Briefing Note:
Projected Scottish Budget to 2014-15
6th August 2010 (Embargoed until 00.00 8th August)

THREE POSSIBLE SCENARIOS FOR THE SCOTTISH BUDGET

INTRODUCTION

The publication of the Independent Budget Review group report – the IBRR – not only confirms the size of the budget gap that the Scottish Government is likely to need to fill but also the need for both leadership and speed in deciding which of the options outlined are to be implemented. To date, few, if any, cuts have been proposed by any of the political parties. Rather, they have tended to concentrate on which areas remain out of bounds.

The challenge facing Ministers and politicians is not easy and is not without political risks. In order to help those who have to plan spending commitments for the next 4 years (with the first year, 2011-12, starting in less than 8 months) the following 3 scenarios outline different approaches on how the projected shortfall in the Scottish Budget might be met. These are based on (i) the Independent Budget Review group's report; and (ii) Andrew Goudie's Budget Prospects[1] facing the Scottish Government report.

The 3 scenarios are characterised as "conciliatory", "simple", and "structural", in nature.

The purpose of the analysis is to illustrate the sort of options available to decision makers. It also acts as a warning of the repercussions if some of the difficult choices ahead are avoided in the short-term.

THE FUNDING GAP TO 2014-15

Table 1 highlights in both cash and real (2010-11 constant prices) terms what the future Scottish Government (DEL) Budget is likely to be up until 2014-15.

Table 1: Scottish DEL, 2009-10 to 2014-15, £ billion

	09-10	10-11	11-12	12-13	13-14	14-15	Change 10-11 to 14-15 £ billion	Change 10-11 to 14-15 %
DEL cash	***29.1***	**29.2**	**28.0**	**28.2**	**28.1**	**28.1**	**-1.1**	**-3.9%**
- Current	*25.2*	25.9	25.4	25.5	25.6	25.5	-0.4	-1.7%
- Capital	*3.9*	3.3	2.7	2.7	2.5	2.6	-0.7	-21.3%
DEL real	***29.9***	**29.2**	**27.5**	**27.1**	**26.3**	**25.6**	**-3.7**	**-12.5%**
- Current	*25.9*	25.9	24.9	24.5	23.9	23.2	-2.7	-10.5%
- Capital	*4.0*	3.3	2.6	2.6	2.4	2.4	-0.9	-28.4%

Source: Independent Budget Review Report (IBRR) Table 2.1

[1] See Scottish Government website for both reports.

THREE SCENARIOS TO SAVE £1.1 billion CASH (£3.7 billion REAL) TERMS

Scenario 1 – "Conciliatory"

Assumptions

- Health budget (roughly one third of the total, or almost £10 billion) is ring-fenced (i.e. is flat in real - inflation adjusted - terms), costing an extra £1 billion cash;
- a wage settlement, in line with the historical trend of GDP deflator +1% (which in 2011-12 would be 3%), costing an extra £2 billion cash (see Table 4.1 in IBRR);
- cash releasing efficiency savings of 2% a year for the next four years, worth £0.6 billion by 2014-15 (see page 37 in IBRR).

Outcomes

As Table 2 illustrates, this scenario would increase the size of savings to be found by 2014-15 from £1.1 billion to £3 billion[2].

At the same time, the ring-fencing of Health and the omission of wages as a source of savings limits the options as to where in the Scottish Budget this £3 billion can be found. Instead of activities covering the entire £29 billion Budget, savings will need to come from the "Remainder" element amounting to only £9½ billion.

This is equivalent to a cash terms cut of around 32% in all other budget areas (i.e. non-Health, non-wages spending), or around 42% in real terms (increased by the GDP deflator). These savings may need to include further contributions covering the capital budget that could then be deeper than the 21% reduction shown in the IBRR report.

It is almost certain that much of this shortfall would need to be made up for in terms of lost jobs, as other initiatives are unlikely to be sufficient to close the gap in the next 4 years. (See Annexe for other possible sources of savings and ways that this £3 billion gap might be closed.) For example, if even half of this savings figure (£1.5bn) were to be found from job cuts this would amount to the loss of around 54,000[3] jobs.

