Finance and Public Administration Committee

25th Meeting 2022 (Session 6), Tuesday 4 October 2022

Pre-budget scrutiny: Scotland's public finances in 2023-24 and the impact of the cost of living and public service reform

Purpose

1. The Committee is invited to take evidence from the Deputy First Minister, John Swinney MSP, in relation to the evidence it has gathered during pre-budget scrutiny.

2. This paper provides further background to inform the evidence session on 4 October.

Context

3. The Committee held evidence sessions on 7 June with the Scottish Fiscal Commission (SFC) and the Cabinet Secretary for Finance and the Economy, which set the context to, and informed, the Committee's approach to its pre-budget scrutiny. The focus of this evidence-gathering was on Scotland's Economic and Fiscal Forecasts – May 2022 published by the SFC, and the Scottish Government's first Resource Spending Review (RSR) since 2011, and its fifth Medium-Term Financial Strategy (MTFS). All three documents were published on 31 May, alongside the Outcome of the Scottish Government's Targeted Review of the Capital Spending Review, which set out updated spending allocations for 2023-24 to 2025-26.

4. The MTFS provides the medium-term economic and fiscal outlook and the context for the Scottish Government's spending decisions, whereas a spending review is intended to provide a means of prioritising and identifying potential savings options associated with existing expenditure. The Cabinet Secretary explained in evidence on 7 June that the RSR "is not a budget [and] the numbers will fluctuate further", adding "it is clear that choices will have to be made in future Budgets over the remainder of the parliament that take account of the challenges the Scottish economy faces".

5. The SFC Forecasts explain that "the Russian invasion of Ukraine, steeply rising energy prices and further global supply chain disruptions in China have led to a challenging economic outlook" and that Scotland and the UK face the biggest annual fall in living standards since equivalent Scottish and UK records began. The Cabinet Secretary highlights in her foreword to the MTFS that "rising inflation, and the consecutive increases in the Bank of England Interest Rate, are also increasing

budgetary pressures on the Scottish Government and public bodies, and will put pressure on our public services in real terms”.

6. The SFC noted that the main focus of its May Forecasts has been on inflation and the cost of living crisis across many households. After taking account of the block grant adjustment, the position with income tax has worsened since their December 2021 forecasts, and will continue to do so this year and next, before improving for the remainder of the spending review. The Scottish Government’s funding, they explain, “comes under further strain in 2024-25 when it faces a negative income tax reconciliation of over £800 million”. When its forecasts on social security spending are added to the Scottish Government’s plans for health and social care spending, “the funding lifts for other portfolios are very constrained”, and “once adjusted for inflation, funding in those other areas will fall substantially for the first three years of the spending review period”.

7. The Cabinet Secretary explained in her evidence to the Committee that the Scottish Government’s RSR priorities are “tackling child poverty, transitioning to net zero, economic recovery, and strengthening the public sector in Scotland”, and that responding to the cost of living crisis had also been added to this list of priorities. She said: “we have also set out commitments to drive reform and greater efficiency across the public sector because, notwithstanding the current uncertainties, the funding position is constrained”. In achieving effective public services, the RSR identifies the need for “an enhanced focus on delivering efficiency savings across the public sector” over the life of the Parliament[1], including through: digitalisation; maximising revenue through public sector innovation; reform of the public sector estate; reform of the public body landscape, and improving public procurement. The RSR states that the public service reform programme will be undertaken over the remainder of the Parliament, with initial outcomes to be reported in the 2023-24 Scottish Budget, “underpinned by delivery plans to be produced by individual public bodies”.

8. The Committee has heard evidence during its pre-budget 2022-23 scrutiny that budget planning should be better linked to delivery of national outcomes in the National Performance Framework[2], however, there is only passing mention of national outcomes in the RSR.

9. Since these documents were published in May 2022, inflation (Consumer Price Index) rose to 10.1% in the 12 months to July, before dipping to 9.9% in August.[3] The Bank of England has indicated that inflation could peak at more than 13% this year. Its Monetary Policy Committee met on 22 September and agreed[4] to increase interest rates by 0.5% to 2.25%, the highest level since November 2008. Ofgem announced in August that the energy price cap would increase to £3,549 per year for an average household from 1 October 2022. Pressures from inflation and a cost of living crisis has prompted public sector pay increases costing £700m more than Ministers had originally budgeted for. The First Minister, in her statement to

[1] Which the RSR indicates “generally excludes local government given their separate responsibilities”.
[2] Pre-Budget Scrutiny 2022-23: Scotland's Public Finances in 2022-23 and the Impact of COVID-19 (azureedge.net)
[3] ONS statistics 14 September 2022
[4] Bank Rate increased to 2.25% - September 2022 | Bank of England

Parliament on 6 September, indicated that the current year's budget is worth £1.7bn less than when it was published in December 2021.

