Deputy First Minister in March 2023,
- details of each workstream under the programme, milestones for their delivery and clear measurements of success, and
- an explanation of how the programme will impact on delivery of the national outcomes.

175. The Scottish Government's first update was provided alongside its response to our Pre-Budget 2024-25 Report on 19 December [16] . It states that the scale of the financial challenges necessitates delivering efficiencies and making more effective use of resources to deliver services and improve outcomes, and that strategic change is needed longer-term to reduce demand, reduce costs and improve outcomes. The update sets out its "key aims and principles for a 10-year programme of public service reform, and the actions we need to take in the next 1-2 years to respond to our immediate budget challenges, and to build the platform for ongoing change". Four new workstreams have been established—

- **Convening**: agreeing a common vision across the public sector for achieving sustainable public services and establishing the infrastructure that enables progress to be made,
- **Saving**: identifying where clear and quantifiable, cashable savings, can be made, setting out targets for reducing/avoiding costs through efficiencies and supporting a longer-term approach to reformed services,

- **Enabling**: creating the conditions for systemic reform, removing barriers to change and establishing ways that the public can see, understand, and influence the changes, and
- **Aligning**: driving policy coherence and consistency across significant policy led reforms that will shape the future service landscape.

176. The update provides actions under each of the workstreams and sets out the progress it will make in Years 1 to 3. Over the next three months, it will agree a shared approach, working with local government, the public and third sectors “to align, enable and deliver”, and require all Scottish Government portfolios to set out their savings and reform plans by the end of the financial year “in line with the principles in this document and set out clear savings targets to public bodies”.[xvi] Portfolios and public bodies will be asked to “follow a cascade of options in delivering savings, taking all opportunities to increase the efficiency with which they deliver their functions, taking all opportunities to offer services in different ways, considering reclassification/alignment/merger of bodies or function, and reducing service only where these options are exhausted”.

177. Finally, the update indicates that the Scottish Government will “establish enabling environment for workforce reform, including support for voluntary severance”.

178. The SPICe briefing [14] highlights that the level 4 budget line for the Constitution, External Affairs and Culture portfolio includes a “5% efficiency saving that has been taken across all public bodies as part of public service reform”. There is no mention of this 5% efficiency saving in other budget lines or in the reform update provided by the Scottish Government to this Committee. Overall, SPICe comments that there remains a lack of detail on the specifics of what the public service reform programme will mean in practice, or how it will help to address the immediate pressures on the budget.

179. Witnesses suggested that an ‘honest conversation’ is needed about how public services should be delivered and reformed [15] . Colleges Scotland support this idea and suggested that “if there are limited resources, let us be honest about what we can deliver, rather than having lots of cuts all over the place, which is really inefficient”. It added “we will not deliver on priorities, because the cuts are like taking the head off everything, rather than being specific and saying what our priorities are”. NatureScot highlighted opportunity to make efficiencies through the reform programme, including in relation to estates, collaboration and digital technology.

180. The GMB Union said it is often not recognised that public bodies have been reforming for some time, while GCC noted that, without proper reform, some local authorities could follow some counterparts in England in being declared bankrupt. As the Committee has heard before, some reforms will require funds upfront and it is unclear whether these funds will be forthcoming. Audit Scotland highlighted that the Auditor General for Scotland continues to have an interest in fiscal sustainability and public service reform, as well as ensuring that spending can be tracked. It went

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xvi The update recognises there are some bodies and core services (such as the NHS, Police and Fire, Social Security Scotland, Colleges and some very small bodies), “which will require specific approaches based on their existing reform plans and service pressures”.

on to emphasise the urgency of reform, savings and costs, “because reform is not always free”, as well as “what type of financial return or improvement to services are we going to get” as a result.

181. The Deputy First Minister was asked [13] when the Scottish Government would provide the accompanying financial strategy committed to by her predecessor in March 2023 and requested with this Budget by the Committee. She said the intention was to provide this once the early scoping phases are complete, adding “the problem at the moment is the level of uncertainty, which makes it very challenging to set out a position, because it could be buffeted and changed by forthcoming fiscal events”. She said she hoped that the publication of the MTFS in May 2024 would be an opportunity “to look at the longer term”.

