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Independent Advisory Budget Review Panel final report

This paper outlines a number of important issues arising not only from the Independent Advisory Budget Review Panel (IABRP) report but also from other recently published financially related reports and covers the following areas:

1 Independent Advisory Budget Review Panel (IABRP) report
2 Comparison with the An Bord Snip report for Ireland
3 The 'Outlook for Scottish Government Expenditure: June 2010 Emergency Budget Update'
4 CPPR briefing paper on the 'Outlook for Scotland's infrastructure'
5 Latest GDP figures for Scotland and the UK

1 Independent Advisory Budget Review Panel report

On 29th July the IABRP published their findings. The main areas looked at were: Efficiency; Remuneration and Workforce; Universal Services; and Capital.

The report did not seek to find specific cash savings from any Budgets but rather set out the arguments in relation to a few big strategic decisions that the Scottish Government and Parliament will need to address.

The report takes the recent Scottish Government update on its future Budget prospects (see Section 3 for discussion of this) as fairly representing the challenge ahead, i.e. a £3.7 billion real terms cut in the next four years to 2014-15.

In general terms, the reports Chairman highlights the need for: strong leadership; urgency; frank discussion; and cross party co-operation, at all levels of government.

Recommendations by the Panel of particular interest to Scottish Local Authorities, in relation to future budget levels, included:

- A presumption against any ring fencing, or 'protection', of budgets e.g. Health. (Note, however, that the Panel go on to say that if such ring-fencing were to occur that it might be broadened to include non-NHS services that support health. This could have the knock on effect of even bigger cuts outside these protected areas than if just health were protected.)
- To discontinue the current Council Tax freeze. This would release £70 million per annum, or £280 million over the 4 years of the spending review, from the Scottish Government's budget. It would simultaneously allow local authorities to raise council tax rates to help fill any funding gaps they may be facing.
- To seek efficiency savings across the board of 2-3% p.a., which would be worth between £600-900 million by 2014-15. However, unlike the current efficiency

programme, the IABRP advocate these savings should not be retained where they were raised but should be used to help reduce the negative impact of the budget cuts overall.

- To look to all public bodies to identify new means of raising funds that would be within the powers of the Scottish Parliament including, for example, congestion charging or charges for missed appointments, as a means of reducing demand whilst also helping to raise quality standards.
- An outline of 4 different pay scenarios over the next 4 years, supplemented by additional job cuts necessary to keep total remuneration flat as a share of total resource DEL.
  - For 2011-12 and 2012-13, the pay scenarios range between a total freeze on all pay (including all progression-related elements) and the current UK option which allows for both progression and increases for those earning under £21,000.
  - For 2013-14 and 2014-15, the options are for a net increase of between 2 to 3% per year.

  Depending on which pay package is to be followed, the additional job losses required, in order that overall remuneration takes its proportionate share of the budgetary pain, ranges between 30,000 and 50,000 by 2014-15.
- A call to review whether all free or subsidised universal services should be retained in their current form. In particular, looking at eligibility criteria and the introduction of means testing or user charging. The report highlights, for example, the impact of selective changes to criteria in areas like free bus travel, free personal and nursing care for the elderly and free prescription charges on overall costs, including the degree to which they simply offset anticipated future demand-related increases.
- The need for greater clarity over capital expenditure priorities. This includes an enhanced role for the Scottish Futures Trust as a means of securing more efficient procurement and to assess all possible means of funding Scotland's public sector infrastructure maintenance as well as any proposed new developments.
- Under the section on capital spending two additional specific options are mooted. First, the removal of Scottish Water from the current public sector model into a public interest company that would allow it to get access to private debt and secondly, urging the Scottish Government and others to assess the feasibility of adopting road user charging.
- Finally, the IABRP highlights the large and growing funding gap that appears to be emerging as the Scottish Government seeks to accommodate its known capital spending plans; by 2011-12 there is a projected shortfall of £500 million rising to £1 billion by 2013-14.

While some ranges are given for the financial implications of the IABRP's changes, no priced menu is supplied to choose from. However, if all the options outlined were followed, this would go well beyond the £3.7 billion real terms cuts sought by 2014-15. In that sense the Report can be seen to offer alternatives for politicians, in that not all the recommendations need to be carried out.

