Finance Committee

2nd Report, 2011 (Session 3)

Report on Scotland's Spending Plans and Draft Budget 2011-12

Volume 1: Finance Committee Report
Finance Committee

2nd Report, 2011 (Session 3)

Report on Scotland's Spending Plans and Draft Budget 2011-12

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ANNEXE C – FINANCE COMMITTEE ORAL EVIDENCE AND ASSOCIATED WRITTEN EVIDENCE (published electronically only)

17th Meeting, 2010 (Session 3), Tuesday 29 June 2010

ORAL EVIDENCE
   Rt Hon Danny Alexander MP, Chief Secretary to the Treasury, UK Government

18th Meeting, 2010 (Session 3), Tuesday 7 September 2010

ORAL EVIDENCE
   Crawford Beveridge CBE, Chair of the Independent Budget Review Panel
   Sir Neil McIntosh CBE, Member of the Independent Budget Review Panel

19th Meeting, 2010 (Session 3), Tuesday 14 September 2010

ORAL EVIDENCE
   John Swinney MSP, Cabinet Secretary for Finance and Sustainable Growth

21st Meeting, 2010 (Session 3), Tuesday 5 October 2010
ORAL EVIDENCE
Paul Grice, Clerk and Chief Executive, Scottish Parliament
Derek Croll, Head of Financial Resources, Scottish Parliament

26th Meeting, 2010 (Session 3), Tuesday 23 November 2010

WRITTEN EVIDENCE
Scottish Parliamentary Corporate Body

ORAL EVIDENCE
Tom McCabe MSP, Member of the Scottish Parliamentary Corporate Body
Paul Grice, Clerk and Chief Executive, Scottish Parliament
Derek Croll, Head of Financial Resources, Scottish Parliament

27th Meeting, 2010 (Session 3), Thursday 25 November 2010

ORAL EVIDENCE
Rt Hon Danny Alexander MP, Chief Secretary to the Treasury, UK Government

28th Meeting, 2010 (Session 3), Tuesday 30 November 2010

WRITTEN EVIDENCE
Centre for Public Policy for Regions
Fraser of Allander Institute
Reform Scotland

ORAL EVIDENCE
Sir John Arbuthnott, Royal Society of Edinburgh
Jo Armstrong, Centre for Public Policy for Regions
Professor Brian Ashcroft, Policy Director, Fraser of Allander Institute
Graeme Blackett, Reform Scotland
Peter Wood, Director, Optimal Economics

29th Meeting, 2010 (Session 3), Tuesday 14 December 2010

ORAL EVIDENCE
John Swinney MSP, Cabinet Secretary for Finance and Sustainable Growth
# VOLUME 2: REPORTS FROM OTHER COMMITTEES AND THE SCOTTISH COMMISSION FOR PUBLIC AUDIT

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# VOLUME 3: SUBJECT COMMITTEES’ ORAL EVIDENCE AND ASSOCIATED WRITTEN EVIDENCE

Please note that Volume 3 is published on the Scottish Parliament’s website only, at: [http://www.scottish.parliament.uk/s3/committees/finance/index.htm](http://www.scottish.parliament.uk/s3/committees/finance/index.htm)
Finance Committee

Remit and membership

Remit:

1. The remit of the Finance Committee is to consider and report on-

   (a) any report or other document laid before the Parliament by members of the Scottish Executive containing proposals for, or budgets of, public expenditure or proposals for the making of a tax-varying resolution, taking into account any report or recommendations concerning such documents made to them by any other committee with power to consider such documents or any part of them;

   (b) any report made by a committee setting out proposals concerning public expenditure;

   (c) Budget Bills; and

   (d) any other matter relating to or affecting the expenditure of the Scottish Administration or other expenditure payable out of the Scottish Consolidated Fund.

2. The Committee may also consider and, where it sees fit, report to the Parliament on the timetable for the Stages of Budget Bills and on the handling of financial business.

3. In these Rules, "public expenditure" means expenditure of the Scottish Administration, other expenditure payable out of the Scottish Consolidated Fund and any other expenditure met out of taxes, charges and other public revenue.

(Standing Orders of the Scottish Parliament, Rule 6.6)

Membership:

Derek Brownlee
Malcolm Chisholm
Linda Fabiani
Joe Fitzpatrick
Tom McCabe (Deputy Convener)
Jeremy Purvis
Andrew Welsh (Convener)
David Whitton

Committee Clerking Team:

Clerk to the Committee
Jim Johnston

Senior Assistant Clerk
Terry Shevlin

Assistant Clerk
Allan Campbell

Committee Assistant
Jennifer Bell
The Committee reports to the Parliament as follows—

INTRODUCTION

Background to scrutiny of Scotland’s Spending Plans and Draft Budget 2011-12

1. The Scottish Government’s budget document, Scotland’s Spending Plans and Draft Budget 2011-12¹ ("Draft Budget 2011-12") was published on 17 November 2010, four weeks after publication of the UK Government’s Spending Review (SR)² on 20 October 2010. The UK SR includes spending allocations for the Scottish Government until financial year 2014-15. However, in its budget document, the Scottish Government chose to set out firm plans for 2011-12 only, alongside a series of “Strategic Chapters”. Following a resolution of the Parliament on 25 November 2010, the Scottish Government indicated that it would publish additional indicative figures for the period to 2014-15 after the Christmas recess.

2. As at the beginning of the current parliamentary session for scrutiny of Spending Review 2007³, the timetable for publication of the UK SR had a significant impact on the timetable for the Scottish budget process. Normally the Scottish Government publishes its draft budget by 20 September. However this year the total Scottish budget was not known until the UK SR was published on 20 October. Prior to the 2010 summer recess, the Committee and the Cabinet Secretary for Finance and Sustainable Growth agreed an alternative timetable for scrutiny by the Finance Committee and subject committees. This revised timetable also necessarily means that the debate on the Finance Committee’s

report, which normally takes place late in December, will be included in the forthcoming Stage 1 debate on the Budget Bill.

3. In order to inform its scrutiny of the Draft Budget 2011-12, the Committee agreed to conduct a budget strategy phase (BSP) in Spring 2010 (reporting in June 2010), which replaces the previous Stage 1 of the budget process, in line with a key recommendation from the Committee’s Report on the Review of the Budget Process. The Committee agreed that it would be useful, as part of the BSP, to undertake an inquiry examining what preparation should be underway by the public sector to ensure the efficient delivery of public services within a period of tightening public expenditure. The Committee’s report called on decision makers within all publicly funded bodies, and the Scottish Government and parliamentary committees, to show far greater leadership by discussing in more open and realistic terms the impact that the budget cuts will have and the options that are available to deal with these cuts. The key themes and issues raised in the BSP report are referred to throughout this report.

4. Alongside its work on Draft Budget 2011-12, the Committee has also carried out an inquiry into preventative spending. The issues raised during that inquiry and other issues around the longer term direction of public spending in Scotland are closely interlinked with the Committee’s scrutiny of the Draft Budget.

5. Throughout this session (and in previous sessions), the Finance Committee has sought to improve and expand the budgetary information provided by the Scottish Government to assist the budget scrutiny process, and has examined the process itself in detail. This report also considers how these issues have developed since 2007 and will inform the Committee’s legacy paper.

Evidence taken by the Committee

6. The Committee took evidence on the expenditure plans set out in Draft Budget 2011-12 from the Cabinet Secretary for Finance and Sustainable Growth on 14 December 2010, and from a panel of Scottish public finance experts on 30 November 2010. In preparation for its formal budget scrutiny, the Committee took evidence from members of the Independent Budget Review Panel and the Cabinet Secretary on the IBR in September 2010.

7. The Committee also received briefing papers on Draft Budget 2011-12 from SPICe and its budget adviser, Professor David Bell of the University of Stirling. The SPICe briefing is published separately, and the papers from Professor Bell form Annexe B to this report. In addition, the Committee held a joint seminar with

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6 The IBR was undertaken by a panel of three – Crawford W Beveridge (Chair), Sir Neil McIntosh CBE and Robert Wilson and supported by a small secretariat. The remit of the review can be found on the Scottish Government’s website at: http://www.scotland.gov.uk/About/IndependentBudgetReview
the David Hume Institute in October 2010, which was also very useful in setting the context for its budget scrutiny.\(^7\)

8. For the first time the Committee also took evidence from the UK Government on both Budget 2010\(^8\), published in June, and the SR. The Committee is grateful to the Rt. Hon. Danny Alexander MP, Chief Secretary to the Treasury, for giving evidence in both June and November 2010.

9. The Committee also took evidence from the Scottish Parliamentary Corporate Body (SPCB) on its budget planning in October 2010 and on its spending plans for 2011-12 in November 2010.

10. Various other committees took evidence on expenditure plans in particular Scottish Government portfolios and the Committee has had the opportunity to consider their reports, which are published as Annexes D-M to this report. Many of them were assisted in this by their own specialist budget advisers. The Finance Committee thanks these other committees for their input.

11. These other committee reports provide detailed commentary on budgetary proposals in the different portfolios. Although they are annexed to this report, they can be viewed in their own right as free-standing reports which contain many recommendations which subject committees may wish to follow up with relevant Ministers. Many of these are matters of detail which appear likely to inform their own legacy work. This report is only able to highlight key points which the Finance Committee has considered in the course of its examination of the overall budget and cross-cutting and strategic issues.

12. Unfortunately, due to the adverse weather conditions experienced in December 2010, the Committee was forced to cancel its planned external meeting in Carnoustie. The Committee would like to express its gratitude to the staff at the Carnoustie Golf Hotel for their work in organising the event and those organisations invited to the workshops for agreeing to give up their time to take part. The Committee hopes its successor committee will be able to visit the area in future.

13. The Committee would like to record its thanks to all those who participated in its budget scrutiny, and who provided evidence and advice in the process.

**Structure of report**

14. This report begins by briefly examining the SR. It then considers—

- the overall strategy and priorities set out by the Scottish Government in the Strategic Chapters of the budget document;

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scrutiny of the detail of specific portfolio issues in the Draft Budget 2011-12; and

• the development of budgetary information and the budget process with a view to informing the Committee’s legacy paper.

THE UK GOVERNMENT’S SPENDING REVIEW

Introduction

15. The UK Government published its SR on 20 October 2010, containing spending plans from 2011-12 to 2014-15 for all areas of UK policy. The combined effect of the corresponding Barnett consequentials on areas of devolved spending produces the total Scottish Departmental Expenditure Limit (DEL) budget. This section of the report first discusses the figures in the SR and those produced by the Scottish Government, then the evidence taken from the Chief Secretary to the Treasury and finally outlines the impact of the SR measures on local authorities.

Reconciliation of UK Government and Scottish Government figures

16. At the time of publication of the SR, both the UK Government and Scottish Government presented different figures for the Scottish budget. The Parliament’s Financial Scrutiny Unit (FSU) produced a useful briefing clearly setting out the differences between the figures.9

17. In short, due to a range of factors, including the Scottish Government’s decision to defer its share of the £6 billion cuts announced in the UK Emergency Budget from the 2010-11 Budget (around £370 million), plus the inclusion of End Year Flexibility (EYF) draw-downs in the 2010-11 budget, the Scottish Government has stated that the 2010-11 actual spending figure was higher than the Treasury baseline of £28.2 billion. The difference between the Treasury and Scottish Government position results in a different assessment of the fall in the Scottish Budget in 2011-12. According to the Scottish Government’s definition, the fall in 2011-12 actual spending is £1.3 billion, as opposed to a £900 million reduction using the Treasury’s methodology, which includes removal of the Scottish share of the 2010-11 cuts from the baseline.

GDP deflator

18. In addition, since the publication of Draft Budget 2011-12, the Treasury has increased the GDP deflators for 2010-11 and 2011-12 to 3.1% and 2.5% (from 2.9% and 1.9% respectively).10 This will increase the real terms budget reductions for the figures contained in Draft Budget 2011-12. However, all real-terms figures

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in this report use the original deflator for 2011-12 of 1.9%, as used in the SR document and *Draft Budget 2011-12*.

**Evidence from the Chief Secretary to the Treasury**

19. The Committee held two evidence sessions with the Rt. Hon. Danny Alexander MP, Chief Secretary to the Treasury. The first, in June, concerned *Budget 2010*, and the second, on 25 November 2010, the SR. This section of the report focuses on the latter of these two sessions.

20. The Committee discussed a range of issues with the Chief Secretary. The SR indicates that the current system of EYF is to be abolished and “replaced with a new system which will retain an incentive for departments to avoid wasteful end-year spending and strengthen spending control.”\(^{11}\) There is, however, no further detail on the new system in the SR document. Although the Chief Secretary was not able to confirm details of the final system he did explain that the Treasury was “considering a system that allows planned underspends to be carried forward from one year to the next.”\(^{12}\) While UK Government Departments will need the Treasury’s permission to do this, the Chief Secretary outlined two additional flexibilities for the devolved administrations—

> “First, underspends can be carried forward without Treasury permission. Secondly, although for UK Government departments the current system will end at the end of this financial year—there will be a hard end and then the new system will start—the Scottish Government and the other devolved Administrations will be able to carry forward underspends at the end of this financial year into next year.”\(^{13}\)

21. The SR also contains £1 billion of DEL funding (in 2013-14) for a Green Investment Bank, £250 million of which “will be made available on the basis that the Scottish Executive agrees to the drawdown of funds from the Scottish Fossil Fuel Levy surplus.”\(^{14}\) The Chief Secretary explained this in more detail—

> “The Scottish Government’s budget is set through the Barnett formula—that is how departmental expenditure limits for the Scottish Government and other devolved Administrations are set and we cannot simply add to those. The Scottish Government is free to draw down the fossil fuel levy—over a period of time if it wishes—to support its investment programme in renewables. If it does so, as a way of resolving the problem and as a signal of the Government’s commitment to the renewables industry in Scotland, we will set aside a further £250 million to support investment in Scottish projects through the green investment bank. That is a positive offer to resolve a significant dispute and, what is more, put real, substantial additional investment into the


renewables sector over the next few years, which is a critical time for that industry.”

22. The Committee notes the response from the Chief Secretary. However, the Committee would support and encourage the Scottish Government to explore with the Treasury the possibility of levering in additional funding in advance of 2013-14.

23. One of the key messages from the budget adviser to the Committee was to ensure that the Committee considered the full impact of cuts in the SR to reserved areas on Scotland, especially defence and welfare. In terms of the regional impact of the SR, the Chief Secretary explained that—

“...In the spending review, we signalled our wish to ensure that there were no disproportionate impacts and that no local hot spots were created. As a result, we will go through a process in order to understand in advance the workforce planning that departments might carry out, or the impact of particular decisions, in order to avoid or mitigate any that might have a particularly heavy localised impact.”

24. The Committee would welcome a response from the Scottish Government explaining its consideration of the impact of cuts in reserved areas on Scotland and how these influenced its own budgetary decisions.

Impact of SR measures on local authorities

25. The Local Government and Communities Committee also raised the important point of the direct impact of some SR measures on local authorities. In particular, it is concerned by the additional costs that local authorities will have to bear as a result of changes to council tax benefit, changes to the carbon reduction commitment regime, a reduction of 10% in the housing benefit administration grant and an increase of 1% in interest rates for loans from the Public Works Loans Board. While the final cost of these changes is not known in detail, the Committee notes that individual local authorities and SOLACE have identified these changes as additional pressures which will have an effect on local authorities, and over which they have no effective control.

