FINANCE COMMITTEE

AGENDA

4th Meeting, 2006 (Session 2)

Tuesday 7 February 2006

The Committee will meet at 10.00 am in Committee Room 3 to consider the following agenda items:

1. Bankruptcy and Diligence etc. (Scotland) Bill: The Committee will take evidence on the Financial Memorandum from—

   Paul Cackette, Head of Division, Civil Justice and International Division, Scottish Executive Justice Department; Andy Crawley, Bill Team Leader, Scottish Executive; and Beverley Francis, Bill Team Manager, Scottish Executive.


3. Deprivation Inquiry (private): The Committee will consider submissions to its deprivation inquiry.

Susan Duffy
Clerk to the Committee
Room T3.60
Extn 85215
The papers for this meeting are:

**Agenda Item 1**

Submission from the Committee of Scottish Clearing Bankers (CSCB)  
*Bankruptcy and Diligence etc. (Scotland) Bill* and associated documents available online (previously circulated to members in hard copy only; electronic versions available via Parliament website)

PRIVATE PAPER

**Agenda Item 2**


PRIVATE PAPER

**Agenda Item 3**

PRIVATE PAPER
Finance Committee

4th Meeting 2006 – Tuesday 7 February 2006

Scrutiny of Financial Memorandum – Evidence on the Bankruptcy and Diligence etc (Scotland) Bill

1. The Bankruptcy and Diligence (etc) (Scotland) Bill (“the Bill”) was introduced to parliament on 21 November 2005. The Enterprise and Culture Committee has been designated the lead committee for the Bill at Stage 1.

2. The Finance Committee agreed at its meeting on 10 January to adopt a level 3 approach to its scrutiny of the bill. Specifically, the Committee agreed to issue its standard questionnaire to potentially affected organisations and take oral evidence from the Accountant in Bankruptcy and Scottish Court Service followed by evidence from Executive officials.

3. At it’s meeting on 31 January, the Committee took evidence from representatives from the Scottish Court Service and the Accountant in Bankruptcy. The Committee will take evidence from one panel of Scottish Executive officials on 7 February.

4. In addition to the submissions issued for last week’s evidence session, a response has been received from the Committee of Scottish Clearing Bankers (CSCB) and this is attached:

Roz Wheeler
Senior Assistant Clerk
SUBMISSION FROM THE COMMITTEE OF SCOTTISH CLEARING BANKERS (CSCB)

The Committee of Scottish Clearing Bankers (CSCB) is the representative body of the four Scottish clearing banks (Bank of Scotland, The Royal Bank of Scotland plc, Clydesdale Bank PLC and Lloyds TSB Scotland plc). The Committee represents Scottish clearing banking in the financial structure of Britain and seeks to promote the industry by providing an authoritative voice on Scottish matters to ensure that they are adequately recognised and safeguarded. We are pleased to have been invited to comment on the Financial Memorandum to the Bill and our comments and observations are included within the following responses to the specific questions posed and in the attached Annex 1.

1. Did you take part in the consultation exercise for the Bill, if applicable, and if so did you comment on the financial assumptions made?

   CSCB took part in the consultation exercise but did not comment on the financial assumptions made.

2. Do you believe your comments on the financial assumptions have been accurately reflected in the Financial Memorandum?

   Not applicable. See the answer to question 1 above.

3. Did you have sufficient time to contribute to the consultation exercise?

   Yes. However, the timescales for contributing to this part of the consultation exercise have been too short to allow a detailed response.

Costs
4. If the Bill has any financial implications for your organisation, do you believe that these have been accurately reflected in the Financial Memorandum? If not, please provide details.

   Please see Annex 1.

5. Are you content that your organisation can meet the financial costs associated with the Bill? If not, how do you think these costs should be met?

   Please see Annex 1.

6. Does the Financial Memorandum accurately reflect the margins of uncertainty associated with the estimates and the timescales over which such costs would be expected to arise?

   Please see Annex 1.
Wider Issues

7. If the Bill is part of a wider policy initiative, do you believe that these associated costs are accurately reflected in the Financial Memorandum?

