
INDEPENDENT BUDGET REVIEW

The Report of Scotland's Independent Budget Review Panel
July 2010

INDEPENDENT BUDGET REVIEW 2010



Chairman's Message

When the Panel first met to consider the Independent Budget Review in February, we were concerned that very little knowledge of the extent of the looming challenge was in the public domain.

How much has changed in five months! Now there is rarely a day without some mention in the media of the difficulties we are all facing, and it has also become obvious that this is not just an issue in Scotland or, indeed, the UK, but a pain that is being shared by many countries.

There are very difficult decisions to be made over the next few months, requiring strong leadership not just in their making but also in their subsequent implementation.

Clearly, there are significant short-term challenges. However, important decisions also need to be taken about the future. Scotland needs to decide what form and shape of public services it desires and can afford. What do we want the state to do? What level of taxes are we willing to bear for the provision of our public services? How much should we change the mix between the state, the individual, the third/voluntary sector, and the private sector?

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.

As Sir William Beveridge stated in the introduction to his 1942 report that started to revolutionise welfare provision: *"The first principle is that any proposals for the future ... should not be restricted by consideration of sectoral interests."* This message is one for all of us.

I would like to thank my colleagues, Sir Neil McIntosh and Robert Wilson, who have given so much time and thought to these issues over the last five months, and I would also like to thank the team on secondment from the Scottish Government, whose task it has been to help us sort through the volumes of input.

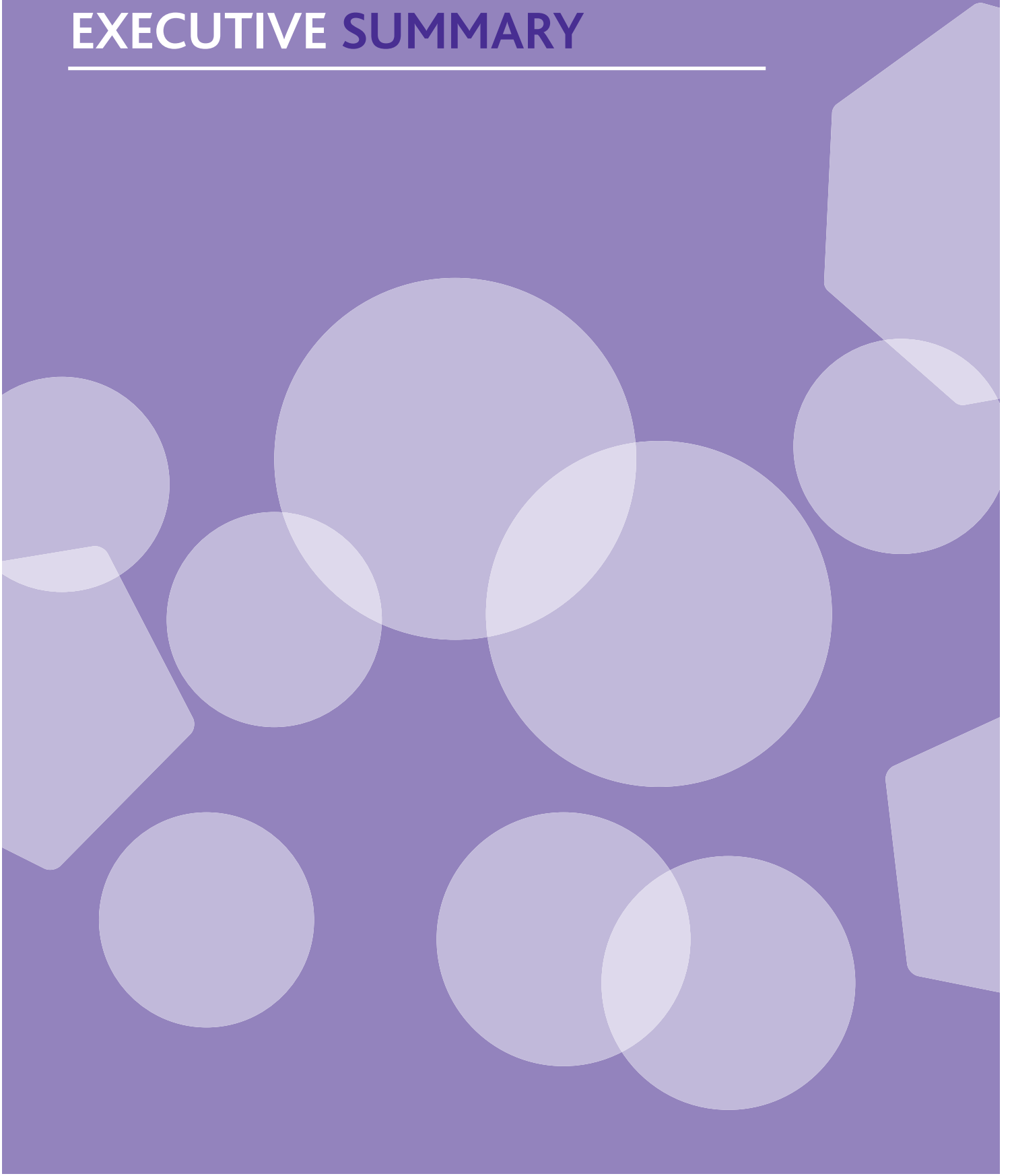
A handwritten signature in dark ink, reading 'Crawford W Beveridge'. The signature is fluid and cursive, with a long horizontal stroke at the end.

Crawford W Beveridge CBE
Chair, Independent Budget Review
July 2010

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EXECUTIVE SUMMARY



OPENING REMARKS

The Panel would like to thank the many individuals and institutions who took time to submit written and oral contributions. It was clear that everyone understood the difficult times ahead, made thoughtful commentary about the options, and in many cases were already advanced in their thinking about the contingency plans they need to consider.

Our remit was challenging, with potentially conflicting elements – assisting economic growth while managing service delivery with significantly reducing resources.

Time has not allowed us to deal with every issue in each functional segment of the public sector, and we would encourage review of the individual submissions for a more complete understanding of the challenges faced.

Many will find this report uncomfortable reading. The Panel was asked to make recommendations on options that the Scottish Government and the Parliament should consider in the face of the most challenging public spending environment since the Second World War. This is not simply a matter of balancing the books and managing finances. It involves real people, their lives, their families, their hopes and aspirations. However, difficult choices will have to be made. There are no 'quick fixes' or 'silver bullets'.

Our main recommended options have been brought forward from each of the chapters and are summarised at the end of this section.

A CHANGED ENVIRONMENT

In the first 10 years of the Scottish Parliament, there has been an annually growing budget. However, the future will require a very different mindset. Figures from the Scottish Government show that we are entering a long period, perhaps as many as 15 years, before the budget will return in real terms to 2009-10 levels.

Parliament will be tested, and the results of its decisions on the difficult choices it faces will affect all of the people of Scotland. The challenges are to focus on the most significant priorities for the nation, to reject the notion that lower cost must inevitably mean lesser service and to embrace an ethos of doing more with less.

TAXATION AND INCOME

Some of the many contributors to our work expressed the view that the projected budgetary problem could be solved through increasing the Government's revenue, either through economic growth, increased taxes or additional charging rather than reducing spending.

We have seen no current forecasts for economic growth which would suggest a level that would allow us to grow our way out of this problem within the timeframe of Spending Review 2010, which will cover the four years from 2011-12 to 2014-15. Although taxation was outwith our remit, the Scottish Parliament does have limited tax-raising powers, but any change here may need to await the outcome of the Calman proposals. A strong case has been presented for ending the freeze on council tax and, given the size of the challenge, all public sector bodies should be encouraged to look at the opportunities for increased or new charges.

CAPITAL EXPENDITURE

It appears that the decreases in the Scottish Government's available capital budgets will be far greater than in their other expenditures. Capital expenditure, especially on infrastructure, can create jobs and drive economic growth. All possible avenues should be pursued to sustain borrowing and investment, including consideration of the limited ability that exists to move funding from revenue to capital.

In the specific case of Scottish Water, which has featured very heavily in the submissions, we are aware of strongly held public views that this service should not be subject to privatisation. Noting that, we are of the opinion that alternative models should still be considered and that there is at least one alternative route, that of a public interest company (similar to Welsh Water), which should permit the release of significant capital to the Scottish Government for other projects while allowing the attraction of private investment and the return of any surplus to the public benefit.

PROTECTED AREAS

An early decision must also be made on whether any areas of public spending in Scotland should be protected. We could find no overwhelming rationale for protecting major blocks of expenditure, particularly in the context of integrated services and early intervention programmes, and would be concerned about the burden this would place on non-protected areas.

PAY AND PENSIONS

The UK Government has already made some decisions about constraining public sector pay. The Scottish Government needs to decide whether or not to follow this route. As will become clear on reading the report, it seems inevitable that the level of employment in the public sector will fall. The extent to which employment needs to fall may be mitigated by recourse, for example, to pay restraint, recruitment controls and revised working arrangements. However, it is important to establish quickly whether public sector employees and their representatives will be willing to negotiate on such pay-related issues in order to mitigate job losses.

The issue of public sector pensions is a major one which must be addressed, but this is largely a reserved issue. The UK Government has set up a commission to consider pensions, and the Scottish Government's contribution to this will help to determine the action to be taken in this vital area.

EFFICIENCY SAVINGS

We have been advised that public services in Scotland have met or exceeded the targets that they were given for efficiency savings. If they can meet similar targets over the coming four years, with the savings offsetting budget reductions, this will go some way to help offset job losses.

Our experience is that those who are closest to the work are best placed to know what savings can be made. If, for example, everyone in public service in Scotland were to be encouraged to propose even a small saving, then this, cumulatively, could go some way to bridging the funding gap. However, the current approach to financial management would need to be revised from one where the imperative appears to be to fully spend up to budget each year.

In recent years, other groups have considered public sector efficiencies, such as the McClelland Review of purchasing, the Crerar Review of scrutiny and regulation, and the Arbuthnott Review of shared services in the Clyde Valley area. All of these delivered recommendations for a more efficient and effective public sector. Although some progress has been made, there are still many savings to be made in each of these areas. We would suggest that the Scottish Government considers how to pursue these more vigorously.

However, the Panel is of the view that the funding gap is unlikely to be bridged by efficiency savings alone.

UNIVERSALITY

The principle of universality in the delivery of many of our public services, such as concessionary travel, prescription charges, eye examinations, free personal and nursing care and tuition fees is commendable, but simply may no longer be affordable. A debate needs to be had on whether those who can afford to pay might be invited to do so, thus allowing better targeting of those in most need.

STRUCTURES

For a small country, Scotland has a plethora of institutions, including 32 local authorities, 23 NHS bodies, 8 police forces, 20 universities, 43 colleges, and over 100 other public bodies. An immediate wholesale restructuring of public services would be counter-productive in the present circumstances, but consideration of this issue should be an integral part of a strategic review of the future delivery of public services. In the short term, the Scottish Government should encourage progressive changes and joint action between public bodies to produce new and more effective service delivery models.

LOOKING AHEAD

While our remit covered the next four-year Spending Review, it quickly became clear that the challenges will persist well beyond that timeframe and, therefore, a more strategic longer-term perspective needs to be developed. Many of the submissions we have received support this view.

The medium to longer term creates an imperative and an opportunity for our politicians and civil society more generally to engage in a debate about transformation of the organisation and delivery of public services in Scotland to meet future needs.

Fundamental to this debate is consideration of the appropriate balance of responsibility between the individual and the state. This is urgent. It must start in parallel with the current budget process so that developing thinking can feed back into decision making about priorities.

MOVING FORWARD

Finally, we cannot stress too highly the importance of taking immediate action. Throughout the public sector, managers are expecting strong leadership from the Scottish Government and Parliament in terms of early identification of key priorities. They are also looking for an outcomes-based, rather than an input-based, approach to tackling the challenges ahead.

The final settlement for the Scottish Government's Departmental Expenditure Limits will not be available until the Comprehensive Spending Review in October. In the meantime, each budget holding body will require to take restraint and cost reduction measures to match its own circumstances. This emphasises the need for the earliest possible central guidance on service cost reduction figures to permit meaningful contingency planning to take place. Enough is known about the order of magnitude that we can start planning now for what must be done, building on the extensive input to this Review and the work of the Parliament's Finance Committee.

CONCLUSIONS AND RECOMMENDATIONS ON OPTIONS FOR DELIVERING PUBLIC SERVICES WITHIN THE CONSTRAINED PUBLIC EXPENDITURE ENVIRONMENT IN SCOTLAND

CHAPTER 2: PUBLIC SPENDING ENVIRONMENT

CONCLUSIONS

1. Whilst noting the debate and difficulties surrounding the accuracy of economic forecasting, the Panel is of the opinion that the projections of the Chief Economic Adviser are indicative of both the direction of travel and the scale of the challenge for public spending in Scotland.
2. In attempting to achieve a better balanced public sector spending position, the options for increasing revenue (for example through increased taxation) and for reducing public sector expenditure will need to be carefully balanced, not least to avoid damaging economic recovery.
3. In reaching this balance, difficult decisions on competing resource demands will need to be made. These will include whether or not to utilise potential revenue increasing powers and ring-fence funding to certain areas, and how to handle current emerging pressures, such as those resulting from demography and climate change.

RECOMMENDATIONS

4. Given the scale of the reductions which would otherwise have to be met from 'non-protected' areas of public services, the Panel would strongly advocate as an option an approach which would not have an over-riding presumption of whole segment 'protection', but which would instead be built upon all services being subject to scrutiny and comparative prioritisation in the allocation of resources.
5. If, however, 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.
6. 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.

CHAPTER 3: EFFICIENCY

CONCLUSIONS

- 7.** The Panel recognises the progress on efficiency improvements made in the Scottish public sector but also the importance of ensuring continuous improvement. However, 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.
- 8.** Achieving further efficiencies is likely to require a portfolio of further streamlining and simplification, progressive development of shared services, more outsourcing of services, improvement of procurement practice, and better management of absence.
- 9.** Continuing to make efficiencies will become increasingly challenging and may, in some instances, require radical redesign in the way that services are provided to the public.
- 10.** However, best estimates suggest that contributions from efficiency savings alone would not be sufficient to fill the immediate gap in public spending budgets, and urgent examination of additional options will, therefore, be necessary.
- 11.** The Panel considers that there remain major opportunities to build on existing good practice to develop shared services further and to improve joint working across the public sector.
- 12.** The Panel is of the strong view that clear leadership and commitment to change is fundamental in encouraging effective shared services arrangements across the public sector.

RECOMMENDATIONS

- 13.** The Panel suggests that, in light of the projected financial constraints, the Scottish Government and Parliament should consider:
- (i) revising the current approach of the Efficiency Programme which allows efficiency savings to be retained and recycled with a view to reducing future budget allocations across the public sector to incorporate an assumed annual efficiency saving; and
 - (ii) ensuring that future annual efficiency targets are no less than 2 per cent per annum.
- 14.** The Panel suggests that the Scottish Government and Parliament should consider using the provisions of the Public Services Reform (Scotland) Act to further reduce the number of public bodies.
- 15.** The Panel would advocate the implementation of a regular review process of all public bodies which:
- (i) identifies the need, purpose, cost and value of retaining the public body in that category; and
 - (ii) states specifically why the work must be undertaken by the public body and not by the core Scottish Government, private or third/voluntary sector.
- 16.** The Panel welcomes the changes implemented following the Crerar Review but considers that greater pace in delivering its recommendations is needed if the momentum that has been built up is not to be lost.

17. The Panel suggests that the Scottish Government and Parliament should consider the remaining scope to merge different scrutiny bodies as part of the current Simplification Programme and ensure that the work of scrutiny bodies is proportionate and appropriate and takes full account of the time and cost implications for the wider public sector.

18. The Panel looks to the Scottish Government and Parliament, together with local authorities and leaders of other public bodies, to provide an appropriate level of leadership to ensure that barriers to shared services development are addressed with determination.

19. The Panel believes that the challenges arising from the projected financial outlook should act as a stimulus for the public sector to review its current delivery models, including consideration of alternatives. Looking ahead, the Panel envisages mainstream roles for the private and voluntary/third sectors as collaborative partners in the delivery of public services.

20. The Panel welcomes progress made by the Scottish Government to accelerate the pace of improvement in procurement performance and endorses Audit Scotland's recommendations for improving public sector purchasing.

21. The Panel suggests that the Scottish Government should consider strengthening its work to deliver the Public Procurement Reform Programme by agreeing clear targets for improvement, and should build on and share good practice to drive and accelerate improvement.

22. The Panel believes that any reduction in the level of absence has the potential to contribute to greater public service efficiency and suggests that the Scottish Government should consider taking the lead in exploring the scope to improve the measurement and benchmarking of absence levels across the public sector in Scotland, and that all bodies subject to the Scottish Government's efficiency targets should identify clear targets for reducing absence, ultimately to a level equivalent to the private sector average.

CHAPTER 4: REMUNERATION AND WORKFORCE

CONCLUSIONS

23. It is clear from the evidence that the public sector in Scotland has expanded significantly over the last decade. While this expansion could be accommodated when budgets were rising year-on-year, it is unsustainable in the face of the projected significant budgetary cuts.

24. In light of the analysis produced by the Office of the Chief Economic Adviser, which makes it clear that we are entering a period of significant financial constraint for some time to come, the Panel believes that a balance needs to be struck between options that will have an impact immediately and those that are capable of delivering more sustainable reductions in the pay bill.

25. While pay and recruitment freezes have a critical role to play in constraining growth in the pay bill, they are insufficient on their own, both in terms of scale and duration, to represent an effective response to the forthcoming reductions in public spending in Scotland.

26. 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.

27. In addition, the Panel's conclusion is that an approach of blanket reduction in pay levels applied across the public sector is unlikely to be appropriate or deliverable in the Scottish setting.

28. Given the projected severity of pressures on the Scottish Budget in the years ahead, the Panel concludes that Scottish Ministers will need to continue to work proactively and urgently to influence and, ideally, agree the terms of the pay settlements and will need to consider whether or not to follow the UK pay recommendations, including those of the UK pay review bodies, in the same way as before.

RECOMMENDATIONS

Pay restraint for 2011-12 and 2012-13

29. The Panel recommends that the Scottish Government applies a pay freeze as the first essential step to constrain growth in the public sector pay bill. Four options have been identified for consideration:

- **Option 1: UK option** – a two-year pay freeze for public sector workers, from 2011-12, except for those earning £21,000 or less, who would receive at least £250 in these years. At the current time, the UK position appears to be that, where public sector employees are entitled to progression, these payments would be continued;
- **Option 2: pay freeze with no threshold for lower paid workers** – a two year pay freeze for all public sector workers, from 2011-12. All progression payments would continue;
- **Option 3: freeze on all pay (i.e. including progression) for all public sector workers** – a two year pay freeze and suspension of progression pay for all public sector workers, from 2011-12; and
- **Option 4: pay freeze with a threshold for lower paid workers which is either in line with the UK threshold or the Scottish Government's target for reducing poverty and income inequality in Scotland** – a two year pay freeze for public sector workers, from 2011-12, except for the lowest paid as defined by the Scottish Government's solidarity target. Progression payments could be continued or suspended.

Pay restraint for 2013-14 and 2014-15

30. Assuming any pay freeze would be lifted after two years, further pay restraint would be required to constrain growth in the pay bill. The Panel has identified two options for the Scottish Government to consider for 2013-14 and 2014-15:

- **Option A:** tight pay restraint with a net increase in the pay bill (including costs of progression) of 2 per cent; or
- **Option B:** a pay award in line with projections for General Government average earnings growth (3.1 per cent in both years).

Recruitment freeze

31. The Panel suggests that the Scottish Government should consider the immediate implementation of a recruitment freeze across the public sector, with exceptions only granted for essential staff posts. The period of the freeze will be dictated by the success of the action taken above.

Reductions in public sector employment, 2011-12 to 2014-15

32. The Panel suggests that the Scottish Government and other public sector employers have only two broad options:

- to reduce the average cost per employee – e.g. by freezing pay, adjusting other elements of the remuneration package, reducing hours of work; and/or
- to reduce the number of employees – e.g. through a freeze on recruitment, natural wastage (i.e. non filling of posts when people leave or retire) or redundancy.

33. The Panel is of the opinion that both of these approaches will require to be considered. The first option clearly has the ability to constrain growth in the pay bill and hence mitigate the scale and impact of individual job losses and redundancies in the short term.

34. In 2011-12 (when the budget cuts are anticipated to be particularly severe), the Scottish Government has a choice between:

- a 2.3 per cent to 3.5 per cent reduction in public sector employment, managed as far as possible through natural wastage; or
- a smaller reduction in public sector employment in 2011-12 with the remainder of the gap in the pay bill financed from additional reductions in non-pay bill resource expenditure.

Bonus payments

35. The Panel suggests that the Scottish Government provides evidence to the Fair Pay Review urging that particular attention is paid to the NHS Distinction Awards scheme, the cost of which appears significantly out of line with all other public sector non-consolidated performance pay/bonus arrangements, and further considers the position once the Fair Pay Review is completed.

Pensions

36. The Panel suggests that the Scottish Government recognises that changes to the current public sector pension arrangements are essential and almost certainly unavoidable and that it should engage proactively with the work of the Independent Public Services Pensions Commission.

Workforce planning

37. The Panel 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.

CHAPTER 5: UNIVERSAL SERVICES

CONCLUSIONS

38. The operation of free or subsidised public services on a near universal basis over the last 10 years has benefited a wide range of people, including those who might have had the resources to fund them themselves. Unfortunately, demography and other drivers are expected to continue to stimulate demand and inflate costs to levels which appear to be unsustainable. The issue is not one of desirability, but of affordability.

39. There is a pressing need to review the current approach in order to reduce future inflationary cost pressures and to ensure a more sustainable approach to funding. The Panel considers that there is scope to look again at eligibility, as well as the selective introduction of means testing and user charging for all universal services. This will help to ensure that public services are focused on those with greatest need as well as helping to control future costs.

40. The Scottish Government should build on the indicative analysis of universal services in this chapter 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 in greatest need. The scale of the savings has the potential to make a significant contribution to filling the projected funding gap.

RECOMMENDATIONS

41. 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.

42. In addition, the Panel suggests that the Scottish Government should encourage all public sector bodies to examine the potential for additional income generation by reviewing the level of charges within their scope or by introducing new charges.

43. The Panel suggests that the Scottish Government should consider taking immediate action to review eligibility criteria for the Scotland-Wide Free Bus Travel Scheme for Older and Disabled People, and to continue to work with the bus operators to manage costs in the longer term.

44. The Panel suggests that the Scottish Government should consider building on its current consultation on *Reshaping Care for Older People* with a view to taking early action to review eligibility criteria for free personal and nursing care.

45. The Panel suggests that the Scottish Government and Parliament should consider suspending the final stage of the planned reduction in prescription charges and take early action to consider charging for non-exempt groups.

46. The Panel suggests that the Scottish Government and Parliament should consider immediate action to review eligibility for free NHS eye examinations and to continue to work with the optical profession to identify any further action needed to control costs.

47. The Panel welcomes ongoing work to target free school meals to improve health and to tackle poverty, and looks to the Scottish Government and Parliament to continue to monitor the impact of this policy.

48. In relation to tuition fees the Panel recognises the importance of the Browne Review and the implications it may have for higher education in Scotland. It also recognises that the appropriate time to take action in Scotland is once the outcome of the Review is known. In that context, the Panel suggests that the Scottish Government and Parliament should consider whether to maintain the current funding arrangements or to implement a scheme similar to that in England, such as tuition fees, or other alternative arrangements such as graduate contributions.

CHAPTER 6: CAPITAL

CONCLUSIONS

49. The Panel views the predicted contraction in the Scottish Government's Capital DEL budget with concern given the backlog identified by Audit Scotland and the vital role of capital spending in supporting economic recovery and enhancing Scotland's longer-term prosperity. To address this, it will be important to explore all available routes to resource and manage the capital programme.

50. The Scottish Government faces significant challenges in managing its capital programme, including the need to prioritise capital spending that delivers the greatest boost to economic growth. In seeking to address these challenges the Scottish Government should consider a central role for the Scottish Futures Trust in addressing the significant task of prioritising and maximising benefit from the capital investment programme.

51. The Panel was struck by the weight of opinion regarding the current position of Scottish Water and concludes that the Scottish Government and Parliament should urgently review the status of Scottish Water with a view to realising the substantial financial benefits which could arise from a change of status.

52. In that context, the Panel believes that there is at least one alternative route, that of a public interest company (similar to Welsh Water), which could permit the release of significant capital to the Scottish Government for other projects while allowing the attraction of private investment and the return of any surplus to the public benefit.

RECOMMENDATIONS

53. The Panel suggests that prioritisation of the key strands of capital expenditure, including essential maintenance, should be guided by national priorities and coordinated to ensure that maximum strategic coherence and public value is derived.

54. In that context, the Panel suggests that the Scottish Government should consider:

- enhancing the role of the Scottish Futures Trust to allow it to lead improvements in capital procurement. Savings derived from better capital procurement should be recycled into additional capital investment;
- tasking the Scottish Futures Trust, in a development of its submission to this Review, to assess and report upon the potential and practicality of all the available financing options to sustain capital spending at levels supportive of economic recovery and consistent with the Government's longer-term strategic objectives;
- developing the role of the Scottish Futures Trust to establish a centre of expertise in the ownership, management and disposal of public assets. This would operate as a source of independent advice for all public bodies and ensure maximum value for the public purse.

55. The Panel suggests that the Scottish Government should take steps now to explore, in liaison with HM Treasury, options for changing the status of Scottish Water that could permit the release of significant capital to the Scottish Government for other projects, while allowing the attraction of private investment and the return of any surplus to the public benefit.

56. The Panel suggests that the Scottish Government should consider the feasibility of adopting road user charging as a means to both better managing the use of the existing transport networks and financing improvements to those networks.

CHAPTER 7: SHAPING THE FUTURE

57. The Panel concludes that the developing response to future challenges needs to be set in a more strategic, longer-term framework, and Parliament must provide the essential leadership in shaping the future of our public service delivery.

58. The Panel also 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 and scrutiny role.

CHAPTER 1

INTRODUCTION



Challenges and choices

BACKGROUND

1.1 On 3 February this year, the Cabinet Secretary for Finance and Sustainable Growth, John Swinney MSP, announced the Scottish Government's intention to commission an independent review of public expenditure in Scotland. This decision was made as part of the Scottish Budget process for 2010-11.

1.2 The Review has been undertaken by a Panel¹ of three – Crawford W Beveridge CBE (Chair), Sir Neil McIntosh CBE and Robert Wilson – supported by a small secretariat.

1.3 The Independent Budget Review is intended to inform public and Parliamentary debate ahead of the next UK Spending Review (SR2010)², which is due to conclude by 20 October 2010, about the key challenges and choices that will exist in a significantly constrained public spending environment.

1.4 The next Spending Review will mark a watershed for public services:

"We are in for a long hard financial winter, which will require very difficult choices to be made about priorities."

Robert Black, Auditor General for Scotland, letter to the Chair of the Independent Budget Review Panel (June 2010)

1.5 Though the timeframe for some decisions is very short, the Panel believes strongly that the choices to be made should reflect a medium to longer term view of the priorities for Scotland's public services. Debate on these matters is critical and should be as far-reaching and as open as possible.

Changed budget pattern

1.6 Since Devolution, the budget for the Scottish Government and Parliament has risen rapidly in real terms, but is now projected to fall throughout the term of the next Scottish Parliament and beyond. These expected reductions are largest next year but their impact will extend into the medium to longer term.

1.7 The Panel has considered the implications of the projected budget reductions and this report presents an informed and dispassionate view of the practical options available to those who will determine how the Scottish budget is allocated.

1.8 Given the short timeframe of the Review (five months), the perspective it takes is consequently relatively high level. Explaining the current economic and fiscal situation was not part of the remit, and the Review was not intended to be a spending-line-by-spending-line examination or functional analysis of the entire Scottish budget.

1 Short biographies for the Panel are available on the Review's website: www.independentbudgetreview.org.

2 SR2010 will set spending limits, known as Departmental Expenditure Limit (DEL) budgets, for every Government department, including the Scottish Government, for the four-year period: 2011-12, 2012-13, 2013-14 and 2014-15.

1.9 Although outwith its remit, the Panel did consider modelling the financial consequences of the various choices outlined in this report. However, given the number of variables and the potential number of option combinations, it very quickly became clear that this task was not achievable. Instead, the report provides some high-level, indicative figures to aid perspective. As such, the financial figures should be regarded as directional rather than absolute and much more detailed financial modelling will have to be done in taking decisions on the various options.

1.10 The focus in this report is a balance between choices that are applicable across the public sector and some more detailed sectoral opportunities. Again, given the timescale and resource constraints, the Review has not attempted to examine every issue in every segment of the DEL Budget. In terms of quantifying the scope for savings, the Review deals principally with the next four years though the Panel acknowledges that the challenges will persist through the medium to longer term.

Aims of the review

1.11 The remit of the Review³ states that it should consider:

- the implications of forecasts of reductions in public spending in Scotland in the short and medium term for the patterns of public spending that have developed since the establishment of the Scottish Parliament;
- the implications of these forecasts on spending programmes with a view to ensuring the long term sustainability of public spending in Scotland; and
- make recommendations about the options for delivering public services within the constrained public expenditure environment in Scotland.

1.12 The Review includes within its scope all classes of expenditure over which Scottish Ministers have control and which are included within the Scottish Government's Departmental Expenditure Limit (DEL) budget. However, the remit of the Review does not include consideration of options for increased fiscal powers for Scotland or any other matters for which responsibility is not devolved to the Scottish Government and Parliament.

Impacts on people

1.13 The Panel is conscious that the next Scottish Budget will have serious consequences for organisations, communities and individuals across the length and breadth of Scotland.

1.14 Many people in Scotland rely heavily upon, and greatly value, the public services they receive. The livelihoods of hundreds of thousands of Scottish households depend on employment in the public sector and the jobs supported by public expenditure. For these reasons, great care must be exercised in

3 See Annex A. The remit was published on 3 February 2010 as one of the Budget Bill 2010-11 documents:
www.scotland.gov.uk/Topics/Government/Finance/18127/independent-review.

determining priorities and allocating resources. However, it is inevitable that difficult decisions on tough choices will have to be made with some unfortunate consequences.

CONTEXT FOR THE REVIEW

1.15 The Review is set in a particular context that is highly challenging and dynamic. In the brief timeframe for the Review a number of significant developments have occurred, including a Westminster election and the formation of a new Coalition Government in London, a UK emergency Budget in June, and the unfolding of a major government debt crisis within the Eurozone.

1.16 At the same time, enduring background influences such as demographic shifts and climate change are gradually building new pressures on public services.

1.17 As Scotland's private sector economy begins to recover from recession, the public sector is braced for a substantial contraction in resources. The scale of the public expenditure challenge that Scotland will face over at least the coming four years, under a generally accepted but not unchallenged set of assumptions,⁴ is unmatched since the Second World War.

Economic outlook

1.18 The macroeconomic environment is no less challenging than the fiscal outlook. While all of the world's major economies have now emerged from recession, technically at least, the global economic recovery is far from complete and the near-term economic outlook, in particular, remains decidedly fragile.

1.19 Scotland's economy is growing and is forecast by the Fraser of Allander Institute (FAI)⁵ to strengthen, albeit modestly, to an annual rate of 1.1 per cent in 2011 and 2.1 per cent in 2012. However, this projected upturn in output is unlikely to be of sufficient strength to provide much impetus to employment. The FAI's latest *Economic Commentary* shows that unemployment (ILO⁶ measure) is expected to peak at 228,000 or 8.9 per cent in 2010 before falling to just under 224,000 or 8.7 per cent in 2011 and further to 211,000 or 8.1 per cent in 2012.

Budgetary outlook

1.20 Estimates provided to the Panel by the Scottish Government's Chief Economic Adviser,⁷ which are based on analysis of the June 2010 UK Budget, indicate that the resources controlled by the Scottish Government are projected

4 Professor Arthur Midwinter of the University of Edinburgh, for example, challenged in his submission to the Review the forecasts quoted in the Review's Initial Call for Contributions document.

5 *Economic Commentary, Vol 34 No 1*, Fraser of Allander Institute (June 2010).

6 International Labour Organization.

7 *Outlook for Scottish Government Expenditure - June 2010 Emergency Budget Update*, Dr Andrew Goudie, Chief Economic Adviser, Scottish Government (July 2010) www.scotland.gov.uk/Topics/Economy/17858/ScotGovExp

to fall by 3.3 per year on average in real terms over the next four years.⁸ In total, the purchasing power of the Scottish Government's DEL budget is expected to be cut by £3.7 billion or 12.5 per cent over the next Spending Review period to 2014-15.⁹

1.21 These projected reductions are largest in the first year of the new Spending Review period (£1.2 billion in cash terms or £1.7 billion in real terms in 2011-12¹⁰), when the reduction of £332 million in the Scottish budget, which was postponed by one year, takes effect.¹¹

1.22 Looking beyond the next Spending Review period, the analysis published by the Chief Economic Adviser suggests that real terms budgets are set to decrease until 2015-16 and may not climb back to their 2009-10 level in until around 2025-26. These projections are reviewed in greater detail in the next chapter.

Financial assumptions

1.23 The Panel decided for the sake of consistency and comparability to operate within the same set of financial assumptions as are used by the Scottish Government, based on advice from the Chief Economic Adviser.

1.24 The Panel appreciates the difficulty of making accurate public finance predictions for the medium term, as all forecasts are sensitive to a range of factors that change significantly over time, and is conscious too that there are alternative views concerning the fiscal outlook.

1.25 The Panel makes no comment on the basis on which Scotland's devolved budget is set or the decisions made as to the proper balance between increasing taxation and reducing spending to address the UK structural budget deficit, since, as stated earlier, such matters are beyond the remit of the Review.

The political dimension

1.26 The Scottish electoral cycle is another important background factor to the Review. The Panel is conscious that elections to the Scottish Parliament will take place in less than a year from now, in May 2011 (to be followed in 2012 by elections for Scottish local authorities). This electoral timetable will inevitably influence the atmosphere of debate around the shape of future budgets and the forward direction of public services.

8 These figures are estimates supplied by the Scottish Government. Precise Departmental Expenditure Limits for the next three years will be confirmed when SR2010 is published in October 2010.

9 Compared with 2010-11 and calculated in real terms.

10 The 'real terms' figures have been adjusted to reflect the effects of inflation – that is, changes in general inflation as measured by the GDP deflator.

11 The £332 million, which is expressed in cash terms, arose from the UK Government's decision to make £6.2 billion of savings in 2010-11.

www.hm-treasury.gov.uk/psr_reducing_government_deficit.htm

1.27 The pre-election period, though a natural opportunity to debate matters of public policy, inevitably heightens the risk that short-term political imperatives polarise national discourse and exaggerate differences of approach. Given the seriousness of the current fiscal situation, and the high degree of consensus evident in representations to the Review, the Panel would strongly encourage the maximum degree of frankness and cross-party agreement about the scale of the problem, potential solutions and the necessity to act now.

1.28 There is a duty on Scottish Ministers, in particular, to be as clear as possible about the realities of the situation, to signal clearly national priorities and to convey the right degree of urgency. This point is made well in a recent paper from the Centre for Public Policy for Regions (CPPR),¹² which highlights the front-loaded nature of the budget cuts and emphasises how important it is that the Scottish Government should communicate a transparent chain of reasoning to link early actions for 2011-12 with the path to the longer term.

1.29 Being mindful of political realities, and in the context of the current financial situation, the Panel would counsel against the over use by all political parties of input targets and guarantees in pre-election statements and manifestos. Such statements can create an unhelpful focus on inputs rather than outputs and outcomes.

APPROACH TO THE REVIEW

1.30 The Panel has operated independently of the Scottish Government and in consultation with a wide range of individuals, organisations and representative bodies from across Scotland in forming its opinions. This section summarises the main steps taken in the Review process.

Way of working

1.31 As stated earlier, the Review was not intended to be a 'spending-line-by-spending-line' examination or functional analysis of the entire Scottish budget. However, the Panel believes that others with closer operational knowledge of delivery systems and the demands upon them need to take this essential task forward.

1.32 The thinking it presents aims to achieve four main objectives:

- (i) focus attention on those categories of planned spending where the Panel believes there is a realistic prospect of making adjustments in the near term to rein in spending;
- (ii) develop a set of practical options applicable across the public sector for delivering public services within reducing budgets;
- (iii) illustrate the potential scale, in approximate orders of magnitude, of those options and indicate the timescales over which savings might materialise; and

12 2011-12 – A Difficult Year for Scotland, CPPR (2010)
www.cppr.ac.uk/centres/cppr/analysisofthescottisheconomy/

Evidence gathering

- (iv) highlight ways to set the foundations for the medium to longer term sustainable future of Scotland's public services.

