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Finance and Public Administration Committee

Pre-Budget Scrutiny 2023-24: Scotland's Public Finances in 2023-24 and the Impact of the Cost of Living and Public Service Reform

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Finance and Public Administration Committee

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(c) Budget Bills; and

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(e) matters relating to public service reform and the National Performance Framework within the responsibilities of the Deputy First Minister and public administration.

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3. In these Rules, "public expenditure" means expenditure of the Scottish Administration, other expenditure payable out of the Scottish Consolidated Fund and any other expenditure met out of taxes, charges and other public revenue.

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Introduction

1. The Finance and Public Administration Committee's pre-budget scrutiny for 2023-24 comes at a time when the cost of essential items such as food and energy is increasing at a faster level than wages, with inflation recently hitting a 40-year high. Households and businesses are being forced to make difficult decisions to limit their spending, while public finances and government spending plans are also being squeezed.

2. Unprecedented levels of public spending and a changing labour market during the Covid-19 pandemic have also had a lasting impact on the economy, as well as on government debt levels in the UK. Governments are now facing challenging decisions on how to balance the books. The Scottish Government announced in May this year that it is looking to reform public services and achieve efficiency savings to plug some of the gap between its longer-term spending ambitions and its approach to revenue-raising. The Committee has therefore this year focused its pre-budget scrutiny on the impact of the cost of living crisis and public service reform on Scotland's public finances in 2023-24. Our report also explores some of the Committee's other ongoing areas of interest, including funding net zero targets, making progress against the national outcomes in the National Performance Framework, and ensuring greater fiscal transparency.

3. To set the context to, and inform, our pre-budget scrutiny, we first heard from the Scottish Fiscal Commission and from the Cabinet Secretary for Finance and the Economy in early June 2022. [1] This evidence-gathering focused on Scotland's Economic and Fiscal Forecasts – May 2022 [2] published by the Scottish Fiscal Commission, and the Scottish Government's first Resource Spending Review [3] since 2011, and fifth Medium-Term Financial Strategy [4] . All three documents were published on 31 May 2022 alongside the Outcome of the Scottish Government's Targeted Review of the Capital Spending Review, which set out updated spending allocations for 2023-24 to 2025-26 [5] .

4. Our call for views, which ran between June and August 2022, received 44 submissions [6] . We took evidence from two panels of witnesses and held one round-table session during September [7] , before hearing from the Deputy First Minister and Cabinet Secretary for Covid Recovery on 4 October. [8]

5. More recently, the UK has experienced significant political and economic volatility, with rising interest rates and borrowing costs compounding existing inflationary pressures on households and businesses. At the time of publishing this report, a third UK Prime Minister has been appointed in as many months. The new Chancellor of the Exchequer has just delayed publication of his Medium-Term Fiscal Plan, and Economic and Fiscal Forecasts from the Office for Budget Responsibility to 17 November. It is now time for the UK Government to concentrate on putting in place measures to bring more stability to the UK economy, as well as greater certainty for individuals and businesses in dealing with energy costs, food and fuel prices, and mortgage payments.

6. Our report focuses on the evidence we heard prior to these most recent events. The

Committee thanks all those who took the time to contribute their views, which have helped to shape our findings. We are also grateful to our adviser, Professor Mairi Spowage, for her invaluable expertise throughout this inquiry.

Scottish Government Budget: context

7. The Scottish Government's Medium-Term Financial Strategy (MTFS), published on 31 May 2022, sets out Scotland's medium-term economic and fiscal outlook and the context for the Scottish Government's spending decisions. Its Resource Spending Review (RSR), published the same day, outlines the high-level parameters for resource spend within future Scottish Budgets up to 2026-27. The RSR is intended to provide a means of prioritising and identifying potential savings options associated with existing expenditure. The Cabinet Secretary explained in evidence on 7 June that the RSR "is not a budget" and "the numbers will fluctuate further". She was also clear that choices would need to be made in future Budgets over the remainder of the Parliament session that take account of the challenges the Scottish economy faces. [9]

8. The accompanying Scottish Fiscal Commission (SFC) Forecasts state that "the Russian invasion of Ukraine, steeply rising energy prices and further global supply chain disruptions in China have led to a challenging economic outlook" and that Scotland and the UK face the biggest annual fall in living standards since equivalent Scottish and UK records began. [10] The Cabinet Secretary highlighted in her foreword to the MTFS that "rising inflation, and the consecutive increases in the Bank of England interest rate, are also increasing budgetary pressures on the Scottish Government and public bodies, and will put pressure on our public services in real terms". [11]

9. The main focus of the SFC's May Forecasts "is on inflation and the cost of living crisis across many households". After taking account of the block grant adjustment [12] , the SFC reports that the position with income tax has worsened since its December 2021 forecasts, and will continue to do so this year and next, before improving for the remainder of the spending review to 2026-27. The Scottish Government's funding, the SFC explains, "comes under further strain in 2024-25 when it faces a negative income tax reconciliation of over £800 million". [13] When its forecasts on social security spending are added to the Scottish Government's plans for health and social care spending "the funding lifts for other portfolios are very constrained" and, "once adjusted for inflation, funding in those other areas will fall substantially for the first three years of the spending review period". [14]

10. The RSR notes that the "challenges, uncertainties and constraints in the economic and fiscal outlook make it essential to drive reform across public services, policies and programmes, in order that resources are targeted effectively to deliver the best outcomes for Scotland". It goes on to say that "the cost of delivering public services and of building public infrastructure is increasing … with inflation, [and] this situation demands a range of responses, including a re-energised drive for innovation and efficiency". [15]

11. Since these documents were published in May 2022, inflation (Consumer Price Index) has risen to 10.1% in the 12 months to September 2022 and the Bank of England has indicated that inflation could peak at more than 13% this year. [16] Its Monetary Policy Committee increased interest rates on 22 September by 0.5% to 2.25%, the highest level since November 2008. [17] Ofgem (the energy regulator)

announced in August that the energy price cap would increase to £3,549 per year for an average household, from 1 October 2022. [18] Pressures from inflation and a cost of living crisis has prompted public sector pay increases costing £700m more than Ministers had originally budgeted for. [19] The First Minister, in a statement to Parliament on 6 September, noted, as a result, that the current year's budget is worth £1.7bn less than when it was published in December 2021. [20]

12. In recognition that the Covid-19 pandemic continues to affect many parts of society, the Scottish Government's Covid Recovery Strategy: for a Fairer Future Scotland, published on 5 October 2021, aims to work with local government, business, community and voluntary organisations to “address the systematic inequalities made worse by Covid, make progress towards a wellbeing economy, and accelerate inclusive person-centred public services”. In his foreword to the Strategy, the Deputy First Minister makes clear that a thriving economy underpins a successful recovery.

13. The Deputy First Minister wrote to the Committee on 7 September 2022 outlining a series of savings that the Scottish Government has already identified "to enable us to meet our increased costs, increase help for those hit by the crisis, and fund enhanced pay settlements". The letter further details announcements made by the First Minister on 6 September to "take forward a rent freeze and moratorium on evictions to help people through the cost crisis, increase the Scottish Child Payment to £25 per week per eligible child from November, double the Fuel Insecurity Fund to £20 million and confirm rail fares will be frozen until March 2023". [21] The Deputy First Minister indicated that "further savings will be required to balance the budget, particularly if inflation continues to rise, and to direct maximum support to those who need it most". The First Minister, in her statement to Parliament on the Programme for Government on 6 September, confirmed that the cost of living support being provided by the Government "will mean stopping some of the things we planned to do to fund what is essential to support people through this crisis". [22]

14. The Deputy First Minister told the Committee on 4 October that his Emergency Budget Review (EBR) would "focus on this financial year only and on any measures that the Government can take to support those who are facing difficulty", along with other issues that have arisen due to inflationary pressures and higher pay deals than anticipated. To inform the review, he appointed a panel of economic experts tasked with studying the impact on Scotland of the Chancellor of the Exchequer's fiscal approach. The First Minister in her statement to Parliament on 6 September indicated that the EBR would also inform the annual Budget Bill for 2023-24. [23]

15. The Deputy First Minister announced on 25 October that the EBR would be deferred until after the planned fiscal statement by the new UK administration which, at that time, was scheduled for 31 October. [24] The UK fiscal statement has been delayed until 17 November. The Deputy First Minister announced the outcomes of the EBR on 2 November and the Committee will consider the implications in due course.

