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UK COVID-19 INQUIRY
MODULE 2A

WITNESS STATEMENT OF THE DIRECTOR GENERAL SCOTTISH EXCHEQUER

This statement is one of a suite provided for Module 2A of the UK Covid-19 Inquiry and these should be considered collectively. In relation to the issues raised by the Rule 9 notice ref M2A-SG-01 dated 2 February 2023 served on the Scottish Government, in connection with Module 2A, the Director General Scottish Exchequer will say as follows:

Introduction

This statement is one of a suite provided for Module 2 and 2A of the UK Covid-19 Inquiry and these should be considered collectively. Furthermore, in this statement, additional material is included for further context, which relates to the period prior to the Module 2A timespan and is consistent with the content of the DG Scottish Exchequer statement for Module 1 (M01-SG-01).

How the Scottish Government is funded

The majority of the funding for the Scottish Government is a grant from the UK Government.

1. How the Scottish Government is funded has changed significantly over time. This has brought both opportunity and a greater level of fiscal risk. The *way* the Scottish Government is funded does not have to drive the *allocations* of that funding. Those

allocative choices are for Scottish ministers, with their authority to spend coming from annual Budget Acts authorised by the Scottish Parliament each year.

2. The Scotland Act 1998 legislated for the establishment of both the devolved Scottish Parliament with tax varying powers and the Scottish Government. Both were set up in 1999. At this point, over 90% of money for the Scottish Government's Budget came in the form of a block grant calculated through the Barnett formula, with the remaining balance from Non-Domestic Rates.

3. This was the case for many years, prior to the Scotland Act 2012 and the Scotland Act 2016. The growth of the annual Block Grant was (and still is) determined by the operation of the Barnett Formula. The Scottish Parliament's main tax powers were then limited to local taxes for local expenditure. In particular Non-Domestic Rates, which are collected by Scottish Local Authorities. The Scottish Government guarantees the revenue funding available to Scottish Local Authorities through the combined total of Non-Domestic Rates income and a General Revenue Grant.

4. The Scotland Act 2012 and the Scotland Act 2016 devolved a number of significant new fiscal powers, both tax and spend, to Scotland from the UK Government.

5. The tax raising elements of this are described in more detail below at para 18.

6. Briefly, Land and Buildings Transaction Tax (LBTT) and Scottish Landfill Tax (SLfT) were fully devolved from the financial year 2015-16 under the Scotland Act 2012. These replaced the UK taxes for Stamp Duty and Landfill and are administered by Revenue Scotland. The Scottish Rate of Income Tax was devolved under the Scotland Act 2012, with the Scotland Act 2016 extending income tax powers significantly from 2017-18 (known as Scottish Income Tax).

7. Only when the further three tax changes of assigned VAT, Air Passenger Duty and Aggregates Levy are fully implemented will over half the Scottish Government's budget[1] come from taxes raised in Scotland.

8. As part of the Scotland Act in 2016, eleven social security benefits transferred to the Scottish Parliament. Since then, the Scottish Government has introduced thirteen

[1] DEL – Departmental Expenditure Limit comparison

benefits, seven of which are entirely new forms of financial support available only in Scotland. Any excess social security demand in any one year has to be made by compensating reductions in spend elsewhere in the Scottish Budget. A full list of the benefits is provided in paragraph 72.

9. The devolution of tax and social security powers to Scotland was informed by the 2014 Smith Commission. A key principle in the Smith Commission's findings was that there should be "no detriment" to the UK as a whole or its constituent parts as a result of devolution.

10. To implement the Smith Commission's recommendation [AS2/0001-INQ000102915], the Scottish Government and UK Government reached agreement on a Fiscal Framework for Scotland in February 2016. [AS2/0002-INQ000102914]. The "no detriment" principle was achieved through the implementation of Block Grant Adjustments (BGAs). In principle, a BGA acts by reducing the Scottish Government's block grant by an amount deemed to be equivalent to the tax revenue foregone as a consequence of devolution.

11. The Scottish Government's Fiscal Framework also put in place agreements over the forecasting landscape that would support the new arrangement, and risk management tools, including borrowing and reserve powers.

12. The Fiscal Framework lays down three main components for calculating the Scottish Government's Budget:
    a. Component One – Barnett-determined Block Grant. Barnett continues to determine the initial size of the Block Grant.
    b. Component Two – Adjustment to the Block Grant. The Block Grant is adjusted to reflect the impact of the transfer of tax and social security powers to the Scottish Budget. These are called Block Grant Adjustments (BGAs).
    c. Component Three – Devolved Revenues. These are the revenues retained from devolved and assigned taxes that contribute to Scotland's funding.

