FINANCE COMMITTEE

Tuesday 28 April 2009

Session 3

£5.00

Produced and published in Scotland on behalf of the Scottish Parliamentary Corporate Body by RR Donnelley.

CONTENTS

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FINANCE COMMITTEE
10th Meeting 2009, Session 3

CONVENER

*Andrew Welsh (Angus) (SNP)

DEPUTY CONVENER

*Jackie Baillie (Dumbarton) (Lab)

COMMITTEE MEMBERS

*Derek Brownlee (South of Scotland) (Con)
*Linda Fabiani (Central Scotland) (SNP)
*Joe FitzPatrick (Dundee West) (SNP)
*James Kelly (Glasgow Rutherglen) (Lab)
*Jeremy Purvis (Tweeddale, Ettrick and Lauderdale) (LD)
*David Whitton (Strathkelvin and Bearsden) (Lab)

COMMITTEE SUBSTITUTES

Murdo Fraser (Mid Scotland and Fife) (Con)
Kenneth Gibson (Cunninghame North) (SNP)
Lewis Macdonald (Aberdeen Central) (Lab)
Liam McArthur (Orkney) (LD)

*attended

THE FOLLOWING GAVE EVIDENCE:

John Aldridge
Jo Armstrong (Centre for Public Policy for Regions)
Russell Frith (Audit Scotland)
Caroline Gardner (Audit Scotland)
Stephen Humphrey (Government Actuary's Department)
Stella Manzie (Scottish Government Director General Finance and Corporate Services)
John McLaren (Centre for Public Policy for Regions)
Angela Scott (Chartered Institute of Public Finance and Accountancy)
Jenny Stewart (KPMG)

CLERK TO THE COMMITTEE

Mark Brough

SENIOR ASSISTANT CLERK

Lewis McNaughton

ASSISTANT CLERK

Allan Campbell

LOCATION

Committee Room 1

Scottish Parliament

Finance Committee

Tuesday 28 April 2009

[THE CONVENER *opened the meeting at 14:13*]

Decision on Taking Business in Private

The Convener (Andrew Welsh): Good afternoon and welcome to the Finance Committee's 10th meeting in 2009 in this the third session of the Scottish Parliament. I ask everyone—members and public—to turn off any mobile phones.

Agenda item 1 is to decide whether consideration of a draft report on public sector pay at this and future meetings should be taken in private, and whether to consider the evidence heard to date on our strategic budget scrutiny inquiry in private at this and future meetings. Do members agree to take those items in private?

Members *indicated agreement*.

Strategic Budget Scrutiny Inquiry

14:13

The Convener: Item 2 is to begin the evidence programme for our strategic budget scrutiny, focusing on the effects of recession on public sector budgets in Scotland, the immediate pressures on the 2010-11 budget and likely future trends. As the first of three panels of witnesses, I welcome to the committee Jo Armstrong and John McLaren from the Centre for Public Policy for Regions. They have produced a briefing that analyses public spending trends and prospects, drawing in part on the analysis of the Institute for Fiscal Studies. I invite Jo Armstrong and John McLaren to give us an opening statement, perhaps updating their briefing in the light of last week's United Kingdom budget.

14:15

John McLaren (Centre for Public Policy for Regions): Good afternoon. I think that you received our updated briefing only today, so I will take a few minutes to go through it in case you have not had time to take it on board fully. First, the good news is that the £6 billion cuts that were projected in some newspapers in the past few days are wrong; I think that some journalists had double, triple and quadruple counted the figures, which is somewhat difficult to believe, but it happened. That is the good news—but it is the end of the good news.

The big picture is that public sector accounts deteriorated a lot between the pre-budget report and the budget. As a result, what had been our more pessimistic scenario became our more optimistic scenario. It is anticipated that by 2013-14 the budget will be between roughly £2 billion and £4 billion lower in real terms than it is at its peak in 2009-10. That represents a 7 to 13 per cent real-terms cut over that four to five-year period. We are not living in an age of certainty, so there is uncertainty associated with those forecasts, as there is with all forecasts, but they are based on HM Treasury figures and the Institute for Fiscal Studies analysis.

The briefing looks at three timescales. The first goes up to 2013-14, when we see the real-terms cuts of between 7 and 13 per cent. The second looks forward to 2017-18, when, on the basis of Treasury and IFS figures, we expect a return to positive, but very low, real-terms growth of perhaps around 1 per cent. By way of comparison, for the first six or seven years of devolution, the real-terms positive growth was more than 4 per cent each year and it averaged 6 per cent, so even 1 per cent growth is a big cut from what has happened in the past. The third period is post

2017-18, when we will probably still have pretty slow positive growth if the United Kingdom wants its net debt position as a percentage of gross domestic product to come down from around 70 per cent to around 40 or 50 per cent.

Those are the projections. The risks around that are still mainly on the downside. Most analysts consider the economic growth in the Treasury budget to be on the optimistic side. Debt interest payments could be higher if the current low interest rates move up. The financial sector's losses to the Government could increase; I think that the International Monetary Fund's estimates are higher than the Treasury's estimates.

I will leave it to Jo Armstrong to outline some ideas about how the Government might restructure itself to deal with that, but I will touch on a few issues that you might want to discuss. I will outline an exemplar of what might happen in Scotland. The Irish Government has had three budgets in the past six months, with each one getting tougher. There are examples in there of what you have to do if you are going to cut back to the extent that we are talking about.

Initial sources that might guide you are the Howat report, which was published a couple of years ago and is in stock. There are performance comparisons of what has happened in the four constituent parts of the UK, to see who has done better than others. You could also look at the analysis of spending per head to see whether it is delivering in Scotland. For example, law and order spending per head is lower in Scotland than it is in England, but health spending in Scotland is a lot higher than it is in England. Why is that and is the spending delivering as much as you would hope for?

Before looking into what to cut, it is important to consider the principles and priorities that are in place. Issues that the Irish Government has covered include whether certain things should be targeted rather than provided universally—whether you are looking at a shared interest or a fairness issue—and whether jobs, or something else, are the main priority. Questioning the evidence base on class sizes and vocational qualifications, for example, which has recently been done in studies, will become more important. Given that roughly 50 per cent of the budget goes on wages, future wage settlements will be very important.

Jo Armstrong (Centre for Public Policy for Regions): I will pick up on what our submission says on the possibility of structural change in Government, the aim of which would be to take account of and deal with the difficult times that lie ahead. We suggest that you need to have an independent budget office. I am acutely aware that at least two colleagues in the public gallery behind me work in the finance sector for the Scottish Government. Our suggestion of a budget office was made not to impugn their integrity, ability or capacity to challenge. When life gets tough, any organisation in which there are perceived conflicts of interest will experience difficulties when it comes to addressing the issues. There will always be areas in which the evidence is weak on whether to continue expenditure, and others that are sacred cows, in which cuts cannot be made. An independent budget office would be given the challenge of ensuring that the evidence was strong enough to support the continuation or extension of programmes.

I turn to an area in which substantial efficiencies have been delivered, not through a continuation of salami slicing. Significant efficiencies have been delivered through the efficiency programme over the past few years, and continuation of that seems unlikely to be possible if services are not to be challenged. The Scottish Water model has a lot to offer as a possible solution or way forward for public service provision. Over a relatively short space of time, it has delivered not only 40 to 50 per cent efficiency savings, but increased output and quality. One submission to the committee today mentions that. There is also the piece of work that the David Hume Institute undertook on the lessons that can be drawn from that model. We cannot simply say that what was done in Scottish Water can be applied lock, stock and barrel across all public services, but some generic lessons can be learned. The model has applicability across Scotland's public services; it could be used to deliver significant change.

We require not the continuation of short-term measures but structural change. Current spending levels are not sustainable; we will have to deal with a £2 billion to £4 billion spending cut from today's levels.

The Convener: Thank you. Your predictions are gloom, gloom and thrice gloom. That was a realistic but not very cheery start to our meeting. Your forecasts are now worse than your previous pessimistic forecasts, and you say that the situation will deteriorate further if interest rates rise. You also say that the situation could continue to 2014, if not beyond, particularly if the accompanying demographic crisis is taken into account. You have set out the problem; what is the answer?

John McLaren: At this early stage, I would hazard not an answer but a way forward. At present, there is not enough evidence and information gathering to say what would be the right thing to do. That is one reason for our suggestion of setting up a budget office. Whichever minister was put in charge would have a full-time role in looking at those things, and I assume that such an office would increase their capacity to collect all the information and decide on the right way forward.

As I said, there are different answers to the problem. Before politicians start to make big spending cuts, it is important for them to consider the principles and priorities that they set or which they set as part of the debate with the public. All Governments will have to take that on board. They must ensure that they are heading the way in which the electorate wants them to go. Everything cannot remain funded at current levels. The question is whether that means change in capital spending on areas such as health, education or transport. I am happy to talk about the different ways in which we could go forward, but I am not in a position to set out the right way in which to go forward.

Jo Armstrong: I agree with John McLaren that what needs to be done is considerable. It needs to start with the objectives of the Government of the day or of the Parliament, whichever is the most appropriate. Each individual project, spending line and commitment that is currently being made must prove its worth in delivering the set of objectives that have been identified by the Government and the Parliament. That requires a long hard look to be taken at the Government's economic strategy. It was developed in a world that was quite different from the current situation, and it is worth investigating whether it still stands up to scrutiny. That is not to say that the strategy was wrong; it is just that the world that it looks forward into is different from the world in which it was first developed. You need to start from the objectives of your current spending commitments, and somebody must then stand up and say whether all the spending lines meet those objectives.

The Convener: In looking forward, we are all looking through a glass darkly. The committee is interested in such a mechanism. Would the independent budget office that you talk about be within or outwith Government? What would it do and how would it be organised?

Jo Armstrong: I think that it has to be within Government. We are an independent challenge function. We are small and have a limited resource. In all honesty, the ability to influence spending must come from within rather than from outside Government. An independent finance committee, ourselves or other think-tanks can keep challenging an independent office such as a budget office, but the resources are needed internally to have robust in-house debates about what will and will not work and about the evidence that supports the continuation of expenditure.

I think that a challenge function must be in-house rather than outside. It must be within the finance function, must have a minister who is independent of all other ministers, so that it is not trammelled with spending obligations, and must have significant support from the First Minister. If the First Minister outlines a set of objectives that the organisation is trying to deliver, the budget office must ensure that those objectives are met through spending commitments and challenge when it appears not to have the evidence to support spending.

The Convener: I am interested in how practical the idea is. In the past, I have heard about zero-based budgeting, but I have never seen it in practice. It is a theoretical concept. How practical would it be?

Jo Armstrong: You are absolutely right. The ability to make substantial changes to budgets year on year is limited if there is not sufficient resource to challenge the experts, and the experts are the budget holders. Each individual department must have all the evidence to hand to say, "This is why we need the spending commitments that we are asking for." A budget office would need quite a bit of resource to take on that challenge. Over time, however, I believe that an independent budget office could make a substantial difference in challenging budget commitments. Yes, it is theoretical today, but it need not be theoretical from tomorrow onwards.

John McLaren: The budget office that is created must be the most important office in the Government. So far, under devolution, the finance department or office has not really held that role. It is imperative that, like the Treasury in London, it is seen as the department that decides who gets the money. That is why it should not have any spending decisions to make that pertain to its own budget. Every other department would have to explain itself to the budget office, and it would be the arbiter of what constituted best value for money and where the money would go. It would be the key department and would have the key ministerial position.

I agree with Jo Armstrong that budget advice must be an internal matter. The final decisions are always political ones that are made by the politicians and the Government, but there can be an input from independent elements, as happens with the Economic and Social Research Council in Ireland. Also, the existing Council of Economic Advisers could—as happens in certain European countries—look not necessarily at this year, next year and the year after, but at the longer-term issues concerning demographics, pensions and long-term infrastructure projects. If those issues are considered by more independent-minded people—economists or whoever—as a first step in deciding which measures are the most important and when they will happen, that could provide a good input to the Government to help it think on a longer-term basis.

14:30

The Convener: In a sense, Scotland is in a financial straitjacket, in that money is sent up to us. How would your idea fit into the UK spending system, which decides the amount that Scotland is allocated?

John McLaren: Do you mean the idea of a budget office?

The Convener: Yes. How would it fit into the UK system?

John McLaren: To my mind, that role is already there, in the sense that the Treasury, as well as doing macroeconomic work, acts as an independent arbiter on whom the budgets should go to. So the Treasury already has that role, although there is an issue about whether its capacity might need to be beefed up in the current circumstances if it is truly to understand where the wisest cuts will be. The Treasury could learn from other countries on looking to the longer term a little more and using independent expertise.

Derek Brownlee (South of Scotland) (Con): Your paper is interesting and is, in some ways, a wake-up call—it is not particularly pleasant to consider the implications. If I read it correctly, you suggest that the landscape within which we deal with the devolved budget will be affected not just for the next few years, and not even just for the next decade, but possibly for the next several decades, at least in relation to reducing debt as a share of GDP. Given that, it is tempting for politicians to fasten on to efficiency savings, on the basis that no one will notice that cuts are being made and everyone will be happy. In your assessment, for your least and most pessimistic scenarios, what balance is achievable between efficiency savings and what we might classify as straightforward cuts, which involve difficult political decisions?

Jo Armstrong: The numbers look bad, but it depends on where we start from. The figures that we give for 2013-14 would take us back to 2005-06 levels, and life was all right then. We delivered services and kept a level of employment that was acceptable to most people at the time. Clearly, structural change and some unemployment will come through in the short term, but we are not talking about a complete collapse of the budgets.

I return unashamedly to my example of Scottish Water, which took 40 per cent of its operating costs out of its system in four years while increasing output and quality, as has been independently verified. I am not saying that that is deliverable in all public sector services, but the current approach of saying, "We must continue with a 2 per cent cut—you decide how it is done," will not continue to cut the mustard: services will be pared away. As a trustee of a charity, I am acutely aware that local government is first looking after its own services, before it considers services in the voluntary sector. Therefore, the voluntary sector will take significant pain before local authorities do. There are differences in the pain that will be felt by different people. The voluntary sector will probably take the most immediate and painful hit, because the costs in the sector are primarily wage costs, so individual jobs will be affected.

