Finance and Public Administration Committee

12th Meeting 2024 (Session 6), Tuesday 26 March 2024

The Scottish Fiscal Commission's Report on Fiscal Sustainability Perspectives: Climate Change

Purpose

1. The Committee is invited to take evidence from the following witnesses from the Scottish Fiscal Commission (SFC) on its report on *Fiscal Sustainability Perspectives: Climate Change*, which was published on 14 March 2024—

   Professor Graeme Roy, Chair; Professor David Ulph, Commissioner: John Ireland, Chief Executive; and Claire Murdoch, Head of Fiscal Sustainability and Public Funding.

2. An accompanying letter to the Committee from the SFC is attached at Annexe A.

Background

3. The UK has set itself a legally binding target to achieve net zero carbon emissions by 2050. The Climate Change (Scotland) Act 2009 was amended by the Climate Change (Emissions Reduction Targets) (Scotland) Act 2019, increasing the ambition of Scotland's emissions reduction targets to net zero by 2045 and revising interim and annual emissions reduction targets.

4. As noted in the SFC's letter (Annexe A) to the Committee, the SFC's report explores "how climate change could affect the Scottish Government's fiscal sustainability" and considers "the potential effects on Scottish public finances from damage created by climate change, the costs of adapting to a changing environment and taking action to meet Scotland's statutory emissions targets to reach net-zero by 2045".

5. The SFC does not project funding and spending in this report and does not assume current polices are held constant. Its report notes that "given the current lack of costed climate change plans, we use the Climate Change Committee's Sixth Carbon Budget to make financial estimates and we discuss risks around adaptation and damage". It further looks at "how the sustainability of the devolved public finances is affected by the interaction of the fiscal framework with the policy choices made by both the UK and Scottish Governments".

6. The report also discusses the data and information that the SFC considers is needed to be provided by the Scottish and UK Governments to produce projections of climate change funding and spending.

Climate Change Committee

7. The Climate Change Committee (CCC), an independent statutory body, has a role in providing expert advice as part of Scotland's approach to climate change. Scotland's climate change legislation sets out a statutory role for the CCC, and it provides regular advice, including an annual Scottish progress report on reducing emissions, advice on emissions reduction targets and regular independent assessments of Scotland's adaptation programmes.

8. The Scottish Government intends for Scotland to reach net zero by 2045. The Climate Change (Emissions Reduction Targets) (Scotland) Act 2019 sets annual targets in addition to the interim targets of cutting greenhouse gases by 75% by 2030 (this compares with the UK's target of 68% by 2030) and 90% by 2040.

9. The CCC published its Progress in reducing emissions in Scotland: 2023 Report to Parliament on 20 March 2024. The report states that Scotland has missed eight of the past 12 annual targets for cutting emissions and looks set to miss its 2030 interim target. It suggests that the "Scottish Government is failing to achieve Scotland's ambitious climate goals" and that "current overall policies and plans in Scotland fall far short of what is needed to achieve the legal targets under the Scottish Climate Change Act". It believes that the "acceleration required in emissions reduction to meet the 2030 target is now beyond what is credible... given the pace at which supply chains and investment would need to develop".

10. The CCC's Sixth Carbon Budget (9 December 2020) provided estimates of the additional capital investment required each year in Scotland to reach the UK Government's target of net zero by 2050. Using this data, the SFC estimates that an average of £1,136 million a year (in 2024 prices) as an additional cost to the public sector will be required as additional capital investment from the Scottish Government to reach net zero over the period 2020 to 2050. This is equivalent to 18% of the Scottish Government's 2024-25 capital budget of £6,193 million and compares to a figure of £9,582 million required in the rest of the UK. This, the SFC states "will create a pressure for the Scottish Government to manage as it will have to meet the differential need from within its existing budget or raise more revenue from other devolved sources". These figures do not include the costs associated with adapting to climate change or damage from climate change.

