SCOTLAND OFFICE

Parliamentary Under Secretary of State

Dover House
Whitehall
London SW1A 2AU

Telephone: 020 7270 6806/6816
Fax: 020 7270 6815
www.scotlandoffice.gov.uk

The Lord Kerr of Kinlochard GCMG
The Earl of Kinnoull

17th March 2016

My Lords,

Thank you for your active contributions to our debate on the Scotland Bill at Report Stage on 29th February. I very much welcome the scrutiny which the Fiscal Framework received and I hope there will be opportunities to discuss these issues further.

During the debate I offered to write to you on some detailed points in relation to resource borrowing, agreed as part of the new Fiscal Framework for the Scottish Government published on 25th February.

<u>Paragraph 66 of the agreement</u>

You asked about the use of onshore GDP to identify Scotland-specific shocks and whether the current low oil price level would constitute such a shock.

First, we are using a GDP-based measure as the Smith Commission set out that the Scottish Government's fiscal framework should be consistent with the overall UK fiscal framework. The UK fiscal rules are based on a surplus rule that has a GDP trigger, which has been chosen as an appropriate and simple measure of the state of the economy. It is therefore right that we also use a GDP-based measure for the Scottish Government to ensure consistency.

Second, we are using onshore Scottish GDP as this reflects the economic impacts that the Scottish Government will need to manage. In particular, it is onshore economic output that will affect the Scottish Government's tax revenues (in particular income tax and VAT). Economic output from the North Sea contributes to *offshore* GDP, and any impact on offshore tax revenues remains for the UK government to manage. The low oil price would therefore only constitute a Scotland-specific shock if it had a sufficient impact on onshore Scottish GDP (e.g. through the supply chain etc.).

<u>Limits on resource borrowing (Paragraph 69)</u>

You asked how (using price or principal and in which currency) we will assess whether a borrowing limit has been breached.

The annual and overall borrowing limits refer to the principal only. The cost of interest payments on any borrowing would be for the Scottish Government to plan for and manage separately. On currency, all Scottish Government borrowing will be in Sterling. For resource borrowing, the Scottish Government will only be able to borrow from the National Loans Fund (NLF) so this will be in Sterling. For capital borrowing, the fiscal framework agreement states that borrowing must be in Sterling.

Refinancing (Paragraph 69)

You asked how refinancing would work. The Scottish Government will have the ability to refinance resource borrowing that is due for repayment at the time of a Scotland-specific shock. This will mean that resources can be directed at responding to an economic shock not repaying debt. Refinancing on the same terms means that the borrowing will be extended for the previous length of the term – that is between 3 and 5 years as determined by the Scottish Government.

Paragraph 70

You asked how we interpret 'temporarily' in this paragraph, referring to when an escape clause from borrowing limits might apply.

In the instance of a Scotland-specific shock, it will be at the Treasury's discretion to agree to a request from the Scottish Government for extra borrowing (above the agreed £600m annual limit or statutory £1.75bn overall limit) to reflect the scale of the fiscal impact. However, it should be noted that the agreed limits would have been sufficient in historical instances of a Scotland-specific shock (at least over the past 50 years or so for which data is available). The escape clause therefore exists in case there is a worse scenario in the future.

Guaranteeing Scottish Government debt

You asked whether the UK government would stand behind ('bail-out') Scottish Government borrowing.

Scottish Government borrowing counts towards overall UK borrowing, so it is important to have a fiscal framework that delivers sustainable public finances for the UK as a whole. However, it is important to be clear that the Scottish Government is fully responsible for all its borrowing and debt - the UK government does not stand behind this borrowing. Instead the agreed limits have been set at a level that the Scottish Government is expected to be able to manage.

I hope that answers your questions from the debate, but as always I would be happy to discuss these matters further.

I am placing this note in libraries of both Houses, and copying this to the Chief Secretary to the Treasury and the Secretary of State for Scotland as well as the Chairs of the Economic Affairs and Constitution Committee and noble Lords who spoke on the Fiscal Framework at Second Reading of the Scotland Bill.

Yours Sincerely

LORD DUNLOP

PARLIAMENTARY UNDER SECRETARY OF STATE FOR SCOTLAND