UK Government Budget: context

16. In response to the planned increases to the energy price cap, the Prime Minister announced on 8 September 2022 an Energy Price Guarantee limiting the price that suppliers can charge customers for units of gas, as well as a temporary removal of green levies from bills. [25] This is in addition to the previously announced £400 energy bills discount for all households. The UK Government argued at the time that these plans would ensure that a typical UK household would pay around £2,500 a year on their energy bill for the next two years, from 1 October 2022. This policy intervention has since been scaled back and will now end in April 2023. [26]

17. Many other announcements made by the former Chancellor of the Exchequer, The Rt Hon Kwasi Kwarteng MP, in his Fiscal Statement (or 'mini-budget') on 23 September 2022, were also subsequently reversed after the cost of UK Government borrowing increased and the pound fell against the dollar on 26 September to $1.03, a record low. [27] The Bank of England announced on 28 September that it would start buying government bonds at an "urgent pace" to help "restore market functioning and reduce any risks from contagion to credit conditions" for UK households and businesses. [28]

18. Appointed on 14 October, the new Chancellor, The Rt Hon Jeremy Hunt MP, announced on 17 October that he would proceed only with those plans announced by the former Chancellor that had already begun legislative passage through the Houses of Parliament. This includes reversal of the planned 1.25 percentage point increase in National Insurance Contributions rates from 6 November 2023, repeal of the Health and Social Care Levy Act 2021, and an increase to the threshold for paying Stamp Duty Land Tax from £125,000 to £250,000 and for first-time buyers from £300,000 to £425,000. He has also asked all government departments to find efficiency savings and confirmed that difficult decisions will be needed "across the board". [29]

19. Establishment of investment zones in England was included in the former Chancellor's 'mini-budget', with the aim of providing tax incentives, planning liberalisation and wider support to the local economy. At the time, he indicated that the UK Government intends "to work closely with the devolved administrations and local partners to deliver this opportunity to drive local growth in Scotland, Wales and Northern Ireland". [30] Mr Hunt MP has since committed to implement investment zones "in a way that learns the lessons of when similar models have been tried in the past". [31]

20. The Prime Minister, The Rt Hon Liz Truss MP, resigned as Conservative Party Leader on 21 October 2022, triggering an election for her successor. The Rt Hon Rishi Sunak MP took office as Prime Minister on 25 October. Under Mr Sunak's premiership, Jeremy Hunt MP was reappointed as Chancellor on 25 October.

21. The Chancellor announced on 26 October that he and the Prime Minister had agreed it would be "prudent" to make his statement on the Medium-Term Fiscal Plan on 17 November and that this Plan would be "upgraded to a full Autumn Statement". He said the delay would ensure plans are based on the "most accurate

possible economic forecasts" from the OB'. [32] The UK Government's Fiscal Plan was originally intended to be announced on 23 November, before being brought forward to 31 October.

Economic and fiscal context

22. The expected downturn in the Scottish economy is now showing in the latest official data. [33] The Scottish economy shrank by 0.2% in July, the second consecutive month of negative growth. This was primarily driven by a fall in the services sector of 0.3%, which accounts for around two thirds of the Scottish economy – and tends to be the section of the economy most supported by consumer spending.

23. The Fraser of Allander Institute suggests this means that Scotland is likely already at the start of a recession (defined as two quarters of negative growth in the economy). [34] Similarly, at the UK level, recent performances of private sector indexes suggest that the UK may have already been in a recession for the past few months, with significant falls in new orders and business confidence. The Bank of England's view is also that the UK economy contracted in Q3 2022. [35]

24. The backdrop to this difficult economic outlook is very high inflation – the latest data from the Office for National Statistics (ONS) for September 2022 shows that Consumer Price inflation is back up at the 40 year high of 10.1%. [36] This is before the further increase in energy prices which happened in October, so there is likely to be a further rise in the headline inflation rate when the October data is published. As noted by our adviser, the high inflation rate, as well as being driven by very high energy prices, is also being driven by large increases in food inflation, which is currently running at 15%.

25. Separate data published by the ONS last week [37] shows that the prices of the lowest cost items are increasing even faster than this rate, at 17%, highlighting the impact that price rises are having, particularly in vulnerable households.

26. Despite the uncertain economic climate, the labour market continues to show signs of strength. The latest ONS Labour Force Survey (UK) estimates for June to August 2022 indicate that over the quarter, the unemployment rate decreased, while the employment rate increased, and the economic inactivity rate fell.

27. This Survey estimates that the unemployment rate in Scotland was 3.3%, down 0.3 percentage points over the quarter and below the UK rate of 3.5%. The estimated employment rate (the proportion of people aged 16-64 in work) in Scotland was 75.8%, up 0.4 percentage points over the quarter, and higher than the UK rate of 75.5%. The estimated economic inactivity rate in Scotland was 21.6%, which is now lower than the pre-pandemic level and also slightly below the UK rate of 21.7%. There is considerable variation across Scotland's local authorities, for example, the Scottish Government has reported levels of economic inactivity rates in 2021 of 30.4 per cent in North Ayrshire compared with 17.3% in Midlothian. [38]

28. The number of job vacancies across the UK remains very high, despite falling back over the last few quarters. It is now at a record low of 0.9 unemployed people per vacancy.

29. After the political and economic turmoil of the last few weeks, the UK Government's Medium-Term Fiscal Plan has now been delayed to 17 November and upgraded to a full Autumn statement. The Committee's adviser explained that this is likely to

mean that more detail on the outlook for departmental spending will be provided than otherwise would have been the case, thus providing more information about the consequential impacts on the Scottish Budget. Our adviser further noted that the delay is also likely to give the new Prime Minister and Chancellor of the Exchequer a bit more fiscal headroom, given the relatively calm period we are in for the markets compared to mid-October. The window that the OBR will use to calibrate their outlook for the cost of government borrowing will switch to late October, which is likely to improve the outlook considerably.

30. However, despite the markets seemingly having more confidence following the change in Prime Minister and Chancellor, the UK fiscal position is still extremely challenging. The ONS latest Public Sector Finances, UK: September 2022 release contains up-to-date statistics on the size of the UK National Debt. [39] This shows that debt has reached £2.5 trillion, which is equivalent to 98% of GDP – levels not seen since the 1960s. [40]

Linking budgetary decisions to the delivery of national outcomes

31. The Scottish Government introduced the National Performance Framework (NPF) in 2007 to provide an outcomes-based framework to underpin the delivery of its policies. [41] Earlier this year, the Committee undertook an inquiry into the NPF: Ambitions into Action to establish the extent to which the national outcomes in the NPF shape policy-making and decisions on spending priorities, as intended. We found little evidence to suggest that financial decisions derive explicitly or transparently from the national outcomes, nor is the NPF a mechanism by which organisations are held to account for spending their funding effectively. The Committee also heard that national outcomes were not placed at the heart of a plethora of government strategies and plans, and indeed some were 'retrofitted' to 'match up' to the NPF ambitions. [42]

32. In thatreport, we called for closer alignment between the NPF and financial decision-making, a recommendation we also made in last year's pre-budget and budget reports, and on which we still await a response from the Scottish Government. [43]

33. Similar concerns were raised with the Committee again during this pre-budget 2023-24 inquiry. For example, the Scottish Women's Budget Group (SWBG) highlighted in its written evidence that "the RSR should have presented a clearer set of information about how the decisions made impact on the delivery of national outcomes". The SWBG suggested that "as budget decisions are made, how these align with the NPF and the outcomes that have been identified as a measure of what Scotland values through its revenue-raising and resource allocation are critical in developing an outcomes-based budget". [44]

34. In its submission, the Scottish Human Rights Commission (SHRC) claimed "if we are saying that the national outcomes are the key concerns to be addressed, then the annual Programme for Government and the Budget need to be aligned with them". The SHRC goes on to suggest that the Scottish Government, in its upcoming review of the national outcomes should consider redesigning the NPF in line with the Budget, noting that "they have to be designed together with processes and purpose, in tandem with one another". [45] Both Citizens Advice Scotland (CAS) and the David Hume Institute (DHI) [46] called for greater transparency regarding how national outcomes are affected by different spending decisions. CAS explained that "if we do not have transparency about outcomes and where money is being spent, it is really hard to decide where to place that money to realise best value". [47]

35. The Deputy First Minister accepted that "it is difficult to look at a pound in the budget and follow its journey into the NPF". He suggested, however, "it is possible to look at the NPF periodically and ask "Do we think that public expenditure and policy decisions are supporting the achievement of this direction of travel and, if not, what do we need to reshape about public expenditure or policy to enable that to be more the case?" [48]

36. **The Committee looks forward to receiving the Deputy First Minister's response to our report on the National Performance Framework: Ambitions into Action. We repeat our recommendation once again that there needs to be a clearer link between spending decisions in the Scottish Budget and their impact on the delivery of national outcomes and we ask the Scottish Government to confirm it will seek to make progress on this matter in its 2023-24 Scottish Budget. This is particularly important during uncertain times where funding allocations and decisions around efficiencies and revenue-raising may be more fluid and challenging to track.**

37. **While we welcome the Deputy First Minister's continued engagement with the Committee on the spending challenges it faces in current and future years, we ask the Deputy First Minister to also provide detail in his updates to the Committee of the potential impact of these changes on the delivery of national outcomes.**

Fiscal transparency

38. Scotland's Open Government Action Plan 2021-2025, published on 25 March 2022, identified financial transparency as one of three areas prioritised for promoting Open Government values of "openness, accountability, transparency and involving people". [49] As part of our pre-budget scrutiny, we were keen to determine the extent to which the RSR reflects this Scottish Government commitment. Drawing on an ongoing area of interest to the Committee, we also wanted to establish whether there is sufficient transparency to properly identify and track spending.

