

Ministear airson Ionmhas Poblach agus Eaconomaidh
Dhidseatach
Ceit Fhoirbheis BPA
Minister for Public Finance and Digital Economy
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Bruce Crawford MSP
Convener
Finance and Constitution Committee
The Scottish Parliament
Edinburgh
EH99 1SP

3 March 2020

Dear Bruce

FINANCE AND CONSTITUTION COMMITTEE – REPORT ON 2020-21 SCOTTISH BUDGET

Thank you to the Committee for its detailed report on the 2020-21 Scottish Budget which the Scottish Government has considered carefully.

I welcome the Committee's recognition that the Budget process this year has been unprecedented and that the Scottish Budget is managing significant uncertainty. It is helpful for the Committee to note this and to recognise the wider challenge of managing reconciliations under the Fiscal Framework.

As you are aware the Framework is due to be reviewed after a Parliament's worth of experience, informed by an independent report to be completed before the end of 2021.

I firmly believe that a stronger, more flexible Fiscal Framework is in the interest of both the Scottish and UK Governments, and hope that the UK Government joins us in engaging positively with the review.

In the meantime it is clear that the borrowing and reserve powers available to the Scottish Government are insufficient to manage the volatility inherent in the Framework. I am seeking urgent changes to these from the UK Government and will keep you informed of any progress on this issue.

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There are a number of points in the Committee report on which I offer a response and these are detailed in the attached table.

I trust this information is helpful. I am copying this letter to Dame Susan Rice at the Scottish Fiscal Commission.



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Committee Report Paragraph	Scottish Government Response
<p>31 - The Committee notes that the SFC's estimates of trend productivity growth are still near zero and below expectations and that "an immediate pick-up in productivity now looks implausible". The Committee invites the Scottish Government, recognising it has limited macro-economic powers, to explain how its priorities in this year's budget seek to address this long-running problem.</p>	<p>Scotland is the top performing part of the UK in productivity. Over the last year, productivity in Scotland has grown 0.8%, compared to 0.1% in the UK as a whole. The Scottish Government recognises the challenge of improving productivity to help support sustainable and inclusive economic growth, which is why the Budget includes a range of measures to support productivity by investing in Scotland's assets and institutions and the skills and capacity of the people of Scotland. The budget delivers over £6 billion of investment to grow and modernise Scotland's infrastructure, including increased funding for low carbon technologies and infrastructure. The Budget is increasing its funding for colleges to £640 million, raising their ability to support our economy and deliver a well-educated skilled work force, and is increasing our investment in Skills Development Scotland to £224.8 million, continuing to ensure that apprenticeship opportunities are open to all and supporting the delivery of our new Careers Strategy. It is also supporting regional economies with £28 million for the South of Scotland Enterprise agency as part of our expanding enterprise reach across the country.</p>
<p>40. The Committee invites the Scottish Government to provide specific examples of how its wellbeing approach has resulted in a shift in policy direction and expenditure from previous Budgets.</p>	<p>The Scottish Government's budget and wider policy programme is guided by the vision of wellbeing in the National Performance Framework. To be a more successful country we need to make progress across a range of environmental, social and economic factors captured in the National Outcomes. Taking a wellbeing approach to the budget prioritises investment in areas that will have the greatest impact on both improving lives across Scotland now and creating the conditions to ensure wellbeing for future generations.</p> <p>The Scottish Budget does this through our investments in ending Scotland's contribution to climate change, through our inclusive economy, our support for public services and tackling</p>

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	<p>deep-rooted inequalities including child poverty. Taken together, these endeavours will substantially improve our success as a nation. Examples of priorities that will deliver across multiple outcomes, including where spend has increased can be found at pp.2-3 of the Scottish Budget.</p> <p>This year's budget was preceded by the publication, in May 2019, of Scotland's Wellbeing – Delivering the National Outcomes which, for the first time, drew together key trends and data across the National Outcomes within the National Performance Framework, also drawing on additional existing sources of evidence. This report was produced to support those making decisions on policy, services and spending and to contribute to the 'full-year' approach to the budget.</p>
<p>47. The Committee recommends that in future Budgets, the Scottish Government should make it clear if it is increasing the size of the relevant band by inflation rather than the thresholds.</p>	<p>The approach taken with the Scottish Budget 2020-21 is consistent with how the Scottish Government uprated the Starter and Basic Rate bands in 2019-20 and the approach that HMRC has taken at UK Budgets. This approach, including the corresponding bands and thresholds, is set out in the Scottish Fiscal Commission's report (paragraph 4.3).</p> <p>I will consider the Committee's recommendation further in respect of future communications on tax policy changes.</p>