Table 2: Scenario 1 contributions to proposed DEL budget cuts, 2010-11 to 2014-15, £ billion

		2010-11	2014-15	Change £ billion	Change %
Total DEL (cash)		29.2	28.1	-1.1	-4%
of which	-Wages	15.2	17.2	+2.0	+13%
	-Health, non-wages	4.6	5.1	+0.5	+10%
	-Efficiency savings	0.0	-0.6	-0.6	-
	-Remainder	9.4	6.4	-3.0	-32%

As a result of the assumptions made in this Scenario, Health spending as a share of the Total DEL budget rises from around one third in 2014-15 to 38% in 2014-15, while the share given over to wages rise from around 52% to 61%.

[2] Note: this higher figure excludes any double counting with respect to wages paid to the Health sector. However, it may also mean that the extra money to Health to allow for no real terms decline could now go towards higher wages, as opposed to other improvements in Health services.
[3] This figure is derived by assuming each job saves around £28,000 (taken from IBBR, page 71).

Scenario 2 – “Simple”

Assumptions:

- no ring-fencing of any budget;
- a wage freeze for the next 4 years[4], worth roughly 60% of the resource budget in 2010-11 (but with no job losses outside those that emerge from efficiency savings and capital cuts outlined below);
- cash releasing efficiency savings of 3% a year for the next four years, worth £0.9 billion by 2014-15 (see page 37 in IBRR);
- a cut in capital spend in line with that outlined in the IBRR, i.e. consistent with Scottish Government’s projection for the Barnett Consequentials for DEL capital over the period, worth £0.7 billion in cash terms.

Outcomes

As Table 3 illustrates, this scenario accommodates some £0.6 billion (net) of the £1.1 billion cash (£3.7 billion real terms) cut needed by 2014-15.

The “remaining” £0.5 billion could be sourced from a variety of options given in the IBRR with respect to: targeting existing universal benefits; raising Council Tax; new revenue sources such as Congestion charges (see again the Annexe for details). Note however that much of this extra cash would need to be found quickly as most of this shortfall is due to the extra large cut that is seen in year 1 of the 4 year cuts programme (i.e. in 2011-12).

Alternatively, the saving could be sourced with the help of guidance from the Budget Review group report of 2006 (commonly referred to as the Howat Report) and with reference to An Bord Snip and other reports looking for quick sources of savings identified in the Irish Governments reviews.

Table 3: Scenario 2 contributions to proposed DEL budget cuts, 2010-11 to 2014-15, £ billion

	2010-11	**2014-15**	**Change £ billion**	**Change %**
Total DEL (cash)	29.2	28.1	-1.1	-4%
Of which - Wages	15.2	15.2	0.0	0%
- Non-wages	10.7	11.7	+1.0	+10%
- Efficiency Savings	0.0	-0.9	-0.9	-
- Capital	3.3	2.6	-0.7	-21%
- Remainder	0.0	-0.5	-0.5	-2%[5]

Notes: a) the increase in non-wages is due to the effect of inflation (assuming the GDP deflator); b) wages and non-wages together sum to the Current Budget total shown in IBRR, Table 2.1; c) for 2014-15, the Current Budget total shown in IBRR Table 2.1 is found by adding together all the non-capital elements in Table 3 above.

While this scenario is described as “simple” the reality is that it would also prove to be extremely challenging. For example, a 4 year wage freeze has not been attempted at the UK level, although Ireland has experienced an even harsher wage settlement recently.

[4] Note: this goes beyond what is outlined in the IBRR, which assumed only 2 years of zero growth (their Scenario 3).
[5] Note: this % change is calculated with reference to the total DEL budget (£29.1billion).

