

THIS PAPER IS FOR INFORMATION

SC(20)37

RESTRICTED HANDLING

SCOTTISH CABINET

COVID-19: BUDGET POSITION

PAPER BY THE CABINET SECRETARY FOR FINANCE

Purpose

1. Cabinet is invited to note the Budget position in the light of the COVID-19 outbreak and endorse action I am setting in hand to ensure we work across Government in ways that support both our urgent responses to the outbreak and maintain effective control over the public finances.

Timing

2. This paper is due to be considered at Cabinet on 24 March.

Contribution to the Government's Purpose and National Outcomes

3. The Budget supports the achievement of the Government's Purpose and progress across all the National Outcomes.

UK Government Budget announcements

4. The details of the Scottish Budget consequentials notified in respect of UK Government COVID-19 announcements are summarised in **Table 1** below:

Table 1: 2020-21 consequentials from UK Government COVID-19 announcements

| | £ million |
|----------------------------------------------------------|--------------|
| Local authority Hardship Fund | 50 |
| Business rates reliefs | 105 |
| Business support grants | 215 |
| Total business measures | 370 |
| £5 billion emergency response fund (NHS/public services) | 410 |
| Total UK Budget, confirmed 16 March | 780 |
| Extended business rates reliefs | 930 |
| Extended business support grants | 980 |
| Total supplementary business package on 17 March | 1,910 |
| Total as at 17 March | 2,690 |
| Nurseries rates holiday (consequentials not yet public) | 13 |
| Total as at 19 March | 2,703 |

5. As part of the UK Budget on 11 March, the Chancellor provided a £12 billion fiscal stimulus specifically targeted at coronavirus measures, including at least £5 billion for the NHS and other public services and £7 billion in financial support for businesses, self-employed and vulnerable people – comprising a mix of reserved and devolved measures. The associated Scottish Budget consequentials were only confirmed in the following days; however on the day of the UK Budget £640 million of 'non-COVID' consequentials were confirmed (i.e. separate from the COVID-related £2.7 billion), which was in line with what had been assumed for the Budget Bill (which has now been enacted).

6. On 17 March, the UK Government announced a further support package for businesses consisting of £330 billion (15 per cent of GDP) in government-backed loan guarantees and a further £20 billion of tax cuts and spending. The direct fiscal stimulus is comparable to other countries at 1.5 per cent of GDP.

7. On 20 March, the UK Government announced a further business and welfare support package including: payments towards wages; VAT and income tax payment deferrals; extending the Business Interruption Loan Scheme interest-free period; increasing standard rates of Universal Credit and Tax Credits; and support for renters. These are all UK-wide measures with no associated consequentials. The Chancellor is expected to announce further support for specific industries, particularly aviation and travel, for the self-employed and for families.

Scottish Government Budget announcements

Support for business

8. On 14 March, following the UK Budget, the Scottish Government announced a £320 million package of support for businesses to limit the impact of COVID-19. On 18 March, the Cabinet Secretary for Economy, Fair Work and Culture announced a further £1.9 billion package of business support, and the Cabinet Secretary for Communities and Local Government announced a £350 million Supporting Communities Fund.

9. All consequentials from the Chancellor's announcement on 17 March will be passed on, with every penny to support Scottish business and employers. We will be mirroring the UK Government's package of measures in full.

10. In her statement on 18 March, the Cabinet Secretary for Economy, Fair Work and Culture set out three key aims:

- ◆ Keeping companies in business and keeping productive capacity up so they can continue after the crisis;
- ◆ Maintaining employment levels and providing income support; and
- ◆ Ensuring staff are supported to self-isolate and provide care to loved ones.