_Please see Annex 1._

8. Do you believe that there may be future costs associated with the Bill, for example through subordinate legislation or more developed guidance? If so, is it possible to quantify these costs?

_Please see Annex 1._

ANNEX 1

BANKRUPTCY
References to Paragraphs are to the numbered paragraphs in the Financial Memorandum sent to the CSCB on 11 January 2006.

688, 690, 693, 698 and 701
“Any new impact on creditors……will not significantly affect such interests…it was for that reason not considered necessary to undertake a regulatory impact assessment in relation to the bankruptcy, enforcement and diligence reforms”.

The DTI’s paper “Over-Indebtedness Monitoring Paper Q2 2005” states:

“The figures show a gradual increase in write-offs over the past few years. Such an increase could be expected as a result of the recent rise in personal insolvencies…..Total write-offs to individuals in Q2 2005 increased by 28.7% year on year. Unsecured lending to UK households accounts for the largest domestic contribution to UK bank write-offs in recent years.”

An analysis of the impact of similar changes in bankruptcy laws in other jurisdictions suggests that an inevitable consequence of relaxing the laws on bankruptcy is to increase the number of insolvencies:

USA – US consumer bankruptcies increased dramatically from 718,107 in 1990 to an all time high of 1,625,208 in 2003 (an increase of 126.3%). This equates to around one in every 70 US households declaring bankruptcy every year. By contrast, the number has started to fall since the US government introduced new measures to curb the abuses of the system in 2003. In 2004 there was a drop of 4%.

Australia - Consumer bankruptcies increased from 13,091 in 1990/ 1991 to 24,114 in 2001/ 2000, of which 84% are consumer bankruptcies. In 2001, it was reported that the stigma of bankruptcy had lessened to such a degree that:

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_1 ‘European Counsel’ magazine November 1998_
“There has been significant controversy in recent times over revelations that several Sydney barristers, including high-ranking Queen’s Counsel, were using bankruptcy as a means of avoiding paying substantial amounts of tax”\(^2\)

Like the US, the Australian government was prompted to change the law to curb the costly trend. The Bankruptcy Legislation Amendment Act 2001 was designed to:

“Make a number of significant changes …which, it is hoped, will encourage debtors to seriously consider using alternatives to bankruptcy where possible, and make bankruptcy less of an easy option”\(^3\)

The principal change was an increase in the discharge period to 3 years, effective from May 2003. Recent figures suggest that the Act is starting to have the desired impact: 2002/2003 saw a 6% drop in bankruptcies compared with the previous year. Since then, bankruptcy levels appear to have stabilised.

**England and Wales:** The attached Chart 1 shows that the number of applications by debtors for bankruptcy in England and Wales has increased significantly. By contrast, the chart also shows that, although there has been an increase in bankruptcies in Scotland, the increase has been creditor applications with a significant proportion by local authorities as a result of a recently introduced Local Government policy to crack down on individuals with persistent council tax arrears\(^4\). It is possible to conclude from this, therefore, that England and Wales is reacting to relaxations in access to bankruptcy in the same way as the US and Australia.

The **CSCB queries** whether the projected increase of 25% debtor applications is too conservative in light of the experiences in other jurisdictions and, therefore, whether the projected costs to the Scottish Executive (and, hence, the taxpayer) are reliable. The **CSCB submits that** there will be a significant financial impact on creditors as the number of debtor applications for sequestration will increase and, as a consequence, creditors will experience increased write-offs. The **CSCB also submits** that the costs to the tax payer of the proposed changes to bankruptcy will be greater than projected on the basis of the experiences of the other jurisdictions which have previously taken this route.

**700**

Two likely consequences of increased write-offs for creditors are:

1. Increased finance costs for individuals and businesses, as lenders pass on the cost of rising bad debts (in the US, the average household pays an estimated $400\(^5\) a year to subsidise the cost of those who avoid repaying by going bankrupt).

