

A solid orange right-angled triangle pointing downwards and to the right.

Edward Mountain MSP
Convener
Net Zero, Energy and Transport Committee
The Scottish Parliament
Edinburgh
EH99 1SP

15 August 2024

Dear Convener

I am writing to respond to the Committee's consultation on proposed Scottish Government legislation on its approach to setting targets for carbon emission reduction.

The Commission's report [Fiscal Sustainability Perspectives: Climate Change](#) published in March 2024 analysed the implications for the Scottish public finances of meeting Scotland's statutory emissions target to reach net zero by 2045, adapting to climate change and handling the damage it will cause. Our report made a number of recommendations on improving the data and information provided by the Scottish Government relating to its plans on climate change. These recommendations were focussed on supporting planning and prioritisation to help manage the pressures on the Scottish Budget over the next 25 years.

The annex to this letter responds to the questions raised in the consultation. I have also published this letter on the Commission's own website.

I am happy to discuss any aspect of our response to the Committee's consultation and anything the Commission can do to aid the work of the Committee.

Yours sincerely

A handwritten signature in black ink that reads "Graeme Roy".

Professor Graeme Roy

Annex

Scottish Fiscal Commission response to Net Zero, Energy and Transport (NZET) Committee's call for views as part of pre-legislation scrutiny.

Part One – Carbon budgets

1. Do you agree or disagree with the proposed shift to 5-yearly carbon budgets (in place of current system of annual targets)?

Please set out any advantages or disadvantages of a 5 yearly carbon budget approach in Scotland?

Please set out any advantages or disadvantages of retaining the current annual target system?

The Scottish Fiscal Commission's interest in climate change stems from the implications of the Scottish and UK Government's policies on the Scottish Government's fiscal sustainability. We do not take a view on the most appropriate method of monitoring emissions; however we note that consistency with the approach taken at the UK level may facilitate a clearer understanding of how the UK and Scottish targets and progress against those targets interact, and how UK Government policy decisions may affect progress against the Scottish targets and the funding available to the Scottish Government.

2. What are your views on the advantages and disadvantages of carbon budgets / targets being expressed as a percentage reduction or as absolute levels of emissions?

The Scottish Fiscal Commission has no view on this.

3. The Climate Change Committee (CCC) suggested that the Scottish Government should consider aligning the proposed 5 yearly carbon budgets with the periods that are used for UK carbon budgets (i.e. 2023-27, 2028 – 32, 2033-2037 and 2038-42). What are the advantages and disadvantages of alignment with UK carbon budget periods?

As in our answer to question one, we note that consistency with the approach taken at the UK level may make it easier to monitor and assess progress against the targets and the fiscal implications.

4. At the end of a carbon budget period, there can be a surplus or deficit of emissions reductions. What do you think the legislation should say about how future surplus or deficits in emission reductions are dealt with?

The Scottish Fiscal Commission has no view on what approach should be taken, but the legislation should be clear how future surpluses or deficits are dealt with, and if the Government is required to incorporate those surpluses or deficits into subsequent carbon budget periods then the associated Climate Change Plan should clearly set out the effects on its spending plans. In particular if deficits are incorporated into future

carbon budget periods then the Government should set out policies for making up the deficit and detailed costings of these policies which explain how the cost will be split between the public and private sectors.

5. In early 2025, the Climate Change Committee (CCC) will advise the UK on the level of its Seventh Carbon Budget. This is the legal limit for UK net emissions of greenhouse gases over the years 2038 to 2042. The CCC have suggested that could be used as the basis for advice on appropriate levels for carbon budgets in Scotland. The Cabinet Secretary told the Committee that this ‘might be the point at which we are able to have clarity on the targets, and I would want a plan to be produced very quickly thereafter’. Should the Scottish Government wait for the planned advice on the UK’s seventh carbon budget from the CCC, before setting their carbon budgets?

Should the Scottish Government propose multiple 5-year carbon budgets in 2025 up to the year 2042?

How soon after the Scottish Government has received advice from the CCC should it propose their carbon budgets?

What should the process of parliamentary scrutiny look like for the laying of carbon budgets and plans for meeting budgets?

The Scottish Fiscal Commission has no view on what approach should be taken, but we note that climate change and the required response to climate change through spending on mitigation, adaptation and damage pose significant risks to fiscal sustainability. As we respond on the Climate Change Plan questions below, there should be clear plans for policies to meet mitigation targets, the cost of each individual policy, and its effect on emissions. It should be clear how these costs are split between the Scottish Government, other parts of the public sector and the private sector where appropriate. The Scottish Government should be clear whether the Climate Change Plan will cover the same timeframe as the 5-year carbon budgets and how far in advance it will set out costed policies. For our assessment of fiscal sustainability it is important that the Scottish Government set out not only policies for the next 5-years but also the approach it plans to take to reach net zero by 2045.

