The Scottish Parliament
Pàrlamaid na h-Alba

Local Government, Housing and Planning Committee

Shona Robison MSP
Cabinet Secretary for Finance and Local Government
The Scottish Government

5 November 2024

Dear Shona,

Pre-Budget Scrutiny 2025-26: Sustainability of local government finance

I am writing to inform you of the Committee's views in advance of publication of the Scottish Government budget for 2025-26 which focus on the sustainability of local government finance. This letter also provides our conclusions following evidence taking on the Scottish Local Authorities Remuneration Committee (SLARC)'s recommendations on councillor pay given the connection of this issue to the budget.

Budget scrutiny is an ongoing process, and the Committee has considered issues relating to the sustainability of local government finance throughout the session. In addition to our ongoing work, the Committee took evidence at three meetings on 24 September and 1 and 8 October. We are grateful to you for providing oral evidence and to all other witnesses and respondents to our call for views who helped inform our scrutiny.

This letter highlights matters arising out of those sessions that the Committee urges you to consider as you prepare the budget for 2025-26. Whilst we had agreed that our primary focus would be on capital investment and reserves, it is impossible to look at this in isolation given the interrelations between capital spend and other elements of council budgets. This letter therefore highlights various issues relating to the sustainability of local government finance. It also considers the commitments set out in the Verity House Agreement (VHA) as a common thread running through many areas of interest.

First, it is important to note that the Committee recognises the challenging economic circumstances under which you are preparing the budget, coupled with a lack of certainty in respect of the UK Government's plans which were announced in its autumn budget last week. Unfortunately, timescales for reporting our recommendations mean that it was not possible for us to fully reflect on the implications of UK Government budgetary decisions for Scotland, and in particular, for councils although we have touched on a few key points in this letter.

Contact: Local Government, Housing and Planning Committee, The Scottish Parliament, Edinburgh, EH99 1SP. Email: localgov.committee@parliament.scot. We welcome calls through Relay UK and in BSL through Contact Scotland BSL.

We heard from the Accounts Commission that the financial outlook for councils is extremely challenging as they face unprecedented financial and service demand pressures which present real risks for the future. Councils will have to make increasingly difficult decisions about, how they deliver services and what services may have to stop or reduce if they are to deliver balanced budgets as required by statute. We received evidence from the Local Government Information Unit (LGIU) that some service areas are experiencing significant cost pressures with eight respondents to its survey of Scottish councils stating that there was a risk that financial constraints could leave them unable to fulfil their statutory duties. Witnesses told us that the challenging situation for councils was being exacerbated by changing demographics, most notably in relation to adult social care. The National Audit Office (NAO) explained that "the greatest drivers of demand and cost are, in themselves, broken systems. Unless those systems are revised and improved in order to better prevent and manage demand, it is very difficult for the spending side of the ledger to keep up with the demand." We also heard of a gap between anticipated expenditure and the income that councils expect to receive. Our witnesses were clear that there was little reason for optimism that these challenges would reduce in the coming years and that many of the options councils were currently taking to fill budgetary gaps, including the use of reserves, service spending cuts, and asset sales, could not be relied upon indefinitely. Reform Scotland told us that "if the situation continues, debt levels will rise and the financial sustainability of councils will get worse, or much-needed community-based services will implode and will no longer be there. There is a perfect storm, and it needs intervention."

In COSLA's view, the 2024-25 local government settlement did not provide sufficient funding to address increased demand for services, increased operational costs due to inflation, or increases in outgoings to support pay awards. COSLA was clear that councils cannot keep delivering the same number or level of services with the funding they currently receive from the Scottish Government. However, we note your statement that "the local government settlement this financial year provided record funding of more than £14 billion to local authorities—a real-terms increase of 2.5 per cent—and local government received an increased share of the funding that was at ministers' disposal."

UK Autumn Budget

COSLA recently wrote to the Chancellor of the Exchequer calling for the UK Government "to provide additional funding to the Scottish Government which in turn will allow our councils to meet these pressures and secure vital jobs and services." The letter highlighted the particular importance of capital funding and suggested that "the provision of additional investment could unlock a myriad of benefits for both local and national economies." We note that the Autumn Budget document states that "the Budget increases capital spending by over £100 billion over the next five years, with a £13 billion increase next year (a real terms increase of 9.9%) … this equates to an average annual real increase in capital DEL of 3.0% between 2023-24 and 2029-30." Local government funding in England is expected to see an average annual real terms resource increase of 10.2% from 2023-24 to 2025-26. The central Ministry for Housing, Communities and Local Government budget is also expected to see a resource increase of 7.5% over the same period. The Budget document also states that "the core schools budget will increase by an additional £2.3 billion next year" although it is worth noting that councils in England are not responsible for such spending as is the case in Scotland.

In respect of capital funding, the Ministry for Housing, Communities and Local Government is expected to see a 10.7% average annual real terms increase from £6.8 billion in 2023-24 to £8.8 billion in 2025-26. The settlement also provides £6.7 billion of capital investment for spending on schools which constitutes a 19% real-terms increase from 2024-25.

The Budget document states that in respect of local authorities in England, "together with council tax flexibilities and locally-retained business rates, this will provide a real-terms increase in total core spending power in 2025-26 of around 3.2%."

We note that following the Budget statement, the Fraser of Allander Institute stated that "funding for day-to-day spending is £1.5bn higher this year, [2024-25] which is likely to make the Scottish Government's job of balancing its budget significantly easier."[1] We further note that the Budget document states that "the Scottish Government is receiving £47.7 billion in 2025-26, including an additional:

- £3.4 billion through the operation of the Barnett formula, with £2.8 billion resource and £610 million capital.
- £130 million targeted funding, with £10 million resource and £120 million capital, including for City and Growth Deals."

It is also worth noting that the planned increase in employer National Insurance contributions from 13.8% to 15% and the lower payment threshold along with increases to the minimum wage can be expected to impact on Scottish councils in their roles as employers.

We note that it is, of course, for the Scottish Government to allocate Barnett consequentials as it sees fit and would welcome your reflections on the stated increase in funding from the UK Government, including on its implications for next year's local authority budgets.

