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

Dear Rishi,

In advance of your Economic Update on 8 July, I wish to offer some key points on behalf of the Scottish Government to inform your consideration, in line with my constructive dialogue with the Chief Secretary on our continuing response to the COVID-19 crisis.

My position reflects the analysis set out in our recent publication, 'COVID-19: UK Fiscal Path – A New Approach', which I had shared with the Chief Secretary to the Treasury and also enclose here, reiterating the importance of fiscal flexibility for the devolved administrations to be able to respond appropriately.

The central recommendation of this report is that the UK Government should avoid a return to the austerity of the past and adopt flexible fiscal rules. Growing the economy and reducing inequality should take priority over deficit reduction until the economy has fully recovered.

The report calls for a UK-wide fiscal stimulus package worth £80 billion, or 4% of UK GDP, to deliver an investment-led recovery, accelerate the transition to net-zero and build an economy which has the broader wellbeing of the population at its heart. This package should enable Scotland to shape its own response to the pandemic by providing further consequentials for investment into the Scottish economy, extending Scotland's fiscal flexibilities, and including a guarantee against negative Barnett consequentials being applied to the Scottish budget in the current financial year.

The report also outlines a number of specific actions we propose the UK Government takes to kick-start the economy that include:

- a temporary reduction in the standard rate of VAT to 15 per cent, and application of the reduced rate of VAT for key sectors in need of additional support, including the tourism and hospitality industries and construction;
- a jobs guarantee scheme for young people and extended sector-specific employment and business support schemes;
- two pence cut in employers' National Insurance contributions to reduce the cost of hiring staff;
- suspension of the Apprenticeship Levy to minimise the impact on payroll for employers, while maintaining investment in skills and apprenticeships;
- a National Debt Plan to help business and household budgets recover from the effects of the pandemic;
- using public money to protect jobs and livelihoods through support schemes, and to increase the responsiveness, accessibility and generosity of the UK welfare safety net so that it provides sufficient support for people in and out of work;
- new fiscal rules which prioritise economic stimulus over deficit reduction in times of crisis; and
- accelerated major investment in low-carbon initiatives, energy efficiency and digital infrastructure.

It is clear that there has already been a significant and widespread increase in debt as a result of COVID-19. This affects all parts of society, not just government. We need a National Debt Plan to deal with this in a way that promotes fairness as well as economic recovery. For households, this means working with lenders to ensure that loan, mortgage and rent holidays can be extended to those experiencing financial hardship as a result of COVID-19, and that alternative payment plans are put in place to help prevent people losing their homes. The pilot for no-interest loans for people on low incomes, which was being considered by HM Treasury prior to the pandemic, should also be introduced to prevent people in need turning to high-cost credit. 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.

It is also clear that young people have been particularly affected by the pandemic, as they are more likely to work in industries affected by closure, and less likely to be able to work at home. The UK Government should introduce a jobs guarantee for young people, to ensure that they have access to work, an apprenticeship or training that helps prevent the damaging effects of being out of the labour market at the beginning of their working lives. This should build upon the success of the Edinburgh Guarantee programme, where the public, private, educational and voluntary sectors work together to find placements of at least six months for young people.

We also need to take steps to support consumer confidence, particularly in sectors that have been especially impacted by the lockdown. A temporary reduction in the standard rate of VAT to 15 per cent, coupled with targeted additional measures for vulnerable areas such as hospitality and construction (focusing on repairs and maintenance), would help to support these businesses and boost consumer spending.

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A reduction in the standard rate plus the application of the current reduced rate of 5 per cent to hospitality would save Scottish households over £120 each month on average, providing a stimulus to support businesses. The timing of these measures must be aligned with the lifting of restrictions and changes to the furlough scheme to have the maximum impact.

The COVID-19 outbreak has highlighted pre-existing vulnerabilities in the UK social security system and I would urge the UK Government to take the opportunity now to address known issues with the benefits system to better support economic and social recovery. Households facing financial hardship would be better supported if the UK Government removed the benefit cap, scrapped the two-child limit and replaced the five-week wait and debt-inducing advance payments for Universal Credit with non-repayable hardship grants. . Although I welcome the UK Government's decision to temporarily increase the standard allowance rate for Universal Credit and Working Tax Credits, I believe that this uprating should be made permanent and that the generosity of legacy benefits, such as Employment and Support Allowance or Jobseeker's Allowance, should also be increased.

The welfare system of course is an essential lifeline for households struggling with their housing costs and facing homelessness. The changes made to the Local Housing Allowance rates have been welcome, but fall short of providing the longer-term support needed. I would urge the UK Government to provide a commitment to maintain the increase to the 30th percentile beyond 31 March 2021. We believe that better housing support for young people is crucial and call upon the UK Government to suspend the shared accommodation rate for under-35s, as we know those most likely to have suffered job losses as a result of the crisis are younger people.

