

Scottish Affairs Committee

Oral evidence: [The Fiscal Outlook for Scotland, HC 458](#)

Monday 27 June 2022

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Members present: Pete Wishart (Chair); Mhairi Black; Deidre Brock; Wendy Chamberlain; John Lamont.

Questions 1 - 48

Witnesses

I: Kate Forbes MSP, Cabinet Secretary for Finance and Economy, Scottish Government; and Lucy O'Carroll, Director of Fiscal Policy and Constitution, Scottish Government.



Examination of witnesses

Witnesses: Kate Forbes MSP and Lucy O'Carroll.

Q1 Chair: Welcome to the Scottish Affairs Committee for a one-off session on Scotland's fiscal outlook, as we have grandly called this session. We are very grateful that Scotland's Cabinet Secretary for Finance is joining us today. Cabinet Secretary Kate Forbes, I will now let you introduce yourself with anything by way of a short introductory statement and introduce your colleague at the same time. Thank you.

Kate Forbes: Good afternoon and thanks to the Committee for having me here this afternoon.

This is a particularly challenging time for public finances across the UK. Scotland is certainly not immune to that, and adding to the challenge is the significant volatility in the fiscal outlook. We are managing our budget this year and have just set out a multiyear budget for the next four years in some very challenging circumstances with some very real constraints.

As the Committee will know, we set our budget largely on the basis of funding we receive through the block grant from the UK Government. The most recent resource spending review, which we have just outlined and which covers the next four years, is based on figures that were published by the UK Government when inflation was 3.1% last autumn. Inflation is, of course, now at a 40-year high of 9.1%. While we do not have updated spending plans from the UK Government, we still thought it important to set out what the future spending plans in Scotland will look like.

This year alone, Scotland's budget is being reduced in real terms by 5.2% and real-terms funding is now set to grow by only 2% across the whole of the four-year period of the resource spending review. You will appreciate why it is challenging.

Have said that—this is my last comment—we have also ensured that we are focused on spending £180 billion well over the next four years. To do that, we have outlined four priorities: child poverty, addressing the climate crisis, strengthening the public sector, growing our economy and, of course, trying to support families with the cost of living crisis right now.

I am very happy to answer the Committee's questions. I am here with my colleague Lucy O'Carroll, who is the director of fiscal policy and constitution, and I hope we can get into some of these matters in greater detail.

Q2 Chair: Thank you; I am very grateful for that very concise introduction. Thank you, Cabinet Secretary, for joining us at very short notice. This was a special session that we thought important given the number of issues that you have already introduced in your introduction. We will, of course, be touching on all of them.



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I will start with the cost of living crisis. This is about the worst economic crisis, I think, that we have experienced in the course of the last few decades. Governments around the world have hastily put together all sorts of programmes to try to ameliorate some of the worst aspects of it and to help their citizenry. What is your view of what you have observed from the UK Government? You have mentioned a few of the issues there, with inflation at a 40-year high and households across the whole UK beginning to take some sort of hit in their own standards of living.

The Chancellor introduced a series of measures on 26 May—a £650 payment on means tested benefits, a £400 grant for all households for energy bills, and increases for people on disability benefits as well as those in the household support fund. What do you make, Cabinet Secretary, of the range of measures that you have observed, and do you think they will go some way towards addressing the difficulties that all our constituents are experiencing?

Kate Forbes: I should say at the outset that I did welcome the Chancellor's more targeted approach when it came to the announcement on 26 May because it did try to help those who were most in need, which is the Scottish Government's approach. In this year's budget alone, we have allocated almost £3 billion across a range of different types of support to try to mitigate the impact of the increased cost of living on households. That will include funding that just mitigates some of the policy decisions that have been taken by the UK Government. The funding that is going to households, whether it is from our £3 billion funding scheme or otherwise, I think needs to increase over the next few months considering the challenges that families are facing.

One of the criticisms I have right now is that the funding to date will only slightly offset the increase in energy prices to date. We know that the energy price cap, for example, will increase over the next few months, which means that on average families will see their energy prices increase over the space of a year by an astronomical amount. The most recent support only slightly offsets the increase that families are already experiencing.

We are obviously considering where the need is greatest and where our investment would have the greatest impact. That is where, of course, we have doubled the Scottish child payment to £20 per child per week, we are increasing it to £25 from the end of this year and we are extending it to under 16s too. None of that is available elsewhere in the UK. These are conscious decisions from within our own budget, bearing in mind our budget was set when inflation was at 3.1% and inflation is now at 9%. We are actively trying to prioritise supporting those who need it the most, but we are extremely constrained in not being able to spend more than we receive, because it is a fixed budget. We are also extremely constrained by the fact that we do not have regulatory powers over some of the areas that are having the biggest detrimental impact on families. That would include energy powers and import/export, because we know that Brexit has driven up the cost of food.



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There are limits, and we will continue to engage, but I think a lot more is needed and a lot more is needed very quickly.

Q3 Chair: Last week we had the Secretary of State for Scotland before this Committee discussing a range of issues, and the cost of living was heavily featured. The Secretary of State told us that Scotland's financial settlement was sufficient for the Scottish Government to provide support to people facing problems connected with the cost of living. That was in his view. Is that a characterisation that you recognise? Do you feel that you do have sufficient funding from the UK Government to meet some of the difficulties with the cost of living crisis?

Kate Forbes: You need to unpack what is driving the cost of living crisis. I have just identified two areas that are having the biggest impact on families in need. One is energy. Energy is entirely reserved, of course, even managing payments and so on. That is why the in the most recent funding round UK Government have allocated funding directly to households, so we do not get a consequential benefit from that. The price of food is another area. It is documented that the price of food is one of the areas that is driving up the cost of living. Again, these are not necessarily powers that we have control over.

What we are doing, though, is pushing our budget as far as we possibly can. Take, for example, the Scottish benefits. We chose to uprate eight Scottish benefits by the rate of inflation in April when the budget was passed, which was about 6%. I understand that during the Westminster vote to do the same for UK benefits—of course there are people in Scotland that are dependent on UK benefits—neither the Tories nor Labour supported that uprating.

