2022 MTFS and RSR Accounts Commission briefing

August 2022

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MTFS – The economic context

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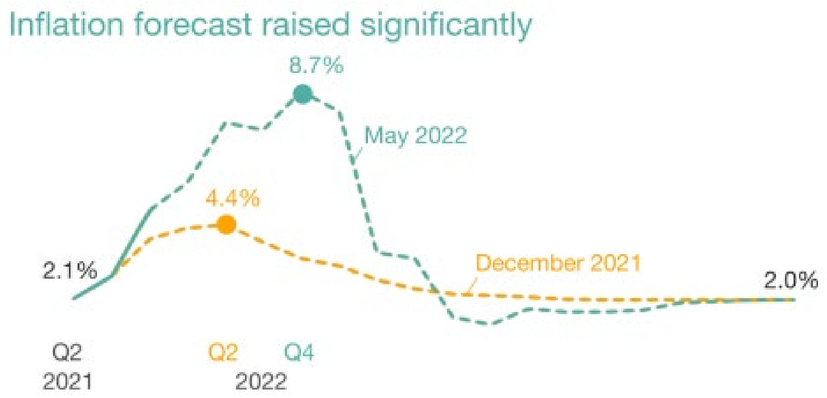
The forecast economic situation in Scotland has changed significantly since the previous MTFS was published in December 2021.

- Inflation has hit a 40-year high of 9.0%, driven by the conflict in Ukraine, rising energy costs, and supply chain bottlenecks in China.
- The Scottish Fiscal Commission's forecasts of GDP growth are slightly lower than in the December 2021 forecast, and states that the risk of recession in both Scotland and the rest of the UK is now materially higher than previous forecasts.
- GDP and employment growth in Scotland is forecast to be lower than in the rest of the UK.

Changes in the economic outlook since the December 2021 MTFS



Source: Scottish Fiscal Commission

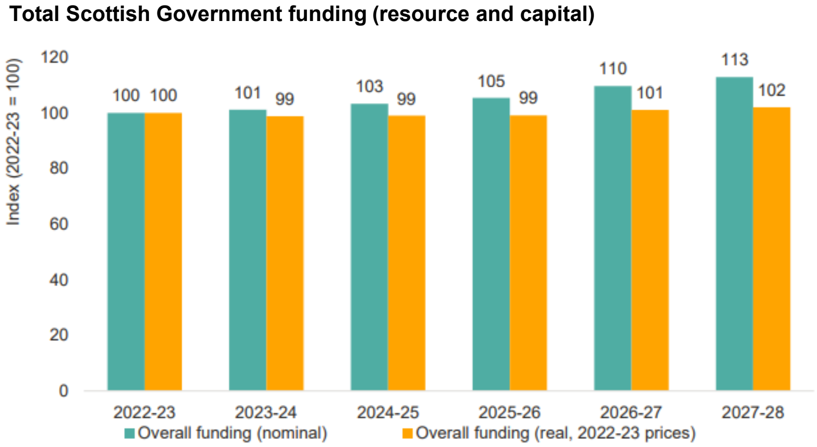
MTFS – The fiscal context

Overall, the Scottish Budget will increase in cash terms over the medium term, but significant uncertainties lie ahead for the block grant and devolved areas of taxes and social security.

- Specific Barnett consequentials for Covid-19 costs have now ended, the block grant for the next five years will remain relatively flat in real terms. With an expected 2 per cent increase to the Scottish Budget by 2026/27.

- Negative tax reconciliations of the block grant adjustment have increased, although the 2020/21 reconciliation will be a positive £50 million instead of the £221 million forecast in the MTFS.

- The funding required for social security in Scotland will increasingly outstrip the associated Barnett consequentials over time, placing additional pressure on the overall Scottish Budget.