The lessons from Scottish Water that might be applied elsewhere are about the need for clarity of objectives: we must know what we are trying to deliver with the funds that we have. If we have less money, we need to know what will not be delivered. We then need to know about good practice and how we can monitor against it. Oodles of information is available from throughout the public services. For example, the 32 local authorities deliver many of the same services: some deliver them extremely well, whereas others appear not to be doing quite so well. We need to know whether the differences are legitimate.

We must put in place competitive pressures or effective economic regulation to ensure that people are called to task if they do not deliver. We also need appropriate incentives. I know that, in relation to the financial services sector, those two features have had a really bad press in the past few months, and I am in no way defending that sector. However, I have seen significant improvements in the water industry as a consequence of effective economic regulation and appropriate incentives. I know that there are discussions about the salary of Scottish Water's chief executive and I am not saying whether it is right or wrong; I am saying only that the model has delivered substantial savings in a short space of time, but we can still flush our toilets, we can still drink the water from the taps and we are still getting new water connections. I urge ministers to consider that as a potential model for use elsewhere, rather than just asking others to deliver a crude 2, 3 or 4 per cent cut across the public sector.

David Whitton (Strathkelvin and Bearsden) (Lab): Page 6 of the CPPR report says:

> "it is important to bear in mind that these are forecasts. Uncertainties over current and future allocations mean that it is difficult to be precise over the profiles."

I do not want to be a glass-half-empty kind of guy; I am always a glass-half-full kind of guy. If I picked up John McLaren correctly, he said that the Treasury and IFS forecasts had been included in making the projections. Is that right?

John McLaren: Yes, the process started with the Treasury's report "Budget 2009: Building Britain's future". The IFS then analysed that and made some assumptions.

David Whitton: So, your assumptions are based on the IFS's assumptions on the Treasury model.

John McLaren: Yes.

David Whitton: Okey-dokey. What deflator did you use for inflation?

John McLaren: The GDP deflator.

David Whitton: Is the GDP deflator 2.7 per cent?

John McLaren: I think that the run is something like 1 per cent, 1.5 per cent, 2.5 per cent, 2.75 per cent and 2.75 per cent up to 2013-14.

David Whitton: Did you think about using the Treasury model as the starting point and then using other forecasts on the back of that? The Treasury is forecasting 0.7 per cent growth.

John McLaren: As the IFS does, we have used those growth forecasts, which is why we and the IFS say that it may be an optimistic scenario. Many analysts do not think that growth will return as quickly as the Treasury projects in its model. However, the public sector borrowing requirements and the GDP growth rates are as the Treasury predicted in the budget.

David Whitton: I have a question for Jo Armstrong on her Scottish Water model. Is it not the case that Scottish Water was massively inefficient before it became more efficient?

Jo Armstrong: I think that people who worked in the industry would have said that it was not, but it is fair to say that bringing water services from local authority ownership, through three independent organisations into a monopoly, generated significant savings that were not a consequence of competition, economic regulation and the Water Industry Commission for Scotland. The model that was imposed on Scottish Water was about ministers being absolutely clear about the outputs that they wanted and Scottish Water being held to account on the efficiencies that it delivered compared to equivalent organisations. There is serious merit in using that model to call to account local authorities, national health service boards and quangos. If a body has no indication of what is possible, it is difficult for it to say whether it is as efficient as it might otherwise be. By virtue of Scottish Water's being in the public sector, there is no market price, which is usually used as an indicator of efficiency and effectiveness, so contestability across different providers is one key—

David Whitton: You were talking about incentivisation. The committee has considered public sector pay, particularly that of senior executives. The highest paid senior executive is the chief executive of Scottish Water, who also has the highest bonus rate.

Jo Armstrong: Indeed.

David Whitton: Are you suggesting that we need a raft of quango bosses who are incentivised to make the savings that you think are necessary?

Jo Armstrong: No—that is absolutely not what I said. I said that those who are in post need to prove that what they are doing is efficient and effective. One key way of doing that is to carry out appropriate benchmarking, which could happen within current organisational structures—for example, local authorities could use Accounts Commission information. There is a vast amount of information that would allow us to benchmark local authority provision of all sorts of services. I am not arguing for changing local authority pay structures—I am talking about effective incentives, which may not need to be monetary.

David Whitton: My final question is directed at Mr McLaren. Do your forecasts relate to economic growth rates rather to than spending growth rates?

John McLaren: Economic growth rates underpin the departmental spending growth rates. The headline figures that are published in the briefing note relate to Scottish budget departmental spending growth rates.

Linda Fabiani (Central Scotland) (SNP): On a point of order, convener. Is it acceptable for people in the public gallery to pass notes with information to committee members?

The Convener: The matter is subject to my discretion. I do not encourage the practice, but I do not object to it if it assists the committee's deliberations. It should not be a common practice.

Jackie Baillie (Dumbarton) (Lab): I return to the figures that appear in table 1 of the CPPR's second briefing note, especially those for cash-terms and real-terms spending in 2008-09, 2009-10 and 2010-11. So many different sets of figures have been bandied around. I want to know what assumptions you have made and where your starting point is.

Do the figures include the £100 million overcommitment that the Cabinet Secretary for Finance and Sustainable Growth clearly wanted to have included, to ensure that the Government spends at the maximum level? Do they include end-year flexibility, which—as you know better than I do—is non-recurring, and the reprofiled capital spending that the Government has moved from a future year into the current year to ease the pressure of the recession? I am interested because the Treasury says that the baseline is different from the figures that you have given. I just need to know where we are.

John McLaren: All the elements to which you referred are included. The different lines are given in table 1 on page 4 of the briefing note. There are different ways of interpreting them: one is a UK Government interpretation, and the other is a Scottish Government interpretation. The footnote to table 1 addresses most of the issues that Jackie Baillie raised and the other points are explained on the next page of the note. It is up to readers to decide which figures they want to use as the baseline. The fall in 2011-12 will not be £3.8 billion, as it will be in later years, in order to take account of the adjustment that has been made.

Jackie Baillie: If the focus of our inquiry is long-term implications, would it be fair for a simple person like me to take the Treasury baseline, which is £27.5 billion for 2008-09, £28.4 billion for 2009-10 and £29.2 billion for 2010-11, as the accurate starting point, given that all the other funding that is quite properly included in the draft budget is short-term cushioning by the Government and relates to short-term initiatives that will not be carried forward?

John McLaren: The Scottish Government's and the Treasury's headline figures are not always in sync, because they take on board different things. It is right to say that the EYF that has been drawn down increases spending power in one year, but is a one-off that cannot be taken forward. The realignment means that there is a steeper decline the next year than there would have been under the UK figures.

Jackie Baillie: I understand that—it reflects the scale of the task that we face. However, is it fair to say, based on the Treasury figures that we have outlined, that there is no cut in the baseline budget?

John McLaren: That depends on whether we look at the matter in cash terms or in real terms. The deflator has come down quite a lot, which means that there is a slight improvement in spending for 2010-11.

I am getting slightly confused about the different figures. The EYF will eventually be reflected in the Treasury's figures, but the Scottish Government will decide to bring forward the capital payment, for example. If, for example, one says that there has been a cut in real or cash terms between one year and another because money has been brought forward, is that because the Treasury has allowed that or because the Scottish Government has done that? How that position was reached is open to interpretation.

14:45

Jackie Baillie: Okay. So from a simple person's perspective, there will be no impact on the baseline if one chooses to bring forward cash that one would otherwise spend later.

John McLaren: That will have no net impact over time, but it will have an impact on the baseline because cash will be moved between the two years. There will be an impact in trying to calculate whether that is up or down. However, there will be an offer from the UK Government and a choice for the Scottish Government about what to do. I am sorry to be so unclear.

Jackie Baillie: We remain confused.

Convener, may I switch to another hobby-horse?

The Convener: The matters that we are discussing are complex. If Mr McLaren wishes to add something to his answer to clarify it, he can do so in writing.

Jackie Baillie: Excellent. That invites me to be difficult with the figures, but I will not be.

I think Jo Armstrong talked about clarity of objectives. I absolutely sign up to having such clarity. The committee has had numerous discussions about outcome budgeting—linking budgets to outcomes—and we have the Scotland performs website, single outcome agreements and frameworks with a plethora of targets. Should we tidy things up and make them into an effective tool that would help to monitor public expenditure?

Jo Armstrong: Jackie Baillie is absolutely right: there is a lot of information out there. When we considered the economic strategy, we said that we thought that a set of absolutely clear objectives was a good step forward, but we were less comfortable with the evidence to support the targets versus what was being done on the ground. The issue is not easy, but many senior civil servants are paid a lot of money to support ministers, so they ought to be forced to bring evidence to bear. They should say, "We want to deliver X, Y and Z policies. This is what we think the outcomes will be and this is the evidence that we are using to support what we think." On the challenge function, the budget office could be the key recipient of that information and could scrutinise it. Sometimes things have to be done on a wing and a prayer because no evidence exists—that is fair enough—but not everything should be done on a wing and a prayer. I assume that not everything is done in that way, but the evidence to support targets does not necessarily exist. In revisiting the strategy, evidence is required to support why people are aiming to develop or deliver policies.

The Convener: The information is plentiful; the difficult bit is obtaining its meaning.

Jeremy Purvis (Tweeddale, Ettrick and Lauderdale) (LD): I have a couple of questions. Many of my constituents have probably been confused over the past few days, because journalists have double-counted or triple-counted or because of what has been understood as having been taken as a peak or a baseline. I think that Mr McLaren referred to using the peak of 2009-10 as the basis of comparisons. Most people take a slightly different view when money that was expected in the following budgets has already been spent.

In your submission, you say that there have been no Scottish Government updates of figures with regard to the departmental expenditure limit since the pre-budget report. Did you consider the spring budget revisions of the previous year in making comparisons from 2008-09 through to 2013-14?

John McLaren: No. I do not think that either of us was aware of any changes to the headline figures for the Scottish departmental expenditure limit that were made last October or November, but I am happy to take them on board. If there have been changes, they might change the profile a little bit over this year to next year, although they will obviously not have a huge impact on the general trend of how things are looking.

Jeremy Purvis: I understand what you say with regard to restraint and expenditure and the environment in which we now find ourselves, which is very different to that post-1999 with the Parliament having been established. Every scenario you use in your report—I do not think any of them could be accused of being Government scenarios, as you take two from the IFS and add your own scenario C—consider a DEL for 2013-14: in scenario A it is £28.4 billion, in scenario B it is £29.8 billion and in scenario C it is £30.3 billion. In all those scenarios the DEL is higher than the outturn for the 2007-08 DEL. That outturn of £27.2 billion is what we know, because it was in the budget and is clearly set out in the table as outturn of DEL. You have not indicated a figure in any year between now and 2014 that is less than the last known outturn of devolved government spend in Scotland with regard to DEL. Is that correct?

John McLaren: As you are talking in cash terms, that is correct. You are not talking in real terms.

Jeremy Purvis: The only comparison that you can make is on what you say with regard to cash. The same deflator as for 2007-08 is estimated for 2012-13 and 2013-14. There is a peak and a difference: there is a peak in growth in the budgets of the intervening period as well as a huge reduction and a deflator. If you want to use real terms, the only comparison is that it is the same deflator in 2007-08 with the outturn as it would be in 2013-14.

John McLaren: No, I do not think so. The use of the deflator is in order to get everything in terms of a specific year—to take any increase in prices out of the equation so that all the figures are on a comparable basis year by year. Considering cash figures only year by year is not sufficient. For example, £30 billion in 2013 will not buy you what £30 billion did in 2007-08, which is why you adjust for the deflator. So—

Jeremy Purvis: I am sorry for interrupting, but I am not sure why you take the Treasury's deflator but you take everyone else's assumptions with regard to the size of the budget. That is the first point.

The second point is that these are forecasts and if you spread the deflator over the entire period from the outturn that we had in 2007-08 to 2013, it is less than 2.75 per cent because it is 1 per cent in 2009-10 and 1.5 per cent in 2010-11.

John McLaren: The deflators work cumulatively: if you have 2 per cent deflation in one year, in two years you deflate by 4 per cent, in three years by 6 per cent and in four years by 8 per cent. It is not that you deflate the figure by just that year's deflator: it is a cumulative impact, which is why it has a large net impact the further forward you go.

To be clear, we use the Government's figures, as does the IFS, wherever possible. The only place where we differ is in trying to break down total expenditure into what will be spent on interest payments and unemployment benefits and what will be left for departments. That is where the IFS examines the numbers.

Joe FitzPatrick (Dundee West) (SNP): The only figures that we can examine are the real-terms figures. The figures that you have projected are quite wide. You suggest a decline of between 7 and 13 per cent, which represents a cut of between £2.1 billion and £3.8 billion. These are stark figures, no matter where on that range you look. It is a lot of money to be coming out of the public sector budget. Have you done any analysis on the impact that such a massive cut would have in respect of threatening jobs?

John McLaren: No, we have not analysed that; it would depend on where the cuts were made, so it is very difficult to say. However, many countries have been concerned about how to ameliorate the impact on jobs, and two obvious routes have emerged. One involves job sharing or reducing people's hours. That would allow more people to stay in work, although they might not earn as much as before. The other involves reduced pay settlements, to ease the pressure on budgets. Everybody would be hit by that a little, but the negative psychological and skills effects that would be caused by people losing their jobs completely would be reduced, so most Governments are considering that option.

Joe FitzPatrick: In Scotland, the public sector is more important to the economy than is the case in the rest of the UK. Are cuts therefore likely to hit Scotland harder in terms of jobs?

John McLaren: Things will be difficult in Scotland and in the rest of the UK. It will depend on where the two Governments decide to make cuts, and on what they prioritise in their budgets.

The GDP figures for Scotland came out last week, and I was slightly concerned by them. Although real-terms spending on the public sector has continued to grow in recent years, that has not contributed to GDP growth in Scotland, whereas it has in England. I am not sure why that should be, but it is slightly worrying, especially if we are going into a downturn and public spending is decreasing.

Jo Armstrong: As an aide-mémoire, if we assume that 50 per cent of DEL spending is on wages—although that is probably an underestimate—a 1 per cent freeze on wages would save about £140 million or £150 million. For each 1 per cent freeze on wages, that is what you could save as you moved towards your £2 billion to £4 billion of cuts.

James Kelly (Glasgow Rutherglen) (Lab): In the paper that you have presented to the committee, you present three different scenarios. Would you spell out for us the assumptions that lie behind each scenario?

