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Derek Mackay MSP
Cabinet Secretary for Finance and the Constitution
Scottish Government
St Andrews House
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26 January 2018

Dear Cabinet Secretary,

Thank you for your letter on 25 January 2018 and for our discussions to date. You have noted that our position has given clarity throughout the process, and that our engagement has been constructive. This has always been our intention, however it is clear that there is still substantial ground to cover in the coming days, if we are to reach agreement.

I would like to share our responses to the key points we have discussed.

Public sector pay

We have argued for an inflation-based pay settlement across the public sector, as the minimum aspiration. Your suggestion of a significantly higher threshold (£36,480 instead of £30,000) between your proposed 3% and 2% increases is welcome progress, and would grow the proportion of workers covered by the 3% rate from roughly half to three quarters.

However you will appreciate that some concerns remain.

3% represents a real terms pay freeze (based on current CPI inflation) at a time when a number of unions are making a legitimate case for a restoration in the value of public sector pay, which has suffered major real terms reductions over the last decade. There is of course no parliamentary vote specifically on the Scottish Government's pay policy as part of the budget process, however we must be clear that even if agreement is reached on the budget

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more generally, the unions making the case for an above-inflation pay settlement will continue to have our support.

Additionally, this change to the Scottish Government's pay policy will inevitably increase the expectation of a similar approach throughout the wider public sector. I understand your view that it would be inappropriate for the Scottish Government to make a hypothecated payment to local government specifically for a pay increase, as councils themselves are responsible for negotiating a pay settlement which is acceptable to their workforce. However this increased expectation on pay must be seen in the context of other factors increasing demand on local government services. We therefore continue to believe that the Scottish Government must make a fair contribution to the increased financial pressures on local government as a result of this decision, over and above the issues set out below in relation to core funding.

We note that the gap between the overall cost of local government adopting a policy similar to the one you propose, and the cost of an across-the-board 2% increase which many councils are already budgeting for, is approximately £35m.

Provided that a fair contribution is made to local government, we believe that our discussions can make progress.

Low carbon investment

We recognise that there has been positive movement on the balance of investment in 2018/19, but low carbon investment remains well below recommended levels. We can progress discussions on the basis of four issues:

- A clear recognition that the low carbon proportion remains too low, and a public commitment at Stage 1 to a yearly increase in the proportion of capital spent on low carbon projects for the duration of this parliament.
- A specific commitment to establish a pipeline fund to progress local rail projects on community empowerment principles, as proposed in our recent correspondence. I understand that a meeting has been arranged to discuss this specifically.
- An increase in the fuel poverty budget of £2m to maintain its value in real terms.
- The provision of sufficient additional budget to implement the four Marine Protected Areas proposed by SNH in 2014.

We also look forward to hearing your response to the cross-party recommendation on Orkney and Shetland ferry services, which was agreed by all members of the Rural Economy and Connectivity Committee during their budget scrutiny, and noted at paragraph 232 of the Finance Committee report.

Local government

As I have previously indicated, core funding for local government is where we are furthest from agreement.

You have acknowledged the different figures we are using to identify the real terms cut to local government funding in the Draft Budget. You refer to a figure which includes the general revenue grant, specific revenue grants and non-domestic rates income, and this places the overall cut at £135m. We have consistently used the figure of £157m, as that is based on the local government finance orders agreed with COSLA.

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The latter figure is consistent with the approach we took last year, and we continue to believe that it is the most appropriate way to understand the support being provided by the Scottish Government for core local government services.

The finance order is the clearest way to support local services, but we also note that the Scottish Welfare Fund and Discretionary Housing Payments play a vital role in allowing local government to achieve more targeted welfare reform mitigation. Action in these areas may be an option.

We stated very clearly at the conclusion of last year's budget process that the cancellation of £160m of cuts in 2017/18 must be seen as the beginning of a process which repairs the damage done by previous cuts. Progress on the pay and investment priorities set out above cannot therefore take place against a backdrop of new cuts to core local services.

Our position on this has been clear and consistent since last year's budget debates. We can only support a budget that protects local government funding and, as explained above, makes a fair contribution to the additional costs of pay and other increased pressures across the public sector.

Income tax

You have described the tax cut for incomes between £43,000 and £58,000 in your tax proposals as an "anomaly". This description is puzzling, since it is the sole consequence of the proposal to increase the Higher Rate threshold. There appears to be no explicit policy intention given for this threshold increase, and we see no justification for it.

In addition to that we have suggested further progressive income tax changes that would raise sufficient resource to meet the priorities which we have put to you, but we have also continually stated that we are open to discussing any alternative ways of funding them that you wish to propose.

Your recent suggestion that a smaller HR threshold increase might raise revenue and resolve the "anomaly" does show willingness to move on this issue. However the increased revenue would be lower than a threshold freeze would achieve, and significantly lower than is needed to fund the above priorities. If this is your final position on the threshold, it significantly increases the case for the 42% Higher Rate that we have suggested, instead of the 41% set out in the Government's proposals alongside the draft budget.

Conclusion

We continue to believe that agreement on the 2018/19 budget is possible. However it is clear that serious movement remains necessary on priorities which have been known to you throughout this process. We hope that we can look forward to resolving these issues in the very near future.

Yours sincerely,

Patrick Harvie MSP

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