13. Overall, the net impact of forecast revenues from individual taxes and Block Grant Adjustments can move the Scottish Government's Budget in a positive or negative direction. If the Scottish Government raises more in devolved taxes than it loses in the corresponding BGAs, the net effect is positive. If the tax BGAs are larger than the corresponding devolved taxes, the net effect is negative.

14. In the case of social security benefits, the situation is reversed – if BGA forecasts for these benefits exceed spending forecasts, this results in a positive net position; there is a negative net budget position if spending forecasts exceed the BGA. In cases where spending exceeds the BGA, the gap would need to be funded from the existing Scottish budget envelope.

Setting budgets and applying spending controls - money allocated by the UK Government in the event of civil emergencies

15. The funding mechanisms set out above, and the fiscal relationship between the Scottish and UK Governments as set out in the *Statement of Funding Policy (2021)* [AS2/0003-INQ000102912] and the *Fiscal Framework Agreement (2016)* [AS2/0002-INQ000102914] continue to apply in the event of civil emergencies.

16. The Statement of Funding Policy (SofP) sets out how UK Government funding for the devolved administrations is determined. It contains the arrangements set out when the devolved legislatures were created and changes to these or to the UK Government budgeting regime since the statement was first introduced in 1999.

17. The parameters set out in the SoFP govern the ways in which any financial response to an emergency event can be delivered by the Scottish Government. In relation to the Covid-19 pandemic, any additional block grant funding made available by the UK Government to respond to the crisis was allocated to the Scottish Government in accordance with the principles set out in the SoFP - with additional funding being calculated as a proportion of allocations to equivalent UK Departments.

Money raised in Scotland by means of taxation

18. The Scotland Act 2012 and the Scotland Act 2016 devolved the following fiscal powers to Scotland:
    - Land and Buildings Transaction Tax (LBTT) and Scottish Landfill Tax (SLfT) were fully devolved from the financial year 2015-16 under the Scotland Act 2012.
    - The Scottish Rate of Income Tax was devolved under the Scotland Act 2012, with the Scotland Act 2016 extending income tax powers significantly from 2017-18

(known as Scottish Income Tax). The Scottish Parliament is able to set the rates and bands for Scottish taxpayers on non-savings and non-dividend income, e.g. earnings from employment, self-employment, pensions or property. The personal allowance, reliefs and the rates and bands for savings and dividend income all remain reserved to the UK Parliament.

- Three Scotland Act 2016 tax revenues are yet to be implemented: assigned VAT, Air Passenger Duty and Aggregates Levy.

19. When the Scottish Budget is set (see para 42 below), the tax revenues which underpin it are based on forecasts from the independent Scottish Fiscal Commission, and the BGAs are informed by forecasts of the Office for Budget Responsibility. When outturn data becomes available (in some cases, over two years later), 'reconciliations' are required to adjust for any differences in the forecast revenue versus actual revenue received. These reconciliations – positive or negative – are applied to Scottish Government budgets in future years.

20. The following tables (figures 1-3) show the forecast tax revenues and BGAs used to set the Scottish Budget, as well as corresponding reconciliations, for 2020-21 and 2021-22.

Figure 1 - Scottish Income Tax

Net Effect to the Scottish Budget (£m)		
	2020-21	2021-22*
Forecast Revenue	12,365	12,263
Forecast BGA	-12,319	-11,788
Net effect at Budget	+46	+475
Outturn Revenue	11,948	
Outturn BGA	-11,852	
Net effect on budget at Outturn	+96	
Final Income Tax Reconciliation	50	

*Income Tax outturn data for 2021-22 will be available in Summer 2023

Figure 2 - Land and Buildings Transaction Tax

Net Effect to the Scottish Budget (£m)		
	2020-21	2021-22

Forecast Revenue	641	586
Forecast BGA	-557	-515
Net effect at Budget	+85	+71
Outturn Revenue	517	807
Outturn BGA	-397	-642
Net effect on budget at Outturn	+121	+164
Difference between net effect at Budget and Outturn	+36	+94

Figure 3 - Scottish Landfill Tax

Net Effect to the Scottish Budget (£m)		
	2020-21	2021-22
Forecast Revenue	116	88
Forecast BGA	-87	-95
Net effect at Budget	+29	-7
Outturn Revenue	107	125
Outturn BGA	-87	-102
Net effect on budget at Outturn	+20	+23
Difference between net effect at Budget and Outturn	-9	+30

21. The Scottish Government sets tax policy at the time of the annual Scottish Budget. Various pieces of legislation are required to give the respective tax policy statutory effect – these are voted on separate to the annual Budget Act.

