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FINANCIAL DEVOLUTION AND CONSTITUTIONAL CHANGE UPDATE

Purpose

1. This paper provides an update on key developments surrounding financial devolution and constitutional change.

Background

2. We provided an update to the Accounts Commission in September 2020 on financial devolution and EU withdrawal.

3. Significant developments since September 2020 include:

    - The impact of the Covid-19 pandemic on the Scottish public finances and significant changes to the funding to local government.
    - The proposed Spring Budget Revision for 2020/21 and the proposed Scottish Budget for 2021/22 have been announced.
    - The Scottish Government has continued to take on wider social security powers, and introduced the first component of the Scottish Child Payment at the start of 2021.
    - The UK has left the European Union.

Impact of Covid-19 on the public finances

4. The pandemic is placing huge demands on the Scottish public finances. Under the Scottish Government's fiscal framework additional Barnett consequentials of £9.7 billion have been added to the Scottish budget in 2020/21. These are based on spending decisions in England taken by the UK Government and the Scottish Government decides how to apply these in devolved areas. It has spent broadly in line with the UK, though it has targeted some aspects to specific needs in Scotland or to align with existing policy priorities.

5. Funding for Covid-19 has built up during the year and applied as both governments respond to the emerging picture. The accumulation of Barnett consequentials and overlapping UK and Scottish Government spending announcements has increased the complexity and volatility affecting the Scottish public finances during the year. The increases in block grant were spread unevenly throughout the year. The Scottish Government has decided to carry the most recently announced UK funding of £1.1 billion to 2021/22.

6. On 24 February the Minister for Public Finance summarised for Parliament the additional Covid-19 funding to local government, including:

    - £456 million of previously announced measures
    - £200 million to compensate for reduced income

- £275 million of additional measures announced by the Cabinet Secretary for Finance on 16 February 2021
- £259 million included in the 2021/22 budget.

7. This represents total additional funding of £931 million in 2020/21 and £1,190 million in total. In addition, the Scottish Government has agreed a number of fiscal flexibilities for local government that it has estimated are worth a further £600 million. These are accounting and financing measures that allow councils to defer some expenditure. COSLA has highlighted that the ability to take advantage of these measures will vary considerably between councils, and that they are likely to be worth less in practice.

8. In late February, Audit Scotland published a briefing paper for the Auditor General for Scotland (AGS) Tracking the implications of Covid-19 on Scotland's public finances, an update from our August paper, Covid-19: Implications for public finances in Scotland. In this, we highlight the ongoing challenges to the Scottish Government's finances and performance caused by Covid-19.

9. The introduction of Barnett guarantees during 2020/21 meant that the UK Government committed to levels of funding to the Scottish budget during the year, in advance of potential UK spending announcements that generate specific consequentials. This provided some earlier certainty to the Scottish Government over aggregate funding levels against which to make its own Covid-19 spending announcements. But also provides challenges and complexities in other respects, as it is not clear what UK spending the guaranteed funding relates to. If the Scottish Government commits this funding to its own spending initiatives, those funds would not be available to match any UK spending announcements made later.

10. We estimated that the Scottish Government made over 170 Covid-19 related announcements between March and December 2020. These figures will not link directly to what is added to the budget for 2020/21, because some announcements are spread over multiple years, some programmes have underspends that are then recycled into other projects and some demand led projects do not include estimates of the required spending in the announcements.

11. The Scottish Government has sought changes to the existing fiscal framework, including additional borrowing powers, to help it respond to the financial impact and uncertainties of the crisis. These have not been agreed by the UK Government. It also sought additional flexibility for Scottish councils to redirect some capital funds for revenue purposes. The UK Government has not agreed this approach providing its view that "financial support for Local Authorities should come from consequentials and not allow for 'additionality' nor borrowing".[1]

Spring budget revision

12. Since the publication of our briefing paper, the Scottish Government has published its third budget revision of this financial year, its Spring Budget Revision (SBR). The Scottish Government's 2020/21 approved budget has increased by £7.1 billion since the beginning of the year, primarily as a result of the additional spending required to cover the costs of the Covid-19 pandemic.

13. The SBR includes a gross total of £3.26 billion of 'Covid-19 and Other Funding' changes in the SBR. The biggest changes by portfolio include:

    - Health and Sport - £494 million all of which is Covid-19 funding.