Capital investment and borrowing

The Accounts Commission noted that councils' net debt had increased by £1 billion between 2021/22 and 2022/23, and net debt increased in 24 councils during the same period. However, borrowing costs have reduced in recent years as many councils have used permitted financial flexibilities to reprofile debt payments as we heard when we considered the Local Authority (Capital Finance and Accounting) (Scotland) Amendment Regulations 2024 in March[2]While this may be helpful in the short-term, it risks adding pressure on future budgets, as it defers costs to later years, and does not address the underlying challenges to financial sustainability. The Accounts Commission explained that there could be good reasons for debt increases, including to take advantage of favourable interest rates. In its view, robust

[1] 2024 UK Autumn Budget: FAI reaction | FAI
[2] Report on the Local Authority (Capital Finance and Accounting) (Scotland) Amendment Regulations 2024

audit and governance arrangements coupled with requirements for access to Public Works Loan Board debt mean that safeguards are in place to prevent councils taking on unsustainable levels of debt and confirmed that it had not seen anything to suggest that there is “a major red flag.” COSLA agreed that “debt is often seen as a bad thing—people do not want to be in it. However, we must be really mindful of the fact that it can be a good thing, as it means that we can borrow and invest in our communities.”

We heard that inflationary pressures and shortages in construction materials and skilled labour had led to increased costs for capital programmes which impacts on councils’ ability to fund capital programmes. The majority of councils reported higher capital expenditure in 2022-23 than in the previous year which was chiefly funded by a 52% increase in borrowing.

We note that the capital funding outlook for the Scottish public sector as a whole is challenging and the Scottish Government is currently undertaking a programme of reprioritisation of capital projects. Professor Heald told us that the condition of council assets was visibly deteriorating, which reflects a lack of maintenance which is often one of the first targets for budget cuts.

COSLA’s submission stated that the budget for 2024-25 saw a £54 million reduction in the capital settlement for local government alongside significant cuts to specific capital grants including the affordable housing grant (£205 million), discontinuation of the regeneration capital grant (£25 million) and majority of place-based investment programmes (£24 million). COSLA also highlighted Scottish Fiscal Commission forecasts that Scotland’s capital budget is expected to fall by 20% in real terms, between 2023-24 and 2028-29. Reduced capital funding weakens the ability of councils to modernise and deliver key services, create local jobs and support supply chains and could affect councils’ ability to meet statutory duties. SOLACE explained that councils “are being asked to deliver additional policy commitments, but we have had cuts to capital funding over a 10-year period.”

In COSLA’s view, the Scottish Government should prioritise capital investment to enable investment in affordable housing and net zero, but it pointed out that the impacts of recent capital spending decisions can be seen in significant year-on-year cuts to the Affordable Housing Supply Programme. However, COSLA recognised that “the capital allocation from Westminster has been cut significantly … and it is well understood that that landscape will not get better any time soon. We are mindful of the context and the landscape in which we are working.” SOLACE also pointed out that capital reductions have coincided with significant cost increases through inflation which had increased the cost of capital investment by around a third over the last decade. It also stated that in respect of net zero investment, “the situation begs for a long-term funded strategy, or a bit of certainty about where we are going, which is exactly what we do not have at the moment.”

The NAO explained that the “essential trade-off with capital is around whether you are doing new things or maintaining existing things” and noted that in England, “maintenance has been severely underinvested in over the years.” It noted that cuts to the housing budget had led to trade-offs between remediating existing stock, for example to mitigate problems like damp and mould, versus how much can be invested in new stock. CIPFA explained that “councils are seeking to invest, improve and maintain their assets to deliver new ways of working so that they can operate within a reduced financial envelope" but "the capital grant allocation is £800 million annually, which does not cover the costs of maintaining those assets." In effect, this means that councils borrow to invest in their assets and deliver new infrastructure, but interest payments on borrowing impact on revenue "which increases the financial pressure and the financial gap."

You acknowledged the "profound effect" that capital reductions had had for both the Scottish Government and councils. You also highlighted the expected spring spending review and noted that "there have been indications that there may be some openness to thinking about a more flexible approach to the fiscal rules around capital borrowing." You explained that you have asked the UK Government to change its approach to financial transactions and spoke of the potential to utilise non-traditional capital funding, including the growth accelerator model and the leveraging of private investment for building for mid-market rent. You then explained that whilst there is no single solution, "we need to be imaginative and open to pushing the boundaries of what can be done on all those things." **We welcome your willingness to explore different funding approaches to maximise the benefits of capital investment and look forward to potential changes to capital borrowing rules and other flexibilities that may arise as a result of the spring spending review.**

In respect of Public Private Partnerships, Professor Heald noted that PPP schools tend to be better maintained than other schools as a result of such work being contractually obliged. However, we note that several such arrangements are approaching the end of their contractual term. For example, Falkirk Council, the first in Scotland to make use of such arrangements for part of its school estate, will see its contract end in 2025. Whilst this will bring financial benefits in that the Council will no longer need to make contractual payments, it will also mean that the Council will be responsible for ongoing maintenance which will bring its own cost implications. Several other councils will find themselves in a similar position in the coming years and **we are clear that effective financial planning is required to ensure adequate maintenance of such school buildings and believe the Scottish Government should support local authorities to ensure this is effectively managed.**

Council reserves

Reserves are the accumulated surpluses available to councils which have been generated over several years from various funding streams. These have grown significantly in recent years, with total usable reserves growing by 56% in real terms between March 2019 and March 2023, a significant portion of which came from additional funding for local government during the Covid-19 pandemic. The Accounts Commission told us that "having reserves is not a bad thing—it is a good, sound financial management tool" but cautioned that it is misleading "to think that a healthy balance sheet reserve is a reserve that can be used for funding services day to day." COSLA agreed with the Accounts Commission's figure of £4.5 billion in total reserves but noted that only £0.5 billion of the total is uncommitted. In COSLA's view, "it is simplistic to think that local authorities are sitting on lots of funds that they can tap into. That is not the reality."

The Accounts Commission suggested that looking at the level of reserves as a proportion of total net revenue expenditure is one way of assessing financial sustainability, with a low figure suggesting a council may struggle financially if it experiences a financial shock. It found that twenty councils had reserves that were over 20% of net revenue expenditure in 2022-23, compared to nine in 2019-20. Many of our witnesses spoke of a lack of transparency and detail in council annual accounts around the purposes for which reserves were held and when they were expected to be called upon.