1.33 The Panel issued an initial Call for Contributions on 8 March 2010.¹³ As well as outlining the broad economic and financial context for the Review, the document included a framework of issues and key questions for respondents to consider.

1.34 The Panel received and has considered 97 written submissions from a wide range of organisations and individuals representing all sections of Scottish life. A list of those persons and bodies who made written submissions is provided at Annex C, and copies of the written submissions are available from the Review's website.¹⁴

1.35 From late March to early July, the Panel held meetings with 37 stakeholder groups or individuals, including representatives of all the political groupings within the Scottish Parliament, to follow up on points made in written submissions and to gather further information. These are listed in Annex B.

1.36 The Panel also engaged on an informal basis with the Finance Committee of the Scottish Parliament as part of its Budget Strategy Phase inquiry into the efficient delivery of public services. The Panel studied with interest the written and oral evidence which the Committee received and the detailed briefing papers prepared by the Committee's budget adviser, Professor David Bell of the University of Stirling, by the Parliament's Financial Scrutiny Unit and by the CPPR.

Learning lessons

1.37 The UK and Scotland are not alone at this time in facing the need to reshape public sector budgets and manage high levels of government debt. In the wake of the global recession, governments across the world have been dealing with falling tax revenues and higher social payments. Serious structural issues have emerged in several Eurozone economies (notably Portugal, Ireland, Italy, Greece and Spain) where we have seen a raft of austerity measures introduced to combat rising levels of sovereign debt.

1.38 The Panel has monitored these developments and studied the CPPR report on lessons learned from past fiscal consolidations produced for the Scottish Parliament.¹⁵ The CPPR report sets out a number of lessons, including: the importance of leadership, openness and transparency; the need to review universal service provision; and the need to not exempt any areas of expenditure from scrutiny.

¹³ www.scotland.gov.uk/About/IndependentBudgetReview/Resources/Contributions

¹⁴ www.independentbudgetreview.org

¹⁵ *Comparative government responses to recessions: lessons to be learnt from fiscal consolidations*, CPPR (April 2010) www.scottish.parliament.uk/s3/committees/finance/inquiries/budget/documents/CPPRbrief.pdf

Support and assistance

1.39 The Panel has worked through a great deal of material in producing this report, including accessing the large body of existing material on Scotland's public services covering earlier public sector reviews, Audit Scotland reports, academic studies, official reports and statistics.

1.40 In addition to this, the Panel received detailed information on current policy, costings and projections from the Scottish Government and the Convention of Scottish Local Authorities (COSLA). Relevant sections of this material are referenced and quoted throughout the report.

1.41 The Panel was fortunate to be able to draw from such a deep well of knowledge, evidence and expertise on Scotland's public services. This input has been invaluable, and the Panel is extremely grateful to all those who engaged so positively with the Review.



CHAPTER 2

PUBLIC SPENDING ENVIRONMENT



INTRODUCTION

2.1 This chapter summarises the financial context of the Review and, in particular, the scale of the budget challenge facing the Scottish Government over the period to 2014-15. Although the options discussed later in this report focus primarily on the next four years, the Panel is of the view that the challenges faced will be over a much longer timescale, possibly extending to the mid-2020s.

2.2 The sections below consider: the global nature of the fiscal crisis; the June 2010 UK Budget and its financial and economic implications for Scotland; the future distribution of the Scottish budget; sources of longer term budget pressures; and, lastly, the taxation options available to the Scottish Government and Parliament.

Scotland is not alone

2.3 A key point to emphasise at the outset is the global nature of the structural economic and financial adjustment currently in progress.

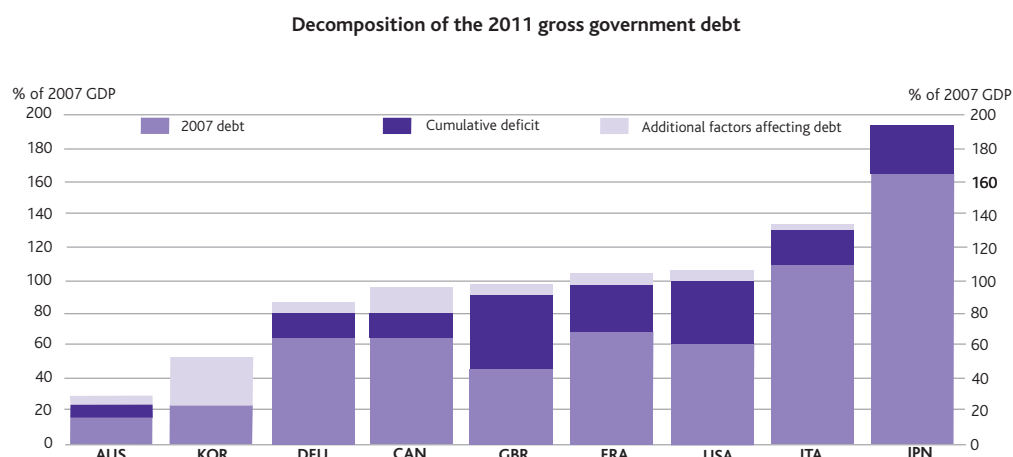
2.4 The worldwide recession that began in the United States in 2008 and quickly swept through global financial markets, threatening the collapse of several of the UK's largest banks, has created severe budgetary pressures for many governments (both national and regional).

2.5 Public sector deficits have risen sharply across developed economies due to a combination of the introduction of fiscal stimulus measures, higher social payments (e.g. unemployment benefits) and falling tax revenues. The UK entered the recession with a relatively low stock of national debt (see Figure 2.1 below) but has accumulated additional public debt at a faster rate than any other advanced economy except Iceland and Ireland.¹

2.6 Debate within academic and political circles about the appropriate timing of the change of stance from one of fiscal stimulus to fiscal consolidation has been vigorous (including at the recent G20 summit in Toronto). Affected governments have to balance the risks of withdrawing stimulus too early, thereby undermining the recovery, against the alternative risk of a loss of a market confidence, which could result in higher interest rates and ballooning debt repayments.

2.7 Doubts about the ability of national governments in countries such as Greece, Spain and Portugal to meet their debt servicing obligations mean that they have been effectively forced by the financial markets to adopt austerity measures. Others countries like the UK and Ireland have chosen to take more voluntarily action to rein in their budget deficits and pre-empt negative market sentiment.

¹ Reflects changes in the gross debt ratio between 2007 and 2010 (*OECD Economic Outlook*, May 2010).

Figure 2.1 Government indebtedness

1. Refers to 2011 debt minus the sum of 2007 debt and the cumulative deficit for 2008-11 and includes debt-increasing equity participation in companies.

Source: OECD Economic Outlook database.

BACKGROUND

2.8 The Chancellor of Exchequer, George Osborne MP, confirmed in the June 2010 UK Budget² that, in the view of the new Coalition Government, the balance of risks for the UK economy at this stage points clearly towards a very substantial fiscal consolidation:

“The most urgent task facing this country is to implement an accelerated plan to reduce the deficit. Reducing the deficit is a necessary precondition for sustained economic growth. To continue with the existing fiscal plans would put the recovery at risk, given the scale of the challenge.”

Budget 2010, HM Treasury (June 2010)

Fiscal consolidation

2.9 The UK Budget, published in June 2010, announced an additional £40 billion of fiscal consolidation per year by 2014-15 – on top of that announced by the previous Government in the March 2010 UK Budget. The bulk of this extra fiscal tightening (80 per cent or £32 billion per year) will be achieved through spending reductions with the remaining 20 per cent achieved through tax rises, including an increase in the main rate of Value Added Tax (VAT) to 20 per cent.

2.10 Taking the UK Budgets of March and June 2010 together, the combined consolidation is £113 billion per year by 2014-15 and £128 billion per year by 2015-16, of which £99 billion per year comes from spending reductions and £29 billion per year from net tax increases.³ The scale of the impending spending reductions is unmatched in the period since the Second World War:

² *Budget 2010*, HM Treasury (June 2010)

www.hm-treasury.gov.uk/junebudget_documents.htm.

³ *ibid.*

"In total, the cut in central government public services spending as a share of national income now planned by the Coalition will more than reverse the entire increase we saw under Labour. We are looking at the longest, deepest sustained period of cuts to public services spending at least since World War II."

Robert Chote, Institute for Fiscal Studies, post-Budget presentation (June 2010)

Tackling the structural deficit

2.11 The first Budget of the new UK Coalition Government was designed principally to reduce the UK's structural budget deficit, which is the second highest of the OECD⁴ economies, and to eliminate it completely by 2014-15.

2.12 The structural deficit captures the element of government borrowing that will not be eliminated by economic recovery. Addressing this issue, Robert Chote, Director of the Institute for Fiscal Studies (IFS), has pointed out that the UK's structural deficit:

"...would be impervious to economic recovery and would put public sector debt on an unsustainable path if left unaddressed."

Robert Chote, Institute for Fiscal Studies, post-Budget presentation (June 2010)

UK spending limits and protected budgets

2.13 The precise implications of the UK fiscal consolidation for Departmental Expenditure Limits (DEL), including the Scottish Government's DEL budget, will not be known until the UK Spending Review concludes on 20 October 2010.

2.14 The June 2010 UK Budget did, however, set the overall total for public expenditure for the Spending Review period and restate the UK Government's commitment to protect budgets for health and overseas aid. The Chancellor's Budget Statement committed the UK Government to "*providing the National Health Service with real increases throughout the Parliament*" and also made reference to "*particular pressures*" within the education system and defence, which might imply that those areas of expenditure will also be less exposed to budget reductions.

2.15 The protection of the health budgets means that non-protected Whitehall Departments could see average real terms cuts to their budgets of around 25 per cent over the next four years.⁵ Had the UK Government instead chosen to implement an even pattern of reductions across Whitehall Departments, then each would be in line for consistent cuts of around 14 per cent.

2.16 Health spending accounts for around one-third of the Scottish budget, compared with around one-sixth of UK Government spending. The Panel notes that the UK Government's decision on health spending, if applied through the operation of the Barnett formula, would provide some cushioning for Scottish DEL.

4 OECD *Economic Outlook No.87*, OECD (May 2010).

5 *Budget 2010*, HM Treasury (2010), page 17.

Capital budget

2.17 The June 2010 UK Budget forecast that capital expenditure is set to contract sharply during the SR2010 period, though there will be no further reductions to Capital DEL above those announced in the March 2010 Budget. UK Capital DEL is expected to fall by 32 per cent in real terms by 2014-15 or an average of 9.1 per cent per year in real terms between 2011-12 and 2014-15.

OUTLOOK FOR THE SCOTTISH BUDGET

2.18 The Scottish Government's Chief Economic Adviser provided the Review with an updated *Outlook for Scottish Government Expenditure* in early July 2010, to replace the previous analysis published shortly after the March 2010 UK Budget.⁶ The key elements of this updated analysis have been used by the Panel to inform its thinking on the scale of the financial challenge and the options for response.

Updated projections

2.19 This updated analysis takes account of the accelerated fiscal consolidation outlined in the June 2010 UK Budget and presents projections for the Scottish Government's DEL budget over the SR2010 period and for the medium term. It concludes that while the path of adjustment is similar to that described in the April *Outlook* the latest analysis:

"... suggests a significantly deeper contraction in Scottish DEL expenditure, followed by a more protracted recovery than previously estimated."

Outlook for Scottish Government Expenditure, Office of the Chief Economic Adviser (July 2010)

2.20 The projections contained in the updated *Outlook* are based on the spending plans of the June 2010 Budget and the forecasts of the independent Office for Budget Responsibility. As previously stated, although final DEL allocations will not be known until the SR2010 concludes on 20 October 2010, the broad implications for Scotland can be projected now.

2.21 The latest projections published by the Chief Economic Adviser (summarised in Table 2.1 below) suggest that:

- the Scottish budget in real terms will contract for six consecutive years from 2010-11;
- total Scottish Government DEL expenditure (current and capital) will decrease by 3.3 per cent per year on average in real terms over the next four years – with the bulk of the expected adjustment occurring in 2011-12;
- the Scottish budget will contract by 12.5 per cent in real terms by 2014-15 compared with 2010-11;

⁶ *Outlook for Scottish Government Expenditure*, Dr Andrew Goudie, Chief Economic Adviser, Scottish Government (July 2010).

- by the end of the SR2010 period in 2014-15, the Scottish budget will be approximately £4.3 billion below its 2009-10 peak in real terms;
- Scottish Government Capital DEL is set to fall by £1.6 billion, around 40 per cent, in real terms between 2009-10 and 2014-15; and
- it may take 16 years (to 2025-26) for the Scottish Government's total budget to return to its 2009-10 levels in real terms.

2.22 While these projections represent an illustration of a possible future path for Scottish Government spending, the Panel accepts that, due to variety of factors, the eventual outcome may differ substantially from these initial projections. Three alternative scenarios were considered in the Chief Economic Adviser's updated analysis, though the report notes that varying the underlying assumptions *"does little to change the key messages that arise from the analysis."*

Reductions front- loaded

2.23 The projected reductions in the Scottish budget are largest in the first year (2011-12) of the SR2010 period, at £1.2 billion in cash terms (down 4.1 per cent) and £1.7 billion in real terms (down 5.9 per cent). The Chief Economic Adviser's report suggests the size of the decrease in 2011-12 reflects a combination of the following:

- the pattern of the UK Government's deficit reduction plan;
- the Scottish Government's decision to defer for a year its share of the UK Government's £6.2 billion in spending cuts implemented in 2010-11;
- the reduction in the 2011-12 baseline as a consequence of the UK cuts in 2010-11; and
- the assumption made in the analysis that no end-year flexibility is drawn down in 2011-12.⁷

Capital

2.24 Table 2.1 shows that the Scottish Government's projected Capital DEL budget falls in real terms in 2011-12 alone by £700 million to £2.6 billion and by 28 per cent by 2014-15, compared with 2010-11. The projections for capital expenditure, their implications and possible options in response, are considered in Chapter 6.

⁷ End-year flexibility (EYF) is a system that allows the carry forward of any unspent resources from one year to the next.

Table 2.1

Projections for the Scottish Government's Total DEL Budget ¹								
	SR2007		Projections for Spending Review 2010 Period					
	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2010-11 to 2014-15	
							Changes	% change ²
Projected DEL Budget (£ billion) – <u>cash terms</u>	29.1	29.2	28.0	28.2	28.1	28.1	-£1.1bn	-3.9%
Current	25.2	25.9	25.4	25.5	25.6	25.5	-£0.4bn	-1.7%
Capital	3.9	3.3	2.7	2.7	2.5	2.6	-£0.7bn	-21.3%
Projected DEL Budget (£ billion) – <u>real terms</u>	29.9	29.2	27.5	27.1	26.3	25.6	-£3.7bn	-12.5%
Current	25.9	25.9	24.9	24.5	23.9	23.2	-£2.7bn	-10.5%
Capital	4.0	3.3	2.6	2.6	2.4	2.4	-£0.9bn	-28.4%

Source: Scottish Government

¹ The table presents projections taken from the Chief Economic Adviser's analysis of the June 2010 UK Budget.

² This column shows percentage changes between the provisional outturn for 2010-11 and the projected budget for 2014-15. The percentages have been calculated on unrounded numbers.

DISTRIBUTION OF THE SCOTTISH BUDGET

Ring-fencing health in Scotland

2.25 Scottish Government Ministers have committed to pass on the consequential arisings from the any real terms increase in UK health spending to health spending in Scotland:

"If there is a real-terms increase in the health budget south of the border, as envisaged in the coalition agreement, we will pass on the consequential to health in Scotland."

Cabinet Secretary for Finance and Sustainable Growth,
Scottish Parliament Finance Committee, 18 May 2010

2.26 As previously stated, because NHSScotland accounts for approximately one-third of the Scottish Government's total DEL (compared with one-sixth of total UK DEL), any decision to 'protect' it from reductions will have significant consequences for all 'non-protected' budgets.

2.27 If the Scottish health budget (i.e. the health element of the Health and Wellbeing Portfolio) is assumed to increase at the projected rate of inflation,⁸ the budget for non-health spending could decline by 10 per cent in real terms in 2011-12 and by 20 per cent by 2014-15, compared with 2010-11.

⁸ Based on the GDP deflators published with the June 2010 UK Budget.

2.28 Table 2.2 shows the effects of holding health spending constant in real terms compared with the alternative of an even pattern of reductions across all spending. Readers should note that these figures, which are consistent with the projections in the Chief Economic Adviser's updated *Outlook*,⁹ are purely illustrative and are provided here to indicate the approximate orders of magnitude only.

Table 2.2

Projections for the Scottish Government's DEL Budget: Percentage Changes Compared to 2010-11 (real terms) ¹				
	2011-12	2012-13	2013-14	2014-15
Changes in projected DEL budgets if distributed evenly across spending areas				
Total DEL	-5.9%	-7.5%	-10.2%	-12.5%
Current expenditure	-4.0%	-5.5%	-7.8%	-10.5%
Capital expenditure	-21.3%	-22.8%	-29.0%	-28.4%
Changes in projected non-health DEL, if health spending is held constant in real terms				
Total non-health DEL	-9.6%	-12.1%	-16.4%	-20.2%
Non-health current expenditure	-6.7%	-9.3%	13.1%	-17.6%
Non-health capital expenditure	-26.1%	-27.9%	-35.4%	-34.7%

Source: Scottish Government

¹ Note: The percentage changes in this table are cumulative – i.e. they are not year-on-year changes.

Given the scale of the reductions that would otherwise have to be met from 'non-protected' areas of public services, the Panel would strongly advocate as an option an approach which would not have an over-riding presumption of whole segment 'protection', but which would instead be built upon all services being subject to scrutiny and comparative prioritisation in the allocation of resources.

If, however, 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.

9 *Outlook for Scottish Government Expenditure*, Office of the Chief Economic Adviser (July 2010).

Impacts of the budget projections

EMPLOYMENT IMPACTS

2.29 The large projected reductions in Scotland's DEL budget resulting from the June 2010 Budget, if realised, would generate significant knock-on effects for output and employment across the Scottish economy, in both the public and private sectors.

2.30 The Fraser of Allander Institute (FAI) has modelled these potential impacts and reported the results in the June 2010 *Economic Commentary*.¹⁰ The FAI's analysis is based on a predicted real terms decrease in the Scottish Government's budget of 14 per cent by 2014-15, which is above the projected reduction of 12.5 per cent reported in Table 2.2.

2.31 The FAI's modelling of the economic impacts of the expected changes in the Scottish budget is divided into two simulations that reflect different scenarios about how flexibly wages and output prices respond to changes in demand. The report notes that these two cases can be viewed as defining the "*likely limits of the economy-wide impacts.*"

2.32 In the first simulation there are "*up to 126,000 economy wide job losses by 2014-15 comprising up to 90,000 in the public sector and 37,000 private sector job losses.*"¹¹ However, in the second simulation where wages and output prices respond flexibly to changes in demand:

"... there will be a 'crowding-in' effect as private sector activity, especially, benefits from improved competitiveness. In these circumstances of flexible wages and prices the shock will reduce jobs in the public sector by the slightly lower number of just under 78,000 while private sector employment rises by nearly 14,000. The overall job loss is thus just above 64,000, about half that in the fixed-price case. There is a 'crowding in' effect on the private sector, but it is insufficient to offset the loss of activity in the public sector."

Fraser of Allander Economic Commentary (June 2010)

LONGER-TERM PROSPECTS

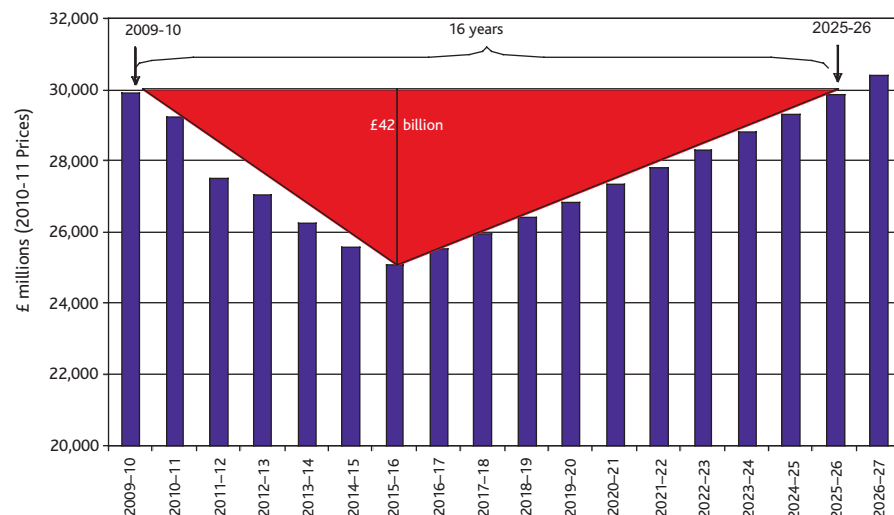
2.33 The Panel is of the view that the budgetary challenges facing the Scottish Government and Parliament will extend beyond the next four years and possibly into the mid-2020s. Analysis produced by the Scottish Government's Chief Economic Adviser¹² suggests that it may take 16 years (to 2025-26) for the Scottish Government's total budget to return to its 2009-10 levels in real terms.

¹⁰ *Economic Commentary*, Vol 34 No 1, Fraser of Allander Institute (June 2010).

¹¹ These employment numbers relate to the whole public sector in Scotland, both devolved and non-devolved services.

¹² *Outlook for Scottish Government Expenditure*, Office of the Chief Economic Adviser (July 2010).

Figure 2.2 Estimated Scottish Government DEL Expenditure – June 2020 Budget Results (2010-11 Prices)



Source: Scottish Government calculations

2.34 Over the time horizon of Figure 2.2, the demands on public services will not be static. The Scottish budget will have to bear significant cost pressures in future years from, for example, new and existing policies to address statutory climate change targets, rising demand for existing universal services (unless action is taken to control their costs) and the costs of supporting an expanding elderly population.

Climate change

2.35 The Climate Change (Scotland) Act 2009 established in statute a target to reduce by 2020 emissions harmful to the environment to 42 per cent below their 1990 levels. This target is widely acknowledged to be extremely ambitious by international standards and it will have significant implications for the whole economy, including public sector budgets:

“Scottish Government funding of action to achieve our emissions targets would, at a time of overall budget reductions, inevitably result in an impact on available spend across all portfolios.”

Scottish Government’s written response to a question from the Review Panel

2.36 A great deal of uncertainty still surrounds the likely costs of meeting the Government’s climate change targets, which could potentially amount to in the order of £8 billion by 2022.¹³ The final costs will depend on the development of the policy framework to deliver the requirements of the Act, which has yet to be finalised.

¹³ Scottish Government estimates provided to the Independent Budget Review.

Demography

2.37 The age-profile of the Scottish population is changing. A document published by the Scottish Government earlier this year confirmed that the population aged 65 and over:¹⁴

"... is estimated to increase by 21 per cent between 2006 and 2016, and will be 62 per cent bigger by 2031. For those aged 85 and over, the population will rise by 38 per cent by 2016 and 144 per cent by 2031. This is particularly significant, as the need for care is far greater among the over 85 population."

Reshaping Care for Older People, Scottish Government

2.38 The same report notes that *"around £4.5 billion was spent in total on health and social care for people aged over 65 in 2006-2007"* and says that if we continue to provide services in the same ways *"this figure will need to increase by £1.1 billion by 2016, and by £3.5 billion, or 74 per cent, by 2031."*

TAXATION

2.39 Although consideration of income tax lies beyond the scope of this Review, the Panel understands that some representative organisations, notably the STUC and UNISON Scotland, take the view that the answer to the budgetary challenge Scotland and the rest of the UK faces might be addressed by increasing taxes rather than by reducing spending:

"The debate about the future of public services needs to face up to the fact that good services cost money. We need to be mature about how we raise that money in terms of both fair taxation and a fair charging regime that reflects local priorities. Cutting public services is not the only way to cut debt: raising taxes for those who can afford to pay more and clamping down on tax avoidance will also reduce the deficit."

UNISON Scotland, submission to the Independent Budget Review

Scottish variable rate of income tax

2.40 There is no reason, in principle, why the Scottish variable rate of income tax (which has not been invoked since provisions to establish it were included in the Scotland Act 1998) could not be used by the Scottish Government to increase its available resources.

2.41 The previous UK Government's March 2010 Budget included the statement: *"A one penny change in the Scottish variable rate (SVR) could be worth approximately plus or minus £350 million in 2010-11 and plus or minus £400 million in 2011-12."*¹⁵ In practical terms, however, the SVR could not be used to relieve budgetary pressures in 2011-12 as there would be a lead-in time of at least one tax year before the powers could be used.

¹⁴ *Reshaping Care for Older People*, Scottish Government (March 2010)

www.scotland.gov.uk/Topics/Health/care/reshaping/reshapingcarebooklet

¹⁵ *UK Budget 2010* (previous administration), page 123, HM Treasury (March 2010).

2.42 The Panel also heard the contrary view, that to increase income tax in Scotland alone would be a mistaken policy. Business organisations, for example, emphasised the possible effects on Scotland's competitiveness at a time of faltering recovery:

"We remain opposed to the use of Scotland's tax-varying power because of the additional cost and complexity that would be placed on employers. If the Calman Report is adopted by the UK government, we would support the devolved ten pence income tax rate remaining on a par with the rest of the UK but we would oppose any increase because Scotland's tax competitiveness would deteriorate."

CBI Scotland's response to the Scottish Government's consultation on its draft budget for 2010-11 (October 2009)¹⁶ provided to the Independent Budget Review as part of CBI Scotland's written submission

Council tax freeze

2.43 The council tax freeze was intended, when announced in 2007, to be a short-term measure pending the introduction of a new system of local taxation. No such new system has been introduced.

2.44 Although council tax revenues do not form part of the Scottish Government's DEL or AME¹⁷ budgets, the cost of compensating local authorities for the revenues forgone as a result of their annual decision to freeze council tax is met from the Scottish Government's DEL budget.¹⁸

2.45 Average Band D council tax levels in Scotland stand at £1,149 in 2010-11 (as in the previous two years), compared with £1,439 in England (an increase of 1.8% over 2009-10) and £1,127 in Wales (an increase of 3.6% over 2009-10).¹⁹ Band D council tax levels in Scotland are therefore some 20 per cent lower than in England.

2.46 The £70 million annual increase in the compensation councils currently receive from the Scottish Government equates to an annual increase in council tax bills of around 3.7 per cent (compared with an increase in the Consumer Prices Index in the year to May 2010 of 3.4 per cent).

¹⁶ www.cbi.org.uk/pdf/20091001-cbi-scotland-response-to-scottish-govt-draft-budget-2010-11.pdf

¹⁷ Annually Managed Expenditure.

¹⁸ Scottish Local Government Financial Statistics 2008-09, Scottish Government (March 2010) www.scotland.gov.uk/Publications/2010/03/23110606/18.

¹⁹ Council Tax 2010-11, House of Commons Library Standard Note SN/SG/5431 (March 2010) www.parliament.uk/briefingpapers/commons/lib/research/briefings/snsg-05431.pdf.

Effect of a continued freeze

2.47 If the council tax freeze were to continue until the end of the next Spending Review period in identical terms to that agreed for 2008-09 (with annual compensation of some £70 million per year), then the cost to the Scottish Government in its budget for 2014-15 would be some £490 million.

2.48 If the freeze were to be removed, it appears likely that its cumulative cost would need to be crystallised at current levels as part of the local government settlement, otherwise councils would be exposed to a large fall in income.

"Council Tax has been frozen for the last 3 years, resulting in £210 million being committed within the Scottish budget. In order to avoid a reversal of the cumulative impact of this freeze, the funding would have to remain within the Local Government settlement on an ongoing basis. Without the ability to raise Council Tax and the existing limits placed on other charges, the potential for local government to raise significant amounts of additional income is very limited."

City of Edinburgh Council Officers, submission to the Independent Budget Review

2.49 The Panel heard that the freeze had effectively restricted councils from fully accessing a source of finance that could have been devoted to local priorities:

"Directors of Finance support a stable and collectable local tax which is determined locally by individual councils. The capacity to increase council tax to help protect services and jobs should be considered."

CIPFA Directors of Finance Section, submission to the Independent Budget Review

"The freeze on council tax reduces the discretion and control local authorities have over their budgets and funding, and in light of the financial challenge faced, removes significant sums that would otherwise be available to support public services."

The Highland Council, submission to the Independent Budget Review

"While the current council tax freeze has helped consumers in the downturn, it limits the ability of local government to manage effectively local needs, services and demands, particularly given the growing financial constraints from national government."

Scottish Council for Development and Industry, Evidence to the Scottish Parliament Economy, Energy and Tourism Committee Budget Strategy Inquiry (April 2010)²⁰

20 www.scottish.parliament.uk/s3/committees/eet/inquiries/Budget%202011-12/SGB-SCDIScottishBudget.pdf

2.50 COSLA also agreed that serious consideration would need to be given to the future of the council tax freeze, emphasising the need to consider, in the round, the opportunity costs of such a decision and its effect on policy choices:

"Given the financial forecasts, one of the obvious areas for Local Government to generate more funding is through the council tax. The Panel will be aware that councils have frozen council tax over the last three years as part of an agreement around funding with the Scottish Government. No such agreement is in place going forward and therefore COSLA believes that any discussions involving council tax into the future must be included as part of the overall policy debate to take place. It is legitimate to make policy choices around council tax but this should only be done with the full understanding of the implications and opportunity costs of taking such decisions."

COSLA, submission to the Independent Budget Review

2.51 The Panel finds these arguments persuasive.

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.

CONCLUSIONS

2.52 Whilst noting the debate and difficulties surrounding the accuracy of economic forecasting, the Panel is of the opinion that the projections of the Chief Economic Adviser are indicative of both the direction of travel and the scale of the challenge for public spending in Scotland.

2.53 In attempting to achieve a better balanced public sector spending position, the options for increasing revenue (for example through increased taxation) and reducing public sector expenditure will need to be carefully balanced, not least to avoid damaging economic recovery.

2.54 In reaching this balance, difficult decisions on competing resource demands will need to be made. These will include whether or not to utilise potential revenue increasing powers and ring-fence funding to certain areas, and how to handle current emerging pressures, such as those resulting from demography and climate change.

CHAPTER 3

EFFICIENCY



INTRODUCTION

"Making efficiency savings is not new and it may be that those efficiency savings that are relatively easy to achieve have been realised already. The whole public sector needs to be considered in any new approach. Excluding any specific sector, policy area or services from the requirement to deliver services more efficiently represents a missed opportunity and could significantly increase the pressure for other spending areas to find savings. This means that new approaches need to be considered, including service redesign, more joint working and collaboration."

Audit Scotland, submission to the Independent Budget Review

3.1 Efficiencies are about enhancing value for money across the public sector, improving public service delivery and raising productivity. They can also make an important contribution towards balancing public finances. Efficiencies have, to date, been used to re-invest in public services. However, there is also an option to use efficiencies as a contribution to closing the projected funding gap.

BACKGROUND

Current Efficiency Programme

3.2 The Scottish Government's current Efficiency Programme realised savings of £839 million in 2008-09 against a two per cent target of £534 million (pay and non-pay). Approximately 84 per cent of total savings in that year were estimated to be recurring.

Local retention of efficiency savings

3.3 To date, the Scottish Government's Efficiency Programme has allowed savings generated to be 'recycled' to support and improve service delivery. In 2008-09, £839 million of savings were re-invested directly in public services. Examples included the following:

- NHS Boards' efficiencies were recycled to deliver new and additional child and adult mental health services, health centres and bowel cancer screening;
- efficiencies generated by the Scottish Police Services Authority were allocated to other police priorities, such as the Gartcosh Crime Campus project; and
- efficiencies were reinvested in delivering affordable housing by adjusting grant rates to increase the level of private finance.

3.4 The Efficient Government Programme has also generated a range of administrative efficiency savings across the Scottish Government, including reductions in the cost of travel, marketing and printing.

3.5 The Scottish Government is currently aiming to achieve efficiency savings of two per cent per annum, amounting to £1.6 billion over the three-year period 2008 to 2011. The 2008-09 target was exceeded, and current indications suggest that savings may also be in excess of the 2009-10 published target. The latest Efficiency Delivery Plan suggests that future savings could be in excess of these targets.¹

¹ www.scotland.gov.uk/Publications/2010/05/EDPMay2010

Progress to date and reliability

3.6 Audit Scotland² reported on the first year (2008-09) of the Scottish Government's Efficiency Programme in February 2010 and confirmed progress was being made in implementing the recommendations of their 2006 report.³ The 2010 report stated that *"the 2005-08 Efficient Government Initiative and the 2008-11 Efficient Government Programme have encouraged the public sector to make efficiency savings by providing guidance and setting targets."*

3.7 While acknowledging progress, Audit Scotland also cast some doubt over the accuracy of the savings being reported, finding 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."

Improving Public Sector Efficiency, Audit Scotland (February 2010)

3.8 This assessment was confirmed by the Deputy Auditor General for Scotland in her recent evidence to the Scottish Parliament Finance Committee:

"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."

Caroline Gardner, evidence to the Scottish Parliament Finance Committee, 20 April 2010

3.9 The Panel understands that the Scottish Government is planning to achieve at least 2 per cent annual efficiencies in the period up 2014-15:

"We have announced our intention to carry forward no less than a 2 per cent efficiency saving target into the next spending review period."

John Swinney MSP, Cabinet Secretary for Finance and Sustainable Growth, oral evidence to the Scottish Parliament Finance Committee, Budget Strategy Phase, 18 May 2010⁴

Estimates of potential savings

3.10 Successfully maintaining the current 2 per cent efficiency target across the public sector on a year-on-year basis could generate savings (excluding pay and capital) in the last year of the next Spending Review period (2014-15) of approximately £600 million. An increased annual target of 3 per cent on a similar basis could, in theory, generate savings in 2014-15 of some £900 million.

² *Improving public sector efficiency*, Audit Scotland (February 2010)

www.audit-scotland.gov.uk/docs/central/2010/nr_100225_improving_efficiency.pdf

³ *The Efficient Government Initiative – A progress report*, Audit Scotland (December 2006)

www.audit-scotland.gov.uk/docs/central/2006/nr_061219_efficient_government.pdf

⁴ www.scottish.parliament.uk/s3/committees/finance/or-10/fi10-1402.htm#Col2300

Applying efficiencies to cost pressures

3.11 These estimates are based on Scottish Government non-pay, non-capital revenue expenditure of £7.5 billion, i.e. the Scottish Government Resource DEL budget for 2010-11 of £25.9 billion,⁵ less an estimated pay bill of £15.2 billion and capital expenditure of £3.3 billion.

3.12 Efficiency savings have to date been retained by public bodies and applied to meet cost pressures within the service delivery areas concerned. For example, Audit Scotland⁶ reported in 2009 that the annual audit reports for NHS bodies in Scotland for 2008-09 detailed a number of cost pressures for NHSScotland, including the following:

- the increasing cost of prescription drugs, which doubled in cash terms between 1996-97 and 2008-09;
- pay modernisation, including Agenda for Change;
- implementation of the European Working Times Directive;
- utilities costs – hospital energy costs increased by 73 per cent between 2004-05 and 2007-08; and
- around a third of the NHS estate will require major upgrading within the next three years.

3.13 The Scottish Parliament Finance Committee has recently invited the Scottish Government to make clear its policy in relation to the retention of efficiency savings by public bodies:

"Looking ahead, the Committee requests that the Scottish Government confirm as soon as possible whether it will allow bodies to retain their efficiency savings in the next spending review period.

"The Committee recommends 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."

Scottish Parliament Finance Committee 4th Report 2010 – Budget Strategy Phase (June 2010)⁷

3.14 The Panel also noted Audit Scotland's view that the approach to efficiency savings should be applicable to the whole of the public sector and that no sector should be seen as immune to efficiency improvements.

⁵ The latest Scottish Government baseline figure for Resource DEL in 2010-11 is £25.9 billion. This differs from the figure presented in the Draft Budget 2010-11, as it takes account of recent HM Treasury adjustments such as the removal of Cost of Capital budgets.

