Finance and Public Administration Committee

15th meeting 2021 (Session 6), Tuesday 21 December 2021

Scrutiny of the Scottish Budget 2022-23

Purpose

1. This paper invites the Committee to take evidence from the Cabinet Secretary for Finance and the Economy in relation to Scotland's Budget 2022-23, which was published on 9 December alongside the Scottish Government's fourth Medium-Term Financial Strategy and its 'Investing in Scotland's Future: Resource Spending Review Framework'.

2. The Committee has agreed to undertake a short, focussed inquiry with a view to influencing the resource spending review and to conduct a review of the content of the MTFS to ensure future strategies are fit-for-purpose and best support parliamentary scrutiny. This does not however preclude the Committee from exploring issues relating to these documents with the Cabinet Secretary on 21 December.

Economic and fiscal outlook

3. The Committee took evidence from the Scottish Fiscal Commission on 14 December on 'Scotland's Economic and Fiscal Forecasts December 2021', which sets out its latest forecast for the economy, tax revenues and social security spending to inform the Scottish Government's Budget 2022-23.

4. Overall the SFC "expects a strong economic recovery in 2021-22 with Scottish GDP growing by 10.4% and economic activity returning to pre-pandemic levels by the second quarter of 2022". However, it also highlights "some evidence that the Scottish economy has been lagging behind the rest of the UK". Key issues highlighted in the forecasts are as follows:

- **The overall Scottish Budget 2022-23 is 2.6% lower than in 2021-22. After accounting for inflation, the reduction is 5.2%. The SFC states that "the 2021-22 Budget included specific funding for Covid-19, however, from 2022-23 onwards there are no specific Covid funding lines and any funding previously in this category which has continued is not part of general funding".** The Committee heard in evidence on 14 December that the distinction between pandemic spending and non-pandemic spending had become increasingly blurred in the 2022-23 Budget. This followed evidence from the Auditor General for Scotland during pre-budget scrutiny raising concerns that tracking Covid-19 related funding would become more challenging.

- **After taking account of inflation, the Scottish Budget is expected to increase by 1% in total by the end of the forecast period (2026-27), largely because of increases in UK Government funding.** The Committee heard evidence around the challenges of comparing levels of funding when different figures were being used by the Scottish and UK governments and the Scottish Fiscal Commission. David Eiser from the Fraser of Allander Institute explained that, while there are always different comparisons that can be made, the "undeniable point is that, in the priorities and commitments that the Government has set and in terms of the legacy of the pandemic on public services, it is a challenging outlook for the budget".
- **Inflationary pressures have intensified since its previous forecasts in August. The SFC, in line with the Office for Budget Responsibility (OBR), forecast annual Consumer Price Inflation (CPI) to peak at 4.4% in 2022 Q2 and gradually return to the Bank of England target of 2% in the second half of 2024 "as supply chain issues ease, global demand re-balances and energy prices fall back".** The Office for National Statistics announced on 15 December that CPI had risen to a 10 year-high of 5.1%. This increase was largely driven by higher transport and energy costs, with clothing and second-hand cars noted as other "big factors", along with the rising cost of raw materials.[1] While there had been some speculation that interest rates would remain at the same level due to uncertainty around the impact of the new variant, the Bank of England Monetary Policy Committee agreed on 16 December to increase interest rates to 0.25%.[2]
- **The unemployment rate is expected to peak at 4.9%, a significant downward revision from the SFC's January 2021 forecast, which peaked at 7.6 per cent.** Professor Roy from the University of Glasgow, however told the Committee that there are important questions around underemployment, skills gaps and skills mismatches.
- **Scottish income tax revenues have fallen behind the Block Grant Adjustment[2], with a shortfall of £190 million forecast in 2022-23. This shortfall is forecast to reach £417 million by 2026-27, driven by slower growth in employment in Scotland compared to the UK.** The SFC explained in evidence that Scottish earnings are growing less quickly than in the rest of the UK, due to the decline in the oil and gas sector (with its high-value wages), and the buoyancy of the UK financial sector in London, which is now expanding to other areas of the country. The decline in labour force participation relative to the rest of the UK, including amongst younger and older people, is also a factor.
- **Spending on the Scottish Government's largest social security payments, including new payments, is forecast to be £750 million more than the forecasts on social security funding to be received from the UK Government as part of the Block Grant Adjustment by 2024-25, reducing the funding available for other spending priorities. The SFC expects social security spending to increase in future forecasts "as it has not yet incorporated any changes in spending arising from the Scottish Government's replacement payments for carers' allowance,**

[1] https://www.bbc.co.uk/news/business-59663947
[2] Bank of England raises interest rates to 0.25% - BBC News

attendance allowance, industrial injuries scheme, and winter fuel payments which the Scottish Government aims to launch by the end of 2025. Any changes to these payments which further increase spending will also need to be met from the wider Scottish Budget". The SFC further told the Committee that the figure does not take account of the undertaking by Social Security Scotland to try to increase uptake of benefit payments.

