Finance and Public Administration Committee
28th Meeting, 2024 (Session 6)
Tuesday 8 October 2024

Pre-Budget Scrutiny 2025-26 - Managing Scotland's Public Finances: A Strategic Approach

Purpose

1. The Committee is invited to take evidence from the Cabinet Secretary for Finance and Local Government, Shona Robison MSP, in relation to its inquiry into Pre-Budget Scrutiny 2025-26 – Managing Scotland's Public Finances: A Strategic Approach. The Cabinet Secretary will be accompanied by the following Scottish Government officials—

- Richard McCallum, Director of Public Spending, and
- Lucy O'Carroll, Director for Tax.

2. The Committee will also have the opportunity to discuss with the Cabinet Secretary the latest Fiscal Framework Outturn Report, which was published on 26 September 2024.

The inquiry

3. The Committee agreed to focus its Pre-Budget 2025-26 scrutiny: Managing Scotland's Public Finances: A Strategic Approach on the following three key areas—

- Progress with the Scottish Government's public service reform programme,
- The Scottish Government's approach to taxation, including what its Tax Strategy should include and how potential behavioural responses impact business and individuals, and
- How the Scottish Government is using its capital expenditure to achieve innovation, productivity, and growth.

4. As part of this inquiry, the Committee is also considering whether the First Minister's four priorities (set out below) are the right priorities for the Scottish Budget 2025-26—

- Eradicating child poverty,
- Growing the economy,
- Tackling the climate emergency, and
- Delivering better public services.

5. The Committee's call for views ran from 10 June until 12 August 2024 and received 44 submissions. The questions asked in the Committee's call for views can be found at Annexe A. SPICe has produced a summary of written evidence to

support the inquiry. Oral evidence sessions with a range of witnesses were held on 10 September[1], 17 September[2] and 1 October 2024[3].

6. To inform its Pre-Budget 2025-26 scrutiny, the Committee held an engagement event with young people and business organisations in Dundee on 28 August 2024, with the aim of hearing views on what devolved taxation and spending policies would best ensure Scotland retains more of its younger working age population. Following a discussion, participants were asked to vote for their three main priorities, the results of which can be found at Annexe B and a summary note of the issues raised is available on the inquiry web pages.

7. As part of its Business Planning Day (BPD), the Committee held a fact-finding visit to the School of Life Sciences at the University of Dundee on 29 August to discuss opportunities to achieve innovation, productivity, and growth. A summary note of the areas explored at the Committee's fact-finding visit and BPD has also been produced.

8. The Committee also held a fact-finding visit to Estonia between 23 and 26 September 2024 to learn from the country's experience of public service reform, and in particular its digital transformation since the 1990s. A summary note of the Committee's discussions during the visit will be published on the inquiry webpages in due course. In the meantime, this paper highlights some of the key issues discussed.

Scottish Budget 2025-26: context

Scottish Budget and associated publications

9. The Chancellor of the Exchequer has confirmed that the UK Government's 2025-26 Budget will be published on 30 October 2024 and that a multi-year Spending Review will conclude in Spring 2025 "to embed mission-led government and transform public services".

10. The Cabinet Secretary for Finance and Local Government, in a letter to the Committee dated 20 June 2024, confirmed that the Scottish Government will publish a final Tax Strategy alongside the Scottish Budget 2025-26. In her letter of 23 August 2024, she indicated that "given the announcement of a UK Government multi-year Spending Review, due to conclude in the Spring, it is my intention not to publish a Medium-Term Financial Strategy (MTFS) alongside the 2025-26 Budget". She went on to say that "it is instead my intention to return to the usual schedule for the MTFS and publish a full MTFS in good time ahead of the Budget 2026-27; recognising the precise timing will depend on the timing of the UK's multi-year Spending Review".

[1] The Committee heard on 10 September 2024 from Audit Scotland, Professor David Bell from the Royal Society of Edinburgh, Professor David Heald of the University of Glasgow, Federation of Small Businesses, Scottish Retail Consortium, and Universities Scotland.

[2] On 17 September, it heard from the Health and Social Care Alliance, Institute for Chartered Accountants Scotland, North East Scotland Retrofit Hub, Oxfam Scotland, Public Health Scotland, Scottish Property Federation, and Women's Economic Empowerment Project.

[3] It heard from COSLA, Comhairle nan Eilean Siar, Scottish Borders Council and CIPFA Directors of Finance on 1 October 2024.

11. In a letter dated 24 September 2024, the Cabinet Secretary for Finance and Local Government confirmed that, as requested by the Committee, she "will proceed on the basis of delivering the 2025-26 Scottish Budget in Parliament on 4 December 2024, with introduction of the Budget Bill two weeks later, on 18 December". This timetable, she explains, is contingent on agreement from the Law Officers and the Secretary of State for Scotland to expedite their post-Stage 3 consideration of the Bill.

12. The Cabinet Secretary goes on to say that she plans "to delay publication of our Infrastructure Investment Plan (IiP) pipeline reset until after the UK Spending Review", which is due in Spring 2025. This IiP reset was originally intended to be published alongside the Scottish Budget 2024-25.

13. The Scottish Government's second six-monthly update on its public service reform programme, which was due in May 2024, was delayed when the UK general election was called. This update was provided in a letter to the Committee from the Minister for Public Finance dated 23 September 2024, which sets out—

- progress since the Scottish Government's first update in December 2023 and key commitments in the initial phase of the programme (to 2026),
- more information on the cashable savings realised through the Scottish Government's efficiency programmes, and
- more information on the Scottish Government's Ministerial Control Framework (MCF) which, the Minister explains, is not the final version and will be subject to review/amendment.

