

## **CBI SCOTLAND'S RESPONSE TO THE SCOTTISH GOVERNMENT'S CONSULTATION ON ITS DRAFT BUDGET FOR 2010/11**

### **INTRODUCTION**

1. CBI Scotland is an independent organisation funded by its members in industry and commerce and representing firms of all sizes and from all industrial and commercial sectors. We welcome the opportunity to respond to the Scottish Government's consultation on its Draft Budget for 2010/11.
2. Business has an essential interest in the budget of the devolved government. Companies contribute to the funding of the devolved government and public authorities, and their success or otherwise can also be affected by the spending decisions taken. CBI Scotland published its business manifesto<sup>1</sup> ahead of the 2007 Holyrood elections, which for the first time set out our members' recommendations and aspirations for how the devolved government should prioritise its spending, become more efficient, and reform the way it delivers services. Since then we have established a Public Services Group and a Scottish Futures Trust Working Group to develop our policy agenda on these issues and to highlight the case for and benefits of greater public service reform involving the commercial sector.
3. UK public finances are in a bleak state, as demonstrated by the CBI's most recent economic forecast<sup>2</sup>, which expects public sector net borrowing to be £176.2bn in the current financial year, rising to £181.8bn in 2010/11 (12 per cent of GDP). Public sector net debt is mounting and is expected to double by 2013, costing £63bn each year to service in interest payments.
4. Given the erosion of the public finances (coupled with other sizeable pressures on public spending e.g. ageing population and rising dependency ratio<sup>3</sup>, rising unemployment, maintenance and renewal of infrastructure) and the pressing need to tackle national indebtedness, we recognise that all tiers of government and the wider public sector will have to operate within a far tighter financial climate, just as businesses are having to do. The constrained spending growth for 2010/11 is merely a harbinger of far tougher

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<sup>1</sup> CBI Scotland's manifesto, 'The Scottish Economy: The Priority of Priorities: Agenda for a growing economy in Scotland', 2006

<sup>2</sup> CBI Economic Forecast, 23 September 2009

<sup>3</sup> Latest Scottish population projections, 21 October 2009



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spending limits ahead. As such they will have to cut their cloth accordingly, though there are different opinions as to the nature, scale and timing of the measures required.

5. However, this should be viewed as a significant and positive opportunity to do things differently, challenge sacred cows and ingrained habits, rethink how and when money is spent, and to make every taxpayers' pound work harder than before. Merely allocating reduced funds to existing policies and shirking difficult issues, a 'less of the same' approach, will not properly address the challenge in a manner which will contribute to a sustainable recovery. The objective should be to 'do more and better, for less', just as businesses have to do each day.
6. Their significant remit and budget, and the freedom they have over how that expenditure is deployed, means the Scottish Government can play a more valuable and pro-active role in stimulating activity and thus helping the economy and businesses emerge from the current economic slowdown, aiding jobs and prosperity.

## KEY MESSAGES

7. CBI Scotland has strongly supported the Scottish Government's stated purpose of increasing sustainable economic growth, and this should guide the prioritisation of the outcomes it wants to achieve. Better use can and ought to be made of the £35bn<sup>4</sup> annual spending plans to realise this and ensure devolved spending is a more effective catalyst for growth, thus helping job creation, prosperity, and by reducing demands on the public purse.
8. Scottish Ministers accept we are now in an era of fiscal rectitude and have taken certain measures in response, but their response to date is inadequate given the more austere times ahead<sup>5</sup> and the need to re-invest in growing our economy. This new era should be seen as a significant and positive opportunity for a more radical approach to fiscal tightening – as well as challenging 'sacred cows' - to demonstrate that the devolved public finances are on a sustainable footing and to protect and enhance GDP-enhancing investments. This should involve a robust but flexible approach to restrain costs, making certain public bodies less reliant on the public purse, pursuing a strategy for the disposal of assets, altering spending priorities, and improving the efficiency of the delivery of public services including through the use of outsourcing. Higher taxation or piecemeal spending cuts would be the wrong approach.
9. This more radical and sustainable approach to cost savings and ensuring value for money would better protect GDP-enhancing investment in infrastructure and business support. The axing of signature project GARL (Glasgow Airport Rail Link), without consultation, and budget reductions for the enterprise agencies sits uneasily with the devolved government's stated growth ambition. GARL should be re-instated, but if necessary and as a last resort only, should be simply delayed until the spending environment is more conducive. Likewise, Scottish Enterprise should maintain support for manufacturers and exporters.
10. The Scottish Government should assume that whomever is Chancellor of the Exchequer after the forthcoming General Election is likely to hold a further austerity Budget shortly afterwards<sup>6</sup>. This may require the 2010/11 Scottish Budget to be revisited. As such contingency plans should be put in place now.