11. The total of £2.2 billion of support for business from the announcements of 14 and 18 March includes:

- ◆ A 100 per cent Non-Domestic Rates relief for retail, hospitality and leisure sectors;
- ◆ 1.6 per cent Non-Domestic Rates relief for all properties across Scotland, effectively reversing the planned below inflation uplift in the poundage;
- ◆ Delivering £10,000 grants to small businesses receiving the Small Business Bonus Scheme (SBBS) or Rural Relief, and properties eligible for SBBS but in receipt of Nursery Relief or Disabled Relief; and
- ◆ £25,000 grants to businesses with a rateable value between £18,000 and £51,000 in the retail, hospitality and leisure sectors.

Support for communities

12. In her statement on 18 March, the Cabinet Secretary for Communities and Local Government announced a package which comprises:

- ◆ A Hardship Fund of £50 million to go direct to local authorities to support their own resilience and hardship plans, with freedom and flexibility on how they deploy the funds;
- ◆ Additional support of £45 million for the Scottish Welfare Fund to meet additional demand for Crisis Grants and Community Care Grants;
- ◆ Increased investment in Council Tax Reduction and benefits of £50 million to help those on lower incomes meet their council tax liability;
- ◆ A Supporting Communities Fund of £40 million to help organisations who are not registered charities, including small scale community groups;
- ◆ A Community Wellbeing Fund of £50 million to cover all charities, third sector and social enterprises;
- ◆ A Food Fund of £70 million to help equip Resilience Partnerships led by local authorities to provide food to people who would otherwise be unable to access it;
- ◆ A Third Sector Resilience Fund of £20 million to support charities and social enterprise with their cash flow; and
- ◆ The remaining £25 million in a Reserve Fund to allow us to respond quickly with targeted additional support.

Support for the NHS

13. At the UK Budget 2020, the Chancellor confirmed that *“whatever extra resources our NHS needs to cope it will get...whether its millions of pounds or billions of pounds... whatever it costs, we stand behind our NHS”*. The Chancellor also confirmed a £12 billion fiscal stimulus, including a £5 billion response fund to *“support the NHS and other public services to respond to the outbreak and to return to normal afterwards”*.

14. The Scottish Government will receive £410 million from the UK Government as part of this response fund, and the Cabinet Secretary for Health and Sport has confirmed that all of this will be passed on to support frontline NHS services in Scotland.

15. We are working closely with the UK Government to ensure that all additional costs for health and care services are fully funded, in line with the Chancellor's commitment.

2020-21 Financial Position

16. These are exceptional circumstances and I am committed to providing the necessary level of budgetary support to meet what are utterly essential interventions in our economy, the public service response and help for our communities. It is clear from the approach being taken by HM Treasury that normal fiscal conventions no longer apply, in common with other countries around the world. All of us recognise that there will be knock-on impacts for the public finances and our economies in future, but the imperative is to deal with the issues that are presenting now and mitigate future impacts. While this paper therefore presents a sober assessment of the budget position, I wish to be clear that this is not intended to suggest barriers to our urgent response. We do however need to ensure that there are suitable processes in place to manage the public finances appropriately over this period and we are conscious of the future implications of decisions taken now.

17. You are all aware that the 2020-21 Budget already embedded a considerable financial challenge with us collectively having to manage a significant over-commitment in the course of the year. I am aware that you are all facing large numbers of calls for additional financial support. Against that background we need to be carefully tracking and managing additional commitments we are making against the evolving funding position as further consequentials become available from the UK Government. To this end, my officials have issued guidance to Accountable Officers to ensure decision-making in authorising spending is as robust as possible and supports a clear process for tracking our financial position.

18. My analysis shows our commitments made to date are likely to exceed the confirmed consequentials we have received. Current projections of Health COVID-19 costs are exceeding the £410 million consequentials on the UK £5 billion response fund by £200 million. We will pursue full funding for these costs from the UK Government (in line with UK announcements), but at the moment those additional costs represent an unfunded pressure on our budget. The £350 million of support for individuals and households announced yesterday was supported by only £50 million of confirmed consequentials, with no guarantees that UK support arrangements that are announced in this area will generate consequentials to cover all or part of the costs. (Indeed, if the proposals put forward in this area are UK-wide, then we will potentially need to fund the entirety of the shortfall from elsewhere in our budget.)