We make the general point that the longer it takes to decide on the new targets, the longer it is likely to be before a new Climate Change Plan is produced, something which is important for understanding the interactions between the targets set, and the level of required public spending to meet those targets. Delays to the publication of the plan run the risk that an assessment of the policies included in the plan and associated costs is not as fully considered as would be desirable. It also increases the risk of delayed action which has potential implications for future spending on reaching net zero.

Our report in March 2024 drew on previous work by the OBR which illustrated scenarios of a late transition to net zero. The OBR demonstrated that the costs of these scenarios outweigh the costs of a balanced pathway to net zero. If efforts are made to mitigate emissions, but these are belated and therefore sudden, we could still see adverse macroeconomic consequences. The economy could be exposed to energy price shocks

for longer and loss of profits if assets become obsolete.¹ It may also be harder to deliver the Scottish Parliament's commitment to a just transition. The OBR's Fiscal risks and sustainability report in 2023 showed how a late and disruptive transition would be more expensive than an early and smooth transition to net zero.²

The extent of macroeconomic risks from climate change will depend on how policies are managed. In its 2019 Fiscal risks report the OBR highlighted how well-signalled and orderly policies that allow time for the economy to adjust and for technological advances to reduce costs might pose little risk.³ In contrast, uncertainty around policy changes could mean a greater risk in terms of foregone economic growth.

Part Two – Climate Change Plan

6. Under the current statutory regime, the legal deadline for laying a draft of the Climate Change Plan (CCP) is November 2024. This Plan was due to apply to the period of 2025-2040. The Scottish Government intends to use the Bill to change the timing for the production of the CCP.

Do you have views on when and how the Scottish Government should publish their plans for meeting the proposed carbon budgets?

What period should the next Climate Change Plan cover?

Do you think the current requirements for Climate Change Plans within the existing legislation provide an effective regulatory framework?

Are there any other aspects of the current legal framework for the creation of Climate Change Plans that you think should be updated?

As set out in our 2024 Fiscal Sustainability Perspectives report and in our forthcoming Statement of Data Needs, the Climate Change Plan should set out planned policies to meet mitigation targets, the cost of each individual policy, and its effect on emissions.⁴ Where policies relate to taxation the revenue from each policy should be set out as well as the effect on emissions. This should be done in a way which allows the spending on those policies and programmes to be identified in the Scottish Budget and ideally tracked consistently over time. The Climate Change Plan should identify the cost for Scottish Government, other parts of the public sector and the private sector where appropriate. The Scottish Government should be clear what timescales are covered by the Climate Change Plan, ideally the plan should cover longer than the 5-year carbon budget period and present costed policies and proposals for reaching net zero by 2045.

We make similar recommendations for the Scottish National Adaptation Plan and both plans should cover the period to 2045. We note that any spending plans for beyond the

¹ Bank of England (2018) [Climate change and the macro-economy: a critical review, Bank of England Working Paper No.706](#)

² OBR (2023) [Fiscal risks and sustainability report – July 2023](#)

³ OBR (2019) [Fiscal risks report – July 2019](#)

⁴ Scottish Fiscal Commission (2024) [Fiscal Sustainability Perspectives: Climate Change](#)

current parliamentary term will be indicative and may change in the future. However, to support wider public scrutiny, these costs should still be set out broken down by policy and by affected sector. This would allow us to assess the consequences for fiscal sustainability as well as monitor the fiscal effects of changes to policy and of meeting any new targets or trajectories.

Knowing whether emissions reductions and adaptation objectives are likely to be met helps in the assessment of fiscal sustainability. Failure to meet emissions targets means further spending will be needed in the future to meet subsequent targets. Insufficient adaptation activity implies costs from damages and retrofitting in the future.

The Climate Change Committee (CCC) produce regular reports regarding Scotland's progress on mitigation and adaptation.⁵ Improved information from the Scottish Government on quantified mitigation and adaptation plans would allow the CCC and other experts to assess whether the plans are likely to achieve targets and to measure progress against those plans. These assessments by the CCC and other experts, together with more detail on policies and associated costs from the Scottish Government, could allow us to incorporate climate change spending in our future projections of the Scottish Government's fiscal position.

The Climate Change Plan and Scottish National Adaptation Plan should set out policies and spending and these need to be presented in such a way that it is possible to track progress both in terms of the level of spending and the extent to which they achieve reductions in emissions and have adapted infrastructure and the economy to the effects of climate change. We recommend that spend on mitigation and adaptation be identifiable in budget documentation and outturn so that spending plans can be linked to delivered spending. This would improve transparency and accountability and support our future work on fiscal sustainability.