Report on Fiscal Sustainability Perspectives: Climate Change

Key issues

11. The SFC report sets out three ways through which climate change will affect public finances—

- "**Damage** from climate change through countries needing to invest in response to more frequent and intense severe weather events.
- **Adaptation** to climate change, such as through investment to reduce the impacts of climate change damage.
- **Mitigation** of climate change as countries transform their economies to reduce greenhouse gas emissions to limit further global warming".

12. The report further notes—

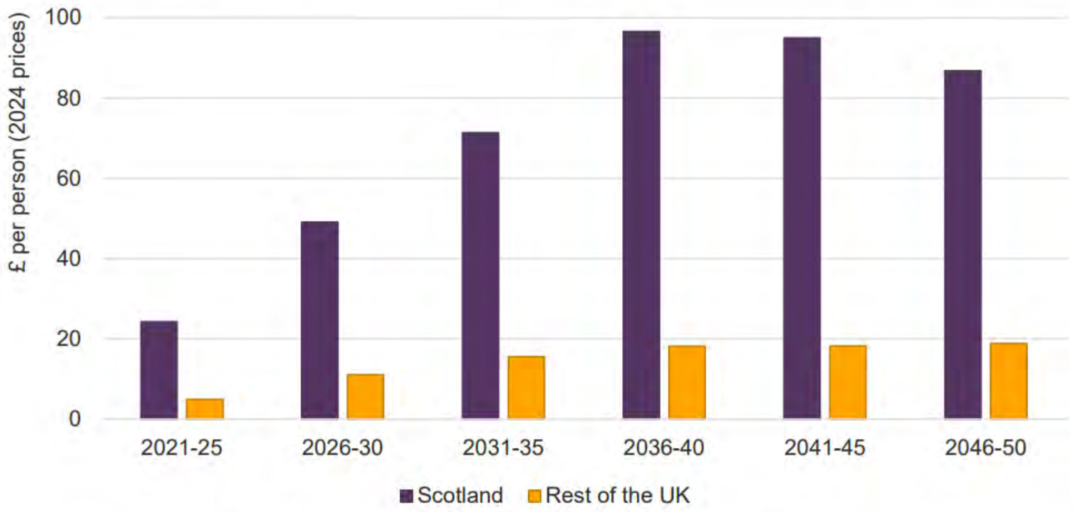
- that "The UK and Scottish Government targets are on a territorial basis The Scottish Government has responsibility for delivering net zero in Scotland though some of these emissions are produced from reserved sectors. The UK Government has responsibility for the entirety of the UK reaching net zero, including Scotland. The challenge of reaching net zero is intertwined for the two governments and each is dependent on the other for achieving their targets."
- the "risks from the UK and Scottish Government policy approaches diverging and UK regulatory choices making mitigation and adaptation more difficult for the Scottish Government", while "conversely, UK Government choices could support Scottish Government achieving its intended outcomes".
- that one of the risks identified is the effects of climate change being felt differently in Scotland to the rest of the UK. If, for example, severe weather caused more damage in Scotland in one financial year and more damage in the rest of the UK another year, the Scottish Government's capacity to cope with the corresponding fiscal pressures could be limited under the fiscal framework. As the Scottish Government cannot borrow to fund additional spending or meaningfully transfer spending between years, "the increasing risk of climate change damage could make the Scottish Budget more vulnerable to volatility and create pressures on spending that required reprioritisation of commitments within the financial year".
- that the costs of adaptation "are likely to be significant for both the overall economy and public sector". The CCC, it states, "has estimated additional investment of around £10 billion a year for the UK on adaptation for the period from 2020 to 2030". This is a partial estimate, and the optimal level of investment is unknown "as the trajectory of warming and climate change is uncertain".
- the SFC calculates that the biggest area of additional capital investment is expected to be in decarbonising buildings, followed by land use, land use change and forestry (LULUCF). The rise in waste and agriculture at the end of the projection is, the SFC notes, driven by an increase in spend on mitigation measures related to waste from 2045, and
- It argues that "meeting the Scottish Government's more ambitious 2030 target is a fiscal risk" as it "would require technologies and other changes to be more advanced than set out in any of the CCC's pathway scenarios to reach net zero, and this would require substantial public investment". The 2045 target is "not considered a risk in the same way as it is achievable under the balanced pathway scenario for the UK's 2050 target".