⁶ *Overview of the NHS in Scotland's performance 2008-09*, Audit Scotland (December 2009) www.audit-scotland.gov.uk/docs/health/2009/nr_091210_nhs_overview.pdf

⁷ www.scottish.parliament.uk/s3/committees/finance/reports-10/fir10-04-vol1.htm

Future approach

3.15 The current approach of allowing any efficiency savings to be recycled (retained) by each body to meet other spending pressures and priorities has resulted in some positive developments. In the light of current financial constraints, the Panel is of the view that efficiency savings will need to be treated as a contribution to the overall budget reduction.

3.16 The Panel heard from a range of stakeholders that public bodies have already implemented the most obvious opportunities for efficiencies and that future savings are likely to be far more difficult to achieve. These would be even more challenging if targets were to be raised above the current level of 2 per cent.

"COSLA would like the Panel to acknowledge that it is sensible to be realistic about what efficiencies can be delivered over the spending review period and there is no benefit in pretending that the reduction in funding can be met by greater efficiencies than is realistically possible. Explicitly we would like the Panel to give weight to the view that the downturn in resources can not be filled solely through efficiencies."

COSLA, submission to the Independent Budget Review

3.17 The Panel agrees with COSLA and Audit Scotland that the reduction in resources can not be met through increasing efficiencies alone. However, the Panel is of the opinion that there remain significant opportunities to improve and to generate more efficiencies through streamlining and simplification, progressive development of shared services, more outsourcing of services, improvement of procurement practice, and better management of absence. The Panel acknowledges that continuing to improve will become increasingly challenging and may, in some instances, require radical redesign of the way that services are provided to the public.

The Panel suggests that, in light of the projected financial constraints, the Scottish Government and Parliament should consider:

- (i) revising the current approach of the Efficiency Programme which allows efficiency savings to be retained and recycled with a view to reducing future budget allocations across the public sector to incorporate an assumed annual efficiency saving; and**
- (ii) ensuring that future annual efficiency targets are no less than 2 per cent per annum.**

STREAMLINING AND SIMPLIFICATION

"One of the first, and simplest, reforms we would recommend is to end the culture of quangos in Scotland. Reform Scotland believes that all national non-departmental public bodies, with the exception of tribunals, should be abolished with the functions either brought back into government, with the possibility of devolving powers to local authorities, or carried out by fully independent bodies which could negotiate contracts with government. As well as being more transparent, this ensures that elected politicians are fully accountable for spending decisions."

Reform Scotland, submission to the Independent Budget Review

Progress

3.18 In 2008, the Scottish Government published its plans to reduce the total number of public bodies, including those commonly known as 'quangos', by 25 per cent by 2011. As a consequence of the Government's Simplification Programme,⁸ the number of public bodies has been reduced from 199 to its current level of 160 (see Annex D).

3.19 This has been achieved through a combination of actions, including merger, abolition, restructuring and transfer of functions to other existing bodies. For example: Creative Scotland brings together the former separate structures of Scottish Screen and the Scottish Arts Council; and the Deer Commission is being abolished and its staff and functions transferred to Scottish Natural Heritage.

3.20 Subject to Parliamentary approval, further legislative changes such as the Children's Hearing (Scotland) Bill would support and facilitate further reductions in the number of public bodies.

3.21 The Simplification Programme was seen as a key element in ensuring efficiency and had a stated aim to:

- streamline decision making and improve transparency;
- bring together organisations with similar skills, expertise and processes;
- stop activity that no longer contributes to the public purpose; and
- apply tough tests to the creation of any new bodies.

Savings

3.22 Although savings were not a key driver of the Simplification Programme, it is estimated that simplification projects will provide estimated net financial savings of £123 million during 2008-13 and annual recurring savings of some £36 million thereafter.

8 www.scotland.gov.uk/Topics/Government/public-bodies/simplification-programme

Future opportunity

3.23 The Panel notes the progress which has been made to date to reduce the number of public bodies, the successful passage of the necessary legislative changes (including the order-making power, which will considerably simplify future changes in the status of a number of public bodies), and the work which is in train to deliver the 25 per cent reduction target. It is also aware of the Scottish Parliament's contribution to this work and, in particular, the Economy, Energy and Tourism Committee's current review of the role of the enterprise network, including possible alternative models.

3.24 The Panel recognises that further simplification in the future will be more challenging and may require more innovative approaches, but is keen to encourage the Government and Parliament to drive further appropriate rationalisation.

The Panel suggests that the Scottish Government and Parliament should consider using the provisions of the Public Services Reform (Scotland) Act to further reduce the number of public bodies.

The Panel would advocate the implementation of a regular review process of all public bodies which:

- (i) identifies the need, purpose, cost and value of retaining the public body in that category; and**
- (ii) states specifically why the work must be undertaken by the public body and not by the core Scottish Government, private or third/voluntary sector.**

SCRUTINY AND REGULATION

"A simplification in the external scrutiny of local authorities should lead to a reduction in the cost of various regulatory and inspection bodies. To ensure this it is imperative that the Scottish Government take steps to reduce the costs of such bodies."

CIPFA Scotland Directors of Finance Section, submission to the Independent Budget Review

Background

3.25 Independent assurance through scrutiny and regulation is an important aspect of public services. The Scottish Government acknowledges the need for scrutiny to be *"accessible, focused on the users or potential users of services, better coordinated, proportionate and based on an assessment of risk."*⁹

9 www.scotland.gov.uk/Topics/Government/PublicServiceReform/IndependentReviewofReg

3.26 Professor Lorne Crerar was asked by the Scottish Government to consider how Scotland's systems of regulation, audit, and inspection and complaints handling for public services could be improved. His 2007 report (the 'Crerar Review'¹⁰) indicated that the role of scrutiny is to provide independent assurance that services are well-managed, safe and fit for purpose and that public money is being used properly. He identified five principles that should govern the application and use of external scrutiny: independence; public focus; proportionality; transparency; and accountability. The Crerar Review made recommendations covering areas such as leadership, accountability and governance, as well as specific recommendations relating to scrutiny in health and local government.

Progress

3.27 In the wake of the Crerar Review, the Scottish Government's intention is to shift responsibility for scrutiny towards service deliverers themselves to drive forward improvement through a greater emphasis on self-assessment and reporting. Good progress has been made to reduce the burden of external scrutiny since the publication of the Crerar Review including reducing the number of scrutiny bodies to 29, a reduction of 7 compared with 3 years ago.

3.28 However, while most contributions on this issue to the Panel suggested that there is a need for external scrutiny, there was still a view that the scale and costs of inspection remain a disproportionate burden on public bodies, requiring unnecessary time and expense:

"SOLACE Scotland would recommend that that the Scottish Government/Parliament should significantly reduce the costs of Regulatory and Inspection Bodies by a meaningful amount and consider ways of ensuring the attitudes and behaviours at all levels in scrutiny bodies are consistent with the post Crerar approach. One approach might be creating a statutory duty on scrutiny bodies to have regard to the cost implications of their proposals/recommendations."

SOLACE Scotland, submission to the Independent Budget Review

Future opportunities

3.29 A suggestion was made to the Panel that scrutiny should become more targeted and consequentially more cost-effective for both the scrutiny body and the service provider, with a greater focus on highlighting good practice. Highland Council went further in this, suggesting that national scrutiny should be further rationalised as an efficiency measure, with local accountability being seen as the default option:

10 www.scotland.gov.uk/Topics/Government/PublicServiceReform/IndependentReviewof-Reg/latest-news/TheCrerarReview

"Given the scale of financial challenge faced, further opportunities to reduce the cost of audit and scrutiny should be introduced as an efficiency measure. This option takes the stance that local is best and that local bodies should be allowed to operate within an economical framework in which national oversight, inspection, target setting and performance measurement are limited to levels which are essential for effective service delivery. The default option should be local with reliance upon local accountability rather than national oversight to highlight shortcomings."

The Highland Council, submission to the Independent Budget Review

The Panel welcomes the changes implemented following the Crerar Review but considers that greater pace in delivering its recommendations is needed if the momentum that has been built up is not to be lost.

The Panel suggests that the Scottish Government and Parliament should consider the remaining scope to merge different scrutiny bodies as part of the current Simplification Programme and ensure that the work of scrutiny bodies is proportionate and appropriate and takes full account of the time and cost implications for the wider public sector.

SHARED SERVICES

"The 32 Scottish local authorities currently run virtually identical back office services – finance administration, HR, payroll, procurement, revenues & benefits etc. Despite much talk of shared services, there has been only modest progress towards any sharing of significant back office services between councils. Some local authorities have made progress with internal shared services, gaining from the efficiency of centralisation. Some councils have incorporated other local bodies in these arrangements."

CBI Scotland, evidence to the Scottish Parliament
Finance Committee Budget Strategy Inquiry (March 2010)¹¹

Background

3.30 The sharing of services provides a major opportunity for reducing costs. Shared services have been defined by the Scottish Government as the *"convergence and streamlining of an organisation or organisations functions to ensure that they deliver the services required of them as effectively as possible."*¹²

¹¹ www.scottish.parliament.uk/s3/committees/finance/inquiries/budget/41%20-%20CBI%20Scotland.pdf

¹² www.scotland.gov.uk/Topics/Government/PublicServiceReform/efficientgovernment/SharedServices

3.31 Development of shared services can produce economies of scale and efficiencies by moving beyond boundaries and merging functions within or across organisations. Shared services can cover a wide range of approaches, including improving internal processes, standardising practice and technology, sharing technology and sharing service provision. However, to date, the number of shared service projects which have delivered significant efficiencies and benefits has been disappointing.

3.32 The Panel believes that shared services can make a greater contribution to the efficiency agenda, but only if they are designed to meet the needs of the citizen and to cope with demand. Audit Scotland confirmed this:

"Users of public services, front line staff and other service providers have an important role to play in helping to redesign services to make them more efficient and effective."

Improving public sector efficiency, Audit Scotland (February 2010)

Barriers

3.33 The Panel heard from trades unions that the initial costs of developing shared services can be considerable and that consequential savings, other benefits and added value can often take some years to realise. Audit Scotland has also highlighted barriers relating to organisational structures, staff terms and conditions, and funding streams.

3.34 However, strong leadership can help overcome these barriers. Many of the tools and processes required to support the development of shared services are now in place.

3.35 The Scottish NHS Board Chief Executives' Group highlighted significant potential for increased regional working within NHSScotland:

"With current constraints on service configuration the benefits of regional working across health systems have not yet been fully exploited and provide an opportunity for significant redesign of services.

"There are clear opportunities within health where Shared Services in areas such as Laboratories could improve services and reduce costs – technology advances may improve opportunity for such initiatives and different ways to finance some of these changes could and should be explored. Shared facilities have been explored and could be expanded: examples could include use of the NHS National Distribution centre by other public sector bodies."

Scottish NHS Board Chief Executives' Group, submission to the Independent Budget Review

3.36 Sir John Arbuthnott made a major contribution to the debate in his 2009 review of the potential for shared services across the area covered by the eight local authorities which, together with their public sector partners, form the Clyde Valley Community Planning Partnership. His report, the *Clyde Valley Review 09*,¹³ recognised the urgent need to act together to address not only the financial squeeze, but also demographic changes, an infrastructure requiring investment, and workforce planning issues. The report identified considerable scope for more joint working and shared services.

"I am of the view that there is considerable scope for:

- Accelerated joint working between the individual Councils and the two Health Boards to deliver a single integrated health and social care service;
- New opportunities for shared services between Councils in civic infrastructure such as waste management, property management and maintenance, and fleet and transport. This may also involve other Clyde Valley partners;
- Further involvement of Education Services in the core shared services agenda, particularly on social transport, asset management, and supply teaching;
- Shared (back office) support services between Councils, building on high level business cases developed through the Scotland wide Diagnostic exercise;
- Re-invigorated approach to regeneration, developing a shared economic approach to addressing the recession in the Clyde Valley area."

Clyde Valley Review 09, Sir John Arbuthnott (November 2009)

3.37 The report's key messages were aimed at public bodies in the Clyde Valley Community Planning Partnership area which has 1.75 million residents, or 34 per cent of Scotland's population. Many of its conclusions are of considerable relevance for public bodies across Scotland. The Panel would encourage all those engaged in public service delivery to have regard to the findings of the *Clyde Valley Review 09*.

The Panel looks to the Scottish Government and Parliament, together with local authorities and leaders of other public bodies, to provide an appropriate level of leadership to ensure that barriers to shared services development are addressed with determination.

13 [www.renfrewshire.gov.uk/ilwwcm/publishing.nsf/AttachmentsByTitle/ce-ClydeValleyReviewNov09.pdf/\\$FILE/ce-ClydeValleyReviewNov09.pdf](http://www.renfrewshire.gov.uk/ilwwcm/publishing.nsf/AttachmentsByTitle/ce-ClydeValleyReviewNov09.pdf/$FILE/ce-ClydeValleyReviewNov09.pdf)

OUTSOURCING

"Broadly speaking Scotland has remained more strongly with the model of direct provision of public services by the public sector, in comparison with England. This particularly applies to front line service provision. England delivers public service provision on a scale that has allowed for more innovation in various delivery models and new forms of collaboration. Public sector leaders and managers in Scotland have great skills, but they do not have the benefit of as much practical experience of diverse delivery models which they can draw on when faced with the squeeze on public finances."

Robert Black, Auditor General for Scotland, letter to the Chair of the Independent Budget Review Panel (June 2010)

3.38 Outsourcing and partnerships, including those with the private and voluntary/third sector, are options to be explored which could: improve public service delivery; provide new, innovative ways of working; and inject competition into services, potentially driving up quality and making them more responsive to the needs of the citizen, with a focus on enabling rather than providing services.

3.39 The provision of public services should be based on quality, value for money and continuous improvement, irrespective of which sector or body delivers the service.

3.40 The changing nature of public services will open up opportunities to strengthen public sector delivery through options such as outsourcing and public private partnership working. In designing new services or re-designing existing ones, the Panel considers that alternative arrangements for service delivery such as outsourcing or public private partnership working should be explored.

3.41 However, it is essential that, in considering alternative delivery models, the delivery agent fully understands the service to be delivered and the needs of the citizens and that low cost/low quality does not become the default standard.

The Panel believes that the challenges arising from the projected financial outlook should act as a stimulus for the public sector to review its current delivery models, including consideration of alternatives. Looking ahead, the Panel envisages mainstream roles for the private and voluntary/ third sectors as collaborative partners in the delivery of public services.

PROCUREMENT

"The work which is being done by a number of councils, in particular, in restructuring their procurement and creating substantial packages of services for competition also offers the prospect of significant savings, while maintaining – or indeed enhancing service levels."

KPMG, submission to the Independent Budget Review

Background

3.42 Procurement spending across the wider public sector in Scotland is estimated to be around £9 billion per annum, with construction, social community care and facilities management representing the top three categories of spend. Savings generated as a result of more efficient approach to procurement can, therefore, make a significant contribution to efficiency. However, there do not currently appear to be specific targets for procurement savings within the overall efficiency targets.

Table 3.1

Estimated Annual Public Procurement Spend by Sector		
	£ billion	Proportion of total (per cent)
Local Government	4.7	52
NHSScotland	1.9	21
Scottish Government 'family'	1.4	16
Higher/Further Education	0.8	9
Police and Fire	0.2	2
Total	9.1	100

Data provided by Scottish Government from 179 public bodies:
169 public bodies covering data from 2008-09 and 10 public bodies from 2007-08

3.43 John McClelland's 2006 *Review of Public Procurement in Scotland*¹⁴ (the 'McClelland Report') has provided the basis for recent moves to reform public procurement in Scotland. The report suggested that improvement in public procurement could achieve savings of £340 million in the first two years of the programme, with savings of £400 million in 2008-09 and £600 million in 2009-10 being possible. These estimates included both cash and non-cash releasing savings, and related to estimates across the wider public sector. They assumed that all public bodies would take urgent action to improve their procurement performance and capability in line with the McClelland Report.

14 www.scotland.gov.uk/Publications/2006/03/14105448/0

3.44 In response to the McClelland Report, the Scottish Government established the Public Procurement Reform Programme which is intended to improve procurement across the public sector.¹⁵ The vision of the Programme is *"the implementation of structures, capability and processes to provide continuous improvement in procurement across the Scottish Public Sector in order to deliver Value for Money improvements and support increased efficiency."*¹⁶

Progress

3.45 In 2009, Audit Scotland's report *Improving Public Sector Purchasing* reviewed progress towards implementation of the McClelland Report.¹⁷ They confirmed that, in a short space of time, a substantial number of the report's recommendations had been implemented and that the foundations were in place for Scotland's public bodies to improve further their spending on goods and services.

3.46 Audit Scotland found that the Programme had cost at least £61 million in its first two years, but had generated savings of £327 million over the same period. (These figures included cash and non-cash savings.) In 2008-09, £160 million of cash releasing savings were realised through procurement, compared with the potential £400 million suggested in the McClelland Report. (From that year onwards, non-cash releasing savings no longer counted towards Efficient Government targets, so information covering both cash and non-cash savings on a comparable basis to that contained in Audit Scotland's report is not available.)

3.47 However, while progress had been made, it had been slower than envisaged and had varied across the Scottish public sector. Audit Scotland made a series of recommendations:

¹⁵ www.scotland.gov.uk/Topics/Government/Procurement/about/Review

¹⁶ *ibid.*

¹⁷ www.audit-scotland.gov.uk/media/article.php?id=114

"To ensure the Programme delivers the maximum potential benefits, the Scottish Government should as a priority:

- introduce its revised plan for the Programme as soon as possible. The plan should have measurable objectives and targets, including savings to be achieved, and make clear who is responsible for delivering it and how much it will cost;
- publicly report progress against Programme objectives and targets;
- explicitly consider and manage risks to the Programme to ensure Programme benefits are delivered as intended;
- work with the centres of expertise and other partners to ensure that:
 - the centres coordinate their work to recruit and retain the highest quality of staff;
 - the centres monitor reported savings and other benefits against forecast on a regular and consistent basis and ensure forecast savings and other benefits can be easily validated. This should include net savings after taking account of the centres' operating costs;
 - existing guidance on good purchasing and responsibilities is developed and maintained;
 - new guidance covers how purchasing strategies and plans may take account of wider policy objectives, such as supporting economic development.

"To increase their effectiveness and demonstrate Best Value, the centres of expertise should as a priority:

- work together to develop the skill-sets of key staff to meet their business needs;
- individually and collectively monitor and manage risks, to ensure that Programme benefits are delivered as intended;
- work with the Scottish Government and partners to identify, develop and demonstrate opportunities for collaboration that most benefit the public sector;
- work with other public bodies to identify good practice and priorities for improving how they buy goods and services and get value for money.

"To demonstrate Best Value when purchasing goods and services, public bodies should:

- have high-quality purchasing strategies and plans in place, including a plan to meet future workforce needs;
- have up-to-date information on their purchasing activities, such as supplier details, volume of transactions, value and type of spend;
- ensure all purchasing practices, including control of spending, comply with good practice as set out in national and centres of expertise guidance;
- work with the Scottish Government and centres of expertise to identify and develop opportunities for collaboration and for improved purchasing practice;
- use BPIs to assess their performance and to continually improve how they buy goods and services;
- report savings and other benefits on a regular and consistent basis."

Improving Public Sector Purchasing, Audit Scotland (July 2009)

Future opportunities

3.48 In response to this, the Public Procurement Reform Board, chaired by the Cabinet Secretary for Finance and Sustainable Growth, developed a high-level strategy, *Transforming Procurement: Accelerating Delivery*, with an emphasis on accelerating the pace of change and the delivery of benefits. This was endorsed by the Board in January 2010.

3.49 It should be possible to build on progress to date to improve procurement performance and make better use of collaborative contracts without an adverse impact on individual users of public services. The Panel heard from stakeholders that there is scope to build on good practice and to make better use of the guidance and tools that have been developed, such as Best Practice Indicators, the Information Hub, the Contracts Portal, the Procurement Capability Assessment, and the eProcurement Scotland infrastructure.

The Panel welcomes progress made by the Scottish Government to accelerate the pace of improvement in procurement performance and endorses Audit Scotland's recommendations for improving public sector purchasing.

The Panel suggests that the Scottish Government should consider strengthening its work to deliver the Public Procurement Reform Programme by agreeing clear targets for improvement, and should build on and share good practice to drive and accelerate improvement.

ABSENCE MANAGEMENT

Background

3.50 Absence has an impact on an organisation's performance and productivity and comes at significant financial cost. Robust and rigorous absence management plays an important part in an organisation's ability to improve efficiency. Absence management is a strand within some sectors of the Scottish Government's Efficiency Programme.

3.51 There is no comparator data held centrally across the public sector or across local authorities in Scotland.

3.52 The Scottish Government is working towards the target set by the Head of the UK Civil Service to reduce the annual Average Working Days Lost (AWDL) to sickness absence by 10 per cent (from a baseline of 8.2 days per employee lost to illness up to September 2009) to below 7.4 days per employee by 2011.

3.53 The quarterly sickness absence report published by the Cabinet Office in March 2010¹⁸ for the year ending September 2009 reported the lowest level of sickness absence across the public sector since 1999, with the average number of working days lost of 8.7 per staff year. The CIPD records:

18 www.civilservice.gov.uk/about/improving/health/sickness-absence.aspx

“The average level of employee absence has fallen to 7.4 days per employee per year from 8.0 days per employee per year in the previous year. The average level of absence remains highest in the public sector at 9.7 days per employee per year, a very slight drop from the previous year’s figure of 9.8 days per employee per year. Non-profit organisations recorded the next highest level of absence at 9.4 days per employee per year and the sector is the only one to record an increase in absence levels from last year’s 8.5 days. Employee absence levels in the manufacturing and production sector fell to 6.5 days per employee per year compared with 7.2 days for the previous 12 months. Private sector services organisations also recorded a drop in the average level of absence from 7.2 days per employee per year to 6.4 days.”

Absence management annual survey report, CIPD (July 2009)¹⁹

3.54 Data provided by the Scottish Government for the period up to end March 2010 shows that the annual Average Working Days Lost (AWDL) has reduced to 7.7 days, below both the Cabinet Office and CIPD averages for the public sector.

3.55 This suggests that the arrangements implemented previously by the Scottish Government are reducing sickness absence. The Scottish Government is on track to achieve the agreed target and is planning further interventions which will go beyond this target.

3.56 Similar arrangements for absence management are in place across the Scottish public sector, notably in NHSScotland.

The Panel believes that any reduction in the level of absence has the potential to contribute to greater public service efficiency and suggests that the Scottish Government should consider taking the lead in exploring the scope to improve the measurement and benchmarking of absence levels across the public sector in Scotland, and that all bodies subject to the Scottish Government’s efficiency targets should identify clear targets for reducing absence, ultimately to a level equivalent to the private sector average.

¹⁹ www.cipd.co.uk/subjects/hrpract/absence/_absence_management_summary.htm

CONCLUSIONS

3.57 The Panel recognises the progress on efficiency improvements made in the Scottish public sector but also the importance of ensuring continuous improvement. However, 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.

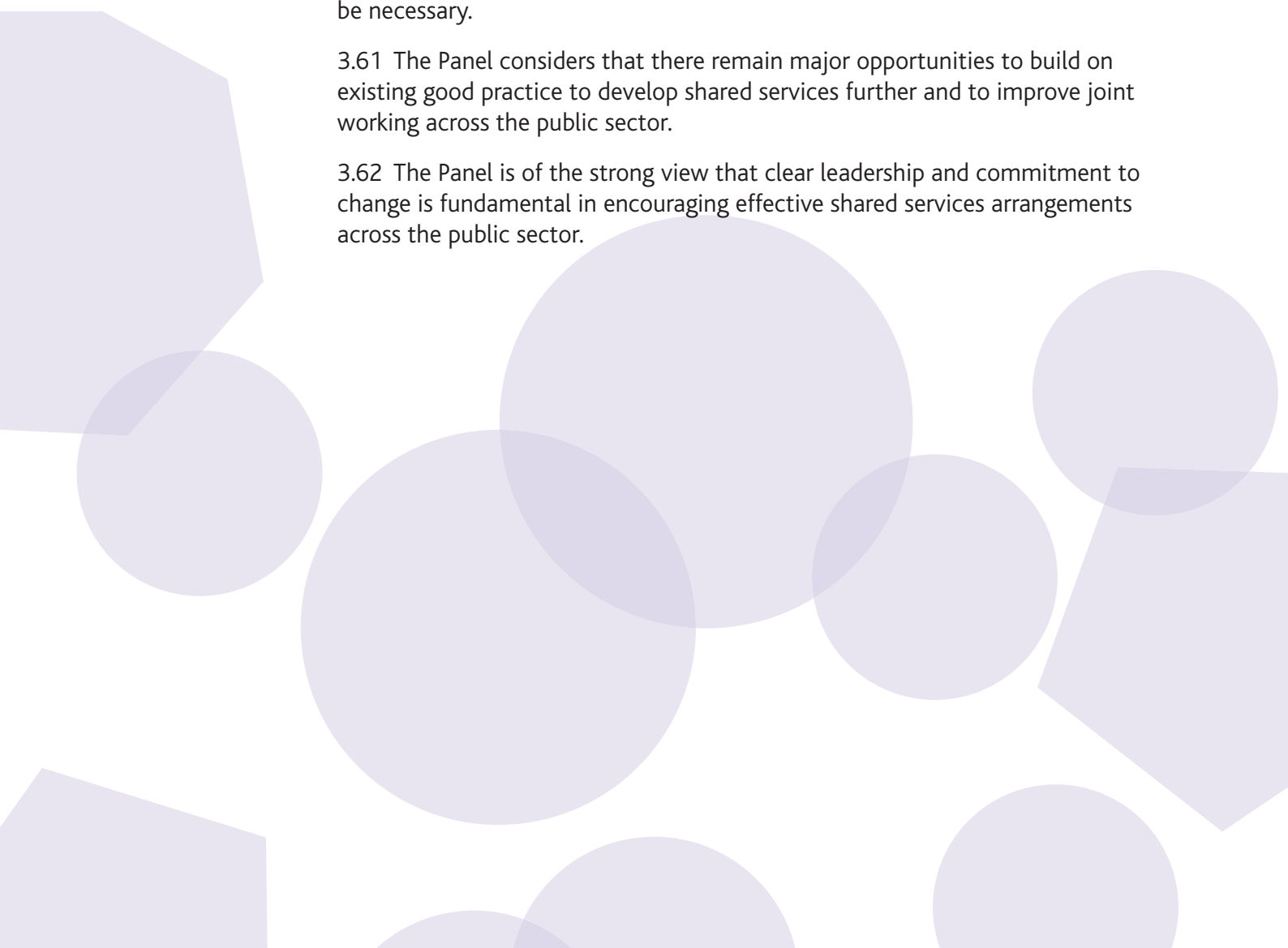
3.58 Achieving further efficiencies is likely to require a portfolio of further streamlining and simplification, progressive development of shared services, more outsourcing of services, improvement of procurement practice, and better management of absence.

3.59 Continuing to make efficiencies will become increasingly challenging and may, in some instances, require radical redesign in the way that services are provided to the public.

3.60 However, best estimates suggest that contributions from efficiency savings alone would not be sufficient to fill the immediate gap in public spending budgets, and urgent examination of additional options will, therefore, be necessary.

3.61 The Panel considers that there remain major opportunities to build on existing good practice to develop shared services further and to improve joint working across the public sector.

3.62 The Panel is of the strong view that clear leadership and commitment to change is fundamental in encouraging effective shared services arrangements across the public sector.



CHAPTER 4

REMUNERATION AND WORKFORCE



Size of the pay bill

INTRODUCTION

4.1 The public sector pay bill¹ (including pension costs) amounted to £15.2 billion in 2010-11, representing 59 per cent of the Scottish Government's Resource Departmental Expenditure Limit budget (Resource DEL).²

4.2 The pay bill represents the most significant cost of delivering the quality and range of public services currently enjoyed in Scotland. Payments to those working in the NHS comprise 40 per cent of the pay bill. Local government spending on pay³ (including fire services) accounts for 31 per cent of the pay bill; teachers and police account additionally for 16 per cent and 5 per cent, respectively. The remainder of the pay bill reflects payments to those working in Non-Departmental Public Bodies, Public Corporations, Non-Ministerial Departments and Agencies (6 per cent) and the Scottish Government Main Bargaining Unit (2 per cent).⁴

"Pay is a significant issue, given that it accounts for at least 60 per cent of Scottish departmental resource expenditure – in fact, it is the key variable. The pay policy that we will set out will be driven by the budget numbers that we receive. It will be a heavily constrained pay policy. ... I think there will be a loss of public sector employment in the years going forward."

John Swinney MSP, Cabinet Secretary for Finance and Sustainable Growth, oral evidence to the Scottish Parliament Finance Committee, 18 May 2010⁵

"Pay accounts for over 50% of the public sector costs, 66% for the NHS and for the police over 80%. Given the scale of the likely cuts it is inconceivable that this can be achieved without some impact on real pay rates and or overall levels of employment."

KPMG, submission to the Independent Budget Review

4.3 Given that the pay bill forms such a significant part of the Scottish budget, pay levels and the number of employees need to be closely aligned with cash term movements in budgets each year.

- 1 Defined as including all aspects of remuneration i.e.: staff salaries, allowances, overtime payments, employers' national insurance contributions and employers' pension contributions.
- 2 The latest Scottish Government baseline figure for Resource DEL in 2010-11 is £25.9 billion. This differs from the figure presented in the Draft Budget 2010-11, as it takes account of recent HM Treasury adjustments such as the removal of Cost of Capital budgets.
- 3 Although teachers and police form part of local government, they are presented separately.
- 4 See Annexes D and E for lists of all public bodies in Scotland and of the bodies within the Scottish Government Main Bargaining Unit.
- 5 www.scottish.parliament.uk/s3/committees/finance/or-10/fi10-1402.htm#Col2300

4.4 Table 4.1 sets out:

- the impact of projected changes in the Scottish Government's Resource DEL budget on resources available to fund the pay bill, compared with 2010-11; and
- the increases in the pay bill that would be incurred compared with 2010-11 if historical trends in public sector pay continued.

Table 4.1

Projected Changes in Resources Available for Pay				
£ million, cash terms	2011-12	2012-13	2013-14	2014-15
Impact of Resource DEL projections on resources available to meet the pay bill. This assumes the pay bill continues to account for 59% of Resource DEL.	-320	-230	-200	-260
Theoretical pay bill increases, calculated in line with historical movements	+420	+900	+1,430	+2,000

Source: Scottish Government

Scale of the challenge

4.5 It is clear from Table 4.1 that the projected Resource DEL figures imply a significant reduction in the resources available to fund the pay bill over the next four years (assuming that pay continues to represent 59 per cent of the Resource DEL budget). In 2011-12, the resources available to meet the pay bill are expected to fall by over £300 million, in cash terms, compared with 2010-11 and to continue to remain below the 2010-11 budget in the three years that follow.

4.6 The actual pay bill is, however, projected to continue to rise over this period. Table 4.1 shows the costs that would be incurred if the pay bill increased in line with historical movements in public sector pay⁶ (i.e. if pay settlements continued in line with recent trends and employment levels remained static). In 2011-12, the pay bill would be over £400 million higher, in cash terms, than in 2010-11, and by 2014-15 it would be almost £2 billion higher.

4.7 Compared with recent trends, therefore, instead of increasing by 2.7 per cent in cash terms, the resources available to fund the pay bill in 2011-12 are expected to fall by some 2.1 per cent. In the same way, by 2014-15, instead of an increase in resources of some 13 per cent compared with the 2010-11 pay bill, resources available are expected to be 1.7 per cent lower than in 2010-11.

6 Assumed to be GDP deflator (a measure of domestically generated inflation) plus 1 per cent.

4.8 The challenge for the Scottish Government and Parliament, local government and other Scottish public sector employers is not only to manage these reductions in the resources available to meet the pay bill, but to do so in a way which:

- maintains and develops high quality public services; and
- delivers sustainable economic growth and the other outcomes achieved through these services.

4.9 This chapter considers the issues which arise in meeting this challenge and presents options for the Scottish Government and Parliament to consider in addressing them. These are based on:

- consideration of current arrangements for setting public sector pay in Scotland and the pay restraining measures introduced in 2010-11;
- a review of the evidence establishing where Scotland stands in terms of pay and workforce levels, relative to relevant public and private sector comparators; and
- an analysis of the scale of the savings that could potentially be generated by the different options that exist to reduce the pay bill and the feasibility of these options.

BACKGROUND

Current Arrangements for Setting Public Sector Pay in Scotland

4.10 The Panel's understanding is that the Scottish Government has the authority to determine pay policy in public bodies which are devolved. Together, these bodies account for 82.5 per cent of total public sector employment in Scotland.⁷ Importantly, however, there are various arrangements in place for determining pay for each of the key staff groups in the public sector.

4.11 It is clear from Table 4.2 below that the Scottish Government determines a small fraction of the pay bill (8 per cent) directly through the application of its pay policy. Pay decisions for local government (which account for 30 per cent of the pay bill, excluding teachers, police and fire services) are determined by: the Scottish Joint Council; the Scottish Joint National Council (SJNC) for Craft Operatives; and the SJNC for Chief Officers. It is important to note that while local government pay is subject to negotiation through national collective bargaining, the implementation of Single Status by councils has meant that the majority of terms and conditions - including local pay structures and pay rates - are now almost entirely determined locally. Pay for teachers is determined separately by the Scottish Negotiating Committee for Teachers (SNCT) - a tripartite group including the Scottish Government, COSLA (as employers) and Trade Unions. The SNCT accounts for 16 per cent of the pay bill.

7 Scottish Government (March 2010), *Public Sector Employment in Scotland: Statistics for 4th Quarter 2009*, p8.

Table 4.2

Breakdown of the Scottish Pay Bill by Pay Determining Bodies, 2010-11			
Pay Determining Bodies for key Staff Groups	Staff Groups	£ million	% of total pay bill
Scottish Government directly controls (i.e. all public bodies subject to Scottish Public Sector Pay Policy)	NDPBs, Public Corporations, Departments and Agencies, Main Scottish Government (excl. SCS) and NHS senior managers	1,178	8%
Scottish Negotiating Committee for Teachers (SNCT). Scottish Government determines alongside COSLA and Trade Unions	Teachers and associated professionals	2,409	16%
Scottish Joint Council, Scottish Joint Council for Craft Operatives, Scottish Joint National Council for Chief Officers	Local authority staff (excluding teachers, police and fire)	4,395	30%
Scottish Government determines but to date has followed UK review body recommendations of which:			
UK Doctors and Dentists Review Body (DDBR)	Employed Hospital Doctors, General Medical Practitioners (GMP) and General Dental Practitioners (GDP)	6,235	40%
UK NHS Pay	Agenda for Change – nurses, allied health professionals, clerical and administrative staff		
UK Police Negotiating Board	Police		
National Joint Council for Local Authority Fire and Rescue Services	Fire		
Reserved to UK Government	Senior Civil Service (SCS)	24	0%
Other	Independent GMP / GDP contractors	925	6%
Total		15,166	100%

Source: Scottish Government

4.12 Independent UK pay review bodies make recommendations on pay for doctors and dentists, Agenda for Change staff (i.e. nurses and other NHS staff), police and firemen. Taken together, these bodies account for 40 per cent of the pay bill (and 46 per cent if the cost of independent medical and dental practitioners is included).

4.13 The Panel's understanding is that Scottish Ministers work closely with pay review bodies to influence pay settlements and that, to date, the Scottish Government has largely accepted the recommendations of these bodies.

4.14 Given the projected severity of pressures on the Scottish Budget in the years ahead, the Panel concludes that Scottish Ministers will need to continue to work proactively and urgently to influence and, ideally, agree the terms of the pay settlements and will need to consider whether or not to follow the UK pay recommendations, including those of the UK pay review bodies, in the same way as before.

2010-11 Pay Restraint Measures

4.15 To date, the majority of public sector workers have been covered by multi-year pay settlements. Nurses, teachers and police, for example, have had three-year pay settlements in place from 2008-09 to 2010-11 and will therefore receive headline pay increases of 2.25 per cent, 2.4 per cent and 2.55 per cent, respectively, in 2010-11. The Scottish Government has aligned itself with the UK Government by not reopening these deals, which will, to all intents and purposes, end by the start of 2011-12.