The Scottish Government should also use both the Climate Change Plan and Scottish National Adaptation Plan to set out its plans for using tax measures to achieve its targets. Where the Scottish Government considers how to use tax measures to control emissions or encourage adaptation activity, the Scottish Government should be clear and quantify the likely effects on emissions and adaptation, the revenue gains and risks of achieving or not achieving these.

Part Three: Monitoring and reporting

7. The Scottish Government has confirmed that their annual reporting on progress towards targets will be retained. The CCC have however, suggested that if 5-yearly budgets are

⁵ Climate Change Committee [Scotland Reports](#)

adopted in Scotland, CCC reporting may move from a system of annual Scottish 'Progress' reports to two dedicated reports on Scottish progress every 5 years.

What are your views on whether there should be changes to the existing Scottish Government monitoring and reporting framework?

What are your views on the potential changes to the level of Scottish reporting provided by the CCC?

There need to be improvements in monitoring the Scottish Government's spending on climate change and the extent to which it is meeting its targets. This is required to monitor progress and identify if policies are sufficient to meet the future targets.

8. A Bill, according to the Standing Orders of the Scottish Parliament, must "...be accompanied by a Financial Memorandum which sets out best estimates of the costs, savings, and changes to revenues to which the provisions of the Bill would give rise, and an indication of the margins of uncertainty in such estimates." (Rule 9.3.2).

The 2045 target will not be amended. How much do you estimate it would cost to achieve that target?

Are current spending levels on policies to achieve this in line with what is required?

Budget

How can the Scottish Government use this year's Budget to ensure all portfolio areas are focused on achieving the 2045 target?

Has the inclusion of a Climate Change Assessment of the Budget improved outcomes and progress towards a target?

What are your views on the presentation of the Climate Change Assessment and are there any changes you would like to see to this?

The SFC published a report, *Fiscal Sustainability Perspectives: Climate Change*, in March 2024.⁶ The lack of published information from the SG on its climate change spending and planned spending meant we could not use costed climate change plans to assess the impact on fiscal sustainability. It also means that it is not possible to judge whether current spending levels are sufficient to achieve the climate change targets.

We used the Climate Change Committee's Sixth Carbon Budget to estimate the potential costs of mitigation. The balanced pathway scenario provides hypothetical emissions reductions for each sector each year and their required investment for the UK and Scotland. We applied assumptions as to whether sectors are devolved or reserved and assume a split of costs between the public and private sectors to estimate the level of investment required by the Scottish Government to reach net zero. These costs are consistent with Scotland reaching net zero by 2045 but did not reflect the target of a 75 per cent reduction by 2030.

Based on these assumptions we estimated the Scottish Government would need to spend an average of £1.1 billion pounds a year over the period 2020 to 2050 to reach

⁶ Scottish Fiscal Commission (2024) [Fiscal Sustainability Perspectives: Climate Change](#)

net zero, around 18 per cent of its capital budget. These figures do not include the spending required on adaptation and damage from climate change.

The UK and Scottish Governments should articulate their plans on how to achieve net zero and what level of public spending will be required. Looking at these plans together with how the economy and demographics will change, long-term spending and funding projections, and pressures on other public services such as health is needed to support planning and prioritisation and to assess fiscal sustainability.

The Climate Change Assessment published alongside the Scottish Budget should show whether spending on individual policies supports mitigation, adaptation or both. It is currently published alongside the Budget as introduced but should be updated with outturn spending amounts. It should be possible to identify from the Climate Change Assessment whether the costed policy commitments in the Climate Change Plan and Scottish National Adaptation Plan are being delivered, both during the budgetary period and once actual spending is known after the year has ended.

When publishing costs in the Climate Change Plan and the Scottish National Adaptation Plan, this work should be aligned with the classification of spending used for the Scottish Budget Climate Change Assessment. The classification of spending as supporting mitigation, adaptation or both needs to be done in a coherent manner. Work to improve the Scottish Budget Climate Change Assessment should be coordinated with climate change policies on mitigation and adaptation. This will ensure there is consistency across costs published in the policies and how this is tracked in budget spending.

As has been recommended by other organisations, if the Scottish Government used a net zero assessment on spending decisions and published the results in a clear and consistent format, that would improve scrutiny and transparency of spending decisions.^{7,8} In turn, this would support our work assessing the fiscal sustainability of mitigation activity. Similarly, assessing how spending decisions contribute to or go against adaptation objectives would help us assess the Scottish Government's fiscal sustainability and would provide greater transparency on the implications of spending decisions.

⁷ Climate emergency response groups (August 2023) [Committing to delivery: certainty and leadership for a just transition to a net zero, climate resilient future for Scotland. Briefing Paper: Net Zero Test](#)

⁸ Fraser of Allander Institute (June 2022) [Improving emissions assessment of Scottish Government spending decisions and the Scottish Budget](#)