- **The SFC expects the Scottish Government to explain further how its sources of extra income of £620 million for the resource budget in 2022-23 develop over the course of the financial year as some "are still a matter of negotiation between the Scottish and UK governments".** The SFC told the Committee that it considered the overall number of £620m to be reasonable, even if it had concerns about whether the individual elements would materialise in full. David Eiser indicated that, on the basis of previous budgets, it was almost inevitable that additional resources of a similar sum would flow from additional UK Government spending and that it was perhaps more prudent to factor this into the Budget when it can be used more strategically and be subject to greater scrutiny than if it was included in the Spring Budget Revision. However, if the full sum did not materialise, this would put additional pressure on the Budget.
- **Capital funding is expected to fall over the next five years in both cash and inflation adjusted terms, primarily due to reduced UK Government funding. As the Scottish Government moves closer to reaching its capital borrowing limit of £3 billion, borrowing is planned to reduce over the next five years, further reducing capital funding.** The SFC suggested that the Scottish Government does not always borrow up to the annual borrowing limit, in which case it would not reach its upper limit as quickly. David Eiser told the Committee "at the very least, there is a very good case for the annual borrowing limit and the overall cap to increase in line with some measure of inflation or of the overall budget", adding that this would be negotiated as part of the fiscal framework review.
- **The SFC forecasts assume that from April 2022 and into the longer term, Covid-19 will become endemic and begin to be managed through guidance and voluntary measures**. Its forecasts were finalised before the emergence of the Omicron variant and, while noting that information on its impact is currently limited, the SFC "broadly think it remains reasonable to assume the effects of Omicron fit within our central assumptions".

5. The SFC's forecasts, along with those of the OBR, provide the latest indication of the potential size of future reconciliations to the Scottish Budget. Figure 2.5 of the SFC Economic and Fiscal Forecasts[3] shows that the latest income tax reconciliations are forecast to be -£97 million in 2020-21 (to be applied to the 2023-24 Scottish Budget) and -£469 million in 2021-22 (to be applied to the 2024-25 Scottish Budget).

[3] Scotland's-Economic-and-Fiscal-Forecasts-December-2021-Full-report.pdf (fiscalcommission.scot), page 28

6. As highlighted to this Committee, forecasting has inherent risks, summarised in the predecessor committee's joint report[4] on the fiscal framework as: the extent of the underlying uncertainty about the economy, availability of relevant and robust data, robustness of, and differences in, methodologies and judgements, and forecast horizons[4]. These risks are more acute during periods of economic uncertainty such as the pandemic. In its pre-budget report, this Committee agreed with its predecessor that "the two governments should consider the extent of the risk arising from potential divergence in forecast error between the SFC and the OBR, learning any lessons from the experience of an economic shock being triggered due to a quirk in timings". There was some discussion on 14 December about differences in the OBR and SFC forecasts, with David Eiser concluding that all forecasters had been open about there being "greater than usual uncertainty around their forecasts, so there is invariably some variation around them".

7. The Committee heard during pre-budget scrutiny that Covid-19 to date had largely had similar health and economic impacts across the UK, a scenario which sees little or no impact on how the fiscal framework operates. However, if these impacts were to disproportionately affect some parts of the UK more than others, the fiscal framework could come under greater strain. The latest SFC forecasts show Scotland lagging behind the UK on economic performance, income tax receipts falling behind the block grant adjustment (BGA) and social security spending exceeding the BGA.

Scottish Budget 2022-23

8. The Cabinet Secretary for Finance and the Economy, in a statement to Parliament on 9 December, announced the Scottish Government's cross-government spending priorities in the Scottish Budget 2022-23 as:

- tackling inequalities,
- ending Scotland's contribution to climate change, and
- supporting Scotland's recovery.

9. Specific measures include doubling the Scottish Child Payment to £20 from April 2022 and starting delivery of the new Adult Disability Payment. Funding has also been made available for decarbonisation of homes, buildings, transport and industry, and minimum wage rises to £10.50 an hour for social care staff and those covered by the public sector pay policy.

10. In terms of tax policy, income tax rates remain unchanged, but thresholds for starter and basic rate bands will increase by CPI whilst the remaining thresholds will remain frozen. Land and Buildings Transaction Taxes rates and bands are maintained at current levels including those for the Additional Dwelling Supplement[5]. Standard and lower rates of landfill tax are increased to maintain consistency with rates in the rest of the UK. The council tax freeze ends in 2022-23 and so, councils will have flexibility to set the council tax rate for the first time since 2007. There will

[4] This is the length of time into the future for which forecasts are prepared.
[5] On 16 December, the Scottish Government launched a call for evidence and views on the operation of the LBTT Additional Dwelling Supplement, along with a wider Framework for Tax setting out the overall approach to tax policy and delivery.

be a 50% rates relief from non-business rates (NDR) for the first three months of 2022-23 for properties in the retail, hospitality and leisure sectors, capped at £27,500 per ratepayer, and NDR basic rate poundage will be 49.8p, a below inflation rise.