19. In aggregate, the pressures and over-commitments we have, and the additional funding requests I am aware of, exceed the confirmed budget by in excess of £1.7 billion. This is before allowing for funding requests that I know I have not yet received, for example on the Rail Franchise and Bus Operators. I will be pursuing the maximum amount of funding from HM Treasury to support the many additional costs we face, and indeed, I expect additional consequentials in areas where the UK is facing similar calls. But these will not cover all the decisions we take: we must also therefore be clear on where offsetting reductions in funding can be made.

20. Alongside this, I recognise that all Cabinet Secretaries are having to take tough choices about areas of policy and programmes which it is not feasible, or not appropriate, to pursue at this time. As we all pare back activity to focus on our response to COVID-19, as well as our absolutely core statutory obligations and critical functions, we must recognise the implications for the Government's targets and commitments – and equally we will need to release money set to be invested in these areas. Once this consideration has progressed, we will have a fuller understanding of the net impact of COVID-19 on our public finances.

Capital implications of UK Budget

21. The UK Budget gave rise to £125 million more in capital consequential than the £326m that had been already assumed in the Scottish Budget. Of this, £4 million was identified as consequential for Health for COVID which I propose to pass on in full. Of the remainder, £50 million is required to fund the capital increases for local government and the police agreed with Opposition parties and which formed part of the deal to secure passage of the Budget Bill. Consequently, £71.1 million remains unallocated, as below:

| Funding Source | £ million |
|----------------------------------------------------------------------|------------------|
| Additional CDEL Consequential from UKG Budget (a) | 409.5 |
| Non-Barnett Additional CDEL from UKG Budget (b) | 41.6 |
| Total Additional CDEL from UKG Budget (c) = (a)+(b) | 451.1 |
| SG Total CDEL Assumption (d) | 326 |
| COVID-19 Consequential (e) | 4 |
| Unallocated CDEL before budget deal funding (f) = (c)–(d)–(e) | 121.1 |
| 20-21 Assumed underspend for budget deal (g) | 50 |
| Unallocated CDEL after assumed underspend (h) = (f)-(g) | 71.1 |

22. In the current circumstances, I would recommend that remaining funds should first be prioritised for COVID-19, and held for that purpose whilst the situation evolves and disbursed as requirements become clearer. I am aware that some portfolios had anticipated 2020-21 capital spending pressures pre-COVID, although the situation will be fast-moving as some major developments are less able to proceed at the original speed. We can keep developments under review. It will also be possible to explore how the Infrastructure Investment Plan and Capital Spending Review might identify priority economic investments, should some of these consequential capital funds remain available for disbursement later in the year.

Other financial risks, including Block Grant Adjustments

23. As the Scottish Budget 2020-21 took place before the UK Budget, the Scottish Budget was based on provisional Block Grant Adjustments (BGAs). We agreed with HM Treasury that the Scottish Government could choose whether the Scottish Budget would use the provisional BGAs or up-to-date BGAs provided alongside the UK Budget.

24. HM Treasury has now produced updated BGAs from the UK Budget. These mean that **the UK Budget BGAs are £231 million more adverse than the provisional BGAs**. £170 million of this relates to a lower BGA addition for social security, with a higher BGA reduction of £62 million for tax.

25. However, neither the OBR's forecasts used for the UK Budget nor the SFC's forecasts used for the Scottish Budget currently factor in the impact COVID-19 will have on the economy, and hence tax receipts. As such, forecasts of Scotland's net position are more uncertain than usual, potentially increasing the risks of larger reconciliations in the future. It is important to note, however, that the Fiscal Framework currently cushions the Scottish Budget from any UK-wide macroeconomic shocks. This is because Scotland's net position depends on how Scotland's economic and tax performance compares to the rest of the UK. As a result, if the COVID-19 outbreak, and resulting economic shock, reduces tax receipts in the two countries by a similar amount, Scotland's spending power would be unchanged from its current position.