13. The SFC assumes that Scotland and the UK will both follow the ‘balanced pathway’ scenario to net zero and, therefore, the Scottish Government would need to invest on average five times as much per person as the rest of the UK in LULUCF. The difference in the scale of investment needed, the SFC suggests, could lead to a potentially substantial pressure on the Scottish Budget.

14. The analysis assumes the public sector is responsible for all of the investment in the LULUCF sector, mirroring the assumption made by the OBR for the UK as a whole. Although a share of the costs could be required to be met by the private sector, there will, the SFC suggests, still be a significant cost to the public sector. The table below sets out these figures compared to the rest of the UK.

Figure 3: Land Use, Land Use Change and Forestry annual public additional capital investment per person on the balanced pathway scenario

Public spending on LULUCF is expected to be considerably higher in Scotland than the rest of the UK per person from 2021 to 2050



Description of Figure 3: Bar chart showing, in 2024 prices, the 5-year average public capital investment per person for mitigation in Scotland and the rest of the UK on Land Use, Land Use Change and Forestry until 2050. The amount of spending Scotland is expected to be considerably higher than in the rest of the UK per person.
Source: Scottish Fiscal Commission

15. As noted above, capital spending in Scotland in 2024-25 is expected to be £6,193 million. Investing £1,136 million a year would therefore represent 18% of the Scottish Government capital budget being spent on mitigation to reach net zero. With capital budgets expected to fall by 20% over the next five years in real terms, this proportion will increase in the years after 2024-25.

16. The SFC argues that “Governments will also need to encourage private investment in mitigation by using taxation and regulation as levers for change”. It also notes that, while the Scottish Government has fewer levers overall than the UK Government to reduce emissions, it does have responsibility to introduce some environmental taxes which can effect behavioural change.

17. In its report, the SFC also makes recommendations on data improvements in order to inform its future work on fiscal sustainability and to improve transparency and accountability—

> "… we make recommendations on data improvements in this report. The UK and Scottish Governments should articulate their plans on how to achieve net zero and what level of public spending will be required. Looking at these plans together with how the economy and demographics will change, long-term spending and funding projections, and pressures on other public services such as health is needed to support planning and prioritisation and to assess fiscal sustainability. We recommend that the Scottish Government publish the costs of each policy and programme supported in the Climate Change Plan and Scottish National Adaptation Plan. We recommend that spend on mitigation and adaptation be identifiable in budget documentation and outturn so that spending plans can be linked to delivered spending. This would improve transparency and accountability and support our future work on fiscal sustainability."

18. The SFC recommends that the Scottish Government's draft Climate Change Plan Update – which has been delayed from November 2023 until later in 2024 – includes detailed abatement and cost estimates for individual policies and proposals. The current Scottish Government Climate Change Plan was published in December 2020. The SFC considers that this does not contain sufficient information on the costs of the policies and proposals. Its analysis on the additional capital investment to reach net zero is based on Scottish data published by the CCC relating to the UK's Sixth Carbon Budget.

19. The CCC has previously described the delay in updating the climate change plan as "very disappointing"[1] and in its report of 20 March 2024 (Progress in reducing emissions in Scotland: 2023 Report to Parliament), states "Scotland is therefore lacking a comprehensive strategy that outlines the actions and polices required to achieve the 2030 target. The Scottish Government must publish the Plan urgently...setting out detail of how policies will work together to deliver the required levels of emissions reduction."