STRATEGIC ISSUES

Introduction

26. This section of the report considers the Scottish Government’s strategic, cross-cutting approach to dealing with the reductions in its budget. The Scottish budget for 2011-12 (as set out in Draft Budget 2011-12) comprises a Total Managed Expenditure (TME) of £33,620 million. This is made up of a
Departmental Expenditure Limit (DEL) of £28,007 million and Annually Managed Expenditure (AME) of £5,612 million. Within DEL, the resource budget totals £25,400 million and the capital budget totals £2,607 million. This capital allocation includes £100 million of underspend carried forward from the 2010-11 financial year.

27. Before discussing the Government’s approach to dealing with its budget settlement, it is clear to the Committee that Draft Budget 2011-12 is, as stated by the Budget Adviser, “the most difficult since devolution.” The Committee recognises that producing a balanced budget in these circumstances is a significant challenge for both the Government and the Parliament.

Decision to produce a one-year budget

28. As noted in the introductory paragraphs of this report, although the SR provides figures for the Scottish budget through to 2014-15, in its budget document the Scottish Government chose to only produce figures for 2011-12. In Spending Review 2007, the Scottish Government produced figures down to level three for the three years covered by the UK spending review. Following a resolution of the Parliament on 25 November 2010, the Scottish Government agreed to publish illustrative figures up to 2014-15 after the Christmas recess, but prior to the Stage 1 debate on the Budget Bill. The Committee notes the points made by the Cabinet Secretary that these figures can only be indicative and are subject to change. Given the timings involved in preparing this report, it has not been possible for the committee to take these figures into account in its budget scrutiny.

The Government’s Purpose

29. The Government states in Draft Budget 2011-12 that: “Our Purpose – to focus government and public services on creating a more successful country, with opportunities for all of Scotland to flourish, through increasing sustainable economic growth – provides the foundation for this Spending Review and Draft Budget 2011-12.” This purpose was first published as part of Spending Review 2007 and is supported by the National Performance Framework.

30. Draft Budget 2011-12 states that the “fundamental strategic priorities central to this budget are:

- to support economic recovery and deliver our Purpose of increasing sustainable economic growth;
- to protect the public services on which people depend and which are most effective in tackling deep seated problems and delivering real benefits and better outcomes for the people of Scotland; and

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- to establish a competitive advantage through the opportunities offered by taking action on climate change.\(^{21}\)

31. These priorities are substantially different from the strategic priorities within Draft Budget 2010-11 which were as follows—

- enhancing learning, skills and wellbeing;
- creating a supportive business environment;
- developing infrastructure and place;
- promoting effective government; and
- ensuring equality.\(^{22}\)

32. However, there is no explanation within the document as to why the government’s strategic priorities have changed or any assessment of the impact of the previous strategic priorities on the government’s Purpose.

33. The Committee has heard evidence which questions the extent to which the draft budget does in fact prioritise economic growth. For example, Peter Wood, Director of Optimal Economics, suggests that given the decision to protect health spending “it does not suggest that the first priority in the budget is promoting economic growth” and that “among the government’s purposes, the protection of services has been given priority over the promotion of growth.”\(^{23}\) However, he also went on to say that no Scottish Government has “really prioritised economic growth.” Rather, “the pressure has been to improve the quality and delivery of public services.” He states that: “I fear that the commitment to economic growth is more of a slogan than a reality.”\(^{24}\)

34. Jo Armstrong, from the Centre for Public Policy for Regions (CPPR), also questions the extent to which economic growth is the government’s main priority: “the areas that are typically related to the generation of economic growth have been cut: higher and further education, water, housing and the enterprise agencies...it is difficult to see the link between the headline of sustainable economic growth and the current budget allocations.”\(^{25}\) This is a point also made by Professor Brian Ashcroft, Policy Director of the Fraser of Allander Institute, who states: “ring fencing a large area of current services that are unrelated to economic growth makes it even more difficult to protect the growth objective.”\(^{26}\)

35. The Economy, Energy and Tourism Committee considered in detail the question of whether the draft budget will support economic recovery and

concluded that: “The Committee recognises the challenge facing the Government in handling unprecedented budget cuts. However, it considers that insufficient priority has been given to sustaining the growth of the economy in setting budget priorities. Decisions to ring fence and protect certain areas of social spending have reduced the scope for manoeuvre.” It suggests that given the heavy cuts in the capital budget and the reductions in support of education, skills, infrastructure and regeneration that “this budget is not best geared to support economic growth.”

36. In response to questioning by the Committee on whether Draft Budget 2011-12 prioritises economic growth the Cabinet Secretary referred to “the test of whether the budget supports economic development” and the assessment that the Government carries out “to satisfy itself that the measures that we put forward in the budget are able to support effectively the process of economic growth. That is what lies at the heart of the decisions that we have taken.”

37. Within this context the Committee notes that the Government has not provided any evaluation of the impact of its spending priorities on progress towards its Purpose despite the recommendation within the BSP report that: “the Scottish Government provides a supporting document to the 2011-12 Draft Budget which sets out the link between performance over the period of the previous spending review, Government priorities for the next spending review and how these priorities are to be funded in 2011-12.”

38. Given that the Cabinet Secretary has confirmed that such an assessment has been carried out, the Committee is disappointed that the government has failed to provide the supporting documentation which it requested. This Committee and its predecessors have continually emphasised the need for the government to provide more detailed information on the linkage between the budget and policy priorities and outcomes. This issue has also been routinely raised by the subject committees and will be considered in more detail in the “legacy issues” section of this report.

39. The Committee regrets the lack of any information within the Draft Budget linking an evaluation of government performance over the period of the previous spending review with its policy priorities for Draft Budget 2011-12 and intends to address this issue in its legacy paper with a view to informing a revised Written Agreement.

40. Given the above criticism of the extent to which the Government’s Purpose does in fact provide the foundation for Draft Budget 2011-12 the Committee invites the Government to publish, prior to the Stage 3 debate, an overview of the assessment which it has carried out to satisfy itself that the measures within the budget support the process of economic growth.

41. The Committee also invites the Government to explain why its strategic priorities have changed, as set out in paragraphs 30 and 31, and whether it has carried out an assessment of the impact of its previous priorities on its Purpose.

42. The Committee will now consider in more detail some of the key strategic, cross-cutting decisions made in Draft Budget 2011-12 and how they contribute to the Government’s Purpose. These are —

- workforce and pay policy;
- efficiency savings;
- maintenance of universal services;
- capital spending; and
- preventative spending.

**Workforce and pay policy**

43. The IBR panel noted in its report that: “The public sector pay bill (including pension costs) amounted to £15.2 billion in 2010-11” which amounts to 59% of resource DEL.28 It is, therefore, inevitable that given the scale of the reduction in public spending that public sector pay and the size of the workforce will have to be reduced.

44. The panel recommended that the Scottish Government applies a two year pay freeze with further options to also freeze progression payments but to protect lower paid workers. The panel also recommended the immediate implementation of a recruitment freeze across the public sector, with exceptions only granted for essential staff posts.

45. However, even with the effective implementation of these measures the panel suggested that they will not be sufficient on their own to provide an effective response to the forthcoming reductions in public spending. Consequently, the IBR set out a number of options for the reduction in the size of the workforce depending on the scale of pay restraint measures. They state that—

“In order to close the gap in the pay bill budget, it is estimated that public sector employment would need to fall by approximately 5.7 per cent to 10 per cent by 2014-15 (depending on the pay restraint options selected). This assumes a pay freeze in the first two years and pay restraint in the following two years.”29

46. However, the Cabinet Secretary stated in evidence to the Committee that while accepting that public sector employment will fall, “one of the principal drivers for the government’s public sector pay policy is to try to protect employment.”30 He

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goes on to state that: “efforts to constrain public sector pay...could save around 10,000 jobs.”

The pay policies

47. The Scottish Government published its Public Sector Pay Policy for Staff Pay Remits 2011-12 ("the pay policy") alongside Draft Budget 2011-12. The pay policy applies to employees in the Scottish Government, executive agencies, Non Departmental Public Bodies (NDPBs), public corporations and certain NHS executives, but does not apply to the majority of employees in the NHS or employees in local government. However, it should be noted that the Scottish Government only determines 8% of the total pay bill directly through the application of its pay policy.

48. The pay policy has three key elements for 2011-12—

- a pay freeze for all staff (subject to measures to address low pay), but no freeze on progression payments;
- access to all non-consolidated pay (i.e. bonuses) is suspended; and
- for lower paid staff, all employers covered by the policy are required to introduce a “Scottish Living Wage” of £7.15 per hour, and all those staff earning under £21,000 are entitled to a minimum pay increase of £250.

49. In addition to this, the pay policy states that the Government “believes that the policy position of no compulsory redundancies can be sustained on condition that agreements are reached on flexible working practices which reduce costs while maintaining headcount and services.” However, the policy does not provide further details on these flexibilities, and only encourages employers to “negotiate no compulsory redundancy agreements with staff and their representatives.”

50. *The Public Sector Pay Policy for Senior Appointments 2011-12*[^37] ("the senior pay policy") was also published alongside *Draft Budget 2011-12*. The senior pay policy applies to chief executives of NDPBs and public corporations, certain NHS Executives and all public appointments (Chairs and Members) to Scottish public bodies. Similar to the pay policy, the senior pay policy includes a pay freeze and the suspension of access to non-consolidated pay. The Government has also announced that the costs of the senior civil service will fall by at least 10 per cent by the end of 2011-12 and by 25 per cent by 2014-15, through (among other things) a presumption of lower starting salaries for new chief executives of NPDBs and a reduction of the number of senior managers in NHS Scotland.

**Local Government**

51. In terms of local government, in 2011-12 there will be a freeze on cost of living increases for local authority staff (excluding senior local authority staff, teachers, police and fire staff). This was part of a settlement imposed by COSLA which gave a basic increase of 0.65% in 2010-11 with a 2-year pay freeze to follow. Progression payments continue to be paid. When this was imposed (which was before the publication of the Scottish Government public sector pay policy), there was no suggestion that either a Scottish Living Wage would be introduced or that there would be a minimum increase for people earning less than £21,000.

52. The Local Government and Communities Committee is concerned that the pay freeze being applied in local authorities leaves the lowest paid disproportionately affected, with no floor on the pay rate to which it applies and no commitment to the introduction of the living wage. It went on to state that this could result in a wider gulf between the lowest paid employees covered by the Scottish Government’s public sector pay policy and those employed by local authorities. It recommended that it is essential further work is undertaken to assess the costs with a view to implementing the same protection for the lower paid in local authorities.

53. The Committee welcomes the commitment within the Government’s pay policy to protect the lowest paid but agrees with the Local Government and Communities Committee that it is essential that further work is undertaken to assess the costs with a view to implementing the same protection for the lower paid in local authorities and indeed across the public sector.

54. The Committee notes the concerns of the Economy, Energy and Tourism Committee in relation to the lack of discussion on the development of a sustainable and coherent public sector pay policy within the draft budget and agrees that the Government should set out in more detail its intentions on public sector pay policy including its position on a recruitment freeze.

55. In particular, the Committee asks whether the Government agrees with the IBR panel that public sector employment will fall by approximately 5.7% - 10%.

56. In evidence to the Committee the Cabinet Secretary confirmed that the Government’s economic model can calculate the impact on jobs of its spending decisions. The Committee would, therefore, welcome an indication from the Government of how many public sector jobs it expects will be cut as a consequence of the draft budget. It would also have been beneficial to have more information published in the budget document on how much savings the Government expects from the pay restraint measures and for the document to spell out the impact on individual budget lines.

57. In terms of senior pay, the Committee again recognises the progress that has been made in reducing the costs of the senior paybill and that access to non-consolidated pay has been suspended for 2011-12. However, it repeats the views expressed in its 2009 report on public sector pay\(^{38}\) that the policy of paying bonuses to senior appointees should be reviewed; and as each of these particular appointments comes up for renewal, bonus arrangements should be altered or brought to an end in line with the outcome of the review.

Efficiency savings

58. A second key element of the Government’s overall strategy for dealing with the budget reductions is efficiency savings. The Government states in *Draft Budget 2011-12* that—

> “… we are seeking efficiency savings across public services of 3 per cent for 2011-12, with each delivery body expected to report publicly on their plans to improve the efficiency of public services, actions undertaken and results achieved.”\(^{39}\)

59. Efficiencies are about enhancing value for money across the public sector, improving performance and raising productivity, but can also make an important contribution to balancing the public finances. Similar to the Government’s approach to public sector pay, it is an attempt to maintain levels of public services despite the overall reduction in resources.

60. The Cabinet Secretary explained the Government’s approach in more detail, stating that—

> “… it is implicit in the Government's guidance on efficiency savings that a reduction in service cannot be deemed to be an efficiency. The test is whether services are maintained. If a measure maintains services, albeit in a different fashion or through different service design, it can be deemed to be

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an efficiency. However, just stopping doing something is not an efficiency but a cut in public spending or public programmes. That is quite a hard test.”

61. For 2011-12, the Government has set a target of three per cent efficiencies across the Scottish public sector. In previous years in this parliamentary session, the Scottish Government has set a year-on-year target of two per cent. The Government has previously allowed savings generated to be “recycled” to support and improve service delivery. In 2008-09, the IBR states that the efficiency programme realised savings of £839 million against a two per cent target of £534 million, all of which “were reinvested in public services”. The 2009-10 outturn was £1470.5 million against a target of £1068.8 million. The target for 2010-11 is £1603.2 million.

Issues around efficiency savings

62. Despite the claims made by the Scottish Government and previous administrations for the effectiveness of past efficiency programmes, the Finance Committee, Audit Scotland, the National Audit Office and many other organisations have consistently raised a series of issues around the delivery and reporting of efficiency savings. First, the problem of year-on-year targets means that the “low-hanging fruit” will most likely have been picked some time ago, and any future efficiencies will be harder to find. This is a point raised by the Society of Local Authority Chief Executives (SOLACE) in evidence to the Local Government and Communities Committee: “Although the efficiencies that we have made to date were achievable, we cannot hope to keep finding those efficiency savings over and over again.”

63. Regular incremental targets also act as a disincentive to bodies that could extract significantly larger costs from their operation in a single year. Setting individual targets for savings can encourage “silo thinking” whereby public bodies focus only on their own contributions to savings, meaning they neglect opportunities to work together with other bodies.

64. However, the major concern with efficiency savings throughout devolution has been the reliability of reporting information provided by public bodies. In its report on the Draft Budget 2010-11 the Committee stated that it —

“... is concerned at an apparent lack of transparency and independent verification in respect of some efficiency savings, which makes it impossible

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to examine adequately the impact they have on the funds available for service delivery.”

65. The government stated in its response that: “It would be excessively costly to set up separate, independent verification for almost 120 Efficiency Delivery Plans.”

66. However, in its report on *Improving public sector efficiency*, published in February 2010, Audit Scotland stated that—

“…although public bodies have some cost information they still do not have the supporting evidence on unit costs, activity and quality needed to provide assurance about the savings reported through the Programme. ...Taking into account the limited progress made in implementing our 2006 recommendations, significant weaknesses in the information available and inconsistencies, Audit Scotland is not able to provide assurance on reported efficiency savings.”