26. As above, the Scottish Government can choose to use either the provisional or UK Budget BGAs. The latter should be more accurate. Using the former would protect the Scottish Budget in the short-term, but at a cost of increasing the risk of having to manage larger reconciliations in future. For income tax, reconciliation would be in 2023-24, but for social security and devolved taxes this would happen initially in the autumn of 2020-21 (with a final tax reconciliation in 2022-23).

27. If we choose to continue with the provisional BGAs from the Scottish Budget we will therefore have to be prepared to manage increased reconciliation impacts in-year – this is in addition to any forecast error we would face in a normal year, which could be substantial in itself. On the basis of the forecasts underpinning the updated BGAs, the increased in-year reconciliation impact would be £206 million of the £231 million total difference between the provisional and updated BGAs (the remainder relates to Income Tax which is not reconciled until 2023-24).

28. We have already planned to use £207 million of the maximum permitted £300 million resource borrowing in 2020-21 to offset the effect of forecast error. The remaining £93 million could be used to manage any negative in-year reconciliations relating to devolved taxes or social security – including the increased risk relating to using provisional BGAs.

29. However, £93 million may well not be large enough to cover the scale of in-year reconciliations. There is also £102 million of resource in the Scotland Reserve, but it has previously been envisaged for use to manage a significant future income tax reconciliation in the Scottish Budget 2021-22.

30. In these circumstances, I plan to seek extra flexibility from the UK Government, as set out below. I therefore propose to use the provisional BGAs as this would avoid committing to spending cuts now, pending further discussions with the UK Government. However, we will have to plan for how reconciliations could be managed if we cannot secure further flexibilities.

31. I propose to request that the UK Government agree:

- ◆ To immediately expand our resource borrowing and Reserve drawdown powers. We have set out a previous request to the Chief Secretary on this. However, in light of the systemic shock to the economy we would seek an immediate expansion of the total annual drawdown to £600 million, which is equivalent to the amount allowed under the Scotland Specific economic shock provisions outlined in the Fiscal Framework. We would also seek to expand the tenor of this borrowing to at least eight years and have unrestricted use of the facility (up to £600 million) for financial years 2020-21 and 2021-22; and
- ◆ To enable us to defer the impact of the social security and devolved taxes BGAs beyond 2020-21, either by writing off a proportion of the deficit in recognition of the high level of uncertainty created by the late UK Budget and the lack of track record on social security expenditure or by cancelling the in-year reconciliation in 2020-21, with only a final reconciliation taking place in 2022-23.

Relationship with UK Government

32. We are working closely with HM Treasury both at Ministerial and official level.

33. I had a productive telephone conference with the Chief Secretary to the Treasury and the Finance Ministers of the other devolved administrations on 18 March. I emphasised that it will cost Scottish Government more to replicate UK Government policy measures than Barnett consequential will cover because of our different tax base. I also noted that a key issue is how to get money to people quickly, for example through wage subsidies and support to those who are vulnerable and most in need.

34. The Chief Secretary to the Treasury and devolved administration Finance Ministers have agreed to a further phone conference in the week of 23 March. However, this engagement could be more meaningful still, with UK Ministers facing similar challenges to us in the context of fast-moving decisions. In particular, the Cabinet Secretary for the Economy, Fair Work and Culture and I are both of the view that there should be more engagement with us in shaping policy and funding decisions, along the lines that the COBR(M) mechanism provides in relation to the operational response.

