



T: 0300 244 4000
E: scottish.ministers@gov.scot

Rt Hon Philip Hammond MP
Chancellor of the Exchequer
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

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Dear Philip,

I am writing to set out the key issues that the Scottish Government wishes to raise ahead of the Budget on 22nd November.

The Scottish Government has a long standing opposition to the UK Government's austerity agenda which disproportionately hurts the poorest and most vulnerable in society. We believe the UK Government position of persisting with the same failed austerity agenda continues to damage public services and the economy.

With Brexit posing an unprecedented risk to the UK economy and consumer confidence, the UK Government must reverse their plans to impose a further £3.5 billion of cuts and set out measures to protect households from further austerity.

Brexit

There is a clear consensus that leaving the European Union will damage the UK economy and there is a growing concern that the lack of progress on the negotiations is leading to even more uncertainty for businesses and others. I want to reiterate the need for the UK Government to engage meaningfully with the Scottish Government on the negotiations and exiting the EU and to rapidly putting in place transition arrangements that will meet the needs of business and others.

EU funding benefits Scotland significantly, supporting jobs, delivering infrastructure, sustaining rural and coastal communities, providing valuable support for the farming and fishing industries, delivering research and innovation funding for universities and businesses, and supporting mobility in education.



As you are aware, the Scottish Government has confirmed that it will be passing on the current UK Government EU funding guarantees in full as appropriate to Scottish stakeholders, to provide stability and certainty for these key sectors of the Scottish economy. However, I and my Ministerial colleagues remain deeply concerned that no meaningful discussions have yet taken place on the precise detail of the guarantees. I must stress the need for a clear explanation of exactly what the nature and timeline of the guarantee is for each of the EU funding programmes, so that we can explain this clearly to stakeholders and thereby both manage expectations and enable businesses to plan for the future.

In addition, the details of successor arrangements to replace the current EU funding programmes after Brexit have yet to be proposed, and the devolved administrations must be fully engaged in decision-making on the establishment of future funding arrangements rather than being regarded as 'consultees'.

DUP Deal

The UK Government has shown flexibility in their approach to austerity, most notably with the agreement signed with the Democratic Unionist Party where £1 billion of additional resource was provided to Northern Ireland for devolved areas of spend, without any additional funds being provided to Scotland or any other part of the UK.

It is imperative that all budget decisions are made in accordance with existing funding agreements, such as the Statement of Funding Policy. Our officials continue to pursue discussions over the appropriateness of the way in which the UK Government decided to provide the additional financial support for Northern Ireland, with the aim of reaching a satisfactory outcome for Scotland and the rest of the UK.

Funding

On Common Agricultural Policy funding, and specifically on the allocation of the UK budget and convergence uplift, I welcome the recent agreement from the Secretary of State for Environment Michael Gove to a review of UK agricultural funding allocation and would urge that the convergence issue is now addressed as a matter of urgency.

On rail funding, the most recent offer of grant funding from HM Treasury to the Scottish Government to fund Network Rail (replacing borrowing) in Control Period 6 (2019-2024) is not consistent with the devolved funding arrangements. It offers less than 11.17%, which is the proportion of the rail network located in Scotland, as determined by the rail regulator in 2005. The offer is also around £600 million short of initial industry estimates on what is required to plan efficiently for the renewal of the network and to meet projected demands for rail use. This is about a fair deal for Scotland's railways, and making sure that we can continue to support sustainable economic growth and provide high quality, resilient services to Scotland's communities. It is essential that we reach a fair resolution as soon as possible.

I must repeat Scottish Ministers' concerns regarding the declining revenue from the National Lottery and consequent reduction in income available to sportscotland. As you are aware, National Lottery income for good causes reduced by 14% between 2015-16 and 2016-17 and by a further 4% in the first half of 2017-18. With National Lottery income making up nearly 40% of Creative Scotland's and sportscotland's total income, these reductions are of critical concern. I encourage you set out action to offset the reductions in lottery income and therefore mitigate against the impact to the sport and culture sectors in Scotland and across the rest of the UK.