67. The Committee looked at this issue again during the BSP and heard some worrying evidence from the deputy auditor general who stated in relation to the 2008-09 outturn, that—

“We were not able to find a clear pattern from bodies in any sector, particularly local government and health, that the amount of efficiencies that people had managed to release related to the amount that they spent or the types of goods that they purchased. One of the key findings in our report is that the information really is not good enough to make it clear that efficiency savings are just that, rather than cuts, reductions in quality or money being moved around.”

68. The government responded that it “did not share the Committee’s view that the words of the Deputy Auditor General...constitute a criticism of public sector efficiency saving.”

69. This issue was also considered by the Local Government and Communities Committee which stated that: “it is not clear what measures exist to ensure initiatives aimed at delivering efficiencies do not actually result in service cuts, either in the quantity or quality of services provided.” The Local Government and

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46 Scottish Government. Letter from the Cabinet Secretary for Finance and Sustainable Growth to the Convener of the Finance Committee dated 18 January 2010.
50 Scottish Government. Letter from the Cabinet Secretary for Finance and Sustainable Growth to the Convener of the Finance Committee dated 6 August 2010.
Communities Committee recommends that: “local authority efficiency savings are subject to independent audit from 2011-12 onwards.”

70. The IBR panel estimates that a three per cent target could “in theory” generate £900million of savings in 2014-15 (based on non-pay, non-capital revenue expenditure). However, unless these savings can be accurately measured there is no way of knowing whether services have simply been cut due to reductions in the budget or a failure to deliver efficiencies. In addition, the lack of a reliable, properly established baseline adds to the difficulties of measuring whether genuine improvements in productivity have been achieved. The key to understanding whether this will simply result in a salami-slice cut to public services (a problem flagged up in the BSP report) or genuine improvements in public service delivery will be through the reporting mechanisms.

71. The Equal Opportunities Committee examined efficiency savings from an equalities perspective, and noted its concern that the incentive to secure further efficiencies may impact disproportionately on the services the most vulnerable members of Scottish society rely upon heavily, and the pressure to deliver ‘short term gains’ will be at the expense of robust and transparent Equality Impact Assessment.

72. The Committee notes that arrangements for reporting have yet to be set out, and would have preferred this to be done alongside publication of the Draft Budget. Given the concerns above the Committee invites the Scottish Government to explain how it will ensure that the “test” which the Cabinet Secretary has set out in relation to efficiency savings will be enforced.

Retention of efficiency savings for 2011-12?

73. The IBR panel stated in its report that: “the focus should now be shifted away from recycling efficiency savings, towards treating such savings as a contribution towards reducing the impending gap in funding.”51

74. Despite the Committee requesting in its report on the BSP that the Government “confirm as soon as possible whether it will allow bodies to retain their efficiency savings in the next spending review period” it is not clear from the budget document whether savings will be retained by public bodies.

75. The Cabinet Secretary stated in evidence to the Committee that—

> “Essentially, the 3 per cent is being applied across the Government's budget programme as an assumption of what we consider individual bodies will have to deliver. Some areas of the budget have been reduced by more than 3 per cent, so there are clearly budget reductions beyond efficiency savings. That is self-evident from the material that is in the budget.”52


76. In evidence to the Local Government and Communities Committee, SOLACE stated that: “If we make efficiencies of 3 per cent, we will use that money to make savings or redesign services.”

77. The Economy, Energy and Tourism Committee states that it: “regrets the lack of clarity within the budget documents over what, if any, sums are expected to be released as a result of the planned 3% savings.”

78. The Committee is concerned that the issue of whether efficiency savings will be recycled or contribute to the gap in funding remains unclear and invites the Government to explicitly set out its position as a matter of urgency.

Maintenance of universal services

79. The IBR panel state in their report that the issue of universal services is not one of desirability but of affordability. They suggest that given drivers such as demography the provision of universal services appear to be unsustainable. The panel identified six services funded either directly or indirectly by the Scottish Government where there are possible options for reducing costs—

- concessionary travel;
- free personal and nursing care;
- prescription charges;
- eye examinations;
- free school meals; and
- tuition fees.

80. Chapter five of the IBR report sets out a number of options for reducing costs in these areas and recommends that the government should build on this work and—

“... take forward further, more detailed work as soon as possible to consider savings that could possibly be made within the next Spending Review period, taking account of the impact on those greatest in need. The scale of the savings has the potential to make a significant contribution to filling the projected funding gap.”

81. In his briefing for the Committee on Draft Budget 2011-12, the Budget Adviser questions how the Scottish Government intends to control spending in

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delivering universal services with open ended commitments or entitlements. For example, the concessionary fares scheme now costs over £0.25 billion and the cost is likely to continue to increase as the population ages. Professor Bell also questions how this fits within the National Performance Framework.  

82. The Committee has also previously addressed this issue of the sustainability of universal service provision within a reducing budget and increased cost pressures. In its report on the BSP the Committee invited the Government to explain the impact which this commitment will have on other budgets.

83. In a briefing provided to the Committee for the BSP, Professor Bell outlined in detail the main arguments for and against universalism and means-testing. The IBR drew heavily on this analysis in preparing its own report. As noted above, the IBR attempted to cost the impact of changing eligibility for many of these benefits, and has identified two options that could have a direct impact on the 2011-12 budget—

- raising the entitlement for the concessionary travel scheme from 60 to 65 would save £46 million in 2011-12; and
- freezing prescription charges at 2010-11 levels (i.e. rather than move to full abolition in April 2011) would save £25 million in 2011-12 (more could be saved by reverting to the level of charges in England).

84. As discussed at paragraphs 33-36 the Committee also heard evidence which questioned whether the commitment to continue to provide universal services means that the Government’s main priority can be viewed as being economic growth.

85. However, despite the recommendations within the IBR panel report that immediate work should be carried out by the Government to “review whether all free or subsidised universal services should be retained in their current form” the Cabinet Secretary has instead chosen within Draft Budget 2011-12 to “reinforce our social contract with the people of Scotland.”

86. The Cabinet Secretary elaborated on this social contract in evidence to the Committee—

“We have to consider the projects and proposals that we think are appropriate as part of the social contract that exists in our society. My view, and the Government’s view, is that the first port of call of any programme to

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reduce public expenditure should not be universal services that have been built up as a consequence of agreement in the Parliament.  

87. The Committee makes no comment on the proposals from the IBR. However, given the Cabinet Secretary’s emphasis on the continued provision of universal services the Committee again invites the Government to be more transparent in explaining how this will have a long-term impact on other aspects of the budget given demographic and other cost pressures.

88. The Committee also invites the Government to respond to the view that given the emphasis on the “social contract” the primary aim of the draft budget is the protection of services rather than economic growth.

89. The Committee also asks the Government whether the emphasis on a social contract means that the Commission on the Future Delivery of Public Services will need to work on the basis of prioritising the protection of universal services.

Capital spending

90. While the protection of the health resource budget in the SR has largely benefited the Scottish DEL resource budget through the Barnett Formula, the Scottish DEL capital budget has been hit harder. The total DEL capital budget for 2011-12 is £2.5 billion which according to the Scottish Government is reduced from a 2010-11 baseline of £3.3 billion. This is clearly a very significant reduction of around a quarter. In order to ameliorate this situation, the Government has agreed with the UK Treasury to carry forward £100 million of underspend from 2010-11 to the 2011-12 capital budget. Under the current public finance arrangements, the Scottish Government also has the power to transfer resources in-year from its revenue budget direct to its capital budget. The Government has chosen not to do this in Draft Budget 2011-12.

91. Given the perceived importance of certain aspects of capital spending to economic growth (transport infrastructure, communications networks etc), the Government’s response to the reduction in capital budgets is of crucial importance in assessing its budget against its core Purpose. This section of the report therefore first looks at the capital spending decisions in Draft Budget 2011-12 and then at the Government’s plans to lever in more private sector investment through the non-profit distributing (NPD) model, which was examined in detail in the Committee’s 2008 report on methods of funding capital investment projects.

The Government’s capital spending plans

92. In the introduction to the Capital and Infrastructure section of the budget document, the Government sets out the key priorities for its capital spending programme, stating that it has—

“… undertaken rigorous prioritisation of the projects and programmes it supports. We have sought to maintain the continuity of our investment plans

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as far as possible, while prioritising investment to support essential public services and economic growth.\(^{60}\)

93. It goes on to specify the Forth Replacement Crossing, the South Glasgow Hospitals Project and the Building Schools for the Future Programme (in conjunction with local authorities) as its major infrastructure investment priorities. However, given the scale of the cuts in the overall capital budget, some elements of capital expenditure have necessarily been subject to severe cuts, including Housing and Regeneration, which is subject to a reduction of £85.6 million, or 26.7% in real terms.

94. The Cabinet Secretary explained the Government’s general approach to capital spending—

“… our choices continue to support economic growth in Scotland. What we have done to supplement our capital investment programme is evidence of our aim of developing a strong Scottish economy. I have found £100 million of savings this year to pass over to next year, and there is the investment in the non-profit-distributing model of capital investment, which will help the Scottish economy.”\(^{61}\)

95. However, the Committee again heard evidence in relation to capital spending which questioned the extent to which the government has prioritised economic growth in the draft budget. For example, Jo Armstrong stated that—

“If we unblock blockages on infrastructure, we help to create economic growth and encourage jobs growth...It would be a big benefit if we reduced the eligibility for bus passes, to save some funding for infrastructure.”\(^{62}\)

96. Housing in particular was an area which was identified by witnesses as an area in which government investment could have an immediate impact on economic growth. Peter Wood stated: “I would suggest finding ways to transfer resources to protect capital spending, notably in social housing”\(^{63}\) while Jo Armstrong suggested “if you want to spend some money quickly to make a difference you should probably put it into housing.”\(^{64}\)

97. On the specific issue of housing, the Cabinet Secretary stated that—

“… the core capital funding for housing is one thing, but Mr Neil is taking forward other initiatives, such as the national housing trust, that look from the first evidence to have the desirable feature that they involve relatively small amounts of Government support but anchor disproportionately greater investment by opening up local authority borrowing. There are interesting and novel ways in which we can try to expand the size of the housing budget,


rather than by simply trying to allocate other capital expenditure, but I do not say that to close down any discussion on how it might be done.  

98. **The Committee welcomes the Cabinet Secretary’s positive response and agrees with witnesses that investment in housing could have an immediate impact on economic growth.**

_The non-profit distributing model_

99. Alongside the investment of its DEL capital budget, the Scottish Government also plans to make use of the NPD model of private sector investment in public infrastructure projects. The budget document states that: “The NPD model seeks to transfer risk and exert private sector discipline both during the construction phase of a project and throughout its lifetime, but without the excessive profits to the private sector and financing costs to the public sector associated with past PFI projects. Key features of the NPD model are that:

- returns to the private sector are capped;
- NPD does not contain dividend-bearing equity; and
- surpluses from NPD projects can be directed in favour of the public sector.”

100. As noted above, the Committee examined the principles of the NPD model (and a range of other funding models) in detail in its inquiry into methods of funding capital investment projects earlier in the parliamentary session. The Committee concluded that it could not “offer any recommendations or conclusions about the operation of the NPD model as there is not yet enough evidence about its effectiveness as an alternative to PPP/PFI.”

101. The Government indicates in the budget document that, based on contracts already signed, the cost of unitary charges will peak as a share of the Resource DEL budget at around 2.3 per cent in 2015-16 (or £613 million in nominal terms). The Government “intends to hypothecate an additional 1 per cent of the RDEL budget, which will be top-sliced to fund new NPD projects. This policy will provide at least £250 million of revenue support, which will be used to fund up to £2.5 billion of capital expenditure delivered through the NPD model.” The Cabinet Secretary confirmed in oral evidence that, in his view, 4% would be the upper sustainable limit of the revenue budget to be committed to unitary charges, although this was not set out in _Draft Budget 2011-12_.

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102. It is clear that committing 4% of the revenue budget to unitary charges will have serious implications for the rest of the budget in future. The Committee invites the Scottish Government to confirm its position on the upper sustainable limit for the percentage of the revenue budget to be committed to unitary charges in future, and the basis for and assumptions behind, the figure.

103. Draft Budget 2011-12 goes on to list a series of projects that the Government plans to fund through the NPD model. However, the Economy, Energy and Tourism Committee concluded that the heavy cuts in the capital budget are especially harmful to growth and: “regrets the slowness of progress in developing the use of” the NPD model and “urges renewed efforts to develop alternative mechanisms to support capital spending.”

104. The Committee invites the Scottish Government to respond to the view that progress has been slow on developing the use of the NPD model.

Preventative spending

105. One of the key recommendations to emerge from the budget strategy phase of Draft Budget 2011-12 was the Committee’s recent inquiry on preventative spending. The remit of the inquiry was: “To consider and report on how public spending can best be focussed over the longer term on trying to prevent, rather than deal with, negative social outcomes.” The Committee’s report was published on 11 January 2011 and is available on the Parliament’s website at: http://www.scottish.parliament.uk/s3/committees/finance/reports-11/fir11-01.htm.

106. The Committee does not intend to repeat the findings of that report here but two issues are worth considering in the context of Draft Budget 2011-12. First, the Committee heard some powerful evidence on the benefits of Early Years intervention and, therefore, welcomes the £5 million fund in the Draft Budget for Early Years and Early Intervention. The Committee also strongly believes that despite the current financial constraints it would be counter-productive and short-sighted if budgets were to be cut in areas such as the Early Years.

107. The Committee also welcomes the £70 million “change fund” in the Draft Budget in NHS board allocations, to “support the redesign of services and help shift the balance towards primary and community care”. The need for more collaborative working has been a consistent theme in much of the Committee’s recent work including the BSP and the inquiry on preventative spending.

108. The Local Government and Communities Committee also considered collaborative working and concluded that increasing the pace of change in delivering shared services is essential if local government is to successfully meet the challenges of the changing nature of public sector finances. While the Committee recognises that sharing services can contribute to savings, it considers that the scale of those savings can only contribute to a limited extent in addressing the funding gap that local authorities will face in the coming years.

109. The Committee welcomes the view of the Cabinet Secretary that “the whole concept of preventative intervention lies at the heart of the Government’s policy
interventions.” However, despite this welcome commitment there is no indication within the draft budget as to the extent to which spending proposals are preventative.

110. The Committee’s report on preventative spending emphasises the effectiveness of investment in the early years and reiterates its view here that the Government should work with its partners in local government, health boards and the third sector to move forward an early years agenda.

111. The Committee recommends that future draft budget documents should include an assessment under each portfolio heading of the progress being made towards a more preventative approach, including an update on the progress made on collaborative working.

112. As stated in the report on preventative spending the Committee will recommend to its successor in its legacy paper that the scrutiny of preventative spending should be integral to the annual budget process.

113. The Committee also welcomes the inclusion of “early intervention” issues within the remit of the Commission on the Future Delivery of Public Services and has submitted a copy of its report on preventative spending to the Commission.

PORTFOLIO ISSUES

Introduction

114. The reports from the parliamentary subject committees provide detailed commentary on specific budgetary proposals across the different portfolios, and this section does not aim to repeat the work of the subject committees at length. However, while the preceding sections of this report examine cross-cutting issues in the budget, this section examines certain key specific spending decisions.