The Committee notes that the terminology around reserves being earmarked, unearmarked, committed and not committed can be difficult to understand and the Accounts Commission suggested that greater transparency in the notes to the accounts, particularly around purpose and timing of use would be helpful. This is currently a key area of its work and, whilst it was clear that its role was to audit rather than to regulate, it stated that "if the committee were to ask for something that would help, we would certainly look to support you in that." In its view, the relationship between recurring and non-recurring savings was worth highlighting as it "would be a helpful barometer to indicate which councils are generating the savings that will contribute to financial sustainability." Such data "might give a sense of trend, where a council is perhaps not getting close to depleting its reserves but is on a trend towards financial difficulty."

The Accounts Commission explained that some councils were committing reserves to financial sustainability funds or budget support funds to cushion the impact of known financial challenges in the years ahead or committing reserves to help fund transformation, potential workforce reconfiguration or pay settlements. The Commission highlighted the local government benchmarking framework indicators developed by the Improvement Service which it described as "a very helpful tool" which "operates almost as a can opener to further analysis" although the indicators need to be kept under review.

CIPFA spoke of the "absolute need to have some uncommitted and available reserves to deal with financial shock". CIPFA explained that within the £4.5 billion figure there were "a plethora of differences." For example, it noted that Housing revenue accounts make up 5% of the total, "but that £200-odd million is tenants' money" and approximately 30% relates to multi-year capital programmes that have yet to be fully delivered. It further explained that "having earmarked and allocated monies, the council makes decisions each and every year as to how much it is going to set aside, and part of that will be for projects spanning one year to the next." CIPFA also explained that councils have statutory duties to carry forward certain funds, one of which relates to affordable housing: "any extra income generated from, say, reducing council tax relief on second homes cannot be put towards council services; instead, it has to be put into our reserves to pay for affordable housing."

You recognised in oral evidence that a significant proportion of reserves were committed and emphasised the principle that councils should decide how to use them where it is prudent and sustainable to do so. You also pointed out that reserves were public money so everyone has an interest in ensuring they are utilised as effectively as possible and agreed that greater transparency would be beneficial. **Whilst we are not suggesting that reserves should be used differently or that doing so would resolve the financial challenges faced by councils, we agree**

that greater transparency and consistency in the classification of reserves would increase transparency and help facilitate greater public understanding. We welcome the work that the Accounts Commission is undertaking to improve transparency and await the outcome of this work with interest.

Ring-fencing/Directed spend

The issue of ring-fencing or directed spend arises every year during budget discussions, with COSLA and the Scottish Government having differing interpretations of their definition. COSLA's submission suggested that less than 30% of funding has been entirely subject to local flexibility in recent years, with 70% being directed spend. Professor Heald told the Committee that ringfencing reduces local accountability, complicates financial management and can lead to underspending. Separate pots of ring-fenced funds can create additional work and reduce the capacity of local authorities to act strategically for their areas. The Accounts Commission agreed that ring-fencing could be unhelpful as it failed to consider variations in local circumstances. In its view councils should have greater flexibility on funding to delivering outcomes more effectively under a form of incentive system.

The VHA contains a commitment to work towards a default position of no ring-fencing or directed funding. The Accounts Commission has welcomed this approach but noted that funding remains constrained as increases in the general revenue grant were often directed towards the delivery of specific policies or to support previous pay awards rather than increasing discretionary funding. CIPFA confirmed that "it feels as if we have definitely seen a shift from what is traditionally called ring fencing" with moves towards a system of directed spend, for example, to deliver duties around early learning.

The LGIU noted that 97% of respondents to its survey of Scottish councils identified ring fencing as a big driver of financial pressure and highlighted the debate around teacher numbers where, in its view, councils were being told "you've got to spend this money on maintaining teacher numbers, whether you feel you need to or not." In oral evidence COSLA noted that other factors such as child poverty can have a greater impact on attainment and agreed that "teacher numbers cannot be looked at in isolation. Therefore, give us flexibility and empower local government to come up with the best outcomes for our young people and children."

You told us that £1 billion of ring fencing, mainly in early learning and childcare, had been removed "as a goodwill gesture in advance of the accountability framework being signed off." You described the accountability framework which is currently being developed as a tool for considering shared accountability of local and central government for delivering shared priorities. However, you also highlighted that ring-fencing accounts for a small proportion of the total local government settlement (£250 million out of £14 billion) and spoke of the benefits such funding can bring, for example by encouraging innovation in schools.

We welcome the VHA's commitment to a shift away from ring-fencing and recognise the progress made in last year's budget. We encourage central and local government to work together to further progress this shift, including developing a shared understanding of what it actually means in practice. We

support the principle that central and local government should be jointly accountable for the delivery of shared priorities. We note that the accountability framework is intended to provide clarity on accountability and ask that we are kept informed of progress.

Revenue raising powers

Council tax accounts for around 20% of local government revenue budgets across Scotland with the remainder mainly consisting of non-domestic rates (19%) and the general revenue grant from central government (62%). The VHA states that “clear routes to explore local revenue raising and sources of funding will be established.” We have heard calls for councils to be given greater powers to raise their own revenues throughout the session. We recently scrutinised the Visitor Levy (Scotland) Bill and continue to closely monitor progress towards the potential introduction of a cruise ship levy. Reform Scotland supported any moves to enable councils to generate their own revenues but suggested that there was a need to “shift away from a drip-drip approach of devolving some small powers, such as a tourism tax, and towards empowerment”. In the Mercat Group’s view, “councils need greater autonomy on revenue raising and spending decisions or the trend towards local government becoming local administration will continue.” In oral evidence, witnesses including LGIU, Reform Scotland called for a “basket of taxes” involving local authorities having greater powers to develop initiatives that work for their area. However, Professor Heald suggested that reform of the outdated council tax system was a more urgent priority.

The General Power of Competence (GPC) was introduced in England, Wales and Northern Ireland by the Localism Act 2011. In simple terms, it gives councils the power to do anything an individual can do provided it is not prohibited by other legislation. The GPC does not apply in Scotland, but the Committee has previously heard calls from Scottish councils that they should be granted similar powers. The NAO explained that English councils were encouraged to become more entrepreneurial and were looking to generate other forms of income including through commercial investment and trading, but a minority got into financial difficulty. In its view, “problems have come about where massive amounts of commercial investment have gone in where there was not enough due diligence, or not enough scrutiny and challenge.” Reform Scotland opposed any suggestion that “we cannot devolve powers because councils might make bad decisions.” In the Mercat Group’s view, “the way forward is not to sit here and legislate for councils to raise individual taxes, but rather to let councils and other public bodies argue that they should be allowed to put a levy on something, if they want to do so.” Professor Heald, meanwhile, agreed on the principle of greater powers for local authorities, “but there are limits on how far one would want to go.”