4.16 The Panel has noted that the Scottish Government, the UK Senior Salaries Review Body (SSRB) and the UK Doctors and Dentists Review Body (DDBR) have taken action to constrain growth in the earnings of those employees who did not have multi-year settlements in place. The pay of all senior staff⁸ has been frozen (i.e. a basic award⁹ of 0 per cent to 1 per cent), and the Scottish Government's Policy for Staff Pay Remits 2010-11¹⁰ has started to bear down on the total costs of the pay bill, with a basic pay award of 0 to 1 per cent (compared with 1.5 per cent in 2009-10 and 2 per cent in 2008-09) and a net pay bill increase¹¹ of 0 per cent to 2 per cent (compared with 1 per cent to 4 per cent in 2009-10 and 3.75 per cent in 2008-09).

4.17 Within the Scottish Government, there is now a presumption against external recruitment, and strict controls are in place in relation to overall staff numbers. The Scottish Government has also urged the leaders of all public sector bodies to *"...look hard at staffing and vacancies to ensure that our workforce in the public sector is the most flexible, efficient and effective possible."*¹²

4.18 At the time of publication, the local authority pay settlement for 2010-11 has yet to be agreed. The Panel is aware that individual councils (which have responsibility for the vast majority of actions that can deliver savings through the workforce) are currently giving active consideration to headcount reductions of up to 10 per cent over the next three years.

8 The Scottish Government Pay Policy for Senior Appointments, UK Senior Salaries Review Body (SSRB) and the UK Doctors and Dentist Review body (DDBR) have all introduced a pay freeze. Senior officers in local authorities have also accepted a pay freeze (despite having a multi-year deal in place).

9 This is the inflation, or cost of living, element of the pay award.

10 This only applied to a small fraction of the public sector workforce whose pay is determined by the policy and who did not have multi-year deals in place.

11 This includes the basic award plus the costs of progression.

12 Scottish Government Guidance on Public Spending, 17 June 2010
www.scotland.gov.uk/News/Releases/2010/06/17154821

"In order to realise substantial savings the Council must reduce the headcount of the organisation. It is estimated that this will need to reduce by at least 10% over the next 3 years."

City of Edinburgh Council Officers, submission to the Independent Budget Review

REVIEW OF EVIDENCE: PAY AND WORKFORCE

UK evidence

Key findings from studies

4.19 Recent studies by the Institute for Fiscal Studies¹³ and others have analysed trends in public and private sector pay and pensions. Seven key findings from these studies are presented below:

Finding 1: The trends in earnings growth rates of public and private sector workers are sensitive to the time period selected:

"The cumulated earnings growth since 2000 in the public sector is more than 5% higher than that in the private sector in October 2009. This gap has arisen partly due to particularly fast growth in the public sector in 2002 and 2003 and particularly slow growth in the private sector in 2008 and 2009.

"But when comparing average earnings growth in the public and private sectors, the reference point of comparison is very important: given that public sector earnings tend to be countercyclical, periods of low growth are followed by periods of catch-up, and conversely. As a comparison..., we plot ... the trends in public and private sector pay since Labour took office in May 1997. This gives a distinctly different impression, with the drop in average earnings in the private sector during the financial crisis merely allowing the public sector to catch back up. By the end of 2009, cumulative average earnings growth since 1997 was slightly higher in the public sector than in the private sector for the first time."

IFS Green Budget, Institute for Fiscal Studies (February 2010)

13 *IFS Green Budget* (February 2010), Section 9 (Public sector pay and pensions) www.ifs.org.uk/budgets/gb2010/gb2010.pdf.

Finding 2: Meaningful comparisons of public and private sector pay cannot be based on average values across the public and private sectors:

"Comparisons between average earnings in the public and private sectors are mostly inappropriate, due to the very different workplace profiles of the two sectors. The term counterparts is not really appropriate since the public sector is not only smaller in size but contains a far higher proportion of professional and specialised staff than the private sector. By contrast the private sector contains a wide variety of roles, and has a greater concentration of very low paid employees on the one hand and very highly paid people on the other. These different workforce profiles are one of the major influences on the very different distributions of earnings in each of the two areas of the economy."

IDS, Pay in the Public Services (March 2010)

Finding 3: After adjusting for the differences between the two sectors (e.g. education, age, qualifications), there is a substantial reduction in the wage differential between the public and private sectors:

"On average, men working in the public sector have wages 19% higher than in the private sector, while women have 26% higher wages. Controlling only for years of education, these differentials are reduced to 12% and 17% respectively. This means that a large fraction of the raw differential is attributable to the fact that the public sector workforce tends to be more qualified than the average in the private sector, largely reflecting differences in the type of services produced. When we also include controls for age and qualification of the workforce, the differential drops to 2% for men and 7% for women. Disney and Gosling (2008)¹⁴ provide even lower estimates for 2006, as they are able to control for more differences in the characteristics of individuals between the two sectors, but the key results are unchanged: almost no wage premium for men and a small one for women."

IFS Green Budget, Institute for Fiscal Studies (February 2010)

Finding 4: The gap between public and private sector wages is more pronounced for females:

"The larger gap between public and private sector median pay for females than for males can to a large extent be explained by the fact that the highest paying industry for females is education. ...

¹⁴ *Changing public sector wage differentials in the UK*, R. Disney and A. Gosling, IFS Working Paper WP08/02 (2008) www.ifs.org.uk/publications/4117

"Nearly a quarter of all full-time females are employed in that sector. At the other end of the pay scale, around a quarter of females were employed in the hotels and restaurants, wholesale and retail trade and manufacturing sectors; all of which have been in the private sector. It is therefore not surprising that on an aggregate level the income distribution appears to be relatively generous for females in the public sector."

Evaluating public and private sector pensions: The importance of sectoral pay differentials,
Dr Frank Eich (May 2009)¹⁵

Finding 5: Pay differentials in the public sector are significantly more compressed than in the private sector:

"Public sector differentials are more compressed across skills groups than in the private sector. This means that everything else being equal, public sector employees further down the skills/income distribution do relatively better, while those further up skills/income distribution do relatively worse."

Evaluating public and private sector pensions: The importance of sectoral pay differentials,
Dr Frank Eich (May 2009)

Finding 6: Significant sectoral and regional differences exist in public and private sector pay:

"Relativities between public and private sector pay differ across regions. Private sector workers appear, if anything to do slightly better than their public sector counterparts in London and the South-East. In contrast, in the rest of the country, on average, public sector workers enjoy a wage premium of roughly 5% for men and 11-13% for women..."

"At the aggregate level, public sector workers do not seem to be paid more than equivalent workers in the private sector. But average figures mask the fact that some groups do seem to be better-paid and have done particularly well in recent years and that the reverse is true for other groups. There is a strong case on efficiency grounds to sort out some of these anomalies, and in particular to deal with differences in the relative generosity of public sector pay in different regions of the country. But a careful and modulated approach is called for, certainly in the long run."

IFS Green Budget (February 2010)

¹⁵ *Evaluating public and private sector pensions: The importance of sectoral pay differentials*, Dr Frank Eich, Pensions Corporation Research (May 2009)
www.pensioncorporation.com/press/evaluating_public_and_private_sector_pensions.pdf

Finding 7: Pensions in the public sector are more generous than in the private sector, and the public/private sector differential has been growing:

"It is clear that the average value of pension provision in addition to salary is much greater in the public than in the private sector. This difference has been estimated to be at least 12% of earnings."¹⁶

IFS Green Budget (February 2010)

Scottish and comparative evidence

Pay 4.20 In light of Findings 5 and 6 above, the Panel was interested to understand:

- how the public-private pay differential in Scotland compares with that in other parts of the UK; and
- how public and private sector pay compares for individuals in Scotland working in comparable occupations.

4.21 At the request of the Panel, the Scottish Government has provided estimates which shed light on each question.

4.22 Figure 4.1 below shows how the public-private pay differential in Scotland compares with that in other parts of the UK, based on 2009 data.¹⁷ It is important to point out that these figures do not represent a comprehensive analysis of the public-private wage differentials, as they do not control for all key factors that differ between the public and private sector. However, the figures have been adjusted to control for the differing occupation structures in the public and private sectors and the impact of differences in industrial structure between the UK countries and regions. They are therefore useful in comparing relative public-private wage differentials but not the magnitude of the differentials.

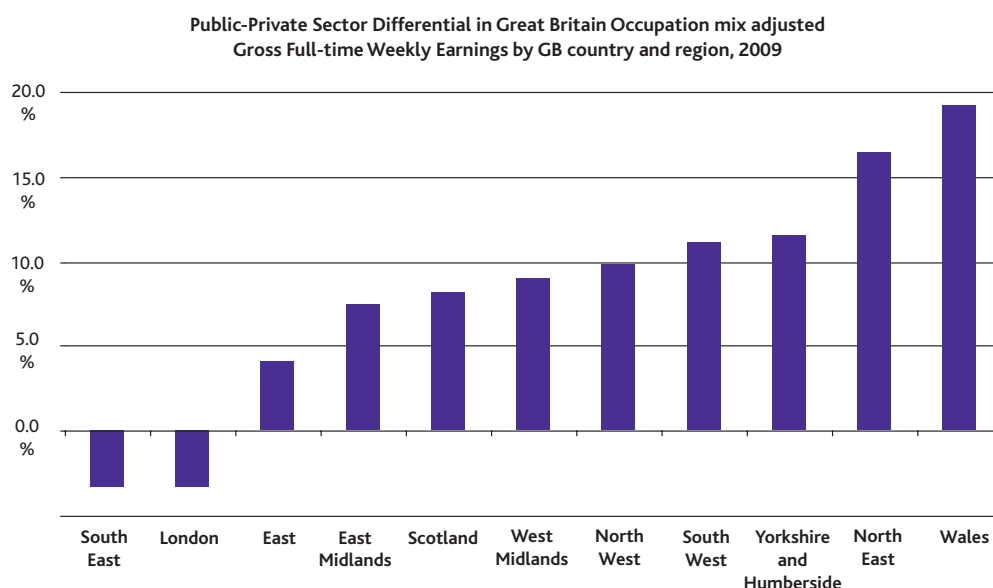
4.23 There is clearly a great deal of variation in the size of the public-private differential across the UK. The public-private pay differential is greatest in Wales and operates in favour of the public sector. London and the South East of England have a negative differential indicating that, on average, private sector workers are better paid than their public sector counterparts. Figure 4.1 suggests that, on average, the public sector-private differential in Scotland is smaller than that in Wales and many English regions.

¹⁶ Figure calculated in A. Bozio and P. Johnson, *Public sector pay and pensions*, in R. Chote, C. Emmerson, D. Miles and J. Shaw (eds), *The IFS Green Budget, January 2008*, IFS (January 2008) www.ifs.org.uk/budgets/gb2008/08chap8.pdf

¹⁷ These estimates are based on the Office of National Statistics (ONS) latest Annual Survey of Hours and Earnings (ASHE) www.statistics.gov.uk/statbase/product.asp?vlnk=13101

4.24 The Scottish Government does not have access to the data required to prepare estimates for Northern Ireland. However, a similar analysis conducted by the Department of Finance and Personnel in Northern Ireland¹⁸ suggests that the differential in Northern Ireland is the highest in the UK: 21 per cent in Northern Ireland compared with 2.3 per cent for the UK as a whole.

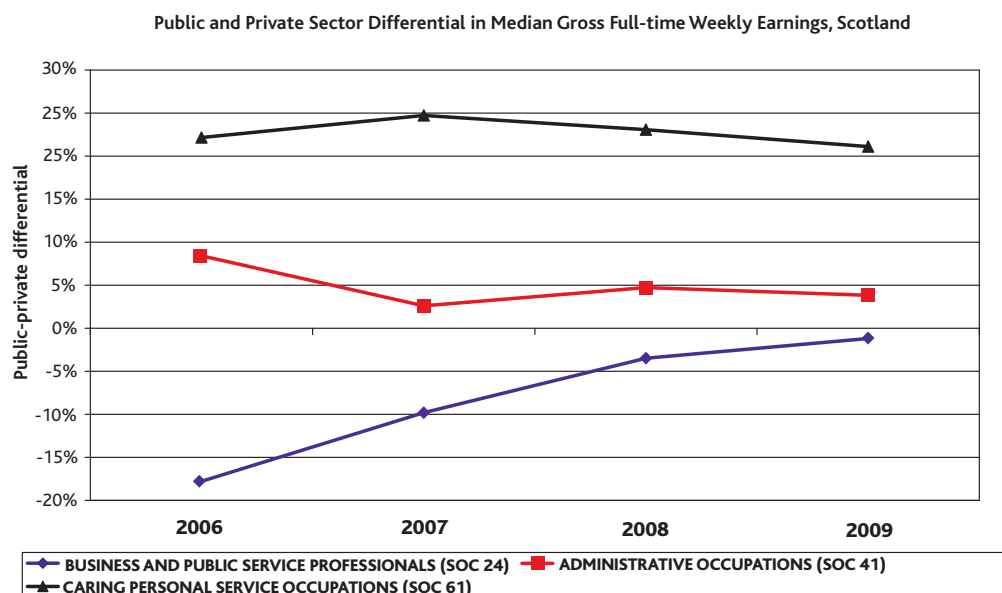
Figure 4.1: Public-Private Sector Differential (Occupation Adjusted)



4.25 Figure 4.2 presents, as examples only, the average public-private pay differentials that exist for three occupational groups. If the differential is above 0 per cent, the differential operates in favour of public sector workers; if, however, it is below 0 per cent then the differential operates in favour of the private sector.

18 2010-11 Northern Ireland Public Sector Pay and Workforce Technical Annex, Department of Finance and Personnel in Northern Ireland (April 2010)
www.dfpni.gov.uk/2010-11-pay-and-workforce-technical-annex.pdf

Figure 4.2: Average Public-Private Pay Differentials for Caring, Administrative and Professional Occupations



Source: Scottish Government, June 2010

4.26 It is clear from Figure 4.2 that public sector workers in caring personal service occupations (e.g. nursing auxiliaries, care assistants, nursery nurses) and administrative occupations in Scotland earn a premium over their private sector counterparts. The premium is particularly high for workers in caring personal service occupations. However, the picture is different for those working in business and public service professional occupations (e.g. accountants, architects, solicitors, social workers) where the differential is now approaching parity.

4.27 Professor David Bell has recently analysed rates of wage cost inflation across the Scottish public sector between 2004-05 and 2008-09 and international benchmarks of public sector pay:

"Some components of the Scottish Government wage bill have been growing very rapidly. For comparison, the UK Average Earnings Index, which measures pay rates over the whole economy, grew at 3.7%..., while price inflation was 2.6%. Some public sector workers have enjoyed very significant real wage increases over this period.

"Payments to those working in the health sector comprise the largest single component of wage costs for the Scottish Government. The cost of employment in the Scottish NHS increased by around £1 billion between 2004-05 and 2008-09 – an average annual increase in pay costs of 6.3%. ...

"Some data is also available to provide international benchmarks of public sector pay. For example, the OECD monitors trends in pay in health and education across all OECD countries. ... the OECD data suggests that UK general practitioners are relatively better paid than any other country in the OECD,¹⁹ while consultants (specialists), though well-paid, are lower down the OECD pay league.

"Similarly, international data is available on teachers pay...It shows that Scottish primary teachers are relatively well-paid compared with teachers in other OECD countries.

"Of course, information on pay provides only a partial view of the effectiveness of government spending in different parts of the public sector. In particular, without information on productivity and conditions in different labour markets, one should not leap to conclusions about value for money. Nevertheless, when budgets are being tightened, it is important that as much of this information as possible is available to decision-makers so that they can best decide how to use taxpayers money. Pay is a vital component of conditions of work and plays an important role in affecting efficiency and morale."

Budget Cuts and Public Sector Pay in Scotland, Professor David Bell (May 2010)²⁰

4.28 During the recession, annual growth in private sector earnings in Scotland fell sharply, from 4.6 per cent in 2007-08 to 0.2 per cent in 2008-09. As yet, public sector wages in Scotland have been less influenced by the recession and grew by 3.7 per cent in 2007-08 and 5.3 per cent in 2008-09.²¹ The same effect is evident in the UK data, with growth in private sector wages falling from 4.6 per cent in 2007-08 to 1 per cent in 2008-09, compared to a fall from 4.3 per cent to 3.1 per cent in the public sector.²²

4.29 The most recent UK data on average weekly earnings are presented in Table 4.3 below. In the three months to April 2010, average weekly earnings in the private sector increased by 4.5 per cent on the previous year, up from 4.2 per cent in the three months to March. The last time private sector earnings grew by over 4 per cent was June 2008. This suggests that private sector earnings are recovering.

19 [www.ois.oecd.org/olis/2009doc.nsf/ENGDATCORPLOOK/NT0000490A/\\$FILE/JT03267652.PDF](http://www.ois.oecd.org/olis/2009doc.nsf/ENGDATCORPLOOK/NT0000490A/$FILE/JT03267652.PDF)

20 www.scottish.parliament.uk/s3/committees/finance/inquiries/budget/documents/adviser_pay.pdf

21 Annual Survey of Hours and Earnings, ONS
www.statistics.gov.uk/statbase/product.asp?vlnk=13101

22 *ibid.*

Table 4.3:

Average Weekly Earnings in Public and Private Sector		
Jan – April 2010 – % increase (year-on-year growth over a 3 month period)		
Month (2010)	Public Sector excluding financial services ²³	Private Sector
January	2.6	-0.1
February	2.5	1.8
March	2.8	4.2
April (provisional)	2.5	4.5

Source: ONS

Workforce

4.30 In 2009, there were 576,700²⁴ people employed in the public sector in Scotland, accounting for 23.3 per cent of total employment. Of this total, 506,000 were employed in devolved bodies in Scotland.²⁵ Devolved public sector employment currently accounts for 20.5 per cent of total employment in Scotland.²⁶

4.31 Devolved public sector employment has increased by 49,200²⁷ (10.7 per cent) between 1999 and 2009.²⁸ This compares with an increase in private sector employment of 4.9 per cent over the same period.²⁹

4.32 The public sector share of total employment in Scotland (23 per cent) is above the UK average (19.8 per cent) but below that in Wales (23.9 per cent) and Northern Ireland (28.8 per cent).³⁰

Employment in devolved bodies

4.33 Table 4.4 provides a breakdown of total devolved employment by key staff group:

23 This excludes 36,700 staff in those financial institutions (RBS, Lloyds Banking Group and Northern Rock) which have been reclassified as public corporations.

24 *ibid.*

25 The remaining 70,200 relate to reserved public sector employment, and 520 relate to the Scottish Parliamentary Corporate Body.

26 Scottish Government National Statistics (2010), *Public Sector Employment in Scotland: Statistics for 4th Quarter 2009*, 17 March 2010.

27 This excludes public sector financial institutions. Total public sector employment increased by 15.1 per cent between 1999 and 2009, but much of this is caused by the reclassification of RBS and the Lloyds Banking Group as public corporations.

28 Scottish Government National Statistics (2010), *Public Sector Employment in Scotland: Statistics for 4th Quarter 2009*, 17 March 2010, Table 2.

29 *ibid.*, Table 1.

30 Currently, because of methodological difficulties, no international comparative data on public employment exists which includes Scotland or the UK.

Table 4.4:

Total Devolved Employment by Key Staff Group	
Public Sector	% of total
NHS Agenda for Change	29
NHS Medical & Dental	2
NHS General Medical Practitioners	1
Local Government (including Fire Services)	45
Teachers	11
Police	5
NDPBs, Public Corporations, Departments and Agencies	5
Scottish Government Main	1
Total	100

Source: Scottish Government

4.34 Significant changes have occurred in the number of people employed in the key staff groups in Scotland's workforce over the last decade. The number of doctors and dentists has risen by 39 per cent, NHS Agenda for Change staff by 27 per cent and police by 19 per cent. In contrast, the number of teachers and public administrators³¹ has risen by 4 per cent and 2 per cent, respectively.

4.35 Figures for local government are not available on the same basis. However, national statistics³² suggest that the number of local government staff (excluding fire and police) increased by 1.7 per cent between 1999 and 2009. Again, there are significant differences across professions. Notably, the category 'Other Education staff' within local government - which includes classroom assistants - has increased by 41.7 per cent since 1999.

31 Public administrators include the Scottish Government Main Bargaining Unit, NDPBs, Public Corporations, Departments and Agencies.

32 Scottish Government National Statistics (2010), *Public Sector Employment in Scotland: Statistics for 4th Quarter 2009*, 17 March 2010, Table 2
www.scotland.gov.uk/Publications/2010/03/16154446/0

OPTIONS

4.36 The size of the pay bill reflects the average cost per employee and the number of employees. Faced with diminishing resources, therefore, the Scottish Government and other public sector employers have only two broad options:

- to reduce the average cost per employee – e.g. by freezing pay, adjusting other elements of the remuneration package, reducing hours of work; and/or
- to reduce the number of employees – e.g. through a freeze on recruitment, natural wastage (i.e. non filling of posts when people leave or retire) or redundancy.

4.37 The Panel is of the opinion that both of these approaches will require to be considered. The first option clearly has the ability to constrain growth in the pay bill and hence mitigate the scale and impact of individual job losses and redundancies in the short term.

4.38 At the request of the Panel, the Scottish Government has estimated the financial impact of a range of pay and workforce options on the Scottish pay bill:

Pay Restraint Measures

A. Payfreeze

4.39 The UK Government has announced that there will be a two year pay freeze (i.e. a basic award³³ of 0 per cent) for public sector workers, from 2011-12, except for those earning £21,000 or less, who will receive at least £250 in these years. The Scottish Government has, to date, reserved its position and has not yet made a definitive statement on whether or not it intends to adopt the UK policy for pay restraint. The Scottish Government has, however, made it clear that it will tightly restrain pay.

4.40 Clearly, there is a wide variety of pay restraint options for the Scottish Government to consider. Four options have been identified:

1. **Option 1: UK option** – a two-year pay freeze for public sector workers, from 2011-12, except for those earning £21,000 or less, who would receive at least £250 in these years. At the current time, the UK position appears to be that, where public sector employees are entitled to progression,³⁴ these payments would be continued;

³³ This is the inflation or cost of living element of the pay award.

³⁴ Pay progression is the increase paid to staff as they move up a defined pay scale towards the rate for the job as they gain experience. While progression arrangements vary across the public sector, progression is generally dependent on satisfactory performance.

2. **Option 2: pay freeze with no threshold for lower paid workers** – a two-year pay freeze for all public sector workers, from 2011-12. All progression payments would continue;
3. **Option 3: freeze on all pay (i.e. including progression) for all public sector workers** – a two-year pay freeze and suspension of progression pay for all public sector workers, from 2011-12; and
4. **Option 4: pay freeze with a threshold for lower paid workers which is either in line with the UK threshold or the Scottish Government's target for reducing poverty and income inequality in Scotland³⁵** – a two-year pay freeze for public sector workers, from 2011-12, except for the lowest paid as defined by the Scottish Government's solidarity target. Progression payments could be continued or suspended.

Situation in England

4.41 In England, Option 1 will apply to the civil service and public workers whose pay is determined by Pay Review Bodies: doctors and dentists, NHS Agenda for Change staff, teachers, the Armed Forces and prisons. The Home Secretary will determine police officer pay, taking into account Police Negotiating Board recommendations and the UK Government's policy on public sector pay. Although pay decisions for local government are for local government employers, the Government has made it clear that they are expected to exercise similar restraint, with budgets adjusted accordingly.

Options for Scotland

4.42 Scotland and the other Devolved Administrations will continue to set pay for their workforces. Table 4.5 below presents the financial impact which the introduction of Options 1 to 3³⁶ would have on Scotland's public sector pay bill and compares these with the increases that would be incurred if the pay bill increased in line with historical movements in public sector pay (see Table 4.1). The figures presented in Table 4.5 show the expected change in the pay bill in 2011-12 and 2012-13 compared to 2010-11.

35 The Scottish Government's solidarity target is defined in the *Government Economic Strategy* (November 2007) as: "To increase overall income and the proportion of income earned by the three lowest income deciles as a group by 2017." www.scotland.gov.uk/Publications/2007/11/12115041/0

36 It has not been possible to estimate the financial impact of Option 4 in the time available. It is clear, however, that this option will be significantly less expensive than Option 1 (as it would apply to a far lower number of staff than 47 per cent of the public sector workforce) and more expensive than Option 2 (which assumes no threshold is applied), assuming progression continues under Option 4. If progression were suspended under Option 4, then it would cost significantly less than Options 1 and 2.

Table 4.5:

Impact of Pay Restraint Options on Total Pay Bill Expenditure		
Cumulative increase in pay bill relative to 2010-11, £ million, cash terms		
	2011-12	2012-13
Pay bill increases in line with historical movements	420	900
Option 1: UK option	180	340
Option 2: pay freeze with no threshold for lower paid workers	110	210
Option 3: freeze on all pay (i.e. including progression) for all public sector workers	0	0

Source: Scottish Government, July 2010

4.43 Table 4.5 shows that Options 1 and 2 would constrain growth in the pay bill but not reduce it. In 2011-12, under Options 1 and 2, the total pay bill would, in broad terms, increase by approximately £200 million and £100 million, respectively, as opposed to an increase of over £400 million which would occur in the absence of any pay restraint. The UK Option, therefore, would generate a saving of approximately £200 million, while Option 2 would generate a saving of approximately £300 million, in the first year.

4.44 It is clear, however, that, under both options, the total cost of the pay bill would continue to rise. This reflects the fact that, under both options, where eligible, staff would still receive progression pay, and, under Option 1, 47 per cent of staff (i.e. those who are paid under £21,000) would be excluded from the pay freeze and would receive an increase of at least £250. The total pay bill may also rise due to increases in employers' National Insurance contributions³⁷ and employers' pension contributions.³⁸

4.45 Under Options 1 and 2, therefore, reductions in staff numbers would be required to hold the pay bill flat in cash terms (i.e. a 0 per cent award) relative to 2010-11. Option 3 would achieve the same result without a reduction in staff numbers. Option 3, however, is still not sufficient to close the gap in the pay bill budget. It is clear from Table 4.1 that the pay bill needs to be reduced by over £300 million in the first year to close the gap. Option 3 would simply keep the pay bill flat at 2010-11 levels; it would not reduce the pay bill. A reduction in staff numbers, therefore, would also be required under Option 3 unless additional cuts could be made from the non-pay bill component of resource DEL.

³⁷ Employers' National Insurance contributions are determined by the UK Government.

³⁸ Employers' superannuation costs will rise or fall depending on actuarial advice on the level of contributions required to keep pension schemes in financial balance. Employers may seek to place some or the entire burden of an increase in contributions on employees. Contribution levels can go up as well as down.

4.46 The effect of Option 3, however, is that, relative to Options 1 and 2, it would do more to mitigate job losses in the first two years of the new Spending Review period (when recovery in the Scottish economy may still be fragile). Some staff groups, however, may have a contractual agreement to progression (e.g. nurses, local government workers, teachers and police), while others may have an expectation of progression. Given the very real pressure which progression and threshold costs exert on the budget and staff numbers, there is a clearly a trade-off to be made between, on the one hand, continuing current progression arrangements and protecting the lowest paid and, on the other hand, mitigating job losses.

4.47 Table 4.6 below presents the costs that would be incurred in terms of pay bill expenditure and job losses³⁹ if progression payments continued and a £21,000 threshold were to be applied in Scotland. The total cost over the course of two years would be approximately £340 million. If this cost is to be accommodated within reductions in pay bill expenditure (as opposed to non-pay bill expenditure), then over 12,000 public sector jobs could have to be lost just to keep the pay bill flat at 2010-11 levels. These job losses could be avoided under Option 3.

Table 4.6

Cost of Progression and Threshold, in terms of Expenditure and Public Sector Jobs				
Cumulative decrease relative to 2010-11				
	2011-12		2012-13	
	£ million	No of public sector job losses equivalent	£ million	No of public sector job losses equivalent
Cost of applying a threshold	70	2,500	130	4,500
Cost of progression	110	3,900	210	7,600
Saving if no threshold or progression applied (Option 3)	180	6,300	340	12,200

Source: Scottish Government, July 2010

"We would recommend that there should be a pay freeze across the public sector in 2011-12 and possibly 2012-13, depending on the severity of the settlement. This will give public bodies some breathing space as they assimilate to the new landscape.... Consideration may also have to be given to other aspects of the public sector pay bill. For example, many organisations have pay grades which provide for incremental progress on an annual basis, over and above any inflationary pay award. This increases costs by tens of millions of pounds each year. We would question whether this is sustainable in the new economic climate."

SOLACE Scotland, submission to the Independent Budget Review

³⁹ Calculated by dividing the increase in expenditure by the average cost per public sector employee (around £28,000).

4.48 The Panel has considered the following questions:

- Question 1:** Would it be feasible to suspend progression payments which may be contractual?
- Question 2:** Is there evidence that justifies the cost (in monetary terms and in terms of job losses) of exempting those who are paid less than £21,000 from a pay freeze?
- Question 3:** What is the Scottish Government's target for reducing poverty and income inequality and what level of threshold would that imply to protect the lowest paid workers?

4.49 On the first question, it is not clear if a suspension of progression arrangements for one or two years would be possible where staff have a contractual entitlement. Most of the key staff groups – NHS, Teachers, Police, local government – may have a contractual entitlement to progression. In contrast, for all public bodies subject to Scottish Public Sector Pay Policy (6 per cent of the devolved public sector workforce), progression is dependent on affordability. For reasons of equity, the Panel is firmly of the view that a consistent policy on progression should apply to all public sector workers.

4.50 In local authorities, although progression increments are contractual, the nature of that contractual obligation will be determined locally. Each contract is a matter for individual councils to determine, and reflects their agreed local conditions. A number of contracts contain contract clauses which would allow the increments to be withheld. For example, such clauses might stipulate that increments would be paid subject to satisfactory performance, or will 'normally be applied'.

4.51 Given the 'patchwork' of arrangements, the Panel's conclusion is that any proposal for the temporary suspension of progression arrangements for one or two years should, in the first instance, be pursued with the employee negotiating bodies. Negotiations would need to be pursued immediately given the possible need to choose between a continuation of progression payments and the loss of public sector jobs.

4.52 Turning to Questions 2 and 3 above, one of the key findings presented in the evidence section of this Chapter (finding 5 in paragraph 4.18) is that the distribution of wages in the public sector is already significantly more compressed than for the private sector and that, therefore, on average, lower paid workers already earn a premium over their private sector counterparts.

4.53 Nevertheless, one of the key considerations set out in the Remit of this Review is the importance of protecting and supporting the most vulnerable in our society, and one of the Scottish Government's key targets set out in the *Government Economic Strategy* – the solidarity target⁴⁰ – is to reduce disparities between the richest and poorest.

40 *The Government Economic Strategy*, Scottish Government (November 2007) www.scotland.gov.uk/Publications/2007/11/12115041/0

"Building on the concept of a Scottish Living Wage and increasing rates of pay at the bottom of the public sector pay spectrum would set an example in tackling in-work poverty."

Child Poverty Action Group, submission to the Independent Budget Review

4.54 The Scottish Government's solidarity target is to: *"reduce income inequality by increasing the proportion of that income received by the lowest earning 30 per cent of the population."* If the UK threshold of £21,000 were applied to Scotland, that would mean that 47 per cent of the public sector workforce would be exempt from a pay freeze. The Panel would question whether this is an appropriate threshold for Scotland.

4.55 The latest projected figures for inflation⁴¹ are presented in Table 7 below.

Table 4.7

Projected Inflation Figures ⁴²				
	2011-12	2012-13	2013-14	2014-15
Retail Prices Index	3.2%	3.2%	3.3%	3.4%
Consumer Prices Index	2.4%	1.9%	2.0%	2.0%

Source: Office for Budgetary Responsibility, June 2010

4.56 Clearly, a pay freeze in 2011-12 and 2012-13 would, in effect, represent a pay cut for public sector workers of either 2 per cent or 3 per cent each year in real terms, depending on whether one uses the consumer price index or the retail price index as a measure of inflation.⁴³ Also, as from April 2011, all employees will pay an additional 1 per cent in National Insurance Contributions. Given the above, the Panel has not considered a pay freeze beyond 2012-13.

B. Non-consolidated, non-pensionable performance pay/bonuses

4.57 Non-consolidated pay⁴⁴ accounts for a small proportion of total pay across the public sector in Scotland. Many large staff groups such as nurses, teachers and police officers do not have access to non-consolidated pay of any kind (although senior police officers do).

41 These projections underpin the UK Office for Budget Responsibility's public finance projections included in the June UK Budget, 2010.

42 *Budget Forecast*, Table C5, Office for Budgetary Responsibility (June 2010) www.hm-treasury.gov.uk/d/junebudget_annexc.pdf

43 RPI includes housing cost inflation and therefore provides a broader measure of increases in the cost of living.

44 Non-consolidated payments are those made to individual staff in the current year but which are not consolidated into their pay for future years (i.e. they do not affect future pay levels).

4.58 Table 4.8 presents the cost of non-consolidated performance pay/bonuses by key staff group. It is clear that payments to NHS medical consultants (via the Distinction Awards Scheme) accounts for the majority of expenditure (£28 million, or 89 per cent). This has been frozen for 2010-11 at that level. The remainder (£3.5 million, or 11 per cent) represents the total cost of non-consolidated pay/bonuses for other key staff groups in the public sector.

Table 4.8

Non-Consolidated Performance Pay/Bonuses by Key Staff Group	
£ million	2009-10
	Bonus
NHS Agenda for Change ⁴⁵	0.4
NHS Medical and Dental	28.0
Police - Officers and Support ⁴⁶	-
Teachers ⁴⁷	-
All public bodies subject to Scottish Public Sector Pay for Staff ⁴⁸	1.3
NDPB and Public Corporation Chief Executives subject to Scottish Public Sector Pay for Senior Appointments ⁴⁹	0.35
Senior Civil Service ⁵⁰	1.3
Local Government (Fire services ⁵¹)	0.2
Total	31.55

45 For Executive and Senior Management cohorts, non-consolidated payments were not part of the 2009-10 settlement. However, in 2008-9 costs were calculated to be around £0.4 million.

46 There are no specified bonuses for the police. There is a bonus scheme which provides for non-pensionable bonuses of up to 15 per cent of pensionable pay for Chief Constables; up to 12.5 per cent for Deputy Chief Constables; and up to 10 per cent for Assistant Chief Constables. If bonuses are paid, this would come from Police Boards' allocated funding and would be a decision for Chief Constables and Police Board Conveners. No central information is held on any bonuses paid. The level of any bonuses are a matter for the relevant Police Board.

47 No bonuses paid.

48 £1.3 million equates to 0.64 per cent of the Scottish Government main pay bill which is the maximum amount that can be paid as non-consolidated performance related pay in each year. The 2008-9 performance payments totalled £0.9 million.

49 Ministers have set an upper limit on the level of non-consolidated payments that can be made – this is currently 10 per cent of consolidated salary. This ensures that such payments are available only where genuinely exceptional performance has been clearly demonstrated and there is a rigorous process in place to ensure that this is the case. The total maximum amount available to senior staff covered by the policy is £350,000.

50 The pay framework for the SCS – including base pay and non-consolidated performance pay – is set by the UK Government following recommendations by the SSRB. On 16 May 2010, the Prime Minister announced a restriction on performance payments for senior civil servants to only the top 25 per cent of performers in respect of performance in 2010-11 (amounts payable in 2011-12). There is no indication as yet of the aggregate financial amount that will be available in 2011-12 or beyond.

51 Only one area – Highland and Islands – has a bonus arrangement in place for fire services.

4.59 It has not been possible to obtain financial information on non-consolidated pay/bonuses in local government⁵² or for senior police officers and, therefore, the costs for these staff groups are not included in Table 4.8. However, COSLA has informed the Panel that bonuses form part of the remuneration package for tradesmen under the Craft pay bargaining arrangements but that as a proportion of the pay bill it is extremely small. The number of senior police officers who are entitled to receive a non-pensionable bonus is also small (27 officers). Non-consolidated pay/bonuses, therefore, are likely to account for a small proportion of the total pay bill, certainly less than 1 per cent.

4.60 The UK Government has announced⁵³ that Will Hutton will lead a review of fairness in senior public sector pay, reporting in spring 2011. The Fair Pay Review will examine all aspects of the public sector pay package, including bonuses.

4.61 The Panel has seriously considered the options that could be taken to reduce the costs associated with non-consolidated performance pay/bonuses very seriously, including the possible suspension of all payments until the Fair Pay Review concludes. However, given the nature of the imbalance represented by the NHS Distinction Award Scheme (the cost of which represents over 85 per cent of the total cost of non-consolidated performance pay in the public sector and is the equivalent of approximately 1,000 public sector jobs) the Panel has concluded that any decisions on non-consolidated performance pay needs to await the outcome of the Fair Pay Review.