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<p>59. The Committee invites the Cabinet Secretary to provide a breakdown of the £460m in lost revenue if the Scottish Government were to entirely replicate the UK Government's approach to tax.</p>	<p>Internal Scottish Government analysis shows that matching the UK's bands and thresholds would cost around £460 million in 2020-21, once behavioural effects are taken into account. This estimate is based on the same modelling framework, assumptions and economic determinants that have been used by the Scottish Fiscal Commission (SFC) to produce the income tax forecasts for the Scottish Budget.</p> <p>As illustrated in the table below, our analysis shows that the policy would reduce revenues by £591 million in static terms, i.e. before factoring in taxpayers' responses to policy changes. This estimate is in the same ballpark as the £650 million pre-behavioural estimate provided by SPICe.</p> <p>However, taxpayers are likely to respond to policy changes, for example by moving into or out of work, changing the hours they work or moving residency. Once these behavioural responses are taken into account, the revenue loss is much lower at around £460 million, using the taxable income elasticities (TIEs) applied by the SFC.</p> <table border="1" data-bbox="819 821 1704 957"> <thead> <tr> <th data-bbox="819 821 1413 855">Illustrative Policy Costing, in £ million</th> <th data-bbox="1422 821 1704 855">2020-21</th> </tr> </thead> <tbody> <tr> <td data-bbox="819 858 1413 892">Static Forecast</td> <td data-bbox="1422 858 1704 892">-591</td> </tr> <tr> <td data-bbox="819 895 1413 928">Behavioural Response (as per SFC TIEs)</td> <td data-bbox="1422 895 1704 928">135</td> </tr> <tr> <td data-bbox="819 932 1413 957">Total</td> <td data-bbox="1422 932 1704 957">-456</td> </tr> </tbody> </table>	Illustrative Policy Costing, in £ million	2020-21	Static Forecast	-591	Behavioural Response (as per SFC TIEs)	135	Total	-456
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<p>70. The Committee requests that the Scottish Government provides a detailed breakdown of each of the small savings within the employability and workforce Skills budget as well as the increases within the Fair Start Scotland budget.</p>	<p>The financial support being made available for employability in 20-21 shows the ongoing commitment from the Scottish Government to help those furthest away from the labour market into work. While there have been changes in some budget lines, overall support in this area has increased.</p> <p>These budgets reflect the increasing investment in Fair Start Scotland as this service moves into its third year of delivery, and our changing priorities around employability as we look to align Scottish Government funding more closely with local authority spending in this area. This is in line with the direction of travel set out in 'No One Left Behind', which looks at how employability support can be better integrated at a local level with other services, such as health, housing and justice.</p> <p>In addition, the Employability and Workforce skills budget includes increased funding for SDS to grow apprenticeships and increased SFC funding which will support skills provision in tertiary education settings.</p> <p>The 5% increase in the Level 4 Employability Fair Start Scotland budget relates to increased costs for Fair Start Scotland programme delivery and reflects the increasing maturity of this programme with greater costs associated with the financial model which contractually and financially rewards job outcome payments to Providers where Participants achieve sustained job outcomes. The Employability Division have engaged closely with the Scottish Fiscal Commission to ensure the Fair Start Scotland budget is aligned with their 2020/21 projections.</p> <p>In relation to the 2.5% reduction in the Level 4 Employability and Workforce Skills budget, we are continuing to work with partners in relation to funding and decisions relating to specific programmes will be made by Ministers and announced in due course. We are also continuing our commitment to support areas such as Community Jobs Scotland, the Employability Fund and the Disability Action Plan, ensuring we deliver on the commitments made within the Programme for Government as we work towards the transition to No One Left Behind.</p> <p>Whilst small savings have been made against the Level 4 Employability and Workforce Skills budget, increases have been made within the Level 4 Employability Fair Start Scotland budget and additional investment of £5m is going to local authorities through the Parental Employment Support (PES) fund, with another £2m through the PES Boost for Early Learning and Childcare. This increases the overall Employability and Training budget, reflecting the continued strength of recent labour market performance and demonstrating the Scottish Government commitment to supporting people into work.</p>

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Committee Report Paragraph	Scottish Government Response
117 - The Committee notes that the devolution of a significant number of social security benefits provides the Scottish Government with opportunities for policy innovation and a different approach from UK Government policy. But with these opportunities come potential budgetary risks both in terms of the actual costs of policy divergence and from forecast error. This adds another substantial layer of complexity and volatility to the Budget which will require to be closely monitored and carefully managed.	The Scottish Government recognises the risks associated with demand-led spend on social security benefits and the potential impact forecast variation could have on the wider Scottish Budget. For that reason there are robust financial management processes in place to manage these risks, both in-year and for future years.
140 - The Committee's view is that there needs to be a clear strategy for the use of the existing budget management tools which is proactive in addressing volatility over a number of years.	Noted
141 - The Committee seeks clarity over the Scottish Government's position about the management of income tax reconciliations and asks how this approach is consistent with the principles and priorities set out in the MTFs, which appear to provide the basis for a strategic approach to the management of reconciliations.	The Scottish Government will continue to have regard to the principles and priorities set out in the Medium-Term Financial Strategy in arriving at the decisions taken as part of the Budget process. However these decisions can only be taken at the time of the budget when all of the increasingly complex elements of the budget come together.
144 - The Committee asks how the Government will seek to find the appropriate balance between increasing the size of the Reserve to deal with future reconciliations and/or committing to further public expenditure.	It is a matter of judgement in finding the balance in managing the impact of reconciliations and this will always be dependent on the circumstances that apply when the Scottish Budget is finalised. Whilst I will continue to refine the principles and policies which will be considered in arriving at that judgement, it is not possible to define how that judgement will be applied in any particular circumstance.

