# FINANCE COMMITTEE

Tuesday 24 November 2009

Session 3

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## Tuesday 24 November 2009



## FINANCE COMMITTEE
**27th Meeting 2009, Session 3**

**CONVENER**

*Andrew Welsh (Angus) (SNP)

**DEPUTY CONVENER**

*Tom McCabe (Hamilton South) (Lab)

**COMMITTEE MEMBERS**

*Derek Brownlee (South of Scotland) (Con)
*Malcolm Chisholm (Edinburgh North and Leith) (Lab)
*Linda Fabiani (Central Scotland) (SNP)
*Joe FitzPatrick (Dundee West) (SNP)
Jeremy Purvis (Tweeddale, Ettrick and Lauderdale) (LD)
*David Whitton (Strathkelvin and Bearsden) (Lab)

**COMMITTEE SUBSTITUTES**

Gavin Brown (Lothians) (Con)
Lewis Macdonald (Aberdeen Central) (Lab)
Stewart Maxwell (West of Scotland) (SNP)
*Liam McArthur (Orkney) (LD)

*attended

**THE FOLLOWING GAVE EVIDENCE:**

John Swinney (Cabinet Secretary for Finance and Sustainable Growth)

**CLERK TO THE COMMITTEE**

James Johnston

**SENIOR ASSISTANT CLERK**

Mark Brough

**ASSISTANT CLERK**

Allan Campbell

**LOCATION**

Committee Room 2

# Scottish Parliament

## Finance Committee

*Tuesday 24 November 2009*

[THE CONVENER *opened the meeting in private at 09:31*]

10:46

*Meeting continued in public.*

## Subordinate Legislation

### Budget (Scotland) Act 2009 Amendment Order 2009 (Draft)

**The Convener (Andrew Welsh):** Good morning and welcome to the Finance Committee's 27th meeting in 2009 in the third session of the Scottish Parliament. We have received apologies from Jeremy Purvis, so I welcome Liam McArthur as his substitute. I ask everyone to turn off mobile phones and pagers.

Agenda item 2 is to consider the Scottish statutory instrument that provides for the autumn revision to the 2009-10 budget. The draft Budget (Scotland) Act 2009 Amendment Order 2009 is subject to affirmative procedure, which means that Parliament must approve it before it can be made and come into force. We will debate a motion in the name of the Cabinet Secretary for Finance and Sustainable Growth, John Swinney, that invites the committee to recommend to Parliament that the order be approved. Before we come to that debate under item 3, we will have an evidence-taking session to clarify any technical matters and to allow exploration of detail.

I welcome to the committee the Cabinet Secretary for Finance and Sustainable Growth, John Swinney MSP. He is accompanied by Alyson Stafford, who is director of finance at the Scottish Government, and by John Williams, who is head of finance co-ordination. I invite the cabinet secretary to make an opening statement to explain the order.

**The Cabinet Secretary for Finance and Sustainable Growth (John Swinney):** I will make a brief opening statement on the draft Budget (Scotland) Act 2009 Amendment Order 2009.

The autumn budget revision is the first of two routine revisions to the budget that occur in year. The second is the spring budget revision, which will be laid in late January. As in previous years, a pattern of authorising revisions to the budget in the autumn and spring is required because the detail of our spending plans inevitably changes from when the budget act was approved.

The revision mainly takes account of amendments that were agreed at the time of the budget bill, changes that have already been reflected in the revised 2009-10 figures that are included in the draft budget for 2010-11 and, most significant, technical changes in relation to the treatment of national insurance contributions and the introduction of the international financial reporting standards.

The changes that are proposed in the autumn budget revision will result in an increase in the approved budget of approximately £1.811 billion, from £32,900 million to £34,711 million. However, the changes are largely due to the £1,724 million technical adjustment for national insurance contributions, which are no longer shown as health income but presented as part of Scottish Government funding as a whole. The presentation of the funding is now consistent with that of the draft budget and of the annual accounts. The budget bill for 2010-11 will be presented on that basis, which will ensure that the adjustment will not be required in future.

Apart from the national insurance contributions, the other main revisions to the budget act are also largely technical in nature. A reduction in funding of £316 million in annually managed expenditure is required for national health service and teachers' pensions as a result of a change in actuarial factors, particularly the discount rate that is applied to future pension scheme liabilities. The impact of IFRS adjustments amounting to £248 million is also included in the order. With the adoption of the IFRS across central Government from 1 April 2009, we are required to convert our budget from United Kingdom generally accepted accounting practice—UK GAAP—to an IFRS basis. The autumn budget revision reflects the first tranche of technical adjustments that have been agreed with Her Majesty's Treasury. The IFRS adjustments to the Scottish budget in the autumn budget revision are spending power neutral. They are technical, non-cash adjustments or transfers from resource to capital to reflect the different treatment of certain transactions under the IFRS.