22. In December 2021, the Scottish Government published Scotland's first Framework for Tax. The Framework sets out the principles which underpin the Scottish Government's approach to taxation. It also provides information on how the Scottish Government takes its decisions on tax policy, including a matrix for decision-making and appraisal of tax policies.

Borrowing

23. The Scottish Government must balance its Budget each year and has very limited borrowing powers. These are set out in the Fiscal Framework between the Scottish and UK Governments published in February 2016.

24. The Fiscal Framework increased the Scottish Government's statutory limit on borrowing for capital expenditure to £3 billion. The annual limit on the amount of borrowing for capital expenditure is set at 15% of the overall borrowing cap, equivalent to £450 million a year.

25. The Fiscal Framework provides the Scottish Government with an overall resource borrowing limit from 2017-18 of £1.75 billion, with a total annual limit of £600 million. Resource borrowing can be used for in-year cash management (maximum £500 million annually) and in cases of forecast error (maximum £300 million annually, increasing to £600 million in the situation of a Scotland-specific 'economic shock'). Details of the circumstances of an economic shock are set out in Fiscal Framework Technical Note (2022) [AS2/0004-INQ000102923].

26. These combined arrangements allow some limited borrowing to support infrastructure investment and to offset errors in devolved tax and social security forecasts. These are the only circumstances in which Scottish Ministers can borrow.

27. Consequently, the Scottish Government cannot borrow to support discretionary resource spending or to respond to an emergency situation, either with economic stimulus or direct support. The Scottish Government only receives financial resources to respond to an emergency event when the UK Government increases spending on devolved areas in response to that same event or funds the Scottish Government specifically for that purpose.

28. The Scottish Government's borrowing powers were exercised during 2017-18, 2018-19 and 2019-20, when in each year capital loans were taken out, and in 2020-21, 2021-22 when both capital and resource loans were taken out. All borrowing to date has been from the National Loans Fund (NLF), which is administered through the UK Government by HM Treasury (HMT). The resource loans in 2020-21 and 2021-22 were to smooth the agreed fiscal framework corrections to previous forecasts.

29. Given the significant constraints on Scottish Government Borrowing, the associated fiscal risks are limited to the ability of the Scottish Government to repay existing debt and

interest payments as they fall due, and the future capacity to borrow within the existing constraints.

30. The Scottish Government is unlikely to use its Cash Management Borrowing facility. This is because as a full member of the UK Cash Management Scheme (see below) the contingency options available for emergent cash issues remain available to the Scottish Government. The cash management borrowing facility is available if cash flow was ever a risk, but it does **not** increase the Scottish Government's spending power.

31. The combination of fiscal framework restrictions and practical considerations mean that it is highly unlikely that the cumulative resource borrowing limit of £1.75 billion will be breached.

32. All borrowing decisions are taken in the light of ongoing analysis of the latest financial position. The Scottish Government monitors the contractual and expected future borrowing repayments as part of its regular internal financial management processes. Borrowing and other funding policies, and analysis of fiscal risks and the approach to management, are outlined in the Scottish Government's Medium Term Financial Strategy, and plans are updated in Scottish Budget documents. The latest medium-term financial strategy publication, dated May 2023, is provided [AS2/0005-INQ000000].

33. The Fiscal Framework Outturn Report details all borrowing undertaken by Scottish Ministers to date. Capital and Resource borrowing information is set out at section 9. The latest publication, the *Fiscal Framework Outturn Report (2022)*, is provided [AS2/0006-INQ000102924].

34. The *Scottish Public Finance Manual (SPFM)* contains a section on Borrowing, Lending and Investment which is provided [AS2/0007-INQ000102913].

35. Individual bodies within the Scottish Government accounting boundary are responsible for managing any debts they have, associated risks, and any related information in accordance with Scottish Government accounting policies and the SPFM.