2. Increased financial exclusion from mainstream credit. This is linked to the use of automatic credit scoring which takes into account the area where someone lives. If an area, by postcode, has a high instance of bankrupts, creditors may adjust their

\(^2\) Source: the preamble to the Bankruptcy Legislation Amendment Bill, Parliament of Australia Library
\(^3\) Source: the preamble to the Bankruptcy Legislation Amendment Bill, Parliament of Australia Library
\(^4\) Sources: Citizen’s Advice Scotland briefing paper 18 on Council Tax Debt; DTI “Over-indebtedness Monitoring Paper Q2 2005”
credit scores to the detriment of otherwise sound potential customers. Similarly, lenders may simply stop lending to high-risk groups, such as tenants (over 750,000 Scottish households) and students (270,000)\(^6\).

**FLOATING CHARGES**

Registration costs are unclear – currently £13 perhaps increasing to £30. There is also potentially the cost of registering the Notice of Proposed Charge, also likely to be £30. Assuming the use of registration of Notices of Proposed Charge would become standard practice, this suggests the cost of registration would increase from £13 to £60. It is likely these costs would not be borne by the Floating Charge Holder but would, instead, be passed on to the customer, as they are at present. The question is whether the benefits of the creation of a new, additional Register, with consequent costs, justifies the additional costs incurred in setting it up and maintaining it. **The CSCB submits** there is insufficient benefit to be derived from establishing a new Floating Charge Register to justify the costs (both “start up” and maintenance). Rather, this would be an additional burden on business. This is of particular concern given the lack of certainty with which the Scottish Executive can predict the start up and maintenance costs. General experience dictates that, especially in relation to IT development spend, estimates are frequently significantly under-stated. Accordingly,

what may at first seem to be an acceptable increase in cost (from £13 to £30) may become unacceptable as the Registrar endeavours to recover ever-increasing IT and other costs.

**DILIGENCE**

733, 734, 735 and 742

**The CSCB queries** the cost: benefit analysis of the Information Disclosure Scheme (IDO’s). The largest users of arrestments are local authorities. To maximise their chances of a successful arrestment, they serve arrestments on all four clearing banks in Scotland (called “Fishing Diligences”). If the projected cost for an individual information request is £100 to £150, it is not clear that this will be sufficiently attractive to local authorities. It would, of course, be welcomed by the banks if its effect were to reduce the number of Fishing Diligences, given the cost to banks of handling large numbers of arrestments which effectively attach nothing. However, the CSCB has doubts that information disclosure orders will make a significant difference to current practices. Additionally, if IDO’s are to be served on banks then there will obviously be a cost associated with researching and responding to them. This may have the effect of increasing costs - at least on an interim basis pending any lasting impact IDO’s might have on the overall number of arrestments being received. Will banks be able to charge for this additional work, on the basis that the costs will, in turn, be recoverable by the creditor from the debtor, assuming the creditor’ action for recovery is successful?

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\(^6\) Based on figures at www.scotland.gov.uk/stats
The CSCB submits that time to pay arrangements may have an impact on overall recoverability of debt, rather than simply a delay in recovery. This may arise if, for example, a debtor who is served notice of proposed diligence then removes the asset (e.g. cash in a bank account) away from the jurisdiction of the diligence.

The CSCB submits that where a debtor has the capability to pay, there should be a requirement on the debtor to pursue alternatives such as the Debt Arrangement Scheme, using bankruptcy only as a last resort. This would minimise the cost of write-offs for creditors, and underpin the importance of individual financial responsibility.

The CSCB supports the introduction of debt advice and information packs as an important part of consumer education which also encourages a responsible and responsive approach to debt management.

Chart 1 referred to above

![Chart 1](chart.png)
Finance Committee

4th Meeting 2006 – Tuesday 7 February 2006

Scottish Executive’s response to Finance Committee 5th Report 2005:
Stage 2 of the 2006-07 Budget Process.

At the Parliamentary debate on 21 December 2005, on the Finance Committee’s report on the 2006-07 Draft Budget, I indicated that the Executive would respond to the recommendations in the Committee’s report before the Stage 1 debate in late January.

The Executive’s response to the Finance Committee’s report is attached at Annex A. If you have any questions about the response, or require any additional information, then you are, of course, very welcome to contact me. I look forward to continuing to work with you on the budget process.