The Panel suggests that the Scottish Government provides evidence to the Fair Pay Review urging that particular attention is paid to the NHS Distinction Awards scheme, the cost of which appears significantly out of line with all other public sector non-consolidated performance pay/bonus arrangements, and further considers the position once the Fair Pay Review is completed.

C. Pay cuts

4.62 The Panel is aware that in Ireland action has been taken to cut pay across the public sector. There, tiered pay cuts will apply: 5 per cent on the first €30,000 of salary, 7.5 per cent on the next €40,000, 10 per cent on the next €55,000 of salary and so on, up to a maximum of 15 per cent for earnings in excess of €200,000. Clearly, the scale of these cuts is significant and has provoked industrial unrest.

⁵² With the exception of fire services.

⁵³ UK Budget (June 2010) www.hm-treasury.gov.uk/2010_june_budget.htm.

"These are drastic measures and have been met with some resistance, though clearly not by as much as the austerity measures in Greece. Unlike the UK, Ireland does not have the opportunity to devalue, which is a much less confrontational mechanism for reducing real incomes.

"The public-private sector pay gap in Ireland was much larger than that in the UK and Scotland. Estimates by Kelly, McGuinness and O'Connell (2009)⁵⁴ suggests that the public sector wage premium⁵⁵ in Ireland grew from 14% to 26% between March 2003 and October 2006. Estimates of the premium in the UK show it is much smaller than in Ireland and is negative for some groups including skilled males."

Budget Cuts and Public Sector Pay In Scotland,
Paper for the Scottish Parliament Finance Committee, Professor David Bell (May 2010)⁵⁶

4.63 Importantly, the Panel has been advised that, in practice, the scope for pay cuts in Scotland is likely to be constrained by employment law and the UK Government's position on pay. Employment law is generally reserved to the UK Parliament. It is considered unlikely, therefore, that the Scottish Parliament could enact the necessary primary legislation to address the contractual issues arising from the implementation of pay cuts.

4.64 The Panel also finds it difficult to envisage a situation where pay cuts would be regarded as a credible policy option in Scotland if the UK Government were not also pursuing such a policy. Accordingly, while the option exists to pursue pay cuts as a means of reducing the pay bill, this action would require to be pursued by the Scottish Government at UK level. To date, there has been no general discussion in the UK of the possibility of pay cuts for public sector employees, although, as mentioned above, the UK Government has commissioned the Fair Pay Review to consider fairness in senior public sector pay.

4.65 The Panel's conclusion is that an approach of blanket reduction in pay levels applied across the public sector is unlikely to be appropriate or deliverable in the Scottish setting.

4.66 It should be noted that application of any of the pay freeze options would, in effect, represent a real terms pay reduction for public sector employees.

54 *The Public-Private Sector Pay Gap in Ireland: What Lies Beneath?* E Kelly, S McGuinness, PJ O'Connell, ESRI Working Paper 321 (2009)
www.esri.ie/UserFiles/publications/20091102110232/WP321.pdf

55 The public sector wage premium is the proportion by which the public sector wage rate exceeds the market rate, after controlling for factors like age, gender, qualifications, etc.

56 www.scottish.parliament.uk/s3/committees/finance/inquiries/budget/documents/adviser_pay.pdf.

D. Pensions and employers' National Insurance contributions

4.67 Employers' pension and National Insurance (NI) contributions represent approximately 20 per cent to 25 per cent of the total Scottish pay bill. Both of these aspects of the pay bill are reserved to the UK Government.

"Older people mainly rely on pensions for income. Relatively few are dependent on investment income or income from other sources as well such as housing. There has been in recent years considerable pressure to reform the UK pension system. Little change has taken place in reality, though there is some political pressure to restore the link with earnings rather than prices. Those entirely dependent on the state pensions, and pension credit, experience a low standard of living, though typically paying less for housing than younger families....

"It is evident that in recent years in the private sector employers have become increasingly unwilling to support defined benefit (DB) pensions. These continue to predominate in the public sector. Many public sector schemes are financed on a pay-as-you-go basis: payments to current pensioners are made by a combination of those currently contributing to the scheme and the taxpayer. This contrasts with a funded scheme, where contributions are specifically interested in a fund that is designed, given expected market returns, to be able to meet future liabilities. Where pay as you go schemes are under-funded taxes have to be increased above where they otherwise would be.

"DB schemes contrast with defined contribution (DC) schemes, which are now more common in the private sector. In these, the individual has to take a greater degree of risk: the value of the pension only becomes known when the accumulated contributions are exchanged for an annuity.

"If the economy does not grow rapidly out of the recession, it will become increasingly difficult for individuals to secure a good return on their savings. This will inevitably mean increased contributions, later retirement or smaller pensions.

"It is likely that there will be increasing pressure on public sector employers to shift more of the risk to their employees, rather than to take on all of the risk associated with meeting defined benefit pension scheme liabilities. Thus, one of the likely pressures associated with budget cuts may be to move from DB to DC public sector pensions. Pension providers are also likely to press for increases in retirement ages, which is one way of limiting their liability. Over the last 30 years long-term investment has been inadequate, reflecting the prioritisation of successive governments in allocating public expenditure. Although this legacy has been recognised and partly addressed through additional public and private sector investment since devolution, more is required."

Demographic Issues and the Scottish Budget
Paper for Scottish Parliament Finance Committee, Professor David Bell (May 2010)⁵⁷

⁵⁷ www.scottish.parliament.uk/s3/committees/finance/inquiries/budget/documents/Adviser_demog.pdf.

"We have seen that public and private pay are broadly in line with each other, but that pensions in the public sector are much more generous, in large part because of greater coverage. Cutting the future value of unfunded public pensions will improve the real state of the public finances in the long term, but will do nothing for the current deficit. But there is one policy alternative worth considering in the current context – a policy implemented in February 2009 by the Irish Government – which is to increase the contributions that employees make now in respect of their future pensions."

IFS Green Budget (February 2010)

4.68 In June 2010,⁵⁸ the UK Government announced the establishment of an Independent Public Service Pensions Commission to undertake a fundamental structural review of public service pension provision. The Commission (chaired by Rt Hon John Hutton MP) will produce an interim report in September 2010 considering *"the case for delivering savings on public sector pensions within the spending review period – consistent with the Government's commitment to protect those on low incomes – to contribute towards the reduction of the structural deficit."* A final report will be produced in time for Budget 2011 making recommendations on how public service pensions can be made sustainable and affordable in the long-term. The scope of the review includes the six main public sector pension schemes in Scotland⁵⁹ and smaller schemes will be required to act on the recommendations.

"The expectation that people will live for longer is increasing the value of pension liabilities. ... Audit Scotland calculates that the level of unfunded liabilities in the five main schemes administered in Scotland may be as high as £43 billion. This excludes the main civil service scheme which is administered at the UK level. If the civil service scheme is included the unfunded liability for Scotland may be about £53 billion.

"... the funding shortfall and unfunded liabilities of public sector pension schemes in Scotland are increasing. The contributions from both employees and employers will almost certainly increase and there are likely to be demands on future public spending to meet these costs."

Robert Black, Auditor General for Scotland, quoted in news release on launch of *Public Sector Pension Schemes in Scotland*, Audit Scotland (June 2006)⁶⁰

⁵⁸ UK Budget, June 2010.

⁵⁹ Local Government Pension Scheme (LGPS), NHS Pension Scheme Scotland NHSPSS), Scottish Teachers' Pension Scheme (STPS), Principal Civil Service Pension Scheme (PCSPS), Firefighters' Pension Scheme (FPS), and Police Pension Scheme (PPP).

⁶⁰ News release: www.audit-scotland.gov.uk/media/article.php?id=22
Full report: www.audit-scotland.gov.uk/docs/central/2006/nr_060620_publicsector_pension.pdf.

4.69 The Panel recognises that the current and projected costs of pensions are an issue of major significance for Scotland's future public finances. Indeed, this issue dwarfs a number of other issues considered in this Report. The Panel has also noted some options that are available to reduce public sector pension costs (such as those discussed by the Scottish Public Sector Pensions Agency⁶¹).

The Panel suggests that the Scottish Government recognises that changes to the current public sector pension arrangements are essential and almost certainly unavoidable and that it should engage proactively with the work of the Independent Public Services Pensions Commission.

4.70 In relation to National Insurance Contributions, the UK Government has announced⁶² an increase in the threshold above which employers are liable to pay NI contributions on employees' earnings. While employers will still be required to pay 1 per cent (which in Scotland will increase the pay bill by approximately £29 million each year), this is less than would have been required at the lower threshold. Again, however, this represents upward pressure on the pay bill which needs to be paid by the Scottish Government and other Scottish employers.

Reductions in the Size of the Workforce

E: Additional options to mitigate job losses and redundancies

4.71 It is clear from the analysis above that pay restraint measures have a critical role to play in constraining growth in the pay bill. The Panel would like to highlight a range of additional options that could possibly mitigate the need for job losses and redundancies in the short term:

- recruitment controls and transfer arrangements;
- revised working arrangements and practices (e.g. reducing hours worked, short working week, short-term working);
- flexible working arrangements; and
- voluntary severance schemes where affordable.

4.72 These and similar options rest primarily with individual employers in the public sector taking into account their own circumstances and consulting with relevant staff and employee representative bodies.

⁶¹ See Annex F: Options available to reduce public sector pension costs

⁶² UK Budget (June 2010).

F. Freeze on recruitment

4.73 Action taken now, in this current financial year, to introduce a general freeze on recruitment, other than for essential/critical posts, could: provide greater flexibility in planning for a prospective reduction in employee numbers; assist in seeking to protect the position of existing employees; and generate current year savings which might assist in meeting costs of voluntary severance schemes. The precise nature and duration of this and any ongoing freeze would be a matter for individual employers, tailored to their own circumstances and the success of other measures applied by them, but the Panel believes that direct guidance from the Scottish Government would be appropriate.

The Panel suggests that the Scottish Government should consider the immediate implementation of a recruitment freeze across the public sector, with exceptions only granted for essential staff posts. The period of the freeze will be dictated by the success of the action taken above.

G. Reductions in the size of the workforce

4.74 The forthcoming reductions in the Scottish Resource DEL budget over the period 2011-12 to 2014-15, imply that significant sustained reductions in the pay bill will be required.

4.75 It is clear from the analysis above that, while pay and recruitment freezes have a critical role to play in constraining growth in the pay bill, they are insufficient on their own, both in terms of scale and duration, to represent an effective response to the forthcoming reductions in public spending in Scotland.

"A couple of years of pay freezes or other restraint could save significant money in the short run and, in current labour market conditions, would be unlikely to create recruitment problems. But, given the tendency for public sector workers to 'catch up' following periods of pay restraint, further cuts in the public sector workforce are more likely to deliver the lasting reductions in public spending as a share of national income sought by the Treasury."

IFS Green Budget (February 2010)

4.76 Reducing the number of employees is an option available to the Scottish Government and other public sector employers in seeking to close the projected budgetary gap.

4.77 Tables 4.9 and 4.10 below include estimates of reductions in public sector employment that would be required to close the budgetary gap if pay freeze Options 1 to 3 were adopted in 2011-12 and 2012-13, followed by pay restraint in 2013-14 and 2014-15.

4.78 Two pay restraint options for 2013-14 and 2014-15 have been considered:

- **Option A:** tight pay restraint with a net increase in the pay bill (including costs of progression) of 2 per cent; and
- **Option B:** pay award in line with projections for General Government average earnings growth⁶³ (3.1 per cent in both years).

4.79 The estimates presented in Tables 4.9 and 4.10 are based on the Scottish Government's projected figures for Resource DEL and take account of the:

- additional costs that would be incurred under pay freeze Options 1 to 3 in the first two years and under pay restraint Options A and B in the third and fourth year; and
- additional costs associated with Employers' NI contributions.

Table 4.9

Effects of Pay Options on the Scottish Government's Resource DEL budget: changes relative to 2010-11				
(£ million, expressed in cash terms)	2011-12	2012-13	2013-14	2014-15
Funding Gap – Based on projected decreases in resource DEL relative to 2010-11, assuming the pay bill equals 59 per cent of total resource DEL)	320	230	210	250
Additional Costs Arising from Pay Freeze Options 1 to 3 and Employers' NI contributions (assuming no changes in employment)				
Option 1: (Pay freeze all workers except for those earning £21,000 or less, plus pay progression)	180	340	-	-
Option 2: (Pay freeze for all workers with no exceptions. Pay progression remains)	110	220	-	-
Option 3: (Pay freeze for all workers, no exception plus no pay progression)	0	0	-	-
Additional Costs Arising from Pay Restraint Options A and B in 2013-14 and 2014-15				
Option A: Net pay bill increase of 2 per cent per annum (including costs of progression)	-	-	280	580
Option B: Pay awards rising in line with projections for General Government average earnings growth of 3.1 per cent per annum	-	-	440	900

Source: Scottish Government, July 2010

63 Office for Budget Responsibility, *OBR forecast: Employment*, 30 June 2010.

Table 4.10

Funding Gap ¹ under a Range of Pay Options, Shown Alongside Equivalent Offsetting Headcount Reductions ²								
(£ million, expressed in cash terms)	2011-12		2012-13		2013-14		2014-15	
	Gap (£m)	Headcount	Gap (£m)	Headcount	Gap (£m)	Headcount	Gap (£m)	Headcount
Under Options 1 & A	500	17,500	570	20,000	830	29,000	1,170	40,000
Under Options 2 & A	430	15,500	450	16,000	710	25,000	1,050	36,000
Under Options 3 & A	320	11,500	230	8,500	490	17,500	830	29,000
	2011-12		2012-13		2013-14		2014-15	
	Gap (£m)	Headcount	Gap (£m)	Headcount	Gap (£m)	Headcount	Gap (£m)	Headcount
Under Options 1 & B	500	17,500	570	20,000	990	34,500	1,490	50,000
Under Options 2 & B	430	15,500	450	16,000	870	30,500	1,370	46,500
Under Options 3 & B	320	11,500	230	8,500	650	23,500	1,150	39,500

Source: Scottish Government, July 2010

1 Funding gap includes projected increases in employers' NI contributions.

2 Headcount numbers indicate the equivalent reductions in public sector employment necessary to eliminate the funding gap shown in Table 4.9, rounded to the nearest 500 full-time jobs.

4.80 It is clear from Tables 4.9 and 4.10 that:

- even if the most severe pay freeze was introduced in the first two years (Option 3), followed by tight pay restraint (Option A) in 2013-14 and 2014-15, a 2.3 per cent (11,500) reduction in public sector employment would be required in year 1. By 2014-15, public sector employment would have fallen by 5.7 per cent (29,000) under these options.
- if the UK Option was introduced in the first two years (Option 1) and average earnings in 2013-14 and 2014-2015 grew in line with projected general government average earnings growth (Option B), a 3.5 per cent (17,500) reduction in public sector employment would be required in year 1. By 2014-15, public sector employment would have fallen by around 10 per cent (50,000) under these options.

4.81 The corresponding UK projections for numbers in General Government employment are presented in Table 4.11. It is clear that the scale of the projected reduction in public sector employment for 2011-12 is significantly higher in Scotland (ranging from 2.3 per cent to 3.5 per cent), compared to the UK as a whole (1.2 per cent). The Scottish Government's decision to defer cuts in public spending for 2010-11 until 2011-12 is a contributing factor to this difference.

4.82 The Panel is aware that many employers are already actively considering significant reductions in headcount. The size of the workforce changes naturally as a result of turnover, with the rate varying between pay groups and over time. If no leavers were to be replaced, even the most static pay groups would see headcount decline by 2 or 3 per cent a year. Some public sector staff groups have projected staff turnover rates considerably higher than this. The core Scottish Government, for example, has projected staff turnover at 5 per cent in 2010-11 (including age retirements). The most recent figure for teachers is 10 per cent. It is possible, therefore, that reductions in employment of the scale indicated in Table 4.10 could be greatly assisted, over time, through natural wastage.

Table 4.11

Projected Changes in General Government Employment (relative to 2010-11)					
	2010-11	2011-12	2012-13	2013-14	2014-15
General Govt. employment growth, % change year on year (1)	-1.2%	-1.2%	-1.3%	-3.0%	-3.7%
General Govt. employment growth, % change relative to 2010-11 (2)	-	-1.2%	-2.5%	-5.4%	-8.9%
Sources: (1) Office for Budgetary Responsibility, OBR forecast: Employment, 30 June 2010 (2) Scottish Government calculations					

4.83 It is important to stress that the change in employment rates presented above are based on the assumption that reductions in the workforce are spread evenly across the public sector. The UK Government has, however, already made it clear that, although the pay freeze in 2011-12 and 2012-13 will apply in health workforces, that the savings will be recycled within the NHS. The NHS workforce in England may, therefore, not bear its full share of the reductions in employment required to close the budgetary gap. If a similar decision is made in Scotland then other key staff groups would inevitably have to bear a proportionately greater reduction in employment. It is highly questionable if the scale of reduction could be achieved through natural wastage.

"I get a bit concerned about the sacred cows – for example, when we say that spending on health and education will not be touched. The definition, or essence, of productivity is that we must get more for what we currently spend. Unless we address the front line – the delivery of service – we will not be able to make the scale of savings and changes that we need. If there is one message to get over, it is that lower spending does not necessarily mean poor service; in fact, if we can eliminate unproductive processes and re-engineer processes, we can get better service for less spend."

Jack Perry, former Scottish Enterprise Chief Executive, oral evidence to the Scottish Parliament Finance Committee, 20 April 2010

4.84 A reduction in public sector employment in the range of approximately 5.7 per cent to 10 per cent over the next four years translates into public sector job losses of between approximately 30,000 and 50,000.⁶⁴ This would take devolved public sector employment back to levels that existed in 1999.

4.85 As noted in Chapter 2, the Fraser of Allander Institute⁶⁵ has recently estimated the impact of anticipated cuts in total Scottish DEL on the Scottish economy. Under a fixed price scenario, by 2014–15 job losses in the public sector amount to nearly 90,000, while private sector job losses are estimated at nearly 37,000.⁶⁶ However, when flexibility in prices (especially wages) is allowed, the impact on job losses in the public sector is much smaller (78,000) and private sector employment rises by 14,000. This reflects the fact that the competitiveness of Scottish industries increase (in response to a fall in production costs) which leads to an increase in demand for goods, services and employment in the private sector and hence offsets the loss of demand from the public sector to some extent. The author concludes: *"There is a 'crowding in' effect on the private sector, but it is insufficient to offset the loss of activity in the public sector."*

4.86 In the course of conducting this Review, the Panel has heard that, given the overarching purpose of increasing sustainable economic growth, and given the priority that both national and local government attach to helping the economy emerge from recession, the phasing and nature of public expenditure reductions in Scotland are matters of legitimate concern.

64 The wages of public sector employees make a major contribution to private sector demand, growth and employment as they are recycled back into consumption and investment in the market place. Job losses in the public sector will therefore have indirect effects on employment in the private sector.

65 *Economic Commentary*, Vol 34, No.1, Fraser of Allander Institute (June 2010) www.strath.ac.uk/media/departments/economics/fairse/Latest-Fraser-of-Allander-Economic-Commentary.pdf

66 These employment numbers relate to the whole public sector in Scotland, both devolved and non-devolved services.

4.87 The Panel has also heard that there might be a real risk of destabilising economic recovery if public sector retrenchment were to translate disproportionately into job losses or redundancies, rather than being managed through the full range of mechanisms suggested in this report. That is not to say that there should be no adjustment to the scale of the labour force, but rather, that there are potentially serious issues concerning the phasing of any such adjustment.

4.88 In 2011-12 (when the budget cuts are anticipated to be particularly severe), the Scottish Government has a choice between:

- a 2.3 per cent to 3.5 per cent (11,500 to 17,500) reduction in public sector employment in 2011-12, managed as far as possible through natural wastage; or
- a smaller reduction in public sector employment in 2011-12 with the remainder of the gap in the pay bill financed from additional reductions in non-pay bill resource expenditure.

STRATEGIC WORKFORCE PLANNING

4.89 Natural wastage and voluntary redundancy measures can play an important part in seeking to avoid compulsory redundancies but would be increasingly random in effect if not set within the context of a strategic workforce planning approach which matches workforce requirements to future needs and service priorities. This planning approach has been touched upon in submissions which we have received from public sector organisations and it would be expected that this process is informing their current contingency planning.

The Panel 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.

4.90 This concept of workforce planning will become all the more significant in the context of the issues raised in Chapter 7 which addresses the future of the public sector.

4.91 A skilled, efficient and effective workforce will continue to be required in a public sector which will, itself, even in a reduced form continue to be the major service provider in Scotland. Any consideration of the future range, nature and distribution of public services would also merit in-depth consideration of the future range and nature of skills required in the workforce, coupled with consideration of the balance of professional, para-professional and support posts required to meet foreseen needs.

4.92 In this setting there would be a natural role for the Scottish government to work with local government, Scottish employers and employee representative organisations to map our future workforce priorities from a national perspective with the objective of investing in a public sector workforce which is:

- highly and appropriately skilled to deliver defined high quality public services while enhancing Scotland's economic performance;
- increasingly productive and innovative, seeking continuous improvement in the delivery of services which match future needs; and
- highly motivated, efficient and effective.

H: No compulsory redundancy

4.93 The Scottish Government is currently pursuing a policy of no compulsory redundancy across the central government sector (including NDPBs and NHS bodies) as part of its approach to the achievement of ongoing efficiency savings. Any change to this policy is a matter for Ministers to consider going forward. Sustaining such a policy in the context of significant reductions in payroll costs becomes increasingly difficult as the process continues and, in the absence of jointly agreed measures to reduce payroll costs, would become extremely difficult.

4.94 The Panel considers it likely that where it is impossible to manage the reductions in staffing required through natural wastage alone and voluntary redundancy, this policy would have to be revisited if the alternative options outlined in this Chapter are insufficient to reduce the pay bill to the extent required.

4.95 The Scottish Government does not hold information centrally on the average cost of compulsory redundancy in the public sector in Scotland. However, the Scottish Government has provided costs of recent voluntary early severance schemes run in February and March 2010. The average cost for voluntary redundancy was £51,000. Clearly, if the reductions in public sector employment presented in Table 4.10 were not manageable through natural wastage, a significantly higher number of public sector jobs would need to be shed to cover this cost. Given that the average cost of employing a public sector worker is £28,000, one voluntary redundancy is broadly equivalent to the one year cost of two public sector jobs.

"In terms of specific pay policy issues examples of current constraints include 'no compulsory redundancy' and 'organisational change protection' – both mean that it is difficult to reduce workforce costs to the extent outlined in the papers through staff turnover and redeployment."

Scottish NHS Board Chief Executives' Group, submission to the Independent Budget Review

CONCLUSIONS

4.96 It is clear from the evidence that the public sector in Scotland has expanded significantly over the last decade. While this expansion could be accommodated when budgets were rising year-on-year, it is unsustainable in the face of the projected significant budgetary cuts.

4.97 In light of the analysis produced by the Office of the Chief Economic Adviser,⁶⁷ which makes it clear that we are entering a period of significant financial constraint for some time to come, the Panel believes that a balance needs to be struck between options that will have an impact immediately and those that are capable of delivering more sustainable reductions in the pay bill.

4.98 Given the projected severity of pressures on the Scottish Budget in the years ahead, the Panel concludes that Scottish Ministers will need to continue to work proactively and urgently to influence and, ideally, agree the terms of the pay settlements and will need to consider whether or not to follow the UK pay recommendations, including those of the UK pay review bodies, in the same way as before.

4.99 Having explored the issues and options, the Panel has identified the following recommendations:

Pay restraint for 2011-12 and 2012-13

The Panel recommends that the Scottish Government applies a pay freeze as the first essential step to constrain growth in the public sector pay bill. Four options have been identified for consideration:

- **Option 1: UK option – a two-year pay freeze for public sector workers, from 2011-12, except for those earning £21,000 or less, who would receive at least £250 in these years. At the current time, the UK position appears to be that, where public sector employees are entitled to progression, these payments would be continued;**
- **Option 2: pay freeze with no threshold for lower paid workers – a two-year pay freeze for all public sector workers, from 2011-12. All progression payments would continue;**

67 *Outlook for Scottish Government Expenditure, June 2010 Emergency Budget Update*, Dr Andrew Goudie, Chief Economic Adviser, Scottish Government (July 2010)
www.scotland.gov.uk/Topics/Economy/17858/ScotGovExp

- **Option 3: freeze on all pay (i.e. including progression) for all public sector workers – a two-year pay freeze and suspension of progression pay for all public sector workers, from 2011-12; and**
- **Option 4: pay freeze with a threshold for lower paid workers which is either in line with the UK threshold or the Scottish Government's target for reducing poverty and income inequality in Scotland – a two-year pay freeze for public sector workers, from 2011-12, except for the lowest paid as defined by the Scottish Government's solidarity target. Progression payments could be continued or suspended.**

4.100 If the aim is to constrain growth in the pay bill in a way that minimises job losses, then Option 3 appears best to accommodate this. This option requires the temporary suspension of progression payments for two years and should, in the first instance, be pursued through employee negotiating bodies. Negotiations would need to be pursued immediately given the choice that exists between a continuation of progression payments in 2011-12 and a loss of public sector jobs in 2011-12. Under this option, Scotland would be adopting more severe pay restraint than the rest of the UK.

4.101 If the aim is to protect the lowest paid then Options 1 or 4 appear best to accommodate this. Option 4 would cost significantly less (both in monetary and job terms) than Option 1 and would be in line with the Scottish Government's target for reducing poverty and income inequality. Under Option 4, a greater number of public sector employees would experience more severe pay restraint than the rest of the UK.

4.102 If the aim is to keep in line with the UK, Option 1 should be adopted. This would mean that Scotland is imposing the same level of pay restraint as the UK, but implicit in this is a more severe reduction in public sector employment than would otherwise be required.

4.103 For reasons of equity, a consistent policy on progression should apply to all public sector workers.

Pay restraint for 2013-14 and 2014-15

Assuming any pay freeze would be lifted after two years, further pay restraint would be required to constrain growth in the pay bill. The Panel has identified two options for the Scottish Government to consider for 2013-14 and 2014-15:

- Option A: tight pay restraint with a net increase in the pay bill (including costs of progression) of 2 per cent; and
- Option B: pay award in line with projections for General Government average earnings growth⁶⁸ (3.1 per cent in both years).

Recruitment freeze

The Panel suggests that the Scottish Government should consider the immediate implementation of a recruitment freeze across the public sector, with exceptions only granted for essential staff posts. The period of the freeze will be dictated by the success of the action taken above.

Reductions in public sector employment, 2011-12 to 2014-15

4.104 While pay and recruitment freezes have a critical role to play in constraining growth in the pay bill, they are insufficient on their own, both in terms of scale and duration, to represent an effective response to the forthcoming reductions in public spending in Scotland.

4.105 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.

4.106 In addition, the Panel's conclusion is that an approach of blanket reduction in pay levels applied across the public sector is unlikely to be appropriate or deliverable in the Scottish setting.

The Panel suggests that the Scottish Government and other public sector employers have only two broad options:

- to reduce the average cost per employee – e.g. by freezing pay, adjusting other elements of the remuneration package, reducing hours of work; and/or
- to reduce the number of employees – e.g. through a freeze on recruitment, natural wastage (i.e. non-filling of posts when people leave or retire) or redundancy.

⁶⁸ Office for Budget Responsibility, *OBR forecast: Employment*, 30 June 2010.

The Panel is of the opinion that both of these approaches will require to be considered. The first option clearly has the ability to constrain growth in the pay bill and hence mitigate the scale and impact of individual job losses and redundancies in the short term.

In 2011-12 (when the budget cuts are anticipated to be particularly severe), the Scottish Government has a choice between:

- a 2.3 per cent to 3.5 per cent reduction in public sector employment, managed as far as possible through natural wastage; or
- a smaller reduction in public sector employment in 2011-12 with the remainder of the gap in the pay bill financed from additional reductions in non-pay bill resource expenditure.

CHAPTER 5

UNIVERSAL SERVICES



INTRODUCTION

“The balance between universal provision and means-tested benefits in different countries reflects different value structures and political realities. However, during the last decade, when resources were growing rapidly, successive Scottish governments have not needed to focus attention on this question. The reductions in the budget that are in train imply that avoiding the question is no longer tenable.”

Meeting the Challenge of Budget Cuts in Scotland: Can Universalism Survive?
Paper for Scottish Parliament Finance Committee, Professor David Bell (April 2010)¹

Changes since devolution

5.1 The Scottish Parliament has expanded the provision of free or subsidised public services on a near universal basis since Devolution over a decade ago. Such universal services were introduced in what was an increasing and buoyant public spending context. This has effectively shifted funding responsibility from the individual to the state. Demographic trends are already increasing the cost of such services – and are expected to continue to drive up costs in future.

5.2 The Panel believes that the continuing provision of a range of universal services on the same basis as at present is unlikely to be affordable in the face of the projected financial challenges. Alternative approaches should, therefore, be considered as a matter of urgency.

“The estimated cost of free personal nursing care, prescriptions, eye tests and concessionary travel is almost £900 million in 2010-11. As the public become more accustomed to these services and Scotland’s demographics change the demand and cost of these services will continue to increase. Future costs are difficult to predict, which raises questions about their long term affordability.”

Audit Scotland, submission to the Independent Budget Review

BACKGROUND

Cost drivers

5.3 The Panel heard from a number of stakeholders that many universal services appear to have been introduced without sufficiently rigorous business case development or a full assessment of rising future demand and long-term affordability. Demographics, consumer expectations and other drivers continue to stimulate demand and, as a consequence, are forcing up the projected cost of many universal services.

1 www.scottish.parliament.uk/s3/committees/finance/inquiries/budget/documents/BSP_adviser1.pdf

Equity and consistency

5.4 The introduction of free universal services has resulted in many beneficiaries receiving free or subsidised services which they might otherwise have been able and, indeed, willing to fund on their own behalf. There is also some inconsistency in the provision of universal services and differences between levels of service in different local authority areas.

5.5 The Scottish Parliament Finance Committee has also identified the provision of universal services as a key issue for the next Spending Review period and beyond:²

"The retention of spending on universal benefits means that there will be less flexibility in seeking cuts in the rest of the budget. Given ... demographic trends, the retention of some universal provision, particularly free personal care, will also have longer-term financial implications."

Scottish Parliament Finance Committee Report - Budget Strategy Phase (June 2010)

5.6 Similarly, a recent report by Professor Charlie Jeffery of Edinburgh University considered the provision of universal services for older people, particularly free personal and nursing care (FPNC) and concessionary travel, and raised some key questions that are more widely pertinent and relevant to the Panel's deliberations:³

"Is it right that all people over 60 – including wealthy ones – get concessionary bus travel when people who may need transport services more (for example, frail older people, people in rural areas) have to pay for demand responsive transport? Is it right that all income groups should have access on the same terms to FPNC? If it is legitimate to target policies in some areas, like fuel poverty, onto the most disadvantaged, why is it not in other areas?"

Older People, Public Policy and the Impact of Devolution in Scotland,
Report for Age Scotland by Professor Charlie Jeffery, Edinburgh University (June 2010)

5.7 Professor David Bell of the University of Stirling, standing budget adviser to the Scottish Parliament Finance Committee, recently set out the principal arguments for and against universalism and means testing:

2 www.scottish.parliament.uk/s3/committees/finance/reports-10/fir10-04-vol1.htm

3 www.ageconcernandhelptheagedscotland.org.uk/documents/893

Arguments for and against universalism and means testing

"The main arguments for means testing and against universalism are:

1. Resources are targeted where they are most needed, leading to lower overall costs compared with universal benefits. Resources are released to other government priorities or taxes can be reduced.
2. Services are not offered to those who could afford and would be willing to pay. Providing a service to those that are willing to pay is a 100% deadweight loss to the taxpayer.
3. Provision of universal benefits can interfere with market provision. Markets may not be efficient where the state is the main purchaser.
4. Provision of free services can lead to inflated demand. This is a variant of the moral hazard problem.
5. Universal benefits are difficult to rescind because they are often seen as entitlements whose removal can be legally contested. Means-tested benefits, on the other hand, are more easily varied. Thus, for example, it may be relatively easy to vary the willingness-to-work conditions associated with unemployment insurance. But removing the right to free health care would be well-nigh impossible politically.
6. Because clients are directly contributing towards some share of the costs, they have a greater incentive to improve the quality of service or make it more efficient.

"The main arguments for universalism and against means testing are:

1. Korpi and Palme (1998, p. 663)⁴ have argued that there is a 'paradox of redistribution' whereby 'the more we target benefits to the poor ... the less likely we are to reduce poverty and inequality.' Highly targeted programmes have a limited support base. They tend to result in conflict between those above and below the means test limit. Such programs therefore have limited appeal to the majority of voters that are above the means-test limit. Universal programs have a much broader political support. Means testing may undermine public support for those receiving benefits.
2. Along similar lines, universal policies may increase the preference for redistribution by generating a more cohesive group identity. Thus, for example, Scandinavian countries have highly redistributive tax systems that are based around universal rather than means-tested benefits.
3. Means testing causes stigmatisation. It inevitably focuses arguments around who is 'in' and who is 'out' and whether those that are 'in' are 'deserving'.

4 *The Paradox of Redistribution and Strategies of Equality: Welfare State Institutions, Inequality and Poverty in the Western Countries*, W Korpi and J Palme (1998) www.fcs.edu.uy/enz/licenciaturas/cpolitica/taller%20democracia%20y%20desarrollo/Unidad%203/Korpi%20and%20Palme%201998.pdf

4. Many people, particularly the elderly, do not take up means tested benefits even when eligible. But as Hancock et al (2005)⁵ argue, take-up is greater among those with greater entitlement.
5. Universalism is less costly to administer since the process of means-testing itself uses significant amounts of resource. Often means tests are carried out by those delivering the service, e.g. medical professionals, which can create conflicts of interest.
6. Means-testing discourages savings because individuals have an interest in letting their assets fall below the means-test limit, knowing that they can then receive services free. But universal provision also discourages saving because it guarantees a certain level of service, irrespective of the level of saving."

Meeting the Challenge of Budget Cuts in Scotland: Can Universalism Survive?
Professor David Bell, Paper for Scottish Parliament Finance Committee (April 2010)

5.8 The Panel also noted the concerns raised by some representative groups about the introduction of charging for services and increased levels of means testing:

"STUC has given strong support to ... policies [such as Free Personal Care, Tuition Fees and Prescription Charges] and more generally supports universal provision backed by progressive taxation as the most efficient and sustainable way to maintain strong services and an adequate safety net.

"STUC would be particularly concerned if the mechanism for moving towards more targeting of services were to be through charging for services (particularly at local government level) rather than using devolved taxation mechanisms."

STUC, submission to the Independent Budget Review

Options for change

5.9 Limiting or targeting free entitlement, tightening of eligibility criteria, introducing or increasing charges (or reducing subsidies) and introducing means testing all appear to have the potential to reduce public costs. The choice of these or any other similar options should be based on the relative importance of activities and robust evidence-based assessments of the effectiveness of services. The approach should aim to protect the most vulnerable in our society and take full account of the direct and indirect consequences of any changes.

5 *What should be the role of means-testing in state pensions?* Seminar 5 in programme *Shaping a stable pensions solution*, R Hancock, S Pudney, H Sutherland, G Barker and M Hernandez (2005), Nuffield Foundation and University of Essex
www.pensionspolicyinstitute.org.uk/uploadeddocuments/PPI_Nuffield_seminar_5_main_paper_Nov05.pdf

Focus

“There is a creeping acceptance that universal provision is the norm but carrying on with universal provision is as much a policy choice as not doing so. In considering policies the starting point must be to ask whether the service should be universal or targeted.”

COSLA, submission to the Independent Budget Review

5.10 The Panel believes that all citizens should have affordable access to public services provided in an equitable way. Universal free services have been developed to meet the needs of large groups rather than focused on those individuals who need them the most. Quality public services should be dynamic and flexible to take account of the changing nature of society, demographics, availability of funding and of the citizen’s expectations about rights to essential services, as well as changes and improvements in service design and delivery.

5.11 That does not mean that a ‘one-size-fits-all’ approach should be adopted in providing free access to public services. There is scope to adopt a more focused approach, prioritising services to individuals’ particular circumstances and needs while also reducing public costs.

**Eligibility
and
means
testing**

5.12 Reviewing eligibility criteria should be aimed at achieving closer alignment between provision and need. This has the potential to ensure that those who have greatest need benefit most from public services. This might include amending age thresholds at which citizens can benefit from free or subsidised services, or it might also include applying limits or caps on the level of benefits available.

