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Rt Hon Rishi Sunak MP
Chancellor of the Exchequer
HM Treasury
1 Horse Guards Road
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20 November 2020

Dear Rishi

I am writing to you in advance of the publication of the UK Government's Spending Review. These are challenging times and the decisions you make will have profound implications. Building on the constructive discussions I have had with you and the Chief Secretary over the course of this year, I hope that you will be open to addressing the important issues I am outlining here, in the best interests of the people of Scotland and the rest of the UK.

UK Government fiscal approach

In June 2020 the Scottish Government published a paper setting out ten principles that should underpin the UK Government's fiscal approach. I have today published an updated version of that paper, in the light of the challenges that have emerged with the resurgence of the virus and the continuing need to support businesses and households through the crisis. This paper reaffirms my view that the UK Government must delay any fiscal consolidation, avoiding a return to the austerity of the past. There is a growing consensus - from international bodies, academia and think tanks - that now is the time to invest for recovery rather than balance the books. Indeed, with interest rates at historic lows, additional borrowing now to enable a more complete recovery would pay off in the longer term.

The importance of fiscal stimulus has never been greater, and there is a strong case for increasing day-to-day government spending to support the economy. This increased spending must generate increased Barnett consequentials for the Scottish Government and clarity that funding for the NHS will be adequate to meet the continued costs of responding to COVID-19. My paper argues that a UK-wide £98 billion stimulus package should be the priority for the Spending Review, to support the resilience of businesses and households; to regenerate the economy and hasten the move to net zero; and to reduce inequalities. Such as package is even more necessary now given the uncertainty caused by the UK Government's approach to EU exit.

It is vital that the Spending Review gives certainty around funding support for people in and out of work. While of course I welcome the extension of the Job Retention Scheme, the decision to do this at the eleventh hour, and only when it was clear that England was to enter a second lockdown, will have undoubtedly resulted in avoidable redundancies. A repeat of this situation must be avoided at all costs. This should be done by extending the furlough and other support schemes as long as they are needed, and possibly until the end of 2021, rather than ending them too early. The support should be targeted at individuals and sectors most in need, such as hospitality and the arts, to ensure an efficient use of public funds, while avoiding last minute changes to allow businesses to plan ahead.

Retention of the £20 uplift to Universal Credit and Working Tax Credits beyond April 2021 also remains vital. As noted in a joint letter from the Devolved Administrations to the Secretary of State for Work and Pensions on 12 November, many more people will have to rely on Universal Credit at this time of increased financial hardship and uncertainty, and people need to know that they can continue to rely on such support.

I also urge you to take urgent steps to support households and businesses manage the debt they have accrued during this crisis. For households, consideration should be given to providing low cost loans to low income households to help ensure they are not forced to take on loans with unmanageably high interest rates. For businesses, we should consider scrapping interest charges on COVID-19 related loans, or converting these loans to equity, managed by public policy banks such as the Scottish National Investment Bank.

And now more than ever we need to protect the value of public services as we continue to grapple with and overcome the virus. In this respect I am concerned by media reporting that the UK Government is contemplating a blanket freeze on public-sector pay next year. This would be a significant retrograde step that would neither recognise the substantial contribution made by public servants to combating COVID-19 nor support economic recovery. Given this and the significant impact that it could have on the Scottish block grant, I strongly urge you not to implement a public sector pay freeze.

Four nations approach

The Finance Ministers of the Devolved Administrations wrote jointly to you on 25 September, highlighting concern about the decisions to scrap the autumn UK Budget and uncertainties about the scope and content of the Spending Review. Even this close to the Spending Review, many of these uncertainties remain, and we have not been involved in discussion of potential UK policy decisions. The letter also made clear the need for effective dialogue around the economic and financial implications of EU Exit which we have not yet seen.