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<sup>4</sup> Scottish Budget: Draft Budget 2010/11, p12

<sup>5</sup> Report to Holyrood's Finance Committee by Prof David Bell, Sep 2009, p8

<sup>6</sup> Financial Times, 8/10/09, p1

11. Devolved politicians will, rightly and robustly, debate the detail of the Scottish Government's spending plans over the coming months. However for the sake of the many firms which supply to the public sector, let alone service users and staff, it is crucial that legislators behave collegiately and that Parliament passes a Budget in a timely fashion which provides suppliers and businesses with the certainty and stability they need. Legislators must refrain from repeating the impasse which marred and delayed the approval of this year's Budget.

## RECOMMENDED ACTIONS TO REDUCE PUBLIC SPENDING

12. With the UK's public finances in a bleak state, restoring them to health is going to take several years and possibly much of the next decade<sup>7</sup>. This period of austerity means the devolved government, together with public and local authorities, must become accustomed to living within a restrained fiscal regime. All spending authorities will have to apply rigorous value for money tests to all spending decisions and introduce smarter ways of saving costs.
13. Every Minister and spending authority should ask him or itself six key questions every time they think about parting with taxpayers' money: Is this something government needs to continue to do? Is this something government can afford to continue to do? Is this something that could be done more efficiently? Is this something that could be delivered better by the private or not-for-profit sector? Is this a service that can be re-engineered to deliver a better outcome? Is this service really necessary at all? If this kind of thinking were applied across the public sector savings could be made while improving or maintaining the quality of services.
14. A number of the savings measures announced to date by the Scottish administration are welcome, indeed some have been previously called for by CBI Scotland<sup>8</sup>. However several of the measures announced to date are at odds with the Scottish Government's stated ambitions for growing the economy, and the overall package of savings measures is inadequate in light of the financial challenges to come and in terms of driving future wealth creation. The difficulties associated with an era of spending restraint and lower revenues could be considerably reduced through a bolder savings programme, involving:
15. **Restraining costs:** A robust but flexible approach to restraining costs is required, including public sector payroll costs - which account for over half of devolved spending<sup>9</sup> - and public sector pensions - which has grown exponentially<sup>10</sup> over recent years - and absence rates. Business have themselves often had to take painful action<sup>11</sup> to ensure the sustainability of their own staffing and pension spend, through controlling costs tightly and adopting changes in work patterns. Government should also accelerate further rationalisation of public bodies in Scotland in order to save money but also to deliver on their stated aim "to deliver smaller, simpler and more efficient government", e.g. by reducing from 32 the number of local authorities in Scotland towards a model based on larger authorities, including metropolitan areas covering the principal cities.

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<sup>7</sup> CBI Budget Analysis 2009

<sup>8</sup> CBI Scotland called for scrapping of £20m set aside to implement LIT - Draft Budget submission 2008

<sup>9</sup> Prof David Bell's report to Holyrood's finance committee, Sep 2009

<sup>10</sup> Total budget for the Scottish Public Pensions Agency has risen from £1.339bn (Draft Budget 2006-07, p167) to £2.528bn (Draft Budget 2010-11, p34).