Source: Scottish Fiscal Commission

Scottish Government spending priorities

The Scottish Government's spending priorities are;

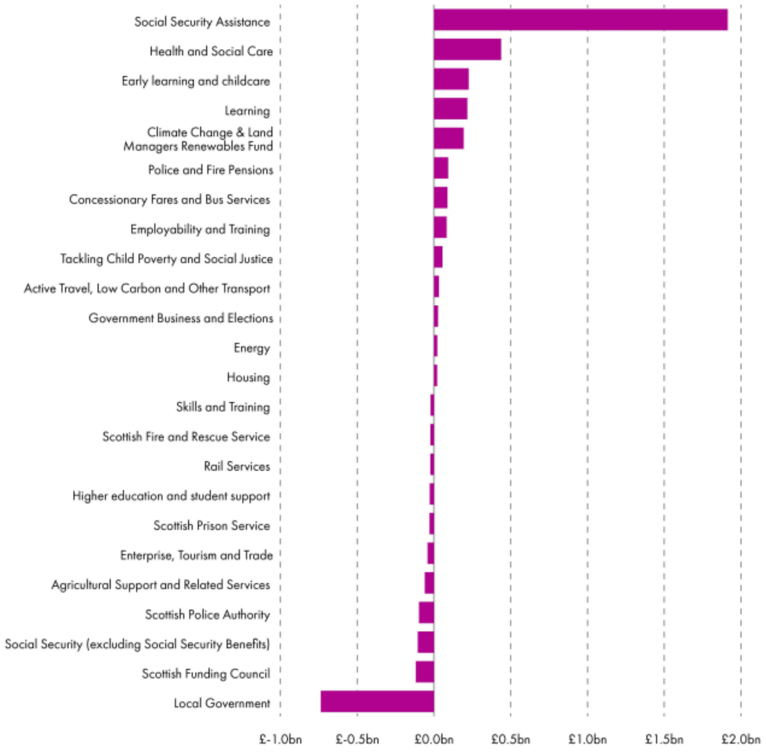
- tackling child poverty,
- addressing the climate crisis,
- securing a stronger, fairer, greener economy, and
- delivering excellent public services.

- Health, social care, and social security will all see clear, real terms increases over the RSR period to 26/27.

- Local Government as well as police, prisons, justice, universities and rural affairs' budgets will all fall by around 8% in real terms over the next four years.

- The Scottish Government is also aiming to shrink the size of the public sector in Scotland to pre-Covid levels by 26/27.

Real terms changes to Level 2 Budgets, 22/23 to 26/27



Source: SPICe

Local Government and the RSR

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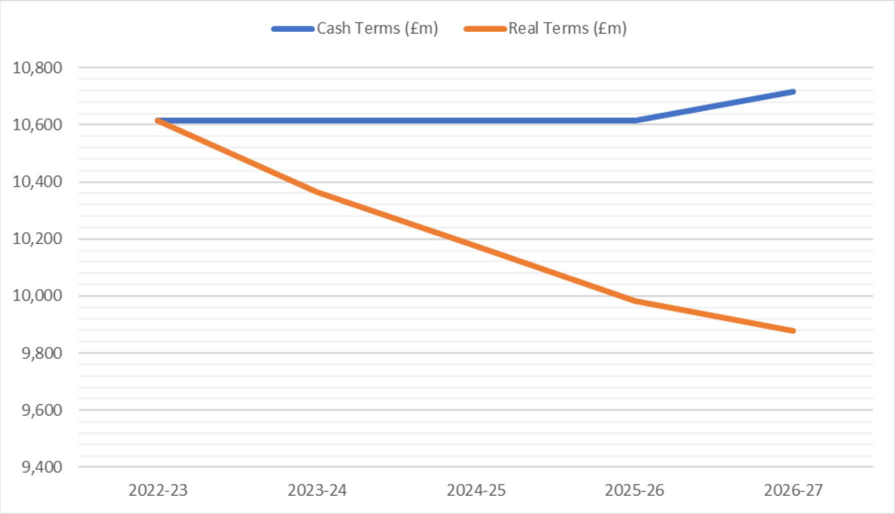
Funding for local government will be maintained in cash terms at 2022/23 levels, with a £100 million increase in 2026/27. Accounting for inflation, this could result in a 7 per cent real terms reduction in funding for local government by 2026/27.

- These figures are the ‘core’ resource budget for local government, which includes the General Revenue Grant, guaranteed non-domestic rate income, specific revenue grant figures (set out in the Scottish Government’s 22/23 Budget), and a now-baselined additional £120 million added during the 22/23 Scottish Budget process.