Public sector workers continue to deliver our public services despite the pressures of austerity, both at work and in their own lives. That is why we are committed to lifting the 1% pay cap and it is now time for others to do so too. In our forthcoming budget we will deliver a pay policy that is both affordable and acknowledges the real life circumstances faced by public servants. But how far we can go will depend on the funding we receive from the UK Government. I urge the UK Government to heed our calls and provide sufficient funds to lift the 1% pay cap in the Budget.

Police and Fire Services VAT, Alcohol Duty and Air Departure Tax

I have raised on numerous occasions the issue with regards to the inability of the Scottish Police Authority and the Scottish Fire and Rescue Service to reclaim VAT which results in an additional unnecessary annual cost of around £35 million. Your officials have always maintained that the reason for the refusal to allow the services the ability to reclaim VAT was due to the way Police and Fire services are funded in Scotland and their lack of any power of precept on local taxation, thus leaving them as the only territorial emergency services in the UK not to have this concession. I find it very difficult to understand why Scotland's emergency services fail to have parity of treatment, as they provide exactly the same services as in other parts of the UK. I therefore urge you to reconsider introducing changes to VAT legislation through the Finance Bill to enable our Scottish emergency services to recover VAT and in doing so reimburse the £140 million that has been paid to date by Scotland's emergency services.

On the alcohol duty system, you will be aware that the Cabinet Secretary for Health and Sport, wrote to you on 29 June 2017 making clear our view that alcohol price should be related to the alcoholic strengths of drinks. We believe this approach would more clearly correlate price to the costs associated with alcohol use, as well as establishing a more consistent treatment of drinks of different types. I urge you to consider a review of the alcohol duty system to relate rates to strength.

Air Passenger Duty (APD) is due to be fully devolved to the Scottish Parliament by 1 April 2018. However, a significant issue has emerged around the Highlands and Islands exemption and the Scottish Government's ability to use the new power fully and flexibly. As things stand, it is clear that the tax has been devolved in a defective state and it is the responsibility of the UK Government to find a solution to this. I have set out a proposal in separate correspondence with the Financial Secretary which would enable APD to be successfully devolved whilst ensuring that neither the Highlands and Islands nor Scotland's public finances suffer detriment as a result. I have asked for a response to this by your Budget to allow me to make the necessary preparations for the Scottish Budget on 14 December.

Industrial Strategy, Renewables and North Sea Oil and Gas

We have been engaging at Ministerial and official level to ensure that the Industrial Strategy and associated funding delivers maximum benefit for Scotland. Despite that, the substance of the Industrial Strategy and its implications for Scotland remain unclear. In that context, it is essential that sector deals and any associated funding reflect Scotland's needs and opportunities. Furthermore, as sector deals are likely to cover both reserved and devolved responsibilities, they should be agreed with the Scottish Government.

To capture the opportunities presented by the fourth industrial revolution and in line with the Industrial Strategy we have ambitious plans for a National Manufacturing Institute for Scotland (NMIS). NMIS will inspire and enable companies and their employees to embrace new approaches and technologies and to undertake cutting edge R&D which can drive productivity growth. The letter in August from 21 senior industrialists including Rolls Royce, Babcock International and BAE Systems to the UK Secretary of State for Business, Energy and Industrial Strategy demonstrates strong demand for NMIS. I am therefore looking for UK Government to match our support for manufacturing in Scotland with the investment of at least £40 million in NMIS.

On renewables, the cost of onshore wind continues to come down and onshore wind remains the lowest cost renewables option. We continue to believe that a well-designed stabilisation mechanism, offering a steady power price and clear route to market but no net subsidy, can reduce costs still further, and deserves serious consideration.