These are simple things that could be done, but I cannot control the breadth of the UK welfare system or interventions in the energy market. What we can do is to push that budget as far as possible, bearing in mind I am operating with a fixed budget—I cannot overspend even by a penny—and I am already prioritising funding for those who need it the most, which is why there are schemes available in Scotland that are not available elsewhere, such as the Scottish child payment. I could go on to identify other areas of support that are available in Scotland. We will push that as hard as possible. We take our responsibility to help those most in need very seriously, but I think we need to be realistic, too, about the constraints of a fixed budget and also the constraints of what is driving the cost of living crisis, with inflation at 9.1% right now and forecast to reach double figures in the next few months. Those macroeconomic, fiscal and monetary levers are well known to sit with UK Government.

Q4 Chair: I asked this of the Secretary of State last week. Does Scotland have specific and particular demographic, population and geographic challenges that exacerbate the cost of living crisis in that country? What do you do to try to influence UK policy when it comes to securing some of these measures? How successful have you been in lobbying the UK



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Government to try to ensure that we do get the necessary measures to challenge the worst aspects of the cost of living crisis?

Kate Forbes: I will start with the first part of your question. I am speaking to you from the Scottish Highlands, where a significant percentage of the population is classified as off grid. We are paying higher costs per unit of energy, and yet we are a very energy-rich part of the world. It may not be raining today, but there is a lot of rain, a lot of wind and a lot of sea out there generating renewables. The irony is that there are higher levels of fuel poverty in the Highlands and Islands than anywhere else in the UK.

In terms of engaging with UK Government, I do have very regular meetings of engagement with my counterparts in the UK Government, most recently at 12.30 pm today. We are engaging very constructively and robustly on some of these points and not just, as it were, saying, "Please do more" but trying to set out policies that would offer long-term solutions. Three obvious examples would be: to permanently uprate all social security benefits as if they had been increased by 10% to match the current level of inflation; a further £25 uplift to Universal Credit, because, as you can understand, the same families that are due to receive the Scottish child payment have probably just had to relinquish the uplift in Universal Credit; and then, of course, I don't think you can divorce pay from the cost of living, particularly for those who earn the least, and we had advocated increasing the national living wage to the real living wage rate for all over 18s. They are just three examples of what we are engaged in conversation about.

Q5 **Chair:** You mentioned the windfall tax, or as the Government describes it, the energy profits levy. After opposing and rejecting a windfall tax for months, in his statement on 26 May the Chancellor introduced this energy profits levy. What do you make of that? Do the 80% investment allowance and the 25% energy profits levy successfully offset any negative impacts for industry? I think the Scottish Government's view is that there should have been a windfall tax on a number of companies that had secured large profits because of the pandemic. What did the Scottish Government intend by that?

Kate Forbes: It was based on the fact—and I think we all agree—that oil and gas companies are not the only businesses that have profited during the pandemic and the current crisis. Therefore, the Scottish Government had advocated a windfall tax that would apply a lot more fairly to all companies benefiting from significantly higher profits. That is partly because there is a question of fairness, but it is also partly a reflection on the fact that Scottish industry—in this case oil and gas, which is predominantly based in Scotland—are now disproportionately carrying the weight of UK-wide interventions. It is Scottish business that is disproportionately funding the response.

We absolutely believe that there should be an adequate, immediate and targeted response to the rise in the cost of living, but I think we do also



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need to reflect on the fact that Scottish business and Scottish industry are disproportionately carrying that weight.

Q6 Chair: One of the most common questions I am asked is how energy-rich Scotland has just about the highest energy bills in the whole United Kingdom. I can never find a satisfactory response to that, but do you have something you can help our constituents with?

Kate Forbes: No, and it is an issue that has obviously been on the go for more years than I can count, in terms of the fact that there are higher levels of fuel poverty. I will use one region as an example: the Highlands and Islands. There are higher levels of fuel poverty here, despite it being an energy-rich region, and that is replicated across Scotland. That is why I come back to one of the arguments that is often made when I say that the Chancellor is sitting on some fiscal headroom, but in the most recent interventions he chose to apply a windfall tax rather than use that headroom. That is his choice to make and his choice to defend, but it is not just a cash response that is required. I think there is a fundamental question about regulation and the energy market, which to all intents and purposes on the surface is broken if you have a position where in areas of the UK you have energy wealth and yet considerable fuel poverty. More needs to be done to tackle this problem at the root.

Q7 John Lamont: I want to start by asking you about something you said in your opening statement. You mentioned a 5% cut to the Scottish Government's budget. Could you just clarify that that is comparing this year's budget to last year, when obviously last year's budget contained a large component of Covid funding? Is that correct?

Kate Forbes: That is right but, of course, Covid did not finish in March 2022.

Q8 John Lamont: You are arguing for a continuation of the exceptional funding that was put in place to support the UK-Scottish economy? You are arguing for that to continue indefinitely?

Kate Forbes: I think there is now another crisis, too. We still have the impact of Covid. Right across the UK, we are seeing the NHS having to remobilise and the justice system dealing with a backlog. The impacts of Covid are still very present, and we are also living through this cost of living crisis. My argument would be that you cannot just turn off the taps, as it were, of additional financial support. Since the UK Government's budget, we have seen that very point played out, where the Chancellor has had to come to the Commons to update on the budget with additional support, proving that you cannot just switch the taps off in March.

Q9 John Lamont: What is the Scottish Government's capital allocation for the year 2022-23?

Kate Forbes: Usually it is about £5 billion. That fluctuates, in part because we incorporate borrowing into that, and we anticipate that the



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final figure for our capital budget this year will be confirmed; that usually happens in late January.

Q10 **John Lamont:** Do you have any estimates? You say about £5 billion, but we have a figure of around £7 billion. Do you recognise that figure?