Economic and fiscal developments

14. The Committee heard evidence from the Scottish Fiscal Commission (SFC) on 3 September 2024 in relation to three reports it had published on 27 August 2024 – a Fiscal Update, Forecast Evaluation Report (FER), and Statement of Data Needs 2024 (SDN). Its Fiscal Update, intended to support Parliament's Pre-Budget scrutiny, highlights the following economic and fiscal developments since its December 2023 forecasts—

- The overall economic context for 2024-25, including Gross Domestic Product (GDP) "is broadly in line with our December 2023 forecast", while Consumer Price Index (CPI) inflation fell back to the 2% target in 2024 Q2, "around a year earlier than we expected in December 2023".
- Latest Real Time Information data shows that Scotland's earnings growth in the first part of 2024-25 has slowed and is now similar to the UK average, following a period where "tighter labour market conditions in Scotland" had pushed up Scottish earnings relative to the UK.
- Latest data relating to real disposable income per person show an increase in 2023-24, mainly as a result of lower inflation, following a record fall in 2022-23. The SFC suggests, however, that "the outlook in the near term remains challenging as the downward pressure from higher prices and the recent period of higher interest rates may continue for some time".
- Statistics showing annual productivity growth in Scotland averaged 0.6% from 2011 to 2023 compared to 1.7% from 1999 to 2010. In December 2023,

the SFC forecast annual productivity growth of 1.1 per cent by 2028-29, broadly in line with the OBR's forecast for the UK, with the underlying assumption that productivity growth in Scotland and the UK "will remain subdued and will not return to the pre-global financial crisis average".

- An 'economic performance gap' in Scottish income tax revenues of £624 million in 2022-23, once taking account of different policy choices in Scotland. The SFC states that, "in addition, the latest data suggests Scottish earnings growth is slowing relative to the UK, meaning the period of catch-up in Scottish income tax revenues may be coming to an end in 2024-25".

15. The SFC also comments on the recently published outturn data as follows—

- 2022-23 "was a relatively positive year for growth in Scottish income tax revenues, with the provisional income tax net position reaching £257 million". As this net funding position is higher than the projected negative £190 million when the 2022-23 Scottish Budget was set, there will be a positive reconciliation of £447 million applied to the 2025-26 Scottish Budget. The SFC explains that this figure "is less positive than the £732 million we expected in December 2023", and that this reduction is "mostly because of revisions in historical income tax data, which have lowered Scottish revenues relative to UK Government revenues". Income tax forecasts from the OBR and SFC (which are published alongside the UK Budget on 30 October 2024) will provide a more complete picture for income tax funding in the 2025-26 Scottish Budget.
- Social security spending in 2023-24 was £5.3 billion. The SFC estimates that spending exceeded the Block Grant Adjustment (BGA) funding by around £0.9 billion and that this gap will grow to £1.1 billion in 2024-25 and £1.5 billion in 2028-29.

16. The SFC's Fiscal Update further highlights that "since December 2023 there have been no significant confirmed changes in the Scottish Government's funding, but the pressure on spending has increased with public sector pay offers in Scotland now coming in higher than the pay policy published in May 2024", adding "there is significant uncertainty on the level of funding the Scottish Government will receive from the UK Government ahead of the UK Budget" on 30 October 2024. The SFC highlighted that the total public sector pay bill for 2023-24 was around £25 billion, over half of Scottish Government resource spending, and that the public sector in Scotland accounts for 22.6% of total Scottish employment compared to 17.6% for the UK overall. The SFC further suggests that—

> "If a Budget is set based on pay assumptions which are lower than those that materialise, this creates challenges with in-year management of the Budget, requiring the Government to reduce its planned spending on services. The recent emergency spending controls the Scottish Government has put in place for 2024-25 are the result of those challenges".

17. The SFC notes that "policy commitments the Scottish Government has made, such as the council tax freeze in 2024-25, social security spending and more generous pay deals in Scotland contribute to the growing pressure on the Scottish

Budget". It also repeats a call made in its December 2023 forecasts for "the Scottish Government to plan its Budget over the short, medium, and long-term".

18. The Scottish Government published the annual Fiscal Framework Outturn Report (FFOR) on 26 September 2024, showing actual receipts collected for devolved/shared taxes and actual spend on social security compared with the forecasts made at the time the budget was set. The FFOR states that total net provisional reconciliation to be applied to the 2025-26 Budget will be +£490.1 million. The Cabinet Secretary for Finance and Local Government wrote to the Committee on 3 October 2024 outlining the impact of the Office for National Statistics (ONS) updating their population estimates for England in 2022-23 on the income tax element of the reconciliation for 2025-26. This letter is at Annexe C and a detailed SPICe briefing on the FFOR is attached at Annexe D.

19. Another ongoing area of interest to the Committee is the replacement of EU Structural Funds, with two evidence sessions held with the then Secretary of State for Levelling Up, Housing and Communities during 2022-24. It is currently unclear whether the current UK Government will progress with all the funding commitments made by its predecessor in relation to specific allocations, for example, under the UK Shared Prosperity Fund (funded to March 2025), three rounds of the Levelling Up Fund, Multiply and City Deals. On 25 September 2024, the UK Government announced that a final decision on the funding for the Argyll and Bute Growth Deal will not be made until after its review of public finances, while the First Minister has indicated he remains "wholly committed" to the deal[4]. The Cabinet Secretary may have further information regarding the status of funding for projects committed to by the predecessor UK Government as well as the potential implications for the Scottish Budget should this funding not fully materialise.

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Scottish Government's Fiscal Statement

20. On 29 July 2024, following a public spending audit 2024-25, the Chancellor announced a series of measures aimed at alleviating a forecast overspend of £21 billion above the resource departmental expenditure limit totals set by HM Treasury in the UK Spring Budget 2024.

