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22 March 2023

Dear Professor Roy

I am writing in response to the Fiscal Sustainability Report (FSR) published today which provides a valuable contribution to our collective understanding of the potential impacts of demographic change on the Scottish public finances over the next fifty years. I want to thank the Scottish Fiscal Commission for undertaking this important new work. We look forward to continuing to engage with you as you develop your work on this over the coming months and years.

Whilst the trends modelled in the report look well beyond the lifetime of this Parliament, I want to take the opportunity to set out the Scottish Government's approach to managing sustainability and our initial reactions to the key points raised in your report.

### ***Fiscal Sustainability***

The report's assessment of fiscal sustainability highlights where risks and pressures on the public finances could materialise in the future. While the report makes assumptions that may change in the future due to different policies or constitutional settlements, the report rightly recognises the challenges that Scotland's changing population profile may present. As you note, these challenges are not unique to Scotland, and are prevalent in many high-income countries. However, Scotland lacks a full range of levers to deal with these in the way that other countries can, particularly over migration. The report also rightly recognises the impact on the Scottish Government's funding, and therefore its fiscal sustainability, will depend on UK Government spending decisions, and the potential impact of future reductions in UK Government spending on Scotland's block grant.

This Government is committed to ensuring we manage the public finances soundly, both now and in the longer-term. We have a strong track record and have continued to deliver

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budgets that are fully balanced, whilst also maintaining the widest range of public services for the people of Scotland. We have done so in the face of huge challenges, including most recently the cost of living crisis, and will continue this approach as we move forward.

As you are aware, alongside the annual budget process, we set out the Government's approach to risk management and medium-term planning annually in the Medium-Term Financial Strategy (MTFS).

As we've set out in each MTFS, the fiscal levers we currently have under the Fiscal Framework are insufficient to mitigate the risks we face. The Fiscal Framework is due to be jointly reviewed by the Scottish and UK Governments and this must ensure that the Scottish Government and Parliament are equipped with the appropriate budget powers and tools with which to manage the Scottish Budget. That should include consideration of more flexible borrowing and reserve powers, alongside the effectiveness of the BGA mechanism.

Under the current constitutional settlement, the operation of the BGA mechanism must ensure that the Scottish Government can make alternative policy decisions on devolved taxation and sustainable finances and benefit from growing the Scottish economy, whilst retaining a degree of protection from economic shocks that affect the Scottish and UK economies equally.

## ***Taxation***

We fully recognise that the tax system plays a vital role in determining how we fund public services in a fair manner. As one of the key fiscal levers at our disposal, both the UK Government and Scottish Government will require to consider how to use taxation measures to sustain public spending.

In December 2021, we published our first Framework for Tax which set out the key principles underlining the Scottish Government's progressive approach to taxation. Our tax policies are rooted in fairness and progressivity, and this will continue to guide the approach in setting tax policy for Scotland.

Growing the economy and tax base in Scotland will be vital to ensuring fiscal sustainability over the medium to long-term. The National Strategy for Economic Transformation is the key vehicle enabling us to do this, and the programmes of action strongly link to the fundamental drivers of Income Tax performance: employment and earnings growth. However, as you will be aware many of the factors affecting tax performance and fiscal sustainability, such as migration, are currently outwith our control and remain reserved to the UK Government.

## ***Spending pressures***

This Government continues to prioritise investment in Health and Social Care, providing record funding of £19 billion for 2023-24, supporting recovery and reform to secure sustainable public services. Despite record investment there remains significant financial challenges across Health and Social Care, not just as a result of demographic pressures but also rising energy costs and the ongoing impacts of Covid and Brexit. We have been clear that balancing the budget will require difficult decisions and reform.

We will continue to work with partners across health and social care to understand and address financial pressures. Our programme of reform will be accompanied by a clear

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financial strategy, taking account of significant changes, available resources and expected cost pressures including demographic changes, technological advances and inflation, as well as considering necessary mitigations.