When asked what additional revenue raising powers it would like to see, the LGIU suggested that local sales taxes, green taxes and visitor levies are all commonplace in comparable jurisdictions and councils could easily be allowed to implement local charges on waste collection and be given the ability to set planning fees differently. In its view, local government could be provided with “a whole range of small but cumulatively impactful revenue streams.” Professor Heald suggested that the introduction of local taxes could continue the trend away from an equalisation system under which “each council should have the ability to deliver a comparable level of service to its population” stating that “clearly, some new taxes would generate a lot more revenue in some local authority areas than in others.” However, the Mercat Group questioned whether this would necessarily be a bad thing in itself.

COSLA confirmed that “a general power of competence is a key ask … and something that we would very much like,” noting that Scottish councils were not exposed to the same risks of commercial investment as some English councils had been. CIPFA highlighted the importance of prudential indicators, which set parameters to ensure that debt is prudent, sustainable and affordable. You acknowledged the ongoing debate about a GPC and giving local government more fiscal powers and confirmed that you wished to do this, but it needed to be a process of “evolution” noting current examples of a potential cruise ship levy, a recent consultation on an infrastructure levy and the decriminalisation of parking enforcement. However, you also highlighted the need for this to be done within a prudent framework and a process that allows the development of proposals in partnership with local government.

Your officials told us that at a recent meeting of the Finance and Public Administration Committee, COSLA “was explicitly asked what extra powers it would like, and its answer was that it did not have a set of proposals and that it does not think that it needs any powers beyond those that have been discussed.” They explained that the concept of a GPC was “quite ill-defined” and the Scottish Government was working with councils “to define what they would like from the concept of a general power of competence, and then to establish whether that is what is needed or whether some other legislative avenue might be more appropriate to deliver the ask.” They also highlighted the experience in Wales where the power had been brought in at councils’ request but had never been used as “councils would still by far prefer to rely on specific powers rather than on the general power.”

The Committee supports moves to enable councils to generate more of their own revenues. We are also clear that any investment by councils should adhere to prudential indicators as recommended by CIPFA. However, we are mindful of the Welsh experience and would wish to avoid a situation where time and resource went into the development of an approach which may not be used. We therefore welcome the work that is underway in respect of agreeing a definition of a GPC and request that the output is shared with us to enable us to form a view on the potential benefits and drawbacks of such an approach.

Multi-year budgeting

The VHA includes a commitment that “wherever possible multi-year certainty will be provided to support strategic planning and investment.” We have frequently heard about the benefits that medium-term or multi-year budgeting would bring to councils by facilitating more effective financial planning and providing a greater degree of certainty. This in turn, would enable them to do the same for partner organisations in the third sector. The Accounts Commission has suggested that the VHA fiscal framework should provide a three-year budget framework for local authorities which would allow planning on three horizons and enable a shift to prevention and early intervention. Professor Heald agreed but noted that the Scottish Government would also benefit from a multi-year funding settlement from the UK Government. In his view, “the Scottish Government cannot credibly offer this to local authorities unless it receives multi-year funding from the UK Government”. COSLA agreed that “it is not always in the gift of the Scottish Government, but where options are available … we would absolutely press for those decisions to be made.”

However, the Accounts Commission suggested that it is not acceptable to argue “we can only give you a one-year budget because we only get one-year funding”. It expects all local authorities to develop medium-term financial strategies based on assumptions as, in its view, “to assume that there will be no funding in the future is probably unrealistic; there is definitely value in assuming the same level of funding in the future.” As explained by CIPFA, “we are looking to promote stability, certainty, transparency and affordability and, ultimately, to give a sense of stability within local government.”

The absence of multi-year certainty also impacts on annual pay negotiations for council staff which have led to industrial action in recent years. We heard that having a public sector pay policy for one year at a time can be challenging whereas clarity on funding over multiple years would help with negotiations. In COSLA’s view, a lack of funding for pay deals coupled with high rates of inflation has exacerbated workforce pressures and means that funding is taken from other key budgets such as roads, leisure and planning services. The Mercat Group also highlighted a further challenge relating to pay in that it has become increasingly difficult to attract key professional staff into local government, a point echoed by LGIU which suggested that this issue was more acute in Scotland than in other parts of the UK. In the LGIU’s view, a lack of early engagement on pay negotiations was a “major symptom of how the relationship does not work properly—the discussion is happening too late and in the wrong place.”

In respect of capital investment, we heard from Professor Heald that “you cannot plan sensibly for capital spending year to year; you need a framework for five or 10 years ahead.” However, he noted the trend in recent years for UK spending reviews to only apply to a single year rather than constituting multi-year spending plans as originally intended. In his view, “everybody says that they want multiyear planning but, unless that is put in place for the system as a whole, it will never happen.” SOLACE agreed that “investment decisions on capital spend cannot be done effectively on a year-on-year basis … Getting to a position of multiyear planning and achieving a better capital settlement will be key.”

You agreed in oral evidence that “the longer-term solution is to provide multiyear deals” but that this would be “almost impossible” in the context of single year budgets. You also told us that the UK Government plans to reinstate the spring spending review of resource and capital funding from next year “which will trigger multiyear funding, with three-year funding being reviewed every two years” and that you would be “delighted” if this provided the certainty needed to deliver multiyear funding for local government. We note that the Autumn Budget Document commits the UK Government to ensuring “a broader redistribution of funding [for local government] through a multi-year settlement from 2026-27.”

We welcome the UK Government's intention to revert to a system of multi-year funding and invite you to update us on the implications for Scotland's funding system once the spending review has been completed, particularly in respect of how the Scottish Government will seek to provide greater longer-term certainty for local authority budgets. Irrespective of expected changes at a UK level, we invite you to respond to the Accounts Commission's suggestion that medium-term financial strategies should still be produced on the basis of stated assumptions.

Public service reform

Given the challenges councils face, our witnesses were clear that they urgently need to transform how they deliver services to become financially sustainable. We heard that sector-led transformation work by SOLACE and the Improvement Service has the potential to help achieve greater financial sustainability. The Accounts Commission recently published a report on Transformation in councils which emphasised the urgent need for change but noted that councils could not deliver this alone as it requires effective collaboration between central and local government as well as with third sector partners. It also noted that transformation will not happen overnight, but must take place over the longer term, something that will not be easy given councils' need to continue to deliver services.