The main implications for Local Authorities' budgets relate to the non ring-fencing of the Health budget (although of how much benefit this will end up being is uncertain given that Health is unlikely to suffer cuts on a par with the average for Scotland) and the ending of the Council Tax freeze, both of which could be to their financial advantage.

The discussion of Remuneration and Workforce issues could also prove useful in terms of easing negotiations, if a similarly tough line (as is advised by the IABRG) is taken across the board.

What the report has not done is of equal interest. It has not identified specific areas or programmes to be cut, or made any value judgments, or prioritised between spending areas (apart from their proposal for Scottish Water). The report states that it aims to provide “some high-level, indicative figures to aid perspective”. However, it also states that “much more detailed financial modelling will have to be done in taking decisions on the various options”.

In conclusion, it has taken 5 months to get to a position where we have some general proposals to discuss but no real agreement between political parties on how to take this forward, no specific costed proposals and no understanding on how such data will be developed and then made public for wider discussion. There is also no timetable for further action but a serious plea from the Chair that immediate action is essential. Meanwhile the Parliament is on holiday until September, after which there will be only seven months until the start of the next financial year.

The contrast with how Ireland has gone about its Budget review process is highlighted in Section 2. The need for urgency due to the biggest cut coming in 2011-12 is highlighted in Section 3.

2 The Irish Review of Public Sector Expenditure and Employment numbers - An Bord Snip proposals

In June 2009 a Special Group – commonly referred to as An Bord Snip – reported to the Minister for Finance of the Irish Government on proposed savings and staffing reductions for the year 2010. The main points from the report were:

- The report concentrated on offering a range of cuts in relation to the current (i.e. resource) expenditure budget.
- It was not asked to look at taxation options, capital expenditure or public service pay and pensions policy.
- The Irish Government had set a target of €3 billion consolidation from the current expenditure budget in 2010.
- An Bord Snip came up with total current expenditure savings of €5.3 billion, in order to provide scope for the Government to choose between some of their proposed options.
- As part of this exercise the Special Group outlined the staffing reductions associated with these expenditure cuts.
- Table 1 below highlights the where the biggest expenditure and staff savings were made:

Table 1: An Bord Snip savings (full year equivalents for 2010)

Expenditure area	Expenditure savings £ million	Staffing reductions
Social and Family Affairs	1,848	-
Health & Children	1,230	6,168
Education and Science	746	6,930
Agric, Fish &Food	305	1,140
Enterprise, Trade & Employment	238	594
Other	943	2,526
TOTAL	**5,310**	**17,358**

The three largest Irish Department's budgets provided the largest financial savings and the two largest employers provided the biggest staff savings.

The Irish Government took the recommendations of the Special Group into account when formulating their Budget 2010 (published in December 2009, see the Irish Government Department of Finance website homepage).

In the end, the proposed savings made (around €2 billion) were smaller than had been proposed by An Bord Snip, as €1 billion was found from payroll savings (which was not part of their remit but separately negotiated by the Government) in the form of substantial cash reductions (ranging from 5-15%).

However, further savings of €2 billion are still to be found from current expenditure and/or current revenues in both 2011 and 2012 so the Irish Government may well return to the Special Groups savings proposals.

In addition to An Bord Snip the Irish Government also initiated a Capital Review and an Efficiency Review of Local Authorities.

The Efficiency Review (published 23/07/10, see Environment, Heritage and Local Government website), outlined reforms worth over €500 million. These 'savings' came in the form of both efficiency savings (€346 million) and cost recovery/revenue raising (€165 million). The main source of new income/revenue is related to tolling national roads, worth up to €100 million.

The Group identified 2,000 additional jobs that might be shed, from an existing full time jobs total of just over 32,000 (itself down 5,000 since March of 2009 due to a recruitment ban). These jobs are primarily focussed on senior and middle managers (770) and senior engineers and planners (500).

The Capital Review (published 26/07/10, see Finance website again) outlined what further cuts, on top of those already made since the 2008 peak spend, were being recommended up to 2016. Overall, capital spend falls by 40% between 2008 and 2011, then remains flat in cash terms. Compared to 2008 the biggest relative losers are Roads and Housing, both falling to around one third of their peak level. The only area to experience an increase in spending is Enterprise, although a small Capital Reserve Fund has also been created.