Uncertainty in relation to UK tax policies means that we will, for the second year running, be forced to set Scottish tax policies in isolation. Our budgets are inextricably linked through the operation of the Barnett formula and the Fiscal Framework, and these circumstances expose our policies and funding to unacceptable levels of risk. This risk could be mitigated by genuine information sharing in advance of our respective Budgets, ensuring of course that robust information security processes are in place.

This is something that should be in place during normal times to ensure good governance and policy making and I would be grateful if your officials would work with mine to agree a process through which it can be delivered.

The Scottish Parliament will likely need to have completed the Scottish Budget process prior to the date of the UK Budget. In order to provide certainty to taxpayers and to public services, we need guarantees that there will not be negative financial impact upon the Scottish Budget arising from UK Budget decisions.

Late announcement of consequentials remains a particular challenge for devolved administrations. The announcement of negative capital consequentials in early 2020, for the 2019-20 financial year was extremely difficult to manage, and had knock on consequences for budget management in future years. Better information sharing on likely underspends earlier in the financial year would allow all the devolved administrations to more effectively anticipate and manage such changes. Clawback of consequentials goes against the idea that Scotland manages its own risks and going forward we would look to have certainty in an allocation, managing it and our risks using our own fiscal powers.

In relation to COVID funding specifically, the UK Government's guarantees on the level of consequentials have been helpful, as was the eventual confirmation of the extension of the furlough scheme. However, the need for further detailed analysis remains, specifically on how funding for UK COVID measures this year breaks down, when Barnett applies and when it doesn't. It will also be important to see how funding for COVID is allocated within the Spending Review settlement.

Non-Domestic Rates

With regards to Non-Domestic Rates, the financial support provided during 2020-21 has been welcome. However, with ongoing restrictions being imposed in both Scotland and England it is clear that some sort of ongoing rates relief will be required for the most badly affected sectors and regions beyond 31 March 2021 even if our attempts to control the virus are successful.

The Scottish Parliament's Local Government and Communities Committee recently took evidence on the Scottish Government's decision to delay our Non-Domestic Rates revaluation to align with the decisions in England and Wales. The evidence presented to the Committee's call for evidence was overwhelmingly clear that the priority for Scottish businesses was clarity on the availability of reliefs in 2021-22 and beyond. In light of the financial restrictions of devolution I have made clear that our ability to continue offering relief next year is contingent on the UK Budget extending the equivalent policy in England and generating consequential funding.

Should the UK Government bring forward such an extension, I am committed to creating a tailored package of business support measures, including rates relief, that best meets Scotland's needs.

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In light of our four nations approach to controlling the pandemic, it is critical that your announcement next week provides clarity on the UK Government's approach to Non-Domestic Rates relief until the next revaluation, thus enabling me to provide Scottish businesses with the clarity they demand in the Scottish Budget. If your decision is delayed until a UK budget in March it will only increase the uncertainty facing business across the UK and put jobs and the economic recovery at risk.

Fiscal flexibilities

As you know, I remain concerned about the constraints the current funding arrangements place on the ability of the Scottish Government to respond to the impacts of COVID. I believe the limited and temporary additional fiscal flexibilities I have previously requested would increase the Scottish Government's ability to respond to COVID, without costing the UK Government anything.

Managing such significant COVID commitments within the narrow margins available to us at the year-end will be extremely challenging. An agreement now to some increase in the limits for both capital and resource (and for both carryover between years and drawdown next year) would therefore be reasonable in this very unusual year.

At this stage, I would also like to acknowledge the agreement made at official level that – as was the case for the 2020-21 Budget – the Scottish Government is able to choose to use either the provisional Block Grant Adjustments (BGAs) based on the OBR forecasts that will be published alongside the Spending Review, or the subsequently updated BGAs based on the OBR forecasts that will be published alongside the UK Budget.