182. On the size of the public sector landscape, she said “there should be an assumption against forming a new body as a solution to a problem, and the Cabinet will be required to give its approval to any suggestion or proposal for a new public body”. Reforming the landscape includes “some rapid work around controls over the size and function of existing public bodies”, shared services, which she described as “a must” and digitalisation, which she explained was why the Scottish Government was making investments in this area.

183. The Deputy First Minister was also asked about the level of reserves being carried by some public bodies and offered to provide further details in writing. She went on to say that some reserves could be key to investment plans and reforms the organisations plan to undertake but “it has to be part of the picture when we consider how we get to a more sustainable position with some of the necessary reforms and think about how reserves are utilised in the short to medium term”.

184. **The Committee previously expressed concerns that the focus of the Scottish Government’s public service reform programme has, since May 2022, changed multiple times, as have the timescales for publishing further detail on what the programme will entail.**

185. **The Scottish Government’s update provides welcome principles and objectives for the reform programme, including recognising the importance of prioritising preventative spend, an area that the Committee has supported for some time.**

186. **There are however few other signs of progress. This is disappointing given the urgent need for reform.**

187. **Without a coherent reform programme in place, we are concerned that financial pressures will drive a series of uncoordinated cuts across the board, rather than genuine reform aimed at enhancing the delivery of public services. Indeed, we note that one portfolio in the Scottish Budget refers to “a 5% efficiency saving that has been taken across all public bodies as part of public service reform”. This is not referred to more widely in the Scottish Budget or in the reform update we received on the same day. We therefore seek clarity on this matter along with details of how this approach aligns with the Scottish Government’s aim to prioritise public services.**

188. **The Committee also seeks assurances from the Scottish Government that it will revisit and implement the recommendations from our Pre-Budget 2024-25 Report aimed at bringing much needed impetus, focus and direction to its public service reform programme.**

189. **This includes publishing the accompanying financial strategy to the reform programme, as requested by the Committee, and committed to by the former Deputy First Minister in March 2023. We do not agree with the Deputy First Minister's explanation that it could not be provided until after the UK Spring Budget.**

190. **We would also like to see greater progress with digitalisation, shared services and rationalisation of estates, along with a presumption against the creation of any new public bodies until an evaluation of the size and structure of the public body landscape is completed.**

## Workforce and pay

191. The Committee set out in our Pre-Budget 2024-25 Report [5] our concerns regarding the confusion that still appeared to exist in relation to the Scottish Government's policy on public sector headcount and workforce levels. In its response [16] , the Scottish Government stated that—

> … expenditure on public sector pay increases in the past two years is now greater than the growth in our resource Block Grant funding from the UK Government. As a result of the ongoing fiscal challenges and uncertainty over UK Government funding and inflation levels the next phase of this work will focus on working with our Trade Union partners to deliver reforms to put our public sector workforce on a sustainable footing. We intend to set out the pay metrics for 2024-25 following the Spring UK Budget.[xvii]

192. The SPICe briefing [14] notes that the recent increases in public sector pay were higher than the Scottish Government previously planned due to inflationary pressures, and "these increases in the pay bill have created a budgetary imperative to deal with the size of the pay bill, and by implication, the numbers working in the public sector". The Committee also heard from Audit Scotland [15] that, as expected, the public sector workforce had increased since devolution, "however, that brings an additional challenge with regard to financing" and "we are therefore looking to promote the need for reform".

193. The SFC has assumed devolved public sector pay growth of 4.5% in 2024-25, which includes an average basic pay award of 3%. Its letter to the Committee of 15 January 2024 [39] explains that "based upon our assumption of pay growth set out in our report, we project Scotland's public sector employment to be 562,000 in

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xvii The UK Government has announced that its Spring Budget will take place on 6 March 2024. This is likely to be after the Scottish Government's Budget Bill is passed.

2024-25, a fall of 4,700 or 0.8% when compared to the previous year". This, it explains, is a broad-brush assumption which could change if, for example, the allocation of funding or grade structures differ.

194. However, the GMB Union told the Committee [15] that public sector pay has "not exploded—it has barely kept up with inflation" and the union therefore expects "decent public sector pay deals for our hard-working public servants".