11. On 14 December, in an update to Parliament on Covid-19 developments, the First Minister announced an additional £200 million in funding had been found to support the pandemic response. This comprised £100 million for self-isolation grants for those having to isolate and needing support, and £100 million for supporting businesses mainly in the hospitality, food and culture sectors, impacted by cancellations in advance of Christmas. There is still uncertainty as to how this will be funded – from which existing Budget lines the money will come and if there will be any UK Government financial support.

12. The Committee published its pre-budget report on 'Scotland's public finances in 2022-23 and the impact of Covid-19' on 5 November. A key theme in the report was the need to balance the short-term demands from the response to, and recovery from, Covid-19, with continuing longer-term pressures such as demography, poverty and inequality. The report also made a number of recommendations aimed at achieving future fiscal sustainability. Since then, as noted above, the SFC's forecasts have painted a more pessimistic economic picture, which may raise questions around Scotland's future fiscal sustainability.

13. The session with the Cabinet Secretary provides an opportunity to explore the Scottish Government's response to issues raised in the Committee's pre-budget report received on 9 December, which is provided at Annexe A. This provides responses against each of the recommendations but includes different levels of detail. For example, it details how the Scottish Government is responding to demographic challenges; but has less information on how the budget has prioritised a preventative approach over others or how budget decision-taking has been influenced by the outcomes contained in the National Performance Framework (NPF)[6]. A Committee debate expected to be arranged for late January provides further opportunity to discuss these issues, and the Stage 1 debate will follow shortly thereafter.

14. Ending Scotland's contribution to climate change is one of the spending priorities in the Scottish Budget 2022-23. The Committee heard previously from the Fraser of Allander Institute about research it has been commissioned to undertake aimed at improving the climate change information included in the budget. Interim changes were made, and the Scottish Budget 2022-23 now contains a carbon assessment of the capital Budget. This highlights a substantial increase in investment for low carbon projects in the coming year, for example on active travel and energy efficiency, while the share of high carbon investment has fallen, with the main areas of spending being improving and maintaining road and bridge networks and funding to help Highlands and Islands Airport Ltd to improve links between airports in the region. Identifying exactly how the transition to net zero influences budgetary decisions may be worthy of further discussion.

[6] National outcomes are however referenced in the Equality and Fairer Scotland Budget Statement under each portfolio.

15. The Budget document is also accompanied by a detailed Equality and Fairer Scotland Budget Statement which assesses where the Scottish Government is proposing to spend public money and how it aims to reduce inequality. In respect of taxation, it commits the Scottish Government to using its powers over income tax "in a progressive manner, aiming to protect tax-payers on low incomes and raise revenue to fund high-quality public services for all". Annexe A to the statement, a Portfolio Assessment and Update to the Key Risks, sets out the portfolio contributions to the national outcomes in the NPF.

The Resource Spending Review Framework and Medium-Term Financial Strategy

16. The Framework document launches the Scottish Government's first multi-year Resource Spending[7] Review (RSR) since 2011, which will set out spending plans for the remainder of the parliamentary term. The RSR will be published in May 2022, following a consultation on the Framework document. As referred to earlier in this paper, the Committee is currently undertaking an inquiry looking at issues such as whether the framework properly reflects the current economic and political context, and how it approaches cross-cutting issues, long-term challenges including demographic trends, and preventative approaches.

17. The Scottish Government's Framework is seeking views on the three priorities of progress towards meeting child poverty targets, addressing climate change, and securing a stronger, fairer, greener economy, which are the same as the spending priorities in the Scottish Budget 2022-23. It also asks whether the following "primary drivers of public spending over the RSR period are correct and whether others should be added:

- changing demographics
- demand on health service
- public sector workforce".

18. The RSR Framework highlights that "with limited resources, increased investment in the Scottish Government's priorities will require efficiencies and reductions in spending elsewhere: we need to review long-standing decisions and encourage reform to ensure that our available funding is delivered effectively for the people of Scotland". It further recognises that the Scottish Government "must rise to the challenges of the future by putting our public finances on a sustainable trajectory".

19. The Scottish Government's MTFS, which is intended to ensure that "both Parliament and Government have foresight of the financial challenges we face and the opportunities that lie ahead", explains that underpinning its priorities is our core public finance principle of fiscal sustainability. It goes on to state that "we must adapt and future-proof our public services, using our limited resources as efficiently and

[7] Resource spending is money that is spent on administration and the day-to-day delivery of services and programmes, such as school meals, concessionary bus passes and most public sector staff salaries.

effectively as possible, and increasing long-term preventative measures to ensure that we are able to meet the needs of future generations”.

20. The MTFS also sets out the economic, fiscal and spending outlook and explores the following fiscal risks, along with some mitigations:

Short-term risks

- UK Government spending decisions
- forecast error
- in-year revenue volatility caused by asymmetrical economic performance between Scotland and the rest of the UK.

Medium to longer-term risks

- reduction in Block Grant growth caused by UK spending decisions
- changes to the Block Grant Adjustments
- fundamental changes to the operation of finance in devolved policy-making as a result of the UK Internal Market Act
- structural differences in UK and Scottish economic performance
- compositional differences in UK and Scottish tax base
- pay agreements are a key driver of public sector costs and spending
- demand pressures caused by an ageing population.