Scenario 3 – "Structural"

<u>Assumptions</u>

In general, this requires a more fundamental review of spending plans and requires more difficult and managerially complicated decisions to be made. These difficult choices made now would be expected to result in more efficient government services in the medium to longer term. As a result, this scenario cannot easily be costed, but it is likely to contain the following elements:

- a pay freeze for 1 year, followed by at, or below, inflation increases for the next 3 years;
- higher job losses than in Scenario 2, as a consequence of this improved pay deal and in relation to structural changes outlined below;
- a fundamental review of the composition of the workforce in comparison to that seen at the start of devolution, or earlier. For example, whether administration posts in health, education, law and order etc, as a share of the overall workforce, have risen and whether that rise is justified;
- the privatisation or mutualisation of Scottish Water;
- a move towards greater funding of early intervention programmes, at the expense of existing, relatively ineffective, treatment or remedial programmes;
- a reduction and streamlining of the organisation and pattern of regional bodies that administer services e.g. police and fire, Local Government, health etc.

Clearly a lot more detailed work needs to be done, and quickly, in order that these more complicated savings can be incorporated into any future Budget plans with the same 'certainty' as is currently shown for Scenario 1 and 2 options.

CONCLUDING COMMENTS

Scenario 1 versus Scenario 2 illustrates the pay-off between a reduced pay settlement and lost jobs in the public sector.

These two Scenarios also show how it would be possible to accommodate the required savings without significant structural changes to Scotland's public sector being brought into effect. However, given the long-term slow recovery of the Scottish Budget (the Goudie Report projects that it might not return to the 2009-10 real terms level until 2025-26) such a stalling of major reform may have long term cost implications.

In other words, as demand for services continues to rise in areas such as Health and care for older people, any such non-strategic approaches may turn out to provide only short-term relief.

It is critical, therefore, that we have transparency over the final choice between options in order to highlight how and where any short-term, expedient, choices are likely to necessitate further change in subsequent spending reviews.

RECOMMENDATION

One of the more overlooked aspects of the Beveridge report is its plea for strong leadership, as well as for "***frankness and cross party agreement about the scale of the problem, potential solutions and the necessity to act now***". We believe that a good starting point for changing the tone of the debate would be for each political party to bring its own set of recommendations on how to stay within the Budget projections, as laid out in the IBRR (i.e. a cash terms reduction of £1.1 billion to 2014-15), to the table by the end of September.

It seems inevitable that many of these recommendations would be common to all parties and so considerable progress could be made in how to accommodate the cuts and allow for service providers to plan in advance. The remainder of the cuts that cannot be agreed, perhaps as little as 10%, could then be haggled over in the traditional manner but at least the bulk of proposed cuts will have been identified with the cross party agreement that is necessary to secure effective implementation.

Such a plan of action seems reasonable given the extreme situation we face and the short time we have to address the problem. Those adversely affected need the remainder of 2010-11 to find ways to minimize the negative impact of any cuts. This would be to the potential benefit of all political parties given the uncertainty over which of them will form the next Scottish Government in May 2011, and so will have to implement most of these changes.

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ANNEXE – A MENU FOR CHANGE

Below are listed a range of potential savings as listed in the IBRR which could be used to meet the gaps identified in the Scenarios outlined in this note[6].

Council Tax	assumed to save the Scottish Government an extra cost rather than provide savings
Scottish Water	saving of £140 million a year, plus the potential to receive a one-off capital receipt of up to £2.75 billion
Charging	no estimate given for areas identified as missed appointments, congestion charging or road charging. In Ireland a report on the potential extra revenue from road tolling suggested a figure of around €100 million
Concessionary Travel	net savings of close to zero due to offsetting anticipated growth in demand
Free Personal and Nursing Care	a particularly complicated area to estimate but net savings of somewhere between £100-600 million by 2012-13 have been suggested
Prescription Charges	net savings of £30 million
Eye Examinations	net savings of £54 million by 2014-15
Free school meals	no estimate given
Tuition fees	net savings of £200 million plus, but again complicated

One of the issues that emerges from these attempts to cost possible savings is the uncertain role of increasing demand over time. This will apply not just to the areas outlined above but also to areas like climate change, where the cost of reducing emissions is likely to rise as stricter targets emerge.

[6] See the full report for details of all the different ways that these policies would need to change in order to deliver the savings shown.