35. It remains essential that we take the most effective decisions for the people of Scotland and the Scottish economy. There have been clear benefits of a collaborative approach with the UK Government in clear public messaging and policy alignment. **I will continue this approach to cross-government working.**

Action for portfolios

36. In addition to the guidance already being applied by Accountable Officer, I propose the following:

- (i) All portfolios work with my officials using the existing expenditure guidance/framework issued last week to identify additional funding requests we envisage making of the UK Government, both in the very short term but also looking further ahead – I will then raise these with HM Treasury;

(ii) We will join up closely with work the Permanent Secretary has already commissioned on the priorities of government, to ensure this also includes explicit consideration of areas where spending will reduce or could be reduced, as Government activity is focused where it is most needed. As a first step, I have asked for an urgent finance analysis of the reprioritisation responses to the commission, to help identify emerging and possible contingency savings options. Unless it quickly becomes clear that planned spending will naturally decline as a result of COVID-19 impacts to a sufficient extent to balance the 2020-21 budget, I will commission further work from all portfolios on options to reprioritise spend;

(iii) I will work with portfolios to develop a strategic framework for the next nine months, through which we can consider the likely shape of the budgeting requests we will need to consider at different stages of our COVID-19 response – including recovery;

(iv) I will work closely with the Cabinet Secretary for Economy, Fair Work and Culture, the Cabinet Secretary for the Rural Economy and Tourism, and the Cabinet Secretary for Transport, Infrastructure and Connectivity – in particular – to develop a coherent economic and finance response, building on the discussion at the meeting of COVID Economy Ministers Group on 20 March.

Potential tax support options

37. Whilst I am not currently proposing any tax interventions beyond our non-domestic rates measures, I include some initial options analysis at **Annex A** for information.

Spending Review processes

38. As part of the work we have all done on reprioritisation, my intention is to postpone the Medium Term Financial Strategy due for May and the multi-year Resource Spending Review that was an option for us this year. Instead, we should focus later in the year on what will be a very challenging Budget 2021-22 and how it respond to the impacts of COVID-19 and underpins our programme going forward. I am keeping work on the Capital Spending Review and Infrastructure Investment Plan, due to publish in June, in progress because the outputs could be key to our economic recovery approach. Clearly, however, the focus and format of these pieces of work and the way in which they are developed will need to evolve with wider events and organisational capacity, in consultation with the Cabinet Secretary for Transport, Infrastructure and Connectivity.

Parliamentary handling

39. The possibility of a COVID-19 Bill in the Scottish Parliament is under consideration which could give a legislative vehicle for any changes to powers required in support of this work. As the Budget Bill 2020-21 has now received Royal Assent, we have wide discretion to make future changes to budget allocations.

Decisions

40. **I invite Cabinet to:**

- (a) **Note the update provided on our overall financial position;**
- (b) **Note my intention to apply provisional Block Grant Adjustments and seek further fiscal flexibilities from the UK Government; and**
- (c) **Agree that all portfolios should work with me to identify options for reprioritising planned expenditure at scale in 2020-21, building on the Permanent Secretary's commission, either through pro-active policy decisions or as a result of an assessment that planned activity will change as a result of COVID-19.**

KF
March 2020

COVID-19: BUDGET POSITION

TAX OPTIONS

1. The following table provides an overview of the potential short term tax measures that could be considered to support individuals and/or business over the coming months. The main aims of these would be twofold: to provide immediate support for households and businesses who are and will experience cash flow issues, and also to protect jobs, by reducing costs for businesses. Longer term economic stimulus will require a different approach and more detail can be advised going forward.

2. Although income tax on non-savings and non-dividend (NSND) income is partially devolved, the tax is administered and collected by HMRC, who have advised that any tax deferrals and payment holidays would have to be considered and implemented at a UK level. For reserved taxes, any decisions on operational or policy changes would fall to the UK Government. Therefore, the main recommendation is to ensure that there is Ministerial and official co-ordination and collaboration at a UK-wide level on any tax changes.

3. The Tax Directorate is liaising with HM Treasury and HMRC colleagues to try to ascertain current policy thinking at an official level.