TOM MCCABE

ANNEX A

FINANCE COMMITTEE REPORT ON DRAFT BUDGET 2006-07:

Extract of Recommendations

GENERAL

The Committee recommends that the Minister for Finance and Public Service Reform ensures that full responses are made by his Ministerial colleagues [to subject committees] to recommendations falling within their portfolios.

The Minister will remind cabinet colleagues of the need for full responses to recommendations.

The Committee repeats its recommendation [from last year] that the spending assumptions for differing forms of care on which the block allocations to NHS boards is made should be published in the Health chapter.

Allocations to NHS Boards are made on the basis of the Arbuthnott Formula, not on the basis of the differing forms of care provided by a particular NHS board. The objective of the Arbuthnott Formula is to achieve equity of access to healthcare. Resources are distributed among Health Boards on the basis of relative need for health care services within that population group, where use of services has been used as a proxy for need.
The formula assesses each NHS Board’s relative need for funding, using information about its population size and characteristics that influence the need for healthcare in terms of hospital services, community services and GP prescribing. The main drivers of the formula are:

(i) share of the Scottish population living in the NHS board area;
(ii) age structure of the population and relative number of males and females;
(iii) morbidity and life circumstances (deprivation); and
(iv) additional costs of delivering healthcare in remote and rural areas.

The costing system in the NHS is organised around specialities and it is therefore not straightforward to link funding to specific forms of care. For instance a patient with colorectal cancer may be admitted to general surgery; but following surgery may then be transferred to intensive care (which is a separate speciality). At a later stage the patient may receive chemotherapy which is part of the general medicine speciality or may receive radiotherapy which is a separate speciality. Similar problems arise when trying to deal with differing forms of care.

NHS Board allocations are inevitably complex. However, discussions will continue with Health Department officials on possible improvements to the presentation of the NHS Board allocations. But it may not be possible to fulfil the committee’s recommendation in this instance.

The Committee recommends that the presentation of cross-cutting information should be addressed in the next Spending Review exercise.

The Executive will review the presentation of the cross-cutting information in the next Spending Review exercise.

The Committee recommends that for Draft Budget 2007-08, portfolios should not simply repeat the narratives on their contributions to the cross-cutting themes and instead should show how they will use the additional/new resources to further the cross-cutting agenda. This will allow members to focus on the budgetary choices being made.

Officials will discuss the presentation of the cross-cutting narratives. We will consider the Committee’s suggestions on how to improve presentation to make it clearer what budgetary choices are being made.

EFFICIENT GOVERNMENT

[in light of concerns that the requisite information needed for monitoring the Efficient Government programme is unavailable] the Committee recommends that Audit Scotland clarify publicly what they believe is now possible in terms of ensuring the transparency of the process, the establishment of baselines and future monitoring of the Efficient Government initiative and what they believe is appropriate for the longer term.
The Executive welcomes this recommendation. However, this is a recommendation for Audit Scotland and it is for them to respond to this.

The Committee calls on the Executive to publish revised ETNs in the spirit of Audit Scotland’s comments by the end of March. The Committee calls on the Executive to update the formal timetable for publishing its performance in terms of the Efficient Government initiative.

As we have frequently stated, we are continuing to revise and update our technical notes as Efficient Government continues to develop. We are already planning to publish revised technical notes at the end of March. UK Departments are doing the same and only published their latest set of technical notes at the beginning of this month. We will be reporting our performance in terms of the Efficient Government initiative following the end of this financial year when it will be possible to compare inputs and outputs from this year with inputs and outputs from last year. We believe this is the most practical, sensible and cost-effective approach.

In the interest of clarity, the Committee recommends that the Executive provides a definitive audit trail which shows how the efficiency savings in health were delivered, and how they were reallocated.

The process was completely clear. No resources were reallocated. Planned spending on the NHS was announced in autumn 2004 as part of the SR2004 settlement. In February 2005, Boards were issued with allocations including a minimum uplift of 7% for 2005-06 and indicative minimum uplifts of 6.75 and 6% in the next 2 years. At the same time they were asked to find cash releasing efficiency savings of at least 1% per annum with the savings to be used to improve services. Many Boards plan to exceed 1%. There was never any question of the 1% being deducted from any existing plans.