39. The Scottish Exchequer Fiscal Transparency: Discovery Report [50] , published in March 2022, identified over 40 different regular financial 'outputs' published by ten government departments or public bodies. The Discovery Report found that existing inconsistencies in data, labels and publication timescales, alongside fragmented information on frontline spending and outcomes, contribute to a general lack of clarity around financial decision making.

40. The SFC, in its May 2022 Forecasts, said that it would like to see the Scottish Government include in its Budget later this year "information on how spending is split by OECD Classification of Functions of Government (COFOG), [which] is used to reflect spending in a consistent way by identifying spending under set definitions". Currently the Scottish Government's Budget documents focus on spending by portfolio area, however, these can change over time to reflect different ministerial responsibilities. The SFC argues that, including this information would "provide a baseline level of spending for us to use in our Fiscal Sustainability Report and provide a benchmark for comparisons of the Scottish Budget in future years". [51] The SPICe Briefing on the RSR and pre-budget scrutiny notes that "this recommendation is certainly a welcome one from a parliamentary budget scrutiny point of view" in improving transparency and allowing for "the consistent presentation of budgetary information by function of government, (for example, Health, Education, Housing, etc.), which is not always possible from looking at portfolio information". [52]

41. Several witnesses noted that it is difficult to track the flow of funding from government to individual organisations and specific initiatives in the RSR, suggesting that greater transparency is needed in future iterations. For example, Alcohol Focus Scotland (AFS), in its written submission, noted that, "without knowing how much money was spent and where it was spent, it is difficult to say where further investment is needed and whether investment is resulting in returns for the people of Scotland" [53] . The SHRC expressed disappointment that "the first spending review in almost 10 years lacks transparency" and highlighted the need for more detailed data for the forthcoming two years. [54]

42. The lack of clear connection between spending announcements, budgets and subsequent spending was echoed by Audit Scotland, which called for better links between spending in portfolios and performance towards achieving national outcomes, particularly in the context of "increased financial uncertainty and tighter public spending envelopes". [55]

43. The availability and accessibility of data was raised as a significant barrier to public

understanding of spending decisions. As noted by the Institute of Chartered Accountants of Scotland (ICAS), RSR documents are publicly available, however, it felt that more should be done to explain the detail to the general public "in a way they can easily understand, such as infographics, explainer videos and suchlike". [56]

44. Some respondents advocated adopting a human rights approach to budgeting to improve transparency around the impact of spending. [57] Others considered that "integration with the NPF is likely to remain the most effective mechanism for ensuring transparency and tracking expenditure" [58] , as noted in the above section of this report.

45. The Chartered Institute of Taxation (CIOT) notes that the Scottish Government's Framework for Tax, published in 2021, allows for a more strategic approach to planning, managing and implementing devolved tax policy, which is "to be applauded". CIOT calls for an annual Scottish Finance Bill as a means of making changes to devolved taxes, as "the current processes do not offer a sufficient balance between the competing needs of speed, scrutiny and responsiveness". [59]

46. The SHRC called on the Scottish Government to make it easier to locate impact assessments on its website, to improve transparency around decision-making [60] , while the Scottish Women's Budget Group would like to see publication of an annual 'Citizens' Budget document to provide clear and accessible budget information. [61]

47. **The Committee welcomes the Scottish Government's commitment to use the conclusions in its Fiscal Transparency Discovery Report to improve the way in which financial information is presented and published in future. However, we note that these changes will not be implemented until 2025. We urge quicker progress on this matter and therefore invite the Scottish Government to revisit this timeframe.**

48. **We note the recommendation by the Scottish Fiscal Commission in its May 2022 Forecasts that the Scottish Government should include in its Budget later this year information on how spending is split by the OECD's Classification of Functions of Government (COFOG), as well as by portfolio. The Committee believes that adding this information would improve transparency and better support parliamentary scrutiny and therefore seeks assurances that the Scottish Government will act on this recommendation in the 2023-24 Scottish Budget.**

49. **The Committee also believes that linking budgetary decisions to the delivery of national outcomes, as recommended earlier in this report, will help to achieve greater transparency.**

Balancing the books

Overview

50. The Scottish Government faces difficult decisions on spending and raising revenue in order to 'balance the books' in these uncertain times. Under the fiscal framework, the Scottish Government has limited capital and resource borrowing powers that can only be used in certain circumstances. The Committee has made the case in previous budget and pre-budget reports that there would be merit in revisiting these borrowing limits, particularly in times of great volatility, such as a pandemic or cost of living crisis. [62]

51. The Deputy First Minister told the Committee on 4 October that he had "never seen financial strain of the order that I am wrestling with just now—not even in the aftermath of the financial crash in 2008 and not even in the years of austerity from 2010 onwards". [63] He highlighted to Parliament on 7 September that "this is the harsh reality of a fixed budget and limited powers" and noted that "the Scottish Government simply does not have access to many of the levers which would provide the greatest support in this crisis". He added that the Scottish Government "will make the hard choices … but only the UK Government can act to end this crisis". [64]

52. Unison Scotland suggested however that "too much is said about having a fixed budget—we hear comments such as 'We've only got a fixed budget' and 'We're entirely reliant on what we get from Westminster'". It argued that, while "this is a critical issue", "the Scottish Government and the Scottish Parliament have the powers to introduce additional means of raising funding and we should be less shy about doing so" because of fears of criticism. Unison Scotland went on to argue that "the other part of the issue is that it is about not only what people pay in taxes, but what they get in return in services". [65]

53. CIOT called for the Devolved Taxes Legislation Working Group [66] to be re-established to encourage a broader annual fiscal discussion beyond just spending, arguing "if we brought tax more to life and had more debate around it and more consideration of it, that would filter through so that tax and spend become better joined up". It admitted that the issues under consideration, including the merits of a Finance Bill, are "quite tricky, so I think that the Working Group would probably be best served with political leadership". [67] When asked whether they supported the idea of an annual Finance Bill, the Auditor General for Scotland (AGS) noted there may be other options to achieve the same aims [68], while the Deputy First Minister said he was "not persuaded that we need more legislation to do that". [69]

Raising revenue and stimulating economic growth

54. On raising revenues, CIOT told the Committee that "the biggest source of funding is income tax [and so] if you want more tax, full stop, income tax is your primary source to look at". It noted that "you probably get more tax by having more

taxpayers and more highly paid taxpayers", adding "that is how to increase the envelope with the powers that you have". [70]

55. Witnesses discussed the potential impact of the Scottish Government following or diverging from the UK Government's tax position, following the former Chancellor's 'mini-budget' announcement on 23 September that he would bring forward the lowering of the basic rate of income tax from 20p to 19p and remove the higher rate threshold of 45p. While there were overall concerns about the UK Government's decision to increase borrowing levels to fund such tax cuts, the Scottish Council for Development and Industry (SCDI) noted there was a range of views amongst its members about whether the Scottish Government "should follow suit". [71] The Scottish Retail Consortium (SRC) called for any increases in income tax for those on modest earnings to be ruled out. [72] Audit Scotland made a wider point that, whatever the Scottish Government decided on replicating or diverging from UK Government tax policy, this decision should be "clearly reported and considered against the assumptions set out in the RSR and in Medium-Term Financial Plans, so the implications for annual budgets and fiscal sustainability are known and understood". [73]

56. The AGS echoed comments made by CIOT that "there is no strong evidence to suggest that the behaviour of Scottish taxpayers is being influenced strongly by the differential that exists between Scottish income tax rates and those in the rest of the UK". The AGS noted however that "the discussion that sticks in my mind is not so much whether people will move … from Edinburgh to Newcastle, but rather the identification of primary residence for those individuals who are able to choose which residence that might be". [74]

57. SCDI told the Committee that there were concerns about increasing complexity in the tax system in Scotland versus the rest of the UK and suggested that, "if we start to diverge significantly from the rest of the UK, that could potentially be a deterrent for some … [growing] sectors in trying to attract new talent to Scotland". It added that "our perception is that people can probably stand a slight differential in Scotland compared with elsewhere, but we need to be mindful of the gap that could widen in the current context". [75] Unison Scotland suggested that "we need to be careful not to talk about economic growth purely in terms of incoming companies", arguing "we do not accept the argument that taxes should be cut or that the higher rate of tax remaining at its current level in Scotland will have any detrimental impact on the economy". [76]

58. Consideration was given to the merits of 'fiscal drag' – the concept where inflation and earnings growth may push more taxpayers into higher tax brackets without raising income tax thresholds. SCDI for example claimed that "fiscal drag can be a blunt instrument to bring more people above a tax threshold" and suggested instead that "we need to make sure we have the right investment in the right places for the long-term sustainable growth of Scotland's economy". It argued that improving productivity levels is not just a medium to long-term endeavour, "there are things that could be done to support productivity now", including investing in infrastructure, particularly for rural areas, innovation and exports, and in universities and colleges "to meet the skills needs we have and create new well-paying jobs in Scotland". SCDI also called for the recommendations in the delivery plan for the Scottish Government's National Strategy for Economic Transformation (NSET) to be

properly funded. [77]