3 The 'Outlook for Scottish Government Expenditure: June 2010 Emergency Budget Update'

The Chief Economic Adviser (Andrew Goudie) of the Scottish Government published an update of his outlook on future funding for Scotland in early July, taking into account CPPR's briefing note on the prospects for 2011-12 and the UK government's Emergency Budget. The main points of interest were:

- The overall outlook worsened considerably in comparison to their previous report (of April 2010).

- This worsening was due to three factors: the deeper cuts proposed by the UK government; the deferral of any 2010-11 cuts by the Scottish Government; and the likely ending of EYF draw-downs.
- For the years 2011-12 to 2015-16, the real terms growth in Scottish Government DEL Expenditure is expected to be approximately: -6%/-2%/-3% /-3%/-2%
- These Scottish estimates are based on the Barnett Formula consequentials expected from the upcoming (October) UK Spending Review where it is assumed that, at the UK level, Health is protected and Overseas Aid increases.
- Two alternative scenarios are also outlined, both resulting in slightly better outcomes.

In cash terms[1], these estimates can be interpreted, in a useful shorthand way, as -4% in 2011-12 followed by four years of flat cash budget (see Table 2). Table 2 also shows what the position would be if the Scottish Health budget were to be protected over the next 5 years.

Table 2: Approximate Scottish DEL growth rates 2011-12 to 2015-16[2], %

	2011-12	2012-13	2013-14	2014-15	2015-16
Cash	-4%	0	0	0	0
Cash (Health protected)	-7%	-1%	-1%	-1½%	-1½%
Real	-6%	-2%	-3%	-3%	-2%

The % change figures shown in Table 2 are in line with the Scottish Government's Total DEL Budget figures, given in £ billion, in Table 2.1 of the IABRP report.

4 Outlook for Scotland's infrastructure – CPPR briefing paper

The additional funding received since devolution substantially eased the development of Scotland's public infrastructure such as its roads, schools, train lines and stations, its lifeline ferries, social housing as well as the country's water and sewerage network. The impending Whitehall budget cuts will have a profound impact on future spending.

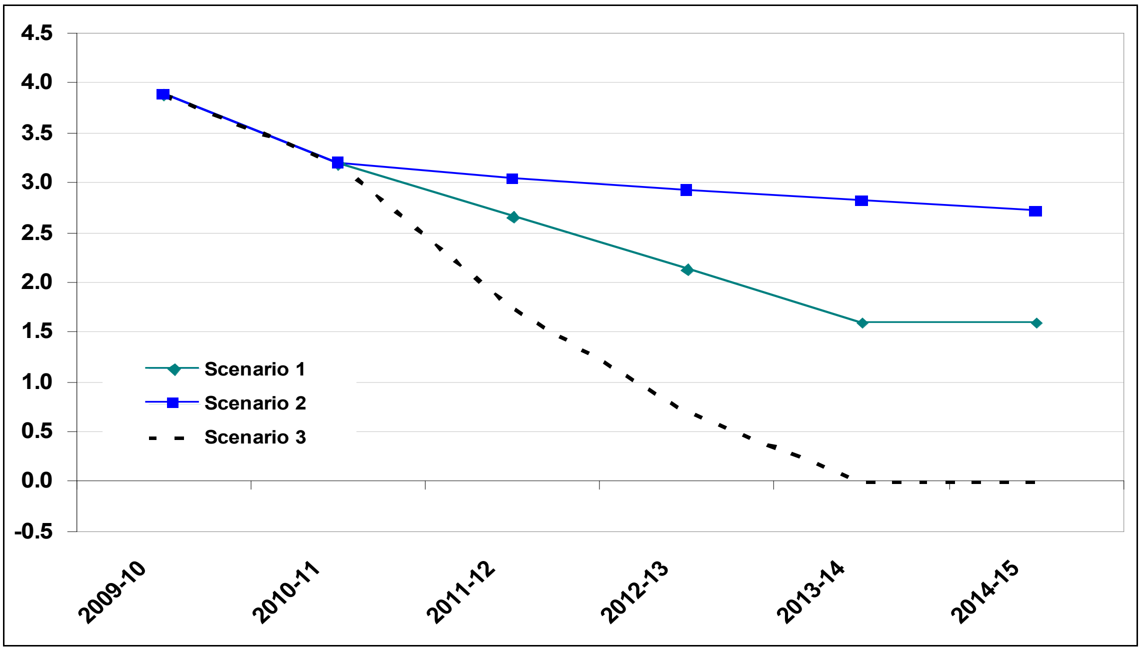
On the capital side, instead of arguing for yet more investment, Scotland's politicians may actually be facing the stark choice of, can we add to the Scottish economy's much needed capital stock or can we only maintain what we have already secured?