195. The delay in producing the Scottish Government's public sector pay policy presented a challenge for the SFC in producing its December 2023 Forecasts and does not meet the requirements of the protocol between the SFC and Scottish Government for the provision of specific data within certain deadlines. The SFC explained [19] that it had extended its deadline for receipt of this information, but that it was still not forthcoming from the Scottish Government.

196. The Deputy First Minister explained [13] that this was similar to the position with the previous budget, when the pay policy was provided in March 2023. She went on to say "there is difficulty in being able to predict the outlook in the light of the forthcoming [UK] Spring Budget, which could make significant changes to our fiscal outlook [and] with the level of uncertainty, it would not be right to [issue pay metrics] now". She added that the Scottish Government had provided the SFC with the latest position on public sector pay costs for 2022-23 and 2023-24 and it had also commented on the pay award assumptions that the SFC had made for future years.

197. She went on to say that "there is an unusual set of circumstances" this year and explained that "the extent of the changes that might be made in the Spring Budget—given that it is an election year and given some of the noises that are being made in the media about what could happen vis-à-vis income tax changes—could have a profound impact on our budget".

198. **The Committee is disappointed with the delay in producing the Scottish Government's public sector pay policy for 2024-25. Given the significant and rising public sector pay bill and its effect on the Scottish Budget, publishing the policy alongside the Budget as usual would have provided much needed clarity and certainty.**

199. **We also consider that the Scottish Fiscal Commission should be able to complete its Forecasts unimpeded, with timely access to all the data it requires to do so. The Committee therefore seeks the Scottish Government's commitment that it will provide this data to the SFC on time in future and publish future pay policies with its December budgets.**

200. **We also request clarification that this year's pay policy 2024-25 will be published as early as possible after the UK Spring Budget and that it will include clarification of the Scottish Government's plans for reducing the public sector workforce to more sustainable levels.**

# Conclusion

201. **The Committee understands that the significant pressures on Scotland's public finances have presented difficult decisions in relation to taxation and spending. We further note the Scottish Government's commitment to spending prioritisation based on delivering its three Missions of Equality, Opportunity and Community. However, we remain to be convinced that this prioritisation exercise has been carried out in a strategic, coherent and co-ordinated way. In fact, some individual decisions appear to conflict with the priorities of tackling poverty, growing the economy and prioritising public services. More explanation on how the Scottish Government has prioritised and deprioritised its spending and developed its tax plans is required in future years.**

202. **The evidence we heard suggests that the Scottish Government remains focused on plugging short-term funding gaps at the expense of medium- and longer-term financial planning. We are not convinced by the reasons provided for delays in publishing multi-year spending plans, the public sector pay policy 2024-25, an updated infrastructure project pipeline and a financial strategy for public service reform. The impression given is that the Scottish Government is procrastinating on important decision-making that would help support medium- and longer-term sustainability of Scotland's public finances.**

203. **As a priority, the Scottish Government must now publish a full response to the significant challenges set out in the SFC's fiscal sustainability report.**

204. **The Scottish Government's public service reform programme is critical to the sustainability of the Budget and ensuring effective delivery of public services. Efficiency savings across the board will not cut it. We therefore expect to see greater focus from the Scottish Government on developing and delivering this reform programme at a quicker pace in the months and years to come.**

# Scottish Parliamentary Corporate Body: budget proposal 2024-25

## Overview

205. The Committee is required to consider and report on the Scottish Parliamentary Corporate Body's (SPCB's) budget proposal as part of its overall scrutiny of the Scottish Budget.

206. The SPCB is required under section 21 of The Scotland Act 1998 [40] to make arrangements for the Parliament to be provided with the property, staff and services required for its purposes. It also provides funding to SPCB-supported bodies (Commissioners and Ombudsman). The SPCB's budget and that of Audit Scotland, is 'top-sliced' from the Scottish Consolidated Fund and so its funding is allocated before the Scottish Government makes any other spending decisions. Nevertheless, the Committee would expect the SPCB to submit a Budget Proposal that reflects wider pressures on Scotland's public finances.

207. To support the Committee's scrutiny of the SPCB's budget proposal for 2024-25, we heard from SPCB Member Jackson Carlaw MSP on 16 January 2024 [13] , along with David McGill, Clerk/Chief Executive of the Scottish Parliament and its Group Head of Financial Governance, Sara Glass.