59. Inclusion Scotland was of a similar view, noting in written evidence that "working with industry to create productivity, raise wages and attract more people to work in Scotland would be a more robust approach to the challenge of generating revenue than 'fiscal drag'" and argued that creating these conditions should be a priority for the Scottish Budget 2023-24. [78]

60. In its written submission, the DHI noted "an urgent need for the Scottish Government to reduce levels of inactivity amongst the workforce" and said that measures should be put in place to remove barriers for those who want to work and support people in transitions between working and receiving benefits. The DHI questioned recently announced budget savings in employment support given "the demographic problem" in Scotland and that "we know we have to grow our tax base". It went on to argue that "regular tracking of the data coming in, to see who is joining, and who is leaving the labour market, is really important". [79]

61. The Fraser of Allander Institute (FAI), in its briefing on The Rationale for Employability Support, published on 20 October, notes that employability services "provide individual support to people who wish to work but face barriers in doing so". It highlights that the Scottish Government's employability support plans "tend to emphasise that some groups will always need additional and continuing support, [including] people with disabilities, people experiencing homelessness, people recovering from substance abuse, and people with convictions". Additionally, the FAI has found that employability support "is frequently cited as a key component of initiatives to tackle poverty and inequality, particularly child poverty". [80]

62. Professor David Heald of the Adam Smith Business School observed that "tackling endemic problems of inequality and poverty should be addressed not by higher benefits than the rest of the UK but by enhanced economic performance." At Conveners Group on 28 September 2022, this quote was drawn to the First Minister's attention when she was asked about the impact of the Scottish Government's plans to reduce the employability budget. [81] Responding, the First Minister reiterated that "employability is important—we still invest a lot in employability… , but we made a careful judgement that we are probably as close to full employment as we will get right now". She argued that, with labour shortages in many areas of the economy, funds need to be focused on pay deals to attract people into those areas. [82]

63. In evidence to the Committee, the Deputy First Minister echoed the First Minister's comments, stating "we have historically low unemployment and we are reducing the level of economic inactivity in Scotland", adding that this takes time and "a lot of focussed activity". He further noted that "fundamentally … we are short of people", as "the consequence of the loss of free movement under EU membership". He went on to draw the Committee's attention to "three big themes" in the NSET of innovation and creativity, the importance of regional economic policy and "activating as many levers in our control as we can in order to support economic activity". He confirmed that he wants Scotland to be an attractive place for investment, highlighting that "other than London and the south-east, Scotland is the most successful location for foreign direct investment across the UK and has been for the best part of the past 10 years, if not longer". [83]

64. The Deputy First Minister also reported that the UK and Scottish Governments are engaging constructively on investment zones and that he has "agreed to explore what those zones might look like" in Scotland, adding that "the critical question is, do they generate real new growth or are they, in essence, providing for displacement?" [84] The potential for displacement – the risk that economic activity including jobs move from one place to another rather than increasing growth overall – is one of the main criticisms of the UK Government's policy on freeports. [85]

65. **Since our establishment in 2021, the Committee has repeatedly heard evidence that suggests more action is needed to increase productivity, wage growth and labour market participation. We explored these issues in some detail in our Scottish Budget 2022-23 Report and recommended that these issues should be a particular focus for the Scottish Government. Its response pointed to the National Strategy for Economic Transformation, which was due to be published shortly thereafter, and to its plans to raise concerns about limited powers as part of the Fiscal Framework Review.**

66. **The Committee seeks details of which areas of the Budget the Scottish Government considers to be key to delivering the National Economic Transformation Strategy. We would also welcome any update it can provide on the timing and remit of the Fiscal Framework Review, to which we look forward to responding.**

67. **The Committee notes the explanation given by Scottish Government that spending on employability services in this financial year is being reduced to fund public sector pay deals, due to current low levels of unemployment. However, we are concerned at the potential impact this cut in funding may have on vulnerable people and those experiencing poverty during these most difficult of times. We therefore ask the Scottish Government to make available any impact assessment carried out to understand any adverse impact of the decision on the most vulnerable in society and on its ability to meet its child poverty targets.**

68. **The Committee is encouraged to hear that both Governments are engaging constructively in exploring the scope to create investment zones in Scotland and considering potential impacts carefully. We would welcome an update on progress with these discussions and on any decisions taken in this regard.**

Spending priorities

Overview

69. In her Foreword to the RSR, the Cabinet Secretary for Finance and the Economy states that—

> Delivering on our key priorities whilst also mitigating the cost of living crisis will require difficult decisions, but the outcome should be lower levels of child poverty, a faster growing economy, continued progress on our journey to net zero, stronger public services and crucial support for households and businesses during a time of extraordinary pressure. [86]

70. As noted in the SFC May 2022 Forecasts, the Scottish Government plans to increase spending on health and social security and, once adjusted for inflation [87] , funding for other areas falls more substantially for the first three years of the RSR and is 8% below 2022-23 levels by 2025-26”. In 2026-27, funding is expected to be 5% below 2022-23 in real terms. [88]

71. **Despite the current challenging fiscal outlook, the Committee heard calls that spending should be prioritised in a number of different areas. We welcome that some witnesses this year provided suggestions of where funding might be de-prioritised and where additional revenue could be raised, particularly in relation to local taxation. We explore these issues later in this report.**

Cost of living support

72. As noted in the SPICe summary, written evidence received by the Committee in relation to this inquiry raised concerns around the cost of living crisis, with impacts for individuals and their communities, as well as businesses, the public sector, and voluntary organisations highlighted. [89]

73. CAS said it supports "any measure that gets cash into people's pockets, whether that be direct cash support to people or through services such as ours, which support income maximisation". [90] The Scottish Council for Voluntary Organisations (SCVO), in its written submission, noted that there is no energy cap for voluntary organisations, which "leaves them completely exposed to the wholesale costs of energy on the market" [91] . The Federation of Small Businesses (FSB) argued that, "with around one in six businesses in Scotland predicting that they will shrink, be sold or close over the next 12 months, it is vital for the wider economy that the Scottish Government does not respond to budgetary challenges by imposing more pressures on small businesses". [92]

74. Engender told the Committee that "women are feeling the cost of living crisis at every possible level; the squeeze is felt in already predominantly low incomes, part-time work, care responsibilities and the gender pay gap [and], on top of that, inflation is highly gendered". It suggested that "investment in women, particularly those on low incomes" should be prioritised "as it will have a major return for society and the economy as well as build more resilient communities". It went on to argue that, while prioritised projects on inequality and gender are welcome, "they become the fig leaf behind which governments hide" and instead a more integrated and systematic approach is needed to tackle the issue. [93]

75. The Deputy First Minister accepted the importance of assessing the impact of budget measures "on women and on other groupings and considerations within our society" and noted that "if we have to take tough decisions during a financial year, it is probably even more important that we pay particular attention to those issues to avoid getting into a situation where we create a potential negative impact during that process".

76. **The cost of living crisis touches on all areas of society, from businesses to households, to voluntary bodies to communities. The Committee welcomes the Scottish Government's commitment to provide immediate support to those most in need. However, inflationary pressures and increasing interest rates are likely to persist into the next financial year at a time when the UK Government's Energy Price Guarantee is also now due to conclude. The Scottish Government is asked to consider carefully if and how short-term measures designed to be an immediate fix over winter might be extended into next year's Budget 2023-24.**

77. **The Committee heard compelling evidence that the cost of living crisis is having a disproportionate impact on women and we therefore ask the Scottish Government to consider how it can best support women through these challenging times.**

78. **The Committee notes that the Equality and Fairer Budget Statement, which accompanies the Scottish Budget, is designed to assess where the Scottish Government is proposing to spend public money and how it aims to reduce inequality. We encourage other parliamentary committees to play a role in scrutinising policy decisions for their potential impact on women, including through evidence-gathering. To support this work, we ask the Scottish Government to put in place robust and transparent processes to evaluate all policies and outcomes for gender impact.**

Public sector pay

79. The SPICe summary of evidence states that "there is a question as to how deliverable the public sector pay spending assumptions are in the RSR given the increase in inflation". [94] As at early September, public sector pay increases were costing £700m more than the Scottish Government had originally budgeted for and this sum is expected to rise. [95]

80. It was noted by Audit Scotland that deviation from the central spending scenario in the MTFS, which factors in a 2% annual pay award and a 1% annual workforce increase, would have a significant effect on the Scottish Budget. [96] The AGS expanded on this position in oral evidence, arguing that "if those figures vary and, for example, we have pay awards of 3% and 2.5% [workforce] growth, it would result in a further £1.3 billion of expenditure by 2026-27". [97]