[1] As quoted in COSLA letter to FCC, 24 November 2020

- Community and Local Government - £844 million, £540 million is Covid-19 funding.
- Education and Skills - £218.7 million, of which £104.2 million is Covid-19 funding.
- Economy - £921 million, of which £782.8 million is Covid-19 funding.

14. The SBR includes £745.4 million of re-prioritisation of spending, usually as a result of underspends. Examples of this include:

    - £180m re-purposing of Business Support Grant underspend (C&LG Portfolio)
    - £211.8m of redeployed/re-purposed funding across the Transport portfolio
    - £93.5m re-purposing/redeployment of SNIB underspend (Economy portfolio)
    - £90.1m of redeployed/re-purposed funding across the Social Security portfolio.

Proposed Scottish budget for 2021/22

15. The Scottish Government announced the proposed Scottish budget for 2021/22 was on the 28 January 2021. This set a total budget of £54 billion, a cash terms increase of 9 per cent on the previous year. This included £1.8 billion of spending for Covid-19.[2] The timing of the budget was disrupted this year as a result of Covid-19, departing from the agreed timetable established following recommendations of the Budget Process Review Group, restricting the opportunity for Parliamentary scrutiny and increasing budget uncertainty for local government.

16. This budget was however set in the context of uncertainty for the amount of money the Scottish Government would have to spend in the year. This was because the UK Budget had been pushed back to 3 March, after the Scottish budget. This meant that the Scottish Government had to make its budget proposals without a clear idea of what funding it would receive from the UK Government (though some information was provided about this at the UK Spending Review in November 2020), or what tax policies the UK Government would set. This made it harder for the Scottish Government to set its own tax policies, particularly for Scottish Income Tax (which needs to be set before the year-end) or introduce its desired policy of 100 percent Non-domestic Rates relief for businesses most affected by the pandemic.

17. In advance of the Stage 1 debate on the budget, the UK Government announced a further £1.1 billion in Barnett consequentials for 2020/21. The Scottish Government intends to apply the latest announced 2020/21 Barnett consequentials of £1.1 billion to its 2021/22 budget, and this has been agreed with HM Treasury.

18. The Cabinet Secretary for Finance has announced that this additional spending will be used to support a range of programmes in 2021/22, including providing full rates relief for properties in the retail, hospitality, leisure and aviation sectors to cover all of 2021/22. Additional funding will also be given to education, to provide support to low-income households, and extra support for mental health and to reduce waiting times.[3]

19. The Stage 1 debate was held on the 25 February. This passed with the support of the SNP, Labour and the Liberal Democrats, with the Conservatives voting against and the Green Party abstaining. This budget is different than most years, with more focus on the Stage 2 and 3 of the bill process, which will be held after the UK budget, on the 3 March.

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[2] For more information about the Scottish budget, please see *Scottish Budget 2021-22*, SPICe, 1 February 2021

[3] Chamber Official Report, 16 February 2021

20. A more detailed briefing on the 2021/22 budget proposals is provided to the Accounts Commission in a separate paper.

Scotland specific shock

21. In the Scottish Budget 2021/22, the Scottish Government announced that the Scotland specific shock powers have been triggered based on Office of Budget Responsibility and Scottish Fiscal Commission (SFC) economic forecasts. These powers were set out in the Fiscal Framework in 2016 and are now available because, on a four quarters on four quarters basis:

    - annual GDP growth in Scotland is forecast to be below 1.0 per cent; and
    - growth in Scotland is forecast to be 1.0 percentage point or more below the UK.

22. The difference in the forecasts of UK and Scottish growth means the resource borrowing limit increases from £300 million to £600 million and the drawdown limits from the Scotland Reserve are removed for the next three years. The capital borrowing limits are unchanged. This has enabled the Scottish Government to fund all of the £309 million of income tax reconciliations from resource borrowing.

23. This difference in GDP growth forecasts is likely because of differences in timing. The latest SFC forecasts have been produced after the national lockdown announced in January, reducing short-term economic growth. The Office of Budget Responsibility (OBR) set their forecasts in November 2020, before the emergence of the new Covid-19 variant and the lockdown that followed.

24. The Scottish Government published its latest medium-term financial strategy alongside the 2021/22 Scottish budget.[4] This sets out its assessment of Scotland's economic and fiscal outlook, as well as a broad spending outlook considering the effect of changing funding levels for government spending. The strategy includes broad funding and spending scenarios and sets out the Scottish Government's overall priorities. There is no information about planned spending options and how these could affect outcomes.