John McLaren: The basic assumptions come from the Treasury's projections for public sector spending and borrowing requirements—especially spending. Back in January, the IFS did a green budget—as it does every year—in which it tried to look behind the overall spending figure that the Treasury publishes, and tried to see the implications for different budgets. The IFS broke the figure down to see what was left after consideration of issues such as debt interest payments and unemployment benefit payments. It was left with a figure for departmental spending, which it then applied to what has been happening in departmental spending in recent times. For example, health has been receiving real-terms increases, but other departments have been receiving cuts.

In the old IFS reports, the implied overall change in departmental spending was zero. The IFS therefore applied its figures across an overall zero change to the budgets. That meant that if a department was receiving a real-terms cut, it would still be receiving a real-terms cut, and if a department was receiving a real-terms increase, it would still be receiving a real-terms increase.

In the scenario for Scotland, the IFS thought that we would be having a cut. However, we decided to apply some variants. One was that our figure would be same as for the UK as a whole, which would be nothing; and another was slightly positive, which was what we thought would happen as a result of Barnett consequentials. This time, we have updated that. The overall zero per cent figure—that is, no change in departmental spending power—has now become -2.3 per cent, because of the worsening public accounts. That is why everything has moved down by about 2.3 per cent, giving lower estimates.

David Whitton and others have suggested that the figures are forecasts—I am happy to acknowledge that. We do not know where things are going. However, there is a range that is based on the Treasury's central estimates, which are then taken apart.

Forecasts will inevitably change in the coming years, but it is prudent—if you like to use that word—to look at what is currently implied by the Treasury's own figures.

15:00

James Kelly: In answer to David Whitton, you acknowledged the Treasury's forecast of growth in spending of 0.7 per cent from 2011-12. If that were delivered, what do you think would be the impact on jobs in Scotland?

John McLaren: I do not think that the Treasury has a forecast of unemployment in its budget report, which probably suggests that it is wary of projecting the impact on unemployment. I do not think that I am in a better place than the Treasury to comment on that. Obviously, things are going to get worse. The increase in unemployment benefit and the like implies that unemployment will worsen. I am not able to judge whether it will worsen to a more serious extent in Scotland than in the UK as a whole.

James Kelly: If we are experiencing growth—albeit slower growth than previously—in the budget, we would not expect the number of jobs to decrease.

John McLaren: Quite often, if there is a slowdown, unemployment can still rise. It depends how the slowdown comes around. The impact on employment is quite complicated, because such things as migration to Scotland—from eastern Europe, for example—and away from Scotland have to be considered. The net impact of all the influences is quite difficult to predict.

James Kelly: This discussion is all about the policy priorities that we want to set for the future. In mapping those, we want to look at some of the policies that have been followed to see whether they have been successful in delivering economic growth. One of the policies that have been implemented since 2007 is a freeze on council tax increases. Do you think that that policy has stimulated economic growth?

John McLaren: That is not something that I have looked at in much detail.

Jo Armstrong: Regardless of whether the policy has stimulated economic growth, a year and a half is a short time in which to see the effect coming through. However, you are right to question what the policy was set up to deliver, how we would know whether it has delivered and when we will see the effect coming through. Those are the questions that have to be asked about each of the budget lines that are currently being spent.

Linda Fabiani: I am quite interested in the idea of an independent budget office. I will be up front in saying that nobody expected the level of problems that we would have with the recession, but it has always been recognised that the grant coming from Westminster would reduce as the years went on and that there are commitments to meet such as private finance initiative payments. In your submission, you refer to the unsustainable boom years from 1999 onwards. Was there any discussion from 1999 through the boom years as to whether an independent budget office should be set up in preparation for reduced levels of income to the Scottish Parliament, or has the issue only now been put to the Government for discussion?

Jo Armstrong: I think that both John McLaren and I have suggested for a considerable number of years that there is a need for an independent budget office—no doubt, he will have his own view on that. We have not suddenly come up with it as a new idea. Officials have also thought that it would be a good thing. In years of plenty, it is perhaps not seen as essential, but I suggest that it is now.

John McLaren: For a number of years, I have been saying both privately and as part of the CPPR that an important step forward would be to have a stronger finance department, with greater power and capacity to decide on the best ways of spending. I may have written that in published articles and so forth, but I do not recall being called in and asked for my opinion. Reform Scotland has also called for such a change and Tom McCabe suggested recently that it might be a good idea. We are the not the only voice to put forward the proposal.

In years when budgets are expanding, it is easy to divvy up the extra money. When it comes to cuts, however, things get much more difficult. A psychological bar comes into play when people have to go from increasing budgets to cutting them. That is much more difficult for people to do; they have to be much surer of their ground.

Linda Fabiani: Like other members, I am keen to ensure that everybody understands the terminology. There has been a lot of confusion as a result of the different terminology that has been used, not least in the chamber last week at First Minister's question time. I note that in your report you always refer to the departmental expenditure limit and not the total managed expenditure limit for your analysis of cuts and efficiencies. Is DEL the proper baseline for budget analysis?

John McLaren: One reason why we use the departmental spending line is that it is more difficult to project what total expenditure will be for Scotland, because that is determined year by year through things that go up and down annually. Also, by and large, DEL is what the Scottish Parliament has to spend; it is not imposed on it by other commitments. That is why we concentrate on that measure.

Linda Fabiani: I seek further clarification on DEL—what the Scottish Parliament has to expend. Westminster is talking about £5 billion efficiency savings. Of course, that will mean a cut in the Scottish block grant. Do you accept that top-slicing a grant is in fact a cut and not an efficiency saving?

Jo Armstrong: We are verging on the political. The CPPR is keen to be seen to be apolitical and focused on economics, rather than worrying about terminology.

Linda Fabiani: Okay. My final question ties into what John McLaren said about an error in the press in reporting a figure of £6 billion. Did the reports in the weekend press make other errors? You were reported as commenting on the inefficient policies that had been put in place in the past two years. Will you say what inefficient policies were brought into place in the previous eight years?

John McLaren: I do not recall saying "inefficient policies". I may have talked about initiatives and policies that have been put in place over the past couple of years that may need to be reviewed, given the cuts that may have to be made. That may mean a review of policies of the past two years. I do not think that I said specifically that they were inefficient.

Linda Fabiani: I may have picked that up incorrectly. Would it be worth while to review any policies from the previous eight years?

John McLaren: Everything post-devolution has to be looked at. Certain things that happened in the past are interesting, as can be seen in some of the evidence that the committee has heard. For example, all the submissions from NHS boards mention the need for political support if they are to make the sort of rationalisations that they have attempted in the past and will probably seek to implement in future. The point relates to the debate with the public. How do politicians persuade someone that moving a facility from their back yard is the right thing to do? Obviously, the school closures in Glasgow last week are an example of that. I assume that the closures are being made as an efficiency, but they are not a popular one. Examples like that will occur more and more in future.

The Convener: I encourage objectivity, but that is not always obvious in the questions that are posed on either side.

Jeremy Purvis: I will try not to let you down, convener.

I want to come back to the scenarios on where we might be in five years' time. Am I right in understanding that scenario C is your preferred scenario?

John McLaren: Scenario C represents our attempt to apply the Barnett formula to the IFS's estimates for other departments.

Jeremy Purvis: If I read across and look at the real-terms DEL in 2013-14 in the scenario in which you apply the Barnett formula, that figure—£27.3 billion—is still higher than the actual outturn for 2007-08. Do you have a comment on that? I do not seek to deny the reality of the present budget position, but that figure still stands. That is the real-terms figure, which has been brought across.

John McLaren: The figures are all in 2008-09 terms. When we look at the preceding year, 2007-08, we have to deflate rather than inflate the figures to provide a consistent picture.

The other point goes back to what Jo Armstrong said—the context is that although spending is going down a lot, the position is not too dissimilar to what it was in 2006-07 and perhaps 2007-08. The big turnaround is that spending is not continuing to go up and up.

Jeremy Purvis: That leads me to ask whether the devolved budget will be cut. Even if we take your 2008-09 figure of £27.9 billion as a base—we are still using Treasury and Scottish Government estimates at this stage; we will not know what the outturn figures are until they are published—that includes some accelerated expenditure, which was brought forward into 2008.

Jo Armstrong: And some non-recurring EYF.

Jeremy Purvis: Indeed. If you strip out those elements, the figure is nearer £27.2 billion. It is not that there is a real-terms cut, even over the five-year period; it is just that the budget is not growing. That is not semantics. Joe FitzPatrick is laughing, but it is a significant matter if we as a Finance Committee send out the signal that there will be cuts across the board in all areas of Government expenditure, when what is happening is that the Scottish budget is not growing. Do you have any comments on that?

John McLaren: It is imperative that we are clear about what we are saying. When one uses the term "cuts", the picture looks slightly different, depending on whether one is talking about cuts in real terms or cuts in cash terms. We are saying that if we examine the real-term figures—in other words, if we strip out inflation to arrive at the Government's real spending power—and make a comparison with the peak year, which is this year, there will be between 7 and 13 per cent less money, in real terms, available to spend on services.

Jeremy Purvis: Forgive me, but I am trying to get the most accurate comparison.

John McLaren: To our mind, that is the most accurate comparison.

Jeremy Purvis: But you have not stripped out the accelerated capital from the peak period.

Jo Armstrong: It is neither here nor there to people out on the street how the amount of money that is being spent is made up.

Jeremy Purvis: No, but any constituent of mine knows that if they buy a car now, they will not have the money to buy another car in six months' time. The real comparison is with where the budget stands if the accelerated capital is not included. We all know that money has been brought down from a future year. Every household knows that if they buy a new kitchen table now, that money has been spent. They will not be shocked to find, in six months' time, that they have no money to buy a kitchen table, because they will know that they have just bought one.

John McLaren: If one were to do the opposite of what we have done, one would say that the £0.5 billion or so that was drawn down from the Treasury this year or last year, and which has been spent, will not be available to spend next year. The true comparison is, as it were, what you got in your wage plus your bonus versus what you are going to get next year—if you are not getting a bonus, you will still have a reduction in how much money you will have to spend.

15:15

Jeremy Purvis: Yes, but my point is that you do not compare spending in five years' time with the situation after the accelerated spend is included—you compare it with the situation immediately before that. That is how you get an accurate trend for the Scottish budget. Taking a peak year, in which money was deliberately drawn down to be spent straight away in the knowledge that it could not be spent in the next budget, is an artificial basis on which to look at a trend.

John McLaren: I would agree with you if that one-off money were spent on a one-off project. However, if that one-off money were spent on, say, the NHS drugs bill, which would continue to require funding, that money would not be there in future years.

Jeremy Purvis: This is not accelerated revenue; this is accelerated capital, so we can say that the money was drawn down specifically into these—

John McLaren: That is fine. However, that has an implication for how much capital there will be to spend on bridges, roads and rail in the future. That is reflected in the figures here.

The Convener: This is tending towards debate. Perspective is all. Derek Brownlee has a quick question.

Derek Brownlee: Just to get some clarity. Whichever of the scenarios you are talking about—I appreciate the uncertainties that exist—the range of £2.1 billion to £3.8 billion for the real-terms decline from 2009-10 to 2013-14 assumes that GDP growth and interest costs are as the Treasury has forecast. If the Treasury has erred on the side of pessimism, which is not what most people suggest, the scenario may not be quite so bleak. However, if it has erred on the side of optimism, if there are not further reductions in spending there will have to be slippage somewhere else, whether in total debt or in spending in non-devolved services.

Jo Armstrong: Yes.

John McLaren: We will move from scenario C to scenario A if things do not turn out as well as the Treasury has predicted in the budget. That is correct.

The Convener: I think that I stopped Jo Armstrong from completing her answer to the previous question. Do you wish to do so now?

Jo Armstrong: My point is about the use and abuse of statistics. The purpose of our exercise here is to show the cash and real-terms cuts in what we are currently spending and what people are currently experiencing in the public sector. Jeremy Purvis is absolutely right. If you wanted to produce something else to show something else, you could use the numbers in a slightly different way. The purpose of our exercise was to show the cash effects and the changes that are likely to be experienced over the next five years—not worrying about the baseline.

The Convener: I will draw this section to a close by referring back to the idea of an independent budget office. What would the public scrutiny process look like? Audit Scotland does a tremendous job after the event. It comes in, looks at the wreckage, cleans it up, cures it and sends it back to work for the public. That comes at the end of the process. However, surely, the independent budget office would assess projects before they commenced and would assess their delivery during the process. What size would the budget office have to be, and what range of skills would it require?

Jo Armstrong: That is almost like asking, "How long is a piece of string?" It would depend on how far and how fast you wanted the office to go and what level of scrutiny you expected it to have. The work that a lot of people do currently within the organisation would continue to be done and it would not be a case of everybody being new. If they were in a separate office, however, they would have a slightly different mindset and a slightly different objective would be set for them. There would also be a different form of management for them.

The additional evidence would not have to be provided in-house; the office could still use external support to provide that evidence. However, the challenge function would need to be in-house. I would not like to put a number on how many people that would involve. The office would not have to be an enormous beast to make the process work more efficiently and effectively than it does at the moment. For example, the Water Industry Commission is a relatively small beast for a relatively large chunk of spending. The budget office could be built up slowly and carefully on the back of what is already being done across the organisation, but that would be corralled within a central, independent office.

The Convener: It is just that the piece of string has to be staffed, paid for and given administration. It would be useful to get an idea of what the beast would look like. Nevertheless, I take your point.

John McLaren: This is a few years old now—I think that it dates back to 1999—but there is a publication by the National Institute of Economic and Social Research that looks at how different countries managed the process at both federal and national levels. It contains some interesting examples, which show that there are a number of different ways in which that can be done.

Like the Council of Economic Advisers, the budget office could be set up to be largely run by civil servants or it could be set up as in the American system, where it is led by some of the top economists in the country, who have at their disposal their own researchers and stuff like that, meaning that they do a lot more of their own work. It depends on how, politically, you want it to work.

The Convener: There are no further questions. I thank you for your written evidence and for your attendance here today, which has been very helpful to the committee. We will take a two-minute break.

15:21

Meeting suspended.