21. The Cabinet Secretary then, in a letter to the Committee dated 27 August 2024, stated that she is "working with my Cabinet colleagues to agree the necessary actions to reduce expenditure and ensure our finances are on a sustainable footing". She went on to say that "further to this, additional measures are now necessary following the UK Treasury's recent audit of public spending and lack of clarity over whether their decision to deliver Pay Review Body recommendations will be fully funded". The Cabinet Secretary highlighted the Scottish Government's decision to replicate the UK Government's decision to restrict eligibility for the Winter Fuel Payment to older people and that "the Scottish Government has also introduced a set of spending controls with the intention of further reduction spend in 2024-25".

[4] City Region Deals and Growth Deals are agreements between the UK Government, Scottish Government and local partners: Argyll and Bute growth deal put on hold by UK government - BBC News

22. Following her Pre-Budget Fiscal Statement in Parliament on 3 September, the Cabinet Secretary wrote to the Committee setting out further reductions and reprioritisation of spending which, alongside implementation of emergency spending controls, would help "to balance the 2024-25 Budget". These measures, she explains, are necessary to fund the public sector pay bill, demand-led activities, and a significant health and social care backlog. The letter notes that "in total up to £500 million savings measures have been taken" across portfolio areas, including reintroduction of peak train fares, not progressing a pilot on concessionary fares for asylum seekers, and restrictions on recruitment, overtime, travel, and marketing across the Scottish Government. The Cabinet Secretary also plans to utilise up to £460 million of ScotWind revenue funding. The measures taken therefore total up to £1 billion in-year changes. A full breakdown of the savings can be found in the Annexe to the Cabinet Secretary's letter.

23. The letter also indicated that, "as required by law, I can assure the Committee that the impact of these measures has been appropriately assessed, including in formal impact assessments where required". The Cabinet Secretary may be able to provide an update on when these impact assessments will be published.

24. In its immediate response to the Cabinet Secretary's announcement of in-year spending cuts, the Institute for Fiscal Studies (IFS) notes that "the last few years have seen the Scottish Government increase public sector pay, and roll out new, more generous social security benefits", which "reduce the amount available for other areas of spending and add to budgetary pressures". The IFS adds that "more difficult decisions are likely next year and beyond given the difficult fiscal outlook", adding that "the Scottish Government should use its forthcoming Budget and subsequent Scottish Spending Review to be clear about priorities – and which areas will see cuts – in order to reduce the need for in-year cuts, which are often more damaging". In its blog, Filling in fiscal cracks … again', SPICe also notes that "this is the third year in a row that the Scottish Government has made in-year changes to the Budget passed by Parliament just a few months previously", adding "it may also not be the end of the story", with some pay deals still to be settled.

25. Writing in the Holyrood Magazine, Professor Mairi Spowage, Director of the Fraser of Allander Institute (FAI), highlights the Scottish Government's decision not to publish a public sector pay policy alongside last year's budget "due to uncertainty about funding". She suggests that "in order to put any sort of budget together, the Scottish Government must have assumed something about how public sector pay would change in 2024-25", adding "so, not publishing a public sector pay policy essentially means that they were not being transparent about what was being assumed". The Scottish Government's Pay Policy 2024 was published in May 2024, with assumptions for "an effective 2.3% pay increase for the full year" for central government. Professor Spowage notes that "given the lack of transparency, we're not sure if the pay policy is in line with the assumptions made at the budget".

26. On 17 September 2024, FAI published its Scottish Business Monitor for Quarter 2 2024: Scottish Income Tax, What do firms think? This publication suggests that, of over 300 businesses across various sectors of the Scottish economy

surveyed[5] in May 2024, more than half (57%) have experienced little or no impact from the Scottish Government's income tax policy, 34% "have felt the effects more sharply". Key issues identified from the responses include recruitment and retention, wage pressures and competitiveness and investment. There was also recognition from some firms that "higher taxes play a role in funding public services in Scotland, such as healthcare and education".

Oral evidence: themes

27. Themes explored during the Committee's evidence sessions include—

Approach to taxation

- Consideration should be given to what the tax system should look like in 10 years' time and how devolved taxes fit into a UK system. The UK Government should be asked to take the lead in looking "at the whole system" including anomalies with marginal tax rates.
- Lack of progress with council tax reform "reflects badly on the Scottish Parliament". Council tax is now inefficient and inequitable. Revaluation should be addressed as a priority as part of the Scottish Government's upcoming Tax Strategy.
- The Tax Strategy should also move beyond the theory set out in its 2021 Framework for Tax and include more commitments. It was suggested that an additional principle of 'competitiveness' should be included in the Tax Strategy.
- The more information regarding potential behavioural change the better to inform Scottish Government decisions on tax policy.
- Given the uncertainty around levels of behavioural change arising from differential tax policies in Scotland and the UK, actual figures may not be as high as those modelled. An environment should be created where people want to stay in Scotland regardless of tax levels. Some said that the starting point should be what kind of society we would want to live in rather than what level of taxation is acceptable. Scottish Borders Council noted that the proximity of the Scottish Borders to the English border "means that taxpayers within our region may be more susceptible to behavioural change, including transit to England where the tax regimes are markedly different".
- Significant concerns were raised in relation to the sustainability of local government finances, with COSLA and local authorities welcoming the creation of new local levies, fees, and charges. However, it was recognised that the revenues gathered from these measures would only plug existing funding gaps.

[5] The survey asked the following two questions: How much has your business been affected by the Scottish Government's income tax policy? How has your business been affected by the Scottish Government's income tax policy?