<sup>11</sup> 'Employment trends 2009: Work patterns in the recession', CBI 2009

16. **Making public bodies less reliant on public purse:** Scottish Water should be made less reliant on the public purse for funding its infrastructure investment, which is expected to cost taxpayers £150m in 2010/11 (and a further £450m over the subsequent three years<sup>12</sup>). This would free up a substantial sum of discretionary spend each and every year, which if implemented previously, could have been used to save GARL and contribute towards the cost of the second Forth crossing. The lack of any Barnett Formula monies coming to Scotland to fund this hefty annual taxpayer support for the water authority ought to be an added incentive and spur to identify other funding solutions and take Scottish Water off balance sheet.
17. **Introducing an asset disposal strategy:** The Scottish Government should put in place a detailed and timetabled asset disposal strategy, something which was absent from the Draft Budget, to take advantage of when market conditions improve and to help finance re-investment in new infrastructure. Candidates worthy of examination could include Scottish Water, Highlands & Islands Airports authority, Forest Enterprise. There should also be a thorough review of other assets e.g. land and properties. One option for example could be the privatisation of Scottish Water, which could well generate a one-off windfall capital receipt, and HM Treasury rules<sup>13</sup> ought to be reviewed to ensure sufficient incentive exists for this option.
18. **Altering spending priorities:** A number of existing government policies and spending commitments were introduced during the 'golden period' of ever rising devolved public spending over the past decade. Some of these policies should be reviewed to see whether they are financially sustainable going forward, or could be better targeted, and whether they meet the test of contributing to wealth creation.
19. **Outsourcing far more services and forcing the pace on shared services:** The Efficient Government Programme and Transformational Government initiatives need to step up a gear and go much farther than currently envisaged. Efficiency programmes need to be more ambitious and stretching than the current target of 2% and can be achieved without impacting on front-line services<sup>14</sup>. However, fundamentally a marked shift in approach is needed to one which encourages the use of the private and not-for-profit sectors in the actual delivery of public services, and which dispenses with the current approach which has favoured banning alternative providers from providing hospital services, hospital catering and cleaning, GP services, prisons etc. Government and public authorities should become more of a commissioner of services, working in partnership with business and other providers, as a different way of providing services will be needed to maintain service quality, innovation and productivity in an era of fewer resources. Some good examples do exist<sup>15</sup> but need to become much more widespread. The opportunity afforded by this new era of spending restraint to deliver on this reform agenda must not be flunked.
20. Sir John Arbuthnott's review of the opportunities arising from shared services must prove a catalyst for change right across Scotland. An early demonstration of change by the councils concerned will be crucial to maintaining momentum. The overall pace of reform on shared services remains slow. The private sector can be a part of the solution. For example, several different companies in the oil and gas sector contract-out their back office finance function to a separate firm's dedicated shared service centre located in Aberdeen. All public authorities should consider whether they too could contract out their payroll and

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<sup>12</sup> Water Industry Commission for Scotland, The strategic review of charges 2010-14 draft determination

<sup>13</sup> HM Treasury Statement of Funding Policy for the devolved governments, Oct 2007

<sup>14</sup> Scottish Government press release, 'Efficiency drive saves NHS £300m', 18 October 2009

<sup>15</sup> See Glasgow City Council/Serco example, p6, 'Doing more with less: a credible strategy for restoring the public finances', CBI, October 2009

other back-office work to such specialist firms, who benefit from economies of scale and a wealth of experience.

21. Given the scale of the financial stringency required, paring existing budgets at the edges is both unattractive and on its own unlikely to suffice. Similarly, higher taxes would be the wrong approach and should be avoided.