15:25

On resuming—

The Convener: I welcome to the committee our second panel of witnesses: John Aldridge, former director of finance at the Scottish Executive; Stella Manzie, director general finance and corporate services at the Scottish Government; and Jenny Stewart, head of infrastructure and government with KPMG, who was also involved in the Howat report on public spending.

I invite short opening statements.

Jenny Stewart (KPMG): As introduced, I am the head of infrastructure and government for Scotland at KPMG, but I also have a wider role within our UK public sector leadership team. I was also a member of the Howat review, which, as you know, Tom McCabe commissioned and John Swinney subsequently published.

KPMG has been actively involved in supporting the public sector to transform its services through reducing costs or improving efficiency, so we have been at the sharp end of delivering some of the savings. I was actively involved in the creation of Scottish Water some time ago so, if the committee wants to pick up on that, I would be happy to talk about it. We have been working across the public sector with, for example, the NHS, police forces and local and central Government, so we have a feel for what efficiency savings—or cuts, depending on how one likes to identify them—are possible.

We have had the budget statement, and things are worse than they were, but significant efficiency savings can be driven out of public services by transforming how they are delivered. A more flexible approach to pay would certainly make some savings, so one should not automatically assume that a budget cut equals X number of redundancies. Cuts can be flexible.

Clearly, difficult political choices have to be made on whether some services that we provide can continue to be provided free at the point of use to everyone in the population, as opposed to taking a more targeted approach. I am thankful that those are choices for members rather than me.

The final question to consider is whether the public sector should deliver absolutely everything or whether there is scope for putting certain services out into the private sector with the public sector rightfully retaining its interest by commissioning and regulating them. I have already mentioned Scottish Water, and other services fall into that category.

Those are the key themes. I am interested in the independent budget office that was proposed earlier. It is not a new concept, as everyone said. Indeed, in the Howat report I think that we called it the challenge function. The proposal has been around for a little while. As I read the other submissions—which were all strong—it was great to see a consensus emerging on some of the matters that could be considered.

Stella Manzie (Scottish Government Director General Finance and Corporate Services): I welcome the opportunity to respond to the committee's questions on the Scottish Government's spending plans for 2010-11 in light of developments, including last week's budget, since plans were first published.

The Scottish Government first set out spending plans for 2010-11 in autumn 2007, following the UK Government's comprehensive spending review, which covered the three years from 2008-09. The financial settlement that was reached then was the tightest since devolution. Commenting on the outcome, the Scottish Government stated that, in the next three years—meaning from 2008-09 onwards—

"real growth for essential public services will be only 0.5 per cent in 2008-09, 1.6 per cent in 2009-10 and 2.3 per cent in 2010-11—an average of 1.4 per cent."

15:30

The chancellor's pre-budget report last November indicated that, in response to recessionary pressures, the UK Government had decided to accelerate capital spending from 2010-11 into 2008-09 and 2009-10. Ministers in Scotland endorsed that. As a result, a total of £347 million in planned capital spending in Scotland was drawn forward into 2008-09 and 2009-10, which is helping to support the economy and jobs. However, it implies a reduction in planned spending in the final year. The PBR also signalled additional efficiency savings in Whitehall of £5 billion in 2010-11 and a reduction of £1.3 billion in the Department of Health's capital baseline in that year. The consequentials for Scotland arising from those two significant changes were estimated at £380 million for the efficiency savings reduction and £129 million for the capital reduction.

Last week's budget confirmed that the negative consequentials for Scotland will in fact be £392 million plus the £129 million capital reduction, which will be partly offset by about £25 million of additional money for Scotland. Our baseline for 2010-11 will therefore be reduced below original plans by £496 million. The Treasury has indicated that it will allow us to use accumulated end-year balances up to the end of 2009-10 to offset the impact of the £129 million reduction arising from the Department of Health baseline reduction. However, that will mean that those balances will be unavailable for other purposes, such as major capital projects, in the future.

The overall effect of the changes is that the Scottish Government will need to reduce spending plans for 2010-11 below the levels that were envisaged originally. In comparison with the restated spending totals for 2009-10, plans for 2010-11 will be roughly at the same level in cash terms. That will be generated by significant reductions in capital spending power that are partly attributable to the effects of capital acceleration, offset by an increase of about £700 million in resource spending. Overall, there will be a reduction in real terms of 1 per cent.

To conclude, there are two important qualifications. First, depending on how events unfold, it is not impossible that the 2010-11 spending totals will be revisited. If that were to happen, our prediction is that any change would be downwards rather than upwards. Secondly, 2010-11 is not an isolated year: as we have heard, it is the first year of a period of real-terms shrinkage in public spending that will last for several years and possibly as far as the end of the next decade. Certainly, as has just been discussed, according to Treasury figures, the period will last until 2013-14, when the UK's public debt is projected to stand at 76 per cent of GDP. Over the period to 2013-14, there will be real-terms reductions in DEL spending, excluding debt service payments and unemployment-related expenditures and transfers, of at least 2.3 per cent annually.

Responding to that will require significant consideration of plans and activities and represents a major challenge throughout the UK and, of course, to us in Scotland. The biggest challenge is how the Scottish Government and its partners in the public sector can support economic recovery while maintaining decent-quality public services in the long term. As the committee knows, key decisions on public spending priorities are for ministers; our role as civil servants is to advise and, where necessary, provide a challenge and review function across Government. As members will imagine, work on the advice is well in hand, but it is by no means complete, given its complexity and importance. I am happy to answer any questions.

John Aldridge: I thank the committee for the invitation to join you. As the convener said when he introduced me, I was finance director of the Scottish Executive until about four years ago. My knowledge of the workings in Government is a bit out of date, but in my time there budgets had to be balanced and difficult decisions had to be taken. One initiative that I played a part in was the development of the e-procurement system, which has shown how big changes can produce large efficiency savings. I understand that the system is now seen as a model throughout the world and is being adopted by other countries. That shows what can be done.

I have two further points. First, the change that we will experience in the next few years in the pattern of public spending that we have been used to since devolution will pose difficulties, but it is also an opportunity to take on some of the vested interests and tackle some of the sacred cows, as was said earlier.

Secondly, like Jenny Stewart, I am attracted to the idea of an independent budget office. The Cabinet Secretary for Finance and Sustainable Growth and finance ministers in the previous Administration expressed frustration at the difficult positions in which they found themselves when they had to challenge themselves on items of spending.

The Convener: Self-challenging can be challenging.

The 2010-11 budget will be a major watershed. The challenge will be to maximise financial resources within tight budgets, which will be difficult. Why are publicly funded projects notorious for being delivered late and over budget? I am thinking of the Parliament building, for example—I will not mention trams. The problem is not new and is continuing. Perhaps a budget office would be able to consider the problem. Why does it happen?

Stella Manzie: It is important to say that it does not happen all the time. In recent times, project management issues in Government have increasingly come to the fore. Project and programme management have a far greater profile than they used to, in a range of Government circles, and much attention is being given to improving skills. Much work has been done on training and development and people are much more conscious of risk management. There is a much stronger focus on risk registers and on considering which projects and programmes are likely to attract greater risk. I hope that that greater focus will increase the efficiency and effectiveness of delivery.

The Convener: I am still hurting from my time on the Scottish Parliamentary Corporate Body, when the Parliament building was being constructed. It seems that any leakage of money will badly affect everyone at a time when the budget is very tight.

Jenny Stewart: In my experience of running infrastructure projects in the private sector, the essential element seems to be how the contract is structured and whether it allows the project to be delivered on time and on budget. The evidence from numerous studies suggests that the public sector has not traditionally been great at delivering on time and on budget. I have not read the most recent Audit Scotland report on the issue, which I think confirmed that although the situation has got a bit better it is still not great.

Public-private partnerships have a better record, as I think I said when I gave evidence to the committee previously. In the previous scenario, the tendency was for 80 per cent of public projects not to be delivered on time and on budget, whereas the opposite was the case under PFI/PPP projects—80 per cent of them were delivered on time and on budget. That is to do with the contractual structures and incentives to deliver. It is clear that PFI and PPP have attracted much attention recently. The question is how we structure the contract if there is not to be a PFI/PPP-type structure. Can we develop a contractual structure that takes the best of the PFI/PPP approach, to drive delivery on time and on budget?

The most recent project that I was involved with was the M80. We advised Transport Scotland on the deal, which was signed in January—that was a major triumph in the current environment. I hope that the project is running on time and on budget. Diggers were on site two days after the deal was signed and I hope that jobs are being created and that work is well and truly in hand.

The Convener: I am cheered up by the phrase

“on time and on budget”.

John Aldridge: I echo what Jenny Stewart said. I agree that PFI and PPP arrangements have been controversial. Nevertheless, I was around when the concept was introduced, and an intention behind it was to bring more discipline into public sector contracting. The PFI process required that the public sector body that wanted the service or building should clearly specify what it wanted before the contract was signed, which had not always been the case in publicly procured contracts. That experience with PFI/PPP has spilled over into publicly financed projects, which is why the record on such projects is getting a bit better, although there is still a long way to go.

Derek Brownlee: My first question is for Stella Manzie and is quite specific. We all understand that, whatever the risk to public spending over the next few years, a significant chunk of public spending is tied up in salaries and wages. Can you give us a specific departmental expenditure limit figure related to wages?

Stella Manzie: I can, but not immediately. We have a three-year pay settlement for central Government staff, although that does not include senior-level staff. The majority of public sector pay does not relate to the civil service—a large part relates to the NHS, local government and so on. Public sector pay is the major element of our expenditure. Funding is used to pay salaries, but those salaries are all about providing services. Generally, it is suggested that about 70 per cent of public spending relates to salaries.

Derek Brownlee: Does the figure of roughly 70 per cent relate to salaries only or to salaries and other costs such as pensions and national insurance that we tend to think of as salary related?

Stella Manzie: It depends on how we define it. We must also take into consideration annually managed expenditure budgets, in which some of the costs are tied up.

Derek Brownlee: I do not want to tie up matters too much today, but it would be helpful if greater detail on such spending were provided. As well as being a significant element of spending, it is politically sensitive and will raise some issues for us.

My next question, which is more general, is addressed first to Jenny Stewart, although other witnesses may want to comment. In my view, the remit of the Howat review was a bit constrained. I cannot remember the exact remit, but I have a vague memory that, effectively, it protected spending lines that related to the partnership agreement that was in place at the time. Is there merit in having a Howat 2 study? If so, what lessons would it be worth our learning, when setting its remit, from the first Howat review on the obstacles that may exist?

Jenny Stewart: I will explain the original remit of the Howat review. We were asked to look at ministerial priorities and to assess the extent to which the Scottish Executive budget at the time was allocated to those priorities and whether there was scope to adjust spending.

The premise of the review was that there might be large pockets of spending that was not related to strategic priorities, but we found that the partnership agreement contained a large number of commitments—I cannot remember the figure, but it was about 129—and when we delved into individual budget lines, it was relatively easy to say that they met one priority or another.

The move under the current Administration to focus on outcomes is welcome and was strongly supported by the Howat review. However, if we were to assess each budget line on the basis of whether it related to a particular strategic outcome, we would be able to say that most budget lines contributed to our being healthier, greener, fairer and so on.

We looked at how effective some of the budget lines were. As I have explained to the committee before, the difficulty was that in many cases independent evaluation of what we were getting for our money was limited. I echo Jo Armstrong's earlier remarks about the need to improve the evidence base in that regard; that is one of the review's key lessons.

In a tougher economic climate, when significant choices have to be made about how we spend our money, it is important to spend it on the most effective measures and on what will deliver front-line services. There is work to be done around that. The first thing is to get the evidence base right and find a way of assessing priorities that will allow ministers to take a view on them.

15:45

We were brought in to do quite a high-level review. As a consultant, I would have loved to have a team of analysts to whom I could say, "Crawl over this. Crawl over that. Do me an analysis of this." Of necessity, the work was a challenge and it was about asking the searching questions. However, we still came up with areas—line by line—where choices could be made. We were clear that we were only putting forward the options and that it was for politicians to take a view on them.

We looked at pay and pensions. There was a feeling among some members of the Howat review group that there was a lot of spending on pay and it was somehow cast in stone. A large number of our members were local authority chief executives, and there was a feeling that because most public sector organisations have a no compulsory redundancies policy, we could have only a limited effect on the whole area. Coming from the private sector, I think that we can now be more flexible than we have been. My organisation has developed a flexible approach to pay and reward. As I mentioned in my evidence, there are options for managing the pay bill without going through massive redundancies.

Some of my public sector clients are tied into multiyear pay deals. The retail prices index is sitting at -0.4 per cent and the consumer prices index is sitting at 2.9 per cent, and public sector chief executives might be facing pay going up by 3 to 4 per cent. Whatever debate we have about whether there is a cut, it certainly feels like there is a cut to the chief executive who has that constraint. Pay budgets might have to be renegotiated or people might have to go on flexible working hours or whatever. There are options; the picture is not black and white.

Stella Manzie: At the moment, in addition to looking at the general contribution that the public sector makes, we must also be concerned about its contribution to the economy. At a time of economic downturn and potential redundancies, there is a difficult balance to be struck in relation to how public sector pay is looked at and how it can act as a force for good in stimulating the economy.

Jenny Stewart: Absolutely. That is why we must look at alternative measures. Now is not the time for wholesale redundancies in the public sector. A bit of sharing of the pain across the public sector might be a way forward.

We have not really touched on pensions. We had a debate on the difference between DEL and annually managed expenditure. A large part of that difference is around pensions, which are more difficult to control. Whatever we give in pay now is going to impact on the people who are retiring next year and each year thereafter. There is a correlation with the impact on public spending. In these tight times, the more that is soaked up in annually managed expenditure—social security payments, pensions and so on—the less that is available for departmental expenditure. External economics commentators have said that if the chancellor's annually managed expenditure forecasts end up being too optimistic, departmental expenditure will take the hit in future years.

Jeremy Purvis: I have a question for Ms Manzie on something that she said. I think she said that, for the coming year, there will be a real-terms cut in the budget of 1 per cent. Is that correct?

Stella Manzie: For 2010-11, there will be a real-terms cut of 1 per cent.

Jeremy Purvis: Would there have been a real-terms cut if the Scottish Government had not accelerated capital expenditure?

Stella Manzie: If there had been no acceleration of capital expenditure, and if the £347 million had remained in the 2010-11 budget—with the applied GDP deflator and so on—there would have been a real-terms increase of 1.7 per cent.