4. In her speech on March 18, the Cabinet Secretary for Economy, Fair Work and Culture called on the UK Government to reduce the pressures on business through, for example, tax holidays through PAYE breaks, VAT reduction and the suspension of the apprenticeship levy. Stakeholders have been lobbying this week for Government to provide further support in some of these areas with the focus being on VAT, NICs and PAYE income tax breaks, alongside a wider stimulus package of employment support.

5. While changes to devolved taxes may impact the Scottish Budget directly, the costs of implementing reductions in reserved taxes in response to COVID-19 would accrue to the UK Exchequer and are likely to be funded through borrowing in the first instance. In the longer term, the burden of paying back these loans would be shared by all taxpayers in the UK, for example through future tax rises or spending cuts, including to the Scottish block grant.

6. It is important to note, however, that many of these tax measures would do little to support the most vulnerable households, i.e. those earning less than the Personal Allowance for income tax (£12,500) or starting threshold for NICs (£9,500) and those who have already been made redundant.

7. The Chancellor is expected to announce further financial support for households later this week but is likely to focus on social security, rather than tax. The Chancellor is also reportedly considering to “urgently develop new forms of employment support”, looking at models from other countries. This could mirror schemes in Denmark, Sweden or Germany and reflects calls from the Glasgow Chamber of Commerce for the Government to provide wage subsidies to businesses to avoid large lay-offs.

OFFICIAL-SENSITIVE

| Option | Aim and Economic Impact | Fiscal impact | Feasibility/operational issues |
|-----------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------|
| Income Tax deferrals/ PAYE and SA payment holidays | Deferral – would have to pay back in the future. Addresses cash flow issues but does not reduce tax burden; Keep liquidity constrained individuals and businesses afloat and protect sectors hit hardest by the collapse in demand. | Devolved power for rates and bands only, all else needs UKG legislation; No immediate impact on Scottish Budget if receipts received later in the financial year. Impact on tax revenue for future Budgets if repayment in next financial year. | HMRC advised this is only possible at a coordinated UK-wide approach; Can't be targeted to specific sectors due to operational issues. |
| Cut to Employers' NICs | Reduce labour costs for firms to protect jobs and livelihoods; Approach favoured by the Institute for Fiscal Studies (IFS) Current contribution is 13.8% for each employee. | Reserved power; Reducing employers' NICs by 1p (Class 1) would cost UKG £6.2 billion (0.3% of GDP) | |
| Cuts to employee NICs | Increase households' disposable income to cover their bills; stimulate demand in economy; | Reserved power, Reducing employees' NICs by 1pp (Class 1) would cost UKG £4.2 billion (0.2% of GDP) | |
| Cut to VAT | Reduce cost of goods and services to stimulate demand; impact likely to be smaller than during financial crisis, due to social distancing measures and total collapse in demand in some sectors (travel, hospitality) | Reserved power; Reducing VAT by 1pp would cost UKG £6.7 billion (0.3% of GDP) | Can be implemented immediately; |
| Suspension of apprenticeship levy | Reduce labour costs for firms. The levy is payable by all employers with an annual pay bill of more than £3 million at a rate of 0.5% of their total pay bill | Reserved power; Apprenticeship levy currently generates £3 billion in revenues which supports funding of apprenticeship schemes. | |
| Cuts to income tax rates | Increase households' disposable income to cover their bills; stimulate demand in economy; | Devolved power for rates and bands; A 1p cut in Scottish Basic Rate costs £180m for Scottish Budget; Net position in Scottish Budget would depend on UK approach to income tax (through BGA) | Requires another Scottish Rate Resolution to be agreed by Scottish Parliament prior to April 6; Additional HMRC administration requirements. |
| Cut to Corporation Tax | Reduce tax burden on capital for firms | Reserved power; Reducing corporation tax 1p would cost UKG £2 billion (0.1% of GDP) | |