<u>The Scotland Reserve</u>

36. In addition to its limited borrowing powers, the Scottish Government has limited Reserve capacity – again limits are set out in the *Fiscal Framework agreement (2016)* [AS2/0002-INQ000102914] and in paragraph 10.26 of the *Statement of Funding Policy (2021)*

[AS2/0003-INQ000102912]. This allows the Scottish Government some ability to smooth spending within and between years, carry forward underspend, and assist in the management of tax volatility, within set limits. The Scotland Reserve replaced the previous cash reserve and access to the UK Budget Exchange facility.

37. Up to £700 million in aggregate may be deposited in the Reserve. Maximum drawdown in any one year from the Reserve is £250 million of resource budget and £100 million of capital budget. Under the Fiscal Framework the drawdown limits are temporarily waived where a Scotland-specific economic shock occurs.

38. The use of resource borrowing is complementary to the use of the Scotland Reserve. The Scottish Government must balance the need for flexibility against the additional costs of borrowing compared to the Reserve to find a solution that is most appropriate to the circumstances.

Cash Management

39. The Scottish Government (along with other devolved administrations and all UK Departments) is a full member of the UK Government Cash Management Scheme. All cash management takes place within the umbrella provided by the UK Scheme and within the cash authorisation limits agreed with HMT as part of the annual budget process. Devolved Governments and UK Departments work within an annual cash authorisation limit which is derived from, and works in parallel to, the annual HMT Budget limit. As the limit is annual and cash is drawn down monthly, the majority of liquidity risk is centralised at a UK level. The Scottish Government undertakes and submits regular cashflow forecasts as part of the scheme.

Overview of the level of funding of the Scottish Government

40. The table below (Figure 4) provides the figures for the funding envelopes, at the passing of the relevant budget bills for this module period. The 'envelopes' are the available funding sources and totals for each Scottish budget.

Figure 4: Scottish Government Funding envelopes at the passing of each Scottish Budget Bill 2019-2021

	Scottish Budget		
Fiscal Resource (£m)	**2019-20**	**2020-21**	**2021-22**
Barnett Consequentials	27,633	29,711	30,892
Covid-19 Consequentials	-	-	3,408
Ringfenced Funding	-	472	756
Social Security Block Grant Adjustment	290	3,203	3,310
Scottish Income Tax	11,684	12,365	12,263
Land and Buildings Transaction Tax	643	641	586
Scottish Landfill Tax	104	116	88
Non-Tax Income	25	25	25
Block Grant Adjustment for Taxes and Non-Tax Income	(12,190)	(12,991)	(12,430)
Tax Reconciliations	(3)	(207)	(319)
Resource Borrowing	-	207	319
Other	709	488	414
Total Fiscal Resource	**28,894**	**34,030**	**39,312**

Capital (£m)	**2019-20**	**2020-21**	**2021-22**
Barnett Consequentials	3,956	4,734	4,973
Covid-19 Consequentials	-	-	237
Capital Borrowing	450	450	450
Other	-	5	-
Total Capital Funding	**4,406**	**5,189**	**5,660**

Financial Transactions (£m)	**2019-20**	**2020-21**	**2021-22**
Barnett Consequentials	519	606	208
Covid-19 Consequentials	-	-	41
Other	-	-	200
Total Financial Transactions	**519**	**606**	**449**

Total cash Funding	**33,819**	**39,825**	**45,421**

41. This shows the Scottish Government funding envelopes per the Scottish Budget applicable to each year before any additional changes were reflected in budget revisions and through outturn processes.

The Scottish Budget year

42. Every year the Scottish Government sets out a plan of how it plans to spend the money it receives from the UK Government and from taxes raised in Scotland. Setting the Budget is a year-round process that begins in May each year. The normal milestones during the year are set out in Figure 5 and related notes below:

Figure 5: Milestones in the Budget year

Event	Date expected
Medium-Term Financial Strategy[2]	May
Fiscal Framework Outturn Report[3]	September
Parliamentary subject committees submit spending proposals	October
The UK Government publishes the UK Budget	November
The Scottish Fiscal Commission publishes Scottish Income Tax Estimates	December
The Budget Bill is introduced, and the draft spending and tax plans published in a supporting document	December

[2] **Medium-Term Financial Strategy** In May the Medium-Term Financial Strategy is published, which:

- sets out our approach to financial management and fiscal rules by outlining the principles and policies to guide the use of fiscal powers to manage budget volatility;
- sets out a range of possible funding scenarios for the Scottish Budget over the next five years; and
- details the Scottish Government's key policy priorities and approach to supporting Scotland's economy.