Jeremy Purvis: My question was quite specific, regarding the acceleration of capital expenditure. I did not ask about the £380 million of efficiencies. I asked whether there would still be a real-terms cut if the Scottish Government had not accelerated the expenditure that it did.

Stella Manzie: I am sorry—the figure was £347 million of capital expenditure; I was not referring to efficiencies.

Jeremy Purvis: So if the Scottish Government had not accelerated the capital, there would not be a real-terms cut.

Stella Manzie: Let us be clear: if the capital within the 2010-11 budget had not been brought forward in the way that it has been, there would have been a 1.7 per cent increase.

Jeremy Purvis: I was interested to note how clear the First Minister was in his language last week. I will quote from the *Official Report*. He said:

"Next year, it will be £29.3 billion."

That is the departmental expenditure limit.

"In real terms, that will be the first cut in the Scottish budget since the Tory years. In real terms, next year's figure will be £28.8 billion."—[*Official Report*, 23 April 2009; c 16717.]

That

"first cut … since the Tory years"

is therefore the result of decisions that the Scottish Government has taken.

Stella Manzie: Clearly, I would rather not get into an overtly political discussion.

Jeremy Purvis: I appreciate that.

Stella Manzie: That would be tricky. I re-emphasise—and I think that this was the figure that the First Minister quoted—that, in the circumstances that we are in now, with the accelerated capital expenditure that was made available by the UK Government but endorsed and taken up by the Scottish Government, the result is a 1 per cent real-terms cut in 2010-11.

Jeremy Purvis: I appreciate what you have said; that is why I was careful to ask about the official basis. The Scottish Government asked for the ability to accelerate the capital, and it made the decision to do so. I am not questioning the motives, but the terminology and the messages are important. You are on the record—which is very helpful—as saying that, if that capital had not been accelerated, there would have been real-terms growth in next year's budget.

The Convener: We have had the answer. It is not fair to draw an official into these deeper waters. You have other ways of expressing the point.

Jeremy Purvis: We will be able to review the record of the answer that has been given. The point is about what is defined as the baseline from which the Scottish Government will take forward its plans and what it will say to the remainder of the public sector and others. As we proceed, it is important to have a clear basis.

Stella Manzie: As was the case in the previous session, the discussion about where we take our baseline from is always open to debate. Clearly, we are looking from the past—that is, 2008-09 onwards. The critical point for us is that our budgets are set for this year, 2009-10. The question is how we proceed into 2010-11. We have examined budgets overall between 2008-09 and 2010-11. We must now look beyond that period as we project forward. The harder information is going into 2010-11. Moving forward into 2011-12 and on to 2013-14 takes us further into areas of uncertainty.

Jeremy Purvis: When local authorities and colleges, for example, accelerate capital expenditure, what will they use as their baseline when they ask for funding from the Scottish Government? What will be used when the Scottish Government sets its budgets in future?

Stella Manzie: I assume that they will look at similar baselines to the one that I have discussed, in alignment with the Treasury red book and knowable amounts based on it. All the figures that I quoted in my opening statement and so on are based on the figures in the Treasury red book.

Jeremy Purvis: At the moment, as all bodies are setting their forward plans, the Scottish Government is taking its baseline as 2009-10. I think that you said that the on-going baseline for 2010-11 is below that envisaged in the original plans.

Colleges, universities and local authorities have accelerated capital in their budgets this year. They would be justified in doing exactly what the Scottish Government has done with regard to the baseline for their 2010-11 budgets. Is that correct?

Stella Manzie: If I understand the direction of your question correctly, I should say that, clearly, in 2010-11 there will be a reduction in capital from the amount that is available in 2009-10, for the reasons that we have discussed. Any of the forward projections of those bodies in relation to capital will have to be based on their knowledge of the accelerated capital and on an understanding of the capital that is likely to come through in 2010-11. Obviously, although we can make projections, we cannot be absolutely certain about what will happen in subsequent years.

Jeremy Purvis: In the coming years, colleges, universities and councils across Scotland that have been specifically asked by the Scottish Government to accelerate capital expenditure—councils were asked to do so with regard to schools and houses in particular—will use 2009-10 as a baseline. They will be able to argue that their budgets have been cut considerably by the

Scottish Government, and the Government will say, "No, you accelerated your spending; you knew that that money was coming out of your on-going budgets." That will be the case because, in your opening remarks, you told us that you are now taking 2009-10 as the peak.

The Convener: I suggest that that is more a question for the minister.

Jeremy Purvis: I am just wondering what the remainder of the public services are going to be told by the Scottish Government at an official level.

The Convener: You could ask the Scottish Government that question.

Stella Manzie: I can provide a general, non-political response.

There has been extensive discussion about the impact of the recession on public finances and about the recent budget. Prior to that, wide-ranging information was issued about the acceleration of capital. Scottish colleges and universities will, therefore, be aware of the public-finance context of the capital that they have received, and the responsibility for that will lie in their hands.

Jeremy Purvis: At an official level, the Scottish Government has told the remainder of the public services not to baseline this accelerated money. Is that correct?

Stella Manzie: The issue is that we have been given the opportunity to accelerate the capital. What is not clear, from a Treasury point of view, is whether that capital will be, if you like, replaced in the system and from what baseline the Treasury will operate.

Jeremy Purvis: I asked whether the Scottish Government has told the remainder of the public services in Scotland—colleges, councils and so on—not to baseline the accelerated capital. Has it done that?

Stella Manzie: The Scottish Government has been perfectly open about the financial projections that are available and about the dynamics around the accelerated capital. It has made it clear that it is trying to boost the economy and wants to work with its partners across the public sector to do that. I do not think that anything is hidden in that regard.

Jenny Stewart: I have a comment that is certainly not political and simply focuses on the numbers. The red book gave the capital expenditure figures for the Scottish Government as £3.3 billion for 2008-09, £3.7 billion for this year and £3.2 billion for 2010-11. My query is whether, if we are still in recession at the beginning of 2010-11, it will be right in effect to reduce capital spending at that time. In cash terms, going from £3.3 billion in 2008 to £3.2 billion in 2010-11 is clearly a real-terms reduction. If the economy does not bounce straight back out of recession, should politicians look again at the split between capital and revenue at that stage? The committee might want to return to that issue as economic circumstances develop.

16:00

Stella Manzie: I will add a little footnote, which is simply that the word "acceleration" indicates that the money is being moved from elsewhere and moved up the system. Eventually, later on in the plans, that will mean that the money is not available, because it has been moved forward.

James Kelly: If I heard Stella Manzie correctly, she said that there will be real-terms reductions in DEL spending from 2011-12 onwards. If that is the case, do you dispute the Treasury statement last week that there will be public spending growth of 0.7 per cent from 2011-12?

Stella Manzie: From our projections, and given the way in which we apply the GDP deflator, it seems as though there will be real-terms reductions in Scotland. The growth to which the Treasury referred relates to TME, rather than DEL. The projections for DEL are for figures of -3.3 per cent in 2011-12, the same again in 2012-13 and potentially -3 per cent in 2013-14.

James Kelly: We had a statement from the Treasury last week that there will be 0.7 per cent growth in real terms. Although that growth will be slower than the growth that we have experienced previously, it is real-terms growth. It does not seem a logical follow-on that there will be a reduction in spending.

Stella Manzie: The difficulty is that it depends on which figures are used and the extent to which the GDP deflator and the various components of the figures are applied. If the figure is calculated in a certain way, it will come to 0.7 per cent. However, we are clear that there will be a decrease rather than an increase in real terms, and that has been substantiated by people other than those in the Government.

James Kelly: My second question is for Jenny Stewart. In your submission, you express surprise that the Skills Development Scotland budget has been cut at a time of recession. Do you see that as a priority area and one that could stimulate future economic growth?

Jenny Stewart: On what the Scottish Government can do to mitigate the effects of the recession in general, as has been discussed, there is acceleration in capital spend, which supports jobs. The other matter that is in the Scottish Government's control is the skills agenda.

I do not know the details on Skills Development Scotland but, from looking through the budget lines, it seemed that, in the midst of a recession, the Scottish Government would want to put money into that. I know that the Scottish Further and Higher Education Funding Council has given extra funding to further education colleges for the skills agenda. I simply thought that that issue might be worth investigating further.

I will pick up the point about the 0.7 per cent increase and try to hammer home the difference between aggregate managed expenditure and DEL. I understand that the 0.7 per cent increase relates to aggregate managed expenditure, which is the whole thing, including pensions and social security payments. If those items are stripped out, Scottish DEL is reducing—as Stella Manzie said—as is that of other Government departments.

John Aldridge: I reinforce what Jenny Stewart said. We are talking about three totals: total managed expenditure is a combination of annually managed expenditure and the departmental expenditure limit. The titles give the explanation. Annually managed expenditure is managed annually because it is very variable. It includes spending on matters such as social security and debt interest, at the UK level. Those totals will increase substantially in coming years, because of the recession. It appears that that will eat up the real-terms growth in public spending that the chancellor announced.

The Convener: I encourage committee members to move on, because we have many topics to cover.

Are the effects of the recession on the budgets of the Scottish Government and the bodies that it funds becoming evident? What analysis has the Government made of the scope for savings from reductions in inflation? What effect—if any—does weaker national insurance contribution income have on the Scottish budget? What are the recession's general effects?

Stella Manzie: It is clear that one critical effect of the recession has been a slowing in the realisation of capital receipts, which have been a component of capital that has been available to a number of public sector organisations. That is a direct impact.

Some budgets on which the recession has an impact, such as those that relate to unemployment, are for reserved issues. That means that the Scottish budget is not directly affected, although the impact on the total UK budget is clear.

Even before the recession had an impact, the Scottish Government was looking for efficiency savings, which the committee has discussed. We have made significant efficiency savings, particularly in areas such as procurement. We have tried to ensure that we drive out those efficiency amounts. You asked what effect the recession will have. Clearly, we will look even more closely at areas for efficiency; we will drive forward on shared services, for example, and try to take a leadership role on procurement—as we have done through the public procurement reform board—to ensure that the maximum money is available to support the skills agenda, to which committee members have just referred, and to support all aspects of business.

We in the Scottish Government have tried to redirect some of our mainstream funding in such a direction and to ensure that our range of policies—officials have examined them throughout the Government—points in the right direction to assist people in dealing with difficulties of the economic downturn. An example of that, which has been well discussed, is the planning reform agenda—the rate at which planning applications with written submissions are coming through has now increased significantly.

We have tried to bend the existing budget in the direction of supporting initiatives to combat the economic downturn. The overall pressures on public expenditure that we will experience are a result—whether directly or indirectly—of some of the problems in the economy overall. It is clear that that will have an impact on the amount of public finance that is available, but we will handle that in an orderly and managed way.

John Aldridge: You asked about the effect of inflation reductions on services in the Government's programme. It is worth bearing it in mind that different services experience different levels of inflation. Historically, the health service has always experienced higher inflation to provide its service than some other public services have experienced. Although national inflation rates—the RPI and the CPI—have reduced a lot, that will not necessarily have the same effect on every service.

I do not know whether the higher inflation rate that the health service experiences is a necessary fact or a function of the fact that the health service has received above-average increases in public spending from year to year. I do not know whether anyone has ever looked into that, but the topic might be worth thinking about.

The Convener: Will you give the committee an idea of the cost pressures that the Scottish Government faces currently or in the longer term?

Stella Manzie: Do you mean the overall cost pressures?

The Convener: Yes. For example, are the increases in employers national insurance and the effect of public sector pay, minimum wage commitments and multiyear pay deals more substantial now than the fluctuations that normally have to be dealt with in any budget planning?

Stella Manzie: Most of those are part of the normal totals that we would consider at this time of year in preparation for advising ministers on the budget that they will publish later in the year. Clearly, we always have to assess profiles of expenditure from a variety of sources and, as the forthcoming budget approaches, it is likely that ministers will wish to consider the elements of the budget that are focused on the economy, because that is a major issue.

Cost pressures in general come from a variety of sources across the board and we need to consider them in balance. They vary according to whether we are talking about health, local government or another area of expenditure. The concordat with local government, the council tax freeze and our continuing partnership with local government through the single outcome agreements have given us greater stability in that budget area, with on-going negotiation and dialogue. We will review the budgets across the board in the normal way.

The Convener: Could I be permitted to ask for your comments on the practicalities and implications of making cuts and savings and the different approaches that can be taken on that?

Stella Manzie: It is too early to comment much on that. We want to continue to focus on efficiencies. A great deal of good work has been done on those. For example, between 2005 and 2008, the Scottish public sector achieved efficiency savings of £1.74 billion against a target of £1.5 billion, going over the target by about 16 per cent. That is where we want to continue many of the drivers. We have identified that there will be significant problems beyond 2010-11, but that will clearly be a longer-term discussion. At this stage, a great deal of work is going on to consider the options, but it is too early to consider using the word "cuts". We will clearly need to make savings, but we would like to focus them on efficiencies as far as we possibly can.

Linda Fabiani: I have a short question—a different question—for each witness, starting with Jenny Stewart. I found interesting the paragraph in her submission that concerned defining the role of the public sector differently. She proposes moving social care from councils to the private sector

"if this was acceptable politically".

That is the big question. Is she aware, for instance, of the recent reports about South Lanarkshire Council's privatisation of care, which resulted in an exposé in the "Panorama" programme?

Following on from David Whitton's questions, I am particularly interested in what Jenny Stewart says about Scottish Water. It has been recognised that Scottish Water was a fairly inefficient, monolithic organisation, so how can we measure the success of something that becomes efficient from such a baseline of inefficiency? What is her professional opinion about whether, in a recession, mutualisation of Scottish Water would still be viable and would raise the level of money that her submission states it would? She also says that it is a model that should be considered for other areas. What other areas does she have in mind?

16:15

Jenny Stewart: There were several parts to your question. I will try to pick up on each one. On social care, the key point is how we define the public sector interest. It is possible to transfer services into the private sector while retaining strong public sector control over the definition and regulation of services. Glasgow City Council's model is interesting in that regard.

I have not read the reports about South Lanarkshire Council, but I know that the provision of home care is controversial. However, when we consider the statistics by local authority area, it is clear that outsourcing is prevalent throughout Scotland. I am sure that there is good and bad performance. What is important is that there should be strong regulation and high-quality services—no one would argue for a diminution in quality. It is about considering other options. The cost differential between the two models is quite significant and is to do with not necessarily what individual home carers are paid, but the management overheads that a local authority charges, which a private sector operator would not charge.