Growing the economy, productivity, and innovation

- Governments in the UK have in recent years opted to cut capital spend at times of financial pressure, rather than reduce ‘day-to-day’ spending. However, capital spend is essential to grow the economy, increase productivity and attract private investment. Better medium- and longer-term planning is required to maximise capital investment. Declining capital investment on maintenance has led to deteriorating public infrastructure.
- The Scottish Government’s priority of ‘growing the economy’ was supported by all witnesses. However, some argued that economic growth should be seen through a wellbeing and/or human rights lens, while others suggested that unless economic growth is achieved, funds will not be available to prioritise wellbeing or human rights.
- Universities Scotland argued that growing the economy will require the Scottish Government to “pivot back” towards funding university research and highlighted that there are now fewer opportunities to access this funding in Scotland compared to England. Universities can also “take the lead on seeking Innovate UK funds to help businesses innovate and access resource”. A decline in the number of international students has diminished the funding available to universities. Visa requirements was cited as a key reason for this decline.
- There was support amongst small and retail businesses for small business reliefs in line with those in place in England and Wales. Regulatory burden was also highlighted as a significant area of concern for businesses, and early consultation and time for delivery of new regulations is required.
- Uncertainty around the Scottish Government’s Housing Bill has led to reduced investment in housing developments, which “kick-start the economy”. On green energy, the approach taken is on single measures, such as insulation or solar panels, rather than a holistic approach. Hubs, such as the North East Scotland Retrofit Hub, support workers to transition from the oil and gas sector and enable professionals to advise on the most efficient approach targeted to individual properties.
- All Governments need to “take people with them” in terms of net zero policy and there is a risk that they move too quickly with “schemes that aren’t thought through” or where infrastructure is not in place to support them, for example, electric vehicles. Public confidence can be undermined through this disjointed approach.
- Investment in social security contributes to economic growth as it leads directly to consumer spending.

Economic inactivity

- Social infrastructure, such as childcare, is important in ensuring a healthy population that contributes to Scotland’s workforce. Learning can be taken from the Marmot Place approach, which “recognises that health and health inequalities are mostly shaped by the social determinants of health: the conditions in which people are born, grow, live, work and age, and takes action to improve health and reduce health inequalities”.

- Scotland currently has around 825,000 economically inactive people, a third of whom are due to ill-health. Good health enables people to work, while good jobs are important to people's health.
- Economically inactive people are often still contributing to society, for example, as unpaid carers, where caring would be a cost to the public purse otherwise.
- Support should be targeted towards those people who want to move into the workforce, including disabled people.
- The system of universal credit currently disincentivises some women for entering the workforce.
- Capital spending on the fabric of buildings can contribute to improving health and the ability of people to work.

Strategic approach

- It was suggested "don't waste a crisis". Current fiscal constraints provide an opportunity to put in place a more strategic, coherent approach to managing Scotland's public finances.
- Longer-term approaches are widely supported, including in relation to multi-year funding and capital spending.
- Using one-off ScotWind funds to plug day-to-day funding gaps limits potential future spend on renewables.
- Local authorities argued that more capital funding is required to help address housing emergencies arising in up to 10 local authorities.
- There should be a focus on outcomes rather than on targets. The National Performance Framework is seen as a "powerful tool", but it does not drive spending and accountability around it is weak. It should be used to move away from working in silos. There was also some disappointment that the Scottish Government's Wellbeing and Sustainable Development Bill has not yet materialised.
- The annual budget would benefit from an approach similar to the mandate letters[6] issued to Cabinet Secretaries, showing how the Scottish Government's priorities are met by overall portfolio spending. An honest conversation is also needed about the areas in which the Scottish Government is prepared to disinvest in order to balance in-year budgets.
- Local authorities highlighted the "disproportionate effects of having ringfenced or directed funding on other areas". They seek more flexibility to take decisions that would improve outcomes and meet their shared ambitions with the Scottish Government. Conditions regarding maintaining teacher numbers are particularly restrictive, especially in the context of school roll figures and projections.
- While the fiscal framework between the Scottish Government and local government is still to be completed, COSLA was positive about the "open dialogue" and significant progress made.

[6] Mandate letters were sent by the then First Minister to all Cabinet Secretaries in September 2023 setting out how priority commitments in his Policy Prospectus will be delivered. Following the appointment of the current First Minister, the status of these letters is unclear.

Prevention and early intervention

- More investment is required in prevention and early intervention, although it was recognised that this can be challenging in the context of financial pressures. There are successful examples of preventative work which should be built upon. Public Health Scotland suggested that (1) a new category of public expenditure on preventative spend should be created to establish a benchmark and enable investment to be tracked over time, and (2) a system of accountability for prevention should be delivered.
- While the real effects of preventative measures can be difficult to assess, these measures are key to addressing long-term health and climate change challenges.
- It was argued that sustained investment is needed in prevention and early intervention and that “councils have the knowledge, expertise and ability to scale up preventative approaches”.
- Scottish Borders Council is “investing heavily” in digitalisation, for example, in relation to care, customer services, and online payments, iPads in schools, and core finance and human resources systems.
- There is a need to “refocus” on joint working between the Scottish Government and local authorities to harness digitalisation and artificial intelligence “in a safe way” and ensure that “no-one is left behind”. Planning was one area highlighted as a possible “first step” towards achieving a “key cohesive space” in relation to digital systems.
- There was a suggestion that local authorities are at the front-end of crisis-management, with significant and sustained demand for support through local authority hardship funds. They said it is unclear whether social security payments, such as the Scottish Child Payment, are helping people avoid crisis point.