21. It goes on to say that it has “limited levers to manage considerable levels of uncertainty and fiscal risk in order to smooth public expenditure over the medium-term”. It adds that “this means that forecasting, controlling and prioritising expenditure is our primary lever for managing fiscal risk, to enable us better to target our spending decisions in order to tackle some of the more strategic and long-term risks to fiscal sustainability, such as changing demographics and climate change”.

22. Another area of the Committee’s focus has been on the replacement of EU Structural Funds in Scotland, post-Brexit – principally the UK Government’s Community Renewal Fund and Levelling Up Fund. Recently the UK Government has announced successful bids for funding from both funds including from Local Authorities and other groups in Scotland. Details of the operation of the UK Shared Prosperity Fund have yet to be announced.

23. In its MTFS the Scottish Government highlighted the potential impact of this UK Government funding in devolved policy areas on its policy making process. In relation to capital funding for the future and the Scottish Government’s National Infrastructure Mission (NIM), the Scottish Government comments that “should the UK Government continue to invest in local and regional infrastructure without consulting the Scottish Government, as is the case with the Levelling Up Fund investments, thereby reducing what would have otherwise come through as capital grant, achieving our NIM target could be at risk.”

Next steps

24. The Committee will report to Parliament on its scrutiny of the Scottish Budget 2022-23 in the week commencing 17 January, with the Stage 1 report on the Budget Bill expected to be scheduled for the following week.

Committee Clerks
December 2021

ANNEXE A

Scottish Government's response to the Finance and Public Administration Committee's pre-budget report

Dear Kenneth

Pre-Budget Scrutiny Report 2022-23

Thank you to the Committee for your pre-budget scrutiny report ahead of the 2022-23 Scottish Budget. I have carefully considered the points raised by the Committee and a detailed response is set out in the annex to this letter.

Given the enormity of the economic and fiscal challenges the Scottish Government is facing in preparing its Budget, I welcome the Committee's acknowledgment of the UK and Scottish economic outlooks, and the impact of having no COVID funding guarantee in 2021-22. I recognise the Committee's views on the need for effective intergovernmental relations, greater transparency and scrutiny, and improving public awareness and understanding of the budget process. The Scottish Government will continue to work together with the Parliament to meet these challenges, to ensure that we take effective action to support economic recovery and manage the risks around the public finances.

I welcome the Committee's ongoing input into the forthcoming review of the Fiscal Framework, and its recommendations and support for the issues that need to be considered. I view contributions from parliamentary committees and wider stakeholders as an integral part of the review process, which is why I am pleased to have agreed with the Chief Secretary to the Treasury that input will be sought at both the report and review stages of the process. I welcome views from the Committee on how best to obtain its input and engage throughout the process, while acknowledging that the review is a joint undertaking with UK Government.

On the independent report, my officials continue to work with HM Treasury counterparts to finalise the terms of reference and to consider potential authorship options. I will keep the Committee updated on progress, which I hope can be made swiftly, to enable commencement of the review as early in 2022 as possible.

Personal Allowance Spillover Dispute

I would also like to provide you with an update on the outstanding dispute with the UK Government in relation to their increases to the income tax personal allowance (PA), and the disproportionate impact these have on Scottish revenues through the operation of the Fiscal Framework. At official level, both governments have signed off a joint analytical framework which agrees that a direct spillover effect arises from the UK Government's changes to the PA, and so a transfer of funding from the UK Government to the Scottish Government is due. However, our Governments are disagreed on the size of the spillover effect.

The period covered by the dispute dates back to 2017-18 and is depriving the Scottish Budget of a material level of funding while it remains unresolved. I am therefore seeking to resolve the dispute without further delay. On that basis, the Scottish Budget 2022-23, published today, includes a funding assumption relating to several different funding sources, one of which is a funding transfer relating to this dispute. This does not pre-judge the outcome of the dispute resolution process. The Scottish Government will continue to engage with that process in good faith, with an expectation of reaching a swift resolution in 2022. I have therefore written to the CST today to request a discussion early in the new year to consider this dispute and to discuss next steps, with a view to progressing the matter to an agreeable resolution.

I hope that the Committee finds this information helpful. I will keep the Committee updated once an agreement is reached with the CST.