Scottish Water has made massive operational and capital efficiencies. Average water bills are about £310, which is well in the lower quartile in the United Kingdom. When the organisation was established in 2002, the average bill was in the upper quartile, although, as I recall, Scottish Water was not a massively inefficient outlier that needed to be brought into the fold. It is interesting to consider how Scottish Water achieved its efficiencies.

The model that I am talking about in the context of Scottish Water is the presence of a regulator who can push down price. We could consider extending that model. In the NHS, for example, there is no price at the point of use, but there might be a role for an independent regulator in considering a proxy for such a measure. Audit Scotland does its work after the event, as the convener said, but more could be done in advance. It would be worth investigating whether the regulatory model could drive up standards in public services, which we are all striving to do.

An impact of the current economic situation is that the volume of my clients' demands is increasing—the committee heard about that. Public sector workers will absorb those demands and productivity will increase de facto. A big problem for the Scottish economy in recent years has been that productivity in the public and private sectors has lagged behind that of our competitors.

Now is the time to start considering how we transform services. It is easy to draw up a list of potential efficiency savings—perhaps it is not easy, but it can be done—but the real difficulty lies in implementation. If we started now and identified £1 billion of efficiency savings, within 18 months we would have delivered only £200 million, because some ideas would have proved impractical or difficult to deliver and so on. It is about starting now and considering what we can do differently, to transform how we deliver services. For example, local authorities need to consider and transform how they communicate with citizens. John Aldridge mentioned procurement. KPMG advised the Government on the setting up of Procurement Scotland, which is a step in the right direction, but much more can be done.

I think that I have answered all your questions.

Linda Fabiani: I asked whether mutualisation is a goer in the current climate.

Jenny Stewart: The capital markets are pretty much seized up. Therefore, if Scottish Water suddenly looked to place a large bond in them in the current climate, that would not happen.

We have talked about the length of time that we will be in the mire. The next 18 months could be spent on considering the options, working out how to do things and getting the necessary legislation through, if that was politically acceptable. The capital markets would have recovered by the time that that was done, and getting them on the up would be a good time to act.

Linda Fabiani: I have a question for John Aldridge. You are the only person who mentioned in their submission the possibility of using the Scottish variable rate.

John Aldridge: Yes.

Linda Fabiani: We have experience in the Parliament of policies that the Scottish Government has implemented and which have had an effect on our block grant income from the UK Government. I refer to the total managed expenditure that is not DEL. Have you seen anything in the Scotland Act 1998, or in any of the concordats that govern such matters, that suggests that if the Scottish variable rate is used to increase or decrease income tax, it could have any effect on the level of the block grant that is not DEL?

John Aldridge: I understand that if the Scottish variable rate is used, the block grant will be either increased or decreased. As my submission says,

"each 1p increase has been estimated to raise some £380 million."

Changing the Scottish variable rate will have an effect on the block grant. There will not be a double bonus. One cannot cut the Scottish variable rate and then hold on to the same level of grant.

Linda Fabiani: If the Scottish variable rate is used to increase income tax, could that reduce the block grant outwith DEL?

John Aldridge: It should not do so. I cannot see any reason why it should.

I want to pick up on a point that was made about efficiencies, which Jenny Stewart discussed. When we talk about efficiency savings, we tend to say that we need to consider efficiency savings that do not affect front-line services. That is not necessarily always essential. Important efficiency savings have been made in front-line services that have had no detriment to the public good. An example that springs to mind is the developments in cataract surgery in hospitals. Twenty years ago, a person would stay in hospital for around a week after they had had a cataract operation. People used up hospital beds and resources. Now, people go into hospital in the morning and go home at teatime. The patients are happier, the outcomes are just as good, and there are large savings to public funds.

Linda Fabiani: It is nice to hear something positive.

I have a brief question for Stella Manzie about the independent budget office. I think that you were here when I asked about whether the independent budget office proposal had been considered or mooted since 1999. Has any work been done on that in your department over the years?

Stella Manzie: I am a relative newcomer to the Scottish Government, so I do not have the historic memory to answer that. However, I will give some reflections on the matter, as I have experience of being involved with the Treasury in the south before I came here.

Any structure that is put together in any situation, particularly in the situation that we are discussing, has advantages and disadvantages. There are people who would argue for an independent budget office and there are people who would say that there are advantages in those who look after the money not being too far away from the reality of how that money is spent. In the south, the Treasury clearly has a specific role.

There are those who would say that there are other ways of undertaking that challenge function. I would say that people underestimate the extent of everyday challenge in Government. Those people who have been ministers know that ministers challenge officials. Challenge comes from a variety of points within the official structure, whether it is at a senior level within the Scottish Government, from specific experts or from the finance function.

It would be wrong to suggest that no challenge comes from the finance function now. We have a public service reform group that is very focused on efficiencies and which works with partners across the public sector very closely to try to bring forward some of that challenge; we also have committees such as this one, the Parliament, and Audit Scotland. Challenge comes from a variety of places, but it would be false to take the view that there is no challenge within Government—I assure the committee that there is.

David Whitton: I will start with Mr Aldridge, now that he is a retired gamekeeper. He made a number of recommendations in his paper. If he were in the position that Ms Manzie is in, what would he say to the minister? Would he suggest targeted cuts, reductions in wages and pensions, increased user charges, the introduction of means testing on many universal benefits, or a combination of all of those?

John Aldridge: Because of the position that we are in, I would advise the minister to consider all the options and not to rule anything out at this stage. Some things will be ruled out because, as I mentioned, there are contractual and legal commitments and not much can be done about that. Other items will have a high political profile and be very important to the Scottish Government so, perfectly correctly, for political reasons it will not want to touch those. Apart from that, as I said in my opening statement, at a time of particular difficulty there is an opportunity to challenge vested interests and sacred cows.

David Whitton: I think that it was Ms Stewart in her paper who spoke about wages in particular being tied into current agreements. Would you recommend, instead of tearing up the agreement, sitting down and renegotiating?

John Aldridge: Possibly, and possibly doing the kind of thing that Jenny Stewart spoke about: considering encouraging people to change the terms of their employment so that they work shorter hours or job share—rather than the option of all or nothing, of either working full-time or being sacked.

David Whitton: But, as you said, nothing ruled in or out.

John Aldridge: I would advise ruling nothing in or out.

David Whitton: Ms Manzie spoke about what the reduction in the budget would be. I think that you said that it would be £392 million plus the capital from the NHS. Am I right to say that the capital taken from the NHS is being replaced from elsewhere, so really the cut is only approximately £390 million?

Stella Manzie: The issue is that the negative consequentials for Scotland will be £392 million plus the £129 million capital reduction. That is then offset by approximately £25 million of additional money for Scotland. Therefore, the overall baseline is reduced by £496 million. The Department of Health capital reduction will affect us. It is not as if that capital is being replaced from elsewhere.

David Whitton: Has end-year flexibility money been put in there as well?

Stella Manzie: The end-year flexibility money is being drawn down in relation to 2009-10. We must look further at the implications of the Department of Health capital money.

David Whitton: You said earlier that you had managed to reduce expenditure by £1.7 billion from 2005 to 2008. Was that done through efficiency savings?

Stella Manzie: Yes, £1.74 billion.

David Whitton: What does that equate to in percentage terms?

Stella Manzie: In overall percentage terms we are focused on 2 per cent efficiency targets each year until 2010-11. Overall, the efficiency—

David Whitton: Is that over and above 2 per cent?

Stella Manzie: That was in the past, between 2005 and 2008. The 2 per cent that we are focused on is running through 2008-09 and 2009-10 and onward into 2010-11, by which time it will be 6 per cent.

16:30

David Whitton: Are you confident that you will hit that target?

Stella Manzie: Yes we are, because we exceeded the target over the previous years. The public service reform group, which I mentioned, monitors the position extremely closely.

In the context of some of the previous discussion, it is important to say that savings have been tracked and audited extremely closely, including by Audit Scotland, and they are genuine efficiencies, whether they have been achieved through changing asset management and procurement systems or through other approaches. Moreover, the efficiencies have been achieved within a general framework of no compulsory redundancies.

David Whitton: You said that the targets have been comfortably exceeded. If a percentage point were added—or even three percentage points, to set a target of 5 per cent—could you exceed the new target comfortably, too?

Stella Manzie: It would be for ministers to decide whether that was an option. It is hard to comment overall. All areas of the public sector in Scotland, and certainly areas that are under the leadership of the Scottish Government, want to operate in a culture of continuous improvement, so efficiencies are constantly being sought, whether one is working in local government or the NHS—

David Whitton: I am sorry to interrupt. You said that you wanted the Scottish Government to be a leader on efficiency savings. You have told local authorities that you expect them to achieve 2 per cent savings—indeed, you have top-sliced local authorities' budgets. If the Scottish Government is to be a model, I expect that you would have no problem in meeting an increased target.

Stella Manzie: We would advise ministers on where it would be appropriate to increase targets, but it would be for ministers to decide whether a new target was appropriate.

David Whitton: Ms Stewart, you come from the private sector, so I was not surprised by elements in your submission. Should the Government consider privatising many services?

Jenny Stewart: No, although the boundary between public and private sectors could be considered, on the margins. I mentioned Scottish Water and home care—

David Whitton: I am sorry to interrupt you, too. Scottish Water was formed when three water companies were merged. If efficiencies had not been made when that happened, people would not have been trying very hard. Are you suggesting that efficiency savings could be made by merging the 32 local authorities into 16 bodies, or are you saying that existing bodies should give more consideration to sharing services?

Jenny Stewart: There are a couple of issues in that regard. One is the boundary between the public and the private sector. What sits formally in the public sector and what sits formally in the private sector? There is scope at the margins for putting out some public sector services to be delivered by the private sector.

The other issue is how overall efficiency savings are delivered in the public sector and what the scope is in that context. In that framework, there is significant scope for the public sector to deliver efficiency savings. Stella Manzie was right to talk about how people strive for continuous improvement. That is what happens in private sector organisations, and I know that it happens in vast parts of the public sector. The question is what efficiency savings are used for. If ministers said, "We want the public sector as a whole to deliver 5 per cent efficiency savings, but we will allow it to claw back some savings into improved service delivery," I am sure that 5 per cent savings would be found.

The debate is all about whether savings are cuts and about inflation but, when we delve into the detail, we will realise that we need a mature debate about what services citizens want, as I said in my submission. Our debate today is, understandably, about what cuts and savings we have to make, what is happening at the top line and how that will filter down, but there should be a debate about what people want. People are sensible. Households are making cuts in their own budgets and a lot of people in the private sector are losing their jobs at the moment. We need to have a mature debate with the public to say, "Look, we cannot have everything that we have had over the past X number of years; we are not going to see the same increases." There will, just by the nature of things, be efficiency savings—as John Aldridge said, for example, the health service is getting more efficient—but we cannot afford everything. If we are truly about continuous improvement, that means delivering more and better services in some areas, while saying, "Sorry, we do not have the money to do some of the other things that are less of a priority." As I said at the outset, I am glad that those decisions are for you rather than for me to make.

Jackie Baillie: Although I am encouraged by that contribution, I will take us back to figures so that I—simple person that I am—understand the situation. I direct my comments to Stella Manzie.

You have chosen 2009-10, and I want to understand this correctly, because people have agreed up to now that the figure for that period includes short-term spending: the £100 million overcommitment, which the cabinet secretary was very clear about, in order to maximise spending in-year; EYF, for which I have the global figure of £900 million, although it might be smaller, and I would appreciate advice on that; and the reprofiling, or acceleration, of capital, which we have already discussed. If those essentially short-term increases were stripped away from 2009-10, what impact would that have on the baseline? What would your projections be for the baseline, based on the Treasury figures?

Stella Manzie: It depends how each of those increases was stripped out. Although I mentioned EYF in my opening statement, the figures that I have quoted in relation to the real-terms decrease of 1 per cent are based on not including EYF. If EYF is included, the real-terms reduction becomes 1.7 per cent. That factor is the most relevant to the question that you have asked. The difference between 2009-10 and 2010-11 would then increase.

Jackie Baillie: So EYF is not included. Is the £100 million overcommitment included?

Stella Manzie: Yes.

Jackie Baillie: And the reprofiling is also included.

Stella Manzie: Yes.

Jackie Baillie: If I have picked this up correctly, you said earlier—it was a welcome clarification—that if the reprofiling was not included, there would be 1.7 per cent growth.

Stella Manzie: Yes, that is correct.

Jackie Baillie: That is helpful to understand—language is everything in politics.

I want to come back to something that you said about ministers endorsing the capital reprofiling. My understanding was that they were made an offer because capital was going to be reprofiled, but it was up to them whether they took that offer forward. It was the Scottish ministers' decision to reprofile.

Stella Manzie: Yes, it was. I believe that it was because they wished to focus it clearly on economic recovery.

Jackie Baillie: Absolutely; I understand that, but I was slightly worried about your language. It is clear that those decisions were actively taken by Scottish ministers.

Stella Manzie: Yes.

Jackie Baillie: Do you agree with the CPPR view that the reprofiling has no impact on the Scottish budget or the DEL baseline in the long term? It is all in the same pot.

Stella Manzie: I have not looked closely at the CPPR report, so I would not want to commit to every syllable, but it is clear that, with regard to the fact that the money was in the programme, it has been accelerated, and therefore moved forward in that sense. I can see that it is possible to argue that it does not have an impact on the programme overall. I imagine that the UK and Scottish Governments wish to pull it forward because they believe that it will have a positive impact now.

Jackie Baillie: Absolutely. I am not disputing their reasons for doing it; I am just trying to understand it in accounting terms. You have simply reprofiled the expenditure and brought some forward, but the overall pot of money remains the same.

Stella Manzie: Yes, although there may be some issues about the price base at different times depending on how we spend it.

Jackie Baillie: Would it therefore be fair to say that, if you stripped away the capital reprofiling—ah, I see that Mr Brown is passing you another note; I make that seven so far—and had the increase of 1.7 per cent, we would be describing slower growth rather than a cut to the baseline?