Social security powers

25. Administrative responsibility and accountability for the benefits - executive competence - has been devolved in stages. For 2019/20, the Scottish Government was responsible for Carer's Allowance, Sure Start Maternity Grant (which it has replaced and extended with Best Start Grants) and Funeral Expenses Payment (which it has replaced with Funeral Support Payment). Social Security Scotland also administered three Scottish only benefits, Carer's Allowance Supplement, Young Carer Grant and Best Start Foods. Executive competence for most remaining devolved benefits transferred on 1 April 2020, at which point Social Security Scotland became accountable for approximately £3.5 billion of annual social security expenditure. The Scottish Government has agreed that the DWP will continue to administer Carer's Allowance and other benefits on its behalf, until it is able to directly administer them.

26. On 1 April 2020 the Scottish Government announced changes to its delivery timetable for the remaining devolved benefits due to the impact of the Covid-19 pandemic. Further announcements followed in August 2020 for the delivery of the Scottish Child Payment and Child Winter Heating Assistance. In November 2020 the Scottish Government set out its revised delivery plans for Child Disability Payment and Adult Disability Payment. An updated timeline for delivery of the remaining benefits is set out below. The Scottish

[4] Scotland's Fiscal Outlook: The Scottish Government's Medium Term Financial Strategy, Scottish Government, January 2021

Child Payment for children under six opened for applications in November 2020, with first payments being made in February 2021.

Figure 1 Timelines for the delivery of Scottish social security benefits

Wave 2 benefits	Delivery date pre Covid-19	Revised delivery
Severe Disablement Benefit Allowance[1]	April 2020	April 2020
Scottish Child Payment (under 6s)	Applications: Autumn 2020 Payments: Christmas 2020	Applications: November 2020 Payments: February 2021
Winter Heating Assistance – Children	By end 2020	November 2020
Child Disability Payment	Summer 2020	Pilot: Summer 2021 Full roll out: Autumn 2021
Adult Disability Payment	Early 2021	Pilot: Spring 2022 Full roll out: Summer 2022
Carer's Additional Child Payment	Early 2021	Delivery timetable being revised - dates to be announced
Pension Age Disability Payment	End of 2021	
Cold Spell Heating Assistance	Winter 2021	
Winter Heating Assistance – Older People	Winter 2021	
Scottish Carer's Assistance	Early 2022	
Industrial Injuries Disablement Benefit	Autumn 2022	
Scottish Child Payment (under 16s)	End of 2022	

27. The 2021/22 budget includes around £3.6 billion of spending for devolved social security payments. This makes it the third largest area of the budget after health and local government. The Department for Work and Pensions will administer £3.3 billion of this, and £158 million will be administered by Social Security Scotland.[5] Devolved social security spending is forecast to grow from £3.6 billion in 2021/22 to £4.3 billion in 2025/26. However, this doesn't take into account that the Scottish versions of DWP benefits could be more expensive. SPICe note that: "the Scottish Government is focusing on 'safe and secure' transfer and not proposing large scale changes. However, given the scale of [Personal Independence Payment], small differences of policy could still have a big impact."[6]

28. The Auditor General published his section 22 report on Social Security Scotland's 2019/20 audit in December 2020.[7] As was the case in 2018/19, the independent auditor's report included a qualified opinion on the regularity of expenditure and income because of overpayments of Carer's Allowance attributable to error and fraud. Expenditure resulting from such overpayments was not incurred in accordance with the Social Security Contributions and Benefits Act 1992.

[5] This does not include spending for Child Disability Payments. If child Disability Living Allowance cases are transferred quickly, this could change for 2021/22.
[6] Social Security Budget 2021-22, SPICe, February 2021
[7] The 2019/20 audit of Social Security Scotland, Auditor General for Scotland, December 2020

EU exit

29. The UK Government and the European Union reached agreement about their future trading relationship and the governance of that relationship on 24 December 2020. Following parliamentary scrutiny on 30 December 2020, the agreement became law. The UK completed its transition out of the European Union at 2300 on 31 December 2020. New border arrangements between the UK and EU member states came into force immediately, along with new arrangements within the UK to maintain the status quo at the border between the Republic of Ireland and Northern Ireland.