Confirmation that the UK Government intends to support remote island wind is a welcome and important step. To ensure delivery of the projects and the transmission infrastructure, clarity is now required on how the £557 million will be allocated between future Contracts for Difference auctions. What developers and the supply chain need more than anything else is certainty. We will want to continue working closely with you to ensure that this certainty, and concrete progress towards building and connecting the huge resources on our islands, is delivered.

Over the course of 2017 there have been welcome signs of confidence returning to the North Sea. However, the downturn has seen investment and new activity fall significantly, and it is crucial this Budget includes immediate measures to maximise economic recovery and support the sector's highly skilled workforce.

The Scottish Government has long called for reforms to decommissioning tax relief to encourage new investment in mature assets and ensure that 'assets are in the right hands' – it is imperative these reforms are now delivered in full. The Minister for Business, Innovation and Energy wrote to you in June highlighting the scale of the opportunities from the introduction of Transferable Tax Histories, and while there should rightfully be safeguards in place to protect the taxpayer, the Expert Panel established to consider these issues concluded in August, offering sufficient time to deliver a robust solution this Budget.

The UK Government must further demonstrate its commitment to the industry by prioritising the development and implementation of a Sector Deal for oil and gas. The Scottish Government has offered its support, and it is particularly important any deal is cognisant to the landscape of devolved and reserved responsibilities. The prize is significant. With the right conditions and support, there is the potential to unlock a further £290 billion of value for the UK economy through increased revenues from sustainable oil and gas production and increased supply chain turnover from doubling the UK's international market share.

City and Regional Deals

I am pleased that you were prepared to match our commitment of up to £300 million to secure a city region deal for Edinburgh and South East Scotland. Tripartite discussions are underway on proposals for city region deals for Stirling & Clackmannanshire and for the Tay Cities of Perth and Dundee alongside their regional partners in Angus and North Fife. I trust that you will be prepared to support similarly transformational city region deals for these regions. I also invite you to join the Scottish Government and commit to supporting a Growth Deal for Ayrshire.

As an outcome from our recent review of enterprise in skills, we have committed to support the creation of regional economic partnerships across Scotland. These build on the approach taken to cities and their regions. To drive growth right across the UK – an aspiration set out in the Industrial Strategy – I would like to see UK Government develop a co-ordinated approach to Scotland, working with us in relation to all areas, including Argyll & Bute, Moray, Falkirk, the Borderlands and the Islands.

Welfare Cuts and Universal Credit

The Scottish Government asked the UK Government on 21 March and again, jointly, with CoSLA on 28 September to consider halting the roll out of Universal Credit which is pushing people into poverty. In particular, the inbuilt delay of 6 weeks wait for the first payment of Universal Credit is resulting in significant financial hardship for families. The announcements by the Secretary of State for Work and Pensions, to refresh the DWP guidance to offer Universal Credit advances upfront do nothing to fix the fundamental design flaws with Universal Credit. I strongly urge you to use the budget to announce a pause to the roll out of Universal Credit in order to fix the problems, or at the very least reduce the wait time for a first payment from 6 weeks to a maximum of 4 weeks; move to twice monthly payments to ease budgeting constraints and reverse the cuts in work allowances.

I would also urge you to reverse the changes which limit the individual child element of Child Tax Credit and the Child Element of Universal Credit to a maximum of two children, including the requirements under the “rape clause”, and reverse the reduction in the benefit cap which impacts hardest on low income families. Further, I also ask you to reconsider the reduction to the ESA work-related activity component which will inflict further pain on this group of claimants, who are already subject to the ongoing freeze to working age benefits.

The freeze on most working age benefits is pushing people into poverty, especially as inflation has increased, and the freezing of Local Housing Allowance (LHA) Rates will mean that for many people renting in the private sector it becomes increasingly difficult to find an affordable home. We would urge you to unfreeze the LHA rates.

I trust that you will consider the issues I have outlined above and that you will reflect them in your Budget on 22nd November.



DEREK MACKAY