Kate Forbes: I probably would need to write to the Committee on that point because of all the budget lines, it is the one that fluctuates the most. We are engaged with the UK Government right now on what our capital budget is most likely to be. The figure that was announced in the budget last October has already fluctuated, and we offset that, in part, with borrowing. We can borrow up to £450 million.

The latest position is that there will be an interim update at the next budget revision, which should be in October, and the final figure will probably be given by the UK Government in January or February.

Q11 **John Lamont:** If that figure of around £7 billion is correct, what percentage increase would that represent, compared with the previous year?

Kate Forbes: Right across the board, we have seen a decrease in our overall budget. With that percentage figure that I shared earlier, we have seen a decrease right across our budget. I am happy to provide the updated capital figures and the latest position to the Committee.

Q12 **John Lamont:** So you do not recognise the figure that we have—the £7 billion figure—representing a 29.3% increase compared to 2021-22. You would dispute that?

Kate Forbes: I do not recognise that. I would be interested in knowing what point in time that figure related to.

Q13 **John Lamont:** Assuming there is some additional investment funding, how would the Scottish Government plan to use it?

Kate Forbes: If there is additional capital investment, we would use it to invest in our infrastructure investment plan. At the moment we have set out a forward look—we have a targeted capital spending review that was published two weeks or so ago—and we would try to accelerate some of that, bearing in mind that not all of the plans in the infrastructure investment plan can now quite be funded. There are plans there. For example, we have set out a commitment to invest £10 billion in the NHS; this is just on capital. Obviously, any additional funding could be used to accelerate that plan.

Q14 **John Lamont:** Okay, thank you. Last week, the Auditor General published a report, which I am sure you are very familiar with, and that report identified a lack of transparency about how the Covid-19 funding had been spent in Scotland. Do you agree with the Auditor General that there needs to be greater transparency about how the funding to support communities and the economy during Covid was spent?



Kate Forbes: We agreed in the sense that we, for example, published more material during Covid, in other words trying to provide greater transparency and very fast moving figures during Covid. Normally, I only update the budget twice a year formally in front of the Finance Committee. During Covid we did it three times a year to try to ensure that transparency and scrutiny.

The Audit Scotland report identified two points. The report only goes up to December 2021, but it argues that if you look at actual spend, actual budgeted spend goes out to the end of the financial year, which is March 2022, leaving a three-and-a-bit-month gap, so it is inevitable that you would have a difference in terms of those figures. The most recent figures have just been published, but they are provisional figures, and they will go to the Finance Committee for scrutiny in the coming weeks.

The second point is around reserves. The report argues that reserves are a perfectly reasonable way of managing our budget but makes it harder to track. We will work with Audit Scotland to make sure there is as much clarity and transparency as possible. The reason that we use reserves is because if we receive late consequentials, say in the last three months of the year, we do not want to lose that spending power. We manage that either through the local government or through the Scottish Government reserves to take it into this year.

Q15 **John Lamont:** On the point of transparency, you say you came to the Scottish Parliament to explain how you were deploying Scottish Government resources, but notwithstanding that, the Auditor General's report said they were not satisfied you were being transparent enough.

Kate Forbes: The use of reserves is a very transparent process. There is no funding that is currently in the Scottish reserve that links to Covid-19 business support, for example. They also identified the use of councils' reserves and the fact that it was harder to track where funding was within council reserves.

Local authorities are, obviously, independent. They are independent corporate bodies with their own powers and responsibilities, but I think that same report is very positive about how much transparency there has been around the final funding position.

Covid was a very fast-moving environment, and announcements were made by the UK Government that were unexpected. There were late consequentials. I think the fact that the Audit Scotland report says—this is not a direct quote; it is a paraphrase—that we managed our budget well is a commendation in light of how challenging it was to manage various announcements and lockdowns.

Q16 **John Lamont:** Just to be clear, are you rejecting the Auditor General's conclusion about transparency?



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Kate Forbes: No, I think I started off by answering your question, and saying that the need for transparency was more important than ever during Covid and we took steps to increase transparency.

Q17 **John Lamont:** Sorry, I am just making the point that you have explained, or tried to explain, how you have increased transparency, but the Auditor General has said you were not transparent enough, notwithstanding the measures that you have put in place.

Kate Forbes: The Audit Scotland report, if you read it in the round, says we managed our budget well, and that there is a gap because they track actuals to December 2021 and our budget is to the end of the year. It is quite clear. When Audit Scotland says it is hard to track, it is arguing on two fronts: first, that there is a gap between actuals and budget, which is in plain sight; and, secondly, where money has gone into, for example, local government reserves, it is harder to track. I think both of those are reasonable notes to make in the Audit Scotland report. I think it is a very useful report. It is a very fair report, if you read it in full.

Q18 **John Lamont:** In terms of the reserves that you mentioned there, and going back to our earlier discussion, can you give a commitment or a guarantee today that all of the approximately £2 billion added to reserves will be spent supporting Scotland with Covid recovery?

Kate Forbes: I can make the absolute cast iron commitment that funding that was for Covid purposes will be used, and in all cases has been used, for Covid purposes.

Q19 **John Lamont:** That figure would be around £2 billion; you would agree with that figure from the Auditor General?

Kate Forbes: No, I would not agree with that figure because, as I say, they are tracking actuals to December 2021 and we are now in June.

Q20 **John Lamont:** One last point from me, which is a local question about Borders Railway. We all know that the funding for the feasibility study is in the Borderlands growth deal, and there is increasing worry in the Borders that there is some foot-dragging with the funding being allocated for that feasibility study. Can you reassure me and my constituents that it is not the finance team of the Scottish Government holding up that feasibility study, please?

Kate Forbes: We never drag our heels on anything; we are always very quick to help and respond, and so I have engaged with representatives of the Borderlands board and will engage again. It largely sits within the transport directorate, as you would imagine, and I will certainly pick up with them to understand where that has got to.

Q21 **Mhairi Black:** Could we turn our attention to the Barnett formula? You mentioned in a previous answer the fact that the Barnett formula does not take into consideration relative need among sparse populations and how public services cost more to deliver in such areas.