5.13 Means testing is another way of assessing the eligibility of an individual to receive a particular service at reduced or zero cost. It can be helpful in identifying those who are least likely to be able to afford to pay for a service. Ensuring services are focused on the most needy can reduce the burden on the public purse and increase the effectiveness of spending. However, the Panel recognises that means testing has a number of potential disadvantages, many of which have been described by Professor David Bell in the paper quoted above. These include impact on self-esteem and responsibility, which can reduce the level of take-up of services by those who would most benefit from them, and an increase in the level of administration needed to support means testing.

5.14 The Panel considers that every effort should be made to avoid implementing additional, bureaucratic administrative processes. It may be possible to minimise additional costs and bureaucracy by adopting existing systems or identifiers which already involve an assessment of suitable eligibility criteria. For example, the existing benefits system might be used to help confirm those who have greatest need of other public services or support. This approach is sometimes referred to as ‘passporting’.

User charging

"Questions should be raised as to why it is proper to charge for services which enable a disabled adult to live an independent life, participating in the lives of their families and communities, but improper to charge for admission to art galleries and museums; and why it is proper to provide free nation-wide bus travel for those over sixty, irrespective of income, but improper to provide subsidised taxi fares."

Independent Living in Scotland Project, Scottish Disability Equality Forum and Inclusion Scotland, joint submission to the Independent Budget Review

5.15 Introducing charging (or reducing subsidy) for some universal services currently provided free or at low cost could ensure that those citizens who can afford to do so contribute to costs. Charging could also free up valuable public resources and might help to limit demand. The introduction of charges – such as charges for missed appointments or congestion charging – has the potential to drive positive behavioural changes. Charging can also drive up expectations of service quality. It appears that, under some circumstances, the public may prefer to pay for specific services rather than see increases in the rate of general taxation.

5.16 The (re)introduction of charging could be challenging to pursue, as people tend to become accustomed to services being provided free at the point of delivery and may come to see them as an entitlement. Charging could also be seen as running against the general direction of policy established over the past decade. The introduction of service charging will not be appropriate for all users or for all services.

5.17 The Panel, however, believes that public sector bodies should be encouraged and have the flexibility to examine the potential for additional income generation by reviewing the level of existing local charges within their scope or by introducing new charges. The Panel believes that any introduction of charging must be affordable, equitable and transparent and should ensure that, as far as possible, the most vulnerable in society are not placed at a disadvantage. In this time of tight financial constraint, the Panel shares the Scottish Parliament Finance Committee's recent conclusion that public debate on this issue should be opened up.

5.18 The Panel considers that work to review the approach to providing universal services and the blocks of spend allocated to these services is now required as a matter of urgency. This work should consider the long-term issues such as changing demographics, affordability, sustainability and the services where scope for reform is possible. It should also consider the extent to which the provision of universal services contributes to national outcomes.

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.

In addition, the Panel suggests that the Scottish Government should encourage all public sector bodies to examine the potential for additional income generation by reviewing the level of charges within their scope or by introducing new charges.

Universal services for further consideration

5.19 The Panel recognises that a wide range of universal, or near-universal, services are currently supported by public expenditure in Scotland. In the limited time available, the Panel was not able to consider all of these in detail. However, for indicative purposes and to inform the debate, it has focused some attention on six services funded directly or indirectly by the Scottish Government where the evidence suggests possible options for reducing costs:

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

CONCESSIONARY TRAVEL

“Studies have shown that lower income groups gain greater improvement in their quality of life from the concession, and use it frequently. By contrast higher income 60+ groups claim that the concession has virtually no effect on their quality of life. But this does not mean that lower income groups are the main beneficiaries of extending the concession in 2006: ‘the larger effect has been one of stimulating pass take-up and thus bus use among wealthier pensioners, albeit at a lower number of trips per person than their poorer counterparts’. Similar to FPNC [free personal and nursing care], the Concessionary Travel Scheme might be criticised as extending a subsidy to those affluent enough to pay for services themselves.”

Older People, Public Policy and the Impact of Devolution in Scotland,
Report for Age Scotland by Professor Charlie Jeffery, Edinburgh University (June 2010)⁶

6 www.ageconcernandhelptheagedscotland.org.uk/documents/893

Experience across the UK

5.20 The Scotland-Wide Free Bus Travel Scheme for Older and Disabled People was introduced in 2006. It provides unrestricted free national bus travel for eligible passengers based on agreed levels of reimbursed payment to bus operators. Eligibility for concessionary bus travel is based upon age (60 or over), residence in Scotland and disability status.

5.21 In England, concessionary bus travel is restricted to off-peak hours between 9.30am and 11pm on weekdays and all day at weekends and on bank holidays for passengers currently aged 60 or over. However, a package of reforms to concessionary bus travel in England was announced in 2009, including a change to the age of eligibility for the concessionary bus pass in line with changes to the state pension age with effect from April 2010. By 2020, the age of eligibility for concessionary travel in England will increase to 65.

5.22 Wales operates a similar all day scheme to the Scottish Scheme for passengers aged 60 or over and disabled passengers of any age. The scheme in Wales also provides free travel on local buses by companions to disabled persons.

5.23 For schemes in both England and Wales, the criteria are enhanced by many of the local authorities.

5.24 The Northern Ireland scheme provides concessionary travel by bus and train across Northern Ireland for all residents aged 60 and over, registered blind or a War Disablement pensioner. An all-Ireland free travel scheme was introduced in April 2007 for senior citizens in Northern Ireland aged 65 and over and for Republic of Ireland senior citizens aged 66 and over.

5.25 In Scotland, an agreed cap limits the future costs of the concessionary scheme to £180 million and £187 million in 2011-12 and 2012-13 respectively. Beyond this, if there is no cap and if bus fare levels were to increase by 8 per cent per annum, costs are estimated to rise to around £261 million in 2013-14 and to around £286 million in 2014-15.

Review

5.26 The Scottish Government's 2009 *Review of the Scotland-Wide Free Bus Travel Scheme for Older and Disabled People*⁷ confirmed that there were just over 1.1 million valid national entitlement cards (representing one in five of the population) and that the scheme was running at an average of 13.2 million journeys each month in 2008-09. There was evidence that, as a result of the scheme, some passengers had travelled by bus at the expense of travel by car. However, there was insufficient evidence to clarify the extent to which the scheme had contributed directly to social inclusion.

7 www.scotland.gov.uk/Publications/2009/05/19093131/0

5.27 The Panel recognises the progress which has been made by the Scottish Government in implementing the Review's recommendations to control costs through the renegotiation of the percentage of reimbursement to bus operators and the capping of the scheme costs. However, the impact of this is likely to be relatively marginal in relation to the total costs of the scheme. Projected costs reflect significant increases in the number of people over 60 and eligible for the scheme.

5.28 The Panel understands that approximately one in five of those eligible for the scheme as a result of their age are in employment. Some of these people may also be both able and willing to fund their own bus travel.⁸ The proportion of older people who will be working longer is likely to continue growing in future. In light of this, the 2009 Review concluded that:

"There may be a case in the future for examining the value of money of concessionary travel for those passengers over the age of 60 in full time employment and earning a salary (with or without a pension supplement) i.e. where issues of social exclusion and mobility are not an obvious priority."

Review of the Scotland-Wide Free Bus Travel Scheme for Older and Disabled People, Scottish Government (May 2009)⁹

Options to reduce costs

5.29 The Panel was attracted to three main options to amend eligibility so as to contain future costs:

- **Option 1:** raise the age of entitlement from 60 to 65 and subsequently in line with retirement age;
- **Option 2:** remove eligibility for those in full-time employment; and
- **Option 3:** restrict concessionary travel to non-peak periods.

5.30 Implementing any of these options from 2011-12 would require a Statutory Instrument to be laid in good time before the end of the current financial year.

5.31 The estimated savings from each option are considered in relation to current estimates of projected costs, assuming no change in the current eligibility criteria. The costs of the scheme to the Scottish Government in 2010-11 are capped at £174 million. Net savings in relation to this baseline generated by Option 1 – which is likely to generate the greatest savings – are also shown, for illustrative purposes.

⁸ The figure of 20 per cent includes both full- and part-time employees as well as the self-employed.

⁹ *Review of the Scotland-Wide Free Bus Travel Scheme for Older and Disabled People*, paragraph 182.

5.32 It should be borne in mind that the estimated savings described here are based on a range of highly sensitive assumptions and do not take account of all factors. They are, however, intended to provide a reasonable indication of the scale of potential savings, all other things being equal.

Table 5.1

Concessionary Travel Scheme: Projected Future Costs (£ million)					
	2011-12	2012-13	2013-14	2014-15	Total cost (2001-15)
Projected costs, assuming no change in eligibility criteria	180	187	261	286	914

Source: Scottish Government

Table 5.2

Estimated Potential Savings (£ million) in Relation to Projected Future Costs (as presented in previous table)					
	2011-12	2012-13	2013-14	2014-15	Total savings 2011 to 2015
<u>Option 1:</u> Raise age of entitlement from 60 to 65 years	46	37	94	102	279
<u>Option 2:</u> Remove eligibility for those in full-time employment	0	0	20	22	42
<u>Option 3:</u> Restrict concessionary travel to non-peak periods	0	0	11	12	23

Source: Scottish Government

Table 5.3

Projected Net Costs of Scheme (£ million) – After Deduction of Estimated Savings of <u>Option 1</u>					
	2011-12	2012-13	2013-14	2014-15	Total net cost 2011-15
Net costs of scheme, after savings applied from <u>Option 1</u> (only)	134	150	167	184	635

Source: Scottish Government

Table 5.4

Estimated Potential Savings from Option 1 (£ million) – Relative to Total Baseline Costs of Scheme in 2010-11 of £174 million					
	2011-12	2012-13	2013-14	2014-15	Total net saving 2011-15
Potential savings (minus sign) or additional costs (plus sign) relative to 2010-11 cost	-40	-24	-7	+10	-61

Source: Scottish Government

Notes:

- 1) Data provided by Scottish Government, May 2010.
- 2) Table 5.4 shows the amount by which the projected net cost of scheme, after deducting the estimated savings from Option 1 above, is less (or more) than the total baseline cost for 2010-11 of £174 million.
- 3) Projected costs and savings shown reflect GROS population forecasts and the following assumptions: i) take-up of concessionary travel cards in the 60+ age group continues at the 2008 rate; ii) 5% of concessionary journeys are made between 7 and 9am; iii) 9% of those aged 60+ are in full-time employment; iv) no change in the average number of trips made by all passholders; v) no change in the number of disabled (etc.) pass holders; vi) average fare increases of 8% per year.
- 4) For the purposes of Option 1, it has been assumed that all people aged 60 to 65 would cease to be eligible on 1 April 2011. The table does not show the (much smaller) savings that could be achieved from the more realistic option of gradually increasing the entitlement age in a phased approach.
- 5) Estimated savings in 2011-12 and 2012-13 take into account agreed caps.

5.33 It is important to emphasise that the projected costs of the scheme are expected to rise by 64 per cent by 2014-15, as a consequence of both demographic change and the ending of the current capping arrangement. All three options for savings would have an impact on the rate of growth in net costs, but the general increase in the number of eligible older people would continue to exert upward pressure on the overall costs of the scheme.

5.34 Raising the age of entitlement from 60 to 65 would be likely to generate the greatest savings, but potential savings could be slightly greater if two or more options were combined (although it should be noted that Option 2 is likely to overlap to a very great extent with Option 1). It should be possible to implement one or more of these options to allow savings to be realised from 2011-12 onwards.

5.35 Clearly, there are other options which would control costs, such as the introduction of a charge for any new concessionary bus passes. A one-off charge of £20 for new passholders introduced as they became eligible might raise approximately £0.8 million over the coming Spending Review period to 2014, based on current eligibility and take-up rates, although this would be less if the introduction of a charge reduced the current level of take-up.

5.36 The Panel recognises that implementing any of these options might result in higher car use than otherwise would have been the case. Restricting concessionary travel to non-peak times might be seen as a retrograde step, by restricting travel to periods when bus frequency is reduced. Arguably, such an option might run contrary to the current aims of the scheme. Changing the eligibility criteria in relation to age and employment has the potential to generate much larger savings.

5.37 In addition to these options, there are variations which might be applied, as well as longer term options which have the potential to reduce ongoing costs, such as:

- other changes to the eligibility criteria, for example, by widening the exempt periods to include the afternoon peak or by amending eligibility to the state pension age rather than a specified age (if the state pension age changed, so would eligibility);
- a revised reimbursement rate to bus operators based on latest evidence; and
- storage of travel rights by providing a funded travel card with limited annual expenditure.

5.38 These options should be considered in the context of the scheme's policy objectives. The Panel considers that the Scottish Government should start work to explore such options now and that they should form an element of the negotiations with bus operators when the current agreement ends in 2013.

The Panel suggests that the Scottish Government should consider taking immediate action to review eligibility criteria for the Scotland-Wide Free Bus Travel Scheme for Older and Disabled People, and to continue to work with the bus operators to manage costs in the longer term.

FREE PERSONAL AND NURSING CARE

"Perhaps one of the most significant policy commitments delivered by the Scottish Parliament, but one on which older people demographic growth will have the most impact, is the introduction of Free Personal and Nursing Care. ... Given the demographic profile within the East Renfrewshire area, this has resulted in a disproportionate under-funding for the Council to support the policy. This will be exacerbated by growth in the number of older people within the Council area in the future. Fundamental consideration needs to be given to the sustainability of the Free Personal and Nursing Care policy and the basis of its future delivery."

East Renfrewshire Council, submission to Independent Budget Review

5.39 Free personal and nursing care in Scotland provides a set of universal services for people with care needs which are not subject to means-testing. Free personal care is now a legal entitlement for people aged 65 or over who have been assessed as having personal care needs. Free nursing care is available to people of all ages who are assessed as requiring nursing care services. Those who are liable for their full residential care costs and described as 'self-funders' receive a weekly contribution of £156 towards their personal care and £71 towards their nursing care costs.

5.40 Prior to July 2002, older people in Scotland were charged for personal care services provided in their own home. Many residents in care homes had to fund their care in full from their own income and savings.

Experience elsewhere in the UK

5.41 Free personal care, as the term is understood in Scotland, has not been introduced in the rest of the UK, although support is provided in other ways. People throughout the UK can apply for Attendance Allowance (over 65) and Disability Living Allowance (under 65) as appropriate, although people in care homes receiving personal care payments in Scotland are no longer entitled to Attendance Allowance.

5.42 In England, all care home residents can receive support from a registered nurse in meeting their care needs. They are also assessed for NHS continuing care, which is entirely free in both England and Scotland. If they are not entitled to this, they should be entitled to a non-means tested NHS nursing care contribution, which is a paid direct to the nursing home and currently amounts to £108.70 per week.

5.43 In Wales, local authorities charge for the accommodation and personal care they arrange in residential care settings and have discretionary powers to recover charges as they consider reasonable from adults receiving non-residential services, including personal care.

5.44 In Northern Ireland, local health trusts pay £100 per week towards fees to cover the cost of the nursing element for those who live in a nursing home and have assessed nursing needs. Some people have the full cost of their continuing health care paid for by their local health trust. Non-residential services, including personal care, are subject to financial assessment.

Demographic changes

5.45 Demographic changes are having a huge impact by driving up the level of demand for free personal and nursing care. In the 10 years to 2016, the population of Scotland aged over 65 is estimated to increase by 21 per cent. Those aged 85 and over – who are likely to have greatest need for care – will increase in number by 38 per cent over the same period.¹⁰ This factor has very significant implications for the projected costs of free personal and nursing care:

10 www.scotland.gov.uk/Topics/Health/care/reshaping/reshapingcarebooklet

"Lord Sutherland made it clear in his independent review in 2008 that the policy was sustainable at that time for the next five years. However, he also concluded that we need to adapt the policy to address demographic changes in the medium and longer terms, and that changes are necessary to ensure the sustainability of the policy."

Shona Robison MSP, Minister for Public Health and Sport, Debate on Free Personal Care, Scottish Parliament Official Report, 24 June 2010¹¹

5.46 Provision of free personal and nursing care on a universal basis means that a significant number of older people are being supported who would otherwise have sufficient resources or disposable assets to fund their own care. At a time when funding is stretched and priorities should be focused on those with the most intense needs, the Panel considers that a wholly universal approach to providing free support along the lines currently in place appears hard to justify.

5.47 The Scottish Government is currently consulting on the how best to reshape care for older people in the context of demographic and other challenges. It has put forward a number of proposals to improve the way support is provided in future. Some of these proposals have the potential to reduce future care costs, such as encouraging people to do as much for themselves as possible, enabling and supporting more volunteers and community bodies to provide 'contact' care and encouraging healthy lifestyles.

"Following the introduction of free personal care in 2002, there has been a significant shift away from care home provision towards greater provision in clients' own homes. Thus, for each older person receiving personal care in a care home in Scotland at the start of 2009, there were 4.7 individuals receiving personal care at home. When the policy was introduced at the beginning of 2002 there were only 3.4 individuals receiving personal care at home for each care home client receiving personal care. This is a very significant shift in the balance of care."

The Impact of Devolution: Long term care provision in the UK, Professor David Bell, report for the Joseph Rowntree Foundation (January 2010)¹²

5.48 The Panel recognises the importance of seeking new ways of supporting an increasing cohort of older people. It is also aware of some of the real challenges in modifying or withdrawing free personal and nursing care. However, in light of future demographic and financial challenges, the extent to which personal and nursing care should remain a free universal service is a critical issue which needs to be tackled urgently.

11 www.scottish.parliament.uk/business/officialReports/meetingsParliament/or-10/sor0624-02.htm#Col27679

12 www.jrf.org.uk/sites/files/jrf/impact-of-devolution-long-term-care.pdf

"It is too simple to imagine that removing a popular and landmark policy such as free personal care would achieve major budgetary savings. Indeed, it might have the opposite effect by pushing up the number of people who seek to remain in hospital beds free of charge because they cannot immediately find the money to pay for their care-at-home packages."

Shona Robison MSP, Minister for Public Health and Sport,
Debate on Free Personal Care, Scottish Parliament Official Report, 24 June 2010¹³

5.49 The Panel acknowledges that this is a complex area in which alternative policy options would have to be considered very carefully, taking into account the risk of unintended consequences. The Panel has, however, considered a number of potential options for changing the basis of funding for residential care (in care homes) as well as for care provided in individuals' own homes.

5.50 Pursuing any of these options would represent a significant shift in the balance of responsibility towards the individual, particularly for those best able to pay for their care. Implementation of any of these options would require primary legislation which would result in any changes being introduced in 2012-13 at the earliest.

5.51 The estimated savings described here are based on a range of highly sensitive assumptions and do not take account of all factors. They are, however, intended to provide a reasonable indication of the scale of potential savings, all other things being equal.

Table 5.5

**Residential
care options**

Residential Care Options: Estimated Savings Compared with Projected Future Costs (£ million)					
	2011-12	2012-13	2013-14	2014-15	Total 2011-15
Reduce free personal care payment to £100 per week	0	37	40	43	120
Remove free personal care in care homes	0	105	110	115	330
Remove free nursing care in care homes	0	32	33	35	100

Source: Scottish Government

5.52 The savings for residential care shown in Table 5.5 are determined in relation to projected future costs. For comparative purposes only, the equivalent annual savings calculated in relation to baseline costs for the current year (2010-11) would be as follows:

13 www.scottish.parliament.uk/business/officialReports/meetingsParliament/or-10/sor0624-02.htm#Col27679

Table 5.6

Residential Care Options: Estimated Annual Savings Compared with 2010-11 Baseline Cost (£ million)	
Reduce free personal care payment to £100 per week	30
Remove free personal care in care homes	93
Remove free nursing care in care homes	27

Source: Scottish Government

Note: According to information received, savings could only be realised from 2012-13, at the earliest.

5.53 The options illustrated in Table 5.6 relating to residential care have the potential to generate estimated cash terms savings to the public purse of between £81 million and £279 million over three years compared with 2010-11 baseline costs in the last three years of the next Spending Review period (i.e. from 2012-13 at the earliest), depending on the option pursued. Any savings would be subject to the early and successful passage of potentially complex primary legislation in the first year of the new Parliament.

5.54 The scale of any changes in funding for free personal and/or nursing care in care homes should be considered in the context of their impact not only on older people and their families, but also on the sustainability of the care homes sector. As a consequence, it might be considered desirable to phase in any change, which would limit the savings available in the earlier years.

Table 5.7

Care at home options

Care at Home Options: Estimated Savings Compared with Projected Future Costs (£ million)					
	2011-12	2012-13	2013-14	2014-15	Total 2011-15
Flat weekly fee of £77 for all personal care clients	0	210	217	220	647
Flat weekly fee of £50 for all personal care clients	0	136	141	143	420
First 15 hours of care free	0	38	40	41	119
First 10 hours of care free	0	70	75	77	222
First 5 hours of care free	0	135	144	149	428

Source: Scottish Government

5.55 The savings for care at home shown in Table 5.7 are determined in relation to projected future costs. For comparative purposes only, the equivalent annual savings calculated in relation to the baseline costs for the current year (2010-11) would be as follows:

Table 5.8

Care at Home Options: Estimated Annual Savings Compared with 2010-11 Baseline Costs (£ million)	
	£ million
Flat weekly fee of £77 for all personal care clients	196
Flat weekly fee of £50 for all personal care clients	127
First 15 hours of care free	33
First 10 hours of care free	61
First 5 hours of care free	119

Source: Scottish Government

Note: According to information received, savings could only be realised from 2012-13, at the earliest.

5.56 It is very challenging to estimate the potential savings generated from a range of options for personal care of older people in their own homes. This is a consequence of a number of factors, such as the different charging policies adopted by the 32 local authorities, the difficulty of predicting the future disposable income of older people, and the unpredictable behaviour of individuals in response to any changes in the charging regime.

5.57 The options for care at home outlined in Table 5.8 suggest that estimated cash terms savings of between £99 million and £588 million might be possible (over three years) compared with 2010-11 baseline costs in the last three years of the next Spending Review period (i.e. from 2012-13 at the earliest), depending on the option pursued. Any savings would again be subject to the early and successful passage of potentially complex primary legislation in the first year of the new Parliament.

5.58 The first two options assume a flat weekly fee of around or just below the equivalent Attendance Allowance rate. They would have the least impact on the existing policy objectives. A limit on the maximum number of hours provided free might encourage older people and their families to consider alternative ways of maintaining their independence at home, such as non-paid care.

5.59 Even greater savings could of course be generated by removing all funding support for care, but this would be seen by many, including the Panel, as a draconian step, politically very challenging and contrary to the social objectives of the Scottish Parliament. The Panel recognises that very careful consideration of the direct and indirect consequences would be required. In particular, any option for change would need to be assessed in relation to the need to support people in their own homes.

The Panel suggests that the Scottish Government should consider building on its current consultation on *Reshaping Care for Older People* with a view to taking early action to review eligibility criteria for free personal and nursing care.

PRESCRIPTION CHARGES

"There is an urgent need for an honest and open debate on what the NHS can and cannot afford, and a number of difficult questions may need to be asked: is the move to free prescriptions still affordable?"

BMA Scotland, submission to the Independent Budget Review

5.60 Since 2007-08, when the standard prescription charge was £6.85, the single item prescription charge has been reduced annually in Scotland and currently stands at just £3. The price of a pre-payment certificate (PPC) has also been reduced in parallel. Exemptions from prescription charges cover:

- age (under 16 or over 60);
- a limited number of specified medical conditions; and
- low income.

5.61 The application of prescription charges already reflects an element of means testing based on income. Around half the population of Scotland fall into one or more of these exempt categories. Around 88 per cent of all prescription items are dispensed to people who fall within one or more of the exempt categories. However, a significant proportion of the remaining non-exempt 12 per cent are likely to be able and willing to pay at least the current level of prescription charge.

5.62 Views were expressed to the Panel that prescription charges can deter some people from collecting their medication. This can result in poor management of some chronic health conditions and, in the long run, increased costs to NHSScotland. It is also recognised that there are a number of serious, long-term conditions which do not appear on the exempt list.

"Any system for charging must also be transparent, and consistent across local authorities. It should not place undue strain on those with conditions like Parkinson's where people are expected to require support on a long-term basis. ... People with Parkinson's are commonly prescribed multiple medications to be taken several times a day, and Parkinson's is one of a number of conditions that is not currently exempt from prescription charges. Paying prescription charges causes significant hardship amongst people with Parkinson's on low incomes who may not be able to pay the upfront costs of prepayment certificates from limited income."

Parkinson's UK, submission to the Independent Budget Review

5.63 Total income generated from prescription charges has decreased annually as the level of prescription charge has reduced. In 2007-08, total income from charges was £49 million, while in 2009-10 it was estimated to be £26 million. Current income from prescription charges represents just 2 per cent of Scotland's total drugs bill of over £1 billion.

5.64 The Scottish Government currently plans to abolish prescription charges entirely from April 2011 at an additional net cost of £25 million when compared with the income expected in 2010-11. This would bring Scotland into line with Wales and Northern Ireland, where prescription charges have already been abolished. In England, charges for prescriptions are expected to remain in force: the standard charge currently stands at £7.20, and three-month and annual PPC cost £28.25 and £104, respectively. In the current financial climate, the Panel considers that there is a pressing need to reconsider the planned abolition of prescription charges in Scotland.

5.65 To help inform the debate, the Panel has considered a range of possible cost savings which could be realised if prescription charges were not to be abolished, as currently planned, in April 2011:

Table 5.9

Prescription Charge Options and Estimated Savings from April 2011 compared with 2010-11 Baseline Costs			
	Item charge	Prescription Prepayment Certificates (PPCs)	Estimated annual savings (minus sign) / costs (plus sign) compared with 2010-11 baseline (£ million)
Abolish prescription charges	0	n/a	+25
Freeze at 2010-11 levels	£3	4 month: £10 12 month: £28	0
Increase to 2009-10 levels	£4	4 month: £13 12 month: £38	-8
Increase to 2008-09 levels	£5	4 month: £17 12 month: £48	-15
Increase to 2010-11 levels applicable in England*	£7.20	4 month: £38 12 month: £104	-32

Source: Scottish Government

* There are no 4 month PPCs in England, although 3 month PPCs are issued at a cost of £28.25 which is the equivalent of £38 over 4 months.

5.66 None of the above options would require primary legislation: each can be implemented by means of a Scottish Statutory Instrument.

The Panel suggests that the Scottish Government and Parliament should consider suspending the final stage of the planned reduction in prescription charges and take early action to consider charging for non-exempt groups.

NHS EYE EXAMINATIONS

5.67 The then Scottish Executive introduced free NHS eye examinations as a universal service in 2006. Prior to this, a free basic sight test was provided to those under 16, full-time students under 19 and everyone over 60. Sight tests were also provided free for those in receipt of benefits or on low income.

5.68 The current free NHS eye examination allows an appropriate health assessment of each patient's whole visual system, tailored to their symptoms and needs. It also allows for the management of a wide range of common conditions in the community and reduces inappropriate referrals to secondary care.

5.69 In England, Wales and Northern Ireland, there is a charge for eye tests unless the patient falls into certain exempt categories related to age, income or specific health-related issues. The Welsh scheme also provides two special types of eye examinations free of charge for selected categories of patients, including those who may be at greater risk of eye disease and those who experience unexpected acute eye problems.

5.70 In Scotland, the General Ophthalmic Services (GOS) budget provides for the cost of the NHS eye examination and the issue of optical vouchers to eligible people to assist with the cost of glasses and contact lenses. Approximately 75 per cent of this budget represents the cost of the NHS eye examination.

5.71 Data provided by the Scottish Government shows that the introduction of free NHS eye examinations in 2006 resulted in an immediate increase in levels of take-up. In 2009-10, the number of eye examinations was 84 per cent higher than the number of eye tests immediately prior to the introduction of free universal provision. Costs have increased almost four-fold over four years.

Table 5.10

Annual Take-up and Costs of NHS Eye Examinations in Scotland		
Year	Number of eye examinations	Total costs - £ million
2005-06*	1.0 million	18
2006-07	1.5 million	43
2007-08	1.6 million	57
2008-09	1.7 million	63
2009-10	1.8 million	67

*NHS sight tests. Source: Scottish Government

5.72 The Scottish Government introduced changes in 2010 to limit the frequency of free NHS eye examinations, reducing overall costs. Estimated savings resulting from these recent changes are expected to be around £2 million, or around 3 per cent per year, although this will not be confirmed until 2011.

5.73 The Panel heard evidence about the considerable health benefits of eye examinations in identifying eye conditions as well as wider health problems at an early stage, potentially averting longer-term problems.

"The percentage of people who would have been excluded from GOS prior to the introduction of free eye examinations is a fraction of this overall cost – reverting back to the old exemptions prior to 2006 would provide an initial short term saving of around £15-20 million but would lead to an immediate increase in referrals to hospitals and GPs with significant higher costs across all other aspects of the service sector now and in the future."

Optometry Scotland, submission to the Independent Budget Review

5.74 The Panel was also made aware of a recent report by RNIB Scotland on the cost of sight loss in Scotland.¹⁴ The report suggests that the number of Scots with sight loss is expected to double over the next 20 years. The public cost of this is estimated to be at least £194 million per annum. The report includes recommendations that emphasise the importance of prevention.

5.75 It is nevertheless clear that a significant proportion of people who currently benefit from free eye examinations could also afford to pay for them on their own behalf. While the Panel understands that the re-introduction of charging might result in a reduction in the number of eye examinations, with potential consequence for health outcomes, it recognises that there is an option that would involve the re-introduction of selective charging for those with the ability to pay. The Panel has, therefore, considered the possible financial impact of introducing differential fee levels for the eye examination.

5.76 The introduction of charges would require an amendment to the National Health Service (Scotland) Act 1978. Subject to the early and successful passage of the required primary legislation in the first year of the new Parliament, charges for NHS eye examinations could be introduced from 2012-13 at the very earliest.

5.77 Certain groups of people, including children, those aged 60 or over, those on low incomes or with certain sight problems, should continue to be exempt, as they were prior to 2006. These estimated savings assume that the number of people previously entitled to receive free sight tests would remain the same and that the take-up of NHS eye examinations for those who would be charged would drop back to the level of eye tests prior to 2006.

¹⁴ www.rnib.org.uk/aboutus/contactdetails/scotland/scotlandnews/Pages/cost_of_blindness.aspx

Table 5.11

Primary Eye Examinations Fee Options: Estimated Potential Annual Savings Compared with Projected Costs (£ million)					
Eye examination fee options	Estimated annual savings				Total savings
	2011-12	2012-13	2013-14	2014-15	2011-14
£20	0	15	15	16	46
£30	0	23	23	24	70
£40	0	30	31	32	93

Source: Scottish Government.

Note: Projected costs assume an annual growth rate of 1.1 per cent in uptake and a 5 per cent in cost of primary eye examinations, based on increase in uptake and cost between 2008-09 and 2009-10. Increase between these years was lower than previously. That trend is expected to continue due to the changes which were made on 1 April 2010 to the frequency of primary and supplementary eye examinations.

Table 5.12

Primary Eye Examinations Fee Options: Estimated Potential Annual Savings Compared with Baseline Costs in 2010-11 (£ million)					
Eye examination fee options	Estimated annual savings				Total savings
	2011-12	2012-13	2013-14	2014-15	2011-14
£20	0	12	12	12	36
£30	0	18	18	18	54
£40	0	24	24	24	72

5.78 Introducing charges of between £20 and £40 for an NHS eye examination for non-exempt categories of people could generate total estimated savings of between £46 million and £93 million compared with projected costs over the next Spending Review period. This represents total savings of between £36 million and £72 million compared with baseline costs in 2010-11.

5.79 If a charge for NHS eye examinations were to be introduced and if optometrists continued to determine their level of private fees, it is possible that some optometrists might choose to charge less than the options set out above, further reducing take-up levels for NHS examinations. Additional savings would accrue if there were to be a further drop in the number of NHS eye examinations.

The Panel suggests that the Scottish Government and Parliament should consider immediate action to review eligibility for free NHS eye examinations and to continue to work with the optical profession to identify any further action needed to control costs.

FREE SCHOOL MEALS

“Cost is a key factor in choosing not to eat a school meal for 21% of primary and 31% of secondary school pupils. Evaluation of the Scottish pilot free school meal programme and of universal free school meal programme in Hull shows that universal provision massively boosts take up of healthy school meals, with real potential for boosting children’s health and learning, as well as relieving pressure on family budgets.”

Child Poverty Action Group, submission to the Independent Budget Review

5.80 The Scottish Government’s free school meals policy is reflected in the Concordat with local government as two commitments:

- extension of free school lunches to all primary school and secondary school pupils whose parents or carers are in receipt of both maximum child tax credit and maximum working tax credit; and
- extension of free school lunches to all P1 to P3 pupils.

5.81 The first of these commitments is primarily a means tested measure to tackle poverty and was introduced in August 2009.

5.82 The second commitment is aimed at improving health from a young age. It extends provision of free school meals beyond children in poverty who currently benefit and was due to commence in August 2010. However, it was recently confirmed by the Scottish Government that local authorities will have flexibility in delivering on this commitment and may implement a similar alternative scheme. For example, local authorities may provide a free meal to all P1 to P3 pupils in schools within 20 per cent of the most deprived communities in their area.

5.83 Free school meals are also available in England and Wales. Eligibility is determined based on parents’ or guardians’ access to income support, other benefits or annual income of less than £16,040.

5.84 Assessing the additional costs of rolling out free school lunches in Scotland is extremely challenging, especially as discussions on how this will be achieved in each local authority area are currently ongoing and because each local authority has responsibility for allocating funding.

5.85 This policy is already focused on the less well-off and the very young in contrast with the original policy intention, which was for a universal scheme. The Panel noted the recent changes which appear to be leading towards a more closely targeted scheme and the variations in approach being adopted locally. The Panel is also aware of the need to ensure early intervention to ensure a positive impact on health and poverty. It has not identified any clear options for further change in relation to free school meals provision at this time.

The Panel welcomes ongoing work to target free school meals to improve health and to tackle poverty, and looks to the Scottish Government and Parliament to continue to monitor the impact of this policy.

GRADUATE CONTRIBUTIONS AND TUITION FEES

"It is clear that Scottish Universities and other colleges are facing difficulties competing internationally because of their reliance on public sector funding, which in turn places a significant burden on the budget. SCC recommends that the Scottish government looks at alternative sources of finance for higher education. Examples include fees backed by bursaries for poorer student, a graduate tax, bond issuance backed by future graduate payments based on income, or encouraging philanthropy."

Scottish Chambers of Commerce, submission to the Independent Budget Review

5.86 The costs of tuition fees are provided as a non-means tested universal benefit in Scotland for eligible students undertaking a full-time undergraduate course of higher education. European Union (EU) law also requires the Scottish Government to pay the costs of tuition fees for EU students, of whom there are currently in excess of 10,000. The Student Awards Agency for Scotland pays fees to Scottish colleges and universities¹⁵ on behalf of such eligible students.

5.87 This currently requires a public contribution of £1,285 per year for each HNC/HND student and £1,820 for undergraduates, except for medical students where the fee is £2,895. Part-time higher education students are currently entitled to up to £500 fee support, which is the level charged by most institutions. In 2009-10, the total cost of fee support for higher education students studying in Scotland was just over £200 million.

5.88 Student loans are also available for all students in higher education. Students resident in Scotland are entitled to a minimum loan of £915, up to a maximum of £6,152 if living away from home (or £605, up to a maximum of £4,107 if staying at home) from the Student Loans Company. There is a cost to the public purse of 31 per cent for every loan advanced. In 2009-10, gross loans advanced were around £202 million. Of those advances, a sum of around £63 million was for universally-available minimum loans, with an associated cost to the Scottish Government's DEL budget of £20 million.

5.89 In England, the Higher Education Act 2004 replaced the previous up-front, flat fee for English and EU undergraduates with deferred variable fees. The previous charge for tuition of approximately £1,000 was replaced by one where universities could choose what fee to charge, up to a cap of £3,000 per year rising in line with inflation. The Act also required universities that charge

¹⁵ The term 'universities' is used here to refer to all Higher Education Institutions.

the maximum fee to provide students from low income backgrounds with a bursary of at least £300 and established the Office for Fair Access. The reforms introduced Government-backed loans to cover fees.