## RECOMMENDED ACTIONS TO SUPPORT RECOVERY

22. A combination of fiscal retrenchment and economic growth is the best antidote to overcoming national debt. The Scottish Government has taken a number of welcome actions to aid firms and the recovery, and thus job retention and creation, including some proposed by CBI Scotland, e.g. deferment of part of this year's bumper 5 per cent rise in non-domestic rates.
23. However, Ministers should continue to review their policies, spending and regulatory decisions in the context of whether it will help businesses thrive and grow and aid the economic recovery. While the financial headroom for significant new investments and support is limited without the implementation of some of the above mentioned actions to reduce public spending, there are further measures that can and ought to be taken to stimulate economic activity and aid businesses and growth prospects:
24. **Introduce business rates transitional relief:** The commercial property revaluation due to come into effect in 2010/11 is based on valuations undertaken at the pre-recession high watermark in Spring 2008. As a result some firms expect their bill for business rates to rise significantly, by double figures, just as the recovery is expected to take hold. Ministers should re-introduce a self-funded system of non-domestic rates transitional relief, to phase in rates increases and aid cash flow, as is envisaged for firms in England where large rises are to be capped. An early announcement on this would provide welcome certainty for firms' budgetary planning purposes.
25. **Avoid higher taxes on business:** The existing strategy on devolved Scottish taxation, involving poundage rate parity and support for SMEs, is the right one and recognises that tax can be a barrier to investment, innovation and maintaining cash flow. We commend the Scottish Government's rates relief scheme for smaller firms, however more should be done to encourage firms to check their entitlement and the banding levels ought to be uprated in the upcoming revaluation. Welcome too is the commitment to retain poundage rate parity with England both during and after the upcoming commercial property revaluation. Ministers are right to resist<sup>16</sup> the use of the tax-varying power as it would place a costly and complex administrative burden on employers in the private, public and not-for-profit sectors alike.
26. **Protect capital expenditure which contributes to economic productivity:** The rail link to Glasgow airport was a key transport infrastructure project in the business manifesto<sup>17</sup> produced by CBI Scotland members, and the decision to axe it was very disappointing not least given the lack of consultation, the abandoned lead-in costs already incurred, and economic and environmental benefits foregone. CBI Scotland warned previously<sup>18</sup> that funding for transport and infrastructure projects is often wrongly seen by politicians as a soft target, and that any reductions could adversely affect productivity and future

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<sup>16</sup> Scottish Budget: Draft Budget 2010-11, p15

<sup>17</sup> The Scottish Economy: The Priority of Priorities, CBI Scotland 2006, p20

<sup>18</sup> CBI Scotland article in The Scotsman, 14 September 2009

maintenance bills. Business is already worried<sup>19</sup> by looming sharp cuts in future capital spending already announced in the UK Budget. The rail link to Glasgow airport could have been protected if Ministers had taken other more radical cost savings measures, as outlined above, and demonstrated the political will necessary to deliver this project. GARL should be re-instated, and if necessary delayed for a short period until budget considerations are more conducive.