As the report recognises, Scotland's funding and fiscal sustainability is largely dependent on UK Government spending decisions, but spending profiles and demographic drivers within Scotland are different to those within England. With those differences, and pressures within Scotland, predicted to increase over time, it is imperative that the UK Government recognises Scotland's specific needs and provides funding at an appropriate level, and the required fiscal flexibilities, in order to address pressures across Health and Social Care now and in the future.

Social security is a priority for this government and we are proud of the increases in benefits expenditure that we will be delivering, in order to drive forward our national mission to tackle child poverty. The projected growth in social security spending from £7 billion in 2027-28 to £13 billion in 2072-73, which is largely due to the impact of inflation, shows the strength of our commitment towards building a modern Scottish Social Security system with dignity, fairness and respect at its heart.

We do, however, recognise the impact of this growth on the broader public finances, alongside the impact of forecast variation. Social security spending is variable and is determined by the number of eligible people who apply for support, all of whom must be paid at the rate set in the policy. Our fiscal tools to manage this are limited.

We need to ensure that we have the capacity to meet that demand from within the Scottish Budget, and through using our limited fiscal tools such as borrowing and reserve powers to meet any forecast variation arising.

The Scottish Government will manage any variance between actual and forecast expenditure or Block Grant Adjustment, in a competent, responsible and balanced way, as part of the annual budget process, in line with the principles and policies set out in the Medium-Term Financial Strategy. Alongside this we will continue to press the UK Government for the necessary fiscal flexibility to manage these risks as part of the upcoming review of the Fiscal Framework.

### ***Ensuring public services deliver for the future***

A key element in ensuring future fiscal sustainability and that public services are appropriate to support the needs of Scotland's changing population is our work on public service reform.

We have commenced systemic action on public bodies reform, to consider all means through which we can ensure that resources are deployed in the most effective and sustainable ways to improve outcomes on our priorities.

### ***Population strategy***

We recognise the significance of long-term projected demographic change in Scotland and the need to consider a broad policy response to tackling this. That is why we commenced work in 2019 through the establishment of a Ministerial Population Taskforce.

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In recent years, all of Scotland's population growth has been sustained by migration, and any reduction in migration impacts on the size of the working age population. Brexit and the unnecessary ending of freedom of movement have hindered our ability to attract people to support Scotland's economy and public services. This presents fundamental risks to the future resilience and sustainability of Scotland's communities – particularly in remote, rural and island areas.

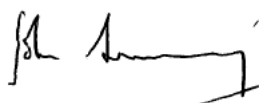
Since publishing the Population Strategy in 2021, the Taskforce continues to deliver a programme of work focussed on this national challenge. This includes working across government – and with local and regional partners – to ensure that Scotland's population profile provides a platform for sustainable and inclusive economic growth and wellbeing, and also ensure that our communities are attractive places to live, work, bring up families and move to.

Throughout the course of 2023, the Taskforce will launch a new Talent Attraction and Migration Service for Scotland, publish a new Addressing Depopulation Action Plan with a focus on resilience for local communities, and continue to call upon the UK Government to make the vital immigration reforms required to meet Scotland's needs.

In conclusion, I value the independent analysis produced by the SFC and its contribution to the debate around fiscal sustainability.

While the Scottish Government will continue to manage the public finances diligently with the powers we have, it is our view that the current constitutional settlement is insufficient to properly tackle the long-term challenges that Scotland faces. I believe the challenges of an ageing population illustrate the necessity for Scotland to be independent, providing the Scottish Government with full powers to manage the economy and public finances effectively and in a way that meets the needs of Scotland. Independence would also give the Scottish Government the power to design immigration policy tailored to Scotland's needs, and return the right to free movement in the EU.

Finally, as I leave the Scottish Government, I want to take the opportunity to thank the Scottish Fiscal Commission for their excellent work over the years and the vital role it plays in delivering independent fiscal scrutiny of Scotland's public finances.



**JOHN SWINNEY**

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