[3] **Fiscal Framework Outturn Report**

In September a Fiscal Framework Outturn Report is published, which covers the following elements of the fiscal framework: Reconciliation process, Scotland Reserve, borrowing powers and social security powers.

The Budget's tax and spending proposals are scrutinised by Parliament	January
The Budget Bill is debated by Parliament[4]	January (stage 1) and February (stages 2 and 3)
The Budget Bill receives Royal Assent and becomes the Budget Act	April
Autumn Budget revision	September
Spring Budget revision	February

[4] **The Budget Bill**
Scottish Ministers must present Parliament with their spending proposals in the form of the Budget Bill within three weeks of the publication of the UK Budget. The Bill is introduced to Parliament a week later. The Scottish Government usually sets tax policy as part of the annual Scottish Budget. Various pieces of legislation are required to give the respective tax policy statutory effect – these are voted on separate to the annual Budget Act. The Bill has three stages. Stage 1 – debate in Parliament on the principles of the Bill; Stage 2 – Bill is scrutinised by the Finance Committee, and Stage 3 – bill is debated in Parliament, after which it receives Royal assent and creates the Budget Act. The Budget Bill is subject to a separate process from other bills. One of the main differences is that only Scottish Ministers can bring forward amendments once the Bill has been introduced. Other proposed changes to the spending plans set out in the Budget Bill supporting document are likely to be debated, and voted on if necessary, in the Finance Committee session which typically takes place in February (stage 2). Stage 3 must be completed within 70 days of the Bill being introduced. To ensure Royal Assent ahead of the start of the financial year, there is limited opportunity to delay the process. The proposed rate of income tax for Scotland must be approved by Parliament separately to the rest of the Budget Bill, prior to stage 3. The rates and bands for the Land and Buildings Transaction Tax (LBTT) and Scottish Landfill Tax are published in the draft Budget Bill supporting document. Any changes to the devolved taxes must be pursued in parallel with the Budget Bill.

43. From 2018, subject committees have had direct input to the budget process. Six weeks prior to the publication of the draft spending plans, the subject committees set out their views on the delivery and funding of existing policy priorities, any proposed changes, and how these should be funded. The Scottish Government responds to their suggestions in the Budget Bill supporting document, then debate any proposed amendments in Parliament prior to stage 1.

44. The Budget Act is typically amended twice a year (although the regulations allow for a third revision if required) via a Scottish Statutory Instrument to better reflect the spending patterns emerging from the monitoring of budgets. These are known as the Autumn and Spring Budget Revisions and are laid around September and February, after which they are scrutinised by the Scottish Parliament's Finance Committee. However, it is not possible to change the Scottish Rate Resolution (the Scottish rate of income tax) once the year to which it applies has begun.

45. Scotland Acts 2012 and 2016 devolved new fiscal powers to the Scottish Parliament which the budget needed to take into account. In 2017 an independent Budget Process Review Group was established to carry out a fundamental review of the budget process. The Budget Process Review Group's final report [AS2/0008-INQ000102916] recommended some structural changes to the Budget process, as well as changing expectations placed on the Scottish Government, the Parliament and public bodies. The recommendations were agreed in full by the then Finance and Constitution Committee and the Cabinet Secretary for Finance and the Constitution and formed the basis of the revised written agreement between the Committee and the Scottish Government which was subsequently approved by Parliament in May 2018.

<u>The process by which funds were sought from the UK Government for the response to the pandemic</u>

46. Scottish Ministers made representations for funding to UK counterparts through various channels (during COBR meetings, written correspondence, statements in the Scottish Parliament), but there was and is no standardised mechanism for Scottish Ministers to bid for funding from the UK Government.

<u>How funding levels were formulated and set</u>

47. The funding arrangements set out above continued to apply in the response to the pandemic. The size of the Scottish budget was impacted by UK fiscal policy and changes to funding for UK Departments for comparable spending, with Barnett consequentials generating the Block Grant for the Scottish budget.

48. This meant that additional block grant funding transferred to respond to the crisis was allocated to the Scottish Government in accordance with the principles set out in the SoFP- with additional funding being calculated as a proportion of allocations to equivalent UK Departments.

49. Therefore, the Barnett formula, BGA mechanisms and borrowing arrangements all continued to apply throughout the period – the fundamental change that occurred was in the quantum of funding.