Stella Manzie: No, I would not regard that as correct. When we consider the total DEL expenditure profile, we see a real-terms cut because of the way that the financial projections take place within the Treasury red book.

Jackie Baillie: I asked you about the baseline DEL. Without the capital reprofiling, which we have just agreed is part of the same pot, the baseline DEL figures—let me share them with you—are £27.5 billion for 2008-09, £28.4 billion 2009-10 and £29.2 billion for 2010-11. Those figures are based on what we have just agreed in discussion, taking out the capital reprofiling. I am not a mathematician, but I can see that, year on year, there is an increase, although it is much smaller than we would all have anticipated. Would it be more accurate to describe that profile as growth, but much slower growth than was originally planned?

Stella Manzie: No. For 2009-10, there is slightly over £29 billion—£29.09 is the figure that I have—and for 2010-11, we have £29.2487 billion. The critical issue is that if we look at those two figures without the GDP deflator, there is an increase of about 0.5 per cent between them but, when we apply the GDP deflator, it becomes a real-terms reduction of 1 per cent.

Jackie Baillie: Okay, but you just confirmed to me—I think that you said it first to Jeremy Purvis—that, if we stripped out the capital reprofiling, there would be growth of 1.7 per cent.

Stella Manzie: We have to deal with the reality, so I think that the information that I have given you is factually correct.

Jackie Baillie: I beg to differ. I am asking you about the baseline with all the additional short-term commitments that the Scottish ministers have made stripped out because they are short term and we are interested in the long-term trend.

Stella Manzie: It depends how you put those figures together. Ultimately, we are dealing with a 1 per cent real-terms reduction between 2009-10 and 2010-11.

The Convener: I think that that is as far as that line of questioning will go.

Jackie Baillie: I must record my disappointment, convener.

Joe FitzPatrick: We are talking about a budget in which money was brought forward. My understanding is that there was no opposition in the Scottish Parliament to reprofiling the capital expenditure. Will Stella Manzie remind the committee why the Scottish Government decided to bring money forward and spend it now?

Stella Manzie: It is basically to support the Scottish Government's economic recovery programme, which, as is a matter of record, has a number of facets to it. Because of the impact of the economic situation on construction in the private sector, it was felt that it would be helpful to bring forward the capital expenditure partly to continue to support the rebuilding of Scotland's infrastructure and partly to support people and jobs in the current economic situation.

James Kelly: I will follow up on David Whitton's point about how the £129 million health cut would be funded. You indicated that end-year flexibility had been fully drawn down. However, there was a £42 million underspend in 2007-08, and I understand that, by the time that we got to budget discussions earlier this year, that had grown to something like £70 million. If that underspend continued through 2008-09 and 2009-10, it would reach or possibly even exceed £129 million. Therefore, funding from reserves that had not been accessed could be used to match the £129 million.

Stella Manzie: I cannot comment on underspending. As a point of clarification and as I think I indicated in my opening statement, the Treasury has indicated that it will allow us to use the accumulated end-year balances up to the end of 2009-10 to offset the impact of the Department of Health baseline reduction of £129 million. However, that is currently under review, because we need to consider the impact of that and how we might or might not wish to use that EYF.

The Convener: In the crossfire from advisers, we are in esoteric and complex territory. If the witnesses wish to add to their answers in any way, they could certainly do so in writing. That would be of help to the committee.

Jenny Stewart: Convener, I am sorry to interrupt, but I am conscious that I did not answer the question that Mr Brownlee asked me about whether now is the time for a Howat 2. After the debate on the budget, there was agreement for an all-party review of public spending. I do not know whether that is the forum in which to start a Howat 2 but, if that review is going ahead, it would be a good thing.

The Convener: I thank our panel of witnesses. I will allow a moment or two for the next panel to come to the table.

16:46

Meeting suspended.

16:48

On resuming—

The Convener: We now move to our third and final panel of witnesses. I welcome Russell Frith, the director of audit strategy, and Caroline Gardner, the deputy auditor general, from Audit Scotland; Stephen Humphrey, a chief actuary in the Government Actuary's Department; and Angela Scott, the head of the Chartered Institute of Public Finance and Accountancy in Scotland.

As no one wishes to make an opening statement, we will move straight to questions.

What effects of recession on the budgets of the Scottish Government and bodies funded by it are already becoming evident to auditors and directors of finance? What are the short and long-term issues that we should be thinking about as we try to control public expenditure, and how will they be monitored?

Caroline Gardner (Audit Scotland): You have heard a lot this afternoon about the pressures on the resources that will be available to the Scottish Parliament and Scottish Government in future. It is clear that, after a period of sustained growth in resources, we are going to see much tighter financial conditions in future. That situation is made tougher by a few factors. One is that we know that there will be falling income from sources such as asset sales. Another factor is that there will be less income than is provided for in the assumptions about capital income that have been built into the budgets over the next few years. For example, income to local authorities from things such as planning is predicted to fall significantly this year and next, as is less significant income from other services that are charged for, such as car parking. Another element of the picture that we must not lose sight of is that the recession is likely to give rise to additional demand for some services, such as health and social care—not only are the demographics of the population changing with the result that we will have more older people, but the recession might lead to more people having to use the social work services and apply for social housing.

The Convener: Will that apply across a wide spectrum of services?

Caroline Gardner: Absolutely.

James Kelly: I have a question for Angela Scott. In your submission, you note some of the weaknesses of incremental budgeting, and one of the other submissions talks about priority-based budgeting. As we enter a period of recession, budgets will come under more pressure. What can we do in our approach to budgeting to get the greatest value out of the Scottish budget?

Angela Scott (Chartered Institute of Public Finance and Accountancy): We were trying to draw attention to the approach to budgeting of all public sector organisations, not just the Scottish Government.

As an accountant, you will appreciate that one weakness of an incremental approach is the tendency automatically to add to the baseline without having undertaken a thorough examination of that baseline. If we stay with an incremental approach, we will need to educate everyone—politicians and non-politicians—that energy needs to go into an examination of that baseline before we start to consider anything added to it.

I was struck by a recent Audit Scotland report on a council that was trying to shift from an incremental approach to budgeting to one of priority. That organisation faced a difficulty because the priorities were not clear. If we are to shift to a priority base, we need clarity around the priorities. That said, we have stuck with an incremental approach because one of its inherent advantages is its stability, which is useful given the timeline that we work within for setting our budgets.

Work needs to be done by politicians and officials to ensure that we do a thorough examination of the base before we give any consideration to adding anything to it.

Derek Brownlee: Picking up on what previous witnesses have said, I understand that people are now talking about the need to go through budgets in greater detail and challenge aspects of them a bit more than before. However, even if you get to a process that has a beefed-up challenge function, will the reality not simply be that the relative tightness of the money that is coming into a budget—be it the budget of a council, a public service, the Scottish Government or the UK Government as a whole—will be what decides how thorough the review is at an operational level?

It is difficult to have a tight review of each individual budget line when everyone knows that the total available for spending is going up; conversely, it is easy to have such a review when the total available for spending is going down or is frozen. How do you get through process and culture barriers to ensure that scrutiny is appropriate and thorough regardless of whether we are in a time of plenty or a time of austerity?

Angela Scott: That is an interesting question. The reception for accountants and auditors is certainly warmer when money is tight than it is when people are awash with money. It all comes back to professional leadership on our part. We have to facilitate the cultural change across all organisations, and that depends on leadership at the top.

In our submission, we draw attention to the role of directors of finance. We do so because we do not want a situation—although it probably is the situation that we face—in which a lot of people are in post whose whole career to date has unfolded during times when there has been a lot of money and not during times when there has been less money. As professionals, we have to be able to respond irrespective of how much money is coming in. Our message is to ensure that we get value for money and spend the right money on the right things.

It is all about professionalisation, leadership from directors of finance, and preparedness on the part of politicians and officers so that they have the right skills to deal with situations, regardless of the financial climate. The Chartered Institute of Public Finance and Accountancy has found, in the space of six months, an exceptional take-up of our offer of financial skills—although we are disappointed that the same level of demand did not necessarily exist over the past five years. It is incumbent on us to take the moral high ground and educate people on the need to invest regardless of the size of the cake. That is no mean challenge, but now that the envelope is shrinking, people are perhaps a bit more willing than before to open the doors and listen to our message from the grim reaper.

Caroline Gardner: I endorse everything that Angela Scott has said. A message from the Obama Administration has been never to let a crisis go to waste, and we have to focus on what is happening in the budgets of individual organisations. Stella Manzie talked about the continuing efficiency programme, which will still be important, but because of the scale of change we should not lose the opportunity to consider whole systems of public services more widely.

I will give a couple of examples. In the care of older people, there is huge variability in the rates at which older people are admitted to hospital and the rates at which they need care in nursing homes or residential homes afterwards. It is quite possible that, if we considered the whole system, we could find ways of spending less money and improving the quality of care. That will not be easy, but it is the sort of opportunity that we should take.

A similar example relates to the justice system. Her Majesty's chief inspector of constabulary recently proposed a review of which areas of policing are national and which are best managed locally. Considering the whole system might allow us to make cost savings and improve efficiency and might also improve services rather than simply cutting them.

The Convener: The written submission from the Scottish Environment Protection Agency refers to "Audit Scotland's 'landscape reviews'". Will you explain further?

Caroline Gardner: That is another example of the systemwide approach that I was talking about. In the health service and in local government, we now have quite a strong track record in reporting across the piece on how money is spent and in trying to link that to what we are getting for the money. Health and local government tend to cover about two thirds of the Scottish budget; that leaves a third for which we have not been able to take such an approach.

We are therefore developing an approach that takes a policy area, such as the environment, and considers it in much more detail, picking up on national priorities, comparing them with the areas in which money is spent, and considering where there might be room for improvement. In some ways, our approach is related to the proposals that the committee has heard today for something like a budget office. The idea is that, somewhere in the system, we need the ability to match up what we are spending and what we are getting. We can then identify where there are areas for improvement in future.

17:00

The Convener: I turn to the application of international financial reporting standards. Are all the issues of budgetary cover resolved? Will the application of IFRS have any real effect on the budget choices that are available this year and in future? What is the state of play on IFRS?

Caroline Gardner: I will bring in my colleague Russell Frith on that.

Russell Frith (Audit Scotland): The public sector conversion to international financial reporting standards is going quite well. Opening balance sheets as at 31 March 2008 have been produced and reviewed by auditors. The core accounts for 2008-09 were produced on the current basis of the UK generally accepted accounting practice, but shadow accounts will be produced on the IFRS basis and subject to audit review. The first live year of IFRS-based accounts will be 2009-10.

As I understand it, the budget position is not yet completely clarified. That said, the intention is that the Treasury will cover any changes to budgets that are brought about as a direct result of IFRS implementation. Again, as I understand it, the negotiations on that are not as yet concluded.

Angela Scott: As the accounting standards setter for local government, CIPFA is bringing in IFRS for local government. We are in discussion with the Scottish Government on regulation to mitigate the bottom line impact for budgets in all of that.

Jeremy Purvis: I have a couple of questions for the Government Actuary's Department, the first of which is about paragraph 6.2 of your submission. You mention the principal civil service pension scheme, which applies to 57,900 staff members. I was surprised to read that

"It is not clear to what extent the pension costs for civil servants in Scotland are financed through the Scottish Government's accounts."

Stephen Humphrey (Government Actuary's Department): The principal civil service pension scheme is a Great Britain-wide scheme. Separate schemes apply to many other public sector employees in Scotland—for example, the NHS scheme and those for teachers, police and the fire service—but the pension scheme for the civil service is GB-wide.

All that I am saying in the submission is that, in the time available, I was unable to split out which civil service employees in the PCSPS get financed through Scottish Government finances. The pensions of some civil servants who work in Scotland will be financed directly through Whitehall whereas others will be financed directly by the Scottish Government through DEL. I am sure that the figures are available somewhere, but I was unable to provide them in the submission.

Jeremy Purvis: Perhaps you will come back to the committee on that.

The Convener: If you could.

Stephen Humphrey: Yes.

Jeremy Purvis: I turn to the local government pension scheme, which I understand differs from those of the police and the fire service, both of which are what I would call cash-flow schemes and not funded schemes. The last triennial valuation of the LGPS was done as at 31 March 2008. Was any assessment made of the funds that were invested in the banking sector, for example in the Royal Bank of Scotland and HBOS? What assessment has the Government made of the valuation of those schemes? What impact has the banking situation had on local authority funds?

Stephen Humphrey: You are correct in saying that police and fire schemes are financed on a pay-as-you-go basis. The local government scheme is pretty much the largest funded scheme. It has a different model from other public sector arrangements.

I do not have separate figures for the amounts that were invested by those funds in the banks, but I am sure that the general reduction in investments over the year will have been negative for the local government pension scheme funds. There will be reporting by local authorities under FRS 17 at the year end. I do not have access to those figures at this point, but they will become available. We have not assessed the exposure of the LGPS to the banking sector. We might be able to provide you with some approximate figures, but it is the overall investment performance of the funds that is of real importance to LGPS funding.

The Convener: It would be useful to bring in Caroline Gardner and Russell Frith.

Caroline Gardner: We can help, because we audit the councils who make up and own the local government pension scheme. We published a report in 2006 that summarised the position across the public sector pension schemes, and we are about to kick off a refresh of that work that specifically examines the fund management aspects. I think that the triennial valuation that was carried out recently has not yet been made publicly available, but my colleague Russell Frith can give more information on what we know at this stage.

Russell Frith: The triennial valuation was at 31 March 2008. Audit Scotland is one of the admitted bodies to the Lothian pension fund, which is one of the local government schemes. We have a copy of the actuarial valuation for that, which sets the minimum contributions from employers for the next three years, which are the current financial year and the years ending March 2011 and March 2012. The rates have been set by the actuary and, as far as I am aware, have been accepted by all the employers. Basically, there are increases in each of the years, as one might expect. In the first year, the increases are from 1 to 1.5 per cent up to about 20 per cent—the figure varies according to the employers' profiles—and in each of the next two years there will be increases of 0.6 and 0.7 per cent.

The employers will find out the impact of falling stock market values in roughly the next fortnight, when we get our updated reports. However, that will not impact on the contributions that the employers need to make until the next actuarial valuation is carried out in three years' time.

