

MEETING: 10 SEPTEMBER 2020

REPORT BY: AUDIT DIRECTOR, AUDIT SERVICES

FINANCIAL DEVOLUTION AND CONSTITUTIONAL CHANGE UPDATE

Purpose

1. This paper provides an update on key developments surrounding financial devolution and constitutional change.

Background

2. We provided an update to the Accounts Commission in September 2019 on financial devolution and the UK's withdrawal from the EU. Our planned update in the Spring was delayed as a result of the Covid-19 pandemic.
3. Significant developments since September 2019 include:
 - The worldwide spread of the coronavirus pandemic. This has had a profound effect on every aspect of Scottish society. At the heart of is the health emergency, and the impact of the thousands of people who have died. For the economy, the lockdown has led to an economic downturn of a scale not seen in recent times. The impact on the public finances is unprecedented. This has put pressure on budget management, and has raised questions about the efficacy of the Fiscal Framework in managing crises.
 - The transfer of executive competency for remaining devolved benefits (except Severe Disablement Allowance) went ahead as planned in April 2020. This means Social Security Scotland is now accountable for around £3.5 billion of annual social security spending. On 1 April 2020 the Scottish Government announced an undefined delay to the delivery timetable for new and devolved benefits as a result of the pandemic.
 - The UK left the EU on 31 January 2020 and is currently in a period of transition until the end of December 2020. Negotiations between the UK and EU on their future relationship are ongoing.

Managing the public finances

The 2020/21 budget before the pandemic

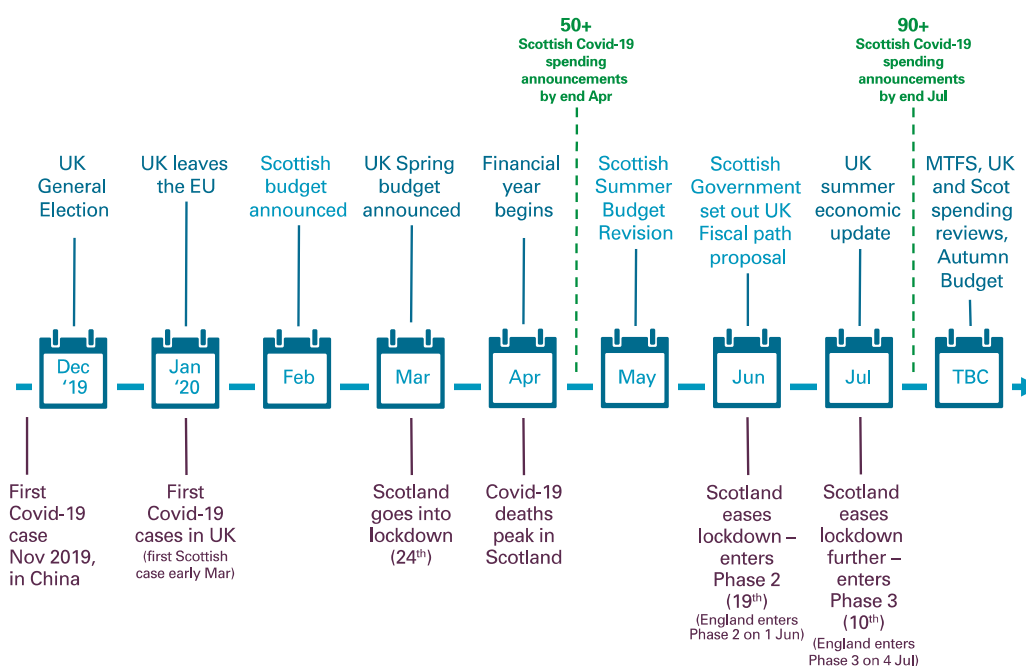
4. The Scottish budget was expected to be published in December 2019 but was delayed because of the UK general election. This led to an unusual budget process for 2020/21, as the Scottish Government published its budget on 6 February 2020, in advance of the UK Government's budget on 11 March.
5. Given the delays to both the Scottish and UK budgets, a bespoke timetable was developed for the Scottish budget's passage through Parliament this year. The revised timetable meant that there was less time for scrutiny between the stages of the budget bill compared to a standard year. The budget bill was approved by the Scottish Parliament on 5 March.

6. As in previous years, the minority SNP government had to gain the support of MSPs from other parties to pass its budget. It agreed a deal with the Scottish Green Party, which included a range of commitments, in particular an increase of £95 million of resource to support local government.¹
7. The level of UK Government funding to Scotland (which is the basis of the Scottish Government's funding and spending decisions) was uncertain at the time of publishing the Scottish budget. Local authorities must set their budgets by 11 March, in line with the Local Government Finance Act 1992, but the UK budget was not held until that date. COSLA raised their concerns about this timing earlier this year in a letter to the Chancellor of the Exchequer.²

The impact of the pandemic on the 2020/21 budget

8. The speed at which financial changes have had to be made due to Covid-19 is highlighted by the fact that the Scottish budget in February included no reference to the pandemic. The UK budget just over a month later included spending of £12 billion to tackle Covid-19. Significant additional spending was announced by both the UK and Scottish governments later in March once the UK entered lockdown (Exhibit 1).