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Committee Report Paragraphs	Scottish Government Response
<p>145-147 – Given, the nature of tax and social security devolution and the Fiscal Framework there is a need across Parliament and for Ministers to consider how the increased uncertainty and volatility can be managed while balancing the budget annually. The Committee believes that consideration needs to be given to the possibility of a different approach to the Budget which shifts to a more medium term financial approach which addresses the increased volatility and recommends that the MTFS should set out the basis for including a more strategic approach to budgetary management beyond an annualised approach and seeks to address volatility and risk and the possibility of multi-annual budgets for public bodies.</p>	<p>It is right to highlight the fundamental change in the budget context caused by devolution of powers and the implementation of the Fiscal Framework, and the need for both the Scottish Parliament and Scottish Government to continue to consider the implications of that change. The Medium Term Financial Strategy (MTFS) will continue to play an important role in ensuring a medium term approach and I will take the Committee’s views into account. However, the Budget Process Review Group’s final report was also clear that the MTFS was only one part of a coherent and systematic budget process. It is not the role of the MTFS to set out spending allocations, which will instead be properly carried out as part of Spending Review and annual Budget processes, supported by engagement with Parliament.</p> <p>The UK Government’s decision not to conduct a multi-year spending review in 2019 and the subsequent uncertainty about a new timetable in 2020, coupled with the late deferral of the UK Budget to March 2020, have created huge challenges and uncertainties for the Scottish Budget process, including limiting Scottish Ministers’ ability to deliver a multi-year resource spending review in 2019. This significantly inhibits the Scottish Government’s ability to deliver multi-year budget planning, which is frustrating for public bodies and third-sector organisations across Scotland. The Scottish Government shares this frustration and has pressed the UK Government to deliver certainty as soon as possible on its plans for a spending review in 2020.</p>
<p>168 / 169 - EU funding makes a significant contribution to supporting communities and organisations across Scotland. It remains unclear what funding will be available once the transition period ends in December 2020.</p> <p>The Committee notes that this uncertainty adds another layer of potential volatility to the Budget. The Committee invites the Scottish</p>	<p>The Scottish Government shares the Committee’s concerns regarding the uncertainty created by the UK’s exit from the EU and the serious consequences for loss of EU funding. Whilst the Conservative Party committed to replacing certain funding streams as part of their election manifesto, the UK Government has yet to provide further detail on the exact amounts, operation of these funds, and when these will be provided. The Scottish Government will continue to push for clarity to ensure that there is no cliff edge from December 2020 onwards.</p> <p>The Scottish Government is particularly concerned by the UK Government’s stance taken on future participation in EU programmes, whereby they are only seeking to participate in a very small number of</p>

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<p>Government to advise on how this year's Budget addresses this potential volatility.</p>	<p>programmes. This excludes a number of key programmes and is not acceptable to Scotland. Scottish Ministers have consistently made clear that the Scottish Government seeks as full participation in as many EU programmes as possible due to the wide range of cultural, social and economic benefits of these programmes. Alongside Wales and Northern Ireland, this Government has consistently pressed the UK Government to ensure our views were taken into account, yet these have been ignored. The UK Government must provide urgent clarity on how it will guarantee that Scotland does not lose out from these vital funding streams and ensure Scotland and the other Devolved Administrations will be able to fully participate in EU programmes independently.</p>
<p>180 – There is a need to manage budget volatility within the existing Fiscal Framework. Current approach of allocating all available resources was prudent when the Budget was almost wholly based on a Westminster Block Grant and was relatively stable. Less clear that such an approach is sustainable in setting a budget which is more volatile but still requires to be balanced annually - issue for the Government and Parliament as a whole to address.</p>	<p>The Scottish Government agrees that this is an important consideration which is why we are pressing for increases to our reserve and borrowing powers in advance of the review of the Fiscal Framework. The existing controls on borrowing and managing the Scottish Reserve are limiting and constrain Scottish Ministers' ability to manage the risk of forecasting errors and demand-led spend volatility. We also agree that such issues are for the Government and Parliament to consider together, in respect of engagement around future budgets.</p>
<p>182 – The Committee recommends that the next MTFS should set out the basis for including a more strategic approach to budgetary management which goes beyond the current annualised approach and seeks to address volatility over the medium term. Consideration should also be given to the possibility of multi-annual budgets for public bodies once the UK Comprehensive Spending Review has been published.</p>	<p>See comments at 145-147 above.</p> <p>The Scottish Government is supportive in principle of delivering multi-annual budgets for public bodies where it has certainty of multi-year funding from the UK Government.</p>

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