Jeremy Purvis: The local government scheme is a big one, with nearly a quarter of a million staff. The Strathclyde and Lothian pension funds have both recommended increases in employer contributions, and the written evidence from the Government Actuary's Department states:

> "GAD understands that the Scottish Government's current Council Tax freeze means that this has not impacted on Council Tax bills."

One would expect local government funds across the board to follow the Strathclyde and Lothian funds, which are the two biggest ones, and one might assume that, across the board, the funds have invested heavily in Scottish banks. The evidence from GAD suggests that employer contributions will have to be found from within local authorities' existing budgets.

Caroline Gardner: That is the case. Given the council tax freeze, the additional contributions will have to be found from within those budgets. Because of the timing of the triennial revaluation, which was carried out at 31 March last year, the increases are smaller than they might have been had the revaluation been carried out later. We have certainty for the next three-year period. The question is what the implications are for the following revaluation and how that ties into other issues that affect the contributions. Those include recent changes to employee contributions, which have come into effect this month and, on the other side of the equation, changes in life expectancy that affect the pension liabilities and which will need to be managed. We know what the impact is for the next three years, but we do not yet know what the longer-term impact will be.

Jeremy Purvis: I have an additional question for Audit Scotland. You probably heard quite a few of the questions to and answers from the previous panel. As far as auditing best practice is concerned, how should the use of accelerated funds, capital in particular, be treated when it comes to the presentation of accounts or to taking a baseline figure? Is there a precedent in the work that Audit Scotland has done with other bodies that would allow it to comment on what the best practice should be in that regard, or on how that information should be presented?

Caroline Gardner: I do not think that there is a precedent that we could usefully draw on. We can certainly say that moving capital expenditure forwards and backwards in time is a perfectly reasonable thing to do in response to any number of circumstances, including the economic circumstances that we find ourselves in. For us, the greater question would apply if we were looking to move revenue expenditure in time. Revenue expenditure obviously has continuing implications in a way that capital expenditure tends not to have. Without wanting to get drawn into the political considerations on either side of the matter, I would say that drawing forward capital expenditure does not seem to us to be a problem.

Jeremy Purvis: And you have no views about a situation in which capital is drawn forward and the year to which it is drawn forward is used as a baseline against further accounting or further presentation of information.

Caroline Gardner: The clue to the answer is in the way that you have phrased your question: it depends what the purpose of the baseline is.

Jeremy Purvis: I do not quite understand what you mean by

"what the purpose of the baseline is."

Caroline Gardner: If we are looking to be clear about what the continuing revenue demands on the Scottish budget are, the revenue budget would provide the better baseline; if we are considering the total resources that are available and that are coming into the Scottish Parliament, adding the two together might make more sense. I do not think that, as accountants, we can add very much to your understanding of that question—at this point in the afternoon.

The Convener: It would be recorded for all to see.

Jackie Baillie: That was a most impressive answer.

The Convener: As ever.

Jackie Baillie: I return to pensions. I will ask Mr Humphrey about some basic cost issues. Do you have an aggregate figure for all the pension-related costs that would fall to the Scottish Government DEL? I am thinking about not just the Scottish Government pension costs, but those of all the public sector bodies that it funds.

Stephen Humphrey: I do not have a figure with me that I can give you. Mostly, our advice is provided to the Scottish Public Pensions Agency, which is the best body to provide that sort of breakdown.

Jackie Baillie: Excellent.

Stephen Humphrey: You would need to be more specific about which schemes you wanted to be included. The Scottish Government is exposed to costs in respect of direct employees and indirect employees, and lots of functions are sponsored through buying services from agencies. There are other areas of cost pressure with pensions; unfortunately, most of those cost pressures are going upwards these days. You might need to do some more specific research into particular areas. I do not have up my sleeve a long list of the relevant schemes that I could give you today, but you might wish to think about which areas you want information on, including the indirect ones.

Jackie Baillie: I suspect that the information we would want would be on all the areas that the Scottish Government funds directly and indirectly. Future claims might be inflated by a rise in pension costs. I take the point—we will get the clerks to write to the SPPA.

Stephen Humphrey: There are different ways of expressing pension costs. One is through the benefit outgo—the actual pensions that are paid out each year. Some schemes are accounted for just by looking at that. Another way to account for them is to consider the employer-contribution rate. In non-technical language, that means the pensions overhead of employing people. Mixtures of approaches are used in the Scottish schemes, so you would need to ensure that you compare like with like. Sometimes it is a good idea to consider both approaches.

You might then get into the DEL/AME question: employer contributions score in DEL and benefit outgo scores in AME. The committee is looking at monitoring them together and separately. They are both worth looking at—as a department, we do projections of both.

17:15

Jackie Baillie: If you could send that to the committee, I suspect that it would be most interesting.

From April 2010, police and fire pension schemes here will be treated as they are in England and Wales. Will that have an impact, such as a net cost increase? There is currently no impact on the budget.

Stephen Humphrey: As long as the appropriate treatment is sorted out with the Treasury, it should not have an impact. In the past, when benefit outgo increased, that was taken into account in the overall police and fire authority budgets. The idea of the change is to take out that element and to put it into AME, so that a police authority's budget is about providing police authority current services, and not about pensions for retired police and fire personnel. As long as the structures are all put in place appropriately, the new system should not have an impact on how budgets are run.

Jackie Baillie: In your submission, some of the employer contributions go up and others go down. I do not understand why they are different. If it is easy to explain, will you tell us? What is the total DEL cash impact?

The Convener: Be gentle with us.

Stephen Humphrey: Most of those charges are what I call the pensions overhead of employing people—the employer's charge. The schemes that are listed do not have the same employee contribution rates or benefit structures. Valuations of the schemes have been done at different dates, so we cannot easily compare different benefit structures using those figures.

However, we are moving to a situation in which schemes are valued on similar methodologies at similar assessment dates. In the contribution changes that are coming in from 2009, you will see that there is more of a move towards consistency. That has been encouraged by Whitehall. The area that I advise—the Treasury—is keen that pension costs be expressed in comparable terms.

I am happy to write the committee with a few paragraphs on the reasons for the movements up or down, if that would be helpful.

Jackie Baillie: That would be helpful. Thank you.

Angela Scott: It is worth putting the pensions discussion into context. Obviously, there are big numbers, and it is understandable that we would want to examine those numbers when we are considering where we can pull back. However, we have to put the discussion into the overall context of pensions provision. A debate is being played out across the media about the generous—or otherwise—nature of some public sector schemes when they are contrasted with pensions provision in the private sector.

My word of caution is that this is about raising the standard rather than lowering it. The standard comes at a cost—that is what we are seeing here. Although we might save in the short term, ultimately, we will all retire, and we will all need pensions provision at some point. The debate on pensions has to be put into context; in other words, we need to consider what standard we aspire to, rather than challenge the public sector provision and aim to reduce it.

Jackie Baillie: For the sake of clarity, I say that that is not what I was seeking to do—I simply want to understand so that I can make informed decisions. Might I say that Angela Scott is too young to be worrying about her pension?

The Convener: Enlightenment is always a desirable goal. Linda Fabiani has a question.

Linda Fabiani: Why do you turn to me when you are talking about pensions?

My question is for Angela Scott and relates to the discussion prior to the discussion on pensions, which has been well covered. In your written submission, you talk about the "five … recognised themes", which we can all understand and agree with. You state clearly that there must be a change in the financial culture in public service bodies. However, on financial monitoring and forecasting, you go on to say that

"The appropriate financial skills to achieve this are crucial at all levels".

That suggests that there is concern that the appropriate financial skills are not, in fact, there. Is that an accurate picture?

Angela Scott: Yes—and we have expressed concern at various levels. The Improvement Service recently published its proposed continuing professional development framework for elected members. CIPFA is normally quite a conservative organisation, but we were robust in saying that we thought that finance should feature as one of the core behaviours of elected members—and not only of elected members, but of non-executive members. We have made that point regularly.

It is worth examining where things have gone wrong. Some of the Aberdeen City Council situation is down to a lack of financial skills, especially in monitoring and control. Among other issues, there was a problem in respect of people's understanding of what it means to be a budget holder and what that involves. There is also a lack of understanding by an elected member and a non-executive member of their role in exercising financial challenge and scrutiny and in testing value for money. That is cause for concern.

We want to ensure that we have professionally qualified staff in all the finance functions to ensure that they give the proper advice. However, we tend in the public sector to devolve vast sums of money to managers who are not financially qualified. We are always confident that they have the necessary professional skills—whether as social workers or road engineers—but we do not always ensure that they have the necessary financial skills.

For a conservative organisation, CIPFA has been pretty robust in the comments that we have made, and we are now seeing recognition of the problem. Folk are now looking to make that investment, particularly in governance and financial management skills. Hopefully, we will start to see improvement.

Linda Fabiani: I have another wee question for Angela Scott, but it would also be worth our while for Audit Scotland to comment. Some of your work in auditing organisations will have thrown up some of those issues.

Caroline Gardner: Yes. As you would expect, such issues are right at the core of our auditing all 200 public bodies in Scotland every year. Their importance is heightened by the financial pressures that we are all facing at the moment.

I endorse everything that Angela Scott said about the need for all managers of budgets to have the skills to do that. Aberdeen City Council is a good example. It is fair to say that, until 18 months ago, the council was approving budget reductions and savings without fully understanding the implications. We can all recall instances of councils' devolution of school budgets not being well managed in terms of pulling everything together and considering the impact on the council as a whole.

Perhaps one of the most difficult things for public bodies to get right is the role of council members and non-executive members of the boards of public bodies. They should not be involved in detailed management of budgets, but they need the skills to challenge them properly and to understand what significant changes or risks look like and how they are being managed. They need to be able to do that in a way that is responsive to the significant pressures that we are all likely to face over the foreseeable period.

Linda Fabiani: Often, the boards of private bodies suffer from the same problems, as we have all seen lately.

I have a quick question for Angela Scott, which relates to something that the convener mentioned earlier about the international financial reporting standards. Your written submission states that

"the move to international financial reporting standards provides opportunity to improve the accountability of public entities in terms of transparent financial reporting."

That sounds great. Why will the introduction of the IFRS improve accountability, and how can we ensure that it does so?

Angela Scott: Are you sure that you want to ask me that at 5.24 pm? I will try to give a brief answer, which I will be happy to follow up with a written submission—I am not trying to be flippant.

The Convener: It would be good if you could be brief, and a written follow-up would be great.

Angela Scott: The approach to the Icelandic banks offers a good example. The use of financial reporting standards that are consistent with the spirit of the IFRS has ensured transparency in everything that has happened in relation to those accounts. I will write to you about the benefits of the IFRS.

Linda Fabiani: I suppose that PFI/PPP offers a good example, too.

The Convener: Let us not get embroiled in that debate.

Linda Fabiani: That is a shame.

David Whitton: An independent budget office has been mentioned. In a sense, Audit Scotland carries out some of the functions that such an organisation would have, because it holds public bodies to account for how they spend money. We will take evidence on whether there should be a Treasury scrutiny function. How would such a body work?

Caroline Gardner: I hope that I did not suggest that we think that an independent budget office is the right model. For a long time, we have recommended that the Scottish Government ensure that its finance function focuses on the strategic issues that the Government faces—which is all the more important now. We have said that the Government should have the capacity to do the analysis, meet the challenge and present transparent information about what is spent and what we get for our money.

The appointment of Stella Manzie as director general for finance and corporate services is part of the strengthening of the approach, but the Scottish Government's journey has not yet been completed. A few times since devolution, Audit Scotland has reported on policies that were proposed without being properly costed. It is important that there should be the capacity for the Government and Parliament to understand fully policies' financial implications and to consider how policies rank by their relative priority. It is always important that that should happen, but it will be all the more important when we face difficult choices in the future.

The establishment of an independent budget office is not the only way of ensuring that such an approach is taken. That is just one model, and costs would be associated with the approach. Another model might be the continued strengthening of the finance function in Government and the strategic linking up of the Parliament's budget scrutiny with Audit Scotland's work, through the conduit of the Public Audit Committee, which maintains an overview. That work could be played back into the budget process.

We talked about the ability to take a more strategic approach to considering policy areas, and there is mileage in further exploration of how that might work in the future.

Angela Scott: I support that. I had the benefit of doing my finance training in local government. The director of finance ruled us with a rod, and when we were in spending departments our role was to be his watchers. Financial management is based on financial stewardship. That is what our professional training is about and that is the role of the director of finance and the finance function. Instead of setting up a separate body, we should be enhancing the role of the director of finance and the finance function, and reminding organisations that that role is to challenge. We should be encouraging our finance functions to do what CPPR suggested should be done.

17:30

David Whitton: Are the waters muddied if the minister who has responsibility for the Government's finances is also in charge of a spending department? Would you separate the two functions?

Angela Scott: No. Directors of finance throughout the land have small budgets for the finance function, but that does not prevent them from challenging other spending departments. It is about the director of finance's leadership and visibility, which is why CIPFA advocates that the role should sit in the management team.

I agree with Caroline Gardner that it is about the visibility and leadership of the finance function in the Scottish Government, which will benefit from the professionalisation that has come from the appointments of Alyson Stafford and Stella Manzie. A third party is not needed; the role that we are talking about is the role of the director of finance and the finance function.

Caroline Gardner: My view on the minister's position probably differs slightly from that of Angela Scott. It is difficult for a minister to be responsible for challenging proposals from spending portfolios while having responsibility for a spending portfolio of his or her own. That is not to say that it cannot be done, but it is worth examining the alternatives. Those are issues for the Government and Parliament. There could be mileage in creating a bit more independence around the spending minister.

The Convener: Would the structural differences between how local government and central Government operate play a major part in the decision on the configuration? Where is the equivalent of the director of finance in central Government?

Caroline Gardner: There is now a director-general for finance and corporate services in the civil service, who reports directly to the permanent secretary, as local government directors of finance do. The challenge is to continue to develop that function's capacity, to ensure that it can carry out the analysis and reporting that is required and focus on strategic issues, rather than get dragged into the detail. The question is how that function is played into the political structure of Government, to ensure that spending proposals are robustly challenged before commitments are entered into.

The Convener: Educating politicians is a formidable task. Please keep trying and thank you for the tutorial. The final panel of witnesses in a meeting must always be patient, and you were especially patient. We thank you for that and for your contribution to the committee's inquiry. We will take more evidence next week.

17:32

Meeting continued in private until 17:36.

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