50. While the overall arrangements remain determined by the SoFP, processes or considerations were developed during the course of the pandemic to aid planning and management. For example, before July 2020 the level of funding provided to the Scottish Government by the UK Government was determined by UK Government departmental spending plans via the Barnett Formula (in accordance with the SoFP). From July 2020, following recognition of the need to support planning in Devolved Administrations, the process was changed so that the UK Government guaranteed up front an amount at various points during the Covid-19 pandemic it would provide to Scottish Government prior to determining and declaring the final change to the Scottish Block Grant at UK Supplementary Estimate by reference to changes in UK Government departmental spending plans.

51. The Scottish Government was also allowed to carry forward a larger proportion of Covid-19 consequentials, out with the usual Scotland reserve arrangements in the years 2020-21 and 2021-22.

52. Whilst the minimum funding guarantee supported some aspects of financial planning within the Scottish Government, the formulation and setting of funding levels remained at the discretion of UK Government Ministers at all points, with a number of revisions to the level of guaranteed funding. Final allocations to the Scottish Government remained calculated by reference to the standard Barnett calculations.

<u>The process for provision of funds</u>

53. The Fiscal Framework and SoFP set out the mechanisms by which funds are allocated to Scottish Government by the UK Government. Funding is provided via the Block Grant, the size of which is determined by the Barnett Formula and the Fiscal Framework. Funding was announced at numerous different points throughout the pandemic years, as illustrated in Figure 6 below. Funding is formally allocated at HMT Main and Supplementary Estimates, and is formally reflected in the Scottish Budget, as well as in the Scottish Budget Spring and Autumn Revisions (which allow additional consequentials received in-year to be formally allocated to Scottish Budget allocations).

Figure 6: Timeline of in year fiscal movement to Scottish Government funding 2020-22

Date	Change in 2020-21 funding
March 2020 – May 2020	UK Government provides numerous (indicative) estimates of Covid-19 funding available in 2020-21. £3.1 billion was formally added at Main Estimate in May 2020. The informal estimate had reached £3.6 billion which was allocated by the Scottish Government in the Summer Budget Revision on 27th May 2020.
27th May – 24th July 2020	HM Treasury continue to provide informal estimates of Covid-19 funding available. The figure reached £5.7 billion (£2.6 billion more than the confirmed amount from Main estimate)
24 July 2020	HM Treasury confirmed a minimum level of guaranteed Resource funding for Devolved Governments to support the Covid-19 response – an uplift of £800 million to £6.5 billion for the Scottish Government.
9 October 2020	HM Treasury confirmed a further £700 million Resource uplift to a guaranteed total (floor) of £7.2 billion.
5 November 2020	HM Treasury announced a further £1 billion Resource uplift to the guaranteed total (now £8.2 billion in total).
24 December 2020	HM Treasury confirmed a further £400 million Resource uplift to the guaranteed total (**now £8.6 billion in total**)
15 February 2021	UKG announce a further £1.152 billion of Barnett consequentials to help tackle Covid-19 (£874 million Resource, £237 million Capital and £41 million of Financial Transactions). This **funding was to be carried over into the 2021-22** financial year. **This increased the overall guarantee to £9.7 billion**
25 February 2021	The final tranche of the £8.6 billion of 2020-21 consequentials were allocated in the Spring Budget Revision (earlier allocations were included in the Summer and Autumn Budget Revisions)

Date	Change in 2021-22 funding
25 November 2020	UK Spending Review confirms allocation of £1.328 billion of Covid-19 consequentials for the Scottish Government in 2021-22
15 February 2021	UKG announced a further £1.152 billion of Barnett consequentials in financial year 2020-21 to help tackle Covid-19 (approx £874 million Resource, £237 million Capital and £41 million of Financial Transactions). **This funding was to be carried over into the 2021-22** financial year.

3 March 2021	UK Budget allocated £1.206 billion of Covid-19 consequentials to the Scottish Government for 2021-22.
14 April 2021	A further £1 billion of Covid-19 consequentials were allocated to Scottish Government at the UK Main Estimates bringing the total for 2021-22 to £3.534 billion (including the consequentials carried forward **the total consequentials for 2021-22 is £4.686 billion**)
27 October 2021	UK Government included £516 million of additional Covid-19 consequentials for 2021-22 as part of the UK Spending Review 2021.
14 December 2021	UK Government announced £220 million of additional Covid-19 funding for the Scottish Government to address the Omicron wave, doubled to £440 million on 19 December.
January 2022	During January 2022 HM Treasury officials provided Scottish Government officials with indicative figures for Covid-19 funding. These estimates changed considerably but one formal confirmation at this time was that £143 million of Covid-19 related test and trace funding (but not consequentials) was to be in addition to (rather than within) the Omicron funding announced in December 2021.
21 February 2022	The final Supplementary Estimate numbers provided a further £125 million of Resource Covid-19 consequentials, and £55 million of additional Covid-19 Capital consequentials, confirming a total increase of £762 million since the previous estimate in October 2021. This brought total Covid-19 funding received in 2021-22 to £5,964 million (£5,631 million Resource; £333 million Capital) including the Test and Trace budget cover transfer and the funds deferred from 2020-21. The total Covid-19 funding received across both years (on the same basis) was just over £14.5 billion.