5.90 Universities in England currently charge a tuition fee of up to £3,225 per year for full-time undergraduate courses which is due to increase to £3,290 in academic year 2010-11. In most cases, this is funded from a loan from the Student Loans Company which begins to be repaid once the graduate starts earning £15,000 per year. Interest rates on student loans are subsidised and do not reflect the true cost of borrowing to the UK Government. As a result, graduates only pay back the money borrowed at today's prices.

5.91 The introduction of fees in England in 2006 was accompanied by the introduction of additional student support. There is some evidence that higher education participation by young people living in the most disadvantaged areas of England may have improved since 2006. This is likely to reflect the introduction of additional student support in parallel with the introduction of fees in England.¹⁶

5.92 In Wales and Northern Ireland, fee loans are available to cover the cost of variable fees at the same level as in England. The levels of means-tested grants and maintenance loans in Wales and Northern Ireland are broadly similar to those in England.¹⁷

5.93 A major review of higher education funding and student finance in England (the 'Browne Review') is under way and is expected to report to the UK Government in autumn 2010.¹⁸ The Browne Review is considering the balance of contributions by taxpayers, students, graduates and employers and will make recommendations on the future of fees policy and financial support for students in England. The review is also likely to make recommendations on changes to the current cap on variable tuition fees in England.

5.94 The implications of the Browne Review for Scotland could be considerable. Any reduction in the level of public subsidy for higher education in England could also have a negative impact on the Scottish Government's budget through the Barnett formula.

16 See Independent Review of Higher Education Funding and Student Finance, *Call for Proposals* (March 2010) <http://hereview.independent.gov.uk/hereview/call-for-proposals/>

17 This reflects the position in 2010-11.

18 The Independent Review of Higher Education Funding and Student Finance, *Call for Proposals* (March 2010) <http://hereview.independent.gov.uk/hereview/call-for-proposals/>

5.95 The Panel is of the view that, if the UK Government decides to increase or remove the cap on tuition fees in England, the Scottish Government will need to respond to ensure that universities in Scotland maintain their competitive position. In the context of the current financial challenges and the recognised benefits of higher education for individuals, there is an even more pressing need to have an open debate in Scotland on the contributions which students and graduates make to the cost of higher education.

"Graduates should contribute towards the cost of their higher education by means of a deferred fee to be repaid once they earn more than the Scottish average salary – Higher education cannot be seen as an entitlement in the way school education is – it is something that has to be academically achieved. ... While it is true to say that society as a whole benefits from having a well-educated workforce, the individual graduates themselves also benefit from the higher earnings they accrue. At present, only wider society pays for graduates through the tax system, while the graduate does not contribute. ... There needs to be a better balance with the individual graduate as well as taxpayers contributing towards higher education."

Power to Learn,

Paper for Reform Scotland by Ben Thomson, Geoff Mawdsley and Alison Payne (June 2010)

5.96 The graduate endowment fee was a form of graduate contribution which was abolished by the Scottish Government in 2008. A so-called 'graduate tax' is a variation of this which may be worthy of consideration. However, its introduction would be very challenging. Revenue streams from a graduate tax would only start to emerge strongly after five years or more – beyond the period of the next Spending Review – and the administrative costs might be significant. Legal powers to implement such a tax are wholly reserved to the UK Government. There would also be a number of cross-border challenges to be addressed.

"We are not opposed to looking at distinctively Scottish funding models which maintain international excellence and protect wide access, but there is a lot of work to do to establish whether there is any model which would secure these objectives while avoiding the pitfalls of the English system including its very high cost to Government (it currently costs as much to administer as it raises for universities, because of additional student support costs of subsidised loans). If the Ministers of a post-2011 Scottish Government were minded to legislate for an alternative funding model we could not expect to see any realisable benefit during the SR2010 period."

Universities Scotland, submission to the Independent Budget Review

5.97 The Panel is of the view that the (re)introduction of tuition fees in Scotland on a similar basis to that likely to be proposed in England appears to be a further option worthy of serious examination in the current financial context. The position in England may of course evolve following the outcome of the Browne Review. Such an approach should ensure that higher education continues to be free at the point of entry for the undergraduate. It might be possible to start implementing this from 2012-13 so that any savings could be generated within the next Spending Review period. Income from fees might also be seen as a way of offsetting any budget reductions in the Scottish Government's allocation to the Scottish Funding Council while maintaining universities' competitiveness.

In relation to tuition fees the Panel recognises the importance of the Browne Review and the implications it may have for higher education in Scotland. It also recognises that the appropriate time to take action in Scotland is once the outcome of the Review is known. In that context, the Panel suggests that the Scottish Government and Parliament should consider whether to maintain the current funding arrangements or to implement a scheme similar to that in England, such as tuition fees, or other alternative arrangements such as graduate contributions.

CONCLUSIONS

5.98 The operation of free or subsidised public services on a near universal basis over the last 10 years has benefited a wide range of people, including those who might have had the resources to fund them themselves. Unfortunately, demography and other drivers are expected to continue to stimulate demand and inflate costs to levels which appear to be unsustainable. The issue is not one of desirability, but of affordability.

5.99 There is a pressing need to review the current approach in order to reduce future inflationary cost pressures and to ensure a more sustainable approach to funding. The Panel considers that there is scope to look again at eligibility, as well as the selective introduction of means testing and user charging for all universal services. This will help to ensure that public services are focused on those with greatest need as well as helping to control future costs.

5.100 The Scottish Government should build on the indicative analysis of universal services in this chapter 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 in greatest need. The scale of the savings has the potential to make a significant contribution to filling the projected funding gap.

CHAPTER 6

CAPITAL



INTRODUCTION

6.1 This chapter presents the Panel's consideration of the options relating to capital expenditure and the management of public sector assets. It starts with a short definition of capital expenditure before summarising the latest budget projections, the shape of the expected capital programme and the size of the projected budget shortfall. The last two sections discuss a range of response options and present the Panel's conclusions.

Definition

6.2 Public sector capital expenditure represents the flow of new investment into the asset base that supports the delivery of public services and private sector economic growth. This includes the development of public sector infrastructure, new construction and significant upgrades of existing assets (roads, schools and hospitals, etc.), acquisition of land and buildings, and capital grants to support investment. The asset base is the cumulative product of many years' capital expenditure, after deductions for depreciation, obsolescence and disposals.

6.3 Capital expenditure is distinct from current (or resource/revenue) expenditure as it creates "...assets that can be used repeatedly to produce goods and services and generally have an economic life of more than one year."¹ Today's investment is made on the understanding that it will return a stream of benefits over many years, or generations, to come. The longevity of capital assets is an important factor when we consider how, and by whom, they should be funded.

6.4 In another respect – variability – capital expenditure differs from current spending. Capital investments, such as major infrastructure, are often large and 'lumpy' in the sense that their construction costs are highly concentrated over a fairly short run of years while the resulting benefits are much more evenly distributed through time. In addition, compared with other types of spending, particularly those related to front-line services and permanent public sector employment, capital expenditure is more susceptible to slippage, postponement or cancellation.

6.5 This is not always the case, however, as certain capital projects may be of such high perceived importance that they prove very difficult to forgo for political and presentational reasons – even when costs climb well above initial estimates.

Economic benefits

6.6 Evidence to suggest that public investment is an important contributor to the vibrancy and long-term growth prospects of the modern economy is strong.² Research shows that public investment that supports better

1 *Government Expenditure and Revenue Scotland 2007-2008*, Scottish Government (June 2009) www.scotland.gov.uk/Publications/2009/06/18101733/0.

2 See, for example, discussions in the Scottish Government *Economic Strategy* and the *Annual Reports* of Scottish Council of Economic Advisers that stress the economic value of infrastructure investment.

connectivity such as transport infrastructure, for example, can drive higher national productivity and improve competitiveness by expanding opportunities for trade and reducing transportation costs.³

6.7 The *Infrastructure Investment Plan*, published by the Scottish Government in 2008, focused on the role of infrastructure investment in relation to economic growth, making two telling remarks about the quantity and quality of past spend:⁴

"Over the last 30 years long-term investment has been inadequate, reflecting the prioritisation of successive governments in allocating public expenditure. Although this legacy has been recognised and partly addressed through additional public and private sector investment since devolution, more is required.

"Assets created some 30-40 years ago have not always provided the length of good service anticipated at the outset. In hindsight, contributory factors in some cases have been short-term forecasts of demand and user specification, non-sustainable design and construction practice, and inadequate lifecycle maintenance."

Infrastructure Investment Plan, Scottish Government (March 2008)

Employment

6.8 In addition to longer-term effects, the construction phase of capital projects provides short-term impetus to demand and employment. The Scottish Government's *Economic Recovery Plan*⁵ suggests that over 5,000 jobs were directly supported through the Scottish Government's capital acceleration programme, which brought forward £53 million of capital spending into 2008-09 and a further £293 million into 2009-10.

6.9 Given the importance of these linkages in supporting economic recovery and increasing sustainable economic growth, the Panel would urge the Scottish Government to take every possible step to prioritise and fund capital expenditure even in the context of shrinking public sector budgets.

CAPITAL BUDGET

Budget projections

6.10 The Scottish Government's capital budget fell by £580 million (or 15 per cent) this year, reflecting both the reduction in Departmental Expenditure Limit (DEL) available through the Barnett formula and the Government's earlier decisions to accelerate capital spend to boost economic recovery.

3 Rice, P., and Venables, A.J., (2004), *Spatial Determinants of Productivity: Analysis for the Regions of Great Britain*, CEP Discussion Paper No 642.

4 www.scotland.gov.uk/Publications/2008/03/28122237/0

5 Scottish Government (March 2010), *Scottish Economic Recovery Plan: Accelerating Recovery*. www.scotland.gov.uk/Topics/Economy/economic-situation

6.11 The June 2010 UK Budget⁶ showed that the fiscal adjustment needed to reduce the UK's structural deficit will bear down disproportionately on capital spending. While precise numbers for Scotland's Capital DEL will not be confirmed until the UK Spending Review concludes in October 2010, the outline shown in last month's UK Budget suggests that Scotland's capital allocation will fall by approximately one fifth, or £700 million in cash terms, over the next four years (see projections in Table 6.1 below).⁷

6.12 In real terms, the capital budget is projected to fall by £900 million by 2014-15 or 28 per cent, compared with 2010-11.

6.13 The anticipated pattern of retrenchment in the Scottish Government's capital budget is highly uneven over the next four years, with the biggest annual decline expected next year.

Table 6.1

Projections for the Scottish Government's Capital Budget (Cash Terms)								
	SR 07			Projections for Spending Review 2010 Period ¹				
	2008-09	2009-10	2010-11 ²	2011-12	2012-13	2013-14	2014-15	Total % change ³
Projected Capital DEL Budget (£ billion)	3.3	3.9	3.3	2.7	2.7	2.5	2.6	-21%
Percentage change on previous year ⁴	-11%	+19%	-15%	-20%	0%	-6%	+4%	-

Source: Scottish Government estimates produced for the Independent Budget Review. Expressed in cash terms.

1 These are projections based on Scottish Government analysis of the June 2010 UK Budget.

2 Provisional outturn. Budget 2010-11 passed by the Scottish Parliament comprised £3.2 billion of Capital DEL. Consequentials of £0.1 billion were added subsequently.

3 Percentage change between the planned levels of spending in 2010-11 and the projected budget for 2014-15.

4 Percentage changes calculated on unrounded numbers.

6 HM Treasury (June 2010), *Budget 2010*.

7 *Outlook for Scottish Government Expenditure*, Office of the Chief Economic Adviser (July 2010).

Public sector capital programme

6.14 The Capital DEL available to the Scottish Government is not the full picture, however, as the capital programme for the whole public sector is much greater.⁸ The combined infrastructure investment of the Scottish Government and other Scottish public bodies is around £5 billion per year.⁹

6.15 This larger public investment programme is planned and resourced by a range of bodies alongside the Scottish Government, including: local authorities, health boards, agencies and NDPBs,¹⁰ public corporations (in particular, Scottish Water), Network Rail,¹¹ institutes of higher and further education, and registered social landlords.

Capital planning and financing

6.16 Responsibility for investment planning and asset management is widely distributed among these bodies (see Annex G for detail) which, in turn, support their capital programmes through a mix of resourcing methods from government grants, to service charging and rents, prudential borrowing, private finance arrangements, leasing, capital receipts and accumulated reserves.

6.17 Of these funding streams, many do not count against the Scottish Government's Capital DEL budget but are instead financed out of current (resource/revenue) budgets. School building programmes since 1998, for example, have been largely financed up-front through private investment.¹² Payments under such contracts, which usually cover construction financing costs plus facilities management and maintenance, are covered from within resource budgets.

Scale of the capital shortfall

6.18 The Panel has been keen to understand the full dimensions of the potential deficiency in capital funding. The gap can be envisaged from a range of different perspectives and the variety in the arrangements for planning and financing public investment further complicates the picture.

6.19 What is clear is that parts of the capital programme are more exposed to reductions in Scottish Government's capital budget than others that rely more heavily on private finance, service charges or cover from within resource budgets.

8 For the purposes of the capital chapter the public sector is defined in broad terms. Where the term is used in this chapter it refers to the entire portfolio of capital assets that support the delivery of public services, broadly defined, in Scotland. Some of these assets will be owned by the Scottish Government or its agencies, some by local authorities, some by universities and other bodies outside the normal accounting boundaries of government.

9 Figure reproduced from the Scottish Futures Trust's *Business Plan 2010-2011* (Executive Summary, page 4).

10 Non-Departmental Public Bodies.

11 Network Rail is a private company limited by guarantee (see www.networkrail.co.uk).

12 For details see *Education Revenue Costs of PFI School Estate Scheme*, Scottish Government, March 2010: www.scotland.gov.uk/Topics/Education/Schools/Buildings/funding/School-EstateScheme.

Predicted demand for capital

6.20 To gain a reasonable grasp of the approximate size of the projected shortfall in capital funding, and in considering ways to leverage in additional resources, the Panel has considered the following points:

- predicted demand or need for capital spending and the degree to which future budgets are already committed;¹³
- the condition of the existing asset base (i.e. the stock of capital); and
- emerging budget pressures linked to climate change legislation and other environmental obligations.

6.21 The Scottish Government informed the Panel that it could not readily provide an assessment of total public sector demand for capital spending or approximate the resources required across the public sector to maintain given levels of capacity or service. However, the Scottish Government was able to provide the Review with its current forecasts of 'indicative spending pressures' (see Table 6.2 below).

6.22 The figures provided represent the pressures that have been identified to the Scottish Government as priorities at this stage in Spending Review preparations, prior to rigorous examination in the course of the Spending Review.

6.23 Comparison of these pressures against the Scottish Government's projected capital budget points to a significant shortfall in each of the next three years (forecasts of pressures beyond 2013-14 are not currently available).

6.24 As Table 6.2 shows, the expected gap is greatest in 2011-12, at £500 million, and it cumulates to over £1 billion by 2013-14. The Panel views this deficiency with some alarm given the role of public investment in supporting economic growth and employment and, added to that, the indications the Panel received that demands on the capital budget continue to increase.

6.25 In addition, it is worthy of note that around two-thirds of the Government's 'spending pressures' forecast up to and including 2013-14 is already committed, according to its own estimates shown in Table 6.3. This information provides an indication of the room for manoeuvre in the Government's Capital DEL budget.

¹³ For the purposes of the report, this term is deemed to include: (i) items where there is legal commitment - i.e. a signed contract; (ii) projects or programmes at an advanced stage of procurement; and (iii) major projects or spending programmes which are deemed to have strong Ministerial backing.

Table 6.2

Scottish Government's Capital Spending Plans and Projected Budget					
	SR 07	Projections for SR 2010 Years			
	2010-11	2011-12	2012-13	2013-14	2014-15
Indicative Spending Pressures (£ billion)	3.3	3.2	3.1	2.7	n/a
Projected Capital DEL Budget (£ billion)	3.3	2.7	2.7	2.5	2.6
Shortfall in Capital (£ billion)	0	0.5	0.4	0.2	n/a

Source: Scottish Government estimates produced for the Independent Budget Review

Table 6.3

Degree of Commitment in Capital Spending Plans and Projected Budget					
	SR 2007	Projections for SR 2010 Years			
	2010-11	2011-12	2012-13	2013-14	2014-15
Committed (£ billion)	3.0	2.0	1.8	1.6	n/a
Uncommitted (£ billion)	0.3	1.2	1.3	1.1	n/a
<i>Proportion of planned spending (indicative spending pressures) that is committed*</i>					
Committed (per cent)**	91%	64%	59%	61%	n/a
Uncommitted (per cent)**	9%	36%	41%	39%	n/a

Source: Scottish Government estimates produced for the Independent Budget Review

* Committed spending is defined here to include expenditure that is not yet legally committed but which is planned and in practice difficult or impossible to stop.

** Percentage changes calculated on unrounded numbers.

Condition of the asset base

6.26 Asset management is another important part of the capital story as the condition of the asset base affects: the level of spending required to maintain its productive life; running costs (e.g. buildings with low energy efficiency are costlier to operate); and the potential to generate capital receipts for reinvestment.

6.27 Capital receipts from the sale of surplus assets count as one-off efficiency savings and can be used only to support expenditure of a capital nature.

6.28 The Scottish Government was not able to provide the Panel with an overall estimate of the level of capital spending required to maintain the public sector's capital base at its current capacity as:

"Each [public] body prioritises and makes provision for maintenance from within their available capital on that basis. We are not in a position to determine whether the aggregation of these provisions represents what is required to achieve steady state."

Scottish Government's written response to a question from the Review Panel

6.29 Audit Scotland has conducted several sectoral surveys of asset management, including a recent report¹⁴ which focused solely on Scottish local authorities' property assets. This indicated clear room for improvement. Councils reported that around a quarter of their property assets were in "*poor or bad condition*" and the total reported backlog in property maintenance was £1.4 billion and rising (across 23 of the 32 local authorities that were able to report on their maintenance arrears). Audit Scotland note that if the levels of backlog were similar in the remaining nine councils then the total maintenance backlog would be around £1.8 billion. Over a quarter of the reported backlog (£376 million) was rated as urgent, while the next 50 per cent (£667 million) was considered essential within two years.

6.30 Audit Scotland also informed the Panel that their analysis of asset management processes across the public sector had identified an outstanding need for maintenance and repairs of around £4 billion over the coming years:

"We have also recently highlighted the burden of maintaining the public sector estate in good condition is growing – around £3.7 billion is needed to maintain the public sector estate."

Audit Scotland, submission to the Independent Budget Review

Capital costs of environment obligations

6.31 The Climate Change (Scotland) Act 2009 set a target to cut emissions harmful to the environment by 42 per cent by 2020, compared with the 1990 baseline. Budget pressures arising from this commitment are certain to impinge on a range of Government programmes – particularly budgets linked to energy, housing, transport and the public sector property estate. These pressures are highlighted in a number of the submissions to the Review, including one from the Scottish Building Federation:

"One third of these emissions is currently generated by the use of Scotland's 2.3 million homes. An additional fifth of the total can be attributed to the use of non-domestic buildings."

Scottish Building Federation, submission to the Independent Budget Review

6.32 The Panel is aware that the Scottish Government is planning to publish a statutory report in autumn 2010 setting out the actions it will take to reduce carbon emissions. Although robust cost estimates are not available at this stage, indicative and highly provisional Government estimates supplied to the Review for illustration suggest that the cumulative cost to the Scottish Government of implementing new and altered climate change policies could be in the order of

¹⁴ Audit Scotland (May 2009), *Asset Management in Local Government*
www.audit-scotland.gov.uk/docs/local/2009/nr_090507_asset_management_councils.pdf

£8 billion by 2020.¹⁵ Not all of this outlay will be public capital spending, but a significant proportion of it will be and will require to be accommodated within the capital programme.

OPTIONS

Prioritise the capital programme

6.33 This section presents a range of options that could be implemented within the next Spending Review period and would assist in managing the Government's capital budget, either by creating headroom or by leveraging in additional resources.

6.34 Scaling back the capital programme, either through postponement or cancellation, has tended historically to be the default option in circumstances of budgetary constraint. The nature of capital projects means that this option can often be exercised relatively quickly and, at least in the early stages of planning, at an acceptably low cost.

6.35 Beyond 2010-11, the degree of commitment in the Scottish Government's capital plans appears to suggest that some limited capacity for this kind of action remains available (see Table 6.3 above). The portion of the Government's capital allocation that supports Scottish Water's capital programme is reviewed separately below.

6.36 Across the public sector, long-term capital plans are currently undergoing rigorous examination to identify the scope for savings, tighter prioritisation and re-scheduling. The Panel heard from COSLA political leaders, for example, that the 10-year capital plans of some local authorities are being re-profiled over additional years in order to fit within expected resources.

6.37 In the Panel's view, there is an urgent need to supplement local and organisation-specific prioritisation with a more comprehensive and strategic exercise across the ensemble of capital projects, taking into account the implications of major national projects such as the Forth Replacement Crossing and the Southern General Hospital.

6.38 The Panel would be concerned if decisions regarding the capital budget were fragmented and did not: (i) involve a reasonable degree of national strategic oversight; and (ii) make reference to a set of transparent criteria based around the Government's strategic aims.

¹⁵ Note the margin for error around this estimate is very great.

6.39 These concerns are not new or unique to the Panel. Sympathetic points were raised in discussions during the course of the Review. Audit Scotland's *Review of Major Capital Projects*¹⁶ also highlighted the importance of strategic alignment, with the following specific recommendation:

"The Scottish Government should ... strengthen strategic direction and investment planning through a senior, government wide, investment coordination and challenge function."

Review of Major Capital Projects in Scotland, Audit Scotland (May 2008)

6.40 In addition, the Panel believes that the process of prioritising capital resources should not be confined to new investment only. Where assets are essential for public service delivery, their maintenance ought to be accorded high priority. This point was addressed in submissions to the Review:

"... it is good business practice to maintain one's existing asset base as the utmost priority before expanding that asset base, we have for some time been puzzled by the apparent insistence that funds be available for major new transport infrastructure projects when it is very often the case that funds are not available for maintaining the existing asset base."

Transform Scotland, submission to the Independent Budget Review

"It will be important to ensure that the limited capital resources available are focused on priorities whilst maintaining assets in good condition."

Audit Scotland, submission to the Independent Budget Review

The Panel suggests that prioritisation of the key strands of capital expenditure, including essential maintenance, should be guided by national priorities and coordinated to ensure that maximum strategic coherence and public value is derived.

Improve capital procurement

6.41 The Panel received views about ways to improve public sector procurement practice and enhance the impact of the capital programme through, for example: greater collaboration among public bodies; better use of consultancy support; economies of scale; stronger challenge; standardisation; lower capital financing costs; and independent expertise.

¹⁶ *Review of major capital projects in Scotland - How government works*, Audit Scotland (May 2008)

www.audit-scotland.gov.uk/docs/central/2008/nr_080624_major_capital_projects_km.pdf

6.42 The Scottish Futures Trust (SFT) was designed to address these points in relation to public infrastructure investment. The Panel strongly supports the purpose of such a body.

6.43 The Panel heard from SFT that substantial efficiency gains can be achieved in the planning, procurement and financing of investment projects including measures to: improve needs identification; recast budgets to reflect changes in construction inflation; promote collaborative procurement; and reduce financing costs. Preliminary indicative estimates shared with the Panel suggest that the potential benefits in these areas with targeted and coordinated effort could exceed £200 million per year within the next two to three years.

6.44 SFT's *Corporate Plan 2009-2014* contains a target to achieve a slightly lower level of savings and benefits equivalent to 3 per cent of the investment plan or £100 to 150 million a year. This target is based on the assumption of SFT's active involvement in projects with an in-year spend of around £4 billion.

6.45 Given the deteriorating outlook for Scottish Capital DEL, the Panel suggests that the SFT will need to be held to account by the Scottish Government to deliver the predicted benefits.

The Panel suggests that the Scottish Government should consider enhancing the role of the Scottish Futures Trust to allow it to lead improvements in capital procurement. Savings derived from better capital procurement should be recycled into additional capital investment.

**Pursue
alternative
financing
methods**

6.46 Of the existing capital base available to the Scottish public sector, a sizeable proportion has been provided through non-traditional means (i.e. not from the Government's Capital DEL budget). Alternatives to the use of traditional capital, such as prudential borrowing or private finance arrangements, allow infrastructure to be funded on a 'pay as you use' rather than on a 'pay as you build' basis.

6.47 There is a strong case to fund capital expenditure on a 'pay as you use' basis as it enables capital costs to be spread more evenly over the lifetime of the asset, rather than being paid for up-front, and it allows for construction costs to be shared more equitably among the generations of taxpayers who will benefit from their use.

6.48 Borrowing is, of course, not free of charge. Debt creates interest repayment obligations that, along with any related service or maintenance changes, often extend over a 25 or 30 year horizon and must be accommodated within resource budgets. For this reason, great care must be taken to choose the right form of financing and not to over-commit forward budgets (i.e. tomorrow's taxpayers) and thereby inhibit future flexibility.

6.49 To provide an indication of the order of magnitude of existing private finance arrangements, the total amount that Scottish public bodies will pay under PPP/PFI contracts this year is estimated at over £800 million.¹⁷

6.50 There has been a great deal written over the last year or two about the relative advantages of different forms of borrowing and much analysis done of the financial burden resulting from existing private finance deals. In addition, the merits of extending borrowing powers to the Scottish Government have been addressed at length by Scottish academics, the Commission on Scottish Devolution (the 'Calman Commission'), the Council of Economic Advisers, the National Conversation and, more recently, by the Campaign for Fiscal Responsibility.

6.51 The Panel has chosen not to retread the same detailed territory by taking a view on the methods of borrowing or the powers of the Scottish Parliament and Government. Instead, the Panel has chosen to highlight the case for the Scottish Government to pursue all possible cost-effective options to sustain investment in the interests of economic recovery and Scotland's future prosperity.

The Panel suggests that the Scottish Government should consider tasking the Scottish Futures Trust, in a development of its submission to this Review, to assess and report upon the potential and practicality of all the available financing options to sustain capital spending at levels supportive of economic recovery and consistent with the Government's longer-term strategic objectives.

Review and rationalise public assets

6.52 After payroll costs, the largest outlay for the public sector is the amount spent on the acquisition and upkeep of physical assets. The public sector in Scotland is responsible for a large portfolio of assets, much of it in the form of buildings and other public infrastructure.

6.53 Effective asset planning and management helps public bodies to improve their financial and delivery performance by concentrating their use and maintenance of assets. Poor asset management leads to higher running costs, longer maintenance arrears, reduced market values and shorter asset lives – all of which represent an unnecessary and preventable drain on resources.

17 Scottish Government (September 2009), *Scottish Budget: Draft Budget 2010-11*
www.scotland.gov.uk/Publications/2009/09/17093831/0

6.54 These themes are being addressed across the public sector (see, for example, the Scottish Government's *Asset Management Review*¹⁸ and Audit Scotland's *Asset Management in Local Government*¹⁹). Asset management is one of the key workstreams in the Efficient Government programme and also features strongly in the shared services agenda. Successful shared services should help to streamline the use of property through co-location and the development of other joint facilities such as municipal waste centres (see also Chapter 3). Reductions in the public sector headcount may also reduce the demand for property (see Chapter 4).

6.55 The most recent Efficient Government outturn report²⁰, which relates to 2008-09, records asset management savings of £82 million, or almost 10 per cent of the total for cash releasing efficiency gains in that year.

6.56 The Panel was unable to get a comprehensive picture of the stock of surplus assets across the public sector, but believes that asset disposals can make a useful contribution to bridging the gap in the public sector's capital resources. In order to maximise returns, and not disrupt service delivery, asset sales need to be carefully planned and thought through.

6.57 The Panel can see advantages in pooling property market specialisms within a centre of expertise that would operate advice services for public bodies that are seeking to dispose of surplus assets.

The Panel suggests that the Scottish Government should consider developing the role of the Scottish Futures Trust to establish a centre of expertise in the ownership, management and disposal of public assets. This would operate as a source of independent advice for all public bodies and ensure maximum value for the public purse.

Future of Scottish Water

6.58 The prospect of a large reduction in the Scottish Government's Capital DEL budget has prompted renewed interest in potential ways to reduce or remove Scottish Water's reliance on lending from the Scottish Government to fund its capital programme.

6.59 Scottish Water's investment programme for the period 2010 to 2015 will cost around £500 million per year, funded through a combination of customer charges and borrowings drawn down from the Scottish Government. The Government is committed to new lending to Scottish Water of £140 million per year until 2014-15, equivalent to about 5 per cent of the Government's

18 Scottish Government (January 2008), *Asset Management Review - Report to the Cabinet Secretary for Finance and Sustainable Growth*
www.scotland.gov.uk/Publications/2008/01/AMR.

19 *Op. cit.*

20 *Efficiency Outturn Report 2008-09*, Scottish Government (November 2009)
www.scotland.gov.uk/Publications/2009/11/Outturn2008-09

projected annual Capital DEL budget over the next four years. Because the water industry in England and Wales was privatised in the late 1980s, Scotland does not receive funding for water services via the Block Grant.

6.60 Scottish Water is a publicly owned utility (a public corporation) established under statute to provide water and sewerage services to households and businesses across Scotland. Scottish Ministers set the objectives that drive Scottish Water's operating plans while the Water Industry Commission for Scotland (WICS) is the economic regulator of the water industry in Scotland. The economic regulator is there to promote the interests of water and sewerage customers through: setting prices, monitoring Scottish Water's performance and facilitating competition in the water industry.

Options for change

6.61 The Panel reviewed a range of options that have the potential to: (i) reduce the opportunity cost of the Scottish Government's lending to Scottish Water, and (ii) generate a capital receipt for the Scottish Government through the repayment of Scottish Water's accumulated borrowings since devolution.

6.62 The relative merits of a variety of options to achieve these aims are reviewed in depth in two recently published studies from the Centre for Public Policy for Regions (CPPR)²¹ and the Scottish Futures Trust (SFT)²². SFT's paper fulfils the objective in its Corporate Plan to: *"work-up, and assess options to increase the efficiency of funding for Scottish Water, whilst retaining public ownership, that could be considered by Scottish Ministers"*.

6.63 Other than increasing water charges to fund future investment, which is something that only the economic regulator could sanction, all the main alternatives the Panel studied would involve some change in the legal status of Scottish Water. Change of this kind would require primary legislation, the expected time horizon for which would be a minimum of two years.

6.64 The Panel's consideration focused on three main options:

- privatisation through a sale of the business to private shareholders;
- mutualisation, whereby Scottish Water's customers would become owners of the business; and
- creation of a public interest company – that is, a not-for-profit-dividend company limited by guarantee.

6.65 The Panel is aware of the strongly held public view that water services should not be subject to privatisation. Noting that, the Panel understands that of the remaining two options, the one with the clearest benefits is the not-for-profit company model. Mutualisation presents risks as the model is untested in the operation of UK utilities and it may not adequately safeguard the public interest.

21 *Scottish Water – Threats and Opportunities*, CPPR (April 2010)

22 *Scottish Water Funding in Public Ownership*, SFT (July 2010)

6.66 A water utility along not-for-profit lines is already operating successfully in Wales. Welsh Water is owned and financed by Glas Cymru, a company limited by guarantee, which is run solely for the benefit of its customers. Welsh Water's assets and capital investment are financed by bonds and retained financial surpluses.

6.67 While attracting private investment to replace Government lending, the option the Panel favours could retain appropriate safeguards of the public interest through the economic regulator, while also guaranteeing that any financial surplus/profit would be to the benefit of Scottish Water's users (i.e. the Scottish public).

6.68 This option could release £140 million annually for alternative public investments while the refinancing of Scottish Water's existing debt would generate a capital receipt of approximately £2.75 billion. The UK Government would clearly have an interest in this receipt, which splits roughly into £1.5 billion of pre-devolution debt and £1.2 billion of debt built up post-Devolution.²³

6.69 The Panel is aware of the technical debate about the potential sums that could accrue to HM Treasury and to the Scottish Government. Notwithstanding that, the Panel assumes that, at the very least, the post-devolution debt would accrue to the Scottish Government as a capital receipt. It would be essential to clarify this matter in discussion with the UK Government.

6.70 The potential capital receipt described above would represent a significant contribution to meeting the Scottish Government's capital shortfall, towards the end of SR2010 period, and at the same time provide a huge boost to economic development by supporting capital investment.

The Panel suggests that the Scottish Government should take steps now to explore, in liaison with HM Treasury, options for changing the status of Scottish Water that could permit the release of significant capital to the Scottish Government for other projects, while allowing the attraction of private investment and the return of any surplus to the public benefit.

Develop innovative solutions

6.71 As with other parts of the budget, the prospect of cuts in the Scottish Government's Capital DEL budget should act as a positive spur to creative thinking and innovation, not only in terms of greater value for money or novel methods of finance but also, more broadly, in the way that public services are designed and delivered.

²³ *ibid.*

6.72 Those who operate public services will have to consider how to manage their assets in different and 'smarter' ways that ease pressure on capital budgets, by suppressing demand or providing off-setting revenue, consistent with the Government's national objectives.

6.73 The Panel sees particular scope for change in the use of buildings, for example, through increased deployment of new technologies and through changed working practices, including home working. An example of this kind of initiative is Glasgow City Council's 'Tomorrow's Office' project which aims to rationalise city centre office space:

"[Tomorrow's Office] will reduce the number of buildings occupied in the city centre from 18 buildings to 6 and will reduce annual property costs by £5.95 million per annum. The business plan includes investment in new ICT to move to electronic document management. Tomorrow's Office will account for 16% of the Council's carbon reduction target and is therefore significant both in terms of efficiency and meeting the challenge of climate change."

Glasgow City Council, submission to the Independent Budget Review

Charging

6.74 Transport is another key area where systems can be designed differently to better manage demand, supplement investment resources and reduce, or at least delay, the need for new capital expenditure.

6.75 Faced with the potential alternative of reduced or delayed investment, the public and businesses may be willing to contribute to the capital costs of new infrastructure by a means of access charges or tolls. Evidence to the Panel from CBI Scotland and the Scottish Futures Trust made relevant points:

"In transport, the CBI has supported a mixture of funding structures, for example meeting the cost of road maintenance from the transport budget, while using toll roads to fund new routes."

CBI Scotland, Response to the Scottish Parliament Finance Committee's call for evidence on efficient public services provided to the Independent Budget Review as part of CBI Scotland's written submission

"Where there is a clear economic need, and no other available funding source, opportunities could be considered for increased user-charging to fund infrastructure investment. This is particularly relevant in transport where there are live examples of: tolling for estuarial crossings (applied widely around the world), toll roads (eg France, Spain, USA), city based congestion charging (e.g. London) national level HGV road user charging (e.g. Germany), national universal road user charging (Netherlands in development). Caution would be required over geographic economic distortions, but the principles have been shown to work. User charging could also be used to directly incentivise carbon reduction, providing a secondary policy benefit."

Scottish Futures Trust, submission to the Independent Budget Review

6.76 In relation to reducing transport carbon emissions, Transform Scotland²⁴ also notes that:

"... the most effective interventions in financial terms will be those which require least in the way of expensive infrastructure – for example, the widespread introduction of travel planning, the introduction or increase in parking charges, reductions in road speeds, and introduction of measures to improve the quality of bus services (such as quality contracts or statutory partnerships)."

Transform Scotland, submission to the Independent Budget Review

The Panel suggests that the Scottish Government should consider the feasibility of adopting road user charging as a means to both better managing the use of existing transport networks and financing improvements to those networks.

CONCLUSIONS

6.77 The Panel views the predicted contraction in the Scottish Government's Capital DEL budget with concern given the backlog identified by Audit Scotland and the vital role of capital spending in supporting economic recovery and enhancing Scotland's longer-term prosperity. To address this, it will be important to explore all available routes to resource and manage the capital programme.

6.78 The Scottish Government faces significant challenges in managing its capital programme including the need to prioritise capital spending that delivers the greatest boost to economic growth. In seeking to address these challenges the Scottish Government should consider a central role the Scottish Futures Trust in addressing the significant task of prioritising and maximising the benefit from the capital investment programme.

6.79 The Panel was struck by the weight of opinion regarding the current position of Scottish Water and concludes that the Scottish Government and Parliament should urgently review the status of Scottish Water with a view to realising the substantial financial benefits which could arise from a change of status.

6.80 In that context, the Panel believes that there is at least one alternative route, that of a public interest company (similar to Welsh Water), which could permit the release of significant capital to the Scottish Government for other projects while allowing the attraction of private investment and the return of any surplus to the public benefit.

²⁴ Transform Scotland is a charitable organisation that campaigns for better transport policies and practice.