Health Barnett consequentials

115. As mentioned elsewhere in this report, the decision by the UK Government in the SR to give resource health spending a real-terms increase has benefited the overall Scottish resource DEL budget. However, even before the formal announcement, the Scottish Government stated that it would pass on any Barnett consequentials resulting from protection of the health budget in England to the Health budget in Scotland. This has led to a 1.7% cash terms increase in the Health element of the Health and Wellbeing portfolio (equal to a 0.2% cut in real terms on the basis of the GDP deflator available at the time of the publication of Draft Budget 2011-12). Every other portfolio, with the exception of the local government settlement, has received at least a 10% real terms cut.

116. In contrast the IBR report stated that the panel “would strongly advocate” an approach “built upon all services being subject to scrutiny and comparative prioritisation in the allocation of resources.” However, the panel argued that if—

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“...a ring-fencing approach is adopted, the Scottish Government and Parliament should consider alternatives to ring-fencing the budget of NHSScotland that allow for a broader interpretation of health spending. This broader definition of health might include non-NHS services that support the health and wellbeing of the community, for example, early intervention programmes across the public sector.”72

117. The issue of early intervention and other longer-term approaches to public spending is discussed above. The relative protection of the health budget was also discussed in detail during the evidence session on 30 November, with all witnesses questioning whether protecting health in this manner was desirable, particularly in relation to the Government’s Purpose of increasing sustainable economic growth. For example, Professor Ashcroft stated: “Protecting health may be politically attractive but, from the point of view of economic growth, it is unfortunate that it makes the cuts’ effect on the rest of the budget that much greater.”73 Peter Wood agreed that this decision suggests that the Government’s main priority in the budget is not promoting economic growth.74

118. However, in response from questioning by the Committee as to why he had ring-fenced health the Cabinet Secretary explained that—

“The health service is getting the benefit of a real-terms increase in its resource budget, but I would not want to suggest in any way that that will create an easy situation. Pressures on the service as a result of longevity, new treatments and new circumstances will continue relentlessly, but resources will not rise nearly as swiftly or acutely as they have done. Our judgment was that we had to provide adequate and appropriate support to assist the health service through that challenge.”75

119. In response to criticisms about the contribution of health spending to economic growth, he stated that—

“It is right to ensure that we can deliver the health services that members of the public expect in their localities and that we can sustain employment in the health service as a contributor towards economic growth and economic development.”76

120. The Committee asks whether the Government considered adopting alternatives to ring-fencing the budget of NHSScotland that allow for a broader definition of health spending as recommended by the IBR.

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121. The Committee also invites the Government to respond in detail to the criticism that in ring-fencing health the draft budget gives priority to the protection of public services rather than the Government’s Purpose.

Further and Higher Education Funding Council

122. The Further and Higher Education Funding Council is one of the biggest “losers” in the Draft Budget 2011-12 – subject to a £245.1 million reduction (13.7% in real terms). Despite this however, the Government has indicated that it has agreed with the sector that “core college and university student places will be maintained.”

123. Professor Bell states in his briefing for the Committee that: “one area that may require special attention next year is the funding of further and higher education.” He notes that current funding for FE colleges is scheduled to drop by around 7.6% in real terms in 2011-12 while funding for universities will fall by around 8.1% in real terms. The combined capital grants for FE colleges and HEI institutions will fall by 57%.

124. The Government has published a Green Paper, Building a Smarter Future: Towards a Sustainable Scottish Solution for the Future of Higher Education, which sets out a range of options for the future of Scotland’s universities. The Cabinet Secretary for Education and Lifelong Learning states that—

“The aim of this paper is to reflect the broad range of views offered to me as part of these discussions and to set out the range of options before us. With this paper I want to stimulate a wider, more vigorous discussion right across Scotland which will lead to a conclusion about what the Scottish Solution will be.”

125. The decision of the UK Government to implement the findings of Lord Browne’s Independent Review of Higher Education Funding and Student Finance means that major reforms are likely to take place in England in the academic year 2012-13. Recognising this the Scottish Government has set up a short life technical working group with Universities Scotland to: “consider the size and nature of any gap in funding between north and south of the border which may be opening up, and comment on the possible effect of some of the funding

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solutions” in the Green Paper and report to a reconvened cross-party summit by the end of February 2011.

126. Professor Bell has pointed out that whereas “graduate contributions” may make up some of the shortfall in university funding, it is less clear how colleges, which have fewer potential sources of income, can deal with reduced funding. He argues that: “This is particularly of concern in respect of the skills and therefore the growth agenda.”

127. Sir John Arbuthnott also raised the significance of investment in higher education for the growth agenda —

“If we look critically at the end of the issue—the gross domestic product benefit relative to a country’s investment in higher education—we see that there is a clear link between benefit and investment. I am concerned that, in the UK as a whole, we are taking a strange approach to the future of higher education. We do not yet know the future system for the funding of higher education in Scotland, and our tinkering with the system could have long-term effects.”

128. The Committee recognises the importance of investment in higher and further education in supporting sustainable economic growth, notes the Government’s Green Paper, and urges the Scottish Government to bring forward proposals which secure funding for higher and further education institutions.

129. The Committee also invites the Government to clarify what it means by “core” college and university places.

Local government settlement

Overall settlement

130. The total local government DEL budget for 2011-12 is £9,368.5 million, a £541.5 million cash reduction, or 7.2% in real terms. The budget settlement for local authorities, which has been agreed with COSLA Leadership and all local authorities, represents a 2.6% decrease in resource allocations to local authorities (i.e. resource grants and non-domestic rates monies). If local authorities had not signed up to the agreement then they would have received a 6.4% decrease in their resource allocation. The letter from the Cabinet Secretary and the President of COSLA to the leaders of all local authorities sets out a specified set of commitments that they will be expected to deliver, including a council tax freeze, maintaining the number of police officers at 17,234 and maintaining the pupil-

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teacher ratio in P1-P3. In addition, the Scottish Government plans to increase “business rates that are paid by the largest retail properties, including supermarkets and out-of-town retail parks.”

131. Before discussing two key elements of the agreement between the Scottish Government and local authorities, the Committee notes the conclusion of the Local Government and Communities Committee that it is not convinced, on the basis of the poor delivery record of local authorities on the commitments contained within the Single Outcome Agreements, that these new commitments will be delivered within the timescale of the 2011-12 budget. That committee calls for in-year monitoring of these commitments and reporting on progress within 2011-12. Furthermore, it calls on the Scottish Government to explain how it will hold local authorities to account if they fail to deliver these commitments.

132. The Committee supports this request.

Council Tax freeze

133. The Local Government and Communities Committee explains in its report that the total cost to the Scottish Government of the council tax freeze over the period 2008-09 to 2011-12 will be £700m i.e. £420m for the period 2008-09 to 2010-11 and a further £280m in 2011-12.

134. The Cabinet Secretary explained in his opening statement to the Committee that—

“At a time when many household budgets will be feeling the effects of pay restraint, whether in the public or private sectors, the Government feels it necessary to act to maintain the freeze in the council tax in order to support household income.”

135. The Committee’s budget adviser has done some modelling work on who benefits most from the freeze and also assessed its impact on the Government’s Purpose of increasing sustainable economic growth. In short, he concludes that the differences in household outgoings between freezing the council tax and increasing it in line with inflation are relatively small for most households, although the main beneficiaries are those on middle incomes. Further, he states that “there is no case that it supports economic growth and its fairness implications are certainly not clear cut.”

85 Scottish Government and the Convention of Scottish Local Authorities. Letter from the Cabinet Secretary for Finance and Sustainable Growth and the President of COSLA to the leaders of Scottish local authorities, dated 17 November 2010.
136. The Committee notes the comments of the Budget Adviser at paragraph 135 that the Council Tax freeze does not support economic growth and calls on the Scottish Government to explain how they believe it does so.

137. The Committee welcomes the Cabinet Secretary’s commitment to continuing the council tax freeze, and notes that all 32 local authorities have agreed to freeze council tax when they set their budgets.90

138. The Committee also notes the view of Professor Bell that “it is somewhat paradoxical that taxation on immobile houses is being frozen while that on immobile retail outlets is being increased.”91

Business rates increase for large retailers

139. Details of the levy on large retailers are set out in the *Non-Domestic Rates (Levying) (Scotland) (No. 3) Regulations 2010*,92 which are currently being considered by the Local Government and Communities Committee. Leaving aside the detail of the different levels of poundage in the levy, the Committee notes the conclusion of the Economy, Energy and Tourism Committee that there appears to be a disparity between the statement in *Draft Budget 2011-12* that the new rate supplement will support town centres and the Cabinet Secretary’s admission that large retailers in town centres will be subject to the supplement.

140. The Cabinet Secretary explained to the Committee that—

“I appreciate that the decision that I have arrived at causes concern among the retailers in question, but given the financial health of the retail sector and the limited significance of business rates in retailers' overall economic calculations—typically, business rates account for about 2 per cent of large retailers’ turnover, of which the levy is obviously a component—I think that the increase can be borne by large retailers in Scotland.”93

141. The Committee invites the Scottish Government to reconsider the proposed levy on large retailers.94

Spending proposals from subject committees

142. As set out in the *Written Agreement between the Finance Committee and the Scottish Government*,95 the Finance Committee can propose alternative spending

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90 Paragraph 137 was agreed to by division. For 4 (Andrew Welsh, Linda Fabiani, Joe FitzPatrick, Derek Brownlee), Against 4 (Tom McCabe, David Whitton, Jeremy Purvis, Malcolm Chisholm). Paragraph agreed to on Convener’s casting vote.


94 Paragraph 141 was agreed to by division. For 5 (Tom McCabe, David Whitton, Jeremy Purvis, Malcolm Chisholm, Derek Brownlee), Against 3 (Andrew Welsh, Linda Fabiani, Joe FitzPatrick).

plans in its report on the Draft Budget. Subject committees were, therefore, asked to consider whether they wished to make any alternative spending proposals within the appropriate portfolio. Any changes must keep within the overall spending limit set by the Draft Budget and therefore, any proposed increases should be offset by proposals for decreases elsewhere. The Finance Committee would expect that subject committees would propose additional spend within their remit and that they would take money from another budget line within their remit, since they will have built up an evidence base for this during their scrutiny of the Draft Budget. However, the publication of the IBR places a series of costed options for budget reductions in the public domain for committees to make use of in coming up with spending proposals. No formal alternative spending proposals have been made as such by subject committees.

LEGACY ISSUES

143. The two preceding sections of this report have considered the Government’s broad strategic approach to dealing with its reduced budget and some of the key portfolio spending decisions in terms of how these contribute to the Government’s core Purpose of increasing sustainable economic growth. This section will now look at process issues and, in particular, the provision of budgetary information with a view to informing the Committee’s legacy paper.

144. In its reports throughout this session, the Finance Committee has made a series of recommendations on improving the presentation of information in the budget documents. The Finance Committees in the first two sessions of the Parliament also made similar recommendations. The fact that this committee and previous committees have made similar recommendations indicates that the rate of progress on the provision of budgetary information has been slow.

Performance Reporting and linking budgets to policy priorities and outcomes

145. In its legacy paper at the end of the second session the previous Committee expressed its concern that “the Executive is not subject to robust performance scrutiny.” Following the 2007 election the Government introduced a new approach to performance monitoring as part of Spending Review 2007 in which its stated—

“We are moving the whole of government to an outcomes-focused approach to performance. This means that we will be judged – as we should be – on the results that we achieve.”

146. Based on the outcomes-based model of the Commonwealth of Virginia, Virginia Performs, the National Performance Framework was “designed to be clear, logical and easy to understand.”

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147. However, the Committee has consistently expressed its concerns that while very welcome the *Scotland Performs* website is not the same as a formal report to Parliament. As noted at paragraph 39 above the Committee regrets the lack of any performance information within *Draft Budget 2011-12*.

148. The Committee also notes that the National Performance Framework does not yet make any link between performance indicators and spending priorities and that the Public Audit Committee has requested an indication as to when the *Scotland Performs* website will provide this information.

149. A related issue is the extent to which budget headings are aligned to policy initiatives against which committees may wish to track progress or to targets in the National Performance Framework. In its report on *Draft Budget 2010-11* the Committee recommended that: “the Scottish Government considers and reports to it on how budgetary documents and supporting information can make alignment clearer in general.”

150. This year the provision of level 4 information and accompanying narrative has been of assistance to committees. However, the budget adviser notes that “spending programme titles are becoming increasingly opaque … when reading the budget, members of the public must find it difficult to understand what a spending programme described as “Supporting Sustainability” means.”

151. The IBR panel concludes that—

“…there is a need to move towards a more outcomes-based approach to public service management and to improve the quality, availability and application of evaluation, monitoring and reporting data and information in relation to outcomes across the public sector in order to ensure that resources are applied to full benefit. This is vital if the Scottish Parliament is to exercise an effective monitoring role.”

152. Under the *Virginia Performs* system, on which the Scottish system is largely based, the Committee notes that the Council on Virginia’s Future must—

“develop and submit annually to the General Assembly and the Governor and publish to the public a balanced accountability scorecard containing an assessment of:

- current service performance,

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• productivity improvement, and
• progress against long-term objectives.\textsuperscript{102}

153. The report “presents a high-level assessment of Virginia’s progress in areas that are important to its quality of life. It is issued annually to help track progress over time, highlight challenges, and provide analytic information for leadership and decision-making.”\textsuperscript{103}

154. The Committee invites the Scottish Government to explain why it has not implemented a reporting mechanism similar to the Virginia Performs system on which the National Performance Framework is based.

155. The Committee also invites the Scottish Government to respond to the conclusions of the IBR panel in relation to the need to move towards a more outcomes-based approach to public service management.

156. The Committee also recommends that the Written Agreement is reviewed at the beginning of the next Parliament to include the minimum level of performance information which should be included in the draft budget and that this should be linked to spending priorities.

Level 4 Figures

157. The Committee again emphasised in its report on Draft Budget 2010-11 that: “level 4 budget figures should be provided electronically as a matter of course after the Draft Budget is published.”

158. For this year’s budget process, the FSU worked closely with government officials in ensuring that a large amount of level 4 data was published as agreed shortly after the publication of the Draft Budget 2011-12. However, particular issues were experienced for the Finance and Sustainable Growth Portfolio. The Economy, Energy and Tourism Committee, as it has throughout the session, found it difficult to obtain level 4 figures and wrote to the Cabinet Secretary emphasising that this seriously constrained the Committee’s scrutiny of the draft budget.

159. The Committee recommends that the provision of level 4 figures is included within the proposed review of the Written Agreement.

Equalities

160. As in previous years, the Equal Opportunities Committee scrutinised the Government’s Equality Statement on the draft budget 2011-12\textsuperscript{104} in detail. The

\begin{footnotesize}
\textsuperscript{102} Code of Virginia. Available at: http://law.ongcle.com/virginia/administration-of-government/2.2-2686.html [Accessed 20 December 2010]


\end{footnotesize}
Committee thanks the Equal Opportunities Committee for its work and notes the positive points it has made about the Statement, but also notes that it believes that much work has yet to be done to transform the budget process to ensure resource allocation decisions are informed and, if required, altered by equality considerations.

**Budget process timescales**

161. The Health and Sport Committee states in its submission that as a consequence of the timescales involved “the draft budget scrutiny process is wholly unsatisfactory in any year” and that this has been exacerbated during the current process due to the UK Spending Review and the inclement weather. The Committee has, therefore, agreed to write to the Standards, Procedures and Public Appointments Committee to request a “radical review of the budgetary process in the next parliamentary session.”