However, we also heard that some councils have faced resistance from communities when reducing services to balance revenue budgets. The Accounts Commission highlighted the need for effective and timely consultation and engagement with communities over budget proposals but noted that whilst councils were trying hard to engage with citizens, not all had informed or consulted residents about the financial pressures faced and not all had used equality impact assessments as part of the budget process. Reform Scotland told us that there needs to be a far greater level of honesty with the public about the scale of the challenges faced by local authorities. The Accounts Commission's Transformation report stated that—

> "Public and political support is critical. All elected members must exercise their responsibilities to give clarity on the longer-term vision and ambitions of the councils they represent. A coordinated sector-wide public engagement and communication campaign should be undertaken to help gain backing from communities."

The Accounts Commission told us that there is a range of approaches to the community engagement that councils undertake "but there is not the degree of consistency that we might expect to see in terms of the methodology and frequency of that engagement and, ultimately, how that shapes the budget." It explained that "when difficult decisions have to be made, it stands to reason that robust, meaningful and consistent engagement is needed in advance in order to avoid the scenario that unfolded in certain councils, where the public just were not happy and the options that were put forward were so unpalatable that people protested against them. Councils then had to reverse decisions." The Accounts Commission suggested that if people understand the bigger picture, they can begin to understand how their individual requirement fits in. Whilst this might not be what they want to hear, "until we have proper communication about what the bigger picture looks like and honesty about what is possible, the ability to win hearts and minds at the local level will be harder."

Witnesses also spoke of the impact that the near constant electoral cycle, whether local, Scottish or UK can have in disincentivising meaningful change. In Professor Heald's view "members [of the Scottish Parliament] are pretty clear on what has to be done about those issues, but nobody dares move." Reform Scotland called for longer-term thinking, rather than politicians thinking, "Well, we've got an election coming up and we don't want to risk upsetting the voters." In its view, political leadership is key. Whilst it agreed that there have been examples of such political leadership in the past, "we have not seen it in local government reform and I do not think that anybody has shown it. There are plenty of reports, but there is not the political will." In the words of the Mercat Group, it was important that political leaders "win the crowd" if they intend to bring about meaningful change.

In evidence you agreed that transformation and reform are "absolutely critical" and highlighted examples including digital and the transformation of social work in Glasgow. However, you also noted the expectation that demands will increase in the future due to demographic change and stated that "we need to really step up all that work." You spoke of the importance of supporting and incentivising local government to share best practice and highlighted the ongoing work of the Improvement Service in doing so but suggested that hard questions should also be asked of councils that failed to act on it.

We agree with our witnesses on the urgent need for transformational change but are mindful of the challenges faced by councils in achieving this whilst also delivering vital services. We welcome the work currently being undertaken by the Improvement Service and expect all councils to act on its recommendations although we recognise that this burden should not fall on local authorities alone given the need for wider public sector reform.

We emphasise the importance of meaningfully engaging with communities in the development of budgetary plans, both for revenue and capital, to foster greater understanding of the challenges councils face. Finally, we note that there appears to be a broad consensus on what needs to be done but that there has been a lack of urgency in acting on it and emphasise the need for strong political leadership in all spheres of government to bring about effective change.

Prevention

It is now thirteen years since the Christie Commission report on the future delivery of public services was published. The report highlighted the need for greater efficiencies including the integration of service provision and emphasised the benefits of early intervention to prevent negative outcomes rather than focusing spend on responding to them. COSLA's submission agreed that in order to progress shared priorities, "we must take a 'whole system' approach to funding public services, with a refocus on prevention and early intervention spend." However, we also heard that areas that are central to prevention such as capital budgets and funding for third sector organisations are often the first to be cut with the Accounts

Commission noting that this was “potentially diminishing further movement towards preventative spend.”

The Accounts Commission told us that “movement towards preventative spend has not been as fast or as far as I think people thought was possible and certainly as Christie suggested was needed.” It also noted that many of the cuts it was currently seeing were to unprotected areas, potentially diminishing further movement towards preventative spend. Reform Scotland agreed, suggesting that “Christie has not been properly implemented, because we are firefighting.” The Mercat Group also highlighted similarities to other previous reports including the 1999 McIntosh Report and the 1969 Wheatley Report which consisted of “fine words followed by actions that do not comply with them.”

You acknowledged the challenges of incentivising reform and increased spending on prevention in the context of the need to maintain services and pointed towards relatively inexpensive initiatives in Glasgow and Dundee which demonstrated that “it is not always a question of spending shedloads of money; sometimes, it is about doing things a bit differently.”

We agree on the urgent need for councils to adopt a more preventative approach based on outcomes and regret the slow pace of change since Christie. Whilst we recognise the challenges councils are facing, we are frustrated that the need for such a change is widely accepted, but that with a small number of exceptions, there appears to be limited evidence of such a shift actually happening in practice. We reiterate our point about the need for effective political leadership to achieve a decisive shift towards prevention.

We would like to see specific measures in the Budget that support sector-led transformation in local government. These could include funding for collaborative pilots, for example in areas of digital, human resources and procurement, or in supporting changes in the way services are delivered in specific areas. How any such funds are to be distributed should be agreed in advance with COSLA, the Improvement Service and SOLACE.

Localism

The VHA states that there will be a presumption in favour of local flexibility, other than where there is clear rationale for a national approach and the LGIU spoke of a consensus in its international research on the principle of subsidiarity meaning that everything should be done at the most local level. Professor Heald suggested that devolution had actually led to more centralisation within Scotland rather than less. Reform Scotland called for empowered local leaders, explaining that “local authorities should not just be the delivery arm of central Government” and highlighted the use of the term “a national approach, locally delivered” in the most recent programme for government. In its view, “we should do things differently in local areas to best meet the needs of local communities. That helps to give local communities a voice, whereas doing the same thing all over the country negates that voice.” Reform Scotland also expressed frustration that since devolution, there have been committee reports and cross-party support behind greater decentralisation within Scotland, and for local government renewal, but “nothing has changed.” The LGIU suggested that the only solution to addressing increasing demand for services was to examine it on a place basis: “trying to manage a whole system across a whole country— even a relatively small one—is really challenging. We need to look at things on a place-based level, so that we can start to join up services and make the shift.” The Mercat Group agreed, stating that communities should be “given the opportunity to take decisions at a more local level than the local authority.”