CHAPTER 7

SHAPING THE FUTURE



LOOKING FORWARD

"We are in for a long hard financial winter, which will require very difficult choices to be made about priorities. Political debate is inevitably going to involve where, how, and by how much to cut budgets in the short and medium term. But this is not sufficient. There must also be debate and discussion about the vision for Scotland's civil society, economy and public services that we wish to see growing out of the ground after the long hard financial winter."

Robert Black, Auditor General for Scotland, letter to the Chair of the Independent Budget Review Panel (June 2010)

7.1 This is a message which has been echoed by a significant number of those the Panel met – expressing a shared concern that the drive for economic development and service improvement should continue; that this unfortunate impending period of sharp adjustment should be seen as necessarily tactical; and that we should not lose sight of the more fundamental objective of ensuring that Scotland comes out of this transitional phase better equipped to grow and develop and with a sustainable public services model.

SHAPING PUBLIC SERVICES

"The most important question for policymakers is not whether to make savings, but how. In doing so, NESTA would argue that the Scottish Government should ensure cuts and efficiencies anticipate the services Scotland wants to have in the future and looks to save money in a way that stimulates and supports transformation."

NESTA, submission to the Independent Budget Review

7.2 The previous sections of this report have addressed the timescale within the Review's remit. The conclusions have stressed that immediate action is necessary to contain expenditure growth and that difficult decisions will be required to address and secure the short term budgetary constraints. However, to avoid year-on-year cuts of a random nature – 'salami slicing' – the developing response needs to be set in a more strategic, longer-term framework and direction of travel. There is a need to shape the future scope and model of public service provision.

"... the reduction in resources may cause Councils and their partners to fall back on protecting core services rather than delivering this transformational change. To put it starkly, short-term efficiencies could entrench service models that are not sustainable in the longer term and suffocate early intervention strategies."

COSLA, submission to the Independent Budget Review

7.3 Many of the submissions which the Panel received support this view and point towards themes and developments which are relevant to any such consideration including, indicatively, but not comprehensively:

- planning for future challenges, such as demographic and environmental change;
- sustaining the individual in the community;
- enabling self-help and close support;
- the concept of self-directed support and personal choice;
- realising the potential of preventive measures and early intervention in reducing later demand;
- early years prioritisation;
- integrated service provision focused on the individual;
- shaping organisational boundaries to help, not hinder, service delivery;
- employee engagement – skilling, developing and motivating the workforce;
- realising the resource represented by increasing numbers of older, active and available members of society;
- underpinning and realising the vital role of the voluntary/third sector; and
- engaging the contribution of the private sector in service delivery and choice.

7.4 These examples are all issues which are highly relevant to the future shape of public services. This is an agenda for transformation which cannot be taken forward without a clear sense of direction, and the Scottish Government and Parliament must provide the essential leadership in shaping future public services. This is work which needs to start now.

STRUCTURES AND BOUNDARIES

7.5 Scotland is a small nation which has, arguably, at present a public service infrastructure which is over-complicated, unduly fragmented and in need of fundamental redesign to address the future needs of a rapidly changing society. Unchanged, this could be a barrier to progress.

7.6 This is not to argue for an immediate, sudden, wholesale restructuring of public services. Such a path at this time could be counter-productive and, possibly, unachievable in practice. However, that should not inhibit changes that we are aware have already begun both between and among public bodies.

7.7 This presents a challenge to everyone engaged in the delivery of public services to take further steps to break down barriers, to pursue joint measures, to develop pilot schemes and to contemplate new organisational arrangements to achieve common operational boundaries wherever possible.

7.8 A new approach would be greatly enhanced if the Scottish Government and Parliament were to take the lead and reinforce their expectation that organisations across the public sector should:

- actively pursue mergers of organisations in part or whole where this can be seen to be in the public interest;
- revisit propositions which may not have been pursued vigorously or considered appropriate in less demanding times;
- explore strategic partnerships with the voluntary/third sector agencies and private sector interests; and
- engage internally and work with those in the voluntary/third and private sectors to pursue innovation in the delivery and procurement of services such as those identified by the Auditor General for Scotland in his letter to the Chair of the Panel of June 2010.

7.9 The service delivery options identified by the Auditor General were as follows:

- “ - traditional third sector provision (organisations may have to change and merge to deliver scalable services);
- social enterprise and community interest vehicles;
- services organised by user-led mutual organisations;
- employee led co-operatives;
- strategic delivery partnerships;
- traditional outsourcing models;
- joint ventures;
- public sector owned and managed shared service units;
- in house managed services;
- collaborative delivery units based on two or more public sector agencies;
- delivery companies spun from existing in house provider units;
- public trading companies;
- management buyout led enterprises; and
- trade sales to private sector companies.”

Robert Black, Auditor General for Scotland, letter to the Chair of the Independent Budget Review Panel (June 2010)

DELIVERING TRANSFORMATION

7.10 The task of delivering transformation in public services is inevitably a test of the Parliament's capacity to work across political boundaries, to agree common goals in the national interest and to initiate the necessary developmental work, consultation and public debate which that would entail.

7.11 In practical terms this could involve, for example, a Scottish Parliament cross-party working group, supported by a specialist advisory team or, alternatively, a working group of selected contributors, including an MSP from each of the Parliamentary political parties, to reflect upon and address the prospective longer term nature and shape of public service provision in Scotland, reporting to the Government and Parliament post-election 2011.

7.12 In this connection, the Panel would emphasise the wealth of constructive thought and relevant propositions which featured strongly in the submissions received in response to the Call for Contributions. These contributions coupled with the recent considerations of the Finance Committee represent a comprehensive base upon which to build.

7.13 In democratic terms, it is appropriate to refer to the special role of COSLA acting on behalf of the Scottish Local Authorities. The Concordat between the Scottish Parliament and COSLA will continue to be a vital means of communication and consultation and it may be useful to revisit and refresh this link to maximise the contribution which it can make in the public interest.

SECURING PERFORMANCE AND OUTCOMES

7.14 Given a period of real and noticeable cuts in public expenditure (even when offset to a degree by increased or new charges and higher taxation) current pre-determined service standards will have, of necessity, to be flexed, adjusted or revisited. The emphasis can be expected to shift from directed input controls, more readily achievable in a growth situation, to prioritised outcomes subject to measurement and benchmarking. There is a need to move from the blanket classification of major services as 'protected' to an approach based upon comparative 'prioritisation' within constrained resources.

7.15 In that setting, Parliament needs to be in a position to measure and evaluate the products of its investment. Robust performance information not only ensures that finite resources are appropriately targeted, but also that outcomes are genuine, can be validated and do not result in diminished levels or quality of service to the public.

7.16 It was suggested to the Panel that public bodies do not always have all the relevant performance information they need, or cannot link this properly to cost/productivity information. Baselines tended to be in place for costs but not for activity and quality. This view was echoed in similar evidence to the Scottish Parliament's Finance Committee from the Deputy Auditor General for Scotland, Caroline Gardner:

"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."

Deputy Auditor General for Scotland, oral evidence to the Scottish Parliament Finance Committee Budget Strategy Phase (April 2010)

7.17 The Panel also heard from the CIPFA Directors of Finance that there are currently unexplained cost differences in some services between Scotland and England. They indicated that they would support any encouragement to provide greater understanding of the reason for these differences:

"Councils do compare costs and nature of service delivery through various benchmarking opportunities. Directors of Finance are supporting work being undertaken by Audit Scotland in relation to improving costing information to support political policy decision making. However, there is a lack of opportunity to analyse information across the public sector and importantly between constituent parts of the United Kingdom. Significant, currently unexplained, cost differences are evident in some services between, for example, Scotland and England and any encouragement to provide greater understanding would be welcomed."

CIPFA Scotland Directors of Finance Section, submission to the Independent Budget Review

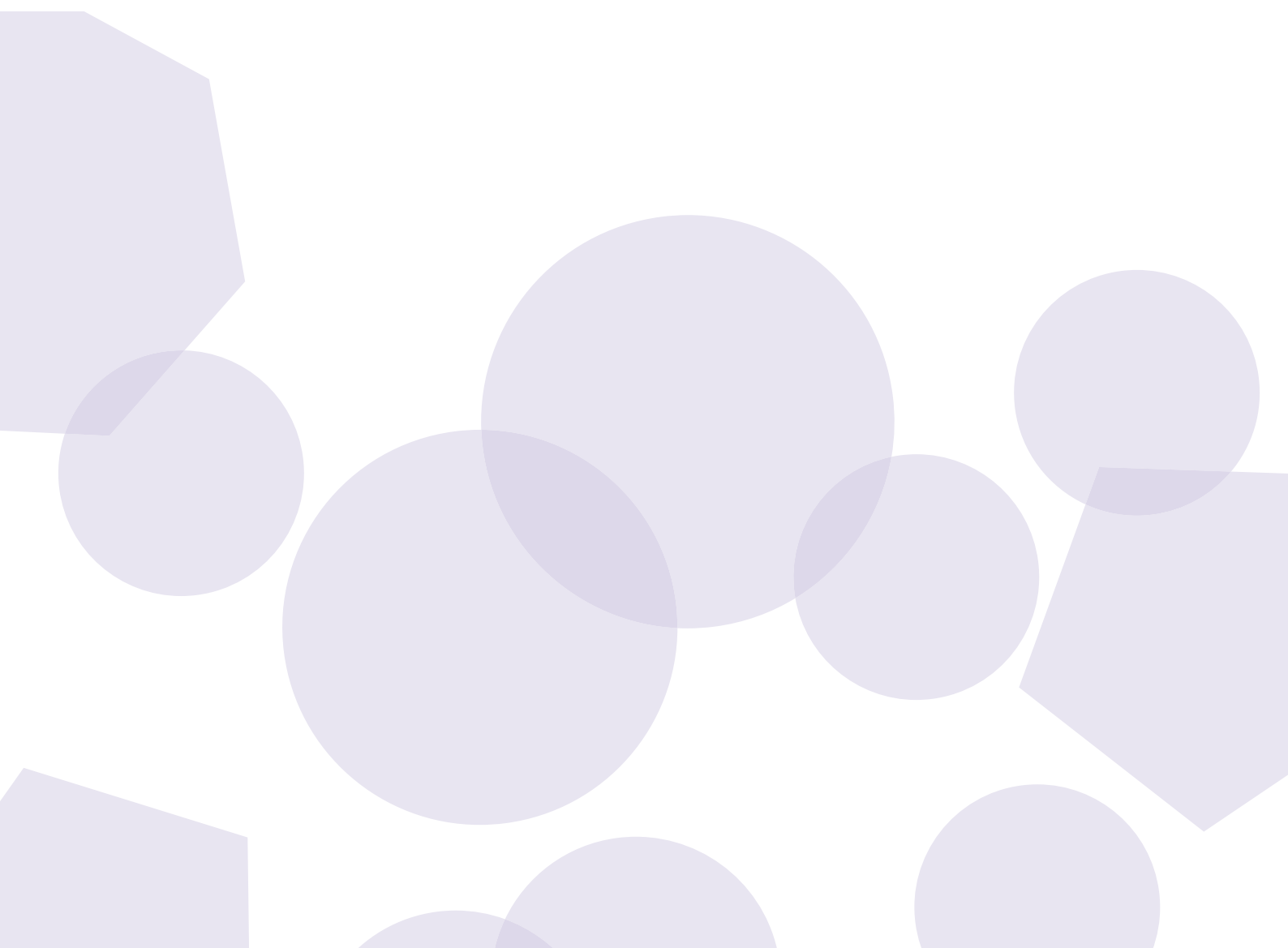
7.18 In that context, Parliament itself, as part of shaping its own future, may wish to reflect upon its own internal monitoring arrangements in the interests of ensuring that it is fully informed about the services which it funds. This would be an appropriate time to examine and review current Parliamentary arrangements to secure the most effective oversight of public sector finances and performance, including:

- challenge function;
- evaluation;
- monitoring;
- performance measurement;
- benefit realisation; and
- outcome assessment.

CONCLUSIONS

7.19 The Panel concludes that the developing response to future challenges needs to be set in a more strategic, longer-term framework, and Parliament must provide the essential leadership in shaping the future of our public service delivery.

7.20 The Panel also 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 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 and scrutiny role.



ANNEXES



ANNEX A**Remit**

The Scottish Government has commissioned an independent review of public expenditure in Scotland. The purpose of this review will be to inform public and Parliamentary debate in advance of the next Comprehensive Spending Review, expected in autumn 2010, about the challenges, and choices that will exist in a significantly constrained public spending environment and to ensure priorities can be established.

The Review will consider the implications of forecasts of reductions in public spending in Scotland in the short and medium term for the patterns of public spending that have developed since the establishment of the Scottish Parliament.

The Review will consider the implications of these forecasts on spending programmes with a view to ensuring the long-term sustainability of public spending in Scotland, incorporating evidence of demographic change. In doing so, the Review Panel will take into account:

- (i) The importance of identifying options that support delivery of the Scottish Government's Purpose and the framework of National Outcomes;
- (ii) The importance of efficiency and value for money in spending programmes and the contribution that local government, other agencies and the third sector make to the effective delivery of outcomes and services;
- (iii) Forecasts of future economic growth in Scotland and the UK as a whole and the types of government intervention that contribute most to stimulating the economy;
- (iv) The importance of protecting and supporting the most vulnerable in our society;
- (v) The importance of designing public services around the needs of the citizens who use them;
- (vi) The appropriate balance between government, community and individual action in the delivery of the outcomes that matter most to them;
- (vii) The importance of responding effectively to the challenges presented by climate change;
- (viii) Distinctions between public goods and services that are provided on a universal basis and those which are not.

The Review will make recommendations about the options for delivering public services within the constrained public expenditure environment in Scotland, which will be published.

The Review will be conducted by three individuals with a broad range of public and private sector experience [who were appointed on 11 February 2010]. The Review will report by end July 2010.

ANNEX B

Meetings with stakeholders*Organisation / Person*

Professor Alan Alexander

Sir John Arbuthnott

Association of Chief Police Officers in Scotland (ACPOS)

Audit Scotland

Professor David Bell, Budget Adviser to the Scottish Parliament Finance Committee

Professor Bill Bound, Non-Executive Director, Scottish Government

Dr Harry Burns, Chief Medical Officer, and Equally Well Taskforce members

CBI Scotland

CIPFA Scotland

COSLA Leaders

COSLA Officers

David Fisher, Non-Executive Director, Scottish Government

Dr Andrew Goudie, Director General Economy and Chief Economic Adviser, Scottish Government

Bill Howat

The Improvement Service

Independent Living in Scotland Project, Inclusion Scotland and the Scottish Disability Equality Forum

Institute of Directors, Scotland

Margo MacDonald MSP, Independent

Rt Hon Alex Salmond MSP, First Minister of Scotland

Scotland's Colleges

Scottish Chambers of Commerce (SCC)

Scottish NHS Board Chief Executives' Group

Scottish Parliament Finance Committee (informal roundtable session)

Scottish Conservatives (Derek Brownlee MSP)

Meetings with stakeholders (Continued)

Organisation / Person

Scottish Council for Development and Industry (SCDI)

Scottish Council for Voluntary Organisations (SCVO)

Scottish Financial Enterprise (SFE)

Scottish Futures Trust (SFT)

Scottish Green Party (Patrick Harvie MSP)

Scottish Labour (Andy Kerr MSP and David Whitton MSP)

Scottish Liberal Democrats (Tavish Scott MSP and Jeremy Purvis MSP)

SOLACE Scotland

STUC

Scottish Water

John Swinney MSP, Cabinet Secretary for Finance and Sustainable Growth

Universities Scotland

Dr Kevin Woods, Director General Health and Chief Executive NHSScotland



ANNEX C

List of bodies and individuals who made written submissions

Aberdeen City Council

Aberdeen College

Association of the British Pharmaceutical Industry Scotland (ABPI Scotland)

Association of Chief Police Officers in Scotland (ACPOS)

Association of Directors of Social Work (ADSW)

Asthma UK Scotland

Audit Scotland, on behalf of the Auditor General for Scotland and the Accounts Commission

BioIndustry Association Scotland

Black Leadership Network

BMA Scotland

Bòrd na Gàidhlig

Campaign to End Child Poverty in Scotland

CBI Scotland

Chartered Society of Physiotherapy Scotland (CSP Scotland)

Chief Fire Officers Association Scotland

Child Poverty Action Group (CPAG) in Scotland

CIPFA Directors of Finance Section (Scottish Branch)

CIPFA Scotland

Citizens Advice Scotland

City of Edinburgh Council Officers

Clackmannanshire Council

Coalition of Carers in Scotland

Comhairle nan Eilean Siar

Community Care Providers Scotland

Consumer Focus Scotland

COSLA

CTC Right-to-Ride Scotland

Dr Colin Currie

Jim Cuthbert

Margaret Cuthbert

List of bodies and individuals who made written submissions

(Continued)

A dental practitioner

East Ayrshire Council

East Renfrewshire Council

Equality and Human Rights Commission Scotland

Equally Well Task Force

Evaluation Support Scotland

ForthRight Alliance

Federation of Small Businesses Scotland (FSB Scotland)

Glasgow Caledonian University

Glasgow City Council

The Highland Council

Bill Howat

Includem

Independent Living in Scotland Project, Scottish Disability Equality Forum and Inclusion Scotland

KPMG

Loch Lomond and the Trossachs National Park Authority

Long Term Conditions Alliance Scotland

Professor Arthur Midwinter

National Library of Scotland and the Scottish Confederation of University and Research Libraries

NESTA: the National Endowment for Science, Technology and the Arts

Nestrans (North East Scotland Transport Partnership)

NHS Lothian

Office of the Chief Economic Adviser, Scottish Government:

- *Outlook for Scottish Government Expenditure* (April 2010); and
- *Outlook for Scottish Government Expenditure – June 2010 Emergency Budget Update* (July 2010)

Optometry Scotland

Parkinson's UK

Reform Scotland

List of bodies and individuals who made written submissions

(Continued)

Royal College of Nursing Scotland (RCN Scotland)

Save the Children UK (Scotland)

Scotland's Colleges

Scotland's Commissioner for Children and Young People

Scottish Association for Mental Health (SAMH)

Scottish Association for Public Transport (SAPT)

Scottish Building Federation (SBF)

Scottish Chambers of Commerce (SCC)

Scottish Children's Reporter Administration (SCRA)

Scottish Council for Voluntary Organisations (SCVO)

Scottish Council of Jewish Communities

Scottish Council on Deafness

Scottish Disability Equality Forum (SDEF)

Scottish Enterprise

Scottish Environment LINK

Scottish Funding Council (SFC)

Scottish Futures Trust (SFT)

Scottish Futures Trust additional submission: *Scottish Water: Future Funding Options*

Scottish Government

Scottish Legal Aid Board

Scottish Library and Information Council and Chartered Institute of Library and Information Professionals in Scotland

Scottish Natural Heritage

Scottish NHS Board Chief Executives' Group

Scottish Water

Scottish Women's Budget Group

Scottish Women's Convention

SOLACE Scotland

Spokes: the Lothian Cycle Campaign

List of bodies and individuals who made written submissions

(Continued)

sportscotland

Stow College

STUC

Swestrans (South West Scotland Transport Partnership)

tactran (Tayside and Central Scotland Transport Partnership)

Transform Scotland

UNISON Scotland

Universities Scotland

VisitScotland

West Lothian Council

John Womersley

WWF Scotland



ANNEX D

Public bodies landscape

Executive Agencies
Accountant in Bankruptcy
Disclosure Scotland
Historic Scotland
HM Inspectorate of Education
National Archives of Scotland
Scottish Housing Regulator
Scottish Prison Service
Scottish Public Pension Agency
Social Work Inspection Agency
Student Awards Agency for Scotland
Transport Scotland
Non-Ministerial Departments (NMDs)
General Register Office for Scotland
Office of the Scottish Charity Regulator
Registers of Scotland
Scottish Court Service
Public Corporations
Caledonian Maritime Assets Ltd
David MacBrayne Ltd
Highlands and Islands Airports Ltd
Scottish Futures Trust
Scottish Water

Public bodies landscape (Continued)

Executive NDPBs
Accounts Commission for Scotland
Architecture and Design Scotland
Bòrd na Gàidhlig
Cairngorms National Park Authority
Creative Scotland
Crofters' Commission
Deer Commission for Scotland
Highlands and Islands Enterprise
Learning & Teaching Scotland
Loch Lomond and The Trossachs National Park Authority
National Galleries of Scotland
National Library of Scotland
National Museums of Scotland
Police Complaints Commission for Scotland
Quality Meat Scotland
Risk Management Authority
Royal Botanic Garden, Edinburgh
Royal Commission on the Ancient and Historical Monuments of Scotland
Scottish Agricultural Wages Board
Scottish Children's Reporter Administration
Scottish Commission for the Regulation of Care
Scottish Criminal Cases Review Commission
Scottish Enterprise
Scottish Environment Protection Agency
Scottish Further and Higher Education Funding Council
Scottish Legal Aid Board
Scottish Legal Complaints Commission
Scottish Natural Heritage
Scottish Police Services Authority

Public bodies landscape (Continued)

Executive NDPBs (Continued)
Scottish Qualifications Authority
Scottish Social Services Council
Skills Development Scotland
sportscotland
VisitScotland
Water Industry Commission for Scotland
Advisory NDPBs
Advisory Committee on Sites of Special Scientific Interest
Building Standards Advisory Committee
Fisheries (Electricity) Committee
General Teaching Council for Scotland
Historic Environment Advisory Council for Scotland (Ceased to operate on 31 May 2009)
Judicial Appointments Board for Scotland
Local Government Boundary Commission for Scotland
Mobility and Access Committee for Scotland
Public Transport Users Committee for Scotland
Scottish Advisory Committee on Distinction Awards
Scottish Industrial Development Advisory Board
Scottish Law Commission
Scottish Local Authorities Remuneration Committee
Scottish Records Advisory Council

Public bodies landscape (Continued)

Tribunals
Additional Support Needs Tribunals for Scotland
Children's Panels (32)
Lands Tribunal for Scotland
Mental Health Tribunal for Scotland
Parole Board for Scotland
Private Rented Housing Panel
Scottish Charity Appeals Panel
Health Bodies
Mental Welfare Commission for Scotland
NHS 24
NHS Boards (14 bodies)
NHS Education for Scotland
NHS Health Scotland Board
NHS National Services Scotland formerly known as the Common Services Agency
NHS Quality Improvement Scotland
National Waiting Times Centre Board
Scottish Ambulance Service Board
State Hospital Board for Scotland
Parliamentary Commissioners and Ombudsmen
Commissioner for Public Appointments in Scotland
Parliamentary Standards Commissioner
Prison Complaints Commissioner
Scotland's Commissioner for Children and Young People in Scotland
Scottish Human Rights Commission
Scottish Information Commissioner
Scottish Public Services Ombudsman
Scottish Commission for Public Audit

Public bodies landscape (Continued)

Other Significant Bodies
Audit Scotland
Court of Lord Lyon
Drinking Water Quality Regulator
HM Chief Inspector of Constabulary in Scotland
HM Chief Inspector of Prison in Scotland
HM Chief Inspector of Prosecution in Scotland
Justices of the Peace Advisory Committee (6 bodies)
Macaulay Institute
Moredun Research Institute
Office of the Queens Printer for Scotland
Scottish Agricultural College
Scottish Crop Research Institute
Scottish Roadworks Commissioner
Standards Commission for Scotland
Sustainable Development Commission in Scotland
Visiting Committees for Scottish Penal Complaints
Waterwatch Scotland

Source: Scottish Government, July 2010

ANNEX E

Public bodies to which Public Sector Pay Policy applies

Architecture and Design Scotland
Bòrd na Gàidhlig
Cairngorms National Park Authority
Caledonian Maritime Assets Limited
Communities Scotland (staff who retained existing terms and conditions of employment)
Crown Office and Procurator Fiscal Service
Dundee Airport Limited
Highlands and Islands Airports Limited
Highlands and Islands Enterprise
Historic Scotland
Learning & Teaching Scotland
Loch Lomond & Trossachs National Park Authority
Mental Welfare Commission for Scotland
National Galleries of Scotland
National Library of Scotland
National Museums of Scotland
NHS Scotland Senior Managers (Grades A-C only)
Police Complaints Commissioner for Scotland
Registers of Scotland
Risk Management Authority
Royal Botanic Garden Edinburgh
Royal Commission for Ancient and Historic Monuments Scotland
Scottish Arts Council
Scottish Children's Reporter Administration
Scottish Commission for the Regulation of Care
Scottish Court Service
Scottish Criminal Cases Review Commission
Scottish Enterprise
Scottish Environment Protection Agency

Scottish Further and Higher Education Funding Council
Scottish Government Main Bargaining Unit:
Fisheries Research Services
General Register Office for Scotland
HM Inspectorate of Education
Mental Health Tribunal for Scotland
National Archives of Scotland
Office of the Accountant in Bankruptcy
Office of the Scottish Charity Regulators
Scottish Building Standards Agency
Scottish Public Pensions Agency
Social Work Inspection Agency
Students Award Agency for Scotland
Transport Scotland
Marine Scotland
Scottish Legal Aid Board
Scottish Legal Complaints Commission
Scottish Natural Heritage
Scottish Police Services Authority
Scottish Prison Service
Scottish Qualifications Authority
Scottish Screen
Scottish Social Services Council
Scottish Water
Skills Development Scotland
SportScotland
VisitScotland
Water Industry Commission for Scotland

Source: Scottish Government, July 2010

ANNEX F

Options available to reduce public sector pension costs

Scottish Ministers are likely to seek Scottish engagement with the work of the Independent Public Services Pensions Commission. It is only possible to speculate what recommendations the commission may make but there would seem to be a number of options available to reduce public sector pension costs. All options can only apply to pensions rights from a future date, as the Commission's terms of reference recognise that accrued rights are protected.

- Option A: Retain a final salary system, selecting from a number of potential changes to the current position:
 - (i) further develop the current cost share/capping agreements by reducing the current employer contribution cap levels with members meeting all costs above that cap;
 - (ii) reduce the level of benefits available within the scheme and therefore reducing longer-term scheme costs but without reducing member contributions;
 - (iii) introduce later retirement ages. At the last round of pension reforms where increases in normal retirement age were introduced the current membership retained their original retirement age;
 - (iv) introduce final salary caps within each scheme which would effectively limit the maximum amount of annual pension that could be paid from the scheme;
 - (v) change accrual rates; and
 - (vi) apply the changes to all members not just new scheme members.
- Option B: Replace final salary terms with a career average scheme. Career average schemes are already used in part of the public sector: for example Nuvos for the Civil Service and NHS scheme provides a career average scheme for General Practitioners. Unlike a final salary scheme where the whole pension is based on the best available final salary, each year is treated separately. The amount of pension entitlement is calculated based on earnings for that year and at retirement is re-valued. The level of savings against a final salary scheme would depend on issues such as:
 - (i) the proportion of members who have significant salary rises throughout their career against those whose career path is steady and stays relatively within a similar pay range;
 - (ii) accrual rates; and
 - (iii) future levels of public sector pay.

- Option C: Movement to a Defined Contribution (DC) scheme or similar. This would mirror reported trends in the private sector where it is reported that increasingly final salary schemes have been closed and replaced by DC or career average schemes.

All schemes currently under Scottish Ministers' responsibility are Defined Benefit (DB) schemes. Under DB schemes it is possible to work out, in advance, and particularly at retirement, precisely how much pension an individual is entitled to, based on length of service, etc. DB schemes are required to pay that pension amount until death. Therefore the investment risk lies with the scheme/ employer.

Under a DC scheme members and their employers pay amounts into an investment fund. At retirement, the member receives their share of that fund (their 'pension pot') which they then use to buy an annuity. Under this model, the only certainty is how much money is being paid into the fund whilst in employment. Because the value of the pensions pot and the annuity they can buy with it are dependent on investment market performance and assessment of risk by annuity providers, the investment risk lies with the employee. This model directly removes the employer's risk of meeting future accruing final salary liabilities and places the risk of uncertainty over the value of their final pension with the member.

This option would see savings moving forward given that accrued rights will be protected. What would also need to be considered with this option would be:

- (i) the likely reduction in pensioner income and how that might consequently impact on the demand for state benefits such as pension credit;
 - (ii) whether this type of change would significantly impact on the retention and recruitment of public sector staff and in particular specialist staff.
- Option D: Design a 'hybrid' scheme, combining appropriate features from the options above. For example, one option could be to establish a DB (final salary or career average) base pension or 'underpin' with an optional, tariff-based top-up. Scheme members would be entitled to the base pension on membership (and would pay an appropriate contribution towards it). The top-up element could be on a DB or DC basis and could allow scheme members to make choices about how much above their base occupational pension they would like to save for their retirement.

Source: Scottish Public Pensions Agency, July 2010

ANNEX G

Asset planning responsibilities

The following table and text, provided by Scottish Government officials, shows which sector(s) is responsible for the construction and maintenance of each of a selection of the key asset bases that support the delivery of public services in Scotland.

Asset Type	Sector(s) Responsible
Schools	Local Government
Local Roads	Local Government
Major Roads	Transport Scotland
Rail Network	Transport Scotland
Social Housing	Local Government / Registered Social Landlords (RSLs)
Flood Defences	Local Government
Prisons	Scottish Prison Service
Health Primary and Secondary	NHSScotland
Higher and Further Education	Scottish Government grant provided to Scottish Funding Council (SFC) which then provides grants to individual institutions which are the ultimate holders of the assets

Summary

The following points provide a brief outline of the asset planning and responsibilities across the Scottish public sector:

- **Local Authorities:** Requirements mainly determined at the local level however there is interplay with strategic national programmes (e.g. schools).
- **NHSScotland:** The majority of decisions regarding prioritisation of capital expenditure rest with NHS Boards. For major capital projects business cases are assessed by SG Health.
- **Further and Higher Education:** Colleges and universities are independent institutions, each responsible for determining how best to develop and manage their capital asset base. Institutions have management teams, led by a Principal or Vice Chancellor, and report to Boards of Governors or Courts. Good practice recommends that an estates committee is set up as a sub-group of the Board/Court.

While the Scottish Funding Council (SFC) is keen to support institutions in their development and usually engages in discussions at very early stages of capital development consideration, the final decision to proceed with a capital project rests with the college or university.

Once an institution has taken the decision to proceed with a capital project, SFC will allocate capital project funding based on their assessment of the individual project combined with an overview of the strategic development needs of the sector as a whole.

- **Scottish Water:** For each regulatory period, Ministers are required to specify their objectives for the water industry. The objectives specify improvements to services, drinking water quality and the environment. These take the form of directions to Scottish Water. In addition, Ministers also specify their Principles of Charging. These specify the principles that the Water Industry Commission for Scotland must apply when setting charges for customers.

The Water Industry Commission for Scotland is the economic regulator. It is required to determine customer charges based on the overall lowest reasonable cost of providing water and wastewater services to customers given the Ministers' objectives and principles of charging. Decisions as to capital investment are taken in this context.

- **Scottish Prison Service:** The Infrastructure Investment Plan 2008 sets out the Scottish Government's investment plans in the infrastructure across the public sector, including prisons, for the Spending Review period 2008-09, 2009-10 and 2010-11. The Spending Review 2010 process will determine the Scottish Government's further investment plans for development of prisons for the next four-year period.
- **Scottish Enterprise and Highlands and Islands Enterprise:** Investment decisions are taken in the context of Scottish Ministers' overall priorities for economic development.
- **Transport Scotland:** The prioritisation of Major Projects is based on the Strategic Transport Projects Review (STPR). In future, although STPR will still remain the basis, there will also be a process of prioritisation applied by Scottish Ministers when allocating the capital budget across all sectors and when determining the level of infrastructure investment that can be supported from revenue finance (e.g. public private partnerships (PPP/PFI), non-profit distributing, and borrowing against regulated asset base (RAB) for investment in rail infrastructure.
- **Registered Social Landlords:** Determined at the local level, within the context of overarching Scottish Government policy.

ANNEX H

Glossary

Annually Managed Expenditure (AME): is set each year and contains the elements of expenditure that are not readily predictable, for example, NHS and teachers pensions.

Audit Scotland: was set up in April 2000 to audit the accounts of the Scottish Government and other public sector bodies in Scotland, and to ensure that public funds are used properly, efficiently and effectively.

Barnett Formula: allocates Scotland a population share of changes in comparable spending programmes in England. For comparable expenditure, Scotland gets exactly the same £s per head increase as in England. Comparability is the extent to which services delivered by Whitehall departments correspond to services delivered by the devolved administrations. Barnett only applies to expenditure classified within Departmental Expenditure Limits - about 85% of Scotland's total budget.

Best Value: is about continuous improvement, seeking to change what we do in a way that transforms and sustains the delivery of quality public services in Scotland.

Capital Expenditure: includes:

- capital formation, the net acquisition of land, and expenditure on capital grants. Fixed assets are assets that can be used repeatedly to produce goods and services and generally have an economic life of more than one year;
- capital expenditure includes the value of assets acquired under finance leases; and
- in-house development of assets such as computer software and databases can be capitalised in government accounts provided certain conditions are met. It is sometimes called 'own account capital formation'.

Central Government: comprises parliaments; government departments (including Scottish Government) and their executive agencies; government funds such as the national loans fund; the foreign exchange official reserves; non-departmental public bodies; NHS trusts and various other non-market public bodies controlled by central government.

Cost of Capital: a cost of capital charge is a notional non-cash item which reflects the cost of holding assets and liabilities. The theory is that if the asset were sold, overall public sector borrowing would be lower by the value of the asset, so the cost of keeping the asset is the same as the interest paid on this higher level of borrowing.

Current Budget: the difference between current revenues (including capital taxes) and current expenditure (including capital consumption).

Current Revenue: all revenue raised by the public sector from tax and non-tax revenues except the sale of assets or interest received.

Departmental Expenditure Limit (DEL): the Departmental Expenditure Limit forms the majority of the Scottish Government's budget and is made up of operating and capital expenditure.

Depreciation: a depreciation charge is a non-cash item which measures the wearing-out, consumption or other reduction in useful life of a fixed asset.

Efficiencies cash-releasing: achieved by delivering an actual resource efficiency because the organisation or function delivers the same service at a reduced cost which might be demonstrated by delivering the same outcome(s) or output(s) for a reduced input (e.g. costs, people, procurement, assets etc) or delivering a reduced unit cost allowing an increased volume of service for the same cost. Cash efficiencies release financial resources to be used for other or increased public services.

Efficiencies time-releasing: defined as efficiency measures which do not release cash but allow frontline services to deliver better services with the same money (for example, through workforce reform or better support).

End Year Flexibility (EYF): is the mechanism that allows the Scottish Government to carry forward any DEL underspends for use in future financial years.

Gross Domestic Product (GDP): a measure of the value of goods and services produced in the UK before providing for capital consumption. It is equal to gross value added at basic prices plus taxes (less subsidies) on products. Alternatively, it is equal to the sum of total final domestic consumption expenditures less imports of goods and services.

Local Government: all 32 local authorities in Scotland.

Net Investment: public sector capital expenditure, net of capital consumption.

Non-Departmental Public Body (NDPB): a non-departmental public body that operates independently of Ministers, although Ministers have ultimate responsibility. There are two main types of NDPB: executive NDPBs, which carry out administrative, regulatory, executive or commercial functions; and advisory NDPBs, which provide independent, expert advice to Ministers.

Prudential Regime: the prudential regime for local authority capital expenditure took full effect on 1 April 2004. It allows local authorities to make their own decisions about how much to borrow or spend, but they are under a duty to determine how much they can afford and to keep that under review.

Public Corporations: a sector from National Accounts consisting of publicly controlled market entities. To be classed as 'market' their sales must be at least 50 per cent of their operating costs.

Public Sector Finances: the monthly statistics on the public sector produced jointly by the Office for National Statistics and HM Treasury.

Total Managed Expenditure (TME): is a definition of aggregate public spending derived from National Accounts. TME comprises the Departmental Expenditure Limit and Annually Managed Expenditure.

UK Public Sector Net Borrowing: the difference between the sum of UK public sector current and capital revenues and UK public sector expenditure as measured in the Public Sector Finances according to the National Accounts framework.

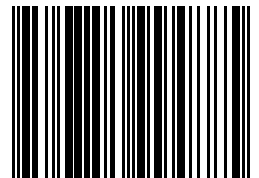
Levering in Finance: where finance has been levered in from an organisation outwith the public sector and this has freed resources which could be offered up in savings or redeployed, then that funding can be counted as an efficiency provided the level of service delivery is maintained or improved.

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