Yours sincerely,

Kate Forbes

ANNEX – DETAILED SCOTTISH GOVERNMENT RESPONSE

Para	Comment/Recommendation	Response
35.	As we turn our attention to recovery from the pandemic, the Committee understands that it may become more challenging to identify and track the flow of Covid-19 spend. However, the Committee asks the Scottish Government to commit to providing transparent and timely information on all Covid-19 allocations to allow proper scrutiny of where, and how effectively, the money has been spent, so that any lessons can be learned for the future.	The Scottish Government understands the importance of this information and will continue to provide transparent information on all Covid-19 funding allocations through timely provision of information to the Committee and through the formal budget revision process.
38-39.	The Committee acknowledges that the minimum funding guarantee of 2020-21 provided welcome certainty for the Scottish Government to announce policies and spending to support those most affected by the pandemic. We note that, despite the pandemic's ongoing impact, no such guarantee was in place in 2021-22, which has made budget management more challenging. Our predecessor Committee's recommendation was that the UK Government should, if the fiscal position rapidly evolves, commit to providing a similar funding guarantee. Longer-term, we believe that there would be merit in both governments reviewing whether this type of guarantee could provide greater certainty for devolved budget planning in the future.	Scottish Ministers recognise the benefit of this guarantee and have continued to seek a formal guarantee of Covid funding for 2021-22. The Government will take forward the possibility of securing similar guarantee arrangements in future.
42-44.	The Committee welcomes the recent announcement that the Cabinet Secretary for Finance and the Economy and the Chief Secretary to the Treasury have agreed to commission an "independent report on the Block Grant Adjustment arrangements, including a call for stakeholder input, prior to a broader review of the Fiscal Framework". We note the Cabinet Secretary's plans to undertake a programme of analysis to inform the broader fiscal framework review, building on the independent report and other key publications and evidence, including last session's joint report. We request regular updates on the commissioning and progress of this independent report. The Committee further recommends that the independent report should be presented to both the UK and Scottish parliaments, as well as the two governments, as recommended in the Legacy Expert Panel report 23 to our predecessor committee at the end of last session.	Scottish Government officials are continuing to work with HM Treasury officials to finalise the terms of reference and consider the potential authorship for the report, to enable us to swiftly commission and complete the report, and commence the review as early in 2022 as possible. Once the arrangements are finalised, we will confirm the authorship and publish the terms of reference. We will keep the Committee updated. The Committee's recommendations on the presentation of the report are noted. As the Committee will be aware, the arrangements for the independent report are subject to joint agreement with HMT. We would welcome the opportunity to present the report and its findings to both Parliaments as well as both Governments.

Para	Comment/Recommendation	Response
48-49.	The Committee concludes that the fiscal framework broadly worked as intended during the pandemic, though this was more by accident than design. Whether this remains the case in relation to Scotland's recovery from the pandemic is something that the Committee will want to return to in future budget scrutiny. We recommend that the review of the fiscal framework should look at how it can be strengthened to withstand the risk from any future health or economic shocks that could disproportionately affect one part of the UK.	The Scottish Government agrees that the Fiscal Framework review must reflect on the experience of COVID-19 and the operation of the framework to date, to ensure that it is robust to future shocks and provides the Scottish Government with the necessary powers and flexibilities to manage associated risks. This should include consideration of the potential for future shocks to disproportionately impact Scotland through the operation of the Fiscal Framework, for example, on account of differences in the sectoral composition of the two economies. The review must consider solutions to address this potential issue.
53-54.	The Committee believes that the fiscal framework review presents an opportunity to consider how communication and transparency between the UK and Scottish governments can be improved, to allow more effective management of public finances in Scotland. We also seek an update from both governments on progress with the ongoing review of intergovernmental relations, the timetable for concluding this work, and how its outcomes will impact on the fiscal framework review.	The intergovernmental relations (IGR) review proposals deliver many elements of what the Scottish and Welsh Governments set out to achieve from the review and offer the prospect of improvements to current processes. The First Minister has written back to the UK Government to indicate she is content to use the proposals detailed in the review as the basis for engagement but that these must be kept under review. It has also been made clear that procedural improvements alone are not enough to reset the relationship. The Fiscal Framework review will provide the opportunity for both governments to embed the IGR principles for collaborative working and reflect on the findings of the IGR review, considering what improvements can be made to support better intergovernmental engagement, coordination and dispute avoidance and resolution.
57.	The Committee believes that the fiscal framework review should look at ways to simplify, and clarify the workings of, the fiscal framework where possible, to improve public understanding and public accountability. We believe that, as a starting point, both governments should commit to providing transparency and enabling Parliamentary scrutiny of their decision-making at key stages during the review process.	The Scottish Government is committed to a transparent review process, while acknowledging that the review is a joint endeavour undertaken with the UK Government, and some elements of the process will require shared, private space for intergovernmental discussion.