In Reform Scotland’s view, “if something is a local government responsibility, local authorities have to have the powers and responsibilities to address it.” Expanding on this, it stated that “it is important that power is devolved and that there are structures in place … to ensure that local communities are properly listened to and represented and that different local issues are properly addressed. That requires an additional level of localism.”

The Accounts Commission stated that whilst some matters were clearly local and should be dealt with locally, “there is a question about whether all the background infrastructure and non-front-facing service delivery sites need to be dealt with at the local level. If we have to make more out of less, we need to be as efficient and effective as possible.” It highlighted some cooperation between councils on procurement and the sharing of internal audit functions, noting that whilst this currently remained “small-scale,” “there are principles and fundamentals that could be scaled up.” Reform Scotland agreed, noting that “our public computer and digitalisation services are completely all over the place, which leads to inefficiencies. In its view, “we should not be developing 32 different ways of providing IT, and we should not have 32 councils and 14 health boards doing it either.”

When asked how the budget could do more to empower local democracy and ensure that communities get the services they need, the Accounts Commission noted that “fostering local democracy and delivering the services that communities need might not be the same thing, so it is important that, if local democracy is the desired outcome, there are clear signals that that is what is expected.” Professor Heald also noted the trend for local elections to be fought more on the basis of national politics then local circumstances although the Mercat Group disputed this to a degree by suggesting that voters recognised the efforts of hard-working councillors who were well known locally.

We agree on the need for local place-based solutions to local problems and support the principle of subsidiarity. We welcome those elements of the VHA that seek to facilitate this but note that it remains a work in progress and call for swifter progress to be made. However, we also agree that not all council systems need to be delivered locally and that the centralisation of certain functions does not necessarily contradict moves towards greater localism. We therefore invite the Scottish Government, councils and other partners to fully consider whether efficiencies and savings could be achieved by sharing or cooperating in the development of certain specific systems and functions.

Verity House Agreement

As noted above, the principles set out in the VHA form a thread running through all elements of our pre-budget scrutiny. We have closely monitored progress towards delivering its ambitions although we note that progress has been slower than hoped, particularly in respect of agreement between the Scottish Government and COSLA on the fiscal framework. Whilst we note that there is a general consensus that the VHA principles are positive, the LGIU reported that having consulted Scottish councils on its implementation, “the evidence is overwhelmingly negative”. Only 8% of respondents were happy with progress made on considering local government in wider policy decisions whilst only 10% of respondents agreed that the VHA had resulted in improved communication between local and central government, although many respondents recognised that it was still early days. In the foreword to the report, the LGIU stated that—

> “After years of despairing results from English councils, we had hoped that the Scottish survey might offer a more optimistic picture. Unfortunately, nothing could be further from the truth. Senior council figures across Scottish local government are calling out for change…. senior council figures are not confident that Scottish Government will change anything.”

The Mercat Group described the VHA as an example of “fine words about devolving power, sharing responsibility, and achieving parity of esteem between central and local government promptly followed by central government decisions and policies that achieved the opposite.”

Almost all of our witnesses highlighted last year’s Scottish Government announcement that it would freeze council tax without having consulted local government. In the view of the LGIU, this demonstrated a failure of the principles of trust and respect in the VHA and would have longer term implications due to loss of growth in the council tax base. In COSLA’s view this decision was not fully funded and “removed local discretion to raise income and the opportunity to invest in services and added complexity to the budget setting process, at a time when councils were having to make challenging decisions about the level of savings to make.” It contended that the £147m provided to councils to compensate for the freeze was insufficient and could have been spent more effectively, for example on prevention. Professor Heald explained that this was not the first time a freeze had been made, noting that “one of the effects of nine years of council tax freeze has been to diminish the proportion of local authority spending that is raised by council tax” thereby transferring the tax burden from local to central Government. COSLA was clear that it would fundamentally disagree with another freeze but noted that early budget engagement with the Government “had started, there are more dates in the diary, and we remain open and talking.”

Reform Scotland noted that whilst announcements of freezes to taxation can be welcomed by voters, particularly during a cost-of-living crisis, “they do not necessarily understand that freezing the council tax will have a detrimental impact on local services overall.” When asked whether you would rule out a repeat of the freeze in this year’s budget, you stated that “it is part of the budget discussions. It is about a package” and you were not prepared to pre-empt these discussions.

The LGIU was strongly supportive of the VHA when published but felt that “the outcome with regard to some of the core principles of the agreement has been disappointing.” In its view, it was still better to have the VHA than not to have it, but it had heard from council leaders that the VHA “is not dead, but it is pretty poorly, and time is running out to revive it.” However, COSLA confirmed that “local government does not want to walk away from the VHA. We have issues of conflict and areas where we do not necessarily agree, but we are still committed to working together on the best outcomes." Your officials told us of more collegiate early engagement on the budget including considering analysis prepared by COSLA as part of your briefings "which would not have happened two or three years ago."

Whilst work on the fiscal framework has been slower than hoped, COSLA stated that there "has been considerable progress" and "a lot of discussions have taken place and there has been learning on both the Scottish Government side and that of local government officials." COSLA noted that the Scottish Government and local government have jointly agreed the following three core principles of what a fiscal framework should do:

- The fiscal framework should promote stability, certainty, transparency, affordability and sustainability;
- The fiscal framework should promote effective use of fiscal flexibilities and levers to address local priorities and improve outcomes;
- The fiscal framework should enable discussion of fiscal empowerment of Local Government.

COSLA went on to explain that "because we do not have something shiny and complete to present to you, there is a perception that nothing has happened with the fiscal framework, but we have made significant progress." We also note your comment that the "fiscal framework … is at an advanced stage of development" and that your officials are discussing the possibility of a rules-based framework with COSLA. You also told us that work was progressing on how to manage in-year changes and there was a possibility of a "shadow period" to test the system in order to reduce the risk of unintended consequences.

The Committee recognises the complexity of this work and the importance of getting it right. We welcome the improved early engagement that has taken place with COSLA along with the progress that has been made on a fiscal framework and request that the Committee is kept informed of progress. However, we also urge both parties to make swifter progress and to build foundations that could help avoid or mitigate the impact of any future perceived breaches of the VHA.