The Committee recommends a review of the scope and objectives of “Changing to Deliver” in light of concerns [over performance monitoring]. The Committee also seeks clarity on the role of the Office of the Permanent Secretary in monitoring all Partnership Agreement commitments and its apparent evolution towards the role of the UK Delivery Unit and the Cabinet Office.

Within the Executive it is clear that prime responsibility for delivery of the Partnership Agreement commitments lies with Ministers and relevant departments. However, the centre of the Executive also supports delivery in different ways - some of this is generic support of an effective delivery culture (through Changing to Deliver, the Scottish Executive’s internal change programme); and some is tailored to particular Partnership Agreement commitments (through Strategy and Delivery Unit).

The present role of the Delivery side of Strategy and Delivery Unit (SDU) in the Office of the Permanent Secretary is to support like the monitoring and delivery of the Partnership Agreement, through, for example:
The Minister for Finance in his bilateral meetings on delivery of the Partnership Agreement with Ministerial colleagues

The Minister for Finance’s regular reports to Cabinet on delivery of the Partnership Agreement

Management Group Delivery Sub-Group in considering the delivery challenges facing particular Partnership Agreement commitments.

As the Permanent Secretary explained in his evidence, relevant aspects of the Prime Minister’s Delivery Unit approach have indeed been adapted and applied here and we will continue to learn from different approached. The twice-yearly report to Cabinet, the format of the Ministerial bilateral meetings, the Management Group Delivery Sub-Group and Efficient Government monitoring are all informed by the approach of the Prime Minister’s Delivery Unit. However, it would not be appropriate, nor practicable, to transfer in its entirety its approach of supporting delivery to the Scottish context.

The Committee recommends that the Executive clarify its position with respect to efficiency savings in education budgets and the Minister’s advice [on education exemptions from the Efficient Government plan] as soon as possible.

The Efficient Government Plan states that “pay provision for education, police and fire was excluded from Efficiency Gains”. On 26 October, the Minister for Education advised the Education Committee that “the Executive exempted education from efficiency gains specifically because we seek to grow teacher numbers”. This is clear: pay provision – which is a substantial element of education expenditure - was excluded from efficiency savings.

The Committee recommends that the Executive provides the necessary information on development costs for each relevant specific project in its annual report next June.

Many of the projects delivering efficiency savings are not being pursued on efficiency grounds alone and will contribute to the general improvement of services. We do not therefore propose to deduct development costs from all efficiency savings. Furthermore, we are targeting sustainable recurring savings in revenue expenditure and one-off capital development costs will need to be carefully treated. We are considering how best to treat development costs on a case-by-case basis, and will reflect this in future iterations of the Efficiency Technical Notes.

LOCAL GOVERNMENT SETTLEMENT

The Committee recommends:

- firstly that the Executive reconsider its own efficiency targets for those departments which have low overall cash savings and have largely been able to retain the proceeds of those savings:
Enterprise and Lifelong Learning (0.22%), Environment and Rural Development (0.63%), Tourism, Culture and Sport (0.86%), Communities (1.09%) and Transport (1.44%) - in comparison with 3.4% for local government where the majority of efficiency savings have been applied as a reduction in baseline funding:

- secondly, the Committee calls on the Executive to reconsider the inequity of its approach in imposing baseline cash reductions which affect frontline services, i.e. health and local government; and

- thirdly, the Committee notes the additional resources allocated in the Chancellor's Pre-Budget Report to hold down council tax increases in other parts of the UK.

The Committee calls on the Executive to use any additional resources to rectify all of the above issues in this and subsequent years. This would address the Committee’s concerns to enhance meaningful efficiencies, protect council taxpayers from excessive increases through downward pressure on council tax levels and prevent inappropriate cuts in services.