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My first question is: do you think that the Barnett formula is a system that does have benefits and could be reformed, or is it your view that we should be looking at an entirely new system?

Kate Forbes: One of the challenges with the Barnett formula is that it is not used as it should be used. For example, the UK Government have, in the past, allocated funding outside Barnett and can do so whenever they choose. For example, the obvious example was during the confidence and supply agreement between the Conservative Party and the DUP. At that point, had funding been provided by Barnett, we would have received almost £3 billion more from that instance alone.

We struggle with the lack of transparency. We would like to see greater transparency about levels of spending from the UK Government as well as clearer information about the impact of UK Government decisions on resources for the devolved nations. Since the DUP deal, we have seen a number of years where devolution has been chipped away at but also, more importantly perhaps, the financial arrangements around it have been chipped away at. Money can essentially leapfrog the Scottish Government and from a position of managing our own budget, it becomes ever more challenging knowing whether the shared prosperity fund will replace EU funding. It is most likely not going to replace EU funding. I think the Barnett formula itself is a system that we can always have a discussion about, but at the end of the day what is more frustrating is that there is so much happening off book, as it were, that it makes it hard to track and hard to manage our own budget.

Q22 **Mhairi Black:** Funnily enough, you have half answered my next question. What is the practical impact of these new forms of essentially leapfrogging the Scottish Parliament, as you put it? I know there are political arguments for saying that you should not be leapfrogging the Scottish Parliament, but in terms of how you assess and manage your own money, what is the impact of these new city deals, levelling-up funds, shared prosperity fund and so on?

Kate Forbes: I would start by saying that I think the city deals—I know I was previously here discussing them—are an example of genuine mutual respect, transparency and understanding of funding. I only say that to prove it is possible. It does not have to be disrespectful, and it does not have to be off book.

Take EU funding. We have calculated that £183 million each year is required to adequately replace EU funding and we will lose out on about £337 million over the next three years when it comes the UK Government not replacing the EU funding in full and £337 million is not small money; that is big money. That is the difference in some cases between capital projects going ahead and capital projects not going ahead. The other part to this is that when we do not get that additional funding, it has to come from within our own budget, which is fixed because we have very limited borrowing powers. So you are starting to talk about the difference between a new school or a new hospital. That is as stark a reality as it is



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when it comes to the funding position. I do not know if that fully answers your question, but when things leapfrog it makes it hard to manage. Equally who is making up the shortfall? If it is us, it means we can do fewer things with less money.

Q23 Mhairi Black: Just to press a little bit further on your answer there, when you are saying that the—sorry, what was it you started with in your answer?

Kate Forbes: City deals.

Mhairi Black: City deals, yes. In terms of procedure, what is it that has made the city deals process pleasantly different to the likes of the levelling-up fund, for instance?

Kate Forbes: There are two things there. The first is the engagement. By engagement I do not mean that once something is signed, sealed, delivered we get a heads up as the press release goes out; I mean that we get proper engagement up front, saying, “Right, what is each side going to invest”—there are three sides, because local authorities are involved as well— “and how can we make this money go as far as possible?” That is genuine engagement, and it works for communities. For example, if you take a project, if the Scottish Government already have plans to invest in something else in that area, we can focus on the things that really need help rather than things that perhaps were going to be funded already. That is proper engagement.

Secondly, that funding is guaranteed; it does not chop and change, it is guaranteed. It goes via the Scottish Government’s budget, and I think it has been transformational in many respects. It works for local communities. I always think that when it comes to the funding position, it is an active choice not to engage constructively. Engaging constructively is always the better result for communities.

Q24 Mhairi Black: Lastly, before I hand back to the Chair, in practice my understanding is that in terms of raw power, to put it like that, the Treasury dictates how the formula works and how it should be applied and then it hands over the reins to the Scottish Parliament eventually. But it says here that there is a policy for dealing with disputes, and although the Treasury is ultimately the kingmaker, there is a policy. Could you tell us a wee bit more about that policy and what your experience of it has been?

Kate Forbes: Is that related to the city deals, or just generally?

Mhairi Black: In general—the Barnett formula.

Kate Forbes: Particularly with the fiscal framework and in terms of disputes to date, it has been quite difficult to deal with areas where there are disputes, because you just go around and around in circles and it gets kicked down the road.



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With the fiscal framework, it was always agreed that after five years, we would have a formal proper review. Because a lot of the disagreements have literally gone nowhere and we have not been able to resolve them over the last few years, we are now trying to focus on the fiscal framework review as being the place to try to deal with all these issues that have been identified. My impression over the last few years, particularly with Covid, has been that some of even the most minor, trivial asks have not necessarily delivered actual results. The only way I think we are going to get some of these things fixed is in the fiscal framework review, and that review is due to kick off probably towards the end of this year. That is an opportunity to manage it.

The dispute processes have been quite ineffective to date. Lucy O'Carroll might want to add something, because it is quite a technical point.

Lucy O'Carroll: Hello; I am happy to come in. The dispute resolution process is quite convoluted. It requires a dispute to be recognised by both sides and then there is a process whereby officials look at it, attempt to come to a resolution and bring that through official channels up to ministerial channels. That process has been quite complex. It requires trusted engagement on both sides. We have all engaged with best endeavours to do that, but Covid came and swept everything to one side and that has prolonged the engagement.

We are currently dealing with dispute resolution but we are, as the Cabinet Secretary says, in the main putting things into the fiscal framework review and planning to deal with them in a package in the round, because the fiscal framework itself is a package in the round. In that sense, it is probably a reasonable approach to take and hopefully will bear fruit.

Mhairi Black: Thank you.

Q25 **Deidre Brock:** Good afternoon, Cabinet Secretary; it is lovely to see you. Thank you, Ms O'Carroll, as well.

I want to continue along the lines of looking at the fiscal framework review and wonder, Cabinet Secretary, if you could perhaps expand a little on what you think the key objectives for the Scottish Government are for the fiscal framework review.