Public service reform

- Costs can be saved through government reform, rationalisation of the public sector landscape and the sharing of back-office functions.
- Faster progress with public service reform can be achieved through commitment to firm milestones and timescales, and pilot projects.
- Additional policy and delivery requirements have “negatively impacted on a public sector already straining under pressure and “can create a significant barrier to reform and improvement across the public sector”.
- The voluntary sector should be included in discussions around reform as they are a key partner in delivering public services.
- COSLA suggested that it can be challenging to cut spending on the ‘here and now’ to invest in the future and, in the context of financial pressures, “it becomes an impossible task”. Local authorities suggested that “sometimes brave decisions need to be taken”, for example, in repurposing buildings that are no longer being used.
- Good progress is being made on a single islands authority (SIA) initiative, which aims to “improve services and outcomes for Western Isles communities by development and implementation of transformational public service reform”. Comhairle nan Eilean Siar suggested that, while the main

driver for creating a SIA is to achieve better outcomes, it could lead to savings of around 3-5% which, it argued, should be reinvested in local public services.
- The Councils of the Future working group is looking at examples of innovation and sharing these across local authorities, while local government benchmarking captures successes in public service delivery on a national basis, which all local authorities have access to. It was noted that the local authority duty of best value requires continuous improvement, while pilot studies are looking at 'outliers' in improving services.

Fact-finding visit to Estonia

28. A report of the Committee's fact-finding visit to Estonia on 23-26 September will be published on the inquiry webpages in due course. In the meantime, key issues discussed during the visit include—

Digitalisation

- In 1998, the Estonian Parliament earmarked 1% of GDP as permanent state funding for IT, ensuring that the policy endures, including during political change.
- Its Tiger Leap programme initiated in 1996 saw significant investment in developing and expanding computer and network infrastructure through public-private partnerships, with a particular emphasis on education. E-banking services and an e-Cabinet followed in 1996, and an e-tax authority in 2000. The Estonian X-road project was initiated in pilot form in 2000 and since became "the backbone of e-Estonia" allowing public and private sector information systems to link and operate together.
- Ninety-nine per cent of public services are now accessible online. A mandatory e-ID card is used in Estonia which enables residents to pay bills, vote online, sign contracts, shop, and access their health information.
- After gaining independence from the Soviet Union, the country aspired to be akin to a Scandinavian country. The new Estonian Government in the 1990s was made up of "fairly young people" who "had a plan and stuck to it". There was no pushback from citizens at the time as they had other priorities.
- The public sector collaborates very closely with the private sector, with a Government priority to provide private companies with stability and an opportunity to be bold and innovative. There is a culture of it being "ok to fail, so we do it quicker and learn from that and move on". Public-private partnerships continue, taking a 'whole nation approach' with the vision of "building something together".
- Transparency has been built into the approach, which has helped build public trust. Estonian people tend to "trust e-systems more than physical systems". The Government is transparent about the nature of cyber-attacks, which have increased in recent years. There is more emphasis on protecting critical infrastructure since the invasion in Ukraine.
- Staff exchanges from Government to the private sector and vice versa are commonplace and continue to be encouraged. The approach enables "good relationships and constructive criticism". People are "mission driven", with

some private companies volunteering their time for free. A new DigiAcademy has been created for civil servants.

- There is an expectation that younger people will help support other family members to overcome digital exclusion, but some people do not wish, or are unable, to use digital services. The State Audit Office suggested that there is a good network of access through local libraries.
- Estonia has developed a “very secure system that people can rely on”. Everyone owns their own data, and each area of the system can only access specific and relevant information to that area on the e-system. Proactive services include automatic maternity and paternity leave and benefits after a person is registered on the e-system as being pregnant by their GP.
- There is a data tracker which allows people to see who has logged into their personal data and criminal proceedings can be brought against anyone inappropriately accessing personal data.
- Estonia has created a Data Embassy in Luxembourg capable of providing data backups and operating the most critical services.
- The State Audit Office has suggested that Estonia’s international image is “still good”, but indicators are lagging. ICT investment has been a priority, the share of maintenance costs is growing, and there is a lack of clarity around overall costs. There can be time delays in legislation being introduced and enacted while supporting e-systems are developed.
- 30+ AI projects have been carried out in the public sector since 2019. Some examples of those projects used to streamline processes and improve public service delivery include:
    - Bürokratt – a network of chatbots for citizen services,
    - AI-driven tax fraud detection systems,
    - Autonomous vehicles – museum buses in Tallinn and Tartu, and
    - Automatic transcriptions of court hearings and Parliament sessions.
- According to a report published in April 2024 commissioned by Google and prepared by Implement Consulting Group in co-operation with the Estonian Government, generative AI could contribute up to €2.5 – 3 billion or 8% to Estonia’s GDP yearly if widespread adoption is achieved.
- The Parliament is exploring how AI can enhance its services, including through AI generated verbatim official reports and creating automated Committee meeting summaries. For committees, staff use the verbatim text to prepare Committee minutes of proceedings. In October 2023, the error rate was around 5%.

Wider public service reform

- Early state reform initiatives were funded by the EU and included reducing local municipalities from 213 to 79, with the criteria of at least 5000 inhabitants per municipality.
- Rationalising agencies, including ICT services, has taken place and Government officials are working on a catalogue of support services to identify opportunities for standardisation.
- Following Covid, there has been a public expectation that “things will happen faster”, which can present challenges for consultation and ‘co-creation’. Civil

servants are expected to provide evidence more quickly to support decision-making.

- A policy driven reorganisation of Government agencies is taking place, and each is subject to around 10% budget cuts.
- The number of Government documents have been rationalised based on feedback. There are now 17 Government strategic documents linked to budgets with clear metrics, an approach which is intended to make it easier to evaluate impact. Metrics includes public satisfaction.