20. The Scottish Government said it was important that ministers took the time required to consider UK Government changes in policy – such as the sale of new cars and the phasing out of fossil fuel boilers - and to "get this plan right". The delay does now present the Scottish Government with an opportunity to reflect the SFC's report in its updated Climate Change Plan.

Sustainability reports

21. The publication of a 'fiscal sustainability report' was recommended by the Organisation for Economic Co-operation and Development (OECD) in its 2019

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[1] Government advisers criticise SNP delaying crunch climate change plan | The Herald (heraldscotland.com)
Scottish Government confirms 'very disappointing' delay to climate change plan (inews.co.uk)

evaluation of the SFC and by the Scottish Parliament's Finance and Constitution Committee in Session 5.

22. The SFC published its first Fiscal Sustainability Report in March 2023. That report included projections of the Scottish Government's long-term spending and funding and informed the Committee's Pre-Budget 2024-25 Scrutiny. The SFC's next full fiscal sustainability report with updated projections is due to be published in 2025.

23. In other years, the SFC intends to publish papers looking at the fiscal sustainability in more specific areas, such as climate change, health and child poverty. This report is the first in the series with a focus on a specific area.

Next steps

24. The Committee can consider any next steps at a future meeting, One option would be for the SFC's report to inform the Committee's scrutiny of the Scottish Government's updated climate change plan, expected later this year.

Committee Clerking Team
March 2024

ANNEXE A

Letter from the Chair of the Scottish Fiscal Commission dated 14 March 2024 to the Committee regarding its Fiscal Sustainability Perspective: Climate Change Report

Dear Convener,

Today the Scottish Fiscal Commission has published a report Fiscal Sustainability Perspectives: Climate Change exploring how climate change could affect the Scottish Government's fiscal sustainability. In the report we consider the potential effects on Scottish public finances from damage created by climate change; the costs of adapting to a changing environment and taking action to meet Scotland's statutory emissions targets to reach net-zero by 2045.

Unmitigated climate change would have catastrophic impacts on individuals, businesses and the public finances. The OBR's 2021 Fiscal risks report considered a scenario of unmitigated global warming which resulted in the UK's debt-to-GDP ratio reaching 289 per cent by 2100.

In line with the Paris Agreement, both the Scottish and UK Governments are committed to help limit global warming through their own emissions targets. These actions impose costs on the public sector, as will the need to adapt to and deal with damage from climate change.

We use the Climate Change Committee's balanced pathway scenario to quantify the potential costs of climate change mitigation for the Scottish Government. We estimate an average of £1,136 million a year (in 2024 prices) will be required in additional capital investment from the Scottish Government to reach net zero over the period 2020 to 2050. This is equivalent to 18 per cent of the Scottish Government's 2024-25 capital budget of £6,193 million.

The challenge of achieving net zero is shared between the Scottish and UK Governments. The Scottish Government's funding largely depends on UK Government policy decisions, including how the costs of the transition are split between the private and public sectors. However, the fiscal burden of reaching the UK's net zero target may fall disproportionately on the Scottish Government because a greater share of the UK reduction in emissions relating to forestry and land use needs to take place in Scotland.

These figures do not include the costs associated with adapting to climate change or damage from climate change. The costs of adaptation are likely to be significant for both the overall economy and public sector, but are highly uncertain. The scale of uncertainty associated with adaptation costs is a risk in itself. We also note that if more investment is required in devolved areas in Scotland than in England, it could present a risk for Scottish Government finances.

Achieving net zero and dealing with the challenges of adaptation and damage is a shared endeavour that needs to be managed well by both the Scottish and UK Governments. The same is true of the fiscal consequences.

To better assess the fiscal risks facing the Scottish Government, we need more detailed information from both governments about their plans, and the associated costs, for tackling all aspects of the climate change challenge.

I look forward to giving evidence on our report later in March and I am happy to discuss any aspect of our report.

Yours sincerely

Professor Graeme Roy
Chair