Para	Comment/Recommendation	Response
71-76.	The Committee considers that the Scottish Government should have more flexibility to carry forward and manage its budget across years in normal times. We look forward to exploring this matter further. We believe that the limits on the Scottish Government's resource borrowing powers to cover forecast error and cash management, and the Scotland Reserve, are not currently sufficient. We consider that these should, as a minimum, be linked to inflation. The Committee agrees with our predecessor that the two governments should consider the extent of the risk arising from potential divergence in forecast error between the SFC and the OBR, learning any lessons from the experience of an economic shock being triggered due to a quirk in timings. Recent publication of the UK and Scottish government budgets has followed a different timeline than was envisioned when the fiscal framework was agreed, which has created additional volatility and uncertainty for the budget process. We believe that greater co-ordination regarding the two governments' budget timings is needed. Noting recommendations from both the Smith Commission and our predecessor committee, as well as evidence gathered during our inquiry, we consider that it is now time to revisit the merits of a prudential borrowing scheme for capital borrowing. The Committee recommends that these issues are considered as part of the upcoming fiscal framework review.	The Government welcomes the Committee's views and support on these issues. As the Committee's report identifies, there is emerging consensus in Scotland around the inadequacy of the current borrowing and reserve powers compared to the volatility and risks to which the Scottish Budget is exposed. The Fiscal Framework review must consider and make changes to these powers, to support sound financial planning and management for future years. In making those changes, the review should reflect on the issues the Committee has identified, including ensuring that the limits are increased over time to reflect growth in tax revenues and the economy, and improving intergovernmental co-operation and co-ordination. We also agree on the need to look again at the case for a prudential borrowing regime for capital. More broadly, we appreciate the part the committee has played in highlighting these issues and illustrating where there are deficiencies in the current arrangements.

Para	Comment/Recommendation	Response
86-89.	The Committee notes that the demographic projections present a double 'whammy' to fiscal sustainability, as the proportion of working age people falls while the number of over 65s continues to grow. The provision of public services and welfare payments would, in this scenario, need to be funded from a smaller and more productive working population. We recognise that reversing these demographic trends will require a focused and sustained approach to policy-making over a number of years. We therefore seek clarification from the Scottish Government as to how this challenge will be addressed in its Budget 2022-23, and its next Medium-Term Financial Strategy, which looks ahead to the next five years. The Committee also notes publication of the Scottish Government's strategy 'A Scotland for the future: opportunities and challenges of Scotland's changing population' in March 2021. We seek an update on progress in delivering its recommendations, including its proposal for a Demographic Commission. The Committee welcomes the Scottish Fiscal Commission's preparatory work to start producing a fiscal sustainability report each session, which would look ahead to the next 30 to 50 years and identify "particular pressures on spending or revenue arising from, for example, population growth". We agree with the SFC that this presents a real opportunity to "consider whether major alterations will be required to adjust for changing circumstances" and we therefore ask the Scottish Government to support the SFC in this important work.	The Scottish Government is conscious of the significant impact that demographic change may have in Scotland, in common with many advanced economies. This was highlighted clearly in the January 2021 Medium-Term Financial Strategy, which also made clear the constraints that the current Fiscal Framework places on our ability to manage these impacts. In October 2021, the Cabinet Secretary for Constitution, External Affairs and Culture chaired the most recent meeting of the Scottish Government's Ministerial Population Taskforce. The Taskforce discussed its cross-portfolio approach to Scotland's demographic challenges ahead, and the arrangements we are putting in place to deliver the initial 36 actions identified in the Population Strategy – across vital areas including talent attraction, migration, housing, and public finance. Exploring a Demographic Commission was one of the Strategy's identified actions, and the Scottish Government will continue to explore this option further into 2022. In the meantime, the Scottish Government's Independent Expert Advisory Group on Population and Migration will continue its work to produce analysis to inform Scottish Government policy development in relation to demographic change in Scotland. The December 2021 MTFS has continued to highlight demographic factors, notably the impact of ageing as a driver of public service expenditure. Scotland's population has increased in past years, and is projected to continue to rise. The largest medium-term trends relate to the significant increase in our older population, and changes in where and in what household size people choose to live. All local authority areas will see an increase in pensioners with implications for services such as health, or the nature of housing required. The biggest change is

		a 71% forecast increase in the number of people aged over 75 in the next 25 years. The Infrastructure Commission for Scotland focused on a range of strategic long term drivers for infrastructure, including how best to optimise the impact of infrastructure in enabling sustainable places. The Scottish Government's response to the Commission, our latest Infrastructure Investment Plan (IIP) for 2021-22 to 2025-26, has building resilient and sustainable places at its heart. The IIP invests in projects and programmes that meet the needs of older people; provide services and homes where people choose to live and regenerate areas of working-age population decline. In addition to this, the Resource Spending Review Framework reflects on the impact that demographic change could have on public finance and need for public services. The Framework highlights changing demographics as one of the key factors which will have a substantial impact on public spending over the Resource Spending Review period – seeking views on this and other trends which the Scottish Government should consider. The demographic outlook will continue to inform decisions made by the Scottish Government. The Scottish Government is fully committed to fiscal sustainability. Accordingly we will support the Scottish Fiscal Commission in the preparation of a fiscal sustainability report, including providing the resources requested, as is reflected in their increased budget allocation.