In respect of the potential for a further council tax freeze this year, we note the widespread opposition to such a move from our witnesses and recommend that unlike last year, meaningful engagement takes place with COSLA in advance of any decision being taken. Should a similar policy be pursued in the future, the Committee would like to see agreement between the Scottish Government and COSLA on what a "fully-funded" freeze looks like.

Comparison with England

The Committee was keen to understand the situation in England where some councils have issued section 114 notices because they expected expenditure to exceed income, effectively declaring themselves bankrupt. The Committee hoped to assess the risk of Scottish councils facing a similar situation, but we heard from LGIU that this was due to specific commercial and governance issues at each council and that Scottish local authorities “are perhaps less exposed to commercial risk as it stands because they lack the general power of competence.”

The House of Commons Library recently published a report[3] which found that in some cases, large-scale borrowing for commercial property or other investments such as energy production had played a role, in others, councils had not followed proper accounting processes requiring funds to be set aside when money is borrowed, whilst some featured poor financial management and the running-down of council reserves. LGIU told us that Scottish councils do not carry the same level of risk in commercial investments that some English councils do, noting that Woking Borough Council effectively has a £2 billion deficit because of commercial investments. However, the Committee notes that councils on both sides of the border face many of the same challenges including increasing demand for social care, homelessness and equal pay claims.

COSLA explained that “while some of the factors affecting English councils do not apply in Scotland (namely risks relating to commercial investments outside their area), many of them do (equal pay claims) and Scottish councils face constraints and pressures that do not exist in England, for example requirements to maintain teacher numbers.” In the words of the Accounts Commission, “the challenges are different, but the pressures are the same. Demand is rising and cost pressures are rising.” It confirmed that at present, “the auditors are not telling us anything that suggests that there is an imminent crisis” but noted the potential for demand not to be met, including through potential changes to eligibility criteria, which it described as “not acceptable.” However, we heard from the LGIU that there was no room for complacency around the risk of financial failure with one Scottish council Chief Executive stating that this was “only a matter of time.” Whilst the LGIU noted what it saw as a perilous situation, it stated that “we still have time to act before we see councils going over the edge.”

The Audit Commission was the main body responsible for financial and performance oversight of local authorities in England, until its inspection powers were removed in 2010 and its responsibility for audit lapsed in 2015. With the abolition of the Commission came new arrangements for the audit of local public bodies. However, we heard from the NAO that this had led to “real demise of that external audit function” with the number of audits that are not completed and certified by the due date rising from virtually zero in 2009-10 to upwards of many hundreds by last year’s statutory deadline. In its view, this was partly due to issues around the new tendering process for audit services coupled with the fact that “internal audit functions have been stripped to try to protect front-line services and provision.” Professor Heald went further, stating that “the local audit system collapsed in England after the abolition of the Audit Commission and district audit. Scotland, Wales and Northern Ireland did not do the same things and do not have comparable problems.”

We heard from the NAO that delays to external audit reporting had led to an absence of data meaning auditors were unable to gather the necessary data to express an opinion on whether investments were justified. In its view, “we saw a lot of mistakes being made, and then a tightening up of, for example, prudential borrowing rules … It

[3] Why are local authorities going 'bankrupt'? (parliament.uk)

has been a case of trying to shut the stable door after the horse has bolted." The LGIU described this as "a constant moving of the deckchairs in terms of centralised accountability methods" and spoke of the importance of democratic accountability "rather than trying to create cumbersome central Government monitoring processes." However, the NAO stated that "what has happened in England has demonstrated that the system also needs some controls at a central level that can keep oversight of how the system is working and certainly spot issues earlier than has happened in England." The LGIU suggested that Scotland should learn from the English experience by introducing a process "by which we enable a frank conversation that puts in support ahead of a section 114 notice—or the Scottish equivalent— being issued" to help address problems before they become too great. Both the NAO and LGIU suggested that one way of reducing the risk of financial failure would be to encourage councils to seek advice and guidance at an early stage rather than such an admission being seen as a failure.

You told us in oral evidence that whilst there was no room for complacency, but you considered that Scotland has "a more prudent set of frameworks, which will prevent some of the more extreme cases that we saw down south." You also suggested that appropriate checks and balances and lines of communication would ensure you were aware of any problems arising at an early enough stage to be able to act to avoid the risk of a Scottish council facing financial failure.

We agree that circumstances in Scotland, including an external audit function which should raise any early warnings of councils facing financial challenges, and Accounts Commission oversight, help mitigate the risk of Scottish councils experiencing financial failure. Robust financial planning is key, with the Accounts Commission expecting to see all local authorities develop medium-term financial strategies which are "developed in a way that is understandable by councillors and communities, and—to be honest—by us, because sometimes they are a bit opaque".

Scottish Local Authorities Remuneration Committee (SLARC)

As part of its work on "understanding barriers to participation in local politics", the Committee has heard that one of the key barriers is the relatively low rate of pay to councillors for what can be a very busy role. In 2022, the Scottish Government and COSLA agreed that a review of councillor pay was necessary "to ensure that terms and conditions truly reflect the responsibilities of a modern-day Councillor, and that remuneration does not act as a barrier to encouraging a diverse range of people to stand for elected office".

SLARC was reconvened in April 2023 to undertake a one-off independent review of councillor remuneration, having last reported in 2011, and published its recommendations on Councillors' remuneration and expenses in February 2024.

SLARC's recommendations cover a range of issues including the establishment of a national dataset showing the demographic composition of the country's councillors, improved support for and induction programmes for councillors, training and resources for councillors relating to their safety, and the introduction of resettlement payments for councillors losing office. The report also recommends that salaries of "ordinary" councillors be set at 80% of the median salary for all public sector employees in Scotland or £24,581, an increase of £4,482 or 22.23% on their current salary of £20,099.

SLARC also recommended that the leaders of Edinburgh and Glasgow city councils be paid the same as MSPs. Under the new three band structure recommended by SLARC, council leaders in other local authorities would see their pay set as a percentage of MSP pay.

SLARC also recommended that the salaries of council leaders in the current Band C be set at 85% of the salary of those in current Band D; and those in the newly combined Band A and B be set at 70% of the salary of those in Band D. In other words, the majority of council leaders would be paid 70% of what MSPs are paid. Finally, SLARC recommended that the salaries of civic heads (for example, provosts) and senior councillors (such as committee chairs and spokespersons) continue to be set at up to a maximum of 75% of the salary of their council leaders.

