

Finance Committee

Strategic Budget Scrutiny

Submission from Jenny Stewart, KPMG

Background and context

The Committee is investigating the impact of the recession on public sector budgets both for the period of this spending review and in the longer term. You are particularly interested in the practicalities of spending and what the real scope for change is.

The Chancellor's Budget statement on Wednesday, 22 April announced a further £9bn efficiency target for 2013/14, which would broadly equate pro-rata to a further **£900m** in Scotland on top of the pro-rated **£500m** for 2010/11. Overall UK Public Sector spending is still planned to increase by 1.1% in 2010/11 and 0.7% the year after.

These efficiency targets will be the subject of discussion between HM Treasury and the Scottish Government – so the precise figure is yet to be decided. But I believe that is the broad order of magnitude. This is on top of the 2% annual cash-releasing savings which the public sector is finding so that it can be re-targeted to other priorities.

While these numbers sound large, as a proportion of total spend, they are still in percentage terms manageable. For example, Scottish Water – a public sector entity – made operational efficiencies between its creation in 2002 and 2007, of almost 40% as measured by its regulator, the Water Industry Commission. Over the period it made cumulative operational savings of over £800m and average annual water bills – at £310 - are now well below the England and Wales average of £330.

Options

Given that the Committee wants to look at practicalities, there are a range of options open to politicians and policy makers to reduce spending. Some thoughts on each are outlined below:

- **Top-slicing** – taking a standard percentage of every budget line and leaving managers to cope with the implementation. This is the least effective option and means that resources are not targeted at where they will add most value. If used repeatedly leads to a “death by a thousand cuts” mentality and does not seize the opportunity to do things differently which a period of cost pressure can instil. Front-line services are usually most adversely affected by this route.
- **Priority based budgeting** – This approach looks at spending in a more rigorous way and how far existing programmes contribute to policy priorities. Most budget lines will be able to demonstrate that they contribute to the Scottish Government's outcomes – there is not some mythical pot of gold that

can be obviously diverted. The issue is how to prioritise one programme against another, and indeed make evidenced based choices on spend within programmes. As we found in the Budget Review, only a limited percentage of Scottish Government funding has been formally evaluated for its effectiveness. In these more stringent times, there is scope for undertaking greater evaluation of individual programmes and assessing their relative impact.

- **Transformation** – we are undertaking this type of programme in many areas of the public sector. Looking at the organisation as a whole, this type of approach identifies which elements of work add real value to public services and how the organisation can be transformed to deliver equivalent or in some cases better services for less cost. Implementation can take between 6 – 18 months. Within local government, the areas where most effort has been focused have been: procurement; management de-layering; asset management; and customer contact management. This work can stand alone and deliver real benefits to the public sector organisation – or can be seen as a first step towards implementing a shared services solution. Typically, this gives a local authority some £30m to use for other priorities.

The shared services agenda has not progressed as rapidly as many would have hoped. This could make significant additional savings, without the need to merge organisations. However, it has to be recognised that we are a small country and a more radical way to reduce costs would be to create more Scotland wide bodies – but with a strong local presence. Again, I would cite Scottish Water as a good example in that respect.

- **Addressing key cost drivers** – pay is a key driver in the public sector. It accounts for some 70% of costs in the NHS for example. Many public sector organisations have agreed multi-year pay deals at between 3% and 4%, which is well above the current rate of inflation. As at 19 April, RPI – the usual measure used as a basis for salary negotiations - had dropped to -0.4% while CPI was at 2.9% and expected to drop further in coming months as reductions in fuel costs feed through. In the private sector, flexibility has been key in the current economic crisis – short-term working; extended holidays on reduced pay; pay cuts and sabbaticals have been agreed with staff and their representatives to avoid the need for wholesale redundancies. I understand that many parts of the public sector effectively have a no compulsory redundancy policy – so keeping pay levels within budget may require the more flexible approaches outlined above as well as a more fundamental look at skill-mix.
- **More user-charging** – This is clearly an area for political choices to be made. The current policy trend in Scotland by both this and the previous administration has been to reduce user-charging and transfer the costs onto the general taxpayer rather than the user eg. concessionary bus travel; free personal care; reduced prescription charges and the scrapping of tolls on the Forth Road Bridge. There is therefore a political choice to be made as to whether these general entitlements are still affordable or whether they should be targeted only at the most vulnerable. Free Nursing and Personal Care costs over £335m and rising. (Its cost was estimated by the Auditor General in

