Dear Bruce,

Many thanks for your letter of 24 June on the impact of COVID-19 on the public finances and the Fiscal Framework. It was very helpful to have the Committee’s view on the evidence it has considered on these matters as I continue to engage with HM Treasury.

As you know, I wrote to the Chief Secretary to the Treasury on 24 June, outlining specific requests for fiscal flexibilities (which I also reiterated in a letter to the Chancellor on 4 July ahead of his summer economic update). These were:

- The ability to offset capital underspend against resource expenditure
- Flexibility over resource borrowing
- Greater flexibility in relation to the Scotland Reserve for capital

I noted that these represented minimum short-term flexibilities that are needed to address the exceptional economic and fiscal challenges brought about by COVID-19. We have engaged collaboratively and carefully with HM Treasury, submitting information and working closely together. I am therefore very disappointed by the lack of progress, but will continue to press the case with HM Treasury.

This directly affects our spending decisions and means that the Scottish Government will be trying to recover from the pandemic with one hand tied behind our back. I will continue to press for change but for that to happen the UK Government will have to engage constructively as well.

I have attached responses to your detailed recommendations and questions in the Annex.
I hope the Committee finds this information helpful

KATE FORBES
ANNEX

The Scottish Government welcomes the Committee’s letter of 24 June. Responses to each of the Committee’s recommendations are presented below.

Summer Budget Revision
The Committee’s view is that consideration should be given to examining whether the existing fiscal rules could be relaxed on a temporary basis in order to allow the devolved governments to deal with unprecedented levels of uncertainty and volatility. The Committee notes, for example, that the OECD has suggested relaxing or suspending the requirement for sub-national governments to balance their budgets as a result of the current crisis.

At the same time the Committee also emphasises that the Scottish Government needs to make full use of its existing powers in responding effectively to the pandemic.

I welcome the Committee’s views on this point. We need as much flexibility as possible to tackle this economic crisis; and so the UK Government must provide the Scottish Government with either the funding or the powers to respond to these challenges.

As mentioned in my covering letter, I have set out some specific asks of HM Treasury which represent the minimum short-term flexibilities that are needed to address the exceptional economic and fiscal challenges.

But this crisis also requires a new approach from the UK Government. On June 29 we published a paper setting out the principles that the Scottish Government believes the UK Government should follow to manage the UK’s public finances and to kick start the economy. The UK Government must adopt flexible fiscal rules so they can prioritise economic stimulus over deficit reduction. That would ensure that our future economy is better able to repay the debt that has accrued.

I am, of course, committed to using the Scottish Government’s limited existing powers to respond to the pandemic. The Scottish Government has already reprioritised £255.2m at the Summer Budget Revision in order to deploy greater resources to combat coronavirus. In addition, I subsequently announced a £230 million capital investment package to help stimulate Scotland’s economy following the coronavirus (COVID-19) pandemic. This was funded by the reallocation of underspends from schemes interrupted by COVID-19, and will support investment across construction, low carbon initiatives, digitisation and business support, which will provide a flow of work for businesses and support jobs.
Re-prioritisation

The Committee asks that you provide further details on what options the Scottish Government is considering in relation to re-prioritisation of existing budgets in addition to the £255.2m in the SBR.

It is inevitable that due to the impact of COVID-19 that some of our programmes and projects have been paused or delayed. We are continuing to assess if we can re-purpose committed but not yet spent plus uncommitted funding across our European Social Fund and European Regional Development Funding allocations, with our spending partners over the summer. These monies, as well as reprioritisation of programmes and projects that have been paused or delayed, will be utilised to support actions to mitigate COVID-19 and economic recovery.

The recovery from the COVID-19 outbreak will require significant further funding. For example:

- Our public transport system will need to adapt to continuing constraints of distancing as the economy reopens.
- The education system, from childcare to universities, will require new ways of working as teachers, children, pupils and students return.
- And our social security system will need to assist those affected by loss of income, while our business, employability and skills support will need to adapt to meet the challenges in the economy and growing unemployment.

Without additional UK Government funding or flexibilities, we will face the impossible choice of not funding these areas, and thus harming the recovery, or making deep cuts to other areas of expenditure, which will similarly undermine the recovery. Our work on reprioritisation will be reflected in autumn and spring budget revisions during the financial year.

Capital to Resource Switches

The Committee’s view is that it may make sense, therefore, to consider whether some of the capital budget could be used to alleviate the pressures on the revenue budget and we encourage HM Treasury to consider the requests from the Scottish Government and the Welsh Government to have greater flexibility on capital to resource switches.

With regards to switching between capital and resource, I would look to manage the overall capital allocation within existing limits. However, I would welcome flexibility to utilise any further emerging underspend on these budgets to fund resource pressures and pressed that point at the Finance Ministers Quadrilateral meeting on 26 June. Flexibility to utilise up to 10% on these budgets - £500 million - to offset resource pressures would help the Scottish Government to manage the COVID-19 pandemic.
response. Any decision to use such flexibility would form part of a balanced approach that also recognises the need to invest in the economy.

Reconciliations
The Committee notes that you have asked HMT to consider the potential to unwind any negative consequentials and tax and social security reconciliations over a longer time period. The Committee would, while recognising discussions are ongoing with HM Treasury, welcome further clarification regarding this proposal as follows:

- Whether this relates only to the current financial year given that the SFC and OBR forecasts were produced prior to the impact of COVID-19 whereas future forecasts will include consideration of the impact;
- If not, the overall period which your proposal would cover and the rationale;
- The basis of repayments;
- How it addresses the immediate shortfall in receipts from the fully devolved taxes and increased social security expenditure.