162. However, the Finance Committee has already conducted a detailed review of the budget process in the current session and published its report on the Review of the Budget Process in June 2009. In its submission to this inquiry the Health and Sport Committee also raised the lack of sufficient time as the main barrier to effective budget scrutiny.

163. The Finance Committee considered timetabling issues as part of its review of the budget process and noted that the tight timescale is determined by the need to have the annual Budget Bill passed and enacted before the start of the next financial year. The Committee did, however, make some recommendations as a means of alleviating timetabling pressures and these can be found at paragraphs 69-78 of the report on the review.105

164. The Committee also recommended the introduction of a budget strategy phase following the review and it is also intended that this will alleviate some of the timing pressures faced by subject committees.

165. While the Committee does not agree with the need for another review of the budget process it would, nevertheless, welcome the views of subject committees for consideration in its legacy paper. In particular, the Committee would welcome views on the proposals for the budget strategy phase at paragraphs 43-49 of the report on the Review of the Budget Process.

**SCOTTISH PARLIAMENTARY CORPORATE BODY**

**Introduction**

166. The expenditure of the Scottish Parliamentary Corporate Body (SPCB) is top-sliced from the Scottish Consolidated Fund and is, therefore, allocated before the Scottish Government is able to make other allocations. The SPCB’s budget also includes the budgets for the various parliamentary commissioners and the Scottish Public Services Ombudsman.

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167. As the SPCB’s budget is not subject to control by the Scottish Government, the Committee considers the SPCB’s proposed budget separately as part of the budget process. At its meeting on 23 November 2010, the Committee took evidence from Tom McCabe MSP, member of the SPCB with portfolio responsibility for finance, Paul Grice, Clerk/Chief Executive of the Parliament, and Derek Croll, Head of Financial Resources for the SPCB. The Committee also held an additional session in October 2010 with officials on the SPCB’s budget planning.

168. The budget proposal submitted by the SPCB and associated information is attached as part of Annexe C.

**Headline figures**

169. The SPCB budget bid identifies a total budget requirement of £88 million for 2011-12. This represents a £4.3 million cash reduction (4.6%) on the 2010-11 budget and a £5.2 million cash reduction (5.6%) on the indicative forecast for 2011-12 provided to the Committee in last year’s budget bid. The “directly controllable costs” of the Scottish Parliamentary Service are £42.9 million, a cash reduction of £3.9 million (8.3%) on the previous year. Using the Treasury deflators in the SR, the total budget bid represents a 7.1% real-terms reduction from 2010-11.

170. The budget bid also includes a detailed indicative forecast to 2012-13 and a headline indicative forecast to 2014-15. By 2014-15, the SPCB’s budget is forecast to fall by 12% in real terms, with the directly controllable costs element due to fall by 15.4% in real terms.

171. The Committee has previously welcomed the rigorous approach that the SPCB takes to scrutiny of budget assumptions before agreeing its proposal to submit to the Committee.

172. This year the Committee particularly welcomes the long-term view taken by the SPCB and, in particular, the commitment to ensure that its budget falls in line with the overall decline in the Scottish budget.

**Staff pay budget**

173. The staff pay budget is scheduled to reduce by £741,000 (3.2% in cash terms, 5.0% in real terms). This is due to a proposed pay freeze (which is accompanied by a proposed guarantee of no compulsory redundancies) and a reduction in the staff complement of around 50 by March 2013, primarily achieved through a Voluntary Early Retirement/Early Severance (VER/ES) scheme. During the evidence session, the SPCB also confirmed that, as for workers falling under the Scottish Government’s pay policy, any SPCB employees who earn under £21,000 will receive a £250 pay increase.\(^\text{106}\)

174. Built into the staff pay budget is a “vacancy factor” of 3 per cent, which is lower than the 5 per cent specified for 2010-11, reflecting lower levels of staff

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turnover in the current economic climate. The SPCB confirmed that this was “a judgement call” and that if the rate of turnover was lower than that specified, reductions would have to be made elsewhere in the budget.

175. The Committee welcomes the approach taken by the SPCB to the staff pay budget.

Commissioners and Ombudsman

176. The other significant element of the SPCB budget discussed in evidence was the budget bid for the parliamentary commissioners and the ombudsman. The 2011-12 submissions for the various bodies amount to £8.4 million, a 4.5% cash terms and 6.3% real terms reduction on the equivalent 2010-11 budget. However, within this global total, there are significant variations in the degree of reductions agreed with the different bodies, ranging from a 1.2% cash reduction for the Scottish Information Commissioner to a 7.5% cash reduction for Scotland’s Commissioner for Children and Young People. When pressed on these differences, the SPCB indicated that, over the period of the SR, the supported bodies would be expected to take the same reductions as the SPCB, but with them being smaller organisations, immediate savings were more difficult. In future years, the SPCB also expects “reasonably significant savings from share services and the amalgamation of existing property from bringing different bodies together.” The SPCB also supplied additional information on supported bodies 2009-10 outturn as compared to the approved budget. This is also enclosed in annexe C and the Committee thanks the SPCB for supplying this information.

177. The Committee welcomes the initial reduction in the budgets for Commissioners but expects all Commissioners’ budgets to match the overall fall in the Scottish budget over the period of the UK SR.

Conclusion

178. The Committee recommends the approval of the SPCB’s budget proposal for 2011-12.

AUDIT SCOTLAND

179. The Public Finance and Accountability (Scotland) Act 2000 provides for the Scottish Commission for Public Audit (SCPA) to examine Audit Scotland’s spending proposals and report to the Parliament. Audit Scotland’s total resource requirement (the net amount it requires after taking account of fees it receives from audited bodies) represents a prior call on the Scottish Consolidated Fund in the same way as does the budget for the SPCB. While recognising the primacy of the SCPA’s role in scrutinising Audit Scotland, the Finance Committee has overall responsibility for scrutinising all expenditure paid out of the Scottish Consolidated Fund and therefore considers the SCPA’s scrutiny and takes account of it in this report.

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107 Scottish Parliamentary Corporate Body. Written submission to the Finance Committee.
180. The SCPA’s report is attached as Annexe L. This shows that Audit Scotland’s total resource requirement from the Scottish Consolidated Fund for 2010-11 is £7.070 million, consisting of a net operating cost of £6.820 million and £0.25 million in capital. This represents a 3.8% cash terms (5.7% in real terms) decrease on the 2010-11 budget.

181. In its report the SCPA has highlighted a number of issues, particularly aimed at encouraging progress towards a more strategic perspective on Audit Scotland’s budget requirements. The main recommendations are:

- The Commission welcomes Audit Scotland’s commitment to provide the same level of activity and audit within reduced resources and the efforts being taken to reduce the cost of audit and to identify further efficiencies.

- The Commission stresses again the importance of maintaining a high quality, independent audit function in times of financial restraint. This is an area that the SCPA will continue to monitor very closely in the future.

- The Commission notes Audit Scotland’s 2011-12 budget proposal shows total net expenditure of £26,218,000. It recommends that its request for a total resource requirement of £7,070,000 for 2011-12, to be provided from the Scottish Consolidated fund, be approved by the Parliament.

182. The Finance Committee notes these recommendations.
ANNEXE A: EXTRACT FROM THE MINUTES OF THE FINANCE COMMITTEE

17th Meeting, 2010 (Session 3), Tuesday 29 June 2010

UK Budget 2010: The Committee took evidence from—

Rt Hon Danny Alexander MP, Chief Secretary to the Treasury, UK Government.

18th Meeting, 2010 (Session 3), Tuesday 7 September 2010

Independent Budget Review Group: The Committee took evidence from—

Crawford Beveridge CBE, Chair of the Independent Budget Review Panel;
Sir Neil McIntosh CBE, Member of the Independent Budget Review Panel.

19th Meeting, 2010 (Session 3), Tuesday 14 September 2010

Independent Budget Review Group: The Committee took evidence from—

John Swinney MSP, Cabinet Secretary for Finance and Sustainable Growth, Dr Andrew Goudie, Chief Economic Adviser and Director General Economy, and Alyson Stafford, Acting Director General Finance, Scottish Government.

21st Meeting, 2010 (Session 3), Tuesday 5 October 2010

Scottish Parliamentary Corporate Body's Budget 2011-12: The Committee took evidence on the Scottish Parliamentary Corporate Body's budget planning for 2011-12 from—

Paul Grice, Clerk and Chief Executive, and Derek Croll, Head of Financial Resources, Scottish Parliament.

26th Meeting, 2010 (Session 3), Tuesday 23 November 2010

Scottish Parliamentary Corporate Body's Budget 2011-12: The Committee took evidence on the Scottish Parliamentary Corporate Body's budget for 2011-12 from—

Tom McCabe MSP, Member of the Scottish Parliamentary Corporate Body, Paul Grice, Clerk and Chief Executive, and Derek Croll, Head of Financial Resources, Scottish Parliament.

27th Meeting, 2010 (Session 3), Thursday 25 November 2010

UK Comprehensive Spending Review: The Committee took evidence from—

Rt Hon Danny Alexander MP, Chief Secretary to the Treasury, UK Government.

28th Meeting, 2010 (Session 3), Tuesday 30 November 2010

Scotland's Spending Plans and Draft Budget 2011-12: The Committee took evidence on the Scottish Government's Scotland's Spending Plans and Draft Budget 2011-12 from—

Sir John Arbuthnott, Royal Society of Edinburgh;
Jo Armstrong, Centre for Public Policy for Regions;
Professor Brian Ashcroft, Policy Director, Fraser of Allander Institute;
Graeme Blackett, Reform Scotland;
Peter Wood, Director, Optimal Economics.

29th Meeting, 2010 (Session 3), Tuesday 14 December 2010

Scotland's Spending Plans and Draft Budget 2011-12 The Committee took evidence from—

John Swinney MSP, Cabinet Secretary for Finance and Sustainable Growth, Alistair Brown, Deputy Director of Finance, and Dr Andrew Goudie, Chief Economic Adviser and Director General Economy, Scottish Government.

1st Meeting, 2011 (Session 3), Tuesday 11 January 2011

Decision on taking business in private: The Committee agreed to consider a draft report on Scotland's Spending Plans and Draft Budget 2011-12 in private at this meeting and future meetings.

Scotland's Spending Plans and Draft Budget 2011-12 (in private): The Committee considered a draft report on the Scottish Government's Spending Plans and Draft Budget 2011-12 and agreed to consider a revised draft at its next meeting.

2nd Meeting, 2011 (Session 3), Tuesday 18 January 2011

Scotland's Spending Plans and Draft Budget 2011-12 (in private): The Committee considered a revised draft report on the Scottish Government's Spending Plans and Draft Budget 2011-12. Various changes were agreed to. Record of divisions in private:

Paragraph 137 was agreed to by division. For 4 (Andrew Welsh, Linda Fabiani, Joe FitzPatrick, Derek Brownlee), Against 4 (Tom McCabe, David Whitton, Jeremy Purvis, Malcolm Chisholm). Paragraph agreed to on Convener’s casting vote.

Paragraph 141 was agreed to by division. For 5 (Tom McCabe, David Whitton, Jeremy Purvis, Malcolm Chisholm, Derek Brownlee), Against 3 (Andrew Welsh, Linda Fabiani, Joe FitzPatrick).
ANNEXE B: BRIEFING PAPERS

The Independent Budget Review

Professor David Bell

Budget Adviser to the Finance Committee

September 2010
Introduction

The Independent Budget Review Panel (IBRP) was set up to consider the future outlook for Scotland’s public finances. It first met in February 2010 and reported in July 2010. This was a remarkably short period over which to compile such an important document.

Between February and July, the outlook for public spending in Scotland became even tougher. The June 2010 UK Budget introduced further fiscal consolidation. In addition to the measures announced by the last Labour government to reduce the deficit, a further £40bn of fiscal consolidation will be implemented by 2014-15. Eighty per cent of this additional consolidation is to be achieved by spending cuts.\(^{111}\)

The effect in 2011-12 will be an additional £9bn of saving on top of the £5.2bn already announced. In total, the Coalition Government’s intention is to have a fiscal consolidation of £128bn by 2015-16. This will include £99bn of cuts in UK public spending. Scotland’s share of these cuts will be determined by the Barnett Formula.

The Chief Economic Adviser to the Scottish Government has predicted that this will mean an unprecedented reduction of £1.2bn in Scotland’s cash budget in 2011-12. If inflation in the costs of public services is at the level predicted by the Treasury, this will mean a 5.9 per cent real cut in public spending in Scotland during 2011-12.\(^{112}\) This is the likely size of the cuts that the Finance Committee will have to confront when it reviews the Scottish Budget in November 2010. There is no precedent for the cuts which the Scottish Parliament will have to impose.

The IBRP Report

The IBRP has examined some of the key issues for Scottish public spending that will arise over the next few years as a result of the fiscal consolidation described in the previous section. Of particular concern to the Finance Committee will be the period immediately following the publication of the Comprehensive Spending Review in October 2010. The IBRP Report has perhaps assisted the public debate on spending cuts to progress further in Scotland than in the rest of the UK. However, there is still a widespread lack of public appreciation of the gravity of the pressures that will confront public services in Scotland in 2011-12.

The Chairman’s Message at the start of the report argues that:

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\(^{111}\) The rationale for the additional cuts was to reduce the risk of budget crises of the form experienced by Ireland and Greece. A good indicator of confidence in different economies is the path of long-term interest rates. Figure 1 in Appendix 1 shows the path of long term interest rates in several mature economies from 2008 to 2010. In July 2010, the UK was paying a small premium on its long-term debt compared with the USA, France and Germany, but its rates are typically lower than Spain and nowhere near as high as those in Greece and Ireland.

\(^{112}\) Note that in previous reports, I have highlighted the uncertainty associated with estimates of "real" changes in government budgets. This is due to a dearth of accurate information on the rates of inflation applicable to education, health etc. The estimates of "real" cuts may also give a misleading impression of the relative balance in real terms between cuts in capital and revenue budgets.
“Our Parliament and political parties have an opportunity to show strong leadership by creating the space for conversations to take place about the future of public services. At the beginning of our devolved Parliament much was said about the opportunity for a new kind of politics. If there was ever a time for this to be in evidence, now is that time.”

The Finance Committee will hopefully provide space for such conversations about the future for public services in Scotland. Fiscal pressures may force the reversal of popular changes to public services that have been introduced by the Scottish Parliament since 1999, which will inevitably create difficulties across the political spectrum.

The IBRP report largely covers issues of principle rather than the detail of cuts by department. Where it was specific, it tended to focus on policies that have been introduced (or revised) recently (bus passes for older people, free personal care, prescriptions and student tuition fees). It did not focus on changes to the pre-devolution structure of public services in Scotland.

For example, an alternative to reintroducing charges for personal care might be to extend charging in the NHS. While Sweden’s public services are usually thought of as exemplars of universal provision, it is not generally known that the provision of services is more competitive than in Scotland and that, for example, user charges provide around 3% of the health budget. Thus, for example, hotel charges for hospital stays and other charges in Sweden provide what would be the equivalent of £300m to the Scottish health budget. The IBRP report did not generally explore such options.

The IBRP focus on post-devolution policies and on generic issues such as pay is understandable given the time constraints under which the group had to work. But what may seem lacking is a general set of principles to guide the redesign of a significantly slimmed down Scottish public sector. The panel may have wished to avoid straying into clearly political territory, but if spending cuts simply return the Scottish public sector to close to where it was before devolution, some uncomfortable questions are likely to be asked about the practical outcomes of devolution.