Projections for what the Scottish Government may have available to spend on capital projects between now and 2014-15 suggest there could be a serious investment hiatus (see Fig 1).

[1] All cash terms % changes are derived by adding back the GDP deflator to the Scottish Executive real terms % change estimates. (Note: The Scottish Executive real terms figures were themselves created by adjusting for the GDP deflator.)

[2] Note: the annual changes shown in this table upto 2014-15 are different to those implied in our Note 1, Tables 3 and 4. This is due to the fact that the Note 1 % changes were based on: a 4 year real terms average applied across each year; and the Barnett Formula being applied to the total UK DEL budget. In Note 2, consistent with the Goudie and Beveridge reports, the changes are now annualised, not averaged , and the Barnett Formula consequentials are boosted by the fact that Health spending is protected.

Fig 1: CPPR projections for DEL Capital spending, £ billion (2010-11 prices)



Under scenario 1, net investment spending is set to fall 50% between 2010-11 and 2014-15; by the end of the next spending review period only £1.6 billion may be available for the Scottish Government to spend on maintaining and developing Scotland's infrastructure.

Maintaining 2010-11 levels of spending on annual revenue programmes, means Scotland's infrastructure spend falls to zero (scenario 3). If DEL capital and resource retain their 2010-11 shares of total DEL, capital spending would fall by £0.5 billion by 2014-15 (scenario 2)

To ensure capital spending is not cut to an inappropriate degree over the next spending review period, greater clarity on the Scottish Government's views on the following strategic questions are needed:

a) **What proportion of the reduced Scottish budget should and will be allocated for capital investment?**
b) **Which of the many potential new infrastructure projects remain a priority and which are now either no longer essential or affordable?**
c) **Does maintenance of existing infrastructure take precedence over further capital developments?**

Table 3: DEL capital allocations 2010-11 & 2014-15, £billion (2010-11 prices)

	2010-11 % share	2010-11 £ billion	All depts share in cuts 2014-15 £ billion	Health capital ring-fenced 2014-15 £ billion
Local Government	27%	0.87	0.43	0.34
Health	18%	0.58	0.29	0.58
Transport	22%	0.72	0.36	0.28
Housing & Regeneration	9%	0.28	0.14	0.11
The Rest	24%	0.75	0.38	0.29
TOTAL	100%	3.20	1.60	1.60

As Table 3 shows, the projected budget cuts could leave some departments with very small allocations by 2014-15. If all share in the pain (ie, they retain their 2010-11 shares) Local Government could have £0.43 billion by 2014-15. However, if Health retains its 2010-11 allocation (ie, £0.58 billion) then Local Government could find it has only £0.34 billion allocated, £0.53 billion less than this year.

The ability of the UK and Scottish Governments to maintain infrastructure development is now at a crossroads. In responding to the independent budget review and the UK Government's spending review, clarity and openness on what and where scarce capital spending should be allocated is needed to ensure those that are funded offer the best returns to the Scottish economy.

5 Latest Scottish and UK GDP data

July saw new figures for Scottish GDP (2010 Q1) and UK GDP (2010 Q2) published.

The new Scottish data was disappointing, showing no growth over the previous quarter (in comparison to +0.3% for the UK in Q1). The main areas of lower relative Scottish growth were Manufacturing, which does not bode well for exports led growth, and Business services.

In contrast, the new UK data was surprisingly good, +1.1% on Q1, with growth being fairly widespread across sectors. However, some of this growth, for example in Construction (+6.6%) is difficult to explain and seems unlikely to be maintained.

In terms of GDP forecasts, the NIESR continue to forecast noticeably lower growth for the UK than the Office for Budget Responsibility for 2011 and 2012. At the world level, the IMF have revised up forecasts for 2010, but largely based on higher developing nations growth.

Authors:
Jo Armstrong (07740 440766)
Richard Harris (07969 697224)
John McLaren (07910 333194
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