Para	Comment/Recommendation	Response
93-94.	We believe that more efficiency can be achieved by streamlining and linking up the various strategies and plans which have an impact on growing the economy and fiscal sustainability as we move out of the pandemic. We ask the Scottish Government to outline how it will make progress on this matter. The Committee considers that the upcoming statutory review of national outcomes provides an opportunity to reposition the National Performance Framework at the heart of government planning, from which all priorities and plans should flow. We also ask the Scottish Government to consider how the NPF could be more closely linked to budget planning.	The Scottish Government recognises the importance of streamlining and linking up various strategies and plans impacting on growing the economy and fiscal sustainability. The Scottish Government recognises the opportunity that the upcoming Review of the National Outcomes presents to further embed the National Performance Framework (NPF) in government planning and will work to ensure that progress is made on positioning the NPF at the heart of government. The Review is planned to commence in 2022.
100-101.	The Committee believes that multi-year budgets are crucial to securing certainty for Scottish public finances, including for local government, the third sector, and other key bodies. We acknowledge that it can be more challenging to deliver this approach in situations where the Scottish Government does not have confirmed multi-year block grant funding from the UK Government. We therefore recommend that both governments consider how multi-year budgets can be achieved more routinely as part of the fiscal framework review. The Committee asks the Scottish Government to set out in its framework document due in December further details of its resource spending review and how this might bring more certainty and efficiency to budgeting arrangements in the future.	The Scottish Government agrees with the Committee that multi-year budgets offer greater certainty and stability for the Scottish public finances, and would encourage the UK Government to provide substantially greater clarity than it has in the past. I will continue to press for this in my regular meetings with my devolved counterparts and HM Treasury. As noted in response to the recommendation at paragraph 49, the Scottish Government agrees that the review of the Fiscal Framework must reflect on the experience of COVID-19 and the operation of the framework to date, to ensure that it is robust to future shocks and provides the Scottish Government with the necessary powers and flexibilities to manage the associated risks. The Scottish Government's Resource Spending Review Framework, published alongside Budget 2022-23, provides more detailed information on the context, objectives and process of the multi-year Resource Spending Review.

Para	Comment/Recommendation	Response
110-113.	The Committee understands that public finances will be under significant pressure in the next few years and that the Scottish Government faces difficult decisions on how it prioritises spend and raises revenue. We further realise that it will not be possible to address the consequences of Covid-19 within the short planning horizon of just one budget round. We therefore recommend that the Scottish Government explores within its next resource spending review and Medium-Term Financial Strategy, which policy interventions would have the greatest impact on cross-cutting issues such as addressing inequalities and poverty. We can see real economic and societal benefits in prioritising spend for preventative measures, whether that be to protect the environment or the health of the nation in future years. We believe that the resource spending review provides an opportunity to introduce bold preventative measures to protect funds and create a wellbeing economy for the long-term. Many of our other recommendations in this report are intended to achieve greater fiscal sustainability, which we believe would allow more preventative spend to be identified and allocated in future years. The Committee asks the Scottish Government to set out in the Scottish Budget 2022-23 and Medium-Term Financial Strategy how it intends to manage the economy to meet its net zero commitments by 2045. Examining the finances behind the net zero targets is an issue we intend to return to in early course. This may also be an area which the Scottish Fiscal Commission will wish to consider as part of future fiscal sustainability reports.	The Scottish Government's Resource Spending Review Framework identifies an outcomes focus as one of the key principles underpinning the spending review process. The focus of the review is to ensure that public spending delivers the best outcomes for our citizens. As part of the Resource Spending Review, three priorities have been identified; • To support progress towards meeting our Child Poverty targets. • To address climate change. • To secure a stronger, fairer and greener economy. These three key, cross-government priorities will inform the assessment and development of future spending plans as the process progresses. The Medium Term Financial Strategy focused on longer-term sustainability. It sets out the economic and fiscal outlook, and the Scottish Government's approach to managing fiscal volatility and risk.

Para	Comment/Recommendation	Response
131-132.	We note that the Scottish Government's Covid Recovery Strategy sets out a range of commitments to reskill and retrain people, as well as support for the creation of jobs. In view of the evidence we received, we believe that the Scottish Government should also look to provide targeted schemes to support older workers into work, to ensure a fair and equal recovery. We recognise that addressing skills shortages is only one half of the challenge; ensuring businesses provide secure, good quality employment is equally important. In line with the Scottish Government's stated priority of building a wellbeing economy, the Committee seeks an update on how it will broaden access (including for older people) to a high standard of employment through its Budget 2022-23 and next Medium-Term Financial Strategy.	The Medium Term Financial Strategy focuses on longer-term sustainability with spending decisions being taken as part of the Scottish Budget and Scottish Government Spending Reviews. In the absence of powers over the employment legislation the Scottish Government will continue to use the levers at our disposal to promote Fair Work principles that improve pay, conditions and opportunities for all workers including older workers. Fair Work First criteria are being applied to public sector grants and procurement and have been expanded this year to include specific promotion of flexible working practices Our Employability in Scotland website brings together information on available employability support schemes. Services such as No One Left Behind, which helps people gain skills and confidence, and Fair Start Scotland, which offers tailored, flexible, person-centred support to find and stay in work, are available to people of all ages. Apprenticeships are another route to supporting people of all ages into sustainable and rewarding careers. Scotland's Modern and Graduate Apprenticeships, of which there are over 100 apprenticeship frameworks available, are accessible to people aged sixteen or older.