We chose not to apply a straight percentage efficiency target across the board since this assumes that everyone is as efficient or as inefficient as the next one. It penalises those who have worked hard recently to become efficient and rewards those who have not tried to become more efficient. We are making efficiency savings where it has been identified that efficiency savings can be made. Local government are autonomous from central government. We have made an assumption that they can deliver a small percentage of efficiency savings over three years, which is entirely reasonable and guarantees that they will deliver a minimum of £197m in efficiency savings.

By 2007-08, local government is being asked to make savings equating to 4% of the 2004-05 GAE with only 2.5% of that (£197m) taken off at source; other service providers have been asked to make similar levels of savings - e.g. Health Department is being asked to save £515m by 2007-08 which equates to 6.4% of the Health 2004-05 baseline.

No savings were imposed that should affect frontline service delivery. Indeed to be classified as an efficiency saving it is necessary to demonstrate that the quality of the service delivered has been maintained. Each technical note specifically addresses this point (paragraph 7). For example in the case of the 1% NHS efficiency saving the comment is: “These savings will not impact on the quality of service provision.”

In England, local authorities are reporting that their performance is on track to deliver savings in excess of their original target of £6.5 billion, which includes time-releasing savings that almost double the total of the target savings.

Under the Barnett formula the Scottish Executive receive a proportionate share of any additional money that is allocated by the Treasury to Central Government
Departments. As a result of the recent PBR the Executive will receive less than £50 million for the period 2005-06 to 2007-08 - split £2.1/£24.2/£23.4 million. The largest element within these totals, amounting to some £25.5m, is associated with extra heating allowances for pensioners. Decisions on the use of these resources will be taken in due course.

As regards the representations which local authorities in Scotland have made for additional funding to be provided here to help them deal with a range of financial pressures and to keep down council tax rises, this is currently the subject of discussion between the Minister for Finance & Public Service Reform and COSLA. On 22 November, the Minister met a cross party COSLA group and a further meeting took place on 23 January 2006. At this stage, it would be premature to pre-empt the outcome of those discussions. A realistic approach is required, but all options are being looked at, including the impact of the significant efficiency savings which councils are reported to be on track to deliver in 2005-06, and also the extent to which councils are able to use the balances they currently hold in reserves.

On a point of detail, the Committee’s assumptions about the scale of any funding gap as set out in the report at paragraphs 85 and 86 and the associated table require some further clarification. The Committee’s report notes that “Given the projected shortfall of £84.9 million, if local government were to make no further savings, this would require a council tax increase of 6.6% on the Executive’s own assumptions”, but the calculations underpinning these assumptions are not at all clear, particularly the treatment of inflation.

The following table summarises the Executive’s assumptions used in calculating the 2006-07 local government finance settlement at the time the outcome of Spending Review 2004. This analysis shows that full provision was made for the inflationary pressures that were assumed at the time of the settlement.

<table>
<thead>
<tr>
<th>SR04</th>
<th>(£million)</th>
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</thead>
<tbody>
<tr>
<td>Expenditure pressures recognised in the settlement</td>
<td></td>
</tr>
<tr>
<td>Increase service provision (e.g. volume pressures)</td>
<td>£184.1</td>
</tr>
<tr>
<td>Increase for inflationary pressures</td>
<td>£184.5</td>
</tr>
<tr>
<td>Less Efficiency assumption factored into the settlement</td>
<td>-£58.5</td>
</tr>
<tr>
<td><strong>Total Expenditure pressures</strong></td>
<td><strong>£310.1</strong></td>
</tr>
<tr>
<td><strong>Funding by</strong></td>
<td></td>
</tr>
<tr>
<td>Contribution met from AEF</td>
<td>£254.1</td>
</tr>
<tr>
<td>Assumed Council Tax increase</td>
<td>£56.0</td>
</tr>
<tr>
<td><strong>Total Funding</strong></td>
<td><strong>£310.1</strong></td>
</tr>
</tbody>
</table>
Perhaps the best way forward is for officials to meet to discuss the relevant calculations to clarify our respective positions.

PARLIAMENTARY NOMINATED COMMISSIONERS AND OMBUDSMAN

The Committee welcomes the announcement by the SPCB that an independent review of the opportunities for the Commissioners and Ombudsman to share services and the associated issue of office location would be undertaken by Audit Scotland.