27. Similarly, the spending envelope for the range of capital and other grants available to business to encourage investment, employment, innovation and R&D, particularly in nascent industries such as low carbon technologies including marine energy, should be protected. One such scheme, the Scottish Funding Council's Innovation Voucher Scheme, is welcome and designed to build collaborative relationships between Higher Education institutions and SMEs. But experience elsewhere in the UK suggests that this kind of scheme works best when it is demand-led not supplier-driven. As such the purchasing power of the vouchers, including the power to choose the most appropriate academic collaborators, should be put into the hands of the participating SMEs rather than the universities.
28. The Scottish Futures Trust's<sup>20</sup> (SFT) hub and schools estates agenda is a useful start in trying to aggregate common infrastructure procurement, but we have strong reservations about whether this flagship initiative is getting the support it needs to actually make a significant contribution to aiding the construction and related industries in the life of the current devolved parliament. The SFT should be given a far greater say over how public sector capital monies are spent so that it works harder in support of economic growth.
29. **Ensure support for manufacturers & exporters is maintained:** We are concerned that the proposed reductions in budget available to our enterprise agencies could lead to less support particularly for manufacturers and exporters, at a time when official figures<sup>21</sup> reveal there has been an unprecedented fall in Scottish manufactured exports. Overseas demand appears to be on the cusp of returning and the opportunity exists to take advantage of the weak pound to deliver a step change notably in our SME manufacturing export performance.
30. **Encourage all public bodies to settle supplier invoices speedily:** We commend Scottish Ministers for making excellent progress<sup>22</sup> on settling supplier invoices within the national target of 10 days of receipt. This must be maintained. Feedback from members and elsewhere<sup>23</sup> suggests the record of some publicly-funded bodies and authorities in achieving the national target is decidedly mixed. Ministers should require public authorities to raise their game and do more to match the Scottish Government's payment performance. A concerted effort on this would help the many firms who supply to the public sector better manage their cash flow, vital during the difficult economic conditions that we have at the moment.
31. **Re-introduce a variation of the Air Route Development Fund:** The loss of the Scotland-wide Air Route Development Fund (ARDF) was disappointing, especially as it helped bring 52 new direct air links<sup>24</sup> to the country since its inception in the early part of this decade. With the original European Commission judgement that led to the winding down of the

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<sup>19</sup> CBI 2009 Pre-Budget Report submission, 15 October 2009

<sup>20</sup> CBI Scotland's position paper on Scottish Futures Trust, February 2009

<sup>21</sup> Scottish manufactured export data, 7 October 2009

<sup>22</sup> Scottish Government press release, 16 October 2009, 'Faster payments supporting business'

<sup>23</sup> Sunday Times Scotland article, 'Scots councils fail to settle bills in 10 day target', 18 October 2009

<sup>24</sup> 'The tourism prospectus: investing for growth', VisitScotland, August 2007

fund now having been called into question by the courts<sup>25</sup>, the Scottish Government should reintroduce a more modestly funded ARDF that meets EU competition rules and supports the introduction of new direct international air services between key business destinations and Scottish airports.

32. **Incentivise more young people to study science and maths:** The Educational Maintenance Allowance, worth £31.5m next year, should be reformed<sup>26</sup> to incentivise more young people to study the STEM subjects (science, technology, engineering and mathematics) in order to sow the seeds of future growth in key industries e.g. electronics, energy, life sciences, aerospace and defence. This would complement the welcome introduction of the Science Baccalaureate. Consideration should also be given to introducing bursaries for those who take up science undergraduate degrees, and to protecting the provision of training and apprenticeships in those areas fundamental to economic productivity and in Scottish Enterprise's priority industry sectors.
33. **Incentivise local authorities to support development:** The decision to examine<sup>27</sup> Tax Increment Financing is welcome. However Ministers should go further and examine the case for introducing the Local Authority Business Growth Incentive Scheme, which is already in operation elsewhere in the UK and which over its first three years distributed almost £1bn<sup>28</sup> to English councils. This could incentivise local authorities to better support economic development by allowing them to retain any growth in non-domestic rates revenue over and above an agreed threshold, and which could then be re-invested back into local infrastructure and wealth creation. Planning authorities must also be properly resourced to accommodate their new responsibilities and to deliver on planning reform which is crucial to facilitating much needed commercial and public infrastructure.

**CBI Scotland**  
**October 2009**

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<sup>25</sup> Ryanair Ltd v Commission of the European Communities, Judgement of the Court of First Instance, Dec 2008

<sup>26</sup> CBI Scotland submission to the Scottish Science & Innovation Strategy

<sup>27</sup> Ministerial response to 1<sup>st</sup> annual report of the Council of Economic Advisers, January 2009

<sup>28</sup> Dept for Communities & Local Government website: <http://www.communities.gov.uk/localgovernment/localgovernmentfinance/labgi/>