Perhaps a more general approach to charging for public services might have been explored. In what circumstances, for example, might it be legitimate to charge for services either on grounds of equity or efficiency? Where charges might be levied, should means tests be applied and, if so, how? In relation to infrastructure, one might consider in more detail than was covered in the report where there might be a case for financing capital projects from user charges.

There are some further issues in relation to equity that might have received more attention. First, significant budgetary changes will have to take account of equality issues in relation to gender, race and sexuality. But they should also consider issues of spatial equity across different parts of Scotland. And finally, they should also consider issues of intergenerational equity – it should not be the case that budget cuts are particularly at the expense of certain age groups.

Nevertheless, the 2011-12 Scottish budget will have to balance and this will inevitably bring the Scottish Government and Parliament into conflict with powerful stakeholder groups. Finding an agreed way forward will partly depend on these stakeholders having an appreciation of the gravity of the budgetary situation that the Scottish Parliament now confronts. The IBRP has performed an important service in setting out the gravity of the fiscal position and laying out
some of the choices that the Scottish Government and Scottish Parliament will confront later this year.

Issues

A brief discussion of some of the key issues raised in the IBRP report:

1. Efficiency Saving

There has been widespread concern about the extent to which efficiency savings are “real”. The IBRP recommendation that efficiency savings should not be retained makes sense. Allowing the recycling of efficiency savings in non-priority areas is inappropriate if one takes a global perspective of Scottish public spending priorities.

Closer scrutiny of the rationale for the existence of public sector bodies again makes sense, as does the recommendation to rationalise the external scrutiny of public bodies. It would be useful to have a more systematic approach to evaluating the costs and benefits of such scrutiny.

2. Pay and Public Sector Employment

Scotland’s DEL budget is largely fixed. Over 50 per cent of this budget is spent on pay. If the budget shrinks, there will be huge pressure to reduce the growth of the pay bill and the number of employees.

From the beginning of the recession until first quarter 2010, private sector employment in Scotland fell by 154,000. Public sector employment (excluding financial institutions) grew by 2,400. Public sector wages were higher than private sector wages at the beginning of the recession. The gap in average weekly wages has increased by a further £20 over the course of the recession. So far, the private sector has borne the brunt of the wage and employment costs associated with the recession.

The IBRP looks at a number of options for pay and employment. This is a useful first step in making clear the tough choices that lie ahead. It then suggests that

“If outcomes are to be maintained, the reductions in public sector employment would need to be driven by a set of clear, strategic priorities across all parts of the public sector. One option for the Scottish Government to consider is the rapid development of a clear, strategic and phased workforce plan which sets out a set of priorities/criteria towards which all parts of the public sector can work”

This proposal does beg a number of questions however:

- How is the plan to be devised and which stakeholders should be involved in taking it forward?
- What are the implications for departmental budgets of an overall plan for employment, given that some departments use more labour than others?

The report also argues for a freeze on all pay in the public sector and suspension of progression for all public sector workers from 2011-12. While this policy is very transparent, it is not necessarily efficient. Public sector efficiency may fall if the more productive workers (those who
ought to receive wage increases) leave their posts. The IBRP also calls for a freeze on recruitment. Again this may carry dangers. If key personnel leave, then the efficiency of the whole system may be impaired.

One approach which may avoid these issues may be to freeze (or reduce) the wage bill, and let employers choose how to allocate funding between wages and employment. Employers may choose to renegotiate individual contracts – e.g. reducing working time – in a way that is less harmful to efficiency than simply freezing wages. It may be best to devolve such decisions, since public sector employers may be better able to control the pay bill in a way that does less harm to efficiency and worker morale.

A further issue is that the IBRP preferred option for pay restraint (option 3) would result in saving of around £900m. It is important to be clear how this relates to the overall cash saving of £1.2bn implied by the Chief Economic Adviser.

Nevertheless, the IBRP is absolutely correct to focus attention on pay and employment. How these are handled by public sector managers will be critical if the forthcoming budget cuts are not to be associated with labour disputes and reductions in service. It is regrettable that these aspects of the IBRP proposals have not been debated more widely over the summer.

3. Ring-Fencing
The ring fencing of the health budget is one of the key concerns in the IBRP review. It advocates that there should be “no overriding presumption of whole segment protection”. This view is largely shared across the media and other informed opinion, which struggles to understand why health spending should be accorded particular protection. If health is ring fenced, then the review predicts that in 2011-12 there will be a real cut of 6.7% in non-health current expenditure and 26.1% in non-health capital expenditure for 2011-12. By 2014-15, the accumulated cuts will amount to 17.6% and 34.7%.

There is a clear need to understand from the Cabinet Secretary what the rationale for protecting the health budget might be (the same question might be asked of the UK Coalition Government). Some relevant considerations in Scotland are:

(a) Scotland already spends 10 per cent per head more than England on health care\textsuperscript{113} and has not seen the improvements in health outcomes that have been observed south of the border during the last ten years\textsuperscript{114}. There are few external commentators who believe that there are no significant improvements in efficiency that could be made in NHS Scotland within its existing resources.

(b) The contribution of health to Scotland’s economic growth prospects is limited. If Scotland was raising a significant proportion of its own tax revenues and faced a similar public sector deficit, it would have to focus more on where tax revenue could be raised. Ireland, faced with an even larger budget deficit than the UK, has reduced its health spending, but maintained a low rate of corporation tax.

\textsuperscript{113} Source: Public Expenditure Statistical Analysis 2010
\textsuperscript{114} See e.g. Nuffield Foundation (2010)
A context for budget cuts should be the previous record of growth or contraction in spending. For example, between 2002-03 and 2010-11, the health budget grew by 67 per cent, the same rate of growth as the Scottish budget as a whole. Other significant budgets have grown much less rapidly. Local government has grown by 55 per cent, colleges and universities by 50 per cent and enterprise, energy and tourism has fallen by 21 per cent. If health is ring-fenced, then these areas face an average cut of 17.6 per cent in their current budgets and 34.1 in capital budgets by 2014-15, as mentioned above.

Along with David Blanchflower, I have argued that the group who have been most adversely affected by the recession are the young. Youth unemployment is at record levels and the young have a low demand for health care. Yet the ring-fencing of the health budget will mean that even less support will be directed to this group, increasing intergenerational inequity.

4. Council Tax Freeze
The IBRP review suggests that “The Scottish Government and Parliament should consider the option of discontinuing the current council tax freeze, which does not appear sustainable in the projected economic environment.”

In cash terms, the freeze on council tax mainly benefits more affluent households. Permitting councils to increase council tax will not generate huge sums in comparison to the cuts likely to be imposed on the Scottish budget, but may partly offset the effect of cuts in Scottish Government revenue and capital support to local authorities. However, unless there is some change in council tax banding or in the multiple applied to each band when calculating council tax liability, those most adversely affected by removing the council tax freeze will be households with incomes just above those that qualify for council tax benefit.

Any increases in business rates must be carefully weighed against the negative effects increased charges may have on fragile businesses.

5. Universal Benefits
“The Panel suggests that the Scottish Government and Parliament should consider undertaking immediate work to review whether all free or subsidised universal services should be retained in their current form. This work should cover issues such as changes in eligibility and the introduction of charges and ensure that those in greatest need are not disadvantaged.”

This analysis draws heavily on the work that I previously provided to the Finance Committee. I have undertaken some further work supported by the David Hume Society, which I hope to discuss with the Committee in October. As the IBRP suggests, it is essential that public debate on this issue is opened up. It should not be the case that entitlements granted by the Scottish Parliament cannot be withdrawn or amended, particularly where the entitlement is demand driven. This would be unfair to those services which may be more effective in delivering the Government Purpose, but are not regarded as entitlements.

6. Capital
The IBRP rightly draws attention to the role of public sector capital spending in supporting the Scottish economy. It draws attention to the needs for maintenance spending and for proper co-ordination of capital spending, with priority being given to projects of national importance.
Most controversially it suggests that “the Scottish Government should take steps now to explore, in liaison with HM Treasury, options for changing the status of Scottish Water”, pointing out that “this option could release £140 million annually for alternative public investments”. As the spending cuts bite, this option may be irresistible. One obvious option is to mimic the structure of Welsh Water. It is owned by Glas Cymru, a single purpose company with no shareholders which is run solely for the benefit of customers.

7. **Shaping the Future**
The final section of the report covers issues that the Finance Committee has frequently raised in the past. These include the establishment of a challenge function; measuring, evaluating and monitoring the performance of public bodies and assessing how far outcomes meets public expectations and the needs of the Scottish economy. The Committee might again wish to consider its own role in this regard and also that of Audit Scotland.
Report on the Draft Scottish Budget 2011-12

Professor David Bell
Stirling Management School
University of Stirling

November 2010
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Introduction
This report analyses the 2011-12 draft budget of the Scottish government. It has been prepared for the Finance Committee of the Scottish Parliament. Its approach is to analyse the draft Scottish budget in relation to its own stated objectives and in relation to the National Performance Framework set out by the Scottish Government in 2007.

The National Performance Framework is a statement of the Scottish Government’s intention to focus government and public services on creating a more successful country through increasing sustainable economic growth. This core purpose was underpinned by the five strategic objectives of making Scotland wealthier and fairer; healthier; safer and stronger; smarter; and greener.

Context
The 2011-12 Scottish Budget is the most difficult since devolution. The Scottish budget is contracting because of the very large cuts in UK public spending being imposed by the Coalition Government. In turn these cuts stemmed from the imbalance in the UK’s fiscal position: in 2009 UK public sector net borrowing was £152 billion, a post-war record. This borrowing partly reflected an increasing structural deficit in the UK, but was mainly a response to the world wide financial collapse in 2007 and 2008, which led to a very significant drop in tax revenues. Similar fiscal imbalances have affected countries around the world. In countries such as Greece and Ireland, the reaction of the financial markets to a build up of sovereign debt has been more extreme than it has been in the UK.

The Coalition Government set out its proposals for UK public spending in October in its Comprehensive Spending Review (CSR 2010). The plan is to cut UK public spending by £80 billion, equivalent to 6% of UK GDP, by 2014-15. This is the largest reduction in public spending ever attempted in peacetime.

Some cuts will affect Scotland, but are outside the control of the Scottish Government. Thus, reductions in the defence budget will increase unemployment and significantly reduce economic activity around Kinloss. The proposed changes to the welfare system for working age adults will have an impact right across Scotland. The Coalition Government’s intention is to reduce the UK welfare bill by around £17.5 billion by 2014-15. If it succeeds, there will be reductions in welfare spending in Scotland of around £1.7 billion per annum by 2014-15. To put this in context, if cuts in welfare spending on this scale are achieved, then the effect on public spending in Scotland will be larger than the reductions in Scottish government spending outlined in CSR 2010.

CSR 2010 poses particular difficulties for Scotland’s public sector capital budget. Table 1 shows how CSR 2010 allocated Departmental Expenditure Limits (DEL) for resource and capital to the devolved administrations from 2010-11 to 2014-15. Scotland fares marginally better than the other devolved administrations in resource spending. The cumulative real reduction in resource

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115 See: http://www.statistics.gov.uk/statbase/TSDdownload2.asp
(current) spending (6.8%) in Scotland is also less than that for the UK as a whole (8.3%). Scotland’s resource spending has largely been protected by the decision to protect the NHS budget in England. The positive Barnett consequentials of this decision have offset the negative impact of cuts elsewhere on CSR 2010.

But on the capital side the situation is less favourable. Public sector capital spending allocations in Scotland are scheduled to decline in real terms by 38% by 2014-15. This is similar to the other devolved administrations, but considerably more than the UK as a whole (29%). It is largely driven by the Barnett consequentials of the decisions to drastically cut back capital spending on social housing and on schools in England.

Scotland’s cut in capital spending is front loaded, with the main fall in cash spending of £0.8 billion occurring between 2010-11 and 2011-12. Thus, the Scottish Parliament faces a particularly difficult set of decisions in respect of capital spending for the 2011-12 budget. This may be offset to a small extent if the Scottish Government moves £100 million of capital underspend in 2009-10 into the 2011-12 financial year, but it will be difficult to assess how this amount has been reallocated.

The existing End Year Flexibility arrangements have been replaced by the Coalition Government. These appear to continue to offer flexibility in how underspends are treated116.

Table 1: Departmental Expenditure Limits for Devolved Administrations and UK as a whole 2010-11 to 2014-15

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<tr>
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<td></td>
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<tr>
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<tr>
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<td>£326.7m</td>
<td>£326.9m</td>
<td>£330.9m</td>
<td>£328.9m</td>
<td>-8.3</td>
</tr>
<tr>
<td>Scotland Share of UK</td>
<td>7.6%</td>
<td>7.6%</td>
<td>7.7%</td>
<td>7.6%</td>
<td>7.7%</td>
<td></td>
</tr>
</tbody>
</table>

| **Capital** |         |         |         |         |         |                            |
| Scotland    | £3.4m   | £2.5m   | £2.5m   | £2.2m   | £2.3m   | -38                       |
| Wales       | £1.7m   | £1.3m   | £1.2m   | £1.1m   | £1.1m   | -41                       |
| Northern Ireland | £1.2m  | £0.9m   | £0.9m   | £0.8m   | £0.8m   | -37                       |
| UK          | £51.6m  | £43.5m  | £41.8m  | £39.2m  | £40.2m  | -29                       |
| Scotland Share of UK | 6.6%  | 5.7%    | 6.0%    | 5.6%    | 5.7%    |                            |

(excludes depreciation)

Source: HM Treasury, Comprehensive Spending Review 2010

One of the key objectives in the National Performance Framework is “fairness”. We discuss the issue of fairness much more extensively later, but it is useful to consider how far the CSR 2010 decisions promote “fairness” in Scotland. This because the Scottish public will have to deal with cuts from both sources, and it is worth understanding how spending cuts from UK sources will overlay those of the Scottish Government. In this context, we interpret fairness as the relative

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116 Scottish Parliament Question S3W-37204
effects of the spending cuts on the rich on the one hand and the poor on the other. There have already been a number of analyses of the impact of CSR 2010 on individuals and households. Carl Emmerson of the Institute of Fiscal Studies recently estimated how the changes in the UK tax and benefit system laid out in CSR 2010 would affect Scottish households. His key result is shown in Figure 1. In essence, it shows that those in the poorest income quintile in both Scotland and the UK will experience the largest cut in net income as a result of the changes in the tax and benefit system set out in CSR 2010. The size of the effect on net income declines with increasing income except for the richest group, some of whom will be hit by higher income tax and national insurance rates. The results for Scotland do not differ markedly from the UK as a whole. This is not surprising, given that the Scottish and UK employment and industrial structures are not substantially different. Figure 1 does not take account of changes in employment and incomes that may take place if the economy recovers. Nor does it account for possible further deterioration in the economic climate. Both of these are difficult to forecast at present and to a large extent depend on external events.

![Figure 1: Impact of tax & benefit reforms to be in place by 2014–15, by nation](image)

Having described the context, this report proceeds by examining the contents and implications of the 2011-12 draft budget for Scotland. Some of the issues are critical to the ability of the Scottish Government to deliver next year’s budget. Others are more concerned with the budget process and with ensuring that its implications are clearly understood by the Parliament and Scottish society more widely.