The Committee believes it may be useful for the SPCB to review the [Children's] Commissioner's budget at regular intervals during the year to consider whether the budget is, and remains, appropriate to the activities being undertaken.

The Committee recommends that there should be a review of the powers of direction in relation to the various parliamentary appointed commissioners and ombudsman in the legislation which set them up. On the assumption that there is a gap in the legislation with regard to budgetary control, then the necessary steps should be taken to strengthen the budgetary powers of the SPCB in relation to the bodies its funds.

As with the current situation, the Committee will scrutinise the budget of the SPCB which will include the budgets of the commissioners and ombudsman, as approved. Given that these bodies were set up separately by both Executive and Committee legislation, then any such review would need to involve both the SPCB and the Executive.

These recommendations are not for the Executive, and it is therefore not appropriate for the Executive to respond formally to them.

January 2005
Finance Committee

4th Meeting 2006, 7 February 2006

Executive response to the Committee’s report on Stage 2 of the Budget Process 2006-07

Introduction

1. There are three aspects of the Executive’s response which in my view are unsatisfactory. These are:

   - the spending assumptions in the health board allocations
   - departmental efficiency targets; and
   - the local government settlement

Health Allocations

2. The Committee’s report repeated the concerns over the lack of transparency in the block allocations and the difficulties this creates for parliamentary scrutiny. For example, the underlying spending assumptions for the different care programmes used in the Arbuthnott formula is the equivalent of the provision of service GAE totals (education, social work etc) in the local government settlement.

3. The Executive’s response that allocations to boards are made on the basis of the Arbuthnott formula, not on the basis of differing forms of care provided by a particular health board is misleading. The response goes on to say that it uses information in terms of “population size and characteristics that influence the need for healthcare in terms of hospital services, community services and GP prescribing”.

4. In practice – as I understand from my membership of the Arbuthnott Expert Group – the formula uses these population characteristics to distribute a predetermined sum of money for NHS care programmes. The Arbuthnott Committee’s final report\(^1\) makes clear that allocations are made on the basis of eight care programmes, and these are totalled to create a block grant – on the same basis as GAE.

5. The eight care programmes used are:

   - Acute hospital services
   - Mental illness hospital services
   - Care of the elderly hospital services
   - Maternity hospital services
   - Specialist hospital services

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• Community health services
• GP prescribing
• General medical services

6. In each programme, a board’s share is calculated on the basis of a weighted population formula, with the weightings for morbidity and life circumstances and remoteness determined through regression analysis of usage of these services. As a result, the applied weightings differ between care programmes. This is demonstrated on p33 of the Arbuthnott Committee’s final report which states that “estimates of the influence of this index on the use of services across the different care programmes is also based on evidence.”

7. Whilst it is right in principle to note that boards may use these resources according to their assessments of local needs, it is also important at a national level that the expenditure assumptions underpinning the allocations are transparent and subject to scrutiny. If the Executive makes greater or lesser provision for spending on care programmes than boards incur, then this can distort the allocations.

8. For example, acute hospital care has a significant adjustment for remoteness costs, while hospital care for the elderly does not. The allocations reflect this. But if the expenditure provision for these programmes is not broadly in line with national expenditure, then board allocations will be distorted. In this case, under-provision for acute hospital care would disadvantage rural health boards, while under-provision for hospital care for the elderly would advantage them relative to need.

9. The expenditure assumptions are therefore important in practical terms as well as for accountability. We are in a position at the moment where we know what the Executive believes ought to be spent on secondary education, but not on acute hospitals. We know how much the Executive believes should be spent on social work services for the elderly, but not on hospital care for the elderly. The Committee may find it helpful to receive evidence from the Department on the calculation of health board allocations to make the position clear.

Efficiency Targets
10. The Executive’s explanation for the differences in cash-releasing targets does not provide any rationale for its treatment of local government.