Kate Forbes: My starting position is fairness. It is a question of fairness for communities, for taxpayers, for public services and when the fiscal framework was agreed, and it was agreed by both Governments, both Governments decided to put in a review period after five years knowing that this would be the first five years of testing it and therefore inevitably after five years you would find ways that needed to be improved. I do not think it is a matter of shame that it needs to be improved; it is just a fact.

We know that there are a number of areas where it does not make sense for communities, for businesses, for taxpayers. For example, one area



where it does not make sense is around tax. Scotland and England and the rest of the UK have differences in the tax base—this is where Lucy O’Carroll is literally the expert—that are not taken into account when it comes to the changes. Where we have made changes to our tax rates, for example, the reconciliations that we are contending with are pretty significant. At the end of the day, if there are slight changes in our tax base—that has happened—and a lot of our additional-rate taxpayers are in one industry such as oil and gas, which then faces some years of challenge, but the additional-rate payers are predominantly in financial services in England where they have seen significant increases in wages, that is not taken into account. We pay the price when it comes to the reconciliation of the difference in how the tax base grows, evolves or changes over time. It is not that our tax policy is not generating more funding; it is that the block grant adjustments or the reconciliations ultimately are not taking into account the differences in the tax base.

I use that as one example of something that I do not think is necessarily fair for our public services, because it means that I have to use actual spending power to offset those reconciliations. That takes me to one final point, and then I will stop talking. Most other Governments around the world would manage those fluctuations, those reconciliations, using resource borrowing. But our resource borrowing is capped at £300 million, and therefore any reconciliations that are over and above that £300 million—that is highly likely, and is forecast for the next few years—have to be actual money you take from other public services.

There is a double whammy there. These are things that I do not think you need to take a constitutional position to say do not really work for our public services or for taxpayers. Surely there is a better way of doing this.

Q26 Deidre Brock: Thank you. Ms O’Carroll, you had your hand up. Would you like to make some comments, as an acknowledged expert?

Lucy O’Carroll: I don’t know about that, but I will do my best. I have two points to make on the back of what the Cabinet Secretary said. One is on the fiscal framework and the fact that what matters is ultimately the relative performance. The fact that we had hit the oil and gas sector, which has top earners in it in Scotland, while top earners in the rest of UK in the finance sector were doing relatively well in terms of earning growth—seeing average growth of earnings of 31% over the period since 2019, according to the Institute of Fiscal Studies, compared with 14% in other sectors of the economy—means that the net performance in Scotland has been less favourable. It is very difficult to deal with that when you have to make the budget balance.

The second point is that our borrowing powers are very constrained. A cash sum of £300 million to cover forecast error per year was agreed between both Governments at the point the fiscal framework was introduced. Of course, with inflation now running at around 10%, which is far higher than had been anticipated at that time, that £300 million is



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constantly being eroded. A small sum to begin with has become smaller in relative terms too. The situation is increasingly challenging.

Q27 **Deidre Brock:** Thank you, both of you, for your excellent answers.

Cabinet Secretary, further to this, have you been able to reach agreement finally with the UK Government—because I know there were some differences of opinion—over the topics that will be included and excluded from the review?

Kate Forbes: That is ongoing. We have finalised the independent report—the report precedes the review—and I am engaged in negotiations and discussions with the UK Government on the actual substance of the review.

Q28 **Deidre Brock:** Watch this space, I suppose.

Finally on the fiscal framework, the UK Government have expressed an ambition to ensure that the settlements for Scotland do not generate unintended consequences or inequities for people in other parts of the UK. What is your response to that?

Kate Forbes: It is not something that I think makes much sense in the context of the fiscal framework review, to be honest. Right now, the Welsh Government, and the Northern Irish Executive prior to the recent elections, and I are all fairly agreed on what needs to change. We all have a slightly different process in terms of devolution and additional powers, but I think ultimately this starts with people. It starts with citizens, it starts with individuals, it starts with businesses, and there is a heightened interest in ensuring that the fiscal framework works.

During Covid, I was at pains to try to find ways to, for example, redeploy existing powers in a more effective way. I was not even asking for more powers. Take, for example, the borrowing point. We have a power for borrowing for cash management purposes, which we have not used. I could really have done with a borrowing power during Covid, that was to manage periods of uncertainty. For example, when Scotland went into lockdown or changed things a few weeks ahead of the UK Government and there was no certainty of funding coming, we could have used that then. Three or four weeks later, the UK Government did something similar and generated funding, by which point we had already made policy decisions.

My argument here is that in terms of other parts of the UK, there is general agreement on what changes we need in our fiscal management procedures, and I do think any of us believes those are at odds with each other. In many cases the asks are fairly minor.

Q29 **Deidre Brock:** Very interesting, thank you. I would like to move on to the shared prosperity fund again. You mentioned the £337 million shortfall that the Scottish Government argue there is over the next three years. The UK Government argue differently. Could you just tell us why



you think the UK Government's analysis is so different?

Kate Forbes: At the moment, the allocation fails to include some of the EU schemes that existed. It fails to include, for example, the European territorial co-operation programmes or the LEADER programmes. It also falls short in terms of the overall quantum. There have been arguments and promises that the amount of funding will be as great as or greater than EU funds, but certainly by our calculations to date, that is not the case. It is a very simple question of maths that we would be looking at the value of the fund being at least at the level that was previously provided by Scotland's EU structural funds, and then of course we would like to see that fully devolved. That is where both the Welsh Government and ourselves are relatively agreed on the fact that the approach to date has not met our expectations.

Q30 **Deidre Brock:** Was part of it that the UK Government stated that the funds that will be received in 2022-23 are part of an earlier EU allocation and therefore they would offer the Scottish Government less money in those periods—that seems to be one point that is being raised, that I have read of, anyway—and so, even though it has been previously allocated, the UK Government are suggesting that it is still to be spent and therefore they would offer less money as part of the funding package and claim that it is still the same as the ERDF funding?