208. The SPCB's letter of 15 December 2023 [41] states that "the budget proposal is aligned with the commitments made in the 2022-23 submission which focussed on setting up the Scottish Parliamentary Service for the challenges of Session 6". The key challenges identified for its budget bid are the same as last year—"inflationary pressures and establishing a budget which is fair and affordable and takes account of continued high inflation".

209. The total proposed budget for the SPCB, excluding capital charges and non-cash items, is £126.5m, a net £8.9m increase (7.6%) on the current financial year's budget. This is an increase of £6m (5%) on the indicative 2024-25 figures provided by the SPCB with last year's bid. It was able to "partially offset inflationary impacts with a 4.5% increase in 2023-24 at a time of 11% inflation", however, with more than 70% of its cost base being staffing, "there are no additional material efficiency opportunities available for the 2024-25 Budget".

210. The Committee considered key elements of the SPCB's budget bid during evidence on 16 January 2024 [13] .

## Overall budget proposal

211. The panel was asked to explain the proposed increase of 7.6% to the overall budget against a background of tight financial settlements for the Scottish Government and other public bodies. Jackson Carlaw MSP told the Committee that this rise is "primarily driven by inflation, electricity prices at rates well above

inflation, and increases in officeholder costs due to anticipated inflationary staff costs". He went on to explain that in previous years "critical decisions" have been taken to increase the staff resource available to MSPs and to support committee scrutiny in response to committee and MSP requests. He added that the Corporate Body is not prepared to submit a budget that would compromise the ability of Parliament to operate "to maximum capacity in its ability to support Members in holding the Scottish Government to account".

212. The SPCB's letter [41] states that "for future budget impacts, we are about to consider whether we need to adapt any services/contracts at Holyrood in light of changes to footfall and usage post-pandemic to ensure we are operating efficiently, and this will be brought forward for a high-level discussion with the SPCB in 2024". The panel explained in evidence to the Committee that this process is ongoing. To date, the work has involved responding to demands for greater flexibility in the use of spaces, through the provision of touchdown and bookable desk spaces and collaboration areas, more hybrid working arrangements, and quiet working spaces. David McGill explained that part of the next phase of this work "might require changes to contracts [and so,] we have been building up the evidence base that we would need in order to make changes to contracts when those come up for renewal".

213. The panel was asked whether it had considered having a fixed budget rather than its allocation being 'top-sliced' from the Scottish Budget before other spending allocations are made. In response, Jackson Carlaw suggested "it is difficult to see anything other than a negative consequential impact on our ability to operate as a Parliament if we were simply to unilaterally adopt [this] principle". David McGill added that the Parliament is currently able to "flex in different circumstances" to respond to significant events such as the devolution of additional powers and the UK's withdrawal from the European Union. Removing that flexibility within a fixed budget would present a "major challenge".

214. The SPCB's contingency figure for 2024-25 reduces from £1.5m to its pre-2023-24 levels of £1.0m, described in the bid as "a prudent contingency for emergencies" to cover potential operational cost pressure and inflationary pressures on contracts. Jackson Carlaw told the Committee that "it is worth remembering that, when we presented last year's budget, the forecast … was that we would be in negative inflation by April this year", and therefore, the SPCB was "slightly cautious" in choosing a higher contingency.

215. Total projected income is £274,000, an increase of £4,000 (1.5%) from 2023-24 figures. This projected income comes from the Parliament shop (including its online offering), based on a "normal year" of opening. The panel was invited to consider any other options for selling Parliament products, such as in other retail outlets.

# Property and running costs

216. The budget bid reflects a rise in property costs to £9.8m, a net increase of £1,123m (12.9%) on 2023-24 figures. This includes a projected increase of £411,000 (28.1%) in utility costs, increases in rates (8.4%), maintenance costs (6.6%) and cleaning (23.7%).

217. The Committee explored further during evidence [13] the three key factors contributing to the rise in property costs. Sara Glass explained that electricity pricing, rather than usage, was a significant issue, however, although the budget bid is “showing that impact in next year’s budget, a significant amount has been realised in the current financial year, which has been covered by contingencies”. The inflationary increases to the cleaning contract had been missed in last year’s budget and therefore the 2024-25 budget is showing two years of contractual increases rather than just one. Finally, an additional £170,000 of costs into the current year has arisen from the district valuer’s reassessment of the rateable value of the Holyrood campus, and these costs roll over to future years.