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117 Carl Emmerson, Institute of Fiscal Studies discussing UK Public Finances at the David Hume Institute, Monday 25th October 2010

118 Note that some of the tax and benefit changes had already been set in train by the previous Labour administration. CSR 2010 largely built on these, rather than rescinding them.
The Size of the Challenge

The changes proposed in the Draft Budget 2011-12 vary substantially by portfolio. Figure 2 shows how percentage reductions in capital and in resource spend are distributed across portfolios. The only positive element is the increase in resource spending in the Health and Well-Being portfolio. It is proposed that all other budgets be reduced in cash terms.

The reductions in Figure 2 do not take account of inflation. Real decreases will therefore be larger. There will be differences in the cost pressures faced by the different portfolios. Thus, for example, the rate of increase of costs in health may be more rapid than the increase facing the First Minister’s portfolio. There is no reliable source of information that would help indicate these differences.

The 60% reduction in capital spending in the Justice and Crown Office Portfolios are by far the largest cut in any of the larger portfolios. The Justice department is unlikely to be able to engage in any significant capital projects next financial year. However, the cut in resource spend which it faces is somewhat less than those being proposed for Rural Affairs, the First Minister, Finance and Sustainable Growth, and Education and Lifelong Learning. All of these can expect cash cuts in resource spending of over 6%. The real cuts that they face will be around 3% larger if costs grow at around the current rate of inflation.

Figure 2 also brings out how ring-fencing the Health and Well-Being budget impacts on other budgets. The value of the 2.5% increase in resource spending in Health and Well-Being is £267 million. This increase is almost exactly equal in size to the sum of the reductions in resource spending being proposed for the Education and Lifelong Learning, and Finance and Sustainable Growth portfolios together. If health had not been ring-fenced, all three departments could have been given the same cash settlement as in 2009-10.

Figure 2: Changes in Capital and Resource Spend by Portfolio
Capital spending in Scotland will be £7.5 billion lower in cash terms by 2014-15 than if 2010-11 levels of capital spending had been maintained. The Scottish Government proposes to transfer £100 million of capital underspend this year into 2011-12 to partly offset this reduction. This seems sensible.

Straying from the 2011-12 agenda and looking further in the future, the draft budget also lays out a plan for an additional £2.5 billion of capital spending in Scotland to be delivered by the Scottish Futures Trust. The draft Scottish budget claims that £111 million of net savings to infrastructure investment was achieved by the Scottish Futures Trust in 2009-10. This presents a relatively modest saving of around 3.3% on the total capital spend of £3.4 billion. While the SFT may be able to improve the efficiency of public sector infrastructure delivery there will still be an irreducible cost for new projects which will reflect competitive prices for new capital assets. The Scottish Government budget will have to bear these costs if projects are taken forward by the Scottish Futures Trust. Around £900 million is being spent annually to service existing PPP contracts. Projects being taken forward by the Scottish Futures Trust will add to this total. The real issue is whether the projects genuinely add to the productive capacity of the Scottish economy, whether they can be delivered on time and on budget and if the Scottish Futures Trust can create a market in which firms are willing to tender and accept lower returns. One factor in the Scottish Future Trust’s favour is that the economic downturn will increase competitive pressures in the construction sector.

More detailed analyses of the individual portfolios will be brought forward by the subject committees. However, one area that may require special attention next year is the funding of further and higher education. Current funding for FE colleges is scheduled to drop by around 7.6%
in real terms in 2011-12 while funding for universities will fall by around 8.1% in real terms. The combined capital grants for FE colleges and HEI institutions will fall by 57%.

It is expected that some proposals will be brought forward that may involve the replacement of teaching grants by “graduate contributions” to make good the shortfall in university funding. Such changes are likely to require legislative action and may need to be put in place before financial year 2012-13. It is less clear how colleges, which have fewer potential sources of income, can deal with reduced funding. This is particularly of concern in respect of the skills and therefore the growth agenda. These cuts particularly affect young people which may not be fair in a generational sense. They may also adversely affect Scotland’s potential for sustainable economic growth i.e. the National Purpose.

The Private Sector
The Coalition Government expects the private sector to expand to absorb job losses from the public sector. This is seen as part of a necessary rebalancing of the UK economy away from consumption and the public sector towards exporting and investment. Hence it is reasonable to assess whether the draft Scottish budget might facilitate such private sector expansion.

One of the budget proposals is to increase sales of surplus public assets. These seem sensible. The cuts in capital spending in the transport budget have been less severe than those in other parts of the public sector, which is also likely to be welcomed by the private sector and should promote growth potential.

CSR 2010 argued that support for science was essential to support sustainable economic growth in the UK. The UK government intends to provide particular support for high-growth companies and the commercialisation of technologies, including funding a network of technology development and innovation centres.

The science budget is reserved to the UK Parliament. But the Scottish government makes a significant contribution towards supporting scientific research in Scotland, mainly through the provision of funding to universities. It is not clear how the aggregate research effort directly supported by the Scottish Government will be affected by the budget since it is spread across a number of portfolios. But it is encouraging that, as in England, the research excellence grant to universities will be protected, at least in cash terms. However, if the Scottish university sector, which is a major export earner for the Scottish economy, is placed at a competitive disadvantage due to changes in the funding of university teaching in England, it will become increasingly difficult to attract the best researchers in Scotland.

The decision to increase business rates on large out-of-town retailers will shift the balance of competitive advantage somewhat towards more traditional town centre businesses if the large retailers raise their prices as a result of the increased rates. But such price rises might also cause Scottish consumers to buy more goods on the internet from outside Scotland, which would be bad both for Scottish jobs and tax revenues.
Demand Driven Services

One area which the Finance Committee may wish to probe is how the Scottish Government intends to control spending in spending programmes where past decisions have led to open ended commitments or entitlements. The following examples illustrate the issue:

Concessionary Fares

The concessionary fares scheme now costs over £0.25 billion - more than 60% of what is spent on Enterprise, Energy and Tourism. The latter budget is relatively easy to control, but Concessionary Fares are based on entitlements and these are likely to increase as the population ages. In 2006-07, the costs of Concessionary Fares represented only a third of the Enterprise Energy and Tourism budget. Not only is it the case that this scheme is demand driven and its costs may therefore be difficult to control, but also, as we shall see later, it is difficult to see how it fits within the National Performance Framework.

Scottish Public Pensions

Scottish Public Pensions are part of Annually Managed Expenditure. They are funded separately by the Treasury and do not have to be balanced by adjustments elsewhere in the Scottish Budget. Nevertheless, between 2006-07 and 2010-11 they grew by more than 100% to £3.2 billion. The forecast for next financial year is that they remain static at this level, which hardly seems consistent with recent trends. Again they are based on entitlements over which the Scottish Government has little control.

Free Personal Care

Between 2006-07 and 2008-09, the cost of free personal care for older people increased from £321.5 million to £376.5 million. Free personal care is an entitlement to those assessed as needing personal care. It would be worth understanding how the government intend to assist local authorities to fund such care in 2011-12, if, as one would expect, demand continues to grow.

Fairness

One of the key issues associated with reductions in public spending is the extent to which they are "fair". Fairness or equity has many dimensions. The most common approach to assessing fairness is to consider how policy measures affect the rich on the one hand and the poor on the other. This is the approach taken by the IFS analysis of CSR 2010, shown in Figure 1. But it is not the only approach. There are many other ways in which it might be assessed. In this section, we discuss some of these.

Gender

In Scotland, about 64% of public sector workers are female. This compares with only 43% in the private sector. Reductions in public spending will almost certainly have a more adverse effect on females than males. Thus far, it has largely been the private sector that has suffered during the recession. The majority of job losses in Scotland associated with the recession have been in the private sector and wages have grown much more slowly among private sector workers. This has primarily affected men. But it is likely that the gender distribution of adverse outcomes will be reversed as the public sector shrinks.
Inter-Generation

The issue of intergenerational fairness is frequently and unfairly ignored by policymakers perhaps because the very young do not have a vote and the relatively young are less inclined to vote. Spending on one generation always has opportunity costs for other generations. The balance of spending between generations may also have implications for economic growth. For example, spending on skills is more likely to yield both private and social benefits if spent on the young generation.

For example, consider the generational effects of the concessionary travel scheme. This is popular and has a high level of take-up. But research commissioned by Transport Scotland shows that the scheme has had only limited impact on improving social inclusion, improving health or promoting a shift from car to bus. It also predominantly benefits those living in urban areas. The Scottish Government’s review implied that there is little evidence that it is achieving more than the previous concessionary travel local schemes that were in place. It also clearly favours the old relative to the young.

Other spending decisions which favour older citizens include the protection of the NHS and the continuation of free personal care for those aged 65 and above. NHS spending is heavily skewed towards older citizens.

Significant cuts in spending on education and justice also shift the scales of spending in favour of older individuals. As we shall see subsequently, other policies such as the council tax freeze and the freeze on public sector pay also have an age dimension.

These measures might contribute to a case that the draft budget is relatively unfair on younger Scots. However, against this, the budget does also take some measures that reinforce the wish of the Finance Committee to ensure that investment in early years is protected. These include:

1. maintaining the pupil–teacher ratio in the early years of primary school;
2. the introduction of a new Early Years and Early Intervention Fund with initial start-up funding of £5 million
3. provision of £45 million to support vulnerable children and young people
4. commitment to the implementation of the Early Years Framework

Who Benefits from the Council Tax Freeze?

The Scottish Government has used £420 million during the last three years to support the council tax freeze. It proposes a further £70 million in 2011-12 for those councils which freeze their council tax for a fourth year. This policy has therefore significant opportunity costs. It is reasonable to assess this policy using the National Performance Framework. Thus we assess its contribution firstly to sustainable economic growth and secondly to promoting fairness.

It is a common argument in tax theory that taxation of mobile factors harms economic efficiency more than taxation of immobile factors. This is for the simple reason that both capital and labour can respond to tax increases negatively, for example by emigrating or by seeking investment

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119 Scottish Government (2010) Review of the Scotland Wide Free Bus Travel Scheme for Older and Disabled People
opportunities elsewhere. This is confirmed in recent OECD research\(^\text{120}\), which argues that "current taxes on immovable property appear to have the least impact" (on economic growth). Thus it is difficult to make the case that the freeze on council tax has had a positive effect on sustainable economic growth.

This argument about the desirability of taxing immobile rather than mobile factors may underlie the decision of the Scottish government to seek approval to levy additional business rates on large retail outlets. It is rather paradoxical that taxation on immobile houses is being frozen while that on immobile retail outlets is being increased.

A second argument might be that the freezing of council tax promotes fairness by making the rich contribute proportionately more. This can be assessed using the same methodology that the Institute for Fiscal Studies used in analysing the fairness of the changes in taxes and spending in CSR 2010. Using the model of taxes and benefits which we have constructed at Stirling University, we have assessed which types of household have gained most from the freezing of council tax. Our model is based on a representative sample of Scottish households from the 2008-09 Family Resources Survey. We assume that if the council tax had not been frozen, it would have risen in line with the Consumers Prices Index. Thus we look at the difference in household incomes, after taxes and benefits, caused by the non-increase in the council tax. Our main results are shown in Figures 2 and 3.

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{figure2.png}
\caption{Percent Change in Equivalised Net Income by Income Decile}
\end{figure}

Figure 2 shows firstly that the freezing of council tax has had relatively small impact on most household incomes in Scotland. The differences in household outgoings between freezing the council tax and increasing it in line with inflation are relatively small for most households.

 Nevertheless, it is clear that the main beneficiaries are those in the middle of the income distribution. This is because households in income deciles 1 and 2 often receive council tax benefit to offset their council tax bills. Thus, they do not particularly benefit from a council tax freeze. For the richest households in decile 10, the effect is small because, although they make the largest cash savings, the effect is very small in relation to their net household income. Thus it is middle income households which benefit most from the council tax freeze. Note the comparison with the effects of the tax and spending changes arising from CSR2010 shown in Figure 1: it is middle income households which will be least affected by changes in tax and benefits at the UK level.

 Figure 3 analyses the freeze in council tax by household type. It shows that the group gaining most from the freeze are two-adult pensioner families. This group may have relatively large houses but low income. Single adults with and without children gain the least due to the combined effect of council tax benefits and their living in accommodation attracting relatively low council tax bills.
Given this evidence, it is difficult to make a strong case for the council tax freeze based on the National Performance Framework. There is no case that it supports economic growth and its fairness implications are certainly not clear cut.

There are other arguments against the freeze. First, council tax is a relatively efficient method of raising tax. It is also almost impervious to the economic cycle. It therefore seems strange to cut property taxes when revenues from other sources such as income tax, corporation tax, stamp duty etc. have fallen.

Before the recession, Ireland’s tax base was highly susceptible to the financial crisis, partly because it had no property tax. The Economic and Social Research Institute in Dublin has recently been modelling likely revenues from a property tax and it is expected that a proposal to introduce this tax will be put forward in the next Irish budget, which is now imminent following the discussions with the IMF and the European Union\(^\text{121}\).

Second, council tax is one of two major sources of revenue available to the Scottish Parliament. With the other source currently unavailable, there is a growing question about the willingness of the Scottish Parliament to accept the responsibility of raising additional tax revenue from Scottish households. Given the opportunity costs of the council tax mentioned at the beginning of this section, the Finance Committee might consider whether the benefits of the council tax freeze outweigh its costs in terms of the services not delivered by local government or by other public bodies due to lack of funding.

\(^{121}\) Irish Independent, November 20, 2010
Efficiency savings

We now turn to the important issue of efficiency savings. The Scottish government intends to use these as a means of maintaining public service and has set an efficiency saving target of 3% for 2011-12. Efficiency savings policies encourage public bodies to improve productivity and hence produce the same outputs with fewer inputs. However, the evidence of past efficiency savings programs is at best mixed. And without a properly established baseline it will be impossible to tell whether the goal of improved productivity has been achieved. It will be particularly difficult to come to any snap judgement on their effectiveness, since evaluation will inevitably take a considerable period of time.

Audit Scotland has produced a number of reports highlighting the risks associated with efficiency savings. These include:

- Setting individual targets for efficiency savings may encourage "silo thinking" whereby public bodies focus only on their own contribution to savings, possibly neglecting opportunities for greater savings that might be made if they worked together with other bodies (see e.g. Audit Scotland 2010\textsuperscript{122,123}).

- Too often efficiency savings are made in an environment where measurement of both quality and quantity of services provided is inadequate (see e.g. Audit Scotland 2010\textsuperscript{124}).

- Regular incremental savings targets act as a disincentive to bodies that could extract significantly larger costs from their operation in a single year.

The Scottish government seems to implicitly acknowledge the dangers of "silo thinking" with its proposal to provide £70 million from within NHS board allocations for a new "change fund" in 2011-12. This should encourage the closer working of NHS and local authorities in improving the quality of care for older people while also making cost savings.

The Independent Budget Review estimated that a 3% savings target, such as that now being proposed by the Scottish Government, “could in theory generate savings in 2014-15 of some £900 million” (my italics)\textsuperscript{125}. Unless they can be measured, the Scottish public will not know whether the savings have been realised. Services may be cut and no clear explanation will be available as to whether these derive from genuine reductions in budget or in failure to make efficiency savings.