I also welcome the extension of the Job Retention Scheme to October, and the extension of the Self-Employment Income Support Scheme. However, we need to ensure that this support continues to be offered for as long as it is required – whether that is through an extension of the existing schemes or consideration being given to specific support measures – and I would urge the UK Government to work with us to ensure that appropriate arrangements are in place beyond October for sectors of the economy that still need support, and for groups of workers including those who are asked to self-isolate.

As we embark on the route to economic recovery the UK Government's Apprenticeship Levy should be suspended, to minimise the impact on employers and allow them to address the immediate need to protect and create jobs. Businesses are already under intense financial pressure and the Apprenticeship Levy places an additional burden on those businesses liable to pay the Levy. It is critical, however, that the UK Government not only maintains but increases investment in skills and apprenticeships to respond to the expected rise in unemployment among young people and the serious, generational challenge that this represents for our country.

In terms of infrastructure investment, ahead of the Prime Minister's announcement earlier this week the Scottish Government had already announced an initial £230 million package focusing on construction, low-carbon projects, digitisation and business and jobs support. I note that the Prime Minister's initial £5 billion package generated nothing in consequentials this year for the Scottish Government, and I hope that will not be replicated in the statement on Wednesday.

I would additionally highlight the need for the regulatory framework to adequately facilitate our ambitions, as at present regulatory barriers risk stalling our progress notably on green recovery and digital connectivity. For example the draft determinations on electricity and gas network business plans expected shortly from Ofgem will be important in ensuring that networks are ready to connect renewable generation and in defining the opportunities for green gas over the next five years. My ministerial colleagues and I will look to engage constructively with UK Ministers on this matter.

I would ask that you encourage all UK Government departments to bring forward large scale procurement programmes that could support economic recovery, particularly capital expenditure that can support key strategic industries.

Our report also sets out the importance of extending Scotland's financial powers to allow the Scottish Government to shape its own response to the pandemic. At the Finance Ministers' Quadrilateral on 26 June, I raised this issue again with the Chief Secretary to request temporary easing of the rigid fiscal rules applied to the Scottish Government, and give us the reasonable flexibility we need to properly address the monumental challenges our economy is facing.

At the meeting, my views were shared by the Finance Ministers from the other devolved administrations. The key flexibilities we seek are the freedom to switch capital funding to day-to-day revenue, removal of the limits each country can draw down from its reserve and an end to the arbitrary limitations on borrowing. The powers we are seeking are focused, limited and temporary, and will enable the Scottish Government to respond more appropriately to COVID-19 and begin to regenerate our economy.

The Chief Secretary indicated that your Economic Update would advance the UK Government's thinking on fiscal flexibilities, and I look forward to hearing more about how you intend to address these issues.

On a related matter, I note and welcome the announcement on 2 July by the Local Government Secretary of the new package of support for local government to address spending pressures, including a scheme to reimburse councils for lost income and allow council and business rates tax deficits to be repaid over three years instead of one. I welcome the confirmation of the additional consequentials for Scotland of £50 million in respect of the grant funding, but there is a lack of clarity on the implications of the remaining measures for local authorities in Scotland, who are facing the same pressures as those in England.

I note the scheme to reimburse councils for a portion of the lost income, which like England is one of the biggest cost pressures councils in Scotland are facing. The detail that has been provided by the UK Government to date does not provide the certainty that either the Scottish Government, or local government in Scotland, requires. Without certainty on the Barnett consequentials that would accrue to Scotland from expenditure on this scheme in England, it will be impossible for the Scottish Government to match this scheme. I urge you to provide that certainty urgently and ensure that guaranteed funding will be made available to Scotland, together with full details of the scheme criteria, to ensure that Scottish local government is not unnecessarily and avoidably penalised. Similarly, further details are required on how the flexibility for council and business rates tax deficits to be repaid over three years will be applied and what flexibility can be extended to councils in Scotland.

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I note that the announcement also included that the UK Government will agree an apportionment of irrecoverable council tax and business rate losses between central and local government for 2020 to 2021 in the next Spending Review. I look forward to receiving further details on this in due course and on what benefits will flow to Scotland to help address the challenges our local authorities are facing in this area.

Lastly, I wish to raise the issue of PPE funding, the approach to which is still unresolved after many weeks of dialogue between the Treasury, the Department of Health and Social Care and the devolved administrations. I appreciate that the Treasury has earmarked billions of pounds of funding, but as things stand we have received minimal provision from the four-nations procurement process and had notification of only £10 million of consequentials. The devolved administrations have been clear that Barnett should be applied to the reconciled position and, whilst respective officials are working to service that approach, not to have had confirmation of it by this stage is disappointing and extremely problematic in terms of our own financial planning. I would be grateful for any assistance you could offer in resolving the matter.

In conclusion, whilst I appreciate the significance of the fiscal implications around many of the issues I have raised, I feel this corresponds with the gravity and urgency of the situation and the type of response that people and businesses across the country are seeking. I trust this letter is helpful in informing your upcoming statement, and I would be happy to discuss any aspects with you or the Chief Secretary. I am copying it for information to the Chief Secretary and to the Convenor of the Finance and Constitution Committee.

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