Economy

- The OECD has recognised Estonia as the top country in the world for Tax Competitiveness. Its transparent and simple tax system includes a flat 20%[7] tax on individual income, no corporate income tax on reinvested and retained profits, a property tax which applies only to the value of land, and a territorial tax system which exempts 100% of international profits earned by domestic corporations from domestic taxation. VAT will rise to 24% and income tax rates will increase from 20% to 22% from January 2025. A new 2% tax on companies' accounting profits will also be introduced in 2025 to "bolster the country's security and defence" and is due to come to an end in 2028, unless renewed[8]. Tax returns are completed online. These forms are mostly pre-filled can take as little as two minutes to complete.
- Estonia has an ageing population. Gradual increases have been made to the pension age. Young people tend to prefer to follow ICT career paths rather than in industry. All university education is currently free of charge, with the Government now trying to target this more towards the skills base needed in the country.
- In addition to the permanent commitment of 1% of GDP for IT, the Estonian Government has a target of 1% of GDP for research and development.
- Companies that come to Estonia "tend to stay", along with the highly skilled workforce. There are a substantial number of micro-businesses in the country, which is partly attributed to the ease of setting up a business.
- The budget in Estonia is now 'activity-based' to enhance understanding of where funds are being spent, an issue of concern previously highlighted by the State Audit Office. It has developed the 'Tree of Truth', a dashboard showing Estonia's progress towards national strategic goals on the basis of national statistics.
- A Government goal is to link strategic and budget planning more clearly. The vision of Estonian's Fiscal Policy Framework is "we help to maximise wellbeing of Estonians, by making smart decisions quickly" and one of its goals is for a "financially literate state".
- The Government has started zero-based budgeting within three Ministries, justifying and approving budget lines each year rather than basing it on past spending. It is hoped that this approach will be extended to other Ministries within four years.

[7] This is due to rise to 22% from January 2025.
[8] Companies contribute to security with a profit tax | Finance

- The Government produces 4-year medium-term fiscal plans as well as an annual budget. Its deficit increased from 0.9% of GDP in 2022 to 3.4% in 2023.

Next steps

29. The Committee is expected to consider and publish its report on Managing Scotland’s Public Finances: A Strategic Approach in early November 2024.

Committee Clerking Team
October 2024

ANNEXE A

Managing Scotland's Public Finances: A Strategic Approach

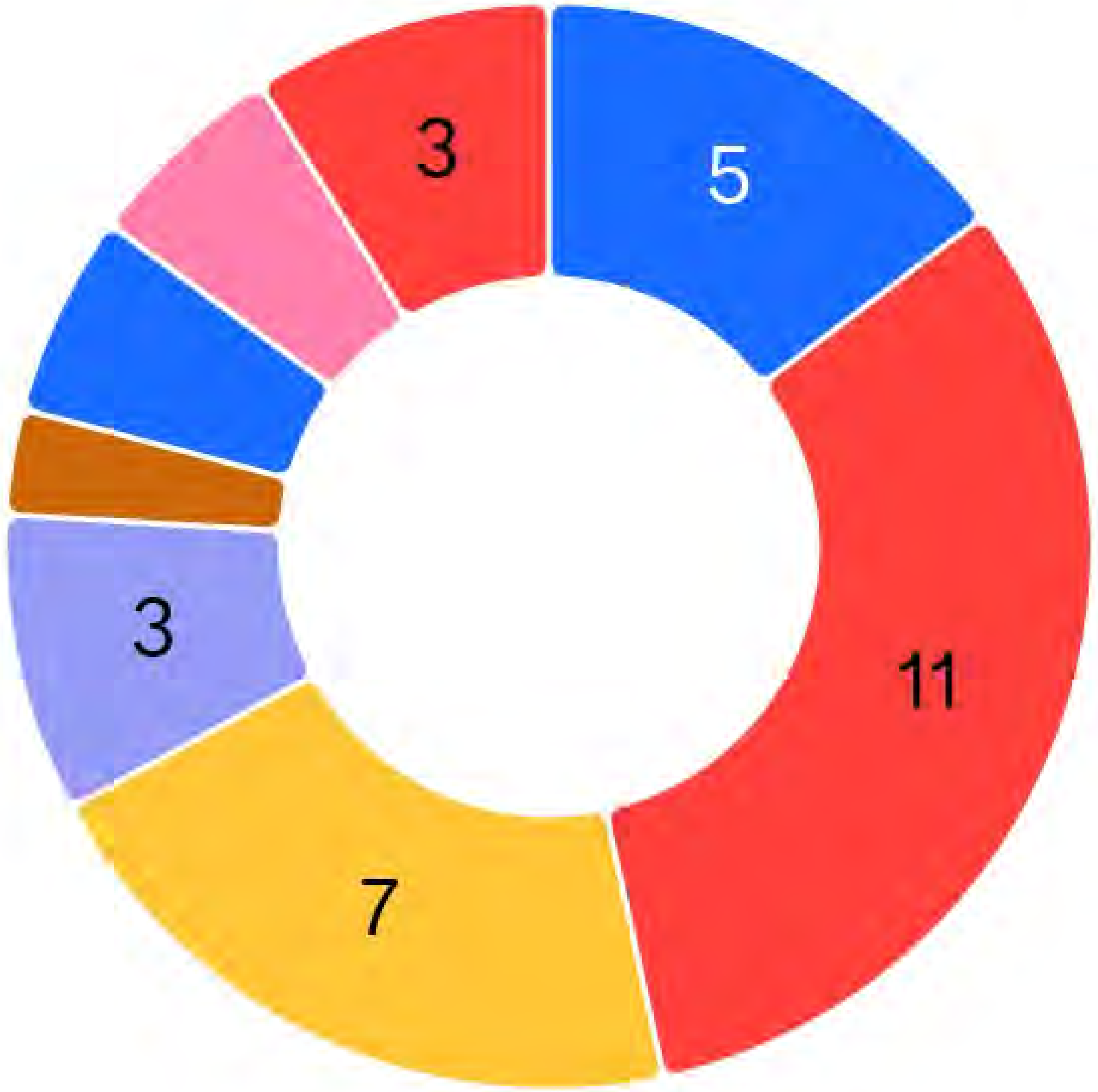
The Committee's call for views included the following questions—