Your officials have indicated that, while the Scottish Government has this choice, you will not provide any extra flexibility to manage any additional budget volatility that could be caused by the late UK Budget and use of provisional BGAs. That is neither fair nor reasonable. Should the UK Government make significant changes to its tax policy in the Budget, or should OBR forecasts change significantly, the BGAs could change substantially – potentially resulting in far larger in-year reconciliations within 2021-22.

My view is that the current flexibilities are insufficient even with normal UK Budget timing – my predecessor made this clear in a letter in September 2019 – and should your decision to hold a late UK Budget cause extra volatility, it is only reasonable that extra flexibility is provided.

Value Added Tax on PPE

The Scottish Government remains deeply disappointed by the decision to end the zero rate on VAT for PPE. The Financial Secretary to the Treasury, Jesse Norman, wrote to the Cabinet Secretary for Health at the Scottish Government on 16 November 2020 to advise that the relief had ended because it was no longer needed in England due to direct supply arrangements put in place. These arrangements do not extend to Scotland, of course, and our initial estimates suggest that, for health and social care PPE, the additional cost to the Scottish Government will be as much as £20 million for the remainder of this year alone. We therefore continue to urge you to reverse this damaging decision and to retain the VAT zero rate for as long as it is needed.

A priority concern here is the impact on social care in Scotland. The Scottish Government has already arranged to reimburse social care providers for VAT costs associated with pandemic-related PPE but there remains a cash flow and administrative challenge for providers, who are already operating under significant pressure. Scottish Government officials are working with organisations representing social care providers to assess the full extent of the implications of this change.

Scottish National Investment Bank

With the launch of the Scottish National Investment Bank ("the Bank") due shortly, there is an opportunity to look again at arrangements for it within the Scotland Reserve. Similar to the British Business Bank, the ability to carry budget between financial years will be essential to enable the Bank to have the economic impact required both to assist with the COVID recovery and to support further transformation of the Scottish economy.
Since April 2018 there has been a series of engagements about this at official and ministerial levels, and I would very much like to see this engagement translated now into an arrangement for the Bank. I would be happy to discuss an extension to current limits for the Fiscal Framework in the context of the other flexibilities set out in this letter, or a ring-fenced arrangement that is specifically for the Bank.

Green spending

The UK Committee on Climate Change has been clear that Scotland's net-zero target is contingent on policy areas which currently remain reserved being fully utilised and that the majority of the fiscal levers for a green recovery remain reserved to the UK Government. We must prioritise partnership working on climate activity as much as possible, particularly as we work towards a green recovery from COVID-19.

In relation to the Prime Minister's announcement and publication of the UK Government's Ten Point Plan for a Green Industrial Revolution, I am disappointed that we have not been more fully engaged in the development of key investments. However, the proposed action on decarbonisation and restated commitment to invest in Carbon Capture, Utilisation and Storage (CCUS) infrastructure builds on many of the policy and investment decisions of the Scottish Government and is a welcome intervention by the UK Government.

Further clarity is needed on what this reported £12 billion green investment means for Scotland. We will need to know:

- how much of the £12 billion will consist of direct investment in Scotland;
- how the Acorn project at St Fergus, Aberdeenshire, as the most advanced CCUS project in the UK, will benefit from the extra £200 million and the total £1 billion identified for carbon capture clusters;
- where will there be consequentials for areas under devolved competence to correspond to the funding offered to England in these areas, e.g. £5.2 billion for flood and coastal defences in England; and
- how much of the investment constitutes new spend.

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We would also urge you to engage meaningfully with the devolved administrations in designing the upcoming green gilt issuance. The Scottish Government welcomes the commitment to developing this market, and is keen to ensure that the proceeds are used to support the transition to net zero across the whole of the UK economy.

Clarity on these investments will allow the Scottish Government to work collaboratively with the UK Government to tackle the climate crisis and end our contribution to climate change.

I trust the information and propositions in this letter are helpful as you finalise the Spending Review, building on earlier discussions through the year, and reflecting the collaborative approach needed for an effective fiscal response in these particularly challenging times.

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