2005-06 at £285m – it will have risen since then - and a further £40m was made available to local authorities in this year's budget.) Concessionary travel is estimated to cost £187.5m per annum. The Scottish Government has also estimated that the complete abolition of prescription charges will cost a recurring £57m by 2011.

Other areas where user charging already exists are areas such as civil court fees; entrance to Historic Scotland sites; planning applications etc. These might also be worth reviewing, although I would not advocate an increase in planning applications fees at this point in the recession.

- **Defining the role of the public sector differently.** Another option is not to provide everything within the public sector, but protect the public interest by purchasing and regulating services. The most obvious example is Scottish Water. If it were mutualised and able to access external funding, the Scottish Government would have some £371m in 2010 and subsequent years to spend on other priorities. There is already a strong public sector regulator in the Water Industry Commission, who protects consumers' interests. Scottish Water has been a strong success story in the levels of efficiencies it has been able to achieve within the public sector – as outlined above - and it is a model which should be considered for other areas. An economic regulator for the NHS in Scotland may be a more radical idea worth considering in more detail.

Another area where services could be provided differently would be in increasing the levels of private provision of social care. Local authorities already purchase significant volumes of residential and social care from the private sector. The hourly costs are substantially cheaper – over a third - in the private sector. With regulation to ensure quality of service and local authorities still in control of purchasing services, an extension of this model could release additional costs for other areas, if this was acceptable politically.

Observations

It is for politicians to make the choices on what we should spend taxpayers money on and to assess relative priorities. Below these strategic priorities, there is much that could be done to improve efficiency in the public sector and release significant cost – either to spend on other priorities or if the Budget were to be reduced in real terms. The transformational and priority based budgeting approaches above would go a long way to releasing savings – and give politicians and policy makers greater room for manoeuvre in the choices they will have to make.

However, it is not enough to simply identify a list of potential savings – typically savings actually delivered are around one third of the original total opportunities identified. There needs to be a concerted programme of action within each public sector organisation to address those – many have already started. It is absolutely right that forward thinking public sector managers are addressing these issues now – implementation can take 6 – 18 months. Given the state of the public sector finances across the UK, it would be disastrous if we were to put our heads in the sand and suddenly have to take drastic action to meet year end budgets in

2011. In those crisis conditions, drastic measures are taken and frontline services adversely affected.

The downturn should be seen as an opportunity to enhance productivity in both public and private sectors – it has been a key drag on our relative economic performance for many years.

I think we would all want to see the Scottish Budget being used to tackle the impact of the recession and lay the foundations for the upturn and work has been done on that. Given the immediate impact that capital investment can make in creating jobs in the short term and enhancing our economic performance in the long term, I would not want to see cuts to vital transport projects, when operational efficiencies could be made elsewhere. Capital expenditure in recent years has been broadly 10% of the Scottish Budget – based on HM Treasury's view. We should think very carefully before cutting that – it may look like an easy option, but not necessarily an effective one.

One other aside on the current Scottish Budget is that it looks odd that Skills Development Scotland's budget is set to decrease during a recession.

Finally, I think a mature debate is needed with the public. Given the state of the public finances over the next 5 – 10 years, we can no longer afford the level of spending increases that we have enjoyed over the last 10 years. In my view, we need to do our best to become much more efficient so services do not suffer overall – but priorities may shift and some services reduced to pay for other more pressing priorities. We should focus our efforts on protecting the vulnerable, while putting the economy on as sound a footing as possible to benefit from the upturn.

Jenny Stewart, Partner
Head of Infrastructure and Government – Scotland
KPMG