I highlighted this issue in my letter to the Chief Secretary to the Treasury on 22nd May. At this time, I have not set out any more detailed request since the need will depend on a number of factors including whether and what the potential for negative consequentials is, and the potential for Scotland to be impacted differently by COVID-19. The need will also depend on how HM Treasury respond to the additional flexibilities I requested in my letter to the Chief Secretary on 24th June.

Borrowing
The Committee recommends that consideration is given to each of these reasons by the Scottish Government and HM Treasury in discussing whether the borrowing powers within the Fiscal Framework are adequate in responding to a crisis such as COVID-19. At the same time the Committee recognises that the discussion about additional borrowing powers for the Scottish Government needs to take account of the impact in Scotland of substantial government borrowing at a UK level.

I agree with the reasons outlined in your letter on the need for additional borrowing flexibility, and that these need to be considered fully by HM Treasury. I think it is very clear that the existing provisions within the Fiscal Framework are not sufficient to address a crisis such as COVID-19.

Nor do I believe that the Scottish Government’s borrowing and reserve powers are sufficient to manage the volatility inherent in the Fiscal Framework even in normal times. I outlined to the committee some other issues with the resource borrowing rules in the fiscal framework. In particular the £500m cash management borrowing power, which is unlikely to ever be used, would be far better suited to addressing fiscal risks which the Scottish Government does have, particularly in this current crisis.

Tha Ministearan na h-Alba, an luchd-comhairleachaidh sònraichte agus an Rùnaire Maireannach fo chumhachan Achd Coiteachaidh (Alba) 2016. Faicibh www.lobbying.scot

Scottish Ministers, special advisers and the Permanent Secretary are covered by the terms of the Lobbying (Scotland) Act 2016. See www.lobbying.scot
The borrowing proposal I have outlined to HM Treasury would provide £500m additional flexibility to address COVID-19 pressures. This can be achieved, and managed sustainably, by providing relatively minor relaxations to the annual restrictions and would not require the total £1.75 billion resource borrowing limit to be extended.

Scotland Reserve
The Committee would welcome further clarity regarding your proposal for greater flexibility in reserve carry over.

This is covered in my letter to the Chief Secretary to the Treasury of 24th June. It notes that in light of the exceptional circumstances presented by COVID-19, that the current limit of £100m for Capital and Financial Transactions together is too small to allow access to the current accumulated balance of Capital and Financial Transactions within the Reserve.

Increasing the limit to £220 million would allow full access to all existing Capital/FT balances. I also noted that I would welcome any possible extension to drawdown limits beyond 2020-21, should that prove necessary, to allow maximum possible access to this funding to support an economic stimulus beyond 2020-21. For example, increasing the annual drawdown limit to match the total of any Capital and FTs deposited to allow maximum flexibility in their future deployment.

Inter-Governmental Working
The Committee was encouraged to hear that you are having constructive conversations with HM Treasury and the other devolved administrations as part of the Finance Ministers quadrilateral. The Committee would welcome your views as to whether the existing intergovernmental machinery is sufficient to deliver a co-ordinated approach across the four nations of the UK in tackling economic recovery following the crisis.

I have put on record the fact that there has generally been close and constructive dialogue at ministerial and official levels during this pandemic.

There are obviously particular challenges now but even in normal times I believe the arrangements need to be strengthened. That includes Finance Ministers’ Quadrilateral meetings, for which there is not even an agreed terms of reference. To have most value, there should be regular meetings guided by a work programme agreed by all administrations. That will be particularly important as we face the economic uncertainties which will be caused by Brexit and COVID-19 and looking ahead to the end of the transition period.

Tha Ministearan na h-Alba, an luchd-comhairleachaidh sònraichte agus an Rùinaire
Maireannach fo chumhachan Achd Coiteachaidh (Alba) 2016. Faicibh www.lobbying.scot

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Fiscal Framework Review

While the Committee welcomes the work of the Group it has been overtaken by events given that it predates the impact of COVID-19. The Committee would therefore welcome your views on the following –

1) Whether there is still an expectation that an independent body will be established in 2021 to review the operation of the framework?
2) To what extent the experience of addressing COVID-19 will now be part of that review?
3) Whether there needs to be a more urgent review of the framework to consider temporary adjustments to deal with COVID-19?
4) Whether the working group should be asked to update their work to reflect the impact of COVID-19 on the operation of the framework?

My view is that adjustments are needed urgently, as set out in the same letter to the Chief Secretary. However, I do not believe that this requires the review itself to be brought forward – changes should be made now through discussions between the Scottish and UK Governments.

Looking forward to the review, I was clear in my letter to the Chief Secretary on June 24 that, while the additional flexibilities I am seeking are not about permanently revising the current Fiscal Framework, the COVID-19 crisis does make clear the need for the review be robust and comprehensive.

It must not only cover the case for revisions to the existing arrangements (such as increased reserve and borrowing flexibility), but also examine more broadly whether the Scottish Parliament’s existing powers are sufficient to manage the budgetary risks we face in operating the additional powers devolved in the Scotland Act 2016 and the Fiscal Framework, and to tackle the many challenges of the post-COVID-19 world, in line with its devolved responsibilities.

I believe that the independent report should play an important role in the robust and comprehensive review I am seeking. I would also wish to ensure that the process allows for the views of stakeholders, such as the Finance and Constitution Committee, to be fully considered.

The process of involving the Committee in the review has already started via the joint working group, and I would be keen that its report reflects on the implications of the pandemic. Discussion is ongoing between Scottish Government officials and the Committee clerks on how best to incorporate these implications.

I am keen for a robust and comprehensive review to take place as quickly as possible, and hope that the UK Government will be equally committed to this goal.