54. In managing the Covid-19 pandemic, the Scottish Government flexed existing budget management and monitoring arrangements to support the funding/spending decisions taken by Scottish Ministers. This included the provision of regular management information to budget holders, to the senior management team and to Ministers, detailing current budget allocations, spending against individual programmes and available funding. Budget revisions were regularly presented to the Scottish Parliament (including an additional Summer Budget Revision) transparently setting out all additional funding allocations, with scrutiny at relevant Committee sessions.

Key decision-makers for allocation of funding

55. As part of the four nations response, the First Minister and other Scottish Ministers were involved in discussions in various fora which had consequences for Scottish Government funding. However, there is no formal requirement of the UK Government to consult with

the Devolved Administration and all decisions on the level and timing of grant funding for the Scottish Government remain the prerogative of the UK Government.

56. With respect to allocations of consequential funding in Scotland from the UK Government, decisions were taken collectively by the Scottish Cabinet on how all funding would be prioritised and allocated in Scottish budgets, whilst living within the legal duty to balance the budget in year.

Contribution by the Scottish Government discussions or negotiations to funding decisions taken by the UK Government

57. The Scottish Government worked closely with the UK Government throughout the pandemic at both ministerial and official levels. For example, over the pandemic the First Minister was included in various COBR meetings, and Scottish Government officials were having daily calls with HMT counterparts at key stages. Another example was on personal protective equipment (PPE), in respect of which, following early discussions involving the four nations to explore UK-wide procurement options, the Scottish Government pressed HMT to allocate consequential funding in the normal way and HMT subsequently did so. However, all decisions on the level of grant funding were ultimately taken by the UK Government.

Effectiveness of the funding process

58. The Scottish Government allocated Covid-19 consequentials broadly in line with the UK funding from which they arose, although the Scottish Government delivered some funding streams slightly differently to UK Government, as well as developing some bespoke spending budgets to meet local needs.

59. The operation of the SoFP means that funding for Devolved Administrations is set by reference to equivalent UK funding allocations. This process did mean that there were points where the Scottish Government was in a position where it was having to fit in with or react to UK Government policy decisions rather than planning what might be the most effective solutions for Scotland with knowledge and full agency over contingency funding available. The introduction of the funding guarantee described above was an attempt to support more effective planning by Devolved Administrations, but minimum funding levels were revised significantly over the course of the period, which meant that Scottish

Ministers were potentially reacting to UK decisions rather than proactively able to respond in accordance with their assessment of priorities.

60. The sequencing and announcement of UK Government departmental funding decisions dictated the value and the timing of the increases to the Block Grant to the Devolved Administrations and impacted on the nature and timing of financial commitments that could be made by the Scottish Government.

61. An important consideration of the effectiveness of the funding arrangements related to the timing of the increases to the Block Grant to the Devolved Administrations. The announcement of funding additions were not always aligned with either the rate and spread of the pandemic across the four nations within the UK, or the dynamic nature of public health responses across different parts of the UK. The lack of alignment in funding was both in terms of timing and scale. While the overall arrangements remain determined by the SoFP, processes or considerations were developed during the course of the pandemic to aid planning and management. Combined with limited advance notice of funding decisions, Scottish Government experienced operational planning challenges at points over the pandemic period.

62. The Scottish Government made over 300 spending announcements during the pandemic, with increased sums being spent ahead of parts of the country entering periods of restrictions. Scottish Ministers did publicly state that adequate funding was not available to support their desired response to the Omicron variant.

63. Scottish Ministers repeatedly requested additional budget flexibilities (such as the ability to borrow for the pandemic) under the Fiscal Framework to support their response to the pandemic but these were not granted. This exposed the limitations of the Fiscal Framework in allowing Scottish Government the flexibility to respond to the degree of volatility that the pandemic presented. As above (paragraphs 51-53) however, the UK Government did provide a guaranteed consequential uplift.