Exhibit 1 Fiscal events and Covid-19 timeline



Source: Audit Scotland analysis

9. Since then, the UK and Scottish governments have made over 150 spending and tax announcements to respond to and manage the changing picture. Audit Scotland's briefing paper '[Covid-19: implications for public finances in Scotland](#)' published in August provides a snapshot of Scottish Government funding and spending relating to Covid-19. It also sets out the emerging financial and performance risks that the Scottish

¹ For more information on this deal, please see letter from [Cabinet Secretary for Finance to Patrick Harvie MSP, 26 February 2020](#).

² [Press release - COSLA writes to chancellor to warn of significant risks to councils over budget delay](#), COSLA, January 2020.

Government is facing as a result of Covid-19 and its economic consequences, and considers at a high level what this may mean for Audit Scotland's work in the future.

10. The paper sets out the £5.3 billion spending announcements made by the Scottish Government until the end of July. Of this, the Scottish Government's current estimate of spending is £4.8 billion for 2020/21.
11. The £5.3 billion includes a significant amount of spending announced for local authorities - £489 million as at 23 June (Exhibit 2).

Exhibit 2 - Scottish Government Covid-19 spending announcements as set out in LG circular in June

Spending announcements related to local authorities	£ million
UK Government Consequentials	155
Scottish Welfare Fund (Communities Fund)	45
Increased demand for social security benefits and Council Tax Reduction costs (Communities fund)	50
Food fund (Communities fund)	30
Free school meals	27.6
Community justice coordinators	0.4
Death registration service to work weekends and bank holidays	0.6
Local Authority Hardship fund (Communities Fund)	50
School attainment	100
Digital inclusion for children and young people	30
TOTAL	488.6

Source: Scottish Government, [LG circular 12/2020, 23 June](#)

12. Further funding of £60 million was also announced at the end of July for teacher recruitment and to support the full re-opening of schools on 11 August. £30 million of the funding was to support local authorities with cleaning, facilities management, school transport and other practical issues to limit the risks of Covid-19 infection in schools.¹
13. In addition, the Scottish Government has also provided funding to local authorities to compensate for the reduction in Non-Domestic Rates (NDR) funding, by increasing the General Revenue Grant (GRG). The Scottish Fiscal Commission has forecast that the cost of these NDR reliefs will be £875 million.² The Scottish Government guarantees the combined amount of NDR and GRG to councils and therefore it holds the financial risk that the cost of the reliefs is higher than forecast in 2020/21.³ However, COSLA have highlighted that any significant reduction in NDR income over the medium term (for example, as a result of a prolonged recession) will present risks to the Local

¹ [Phase 3 continues with further indicative re-opening dates](#), Scottish Government, 30 July.

² [Supplementary Costings: Non-Domestic Rates Measures](#), SFC, March 2020.

³ For more information on the NDR account, please see [The 2016/17 audit of the Scottish Government's Non-Domestic Rating Account](#), Audit Scotland, December 2017.

Government Settlement as well as it forms a key part of the overall funding to Local Government.¹

14. Local authorities have also distributed business grants announced by the Scottish Government. We were aware of some initial problems with the processing of grants in some councils, particularly Glasgow, and some teams were increased to meet the demand.²³
15. Processing applications and appeals are ongoing, but to date distribution is as follows:
 - 89,000 grants valuing over £998 million (out of nearly £1.2 billion) have been awarded through two Business Grant Schemes.⁴
 - £160 million of grants have been distributed through the funds for the Pivotal Enterprises Resilience Fund, the Creative, Tourism and Hospitality Enterprises and Hardship Fund and the Newly Self-employed Hardship Fund, which are worth in total £184 million.⁵
16. Since the end of July, the Scottish Government has made further announcements relating to the Covid-19 response. This includes a £50 million [funding package](#) to support social care providers, which will be allocated to Integration Joint Boards.
17. The Scottish Government's spending and response to Covid-19 continues to be a moving picture. The Scottish Fiscal Commission will be publishing a further fiscal update in early September that will provide more information on these issues, and the Scottish Government's Autumn Budget Revision will also be published later this month.

Social security powers

18. The Scottish Government's social security devolution programme had been working at pace before the pandemic, and was approaching its second phase of delivery, involving the complex disability benefits. The transfer of executive competency for remaining devolved benefits (except Severe Disablement Allowance) went ahead as planned in April 2020. This means Social Security Scotland is now accountable for around £3.5 billion of annual social security spending. The UK Government has agreed to continue to administer these benefits on the Scottish Government's behalf through agency agreements. The Cabinet Secretary has committed to update parliament by the end of Summer 2020.
19. The Covid-19 pandemic has impacted significantly on the social security devolution programme. On 1 April 2020 the Scottish Government announced an undefined delay to the delivery timetable for new and devolved benefits as a result of the pandemic. Along with the safe delivery of the benefits it currently administers, the Scottish Government has said it will prioritise the implementation of the Scottish Child Payment. It still aims to launch this new benefit by the end of 2020 but has acknowledged this may not be feasible. Child Winter Heating Assistance is also still

¹ [Submission from COSLA, SOLACE and CIPFA Director of Finance Pre-budget scrutiny 2021-22](#), August 2020.