81. Unison Scotland told the Committee that the "priority has to be … to get people through the cost of living crisis [and] this means putting money in people's pay

pockets". It went on to "remind people of the austerity that public sector workers have had to experience over the past 12 years … and that the value of their wages has declined by something like 20%" and will continue on a similar trajectory. It argued "if that purchasing power is no longer in the community, the local shops will not get the spending and the footfall that they need to maintain". [98]

82. The AGS told the Committee that, if the Scottish public sector pay bill is steady or flat, given the pay awards being discussed, there would inevitably be a reduction in head count. While he argued that some of this could be achieved by natural wastage, through retirement and not backfilling jobs, it "must be co-ordinated, perhaps alongside the Government's other plans for public sector reform and done transparently". [99]

83. The RSR confirms the Scottish Government's intention to "return to the overall total public sector workforce broadly to pre-Covid-19 pandemic levels …, helping to hold total pay bill costs – as opposed to pay levels – at 2022-23 levels". [100]

84. The First Minister, in her statement to Parliament on 6 September 2022, confirmed that the Scottish Government "continues to support" a policy of no compulsory redundancies in the public sector "notwithstanding the budgetary pressures that we face", adding that this would "give people who are delivering essential services the peace of mind of knowing that their jobs are safe over this winter". [101] The Deputy First Minister reiterated to the Committee that “the public sector head count would have to reduce in the spending review period and throughout the parliamentary session”. He said he wanted to approach this "in the spirit of partnership with our workforce [and] be open about the steps that we are taking to do that". Recruitment controls had already been put in place and, in some circumstances, vacancies are not being filled which, he argued, reduces the public sector head count "in a managed and careful fashion". [102]

85. **The Committee acknowledges the challenges faced by the Scottish Government in identifying additional money to fund public sector pay rises which respond to inflation. We note that, in response to this challenge the Scottish Government will seek to reduce the public sector head count over the rest of the parliamentary session and is currently using recruitment controls and leaving some vacancies unfilled. We understand that this is a concerning time for the workforce and we therefore welcome the Deputy First Minister's commitment to take a partnership approach with the workforce and to be open and transparent on these difficult issues. The Committee further welcomes the First Minister's commitment to a policy of no compulsory redundancies in the public sector.**

86. **We ask for assurances from the Scottish Government that it will approach reducing the public sector headcount in a systematic, transparent, and co-ordinated way, in tandem with the public service reform agenda, with a view to minimising any impact on the delivery of public services. We also seek confirmation that, alongside any consideration of proposals for workforce reduction, an assessment of any impact on the delivery of the national outcomes is undertaken.**

Prevention and early intervention

87. The RSR notes that "over a decade on from the Christie Commission's report on the future delivery of public services, its legacy is even more relevant as we rebuild services from the Covid-19 pandemic and face new challenges such as the cost of living crisis, which has been further intensified by the situation in Ukraine, within the limited powers that are available to the Scottish Government". It goes on to set out "a number of key reforms" intended to support prevention, including creation of a National Care Service, NSET and The Vision for Justice in Scotland. [103] Creation of a National Care Service is an area which attracted some significant concerns during evidence to this inquiry, particularly from trades union and local government bodies. The Committee is currently gathering further evidence on this issue and plans to report our findings separately later this year as part of our scrutiny of the Financial Memorandum in relation to the National Care Service (Scotland) Bill.

88. The Committee heard calls for the Scottish Government to commit more funding to preventative measures, which can both save money in the long term and achieve better outcomes. Both CAS and the SFHA [104] argued for more funding in advice services. CAS suggested that "given that our advisers are giving 20% more advice than they did during the pandemic, and we are not even into winter yet, CAS is facing a crisis, and it is happening because of a long-term pattern of poor funding". CAS called for funding systems to be built around transparency, outcomes and preventative spend. [105]

89. The SHRC too supports preventative spending "as a vehicle for supporting better outcomes", citing research by the London School of Economics which estimated that focusing on the prevention of poor mental health could save £8.8 billion annually in Scotland. The SHRC went on to suggest that "the RSR presents a lot of narrative about preventative spend, but this is not currently backed up with a connection to resource allocation". It asks for more information on how policies are assessed for preventative impact, with explicit analysis within the RSR and ongoing mechanisms in place to monitor and evaluate the impact of preventative spend. [106] The submission from the British Heart Foundation called for increased investment in medical research as a way of driving economic growth and as a preventative intervention to save public spending in the medium to long term. [107]

90. AFS called for the minimum unit pricing on alcohol to be uprated to help reduce inequalities and for a separate alcohol harm levy to help to fund treatment. It highlighted that alcohol costs Scotland £3.6 billion each year, and that there was a 10% reduction in 2019 of alcohol-specific deaths, rising by 17% in 2020, showing "how quickly levels of harm can be affected by changes in consumption levels and drinking patterns". AFS concludes that preventative actions have a short-term benefit as well as a longer-term benefit and that the levy would recoup some of the increased profits it argues retailers have made as an unintended consequence of the minimum unit price. [108] However, the SRC said they would resist any attempt to impose such a levy on retailers, arguing that they are already struggling due to rising costs elsewhere. [109]

91. Alongside health and social care and social security spending, the SFHA argued that funding should be prioritised in the coming budget for long-term outcomes such as affordable housing, as "no other sector is better placed to create real, positive

change across diverse policy areas from health to educational inequalities and decarbonisation". It went on to explain that "if we don't build the homes that we need, the cost of the health service will increase and the number of people out of work will increase". [110] The DHI also highlighted that housing is consistently raised as a key public priority in its research. [111] The Deputy First Minister addressed this point directly in evidence, stating that "the last thing I want to see is any lack of constancy in the housing investment programme – it is not a capital saving that I would be particularly interested in pursuing". [112]

92. More broadly, the Deputy First Minister said that he is "a firm believer" in early intervention, citing expansion of early learning and childcare and the child payment as examples of bold decisions by the Scottish Government "to alter the life chances of children in our society". [113]

93. **While the Committee recognises that the strain on Scotland's public finances is both substantial and immediate, we believe preventative measures are key to unlocking future benefits of a healthier and more prosperous society, while also saving significant sums in the longer term.**

94. **Some witnesses made the case that, with the provision of additional resources now, they could easily identify long-term preventative measures. However, the Committee is disappointed that most struggled to identify where those additional resources would be provided from - whether from areas of current expenditure, areas in which revenue could be raised, or diverted from unallocated funds, in order to deliver better outcomes.**

95. **The Committee asks the Scottish Government to set out how it will make progress with its preventative agenda over the remainder of the parliamentary session given the current fiscal pressures. We also ask in the short-term how the Scottish Government will seek to ensure preventative measures are funded in this year's Scottish Budget.**

96. **The Committee, in addition, seeks information on how the Scottish Government assesses its policy decisions for preventative impact.**

Financing net zero targets

97. In its most recent report on Mitigation of Climate Change, [114] published in April 2022, the UN Intergovernmental Panel on Climate Change highlighted an urgent need to quicken the pace of decarbonisation. A year earlier, the OBR noted in its Fiscal Risks Report that "acting early could halve the net fiscal cost of getting to net zero by 2050 compared to acting late". [115]

98. Scotland's climate change legislation sets a target date for net zero emissions of all greenhouse gases by 2045, five years ahead of the UK legislative target. The RSR notes "experts agree that public spending now to address the climate crisis delivers future benefits which far outweigh the costs today". It also highlights that "while there are areas of society that should always remain government funded, the scale

and urgency of the climate emergency means private and third sector investment will be critical to shift to a net zero, climate resilient, wellbeing economy". [116] The Scottish Government's Targeted Review of Capital Spending 2023-24 to 2025-26, carried out alongside the RSR "supports critical low carbon capital spending, with an increase of over half a billion pounds directed towards net zero programmes to address the climate crisis over the next three years". [117]

99. A number of witnesses argued that improving the energy efficiency of the housing stock would support the delivery of climate obligations. The SFHA called for buildings to be made as energy efficient as possible before investing in alternative heat sources [118], while Homes for Scotland suggested that funding for new housing developments that increase the stock of energy efficient homes must be maintained [119] . SCDI argued that the "procurement of housing should prioritise suppliers who embed net zero carbon design, circular economy principles, modern methods of construction, bio-based materials, and fair work principles." [120] More broadly, CAS called for greater investment in energy efficiency measures to create jobs, support economic growth, and reduce bills for consumers in the long run. [121]

100. The STUC, in its written submission, claimed that "transitioning to net zero will only be realised in a just way, if there is significant investment in rail services, publicly run buses, democratically controlled renewable energy and energy efficient homes." [122] Cycling UK also calls for the Scottish Government to increase its active travel budget from £150m in 2022-23 to at least £235m in 2023-24, to ensure a "straight-line trajectory in funding towards achieving the £320m commitment the following year". [123]

101. In written evidence, the DHI observed that, while EU funding had previously contributed to projects aimed at reducing emissions across Scotland, replacement funding from the UK Government has very different priorities. This, it argues, "means there is even more pressure on the Scottish Government to ensure it maximises the impact of its spending to achieve net zero and to realise the potential economic gains". [124] However, the AGS argued that, while "the collective understanding of what it will take to deliver net zero is still evolving across the public sector, [and] public bodies—including the Scottish Government—need to have clear costed plans for climate change obligations". [125]