In terms of costs, the report states that "overall, the cost of the recommended salaries across all councils would be £4,685,780 which represents an increase of 14.29% on current salary costs excluding the 6.2% uplift due to take effect from 1st April 2024. The cost of the recommended increase in the number of Senior Councillors for councils currently in Band A would be £426,276 which represents a further increase of 1.3% on current costs, taking the total increase in cost to 15.59%."

Whilst the Committee is broadly supportive of SLARC's recommendations as a whole, its primary focus has been on councillor renumeration given the difference of opinion between SLARC and COSLA on the one hand and the Scottish Government on the other as to how any pay increases should be funded as set out below.

The Scottish Government published its response to SLARC's recommendations in July which confirmed that it accepts the pay and banding related changes recommended by SLARC and will introduce regulations early in 2025 to put these into effect from 1 April 2025. However, the response stresses that local authorities are responsible for paying councillor salaries and associated expenses from their annual budgets provided through the Local Government Settlement. The Scottish Government's position, therefore, is that it is for local government to fund any costs, including increased salaries, resulting from accepting the recommendations.

The Convener of SLARC, Angela Leitch CBE, wrote to the Cabinet Secretary on 14 August. Whilst the letter "welcomes the Scottish Government's endorsement of our report" it also states that SLARC—

> "...was disappointed to learn that the Scottish Government's response to the remuneration element of our report was that local government had to find the necessary finances from their existing budgets if they believed it appropriate to implement any increases in remuneration to local councillors. The Committee worked on the understanding that its recommendations would form part of the local government settlement and not solely require decisions

> of individual local councils themselves to determine whether or not to adopt the recommendations aimed at improving wider local representation."

COSLA then wrote to the Scottish Government on 23 August stating that "we find your position, that the costs of the recommendations are for Local Government, very disappointing. We view this as inconsistent with the April 2023 commitment and a setback for tackling barriers to elected office in Scotland."

COSLA therefore asked the Scottish Government to reconsider the decision that funding of recommendations should come from local authorities instead suggesting that "an open and honest dialogue in line with the Verity House Agreement at both political and officer level to enable a fully funded 2024 implementation" should take place.

The Committee took evidence from SLARC, COSLA and the Cabinet Secretary for Finance and Local Government on 17 September and heard from the former Convener of SLARC that "it came as a bit of a surprise to SLARC that total responsibility for that funding would come from finding it in existing local government funding. Had we been aware of that— that certainly had not been our understanding—we would have made a recommendation that, at the very least, a shared approach be adopted."

COSLA also explained that "it was our understanding that the cost of implementation would not be left to local government alone. That point was stressed many times by our presidential team to the cabinet secretary." COSLA further stated that "if we are asked to cover the cost, either the recommendations will not be implemented and, therefore, we will continue to have a very restricted group of people making decisions in our communities, or there will be a further impact on services. From the councillors who I know and work with day to day, they will always put themselves last and the services first. That means that the recommendations of SLARC would not be implemented."

COSLA also confirmed that all 32 COSLA leaders (consisting of members of all parties represented in the Scottish Parliament apart from Alba and the Scottish Green Party) have accepted the recommendations in principle.

However, the Cabinet Secretary highlighted the challenging economic background to this year's budget in oral evidence and explained that the Scottish Government "does not and has never provided funding specifically to meet the costs of councillor salaries; that has always been a matter for local authorities. Councillor salaries and associated expenses are paid from each authority's annual allocation, as agreed under the local government settlement."

The Cabinet Secretary went on to state that she was prepared to consider the matter further in the event that there is cross-party support for the salary increase, stating that—

> "We need to all be on the same page if this is to go forward and money is to be found because, bluntly, I will not fund this in the face of opposition from other parties—I just will not. My challenge is this: if this is a priority, let us take it forward cross-party … All the represented groups in COSLA would need to

> make it clear to me as part of the budget process that this was a collective priority that they wanted to see funded."

Notwithstanding this, the Committee recognises the current challenging economic circumstances and is mindful of competing demands in respect of the Scottish Government's budgetary planning. However, the Committee welcomes SLARC's recommendations and considers that a total cost of around £5.1million is a relatively small price to pay, given the importance of the role of councillors to Scotland's democracy, and the widely acknowledged need for greater diversity of representation.

The Committee therefore recommends, on a cross-party basis, that the Scottish Government work with its partners in COSLA, in keeping with the principles laid out in the Verity House Agreement, to give effect to SLARC's recommendations on councillor remuneration. It is vital that COSLA and the Scottish Government agree on this matter before secondary legislation is laid before Parliament in the new year.

Conclusion

The Committee recognises the challenging financial position that councils, along with all other areas of the public sector in Scotland, are facing. We note the frustration expressed by stakeholders that there is often a broad consensus on what needs to be done, as highlighted in several reports and reviews over the last 25 years, but limited progress has been made. We therefore reiterate the need for political leadership in both spheres of government to make meaningful progress, including through ensuring buy-in or at a minimum, increased understanding of difficult choices within communities facing unpalatable decisions in their areas.

The Committee supports the principle of subsidiarity and the requirement for effective local government as opposed to local administration. We highlight the importance of agreeing principles for the relationship between central and local government and welcome the steps taken towards this in the VHA. However, we also recognise the need for wider public sector reform as recommended by Christie and are clear that local government cannot be expected to make changes of the magnitude required on its own.

We note the continuing pressures on capital budget allocations and emphasise the necessity of investment in infrastructure to facilitate the effective delivery of services in the most efficient way possible. We are therefore clear that capital budgets cannot be looked at in isolation and must be considered as part of the overall budget settlement.

In respect of reserves, we agree that it is healthy for councils to maintain appropriate levels of reserves but agree with the Accounts Commission and others that greater understanding of councils' reserves position could be achieved through increased transparency and consistency in reporting. We welcome the work undertaken by the Improvement Service in developing the local government benchmarking framework indicators but agree with the Accounts Commission's suggestion that they should be kept under review by

councils and other interested parties to ensure they continue to provide timely and comprehensive oversight.

I look forward to receiving a detailed response to the points raised in this letter and to our continuing dialogue on developing proposals for the local government budget for 2025-26.

Yours sincerely,

Ariane Burgess MSP
Convener