218. Overall running costs of the Parliament increase to £7.894m, £685,000 (9.4%) higher than the 2023-24 budget. This includes the cost of IT software and licenses (£388,000) and £160,000 for the planned celebrations for the Parliament’s 25$^{th}$ anniversary under Corporate Events.

219. The panel was asked to provide a breakdown of the £200,000 figure allocated to office space planning and moves. It confirmed that various pieces of work are planned under this budget line, including a review of the upper basement, provision of phone booths for private calls and Teams meetings in the MSP block, new signage, converting a rest area for security staff, and other office reconfiguration and consolidation.

# MSP pay and staff cost provision

220. The SPCB is recommending that MSP salaries increase by 6.7% in line with the Average Weekly Earnings (AWE) index, to £72,195 in 2024-25. This compares to a proposed salary increase of 7.1% for MPs in 2024-25.

221. The SPCB has departed from using the Annual Survey of Hours and Earnings (ASHE) index for MSP salaries as the index “has become misaligned with other wage inflation indices over the past few years, for reasons that we cannot properly understand and that we ourselves are investigating” [13] .

222. The budget bid also sets out the SPCB’s preference to continue using the AWE index to uprate Staff Cost Provision for a second year “to avoid the greater volatility reflected by the ASHE index during this period of inflationary volatility”. An increase of 6.7% is therefore applied, bringing MSP staff cost provision up to the rate of £156,000 per Member.

223. Sara Glass confirmed [13] that the 93% usage factor applied to the 2023-24 Budget will continue into the next financial year into 2024-25. She explained “we have worked out that 93% figure by looking at experience over the years”, adding she does “not expect to have much underspend at the end of this financial year for staff cost provision”.

# Scottish Parliamentary Service staff pay

224. Scottish Parliamentary Service (SPS) Staff pay is budgeted at £40.2m, a £2.9m (7.7%) increase compared to the current financial year and a £1.7m (4.5%) increase compared to the indicative forecast for 2024-25. The main driver for the increase is noted as inflation. A vacancy factor of 5% continues to be applied.

225. The budget bid [41] sets out that the SPS pay scales were evaluated and benchmarked across the public sector and open market in 2023-24 following an increase in staff turnover and recruitment challenges, and notes that “the revised pay scales reflect fairness across the grades and cost of living challenges for lower paid staff”.

226. The panel explained [13] that the Scottish SPS staffing budget “maintains the staffing baseline agreed in 2022-23 with the 2024-25 uprated to take account of anticipated inflationary wage pressures [and] we have also reflected revised increased pension contribution rates within our costs for 2024-25”. Asked whether there was evidence of ‘grade inflation’ within the SPS, David McGill responded that “the profile has barely changed from 2018—if anything, there has been a minor reduction in the proportion of jobs that are at the very senior level”. He added that “all the evidence is that the pay structure that the Corporate Body has, as a strategy, means that the pressures that can lead to grade inflation in other organisations do not exist under Scottish Parliament pay scales”.

227. Other staff related costs are budgeted at £860,000, an increase of £42,000 (5.2%) from the 2023-24 budget. Within this, corporate and job-related staff training is capped, while the travel and expenses budget rises reflecting “a return to pre-Covid travel patterns”.

# Major projects

228. The Committee heard that [13] , following a prioritisation exercise, the total amount included in the 2024-25 budget for revenue and capital projects is £5.3m, a marginal inflationary increase from 2023-24. This includes organisational-wide projects such as the Building and Energy Management System (BEMS), “which is driven partly by green issues and obsolescence issues” and the Corporate Systems Programme, “which encompasses the business-critical applications for finance, people services and payroll”. Projects include replacing Windows 10 as well as the systems used to produce the Official Report (OR) and Business Bulletin (BB). The Committee sought assurances in relation to the demand for, and costs of, the OR and BB projects. Sara Glass advised that “business cases come to the Strategic Resources Board, and projects and programmes are shared with the SPCB, so they are heavily scrutinised in the process of being approved”. The budgets are also closely monitored and challenged on an ongoing basis.

229. On net zero funding amounting to £415,000 in 2024-25, witnesses advised that some of this spend is to be allocated to the BEMS, and work to improve scrutiny of sustainable development. They offered to provide a more detailed breakdown of this spend in writing.