- The 'core' resource budget does not include funding transferred in from other portfolios during the financial year, which now comprises a significant part of local government budgets. The RSR is not sufficiently detailed to quantify the level of transfers expected. However, the it does guarantee that existing transfers for Health and Social Care, Early Learning and Childcare, and additional teachers, worth a total of £1 billion, will be maintained across the review period.

- The RSR expects decisions about workforce management, pay and service provision to be managed by Local Government within the funding available to them.

Local government funding allocation in cash and real terms, 22/23 to 26/27



Council and IJB Reserves

Recent Accounts Commission's reports highlight that councils and IJB reserves have increased since the pandemic

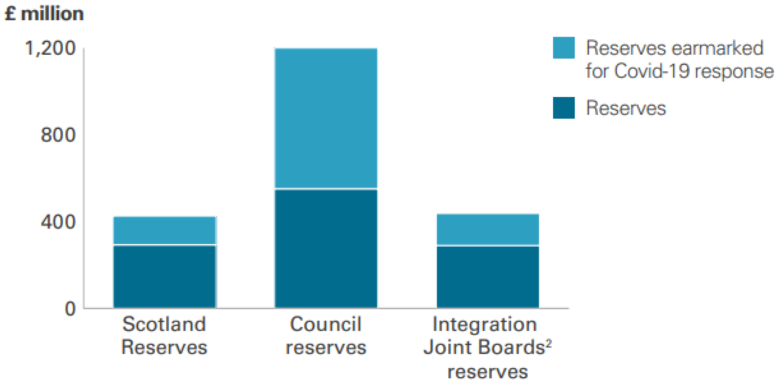
- Councils added £1.2 billion to their reserves, an increase of 46% on the previous year, which was largely attributable to funding received from the Scottish Government late in the 20/21 financial year. Of this, councils had earmarked £650 million for the continuing response to Covid-19 in 21/22 and beyond.

- Integration authorities increasing their reserves by £437 million. This was an increase of 304 per cent, partly due to unspent Covid-19 funding

- Given the financial challenges facing councils it is important that councils are clear about how Covid-19 funding carried forward in their reserves will be spent, and the extent to which Covid-19 funded spending commitments will exist in future years

- We will continue to monitor the use of reserves in our Local Government overview work and Covid-19 tracking.

Covid-19 funding in reserves at the end of 2020/21



Notes:
1. £1.15 billion of deferred Covid-19 Barnett consequentials were carried over from 2020/21 to 2021/22 outwith the Scotland Reserve.
2. Integration Joint Boards are integration authorities which can hold reserves. This covers 30 of the 31 integration authorities in Scotland.

Upcoming changes for Local Government

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The RSR includes a commitment from the Scottish Government to work closely with COSLA and SOLACE to agree a new deal for Local Government in Scotland in advance of the next financial year.

- This new deal will be based upon the dual pillars of a Fiscal Framework for Local Government and a new Partnership Agreement.
- This will include the approach to council tax as well as exploring the scope for discretionary revenue-raising in local government, such as the Visitor Levy and Workplace Parking Levy.
- SPICe notes that the wording of the RSR suggests that progress has been made on the much-delayed review of local governance in recent months, and that more information on the new deal could be available soon.

The RSR confirms that there will be "significant changes to functions currently delivered in full or in part by local authorities" across the spending review period.

- The Scottish Government have committed to establish a National Care Service, which will impact both the functions and funding of local government in Scotland. We don't yet know the details of these changes, but spending on social care is a significant element of local government expenditure in Scotland - SPICe report in 2020/21 it made up 32% of total local government net revenue expenditure.
- The total cost to councils will depend on what services are included in the NCS but there may be an opportunity for savings on services such as finance, digital systems, and premises.

Stakeholder/commentator reactions

COSLA – COSLA have expressed "deep concern" for communities across Scotland, and argue that the RSR does not recognise the fundamental role local government plays in addressing the Scottish Government's stated priorities. They also note the impact of the "flat cash" settlement for local government in the context of increased inflation and energy costs.

Fraser of Allander Institute – The FAI note the effective real terms cut facing local authorities in Scotland, and state that "the real terms erosion of the funding allocations of local authorities, police, universities and colleges represents the continuation of a longer trend".