Disputes on funding between the Scottish Government and the UK Government

64. There was engagement on how Covid-19 related funding changes were presented, largely related to timing differences between UK announcements and formal allocation of funding to Scottish Government aggregates. This led to differences of opinion on what constituted new funding. Final allocations of funding were ultimately calculated by

reference to standard Barnett arrangements and there is no suggestion that the final allocation was not calculated transparently.

65. In addition, there was a dialogue with HMT over the tax treatment of Scottish Government bonus payments for social care workers and National Health Service workers, where the Scottish Government argued that these payments should be tax exempt. Negotiations did not progress to the point of discussing mechanisms, and HMT chose not to make an exemption in this instance, but to maintain the prevailing devolved settlement and interpretation of tax rules, which meant that workers paid tax on their bonuses.

66. Although **not** specific to funding for the pandemic response, in 2022 the Scottish and UK Governments did reach an agreement to settle a longstanding dispute relating to a 'spillover effect' arising from changes to the Personal Allowance (PA). 'Spillover effects' are defined in the 2016 Fiscal Framework Agreement, and concern decisions by either government that result in costs to the other via the operation of the Fiscal Framework.

67. In this instance, any UK Government increases to the PA have a disproportionate impact on Scottish revenues through the Fiscal Framework, due to differences in the income distribution – essentially the higher proportion of lower income taxpayers in Scotland compared to rest of the UK. Consequently, a direct spillover effect arose from UK Government changes to the PA since 2017.

68. After a period of negotiation, an agreement between the Scottish and UK Governments was reached in July 2022 on settling the historic element of the PA spillover dispute, in line with assumptions made within the Scottish Budget 2022-23. The PA agreement means the Scottish Government received an additional £375 million in 2022-23 from the UK Government, as compared with the position if an agreement had not been reached.

Involvement of the Scottish Government in decision making on the level of funding to be provided by the UK Government

69. Scottish Ministers (and officials) were involved in discussions that had spending consequences as part of the four nations response, but maintained no formal decision-making capacity. Indeed, the fact that funding for Scotland could only be confirmed or provided following decisions affecting UK Departmental allocations was a point which Scottish Ministers repeatedly raised, and which ultimately led to the HMT funding

guarantee. For Health funding specifically, participation in the UK wide funded four nations elements of the Covid-19 response enabled a range of measures (including population-wide testing) which enabled the implementation of isolation to reduce transmission. For the main phases of the pandemic, UK Government funding decisions had no impact on specific decisions, and no, or negligible cost consequences of implementing or altering isolation guidance in Scotland.

70. There were points when the Scottish Government would potentially have taken additional steps in response to the pandemic but were constrained by the funding position and the lack of devolved influence over UK Government budget decisions. One example of this was the UK Government's decision-making on the UK-wide Job Retention Scheme, or "furlough", which was entirely funded and administered by UK Government, but is an example of where decisions were taken unilaterally by the UK Government and announced with little prior notice to the devolved administrations. The quantum of support available through the furlough scheme to employers and workers was significant and welcome, and financial support offered by the Scottish Government was additional to that funding and targeted at businesses, sectors or workers most impacted. The inability to influence decisions on the extension of or eligibility for the furlough scheme was a significant constraint on the Scottish Government. In health, UK Government funding did impact on Scottish Government's ability to implement different measures (such as PPE, testing infrastructure, vaccine supply and roll out), although less so for measures that could be achieved through guidance, messaging and legislation.

71. In summary, the Scottish Government had a general concern that decisions taken at the UK-wide level but affecting Scotland were not made with sufficient recognition of circumstances in Scotland, and where the different circumstances in each of the devolved nations' experiences of the pandemic were not reflected in the fiscal arrangements in place.

72. The 13 benefits are Adult Disability Payment, Scottish Child Payment, Best Start Foods, Best Start Grants (Pregnancy and Baby, Early Learning, and School Age), Carer's Allowance Supplement, Funeral Support Payment, Job Start Payment, Young Carer Grant, Child Winter Heating Assistance, Child Disability Payment, and Winter Heating Payment.

Statement of Truth

I believe that the facts stated in this witness statement are true. I understand that proceedings may be brought against anyone who makes, or causes to be made, a false statement in a document verified by a statement of truth without an honest belief of its truth.

Signed: Personal Data

Dated: 23/06/2023