# Commissioners and Ombudsmen

230. Officeholders' bids amount to a total of £18.3m, £1.7m (10%) higher than 2023-24 figures, and £1.2m (7.3%) higher than the indicative forecast, with the main recipients being the Electoral Commission budget increasing from £1.9m to £2.2m (12%) and the Scottish Public Services Ombudsman (SPSO) budget rising from £6.2m to £6.8m (10.2%).

231. During evidence [13] , Jackson Carlaw explained that "above-inflation increases in 2024-25 are driven by anticipated staff costs across all officeholders and additional functions to the SPSO". Staffing costs sit at 80% for officeholders, so their flexibility in relation to non-staffing costs is much reduced. He went on to say that the Corporate Body has "scrutinised, analysed, interrogated and, in some cases, declined" budget bids from officeholders.

232. Asked about the continuing growth in the number of officeholders, Jackson Carlaw reiterated that "Parliament having decided that the officeholders shall exist, our responsibility is to ensure that they are able to undertake and dispose of their functions effectively". He went on to say that "there is a question of democratic accountability in my view as to why we as a Parliament were set up in the first place and whether we are devolving from ourselves to others responsibility for matters", adding "the overall cost of officeholders as part of our parliamentary budget is incrementally increasing, so there is a financial aspect and an accountability aspect".

233. Concerns were also raised regarding the SPCB's capacity to provide governance arrangements to an increased Commissioner landscape as well as "the incredible pressure" the expansions put on the one Member of SPS staff working in this area. David McGill highlighted that, while he would look at existing budgets, "it is not outwith the realms of possibility that I might be sitting in front of this Committee next year looking for an increase in parliamentary capacity in order to continue to oversee the governance of the growing officeholder landscape".

# Indicative forecast for 2025-26

234. The SPCB's budget bid, as with previous years, includes indicative forecasts for 2025-26. Its current expectation is that revenue and capital expenditure in 2025-26 will total £133.425m, compared to its 2024-25 bid of £126.521m. The indicative forecast shows an expected revenue expenditure of £131.925m, compared to £124.972m in 2024-25, while capital expenditure is forecast at £1.5m, compared to £1.55m in 2024-25.

235. The indicative forecasts for 2024-25 are "heavily caveated with continued uncertainties in the economy and around potential additional new Commissioners with associated costs" [41] . They further note that the SPCB has altered its approach for the 2025-26 indicative forecast, moving away from applying the standard rate of inflation for the entire cost base and any known anticipated cyclical additional requirements, and instead opting to apply a "blended inflationary rate" which reflects forecasts for wage inflation as well as price inflation plus any known significant requirements.

236. Known additional requirements for 2025-25 include anticipated costs of £0.6m for election project costs and £0.65m in officeholder costs for the Patient Safety Commissioner, created through recent legislation. The indicative forecasts further highlight the prospect of additional officeholder costs if the legislation to establish three Commissioners proposed in Members' Bills is passed.

# Conclusion

237. **The Committee notes the SPCB's budget bid, which comes at a time of significant financial pressures on Scotland's public finances, with many public bodies seeing reductions to their budgets or flat cash settlements.**

238. **We accept that a large proportion of the SPCB's funding is spent on staffing, whether that be for MSPs, MSP staff cost provision, or SPS staff and there are therefore limits to where it can make savings. Officeholder costs are also continuing to rise due to expansions in responsibilities, additional officeholders agreed, and inflationary staffing costs.**

239. **We further recognise that the Parliament must have the appropriate funding to be able to effectively scrutinise and hold the Scottish Government to account and to fully support elected Members in representing their constituents.**

240. **Nevertheless, given the significant financial pressures in the public sector, we expect the SPCB to focus on optimising value for money in its budgetary decisions and delivery. As part of next year's budget bid, we would therefore like to see additional information on how the SPCB makes the most effective use of its funds, including setting out where savings have been identified and how projects have been prioritised.**

241. **The Committee's concerns regarding the growth in officeholders and associated costs since devolution is well-documented. We look forward to scrutinising these issues in more detail through our inquiry into Scotland's Commissioner Landscape: A Strategic Approach [42] , which is expected to report in summer 2024.**

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