1) Are the First Minister's four priorities the right priorities for the Scottish Budget 2025-26 and, if not, where should the Scottish Government focus its attention?
2) What taxation and spending decisions should the Scottish Government take to make most progress against each of the First Minister's four priorities, within the current financial climate?
3) What are the potential impacts of focussing budget decisions on these four priorities on those groups of society who traditionally experience inequality?
4) What progress has the Scottish Government made against its specific goals in relation to public service reform?
5) Are there any improvements that can be made to achieve faster progress with public service reform and improved outcomes?
6) The Scottish Government recently published its Public Sector Pay Policy 2024-25 which offers pay metrics above forecast levels of inflation. What are the implications of its multi-year framework on public sector bodies and on the Scottish Budget for 2025-26? And for the subsequent two years?
7) What elements should a new draft[9] tax strategy include to achieve such a tax system?
8) How should a new draft tax strategy address potential impacts of behavioural change on individuals, businesses, and the overall tax take?
9) What actions should the Scottish Government take to grow the tax base and increase labour market participation, productivity, and Scotland's economic growth?
10) What steps should the Scottish Government take, in its Budget, for 2025-26, to grow the economy by tackling the climate emergency?
11) Given the limited capital budget available, in which areas should the Scottish Government prioritise its capital spend in the Scottish Budget 2025-26 to deliver increased productivity, innovation, and growth?

[9] At the time of publishing the call for views the Scottish Government's position was to that it would publish a draft tax strategy rather than a final tax strategy.

Mentimeter

What devolved taxation and spending policies would best ensure Scotland retains more of its younger working age population?



5	Affordable housing
0	Better and faster public transport
11	Employment opportunities
7	Access to education (free tuition, non-university pathways)
0	Reputation (quality of learning)
3	Financial support as you grow (e.g. ISAs)
1	Universal services that are available and accessible (e.g. access top free dental care)
2	Sector-based incentives
2	Flexible pathways to work
3	Increased student support in schools and universities
0	Incentives for employers (via tax system)

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Cabinet Secretary for Finance and Local Government
Shona Robison MSP

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Scottish Government
Riaghaltas na h-Alba

Kenneth Gibson MSP
Convener
Finance and Public Administration Committee
The Scottish Parliament
Edinburgh
EH99 1SP

By email: FPA.committee@parliament.scot

3 October 2024

Dear Kenneth,

I wrote to the Committee on 15 July with regards to HMRC's publication of 2022-23 outturn for Scottish and UK Income Tax. This publication allowed officials to calculate the reconciliation for 2022-23 income tax which will apply to the 2025-26 Scottish Budget. My letter to the Committee set out that the Scottish Government's calculation of the reconciliation, which amounted to positive £447 million.

Since then, the Office for National Statistics (ONS) have updated their population estimate for England in 2022-23, which details a slight increase of around six thousand people. As the comparable growth rate between Scotland and the rest of the UK is a component of block grant adjustment (BGA) calculations, this impacts the 2022-23 outturn BGAs and reconciliation.

The outturn BGA has moved from £14,912 to £14,911 million as a result of this population change, which moved the reconciliation from positive £447 million to positive £449 million. This is reflected in the joint statement between SG and HM Treasury, which has now been published. The impact of the population change is outlined in Annex A.

My officials will be happy to answer any questions you have on this.

Yours sincerely,

SHONA ROBISON

ANNEX A

Table 1 - 2022-23 reconciliation applying to the 2025-26 Budget, pre-ONS update

2022-23 Income Tax			
	Revenues (£m)	**BGA (£m)**	**Net Position (£m)**
Forecast at Budget 2022-23	13,671	-13,861	-190
Outturn 2022-23	15,169	-14,912	257
Change	1,498	-1,051	447

Table 2 - 2022-23 reconciliation applying to the 2025-26 Budget, post-ONS update

2022-23 Income Tax			
	Revenues (£m)	**BGA (£m)**	**Net Position (£m)**
Forecast at Budget 2022-23	13,671	-13,861	-190
Outturn 2022-23	15,169	-14,911	259
Change	1,498	-1,050	449

ANNEXE D

SPICe The Information Centre
An t-Ionad Fiosrachaidh

Finance and Public Administration Committee
28th meeting 2024 (Session 6)
Tuesday 8 October 2024

Fiscal Framework Outturn Report 2024

Introduction

The Fiscal Framework Outturn Report (FFOR) was published on 26 September 2024. This report is published annually following a recommendation made by the Budget Process Review Group (BPRG).

The purpose of the FFOR is to show how actual receipts collected for devolved/shared taxes and actual spend on social security compare with the forecasts made at the time the budget was set.

Across the range of these devolved powers, the document sets out the level of either positive or negative "reconciliation" to be applied to the upcoming budget.

The document sets out the provisional closing balance for 2023-24 in the Scotland Reserve (the Scotland Reserve is the account into which underspends or surplus tax receipts can be placed).

The FFOR also contains information on planned borrowing and overall borrowing levels relative to the borrowing limits set in the Fiscal Framework.

The FFOR has a specific role to play in the pre-budget scrutiny process envisaged by the BPRG. Publication of this outturn information allows the Finance and Public Administration Committee the opportunity to question the Cabinet Secretary around how the Scottish Government intends to handle any negative or positive "reconciliations" in the upcoming Budget.

