

Deputy First Minister and Cabinet Secretary for Finance
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airson Ionmhas

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Finance and Public Administration Committee
The Scottish Parliament
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2 August 2023

Dear Kenny,

FISCAL FRAMEWORK REVIEW

I am pleased to report that I have now reached agreement with the Chief Secretary to the Treasury (CST) on a package of changes to the Scottish Government's Fiscal Framework. The agreed changes provide a sensible and proportionate set of improvements that strengthen the financial management levers available to the Scottish Government, and provides the Scottish Parliament with greater long-term funding certainty.

The updated agreement (Fiscal Framework 2023) recognises changed circumstances since 2016 and contains greater budget flexibility and borrowing powers for Scotland. These outcomes are the result of collaborative working between the Scottish and UK Governments and a willingness to compromise on both sides.

The Chief Secretary to the Treasury and I have agreed the continuation of the Indexed Per Capita (IPC) Methodology when calculating block grant adjustments. Previously, the use of this methodology had been agreed on a temporary basis. The agreement to continue using IPC on a permanent basis means that the Scottish Budget will continue to receive a degree of protection in the event of slower population growth. The Independent Report published alongside this agreement shows that other BGA methodologies considered in as part of the 2016 negotiations would have resulted in a substantially worse funding outcome for Scotland.

Your committee has previously raised concerns regarding Scotland's limited borrowing and reserve powers, including noting the need to revisit these limits in your 2023-24 Pre-Budget Scrutiny. These have been expanded in the Fiscal Framework 2023. The main features of this agreement are that:

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- The indexed-per-capita mechanism for calculating block grant adjustments will be adopted on a permanent basis;
- Scotland's resource borrowing powers for forecast error will increase by £300m (to £600m) from next year. Thereafter, they will be indexed in line with inflation;
- Scotland's capital borrowing powers will no longer be fixed, and instead will also increase in line with inflation from next year. Currently, we can borrow £450m per year for capital expenditure;
- The drawdown limits on Scotland's reserve will be abolished. The overall reserve limit will also be indexed in line with inflation from next year;
- The reduction applied to the Scottish Block Grant as part of the devolution of Crown Estate revenues – currently £6.6m – will increase over the next two years to £10m then incrementally to £40m by 2028-29, at which point it remains flat and unindexed. The profile for this reduction from 2024-25 is £10m / £10m / £15m / £20m / £40m.
- Consideration of when and how to implement VAT Assignment will be picked-up in a future meeting of the HMT/SG Joint Exchequer Committee (JEC).
- The Block Grant Adjustment for Fines, Penalties and proceeds of crime will be converted to a fixed amount, given the relative steadiness of this income stream. This will remain at the 2023-24 levels which are currently (£30m).
- The baseline addition to the block grant for the UK's Coastal Communities Fund will be subject to the usual operation of Barnett. This will have no immediate effect on our funding position.

You will recognise that the agreed changes amount to a relatively narrow review. It was clear from discussions with HM Treasury that a more fundamental consideration of the framework, including issues such as further devolution of fiscal powers and improvements to the underlying Block Grant Methodology arrangements, simply was not on the table at this time. Under the circumstances I judged it appropriate to concede to a narrower scope in the interest of securing long sought practical borrowing and reserve flexibilities, and to protect those arrangements that we already have in place which work in our favour. I believe these changes are fair and pragmatic and will strengthen the financial management levers available to the Scottish Government to manage risk and volatility in the Scottish budget, while providing the Scottish Parliament and Government with greater long-term funding certainty.

I will issue a joint communique with the Chief Secretary to the Treasury to announce the updated agreement, alongside publication of the jointly commissioned Independent Report into Block Grant Adjustments that was completed last year, as well as the corresponding evidence submitted by the Scottish Government to the report's authors.

I wish to thank the committee for its contributions to the public discourse on the framework since 2016, which have helped to inform this revised agreement.

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