² [Coronavirus in Scotland: SNP-run Glasgow is slowest council for business grants](#), The Herald, 30 April.

³ [Highland Council adds to team responsible for processing business grants in wake of coronavirus crisis](#), The Inverness Courier, 20 April.

⁴ Coronavirus (COVID-19): business support fund grant statistics, Scottish Government, 4 August 2020.

⁵ Letter from Cabinet Secretary for the Economy, Fair Work and Culture to Convener of Committee on Economy, Energy and Fair Work, 6 August 2020.

planned to be delivered in winter 2020. On 17 August 2020 the Scottish Government launched a further new benefit, the Job Start Payment. This benefit aims to support young people, who have been unemployed for at least 6 months, to transition into new employment.

20. It is too early to predict the extent of any divergence in the impact on social security spending between Scotland and rUK and the subsequent impact on Scottish funding. Of the £350 million Scottish Government fund for communities affected by Covid-19, £50 million has been set aside for additional pressure on devolved social security benefits and Council Tax Reduction. In June 2020 the Scottish Government also made a one-off extra payment to recipients of Carers Allowance Supplement, costing £19.2 million.

EU withdrawal

21. The UK left the EU on 31 January 2020. It is now in a transition period until the end of 2020. The main changes are that UK citizenship no longer means EU citizenship; the UK will not be represented by MEPs in the European Parliament; the UK will not be represented at European Council meetings; and the UK Government's Department for Exiting the European Union has ceased to exist. EU rules still apply in the UK during the transition period and the UK will still be contributing to the EU budget. People and goods will continue to move freely between the UK and the EU during the transition period.
22. The opportunity for the UK to seek an extension to the transition period for the UK's withdrawal from the European Union expired on 30 June 2020. Therefore, the UK will finally leave the European Union on 31 December 2020. Negotiations between the UK Government and the European Union are continuing about their future relationship, and in particular trading agreements, from 1 January 2021.
23. To date, there is very little clarity about what that relationship will look like in detail. In practical terms the negotiations will have to be concluded by October to allow them to be ratified by the 27 member states of the European Union. At this stage, it seems likely that any agreement will be very broad in scope and detailed negotiations will continue beyond the UK's departure.
24. The possibility of a departure from the European Union with no agreement remains high. The immediate issues that this raises in terms of continuity of supplies of food, medicines and medical supplies, in addition to all other supply chains with connections to the European Union, remain the same as in 2019.
25. The Scottish Government has restarted its preparations for a departure from the EU without an agreement. The former Brexit readiness team was expanded earlier in 2020 into an organisational readiness team to enable the Scottish Government to respond to the Covid-19 outbreak. However, this team is starting to shift its focus to preparing for the end of the transition period at the end of the year. The professional lead for EU withdrawal is meeting the Scottish Government's lead on EU withdrawal preparedness on a monthly basis.
26. In terms of primary legislation, the Scottish Government introduced the UK Withdrawal from the European Union (Continuity) (Scotland) Bill in June 2020. The bill gives Scottish Ministers the power to align Scottish legislation with European Union law after 1 January 2021. This focuses on devolved areas with a significant European Union component such as agriculture, the environment and fisheries. This presents a challenge to the UK government's desire to have a consistent regulatory "playing field" across the UK. The bill also proposes the establishment a new public body (Environmental Standards Scotland) to oversee the implementation and effectiveness of environmental law.

Crown Estate Scotland

27. The Scottish Crown Estate Act, which received Royal Assent in January 2019, sets the framework for the long-term management of the Crown Estate in Scotland. It provides for the devolution of management of assets from Crown Estate Scotland to local authorities, public bodies, Scottish harbour authorities and community organisations.
28. Crown Estate Scotland held a consultation on its draft strategic plan, which closed in November 2019. This received responses from 34 organisations and individuals.¹ Scottish Ministers are considering the responses which will inform the development of the final Strategic Management Plan for the Scottish Crown Estate.
29. In July, the Crown Estate confirmed that £9.7 million was being made available for coastal communities in Scotland in 2020/21, from revenue generated by the Scottish Crown Estate's marine assets. This related to revenue generated in 2018/19, the second year that the management of the Crown Estate has been devolved.
30. This funding is shared between the 26 local authorities with coastal communities, depending on their share of the sea area.² The distribution method for future years is being kept under review, as is part of ongoing discussions with COSLA.
31. This funding replaced the previous Coastal Communities Fund. Local authorities are to use the money for coastal benefit such as support for local projects or initiatives, but it is for each coastal local authority to decide how they utilise the funding.³

Conclusion

32. The Commission is asked to note the content of this report.

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27 August 2020

¹ <https://www.gov.scot/publications/consultation-analysis-report-draft-strategic-management-plan-scottish-crown-estate/pages/1/>

² [Scottish Crown Estate: revenue allocations 2020 to 2021](#), Scottish Government, 10 July 2020

³ Coastal Communities Fund, Scottish Government