10. In response to the planned increases to the energy price cap, the Prime Minister announced on 8 September 2022 an Energy Price Guarantee which will limit the price suppliers can charge customers for units of gas, as well as a temporary removal of green levies from bills. This is in addition to the previously announced £400 energy bills discount for all households. The UK Government argues that, under these plans, a typical UK household will pay no more than £2,500 a year on their energy bill for the next two years, from 1 October 2022.

11. In his fiscal statement on 23 September 2022, the Chancellor of the Exchequer announced a Growth Plan "built around three central priorities: reforming the supply-side of the economy; maintaining a responsible approach to public finance, and cutting taxes to boost growth". Announcements in relation to taxation, which were described by the Institute for Fiscal Studies as representing the biggest tax cut of any budget since 1972"[5], included:

- bringing forward by a year the planned decrease in the basic rate of income tax from 20% to 19% to now come into effect from April 2023. Income tax thresholds continue to be frozen until April 2026.
- abolishing the additional rate of income tax of 45% charged on taxable income over £150,000, with the 'higher rate' of 40% being charged on such income from April 2023.
- reversal of the planned 1.25 percentage point increase in National Insurance Contributions (NICs) rates from 6 November 2023,
- introduction of legislation to repeal the Health and Social Care Levy Act 2021, which was due to replace the temporary increase in NICs in April 2023.
- scrapping the planned increase in the main rate of corporation tax of 19% to 25% in April 2023.
- increasing the threshold for paying Stamp Duty Land Tax from £125,000 to £250,000, and for first-time buyers from £300,000 to £425,000.

12. Establishment of Investment Zones in England was also announced, with the aim of providing tax incentives, planning liberalisation and wider support to the local economy. The UK Government intends "to work closely with the devolved administrations and local partners to deliver this opportunity to drive local growth in Scotland, Wales and Northern Ireland". The Office of Tax Simplification is being abolished, the cap on bankers' bonuses (of twice a banker's basic salary, with shareholder approval) will be removed, and legislation will be brought forward "to require unions to put pay offers to a member vote" and to ensure minimum service levels on public transport.

13. The Chancellor confirmed in his statement that the package of measures would be funded by government borrowing. The Government's Debt Management Office has been asked to borrow £72 billion more from markets in 2022/23 than was

[5] Mini-Budget response | Institute for Fiscal Studies (ifs.org.uk)

requested in March 2022.[6] The Institute for Fiscal Studies, in its response to the statement, has been critical that the Chancellor "has avoided scrutiny by presenting a Budget in all but name without accompanying forecasts from the Office for Budget Responsibility".[7] OBR forecasts would normally include an assessment of whether the UK Government is meeting its fiscal targets. The cost of UK Government borrowing has increased since the Chancellor's announcement[8] and the pound fell against the dollar, to $1.03 on 26 September, a record low.[9] Other developments since include that:

- the Governor of the Bank of England noted on 26 September that "the Bank is monitoring developments in financial markets very closely in light of the significant repricing of UK and global financial assets", while major banks paused offering new mortgages.[10]
- the Chancellor announced that day that he would set out a Medium-Term Fiscal Plan on 23 November and that he has requested that the OBR "sets out a full forecast alongside the Fiscal Plan, on 23 November".[11]
- The International Monetary Fund noted on 27 September that this "next Budget will present an early opportunity for the UK Government to consider ways to provide support that is more targeted and re-evaluate the tax measures, especially those that benefit high income earners".[12]
- The Bank of England announced on 28 September that it would start buying government bonds at an "urgent pace" to help "restore market functioning and reduce any risks from contagion to credit conditions for UK households and businesses".[13]

14. Prior to the Chancellor's fiscal statement, the Deputy First Minister had committed to setting out the outcome of the Scottish Government's Emergency Budget Review (EBR) within two weeks of this UK fiscal event. He has since advised that this will take place during the week commencing 24 October.[14] The EBR will be informed by a panel of experts, including economists who will study the impact on Scotland of the UK Chancellor's fiscal approach.[15]

15. The Deputy First Minister wrote to the Committee on 7 September including "a list of savings that the government has already identified to enable us to meet our increased costs, increase help for those hit by the crisis and fund enhanced pay settlements". The letter further noted announcements made by the First Minister to "take forward a rent freeze and moratorium on evictions to help people through the cost crisis, increase the Scottish Child Payment to £25 per week per eligible child