30. The agreement meant that immediate concerns about the supplies of food, medicines and medical equipment into the UK without an agreement ("no deal") were alleviated. There does not appear, to date, to have been an immediate impact on the flow of imports but this may have been offset by stockpiling in advance of the end of 2020. During January 2021 there were significant border problems affecting fisheries exports, trade between Northern Ireland and Great Britain, and other trade. The Scottish Fiscal Commission expect many of these problems to be short lived, but this highlights the border frictions caused by EU exit, and why international trade is forecast to grow more slowly in the future.[8]

Implications for the Scottish public sector

31. We have previously identified people, finance and the economy and rules and regulations as the three key areas of long-term uncertainty associated with EU exit for the public sector. At a strategic level, these three areas remain the most significant.

32. Within the public sector, the NHS, teaching and higher education may be affected by reductions in the number of workers wishing to come to the UK from the EU. Overall, social care is likely to be the most critically affected area, especially in the privately operated part of the sector. In the longer term it is unclear what effect exit from the EU and the UK government's revised migration policy will mean for migration into Scotland.

33. It has always been predicted that for certain policy areas (food and environmental standards), there would be significant regulatory changes associated with EU exit and this has proven to be the case. The provisions of the UK Internal Market Act (UKIMA) provide from an integrated, single market with common standards across the whole of the UK. This may mean that areas that have previously been devolved to the Scottish Parliament may return to Westminster.

34. Under the UKIMA UK Ministers also now have a new power to provide direct funding for activities and infrastructure in Scotland, including in devolved areas, without the funding passing through the Scottish Consolidated Fund. This enables some funding streams replacing those previously provided by the EU (including structural funds) to be provided on a whole of UK basis.

35. On 24 February 2021 the UK Government announced that its Levelling Up Fund would be extended to the whole of the UK. The Chief Secretary to the Treasury, said that "communities in Scotland, Wales and Northern Ireland will now all benefit from at least £800 million of investment by the UK Government for town centre and high street regeneration, local transport, cultural and heritage projects". The fund will invest in local infrastructure and will run from 2021/22 to 2024/25. Previously it had been thought the Fund would be England only, leading to Barnett consequentials (estimated £400 million) that would be assigned as part of the Scottish Government's budget.

[8] Scotland's Economic and Fiscal Forecasts, Scottish Fiscal Commission, January 2021

36. Further details on how the Fund will operate will be published at the UK Budget – including who can bid, the types of projects eligible for funding, and the criteria for assessing proposals.

Implications for the Scottish economy

37. The Scottish Fiscal Commission published their updated forecasts for the Scottish economy alongside the Scottish budget on 28 January 2021. The January 2021 forecasts include the same judgements about EU exit as had been used in their recent forecasts, based on a smooth transition to a new free trade agreement with the EU. These assumptions are broadly in line with those used by the Office of Budget Responsibility in its November 2020 forecast for the UK.

38. The SFC notes: "the deal eliminates the immediate uncertainty around the outcome of the negotiations which has affected our recent forecasts, but there remains significant uncertainty about the long-run effects of Brexit on the Scottish economy."[9]

39. The January 2021 forecasts capture the effects of EU exit through three main channels:

    - Productivity – SFC forecast slow growth in productivity, in part because of EU exit.
    - Trade – SFC forecast slower growth in Scottish international trade from the end of the transition period.
    - Migration – the SFC forecast Scottish population growth to slow over the next few years, in part because of EU withdrawal.

Crown Estate Scotland

40. Crown Estate Scotland launched the Local Pilots Management Scheme in 2018 to create opportunities for communities to get more involved in managing parts of the Scottish Crown Estate. This aims to ensure that communities and local authorities have more say and influence.

41. In November, Crown Estate Scotland announced that it had signed an agreement with Forth District Salmon Fishery Board (Forth DSFB) which will see Forth DSFB take on extra responsibility over salmon fishing rights across a large area of eastern Scotland. The agreement is part of the Local Pilots Management Scheme, and is the first of a number of agreements Crown Estate Scotland currently has planned.[10]

42. In January, Crown Estate Scotland announced that developers will be able to apply for seabed rights to build Scotland's next generation of offshore wind farms. The planned closing date for submitting applications was 31 March 2021. However, in light of the success of the UK bidding process – which led to much higher prices than expected – raised concerns that the existing Scottish process would under-price existing sites. The review of the planned scheme is expected to be completed by 24 March, but the revised closing date is currently unknown. The decision to delay was taken in agreement with Scottish Ministers.[11]

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[9] ibid

[10] Landmark agreement secures local management of salmon fishing rights, Crown Estate Scotland, November 2020

[11] ScotWind Leasing application timings extended, Crown Estate Scotland, February 2021

Conclusion

43. The Commission is asked to note the content of this report.

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