Kate Forbes: That argument can only be proven as true or untrue based on what happens in the coming years. Right now, across a number of organisations or communities or enterprises that were expecting to see EU funding replaced, there is still a big question mark as to whether it will be. In a sense, it is a difficult argument to either prove or disprove, because it is basically saying, "Next year we are going to top it up, so just wait, and the year after we will top it up—just wait". We have been waiting quite a while, if memory serves, not just for the design of these schemes but for the funding to start to flow.

Q31 **Deidre Brock:** Yes, I understand, thank you. Last week we had the Scotland Office Ministers in to see us, and Scotland Office Minister Iain Stewart told us that the Scottish Government were including agricultural funding in their calculations and were not using the correct exchange or inflation rates in their adjustments, and that was one of the reasons for the difference in approach. What are your thoughts on that? Ms O'Carroll, can you contribute on this as well?

Kate Forbes: Lucy O'Carroll is welcome to come in. That sounds to me like you are scrabbling at straws, does it not? If you cannot come out straight and prove that there is a direct replacement as promised, it starts to get a little bit convoluted. Lucy, do you want to add anything?

Lucy O'Carroll: I do not have anything material to add to that, Ms Forbes.

Q32 **Deidre Brock:** Lastly, a point I raised last week, and one you have touched on already, was about shared prosperity funding bypassing the



usual routes that it would have taken in the past in Europe. What work can or will the Scottish Government be able to undertake to help deliver the shared prosperity fund in Scotland? I know from last week that Mr Rockey from the Scotland Office mentioned that there had been 18 civil servants from the Department for Levelling Up, Housing and Communities placed throughout Scotland. That seems to me to be a replication of effort, because we already have civil servants who have established good relationships with organisations across Scotland over many years. I would be interested to see where you think the Scottish Government can fit into the approach the Scotland Office is currently taking to all of this.

Kate Forbes: My first point—I know that you were not intending it this way—is that I do not think that it is for the Scottish Government to try to fit or squeeze into a UK Government process that has been established from a position of not respecting devolution and also not being clear about what these processes are. Obviously, you will be the same, but local communities and local authorities make approaches to us regularly looking for clarity and for understanding of how to access some of this replacement funding. The fact that for a long time they and we were none the wiser about what to do demonstrates that there has been a complete vacuum in terms of understanding how to access this funding. As I said to Mhairi Black, there are good processes already in place that could have been replicated in terms of city deals.

It is quite difficult to know how to squeeze into a process that you have not necessarily been brought into from the outset to help co-design or co-deliver. On all these fronts, it is not good enough to just give us a sign of approval after something has been signed, sealed and delivered already.

Deidre Brock: I just point out that in the UKSPF prospectus the UK Government said that the devolved Governments in Scotland and Wales should be involved in the development of investment plans by lead local authorities. I am not clear at all where that is happening or how it is happening. I am still in the dark about that, and I suspect that everyone in the Scottish Government is as well.

Q33 **Chair:** Cabinet Secretary, Scotland has had powers over income tax since 2016. Can you explain to this Committee what has been achieved by establishing different levels of income tax for Scotland as compared to the rest of the UK in these intervening years?

Kate Forbes: The bottom line is that the tax scheme that we have devised and that has been in operation now for a number of years is fairer. It is fairer in terms of it being more progressive, with those who can paying more, and those who struggle paying less. Also, it has ultimately raised more funding for Scottish public services. Obviously, in any form of tax policy, you want to get a balance between ensuring that there is a fair system but that ultimately there is a reliable source of



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revenue. On both those fronts, we have raised extra revenue and we have created a fairer and more progressive tax system.

Q34 **Chair:** The OBR's forecast projects an increase in Scottish devolved taxes over the next four years worth some £1 billion per year. Do you recognise those figures? If you do, how do the Scottish Government intend to use this additional revenue?

Kate Forbes: That would be the echo of the IFS's view that the tax rises almost certainly have raised revenue. In terms of how that is deployed, we have built our spending review around the four priorities that I mentioned. That funding directly contributes to our public services. It is spent on health services, education and local government. It is also helping to deliver vital forms of support in Scotland that are not available elsewhere, such as our mission to tackle child poverty, which includes increased spend on employability skills and support for parents as well as the Scottish child payment. All of that is coming together to invest directly in public services.

Q35 **Chair:** You also had your mini spending review in the past few weeks, and the resource spending review. Can you describe to this Committee the ambitions in that review and some of the limitations that you identified when you presented this to Parliament?

Kate Forbes: As I said at the outset, the fiscal outlook is extremely challenging. Therefore, we built our spending review around essentially four pillars. The four pillars were tackling child poverty and transitioning to net zero, as well as resilient public services and growing our economy. The funding across the spending review period, across all portfolios, is directly trying to meet those aims and ambitions. With additional funding, of course, we could do more and we could go faster, but at the moment our budget will only grow in real terms by about 2% over the next four years, once we account for the devolution of social security. It is a very, very challenging outlook, and that is why we decided to prioritise those four key pillars. By extension, of course, you cannot prioritise everything.

Q36 **Chair:** As part of the review there is an expectation that public bodies deliver recurring annual efficiencies—savings—of at least 3%. Is it realistic to expect public bodies to achieve savings of 3% in the course of the next few years?

Kate Forbes: Two points: first, the spending review is not a budget. I can only allocate the funding that the Scottish Fiscal Commission forecasts that I will receive or raise. I cannot spend a penny more than that. What the commission forecasts I will receive is very challenging. Secondly, this is not a budget. If you recall, I said that we are basing the spending review on figures that the UK Government provided to us last autumn when inflation was 3.1%. We are at 9.1%. I think that it is impossible that they do not update their own spending outlook, because surely they are contending with the same challenges that we are contending with.



Therefore, we will have to make decisions for next year's budget, and I sincerely hope that it is a more positive outlook than the spending review because UK Government figures will have caught up with where inflation is at. Secondly, my sincere hope is that the Scottish Fiscal Commission can therefore forecast additional funding for us. In the meantime, we can only contend with what the Scottish Fiscal Commission forecasts that we will receive.