102. **The Committee notes the planned increase in capital funding for net zero programmes over the next three years, as set out in the Scottish Government's Targeted Review of Capital Spending (2023-24 to 2025-26) and seeks clarification on whether these funding allocations might be affected given the increasing pressures on the Scottish Budget.**

103. **The Committee invites the Scottish Government to provide details of how it is engaging with the private and third sectors to secure investment in measures to help achieve its interim targets of reducing emissions by 2030 and its net zero targets by 2045. We also ask the Scottish Government to confirm whether it is confident that the plans and funding it has in place, along with those of public bodies and local government, are sufficient to ensure their climate change obligations will be met.**

104. **We also look forward to considering the progress made in the Scottish Budget 2023-24 following recommendations from the Fraser of Allander Institute aimed at presenting climate change information in a more open and transparent way, that better supports parliamentary scrutiny and public understanding.**

Public service reform

105. In achieving effective public services, the RSR identifies the need for "an enhanced focus on delivering efficiency savings across the public sector" over the life of the Parliament, including through: digitalisation; maximising revenue through public sector innovation; reform of the public sector estate; reform of the public body landscape; and improving public procurement. The RSR states that the public service reform programme will be undertaken over the remainder of the Parliament session, with initial outcomes to be reported in the 2023-24 Scottish Budget, "underpinned by delivery plans to be produced by individual public bodies". [126] A flat sum of £3m has currently been allocated to public service reform in the Deputy First Minister's budget in each year for the remainder of the RSR period.

106. Audit Scotland, in its written submission, notes that setting out proposed efficiencies, reforms and spending priorities is sensible, "however, there are financial risks attached which the Scottish Government must manage closely over the medium term". [127] The AGS told the Committee there was a need for public service reform to be delivered "in a clear and transparent way, so that the impact is known, and the anticipated outcomes are clearly set out for users of public services and for public bodies". [128] Several witnesses commented that 'efficiencies' in the public sector tended in reality to result in cuts to services and jobs, with the SHRC noting that "cuts would mean maintaining effective public services would be extremely difficult". [129] Carnegie UK also expressed concerns that pursuing efficiency savings could have the unintended consequences of undermining the priorities in the spending review and lead to poorer outcomes. [130]

107. The SRC however argued that "it matters profoundly that Scottish Ministers succeed in reducing the cost of government …, otherwise taxes might rise, and the recovery and economic growth will be held back" and suggested that savings might accrue from reducing the number of local authorities and quangos. [131]

108. Unison Scotland claimed that, in considering reform, it should be remembered that "the public sector is a driver of the economy". It explained that "indeed, in some areas, it is the only main employer—it is the school, the local hospital or doctor's surgery and so on that create jobs in local areas, and if we start to chip away at that, we start to undermine the local economy". [132]

109. A number of witnesses questioned the timeframe in which efficiencies and reforms could be realised, including the Scottish Property Federation, which argued that "processes are likely to take some time to deliver and therefore may have little

direct benefit in the near future". [133] Audit Scotland similarly highlighted that "structural reform in the public sector can take time to achieve and generate short-term costs" and so the Scottish Government should be "realistic in its budgets about the speed and extent of efficiency savings, as well as reporting openly about the potential effect on services it delivers". [134] The SLC further observed that councils will need time and investment to make changes such as innovation and digitalisation of processes. [135]

110. The AGS highlighted the risk that, "given the scale of the change, it becomes harder to track and monitor whether there are savings or additional costs, particularly when activity is spread over not just different government portfolios but more widely across different parts of the public sector". He added that it becomes more difficult "for parliamentarians to scrutinise the process and for the public to be clear about the intended benefits [and] all those things need to be set out in advance". He went on to highlight how transparency and clarity of the impact of any savings arising from public service reform on delivery of the national outcomes is important not only for the users of public services but also for public bodies. As referred to earlier in this report, the AGS also stressed that plans to reduce the public service headcount must not be done on a 'piecemeal' basis but "must be co-ordinated and fully connected to service delivery requirements and expectations and to the outcomes that are anticipated from Government spending". [136]

111. SCDI proposed the creation of a transformation fund to enable innovation in technology in the health and social care sector to take place, noting that it could result in substantial savings for the NHS in Scotland. It went on to say that it hoped digitalisation of public services could be adopted in a positive way to allow all public sector employees to have the tools they need to do their jobs, and for service users to receive services in a way that suits them. [137]

112. CAS acknowledged that technological reforms can be positive developments but "for vulnerable clients with complex needs there is simply no substitute for local face-to-face advice in person from a trusted empathetic adviser". It further noted that while there may be money for new ideas and pilots that the voluntary sector can take advantage of, there is little funding to maintain and develop them in the medium-term. [138]

113. Questioned on the potential for shared services, CIPFA (the Chartered Institute of Public Finance and Accountancy - local government directors of finance Scotland section) noted that "although we would like to share services, it is not always practical to do that", adding that there may be opportunities to look at sharing some back-office functions now that more people are working remotely. [139] COSLA highlighted that some local authorities are already sharing services, for example, in planning, to help them best deliver services for their communities. [140]

114. The AGS made the point that the public sector estate "is huge in Scotland" and so "considerable thinking and planning need to be done about what public buildings are for, whether they should be owned and used by public sector bodies or whether individual community benefit can ensue from them". [141]

115. On public procurement, SCDI argued that "public contracts should be redesigned to increase opportunities for local supply chains to offer innovative and holistic

solutions and help to grow and harness wealth within communities". [142] The DHI agrees that more can be done "to realise the benefits and increase transparency throughout supply chains" [143] , while the FSB highlight that "the share of contract spend value going to micro businesses is under 5% and has declined in recent years". [144]

116. The Deputy First Minister noted that work is underway with local authorities, the NHS, and other bodies on taking forward a person-centred delivery of public services. This, he argued "is about reforming the way in which we deliver services, so that we support people more directly rather than relying on them to link up public services themselves". He noted that this "requires a great deal of alignment of activity from a range of organisations". The Scottish Government is also "looking carefully at the functions of different organisations" and taking forward work on the public sector workforce to ensure that the sector is appropriately sized and equipped "to meet the challenges that we face". The Deputy First Minister accepted "it is inevitable that challenging decisions will have to be made across the public sector in order to deliver financial balance". [145]

117. **The Committee recognises that the driver for public service reform and efficiency savings, as detailed in the Resource Spending Review, is the significant pressures on public finances in Scotland. Nevertheless, we believe that every effort should be made through the reform process to maintain and build on the person-centred delivery of public services, as described by the Deputy First Minister.**

118. **We note that reform and efficiencies often require costs upfront and time to deliver and we therefore invite the Scottish Government to confirm whether its plans to achieve savings by the end of this parliamentary session are realistic.**

119. **Our recommendation at paragraph 47 of this report identifies that greater progress could made, and more quickly, in putting in place the findings of the Scottish Exchequer Fiscal Transparency: Discovery Report including rationalising the myriad of financial 'outputs' identified.**

120. **We believe that the Christie Commission's pillars of prevention, partnership, people, and performance must be placed at the heart of the Scottish Government's reform programme to ensure that positive outcomes can be achieved. We therefore seek details from the Scottish Government on the action it is taking to embed the Christie Commission pillars within this process.**

121. **The Committee plans to examine the initial outcomes of the Scottish Government's public service reform programme to be published alongside the Scottish Budget 2023-24 later this year. We ask that, in considering potential options, the Scottish Government develops detailed and transparent proposals, clearly setting out priorities, funding, timescales and intended outcomes, as well as the potential impact on service delivery.**

122. **The Committee asks the Scottish Government to confirm how it will work**

with the public sector to minimise the impact of reform and efficiency savings on the quality of public services and the delivery of national outcomes.