Para	Comment/Recommendation	Response
143-144.	The Committee recognises that higher inflation can bring with it increased income tax revenue, but that this must be balanced in the Scottish Budget with higher costs and spend on pay and social security. We ask the Scottish Government if it has assessed the implications for the Scottish Budget of higher inflation rates continuing into the medium-term, particularly given Scotland's demographic position. We would also welcome clarification as to how the Scottish Government intends to reflect the uncertainty of inflation rates in its public sector pay policy.	The Medium Term Financial Strategy economic outlook sets out the outlook for inflation in some depth. The outlook for inflation is also an integral part of SFC forecasts of the fiscal position. The impact of higher inflation on public spending is set out in the Resource Spending Review framework document. The SFC's forecasts also discuss the potential impact of higher inflation on the economy as a whole. The Scottish Government has in recent years stated its preference for an inflation proofed pay uplift, balanced with affordability and value to the public purse. The Scottish Government considers inflation impacts as at September CPI (3.1%) - in line with income tax threshold and pension payment uplifts - in determining headline pay uplifts. The Scottish Government acknowledges the transient nature of inflation and will continue to prioritise progressive, fair pay awards, that provide additional protection to the very lowest paid, where cost of living impacts are felt most profoundly.
157-160.	The Committee recognises the impact of the pandemic on many businesses, including the hospitality, retail, leisure and travel sectors, some of whom have built up significant debt. We ask the Scottish Government to consider how it might best support these sectors to recover, rejuvenate the high street and grow the economy. We recognise that the two non-domestic rates reliefs put in place by the Scottish Government for the year 2020-21 provided much-needed support to those businesses struggling the most. While we appreciate that it may not be sustainable to plan for similar reliefs within the 2022-23 Budget, we welcome the Cabinet Secretary's commitment to be "cognisant of the need to ensure taxation enables businesses to fully recover and fully trade". The Committee understands the continuing pressures on local government finance, with	The continuing pressures on Scotland's local authorities caused by the pandemic are well known and fully acknowledged. In addition to the additional general support the Scottish Government has provided so far we also provided £249 million last year specifically to compensate councils for the loss of income from sales, fees and charges. This extra funding was included in the additional £1.2 billion in direct COVID-19 support provided during 2020-21 through the local government finance settlement – over and above local authorities' regular grant payments. This was supplemented by another £259 million of general support this year. Decisions on local government budget allocations are subject to the outcome of discussions with COSLA and individual local authorities. These discussions include asking local authorities what

	lost income during the pandemic and additional reliance on reserves expected in 2022-23. The Committee asks the Scottish Government to explore whether greater flexibility can be afforded to councils to respond to local priorities and fund local services in the next budget round. The Committee would welcome regular updates throughout the session on how the local government fiscal framework is progressing.	funding flexibilities could be provided to help them fund local services at a time when they are likely to face a very challenging financial settlement. Work to develop a rules based fiscal framework had been delayed at the onset of the pandemic. However Scottish Government and COSLA officials have now recommenced discussions. We still think that it is essential for Local Government to contribute specific proposals to inform these considerations and more substantive work is proposed to be taken forward in the first part of 2022. It can be expected that the development of a fiscal framework will have a direct relevance to the Scottish Government's Resource Spending Review and also have a bearing on the Local Governance Review.
168-169.	The Committee looks forward to exploring evidence from Scottish local authorities on their experiences in relation to the UK Government's replacement for EU funds and to hearing from the Secretary of State for Levelling Up, Housing and Communities on this important matter. In the meantime, we recognise, in line with other findings in this report, that greater communication and sharing of information between the UK and Scottish governments is needed to enable effective public spending in areas where there may be a shared interest.	The Scottish Government welcomes and shares the committee's concerns around the lack of and poor quality of engagement from the UK Government regarding the replacement EU funding and the development of new UK-wide funds being deployed in areas of devolved competence. The UK Government is choosing to use the Internal Market Act powers without the engagement or consent of the Scottish Government and Scottish Parliament. This approach introduces considerable additional uncertainty to future devolved funding settlements, and risks duplication and waste in the delivery of policies and services. Despite years of promises that the UK Spending Review would reveal all about the nature of the replacement for EU Structural Funds – the UK Shared Prosperity Fund – there is still no clarity on Westminster's plans for this Fund. We have had no input into its development, and have seen no evidence that it will meet the needs of Scotland's places and people.

Para	Comment/Recommendation	Response
172.	The Committee notes a lack of clarity as to whether the Scottish public sector will incur additional costs as a result of the proposed increase in employer national insurance contributions, under the UK Government's Health and Social Care Levy. We invite the Scottish Government to provide an update on this issue and any consequences for the Scottish public finances following discussions with HM Treasury.	The Scottish Government estimates that the public sector will incur additional costs of around £150m per annum in Scotland as a result of the increase to employer National Insurance Contributions under the Health and Social Care Levy. HM Treasury have confirmed that the Scottish Government is receiving Barnett consequentials on equivalent spend to cover these costs in England, though have yet to provide an exact breakdown.