Q37 Wendy Chamberlain: Thank you very much, Cabinet Secretary and Ms O'Carroll, for your time today. I want to move on to talk about the Internal Market Act and its implications. Cabinet Secretary, what is your assessment of the current operation of the Act and its implications for the Scottish economy?

Kate Forbes: I think that we share a view with the Welsh Government, in particular, that we are fundamentally opposed to it because we see it as an assault on devolution. No devolved legislature gave consent to the Act, and both the Senedd in Wales and the Scottish Government voted to withhold consent. That is quite significant. The Welsh Government commenced legal action to seek a judicial review of the Act on 19 January last year and there has been a process since then. It is very difficult to both be a devolutionist in terms of supporting that, as my colleagues in other parties in the Scottish Parliament are—including your party, which is why I make that point—and not see this as an Act that drives a coach and horses through the devolution settlement.

It is very difficult to know how else to answer that beyond saying that our position still stands. The process of direct spending by UK Ministers in Scotland with no consultation or oversight from the Scottish Parliament—note that I am saying the Parliament and not the Government—means that you will inevitably get greater levels of policy incoherence, greater levels of lack of accountability and ultimately poor value for money.

Q38 Wendy Chamberlain: Are you seeing some of those concerns being realised?

Kate Forbes: It has the potential to undermine common frameworks that have been established by all four Governments of the UK in terms of regulatory divergence and devolved policy areas. Where right now we might be proceeding down a route of legislation, you have to be cognisant of what the Internal Market Act might do in terms of that kind of legislation. I do not have specific examples right now, but if we were, for example, to want to remain closer to the EU and therefore continue to align with the EU where appropriate, and in a manner that contributes towards protecting and advancing standards across a range of policy areas, the effect of policy decisions in Scotland could be constrained in practice, having implications with alignment in policy outcomes.

The other point I would make is that it is still early days. I am more conscious of the financial impacts, as it were—if there is direct spend in one area, what that means for us. If there is a direct spend in an area



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where we were intending to spend or not intending to spend, what does that mean in terms of us spending in communities from a limited budget and trying to make every penny go as far as possible?

Q39 Wendy Chamberlain: You have mentioned common frameworks. The last update in relation to common frameworks was back in March, and it confirmed that the provisional confirmed frameworks now totalled 29. Previously when this Committee had the UK Business Secretary, Paul Scully, here, he was unable to give me—hypothetical or otherwise—an example of a product or item that would not potentially fit within a perceived common framework and would therefore require the Internal Market Act. Is the ongoing work of the common frameworks assuaging some of your concerns, given that you would hope that all Governments could move to using the frameworks as opposed to relying on the Act?

Kate Forbes: We still need to see how it works in practice. If the frameworks are to do their job and ensure that policy divergence can be managed, on the basis of agreement between equals—and that is the key—we cannot just see them constantly subject to endless process delays, unworkable limits on scope or second-guessing on the part of UK Ministers whenever an exemption is required. Therefore, we need to see them operate in practice before I can come to a conclusion on your question.

Wendy Chamberlain: So as a Committee, we should pay attention to the fact that provisional confirmed frameworks are one thing, but seeing them in practice and having an assessment of them is something else?

Kate Forbes: That is right, yes.

Q40 Wendy Chamberlain: Great. You talked there about potentially making decisions that would align Scotland more closely with the EU, and you talked about financial impact. How much regulatory divergence from England would the Scottish economy be able to tolerate before experiencing negative consequences, given the proportion of our trade with England?

Kate Forbes: It depends on where the UK Government end up. Right now, we have been quite consistent that we are committed to remaining close to the EU. That either means that we will continue to align with the EU where appropriate, or it means that where new decisions need to be made, we will seek to see how we can align.

Again, it is a difficult question to answer because a lot of it is about testing where the UK Government go. We used to have a situation where EU single market rules were applied symmetrically across all constituent parts of the UK in areas of devolved responsibility. The constituent part that is moving away from alignment is the rest of the UK—subject to what Wales does and Northern Ireland does—rather than us consciously moving away from where England ends up.

Q41 Wendy Chamberlain: I understand. I have one last question, and it is a



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bit more concerned with my constituency in North East Fife, which is quite rural. It is a question about the Scotland broadband voucher scheme. There are two elements to the scheme, each with fewer than 1,000 households being supported through the scheme. Given that regardless of political affiliation, we all want to grow the Scottish economy, and given the fact that working at home—living at work—has become the reality for many Scots, what has gone wrong with that scheme and what are we going to do to ensure that our broadband commitment is met?

Kate Forbes: A few points. First, we extended the deadline for the voucher scheme because we were keen to get as many people using it as possible. Secondly, we engaged in a huge exercise of marketing and so on and we did not see a huge increase in numbers of people applying for it. That is matched—it is echoed—by a number of other schemes that operate, either by the UK Government or by others. There is probably some work for us to do to try to unpick why there was not more interest in it, but I would agree with you. I, like everybody else, want to see as much demand as possible for the vouchers. Despite quite a lot of flexibility already on our part—we continue to be flexible because there will be some vouchers that have been successfully provided but the actual suppliers are facing challenges in terms of accessing supplies, with a supply chain that is challenging—we are still trying to be as flexible with them as possible.

Q42 **Wendy Chamberlain:** The interim scheme of £400 has closed, but we know that R100 potentially has timescales extending into 2027. Would you look at reopening that scheme, given that the purpose of it is to help people as they wait for R100 to be delivered?

Kate Forbes: Where I struggle to answer that question is that in extending it by three months, we did not see increased demand.

Q43 **Wendy Chamberlain:** Were you writing to people? I am concerned that it was pointed out to me that a lot of stuff is on the website, but if you do not have broadband, potentially that creates a challenge.