The Draft Budget is not clear as to whether efficiency savings may be retained by public bodies. The Finance Committee has previously recommended "that any relevant public bodies that wish to retain future efficiency savings should only be able to do so if they have clearly demonstrated

\textsuperscript{122} Scottish Police Services Authority, Audit Scotland, October 2010
\textsuperscript{123} Improving public sector efficiency, Audit Scotland, February 2010
\textsuperscript{124} Review of orthopaedic services, Audit Scotland, March 2010
that savings have actually been made and can demonstrate where the savings have been applied.\textsuperscript{126}

\textbf{The Finance Committee may wish to seek further assurance from the Scottish Government that efficiency savings can be demonstrated to lead to improved productivity rather than service reduction.}

\section*{How Much Will a Pay Freeze Save?}

One of the key elements of the draft budget is the proposal to freeze public sector pay. The Scottish Government can only do this directly for those staff groups under its direct control. It also intends to reduce pay costs for senior staff, reducing bonuses and other forms of non-consolidated pay. It also intends to reduce senior civil servants’ costs by 10\% in 2011-12 and by 25\% by 2014-15.

Like efficiency savings, pay restraint offers the possibility of maintaining public services even though the resources available to the Scottish government have been depleted. Pay restraint is also presented as a way of maintaining public sector employment. Since, with a fixed budget, increases in pay implied that a small amount of labour input can be purchased.

However, freezing workers’ pay should not be regarded as a costless exercise. It can lead to increased turnover, poor industrial relations and reduced willingness to improve performance. These effects will be different across the many different labour markets for public sector staff in Scotland.

Where workers are effectively earning a "rent" – i.e. they would be willing to perform the same tasks for lower pay, then there is a case for examining terms and conditions. But if the worker has other opportunities, then a public sector pay freeze may simply lead to the loss of good workers and a consequent decline in productivity and efficiency.

It is also not necessarily the case that high-paid public employees are earning rent. Some will operate in national, or even international, labour markets, where there is a high level of demand for scarce talent.

The details of the pay freeze which the Scottish government propose are similar to that being implemented in England. Workers earning over £21,000 per year will be entitled to pay progression but their basic pay will be fixed. Workers earning less than £21,000 a year will be guaranteed a wage increase of £250 and a minimum hourly wage of £7.15 per hour.

Before looking at how much this might save, it is worth identifying the types of work that are likely to be particularly affected by the pay freeze. Figure 4 shows the proportion of public sector workers in Scotland earning above and below the £21,000 limit by age group. It is clear that middle aged workers will be caught by the pay freeze. The majority of those aged 30 to 50 earn more than £21,000 per year. In contrast, around 70\% of those aged 20 to 24 fall below the £21,000 limit, as to 60\% of those aged 60 to 64.

\textsuperscript{126} Scottish Parliament Finance Committee Fourth Report - 2010-Budget Strategy Phase (June 2010)
The gender distribution above and below the pay freeze limit is shown in Figure 5. Comparative proportions for the private sector are also shown in this figure. In the public sector, over 70% of those earning less than £21,000 per annum are female. In the private sector, the distribution is much more balanced. Because of the preponderance of women in the public sector in Scotland, a majority of those earning over £21,000 per annum are also female, while only 25% of those in the private sector earning over £21,000 per year are female.

The implication of these figures is that slightly more women than men will be affected by the freeze on pay in the public sector. But the £21,000 per annum limit will protect a much larger number of females than males from a complete pay freeze.

Figure 4: Proportion of Public Sector Employees in Scotland Earning above and below £21,000 Per Annum by Age Group

Source: Labour Force Survey
Figure 5: Proportion of Public Sector Employees in Scotland Earning above and below £21,000 Per Annum by Gender

![Proportion of Public Sector Employees in Scotland Earning above and below £21,000 Per Annum by Gender](image)

Source: Labour Force Survey

The "savings" claimed for a pay freeze depend on what would have happened had the freeze not been in place. This cannot be known and therefore one has to assume realistic alternative scenarios. Here we carry out two simple exercises. In the first, we assume that public sector pay will increase in 2011-12 at the same rate as it did in 2009. Data from the Annual Survey of Hours and Earnings show that in 2009, median public sector pay increased on average by 4.6%. This comprises both increases in basic pay and progression along pay spines. Pay increases over the same period in the private sector were 0%.

In the second exercise, we assume that pay stays constant in real terms, implying money increases of 3.1% (the current rate of the CPI inflation). Table 2 shows our results. If pay were to increase at 4.6%, the Scottish government wage bill would increase by £659 million. If the increase were a more modest 3.1% the increase would only be £444 million. If pay were to be restricted to progression only, our estimate is that this would cost around £172 million. Allowing pay increases for those earning below £21,000 would increase the costs to £242.6 million. Finally, ensuring that no public sector worker earns less than £7.15 per hour, the so-called “living wage”, increases costs to £338 million. In those circumstances, the savings that would be made of public sector pay had been growing at 4.6% would be £321 million, while if it had been growing at 3.1%, the savings would be a much more modest £106 million.

In relation to the overall pay bill, the savings shown in Table 2 are relatively small amounts. It is clear that they are significantly reduced by the decision to allow pay rises for those earning less than £21,000. This analysis does not take account of the impact of workers who are paid for less than a full year, though this number is likely to be small.

More importantly, it does not allow for the local government settlement that is already in place and which is for a pay freeze for all staff in 2011-12, with no threshold. Clearly the local government settlement would increase the total savings, but the differential approaches taken on
The net savings from a pay freeze are lower, the lower are the hypothetical wage settlements that public sector unions might have accepted next year. At least for those who negotiate directly with the Scottish Government, these can never be known. It remains to be seen if other workers who are paid by the Scottish Government, but who do not negotiate their wages with the Scottish Government, accept the pay freeze. In the longer term, the Scottish Government might wish to reduce the numbers of workers that it pays for, but with whom it does not negotiate directly. This would seem to be an essential component of extending Holyrood’s fiscal powers.

Table 2: Savings from Pay Freeze

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<th>4.6%</th>
<th>3.1%</th>
</tr>
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<td>No Pay Restraint</td>
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<td>£444.2m</td>
</tr>
<tr>
<td>Progression Only</td>
<td>£171.9m</td>
<td>£171.9m</td>
</tr>
<tr>
<td>Progression plus Pay Freeze Over £21,000</td>
<td>£242.6m</td>
<td>£242.6m</td>
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<tr>
<td>Progression, Pay Freeze and &quot;Living Wage&quot;</td>
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<td>£337.9m</td>
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<td>Expected Savings</td>
<td>£321.2m</td>
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</table>

Presentation

The presentation of budgetary information in the draft budget continues to improve, with complete Level 3 comparisons between 2010-11 and 2011-12. These are not presented in real terms. I have some sympathy with this approach because there are considerable caveats associated with estimates of the "real" changes in provision associated with detailed components of the Scottish budget. I discussed this issue in last year’s budget report. Different portfolios are subject to different cost pressures with health being mentioned as an obvious example. Falling construction costs may mean that the real cuts in capital expenditure are somewhat less than those implied by the draft budget.

However, another aspect of the presentation is less welcome. Spending programme titles are becoming increasingly opaque. For example, when reading the budget, members of the public must find it difficult to understand what a spending programme described as "Supporting Sustainability" means. Perhaps the committee would like to urge the Scottish government to use plainer descriptions of their spending programs.

Single Year Budget

There has been debate as to whether it is appropriate to produce a Scottish budget only for 2011-12 when the UK Comprehensive Spending Review sets out Scottish DEL for the next four years (as
in Table 1). There is a plausible argument that a four-year budget might have to be realigned following the next election and hence it is reasonable to restrict financial plans to 2011-12. Clearly there would be further difficult messages to impart in laying out how the Scottish budget will evolve between 2011-12 and 2014-15. And, by delaying the Comprehensive Spending Review, the last Labour administration did not show any enthusiasm to address the same issue for the UK as a whole prior to the May 2010 election.

However, if it is only a single year budget that is being presented, it is not clear what budgetary purpose is being served by looking beyond 2011-12. For example, it seems incongruous to include “forecasts” of how long it might take public sector spending in Scotland to return to 2009-10 levels when these extend to 2026-27.

The thinking about longer term restructuring of public services appears to have been passed to Campbell Christie’s Public Services Commission. However, like a longer-term Scottish budget, its report will have to pass the test of being acceptable to the next administration. Until there is less partisan acceptance of the need for significant reform of Scotland’s public services, there is little likelihood of substantive change.

At present, what is happening is that structural change is being driven principally from the bottom up. Thus, local authorities are looking at opportunities for joint restructuring and re-profiling of public services. Although this process may seem ad hoc, it may yield long-term benefits. An example might be the proposals for greater joint working in which, for example, Stirling Council is involved. But local authorities can only operate within the existing legal framework. Eventually, if radical reform of Scottish public services to take place, Scottish politicians will have to pass the necessary legislation.

**Conclusion**

There is no doubt that this is a difficult budget. It has both positive and negative aspects. But it is important that the Finance Committee plays a full role in working between the subject committees, the Scottish Government and Scottish civic society in ensuring that a Budget Bill is passed in good time so that public sector organisations can plan at least for next financial year.
Introduction

1. This guidance aims to assist committees in their scrutiny of the Scottish Government’s 2011-12 Draft Budget and its Spending Review 2010.

2. Due to the publication of the UK Government’s Spending Review in the autumn, the timings for scrutiny of the Scottish Government’s Spending Review and Draft Budget will be different from normal. It should be noted that the timetable below is indicative only, and is based on a mid-October publication for the UK Comprehensive Spending Review. If the publication date of the UK CSR is later than this, the timetable for the Scottish process will have to be reassessed.

- Mid-November: Scottish Government publishes its Spending Review 2010 and 2011-12 Draft Budget;
- November/December 2010: Finance Committee and other committees scrutinise the Scottish Government’s spending plans;
- December 2010: subject committees report to Finance Committee;
- Mid-January 2011: Finance Committee publishes its report to the Parliament;
- January/February 2011: the 3 stages of the Budget Bill run as normal, although the Finance Committee’s debate on its report will be rationalised into the Stage 1 debate on the Bill, as happened in 2008.

Preparing for the Draft Budget

3. Committees should be aware of key developments that will take place before the publication of the Draft Budget and the Spending Review that will help to shape their scrutiny of these documents.

4. First, the Finance Committee recently published its Report on the Budget Strategy Phase (BSP), which stated that the current financial situation “will amount to the most significant challenge that both the Scottish Government and the Scottish Parliament have faced since devolution”.

5. The report called on decision makers within all publicly funded bodies, and the Scottish Government and parliamentary committees, to show far greater leadership by discussing in more open and realistic terms the impact that future budget cuts will have and the options that are available to deal with these cuts. The Committee also made more specific requests of the Scottish Government, some of which will be of relevance across committees as they prepare for the Draft Budget. For example, the Scottish Government was asked to—
• set out the principles that will inform its approach to developing its spending proposals, and the degree to which these principles have been discussed with spending bodies;

• state whether it has a specific strategy for protecting vulnerable people from the impact of the cuts;

• explain how it will fund its commitment to maintaining universal benefits given the current financial squeeze, and also explain the impact that this commitment will have on other budgets;

• state whether spending decisions by other public bodies could impact on its commitment to maintaining universal services;

• set out the impact for the rest of the budget of its decision to pass on any health consequentials that would arise from a real-terms increase in the UK Government’s health budget;

• provide more specific information on the number of public sector jobs that it estimates will be lost in future years;

• provide clarity on its planning in relation to pay policy, including the impact of the proposed pay constraints on the budget;

• explain whether it will support the greater involvement of private and voluntary sector bodies in the provision of public services;

• provide reassurances that, in the event of there continuing to be problems with public sector collaboration, it will play a more active role in seeking to drive this process. The Scottish Government should also state whether it has any views on how greater collaborative success could be measured;

• be more consistent in the use of terminology in the spending debate such as “frontline” and “back-office services”;

• confirm as soon as possible whether it will allow bodies to retain their efficiency savings in the next spending review period. The Committee recommended that any relevant public bodies that wish to retain future efficiency savings should only be able to do so if they have clearly demonstrated that savings have actually been made and can demonstrate where these savings have been applied;

• provide a supporting document to the 2011-12 Draft Budget, setting out the link between performance over the period of the previous spending review (i.e. 2007-10), the Scottish Government’s priorities for the next spending review period, and how these future priorities are to be funded in 2011-12.
6. In short, the Finance Committee’s report aims to get the Scottish Government to provide a significant amount of information on its spending plans before the Draft Budget is published. There will be a chamber debate on the report in the last week of June, while a written response should be provided by the Scottish Government before the end of recess (the Scottish Government will also reply individually to those committees that reported to the Finance Committee). Once the Scottish Government’s response has been received other committees may wish to consider whether there is a need to request further, tailored information from their ministers before the 2011-12 Draft Budget is published.

7. A second factor for other committees to be aware of is the work of the Independent Budget Review Group, which will report to the Scottish Government in July. The Finance Committee will take oral evidence from members of the group on 7 September. It is anticipated that many of the group’s recommendations will focus on specific portfolio areas and committees may therefore wish to consider taking evidence from the relevant Scottish Government minister on how the group’s findings will inform the preparation of the Draft Budget.

Scrutinising the Draft Budget

8. Professor David Bell, the Finance Committee’s budget adviser, and the FSU will produce analyses of the Draft Budget for the Finance Committee shortly after it is published. These papers will be made available after they have been considered by the Committee. Analysis of the document may suggest further areas on which committees may wish to focus their scrutiny. Professor Bell will also seek to coordinate discussions with committee budget advisers in preparation for scrutiny, and will support joint discussions among advisers on key issues arising from analysis of the Draft Budget.

9. Committees may also wish to consider last year’s Finance Committee budget guidance, much of which would still be relevant for framing scrutiny of this year’s Draft Budget.

10. There are also some outstanding issues from the Scottish Government’s response to the Finance Committee’s report on the 2010-11 Draft Budget that committees may wish to pursue. For example, the Finance Committee’s report asked the Scottish Government to provide an analysis of how “other pressures” will affect future budgeting.

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128 http://www.scottish.parliament.uk/s3/committees/finance/reports-09/fir09-07-vol1-02.htm#11
129 For example, the rising cost of revenue payments to meet PPP/PFI contract commitments; cost trajectories of some policy commitments (e.g. the small business bonus scheme, free prescriptions, concessionary travel, etc); changes in the demographics of the population and changes in technology; possible costs of equal pay in the NHS. See paragraph 138 of the Committee’s report for full details.
11. The Scottish Government’s response said it would “reflect” on this … “However, until we have greater clarity from the UK Government it is difficult to offer definitive advice about how such pressures might be addressed …”.

12. The Finance Committee also asked the Scottish Government to consider a mechanism for reporting on proofing the budget for social justice. The Scottish Government’s response said—

“The Scottish Government has recently decided to extend the socio-economic duty in the UK Equality Bill to Scotland, and we are currently looking at how this duty may be taken forward. We are planning to develop guidance for relevant public bodies in Scotland - which will include the Scottish Government - and as part of this we are considering the issues of poverty ‘proofing’ or impact assessment of strategic decision making, including budgeting and resource allocation. We will be conducting exploratory work on these issues in early 2010, and are working with our colleagues in UK Government and the other devolved administrations to share learning and develop effective approaches.”

13. Finally, committees may wish to be aware of a recent report by Audit Scotland, Scotland’s public finances, preparing for the future. Pages 5 and 6 of this report set out “Key questions for the Scottish public sector”, some of which committees may also find to be useful in shaping their budget scrutiny.

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