123. **More broadly, the Committee accepts that the Scottish Government faces difficult choices in balancing its approaches to spending and taxation, while maintaining financial sustainability, and at the same time also seeking to support individuals and business as inflation continues to rise. The UK Government should also recognise the inflationary impacts on the Scottish block grant. We believe there is a need to foster an open and honest debate with the public about how services and priorities are funded, including the role of taxation in funding wider policy benefits to society.**

124. **We therefore welcome the Deputy First Minister's announcement that he will give consideration to launching a consultation process "on the various challenges that we face when it comes to tax and public expenditure … to encourage public engagement on those important and difficult choices". We believe that a wider public discussion on these issues would be helpful and we look forward to playing our role as a parliamentary committee in this important debate, including considering in due course the outcomes of such a future Scottish Government consultation.**

125. **We welcome the Scottish Fiscal Commission's plans to publish its first Fiscal Sustainability Report in March 2023, setting out projections and evidence on whether continuing public spending and revenue-raising in line with current policy will put public finances under pressure and become a fiscal risk". This not only provides an opportunity to best equip the Scottish Government to take the challenging decisions that help to secure and maintain future fiscal sustainability, it will also be a valuable contribution to the overall debate on balancing the books.**

Local Government finances

126. In its submission, COSLA argued that prioritising funding for health and social care and social security "does not resolve the underlying causes of poor health and wellbeing", adding that "education, housing and employment are all key social determinants" and investment is needed to "prevent problems". It highlights that "the 7% real-terms reduction in core funding for local government will mean that, by 2026-27, there will be £743m less in real terms to spend on frontline services that matter most to communities – equivalent to 20,000 fewer local government jobs". [146] In its submission, SLC acknowledged that health and social care and social security are considered priorities but that this prioritisation of funds comes at a cost of reducing other budgets. [147]

127. Local government bodies told the Committee that inflation has put additional strain on council budgets, with SLC indicating that it would usually be looking at a budget gap of just under £30 million, whereas the figure this year "will be into the mid-30s because of inflationary pressures". [148] According to COSLA, open and transparent discussions between central and local government is needed about "working together in a much more collaborative way" on budgets rather than funding being ringfenced to deliver national priorities locally. [149] SLC similarly called for "loosening the bonds at local level and trusting an authority to take the right decision for a particular area, which we hope will lead to positive outcomes in that area". [150]

128. COSLA are co-signatories with the Scottish Government to the NPF. In evidence they suggested that the Scottish Government and their local government partners should, in seeking to address the cost of living crisis, consider how best money can be allocated to contribute to the national outcomes. [151]

129. CIPFA argued that "we need to focus on the priorities and on the core budget rather than continually bringing in new policy commitments". It welcomed there being fewer new policy commitments in the most recent Programme for Government and also speculated whether there were existing policy commitments that could be revisited. For example, it highlighted that a significant amount of funding goes towards implementing the expansion of early learning and childcare provision to 1,140 hours, arguing that, "as costs escalate, the core budget is being eroded because of that policy decision". [152]

130. However, Engender argued that local authority cuts to childcare, education, social care and transport "are going to impact disproportionately on women's ability to participate in the economy". She suggested that these cuts should therefore “be analysed for their impact, because there is a risk that making them will be a false economy, given the limitations that they will place on women's participation in the economy in the future”. [153]

131. In written evidence, Midlothian Council claimed that the RSR “does not appear to make any attempt to target spending to help councils achieve net zero targets”, arguing that more engagement is needed between levels of government to understand the costs of achieving net zero targets and how best to fund them across the whole public sector. [154] COSLA also argued that local authorities “face a

delivery gap against our mitigation and adaptation ambitions”. [155]

132. When questioned on their levels of reserves, local authority representatives argued that some councils will need to use reserves in the current financial year to address inflation rises, while others will use them to support capital investment. SLC indicated that most councils have a small amount of money in reserves in comparison with their budgets, including the SLC itself whose “uncommitted reserve is 1.5% of our total and that is ‘in case of emergency, smash glass money”. It was suggested that, the SLC used it “to deal with immediate budget pressures, they would be having a conversation with the Auditor General pretty quickly after that about replenishing my reserves”. [156]

133. The Committee heard that local authorities were looking at ways of increasing revenue to plug their budget gaps and to deliver some of their core provisions. SCDI accepted that “there is scope to think about how tax happens at local government level” however, the “strong message that we have had from our members is that it is not the right time to introduce new taxes on businesses because of all the challenges they face, such as rising costs”. [157] The FSB [158] and SRC [159] have specifically called for no business rates increase this year.

134. One option supported in the submission by local government representative bodies is introduction of a ‘tourist tax’ which they argue would help local authorities fund services that are important to tourism, such as waste services, roads and infrastructure. [160] Unison Scotland agrees that “the ‘tourist tax’ is “just one example of where local authorities could and should be given more leeway to raise funds locally”, but that the funds gathered should be used “to enhance tourists’ experiences and to make better visitor attractions, [with] genuine benefits for local people, businesses and workers”. [161]

135. While there was broad support amongst witnesses that changes to council tax are overdue, there was recognition of the political challenges around this issue. CIOT noted that “it is a difficult tax to replace, because it collects a lot of money without many problems with collection” but, given it is within Holyrood's powers, it is “therefore easier to work with”. [162] The DHI suggested “everyone agrees that change is needed, but no-one can agree on what needs to change”, and asks that “we stop wasting time, get on and make a decision”. [163] Unison Scotland suggested that work on reforming council tax should continue and, in the meantime, additional bands could be introduced “so that people in bigger houses and properties pay a bit more”. [164]

136. The Minister for Public Finance, Planning and Community Wealth told the Committee on 22 March 2022 that a citizens' assembly would be set up to investigate the potential options for replacing or reforming council tax. He could not provide “a concrete timescale” for reforming the tax but that "going from where we are now to a fully embedded and operational new system would go beyond the lifetime of this session of Parliament". He added that council tax reform however remains “a key priority” for the Scottish Government. [165]

The Scottish Government and COSLA are currently undertaking a joint Local Governance Review “to consider how powers, responsibilities and resources are shared across national and local spheres of government, and communities”. [166] The Local Government, Housing and Planning Committee intends to scrutinise this Review in the coming months and, to inform its work on this issue, has commissioned research looking at other local government funding models. [167]

137. **The Committee recognises the ongoing challenges for local government finances, compounded this year by inflationary pressures. We also note the view that local authority core funding is shrinking due to the impact of ‘ring-fencing’ funds to deliver national priorities.**

138. **We ask the Scottish Government whether councils might be given greater flexibility in the next Budget to respond to local priorities, fund local services and deliver national outcomes for their local communities. We also seek assurances from the Scottish Government that it will work in partnership with local authorities in ‘co-designing’ a joint approach to local delivery of new national priorities and any potential impacts on local frontline services. Greater engagement is also needed regarding decisions on how best to fund measures that contribute to achieving net zero targets across local and central government.**

139. **We note that the Local Government, Housing and Planning Committee is undertaking scrutiny of the joint Scottish Government and COSLA Local Governance Review, which aims “to ensure Scotland's diverse communities and different places have greater control and influence over decisions that affect them most”. We look forward to seeing the outcomes of this work, including its commissioned research into other local government funding models.**

140. **In the meantime, the Committee invites the Scottish Government to respond to calls from a number of witnesses for additional local revenue-raising powers, to give greater flexibility for local authorities to build more sustainability into their finances and protect delivery of local services.**

1 Official Report, Finance and Public Administration Committee, Tuesday 7 June 2022

2 Economic and Fiscal Outlook – May 2022 , Scottish Fiscal Commission

3 Investing in Scotland's Future: Resource Spending Review , Scottish Government

4 Scotland's Fiscal Outlook: The Scottish Government's Medium-Term Financial Strategy

5 The Outcome of the Targeted Review of Capital Spending Review – Updated Spending Allocations for 2023-24 to 2024-25

6 Published responses for Scotland's public finances in 2023-24: the impact of the cost of living and public service reform - Scottish Parliament - Citizen Space

7 Official Report, Finance and Public Administration Committee, 27 September 2022

8 Official Report, Finance and Public Administration Committee, Tuesday 4 October 2022

9 Official Report, Finance and Public Administration Committee, Tuesday 7 June 2022

10 Economic and Fiscal Outlook – May 2022 , Scottish Fiscal Commission

11 Scotland's Fiscal Outlook: The Scottish Government's Medium-Term Financial Strategy

12 The Fiscal Framework describes how funding for the Scottish Budget should be adjusted following devolution of taxes and social security. These funding changes are called Block Grant Adjustments (BGAs). Tax BGAs remove funding from the Scottish Budget, because the Scottish Government is now raising its own tax revenue.