Kate Forbes: We advertised extensively in national, regional and local media. I could probably write to you specifically about all the actions that we took try to promote it in that final few months, and we did not see an increase. Therefore, probably the more appropriate question, which is rightly yours to ask, is: what else are we doing to try to connect people faster? There is more that we can say on that front in terms of engaging with Openreach and trying to frontload more of the connections, because the voucher scheme worked where it was applied for and used, but it just did not have the significant levels of uptake and interest that we expected after an extensive marketing campaign.

Q44 **Chair:** I briefly turn back to the single market Act. When the Secretary of State was here last week, we spent an awful lot of time discussing gene-editing reform. It was something that he was particularly keen on, and he



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pointed us to an example of opportunities that the single market Act may be able to give Scotland and encourage Scotland to be part of the Bill that is currently being considered here in Parliament. Why have you not attempted to take advantage of this great opportunity to see the single market Act work and delivering for Scotland?

Kate Forbes: That is probably a question that is very well put to farmers, the Scottish agricultural industry and all those who are concerned by a particular direction in travel. To my mind, it is a very good example of where, ultimately, the Scottish Parliament and Scottish Government are elected to represent the views of the people of Scotland. That is what matters supremely in a democracy, rather than just following in the footsteps of a Government that is made up of a party that has not been elected in Scotland since the 1950s.

Q45 **Chair:** Talking of that, I am quite surprised that we have none of our Scottish Conservative colleagues still with us. I was presuming that they were going to ask some questions about the very contracts that we seem to have run into a number of difficulties with. How did we get to this stage where so much parliamentary time, attention and debate has been taken over with the discussion of these ferries? Could you tell us what went wrong had how this is being resolved?

Kate Forbes: I represent a constituency that is set to benefit from one of those ferries; it does not get much closer to home than that.

It has been well documented that the Audit Scotland report that initiated that interest covered a lot of documents that had been in the public domain for at least two years, so obviously it took the Audit Scotland report for the Opposition to go and read some of these documents. Ultimately, and the Audit Scotland report is quite clear on this, the greatest failing has been in the construction from start to finish of getting these boats ready. However, there are lessons to be learned, too, which we have already implemented in practice, on things like procurement and financial management. On procurement, we have already made substantial changes, which you will see in the most recent ferry contract for the vessels to Islay and also in the financial management in terms of investment in companies. Those changes have been made.

My job right now is to get those boats built, to get them built as quickly as possible and to get them built according to the updated timetable that has been set out. There is a motivated workforce at Ferguson's, despite dealing with quite a lot of grief over the last few months, but we can focus on the end result, which is what Audit Scotland encouraged us to do. Get the boats done, and then there will be time for a deeper inquiry into what should not have happened or what went wrong.

Q46 **Chair:** We are looking at military shipbuilding as part of our many inquiries into the issue of defence in Scotland and our footprint within Scottish communities. Shipbuilding is something that we are looking at and considering. Are we going to see a resolution to all of this soon, or is



this something that is going to continue to grumble on for the next few months, consuming so much parliamentary time in the Scottish Parliament?

Kate Forbes: The resolution is to get the boats built and sailing. We have a new chief executive, who was appointed about five months ago, who is doing a lot of good work. He is responsible for updating the Scottish Parliament every quarter, and there should be another update fairly soon. That is the resolution. The resolution is to get the boats built. Meanwhile, that is not stopping other ferry investment work of £580 million, including two new ships that are being built outwith the UK but are being built to support islanders in Islay, alongside seven new boats—smaller vessels—that there is funding allocated for. We are making progress on the procurement process.

Q47 **Chair:** This has been a fascinating conversation, as always, Cabinet Secretary, and the Committee is very grateful for your candid responses and your acceptance of some of the difficulties and issues that we have. Lastly from me, would all our financial difficulties in the Scottish Parliament be partly assuaged if we had borrowing powers?

Kate Forbes: If we had borrowing powers, we would be able to manage uncertainty and risk. That is what this is about. It is about managing uncertainty and risk. You are probably not asking me for a long answer, but take social security. Social security is demand-led. I have a fixed budget. I allocate funding according to what we think we are going to spend. That is what the Scottish Fiscal Commission tells me that it thinks we are going to spend. However, if, for example, there is a massive increase in demand for social security in the last two months of the year and all that I have allocated has been paid out, within a fixed budget, where do you go? Managing that demand alongside managing tax reconciliations in a period when the economic volatility is such as has not been seen for decades demonstrates the need for managing. I remind you that local government in Scotland have more advanced borrowing powers than the Scottish Government.

Q48 **Chair:** You have £450 million of borrowing powers. That is the limit that you have, so obviously it is something that is accepted by the UK Government. What do they say to you when you raise this issue with them and when you say that this would help with things like social security? You mentioned the Covid example about being able to bring down funding earlier if that was a prioritisation of the Scottish Government. What sort of a response do you get when you put that to them?

Kate Forbes: It is mixed. Often it is just kicking the can down the road and not coming to a conclusion on the request. At the moment, it has been kicked into the fiscal framework review. The final point I would make is this. Remember that we also have a cumulative cap. Most local authorities would borrow according to affordability. We have a cumulative cap of £3 billion for capital over all time, and resource is £1.7 billion



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capital. It is not just that it is £450 million a year; it is that you are going to hit your head on the ceiling at some point as well, which matters. The last thing that they say is what Deirdre Brock quoted to me, which is that pitting one part of the UK against another is unfair for other parts of the UK.

Chair: Thank you ever so much for that. We will be looking at the fiscal framework. This Committee did a serious piece of work on it when it was first established five years ago, and it is something that we will be tempted to have a look at as the review is undertaken. I hope that we will have you back to get your views specifically on that when this starts to go through Parliament this week and is considered by Treasury again.

For now, Cabinet Secretary, thank you ever so much, especially for coming to us at such short notice. We all wish you well in your break from Parliament. You are getting a big yes from everybody around the Committee. We look forward to seeing you back with new baby in tow in the course of the next few months. Cabinet Secretary, for today, thank you ever so much for your attendance.