The data in FFOR

Members should note the following regarding the data used in the document:

- HMRC 2022-23 outturn data for both Scottish Income Tax revenues and the equivalent revenues for the rest of the UK are considered final. This means that the largest component of the reconciliation for next year's budget is set and won't change.
- 2023-24 outturn revenue data for Stamp Duty Land Tax (SDLT) and UK Landfill Tax, which feed into the BGA calculations for Land and Buildings Transaction Tax (LBTT) and Scottish Landfill Tax (SLfT) are considered final and won't change.
- The final, audited 2023-24 LBTT and SLfT revenue data will be published as part of Revenue Scotland's Annual Reports and Accounts towards the end of the calendar year 2024 and the revenue outturn data used within this report is therefore provisional. It is not clear what prevents final outturn from being ready for publication within the FFOR (as envisaged by the BPRG) and the likely scale of any change from these provisional numbers.
- Provisional outturn data is used for 2023-24 Social Security benefits expenditure and final outturn will be published as part of the Social Security Scotland Annual Report and Accounts, which will be published by November 2024. It is not clear what prevents this from being ready for publication within the FFOR and the likely scale of any change from these provisional numbers.
- Provisional UK Government Social Security benefits expenditure outturn data has also been used to calculate the BGAs with final outturn being made available when the Local Authority, Parliamentary, and Country and Regional Tables 2023/24 are published later this year. It is not clear what prevents this from being ready for publication within the FFOR and the likely scale of any change from these provisional numbers.
- Provisional outturn data is used for Fines, Forfeitures and Fixed Penalties revenue outturn for 2023-24. Final outturn will be published as part of the Scottish Government's Scottish Consolidated Fund Account. It is not clear what prevents this from being ready for publication within the FFOR and the likely scale of any change from these provisional numbers.

As is noted above, it is unclear what barriers prevent the Scottish Government from providing final figures in this document which is published 6 months after the end of the financial and tax year. Is it simply the timings of other publications (like Revenue Scotland's and Social Security Scotland's annual accounts) or another reason?

The FFOR concludes its discussion on the data used in the document by noting that "the overall reconciliation applying to the 2025-26 Scottish Budget cannot be finalised at this point, but will be confirmed in the 2025-26 Scottish Budget document." Again, it would be helpful to understand the likely order of magnitude change that might be expected to the overall reconciliation figure contained in the FFOR.

Key points from FFOR

Notwithstanding the provisional nature of the data underpinning the report, key points for members to note are as follows:

- The total net provisional reconciliation applying to the 2025-26 Budget will be positive £490.1 million.
- This positive reconciliation is largely driven by the income tax reconciliation of +£448.7 million (which is final). The combined reconciliation for the fully devolved taxes (Land and Buildings Transaction Tax and Scottish Landfill Tax) and Social Security is +£41.4 million.
- The provisional residual balance on the Scotland Reserve for 2023-24 is £293 million.
- Under current plans, the Scottish Government's capital debt will be £2.7 billion by the end of 2025-26. This equates to 87% of the total debt cap, and leaves £398 million of capital headroom. This is less than the annual Capital borrowing limit for this year of £458 million and comes at a time when Capital budgets have been impacted by the high inflation of recent years and real terms cuts in Capital budgets.
- In 2023-24 the Scottish Government drew down £300 million in Capital Borrowing from the National Loans Fund over a 10 year repayment term at an interest rate of 3.95%. The latest Scottish Government thinking on the potential issuing of Scottish bonds may be helpful to explore, as well as how interest on these might compare with borrowing from the National Loans Fund.
- Outstanding debt from Resource borrowing was £476 million at the end of 2023-24, £1.27 billion below the cumulative Resource borrowing limit of £1.75 billion.
- The Budget for the current financial year (2024-25) was set with plans to borrow £338 million in Resource to offset negative reconciliations. However, the FFOR notes that "all resource borrowing decisions will be finalised at the end of the financial year based on the overall financial position." An update from the Scottish Government on latest Resource borrowing plans would be helpful.
- The document confirms that the BGA methodology for Aggregates tax has yet to be agreed. The Bill to introduce Aggregates tax has now been passed by the Scottish Parliament but the Scottish rates and bands will not come into force until April 2026. When the Scottish Government expects the BGA to be agreed, the extent to which the Committee may be consulted or informed of progress and if there are any sticking points or whether it is expected to be a straightforward process, would be helpful areas to explore.
- Air Passenger Duty and the assignment of revenue from VAT appear to be no further forward and it remains unclear if and when these are likely to go ahead.

Table 1 below provides a breakdown of the £490.1 million provisional reconciliation to the 2025-26 budget.

Table 1: Reconciliation requirement for 2025-26 Budget by Tax / Power

Tax / Power	Final or Provisional outturn reconciliation	Outturn reconciliation amount £ million
Income tax 2022-23	Final	+448.7
LBTT 2023-24	Provisional	+8.7
SLfT 2023-24	Provisional	+7.6
Social Security 2023-24	Provisional	+25.0
Total Reconciliation	**Provisional**	**+£490.1**

Figures may not sum due to rounding.

Proceeds of crime

The FFOR notes that the basis on which the block grant adjustment (BGA) for revenues raised under the Proceeds of Crime Act 2002 remains a subject of dispute between the Scottish and UK Governments.

Whilst this is a relatively small amount of money it is unclear why it wasn't included in the updated Fiscal Framework and what the likely timescale is for any resolution.

Winter fuel payments

Responsibility for Winter Fuel Payment is due to transfer to the Scottish Government in November 2024, with these payments to be funded from within the 2024-25 Scottish Budget.

Following the UK Government's decision to means-test Winter Fuel Payments from this winter, the Scottish Budget will be reduced by between £140-£160 million from 2024-25 onwards.

The Scottish Government and HM Treasury are determining the technical arrangements required for the reconciliation of the BGA. The Scottish Government is in discussion with the UK Government and has committed to make payments this Winter to eligible pensioners in Scotland on terms equivalent to Winter Fuel Payments in England and Wales.

It is not yet clear what progress has been made with these discussions and specifically whether a decision has been made to defer the reconciliation of the £140-£160 million (mentioned above) to future years.

Ross Burnside
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Financial Scrutiny Unit (FSU)