13 Indicative reconciliation figures are uncertain until confirmed outturn data for 2021-22 is published in summer 2023.

14 Economic and Fiscal Outlook – May 2022 , Scottish Fiscal Commission

15 Investing in Scotland's Future: Resource Spending Review , Scottish Government

16 Rising inflation expectations pressure Bank of England | Reuters

17 Bank Rate increased to 2.25% - September 2022 | Bank of England

18 Ofgem confirms energy price cap will rise to £3,549 from October | The Independent

19 Official Report, Scottish Parliament, 6 September 2022

20 Official Report, Scottish Parliament, 6 September 2022

21 Letter from Deputy First Minister and Cabinet Secretary for Covid Recovery to FPA Committee Convener, 7 September 2022

22 Official Report, Scottish Parliament, 6 September 2022

23 Official Report, Scottish Parliament, 6 September 2022

24 Written Question answered by Deputy First Minister, 25 October 2022

25 Prime Minister's Statement to the House of Commons, 8 September 2022

26 Chancellor of the Exchequer's announcement, 17 October 2022

27 Why has the pound tumbled? - BBC News

28 Bank of England announces gilt market operation (bankofengland.co.uk)

29 Chancellor of the Exchequer's announcement, 17 October 2022

30 Chancellor of the Exchequer's Growth Plan Statement to Parliament, 23 September 2022

31 Hunt shunts 'mini-budget' leaving PM with growing (plan) pains (tax.org.uk)

32 UK tax and spending plan pushed back by two weeks, says Hunt - BBC News

33 GDP monthly estimate: July 2022 - gov.scot (www.gov.scot)

34 Businesses hope for some clarity and stability after recent political turmoil | FAI (fraserofallander.org)

35 UK economy likely to contract in Q3 – BoE to hike regardless (currencytransfer.com)

36 Consumer Price inflation, UK: September 2022, ONS

37 Office for National Statistics, Tracking the prices of the lowest-cost grocery items, UK, experimental analysis, April 2021 – September 2022

38 Overview - Scotland's Labour Market: People, Places and Regions – Protected Characteristics. Statistics from the Annual Population Survey 2021 - gov.scot (www.gov.scot)

39 Public sector finances, UK - Office for National Statistics (ons.gov.uk)

40 UK National Debt - Economics Help

41 National Performance Framework

42 FPA Committee Inquiry on the National Performance Framework: Ambitions into Action: Evidence

43 FPA Committee Report on the National Performance Framework: Ambitions into Action

44 Submission from the Scottish Women's Budget Group

45 Submission from Scottish Human Rights Commission

46 Submission from David Hume Institute

47 Submission from Citizens Advice Scotland

48 Official Report, Finance and Public Administration Committee, 4 October 2022

49 Scotland's Open Government Action Plan 2021-25 (www.gov.scot)

50 Scottish Exchequer: fiscal transparency discovery report - gov.scot (www.gov.scot)

51 Scotland's Economic and Fiscal Forecasts – May 2022, Scottish Fiscal Commission

52 SPICe Briefing on the Resource Spending Review and Pre-Budget Scrutiny, 22 June 2022

53 Submission from Alcohol Focus Scotland

54 Submission from Scottish Human Rights Commission

55 Submission from the Auditor General for Scotland

56 Submission from the Institute of Chartered Accountants of Scotland

57 Submission from the Health and Social Care Alliance Scotland

58 Submission from Glasgow Life

59 Submission from the Chartered Institute of Taxation

60 Submission from Scottish Human Rights Commission

61 Submission from the Scottish Women's Budget Group

62 Finance and Public Administration Committee previous inquiries

63 Official Report, Finance and Public Administration Committee, 4 October 2022

64 Official Report, Scottish Parliament, 7 September 2022

65 Official Report, Finance and Public Administration Committee, 27 September 2022

66 Devolved Taxes Legislation Working Group

67 Official Report, Finance and Public Administration Committee, 20 September 2022

68 Official Report, Finance and Public Administration Committee, 27 September 2022

69 Official Report, Finance and Public Administration Committee, 4 October 2022

70 Official Report, Finance and Public Administration Committee, 20 September 2022

71 Official Report, Finance and Public Administration Committee, 27 September 2022

72 Submission from Scottish Retail Consortium

73 Submission from Audit Scotland

74 Official Report, Finance and Public Administration Committee, 20 September 2022

75 Official Report, Finance and Public Administration Committee, 27 September 2022

76 Official Report, Finance and Public Administration Committee, 27 September 2022

77 Official Report, Finance and Public Administration Committee, 27 September 2022

78 Submission from Inclusion Scotland

79 Official Report, Finance and Public Administration Committee, 20 September 2022

80 The Rationale for Employability Support, Fraser of Allander Institute, 20 October 2022

81 Submission from Professor David Heald

82 Official Report, Conveners Group, 28 September 2022

83 Official Report, Finance and Public Administration Committee, 4 October 2022

84 Official Report, Finance and Public Administration Committee, 4 October 2022

85 Government Policy on Freeports, House of Commons Library, 14 February 2022

86 Investing in Scotland's Future: Resource Spending Review, Scottish Government

87 The SFC's forecast of inflation is aligned with the OBR March 2022 UK inflation forecast. It notes that "after peaking in 2022 Q4, we expect inflation to gradually return to the 2% target as energy prices stabilise, global supply bottlenecks ease, and the squeeze on real incomes and demand limits domestically generated inflation". It goes on to say that after it closed its Forecasts, ONS inflation data of 18 May showed inflation continuing to rise sharply, underlining significant uncertainty on inflation.

88 Scotland's Economic and Fiscal Forecasts – May 2022, Scottish Fiscal Commission

89 SPICe, Summary of Written Submissions, 20 September 2022

90 Submission from Citizens Advice Scotland

91 Written Submission from Scottish Council for Voluntary Organisations

92 Submission from Federation of Small Businesses

93 Official Report, Finance and Public Administration Committee, 27 September 2022

94 SPICe, Summary of Written Submissions, 20 September 2022

95 Official Report, Scottish Parliament, 6 September 2022

96 Submission from Audit Scotland

97 Official Report, Finance and Public Administration Committee, 20 September 2022

98 Official Report, Finance and Public Administration Committee, 27 September 2022

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100 Investing in Scotland's Future: Resource Spending Review, Scottish Government

101 Official Report, Scottish Parliament, 6 September 2022 (parliament.scot)

102 Official Report, Finance and Public Administration Committee, 4 October 2022

103 Investing in Scotland's Future: Resource Spending Review, Scottish Government

104 Official Report, Finance and Public Administration Committee, 27 September 2022

105 Official Report, Finance and Public Administration Committee, 27 September 2022

106 Submission from Scottish Human Rights Commission

107 Submission from British Heart Foundation

108 Submission from Alcohol Focus Scotland

109 Official Report, Finance and Public Administration Committee, 27 September 2022

110 Submission from Scottish Federation of Housing Associations

111 Submission from David Hume Institute

112 Official Report, Finance and Public Administration Committee, 4 October 2022

113 Official Report, Finance and Public Administration Committee, 4 October 2022

114 AR6 Climate Change 2022: Mitigation of Climate Change — IPCC

115 Climate-related measures in the Budget and Spending Review - Office for Budget Responsibility (obr.uk)

116 Investing in Scotland's Future: Resource Spending Review, Scottish Government

117 The Outcome of the Targeted Review of Capital Spending Review – Updated Spending Allocations for 2023-24 to 2024-25

118 Submission from Scottish Federation of Housing Associations

119 Submission from Homes for Scotland

120 Submission from Scottish Council for Development and Industry

121 Submission from Citizens Advice Scotland

122 Submission from Scottish Trades Union Congress

123 Submission from Cycling UK

124 Submission from David Hume Institute

125 Official Report, Finance and Public Administration Committee, 20 September 2022

126 Investing in Scotland's Future: Resource Spending Review, Scottish Government

127 Submission from Audit Scotland

128 Official Report, Finance and Public Administration Committee, 20 September 2022

129 Submission from Scottish Human Rights Commission

130 Submission from Carnegie UK

131 Submission from Scottish Retail Consortium

132 Official Report, Finance and Public Administration Committee, 27 September 2022

133 Submission from Scottish Property Federation

134 Submission from Audit Scotland

135 Official Report, Finance and Public Administration Committee, 20 September 2022

136 Official Report, Finance and Public Administration Committee, 20 September 2022

137 Submission from Scottish Council for Development and Industry

138 Official Report, Finance and Public Administration Committee, 27 September 2022

139 Official Report, Finance and Public Administration Committee, 20 September 2022

140 Official Report, Finance and Public Administration Committee, 20 September 2022

141 Official Report, Finance and Public Administration Committee, 20 September 2022

142 Submission from Scottish Council for Development and Industry

143 Submission from David Hume Institute

144 Submission from Federation of Small Businesses

145 Official Report, Finance and Public Administration Committee, 4 October 2022

146 Submission from COSLA, CIPFA and SOLACE Directors of Finance

147 Submission from South Lanarkshire Council

148 Official Report, Finance and Public Administration Committee, 20 September 2022

149 Official Report, Finance and Public Administration Committee, 20 September 2022

150 Official Report, Finance and Public Administration Committee, 20 September 2022

151 Submission from COSLA, CIPFA and SOLACE Directors of Finance

152 Official Report, Finance and Public Administration Committee, 20 September 2022

153 Official Report, Finance and Public Administration Committee, 20 September 2022

154 Submission from Midlothian Council

155 Submission from COSLA, CIPFA and SOLACE Directors of Finance

156 Official Report, Finance and Public Administration Committee, 20 September 2022

157 Official Report, Finance and Public Administration Committee, 27 September 2022

158 Submission from Federation of Small Businesses

159 Submission from Scottish Retail Consortium

160 Submission from COSLA, CIPFA and SOLACE Directors of Finance

161 Submission from Unison Scotland

162 Official Report, Finance and Public Administration Committee, 20 September 2022

163 Official Report, Finance and Public Administration Committee, 20 September 2022

164 Official Report, Finance and Public Administration Committee, 27 September 2022

165 Official Report, Finance and Public Administration Committee, 22 March 2022

166 Local Governance Review - Improving public services - gov.scot (www.gov.scot)

167 Local Government, Housing and Planning Committee | Scottish Parliament Website