Implementing the Scottish Government's Renegotiated Fiscal Framework

December 2023

Scottish Government
Riaghaltas na h-Alba

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Background

1. The 2016 Fiscal Framework Agreement set out the fiscal arrangements required to enable the devolution of new tax and social security powers through the 2016 Scotland Act.

2. The agreement also said that a review, underpinned by an Independent Report on the operation of the Block Grant Adjustment (BGA) mechanism, would be conducted after a Parliament's worth of experience.

3. As a result of this process, a new Fiscal Framework Agreement was published on 2 August 2023, alongside the Independent Report.

4. We are committed to transparency and improving public understanding of the Scottish Government's fiscal powers. This annex provides detail on how our renegotiated fiscal powers have supported decisions at this budget.

Summary of new powers

5. The main changes to the agreement are that:

- The Indexed Per Capita (IPC) mechanism for calculating BGAs will be adopted on a permanent basis;
- Scotland's resource borrowing powers for forecast error will increase by £300 million (to £600 million) from 2024-25, and, additionally, will be indexed in line with inflation using 2023-24 as the baseline year. The associated Scotland-specific economic shock provision has also been removed;
- Scotland's capital borrowing powers will no longer be fixed, and instead the £450 million borrowing limit for capital expenditure will also increase in line with inflation from next year, using 2023-24 as the baseline year;
- The drawdown restrictions on the Scotland Reserve will be abolished. The overall reserve limit will also be indexed in line with inflation from 2024-25;
- The increases in line with inflation to the resource and capital borrowing limits and the Scotland Reserve limit will be measured by the GDP deflator;
- The reduction applied to the Scottish Block Grant as part of the devolution of Crown Estate revenues – currently £6.6 million – will increase incrementally to £40 million by 2028-29, at which point it remains flat and unindexed. The profile for this reduction from 2024-25 is £10m / £10m / £15m / £20m / £40m;
- Consideration of when and how to implement VAT Assignment will be picked-up in a future meeting of the UKG/SG Joint Exchequer Committee (JEC).

- The BGA for Fines, Forfeitures and Fixed Penalties will be converted to a fixed amount of £25 million, given the relative steadiness of the income stream;
- The baseline addition to the block grant for the UK's Coastal Communities Fund will be subject to the usual operation of the Barnett Formula. This will have no immediate effect on the Scottish Government funding position.

How these new powers impact the Scottish Budget 2024-25

Borrowing & Reserve limits

6. As a result of changes agreed in the revised Fiscal Framework, borrowing and reserve limits for 2024-25 will increase as follows:

£m	2023-24	2024-25
Capital Borrowing (Annual)	450	457.5
Capital Borrowing (Cumulative)	3,000	3,050.3
Resource Borrowing (Annual)	600*	610.1
Resource Borrowing (Cumulative)	1,750	1,779.4
Reserve	700	711.7

* Would have been £300 million in 2023-24 were it not for Scotland Specific Economic Shock Provisions having been triggered.

NB: Resource Borrowing continues to be permitted for in-year cash management and for forecast error only.

7. The increase to the resource borrowing limit for forecast error means that the Scottish Government plans to borrow £338 million in 2024-25 to cover net negative forecast error reconciliations in full. This is £38 million more than would have been possible under the previous Fiscal Framework agreement.

8. These additional borrowing flexibilities allow the Scottish Government to effectively spread any negative budgetary impact of forecast errors across multiple years, rather than having to meet the full cost in a single year. Doubling the annual resource borrowing limit, and growing the limits in line with inflation, is a significant improvement in the Scottish Government's ability to deal with the risk of forecast error compared to the original agreement.

9. The uprating of the cumulative capital borrowing limit for inflation in future years increases flexibility. This can be used in a variety of ways, to expand borrowing in the short term without compromising fiscal sustainability and also to look at alternative sources and structures for Capital Borrowing in the medium term. It is in this light that the Scottish Government intends to explore the issuance of bonds as a means of funding capital investment. More on the Scottish Government's plans for bonds, and Capital Borrowing more broadly, can be found in the separate memorandum published at https://www.gov.scot/isbn/9781835218143.

Scotland Reserve

10. By removing the drawdown limits, and increasing the reserve cap in line with inflation, the risk of the Scotland Reserve limits being breached (and the funds lost to the Scottish Government) have been significantly reduced. While this has not impacted on policy decisions for the Scottish Budget 2024-25, longer term, the usability of the Scotland Reserve will improve.

BGAs: Benefit of maintaining IPC

11. The authors of the Independent Report jointly commissioned by the Scottish and UK Governments ahead of the Fiscal Framework Review noted that there can be areas of conflict between some of the Smith Commission principles – notably the “No Detriment” and “Taxpayer Fairness” principles. The Scottish Government has consistently argued that, for the BGA methodologies, the No Detriment principle should be prioritised to protect the Scottish Budget against the risk of slower population growth in Scotland relative to the rUK. This is particularly the case given that many of the key levers needed to address this risk, such as migration policy, remain reserved.

12. The Scottish Government successfully secured the Indexed per Capita methodology, which fully protects Scottish Block Grant Adjustments from population risk. As noted in the Independent Report, it is estimated that the ongoing use of the Indexed Per Capita methodology for calculating Income Tax Block Grant Adjustments alone could be worth around £500 million a year by 2026 - 27 - when compared with other methodologies that were considered, such as HM Treasury’s preferred ‘Comparable Model’, which does not fully protect from relative population growth risk.

Crown Estate Scotland

13. In 2024-25 the deduction applied to the Scottish Block Grant as part of the devolution of Crown Estate revenues will increase to £10m (a c.£4m increase).

14. That is within the context of:

i. Crown Estate Scotland (a Self-Financing Public Corporation) having generated over £100 million net profit/revenue in FY 2022-23 (including Scotwind option fees) with this surplus being returned in full to the Scottish Consolidated Fund to support wider public spending;

ii. Budgeted Crown Estate Scotland net profit/revenue remaining above £100 million (including Scotwind option fees) for FY 2024-25; and

iii. the Scottish Budget continuing to benefit from a Barnett share of expenditure in England supported by Crown Estate revenues arising from England, Wales and Northern Ireland.

Fines Forfeitures and Fixed Penalties (FFFP)

15. The latest forecasts for FFFP BGAs for 2024-25 to 2027-28 were c. £26 million for each year. The agreement to fix the BGAs at £25 million provides a projected annual benefit of c. £1 million.

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