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[6] September 2022 fiscal statement: A summary - House of Commons Library (parliament.uk)
[7] Mini-Budget response | Institute for Fiscal Studies (ifs.org.uk)
[8] UK's cost of borrowing on international markets overtakes Greece and Italy | Bank of England | The Guardian
[9] Pound sank to record low against the dollar and UK economy predicted to flatline next year - as PM and chancellor defend mini-budget | Business News | Sky News
[10] Barclays and TSB pull mortgage products from UK market | Financial Times (ft.com)
[11] Update on Growth Plan implementation - GOV.UK (www.gov.uk)
[12] IMF warns UK against mini-budget that will 'likely increase inequality' | Business News | Sky News
[13] Bank of England announces gilt market operation | Bank of England
[14] Meeting of the Parliament: 27/09/2022 | Scottish Parliament Website
[15] Emergency Budget Review - gov.scot (www.gov.scot)

from November, double the Fuel Insecurity Fund to £20 million and confirm rail fares will be frozen until March 2023". The First Minister, in her statement to Parliament on 6 September, suggested that paying for cost of living support "will mean stopping some of the things we planned to do to fund what is essential to support people through this crisis", while the Deputy First Minister indicated in his letter that "further savings will be required to balance the budget, particularly if inflation continues to rise, and to direct maximum support to those who need it most".

16. The Office for National Statistics published its latest Labour Market in the Regions of the UK publication on 13 September 2022, which noted that the unemployment rate in Scotland was 3.1%. This compares to 3.6% in the UK as a whole. The employment rate in Scotland was 75.2% while in the UK it was 75.4%, with Scotland seeing the "largest increase in the employment rate compared with the same period last year" of any area of the UK (alongside the West Midlands) of 1.1%. The economic inactivity rate in Scotland was 22.4% compared to the UK rate of 21.7%.

Committee's approach

17. The Committee takes a cross-cutting, overarching approach to pre-budget scrutiny, while subject committees examine in detail those spending plans in their own portfolio area. While all committees draw on the MTFS each year to inform their pre-budget scrutiny, this year the RSR provides more context and detail to support that scrutiny.

18. The Committee's call for views was launched on 24 June and closed on 19 August, focusing on the following key areas:

- the impact of the cost of living crisis on the Scottish Budget 2023-24,
- proposals for public service reform and delivery of efficiency savings,
- how spending priorities might affect the delivery of national outcomes,
- responding to the challenge of relative income tax growth,
- how spending in the budget should be used to achieve net zero targets,
- current taxation policies and spending priorities, and
- ensuring fiscal transparency to allow spend to be identified and tracked.

19. The Committee heard evidence from its first two panels of witnesses[16] in relation to its pre-budget scrutiny on 20 September. Issues discussed include: the systems in place to track and identify Scottish Government spending, the extent to which public sector information is 'open data' and how this could support economic growth, growing the tax base, preventative spend within fiscal constraints, funding public body pay deals, structural reform of care versus additional funding within existing structures, local government taxation and reserves, ringfencing funds for local authorities, and the potential for shared services. The Committee, at its round-table evidence session on 27 September, heard calls to: rule out increases in business rates, properly fund actions in the Scottish Government's National

[16] The Committee heard from the Auditor General for Scotland, David Hume Institute, Chartered Institute of Taxation, COSLA and South Lanarkshire Council on 20 September.

Economic Transformation Strategy, support women on low incomes, reverse plans for a National Care Service and instead invest in social care and its workforce, increase the minimum price of alcohol, and fund more support for those most in need. The need for greater transparency over where money is being spent on prevention and the delivery of national outcomes was also raised, along with a recognition that the public sector is a driver of the economy alongside private business.

Fiscal Framework Outturn Report

20. The Scottish Government published its fifth Fiscal Framework Outturn Report (FFOR) on 27 September, which provides outturn and reconciliation information for Scottish Income Tax, Scottish Landfill Tax, Land and Buildings Transaction Tax and devolved Social Security benefits, as well as updates on borrowing and the Scotland Reserve. The report sets out the total provisional reconciliation required in the 2023-24 Budget of £22.5 million (+), and the provisional residual balance on the Reserve for 2021-22 of £650 million. It states that “under current plans, the Scottish Government’s capital debt will be £2.1 billion by the end of 2023-24, 71% of its overall £3 billion limit”. It adds that plans in the 2022-23 Budget to use resource borrowing powers to borrow £15 million remain “subject to change throughout the financial year depending on the movement on in-year reconciliations and volatility of Social Security benefit expenditure”.

21. Paper 2 is a more detailed briefing on the FFOR produced by SPICe.

Next steps

22. The Committee will consider a draft report setting out its findings and recommendations from its pre-budget scrutiny at a future meeting.

Committee Clerking Team
September 2022