11. It also shows that the process is not transparent. For example, we are not given any information to confirm the Executive’s assertion that the targets reflect past performance in making efficiency gains. I have previously advised the Committee that it should not endorse non-specific efficiency savings. The Executive’s response suggests that some efficiency gains have been made within the Executive but not apparently reported to Parliament.
12. Finally, the Executive states that “other service providers have been asked to make similar levels of savings [to local government]” and gives health as an example. However, the figure given in the response includes time-releasing savings which give “softer” targets than cash-releasing savings and time-releasing savings have no impact on the budget. The response does not give any other examples of others who have been asked to make the same level of savings. Moreover, the Committee had already raised concerns that health was being asked to make greater savings than other departments.

13. Therefore, the Executive has not addressed the Committee’s concerns over the inequitable pattern of cash-releasing savings and continues to present the information on Efficient Government in a way which confuses rather than clarifies the situation.

**Local Government Settlement**

14. In the Executive’s response to the Committee’s Report on the 2006-07 Draft Budget, it asks for clarification regarding the Committee’s assumptions about the scale of the funding gap and the treatment of inflation in particular.

15. The Committee made no assumptions. The problem is the inconsistency between the financial assumptions set out in the response, and the financial assumptions set out by the Executive in the Draft Budget.

16. The Executive response states that it made full provision for inflation in the 2004 Spending Review, by increasing AEF and by assuming a 2.5% increase in council tax. The growth of provision would then be funded through real growth in AEF and £58.5m of efficiency savings.

17. Members should be clear therefore, that the cause of the funding shortfall is the **gap** between the £184.5m provision for inflation in the settlement as laid out in the Executive’s response and the 2.7% increase in inflation forecast used by the Executive in the Draft Budget in Table 10.02.

18. Members should also be clear that these are the Executive’s own figures and not mine. What I have done is point out the discrepancy between the Executive’s inflation provision and its inflation forecast.
19. This can be summarised using the Minister’s figures. The provision for additional expenditure is:

<table>
<thead>
<tr>
<th>Provision</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increased service provision</td>
<td>£184.1m</td>
</tr>
<tr>
<td>Increase for inflation</td>
<td>£184.5m</td>
</tr>
<tr>
<td><strong>Total increase</strong></td>
<td><strong>£368.6m</strong></td>
</tr>
<tr>
<td>To be funded by:</td>
<td></td>
</tr>
<tr>
<td>Efficiency savings</td>
<td>£58.5m</td>
</tr>
<tr>
<td>AEF</td>
<td>£254.1m</td>
</tr>
<tr>
<td>Council Tax (2.5%)</td>
<td>£56m</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>£368.6m</strong></td>
</tr>
</tbody>
</table>

20. However, when we turn to the Draft Budget, the Executive’s provides for additional AEF of £258m or 3.2%. With inflation forecast at 2.7%, this means that £219.3m of the AEF is simply used to deal with inflationary costs, leaving only £38.7m available for new services.

21. The Executive’s provision for a 2.5% increase in council tax is less than inflation, creating a further shortfall of 0.2% or £4m. Inflation is forecast at £279.3m in the Draft Budget, well in excess of the £184.5m in the local government settlement.

22. In the Finance Committee’s report on Stage 2 of the Budget Process 2006-07, we used the most up-to-date figures which differ slightly from the Minister’s letter which are from SR2004. Therefore, the calculation in the Committee’s report is as follows:
### Increased service provision
- **£178.1m**
- **£275.5m**

### Inflation at 2.7%
- **£275.5m**

### Total Increase required
- **£453.6m**

### To be funded by:
- **Efficiency Savings**
  - £58.5m
- **AEF**
  - £258.6m
- **Council Tax**
  - £52.0m
- **£368.6m**

### Shortfall:
- **£453.6m - £368.6m**
- **£85.0m**

£85m as a percentage on council tax:
- **4.1%**

Plus 2.5% council tax increase assumed in settlement:
- **6.6%**

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Professor Arthur Midwinter
Budget Adviser

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2 Shown as £184.1m in the Executive’s response
3 Shown as £184.5 or 2.2% of GAE in the Executive’s response
4 Shown as £254.1m in the Executive’s response
5 £52m was shown in Local Government Finance Settlement 2005-06, 2006-07 and 2007-08, published December 2004. The Executive’s response shows £56m