Setting aside those technical changes, which amount to £1,656 million, the budget has increased by approximately £155 million as a result of additional capital acceleration announced during the passage of the budget bill, budget consequentials and increased income from non-domestic rates. That is mainly accounted for by £60 million for town centre regeneration, £16 million for modern apprenticeships, a further £15 million for home insulation, as announced at the time of the budget bill in January, and £20 million for the further education sector arising from 2009 UK budget consequentials.

The other significant transfers within the Scottish block are mostly due to the realignment of budgets within and between portfolios. Those include a net transfer to local government of just under £60 million in respect of police, adult support and protection and the zero waste fund. They also include a transfer of £59 million to further education for nursery and midwifery training.

The brief guide to the autumn budget revision that has been prepared by my officials sets out the background to, and details of, the main changes that are proposed. I hope that the guide has been of help to the committee.

In accordance with our spending review plans, a total of £400 million will be drawn down from our end-year flexibility balances at Westminster's winter supplementary, as agreed as part of the spending review in 2007. That is already reflected in the original budget that was approved for 2009-10 and has no impact on the autumn budget revision.

No further announcements or initiatives appear in the figures that the committee is scrutinising today. The revision reflects decisions or announcements that have already been made.

**The Convener:** I thank the cabinet secretary for his opening statement. I now invite questions from members.

**Malcolm Chisholm (Edinburgh North and Leith) (Lab):** It is interesting to hear that the money that was voted on in the budget several months ago now appears in the autumn budget revision. Obviously, the headline items were the town centre regeneration fund, the moneys for modern apprenticeships and the additional funding for home insulation. People have perhaps been wondering for a while where the money for those came from, so I suppose that we should expect some reductions to have been made to the original budget lines to free up the money for those items. Am I correct in that understanding? What is the explanation?

**John Swinney:** Clearly, one could expect either increases in resources coming into the budget or reductions in other budget lines to pay for those new commitments. Although I cannot remember the exact language that was used at the time of the budget, I am pretty sure that I said to Parliament that an increase in non-domestic rates income beyond what had been expected allowed us to afford some of those priorities. The town centre regeneration fund has been paid for out of the capital acceleration that we agreed with Her Majesty's Treasury. That is where the resources for those three commitments have come from.

**Malcolm Chisholm:** This might not be strictly relevant but, while we are talking about the subject, I will take the opportunity to ask about the town centre regeneration fund. Is the cabinet secretary still insisting that all that money should be spent within the current financial year?

**John Swinney:** We have relaxed the conditions to an extent. We would normally allow resources to be drawn down only when contracts—for example, a construction contract—are at a stage of completion. For the town centre regeneration fund, we have allowed money to be drawn down in those circumstances but also when contracts are put in place. We do not require the work to be completed before we allow the resources to be drawn down, so long as we are certain that the work has been contracted. That offers a degree of flexibility to accommodate the circumstances of particular projects.

**Derek Brownlee (South of Scotland) (Con):** I will not ask from which budget line you have found the resource to send a letter to the Calman commission to ask for borrowing powers. I want to ask about a more anoraky issue. In the introduction to the supporting document on the revision, you talk about the IFRS and public-private partnership projects, which are now on balance sheet. Will you confirm that there is no net change to affordability and cash flow for the Government? We covered that many times before there was clarity about what the final arrangements would be. My understanding is that there is no change in affordability.

**John Swinney:** No. The Treasury has applied the IFRS rules; essentially, we will have to account for private finance initiative projects on an IFRS basis in our accounts, but we will not budget for them in our budget. We have waited a couple of years for that clarification, but we now have it. PFI projects have come on to the Government's account in a fashion that is essentially cost neutral to the Government.

**Derek Brownlee:** I forget the wording that you used in your opening statement, but it is quite clear that the adjustment for the IFRS has been made in some budget headings but not in others. It seems from what you are saying that, even in the areas that have not been agreed, the Scottish Government still expects that the effect will be cost neutral.

**John Swinney:** That has been our expectation throughout the process. As I said in my statement, we have gone through the first tranche of discussions with the Treasury on the incorporation of the PFI projects into the Government's accounts, which is spending power neutral and cost neutral. We have a further tranche of that work to do with the Treasury—I expect there to be just one further tranche. There might be further instalments, but I expect the incorporation to be both cost neutral and spending power neutral.

**Liam McArthur (Orkney) (LD):** In response to Malcolm Chisholm's question, you said that the town centre regeneration fund has been afforded through acceleration in the capital funding agreed with Westminster. I note for the record that Stromness, in my constituency, with which you have a family connection, is a recent beneficiary of the fund. In accelerating that capital funding, are you suggesting that it has not been pre-allocated to any other area? Will you be more specific about whether the funding has had to be moved away from some future capital project in order to fund the town centre regeneration fund now?

**John Swinney:** Clearly, accelerated capital expenditure gave us an opportunity. The Treasury in these circumstances—as in all circumstances—makes financial allocations to us but does not specify how that money is to be spent. In no circumstances does the Treasury apply conditions, other than the financial rules that we have to observe. It certainly does not tell us how the money should be spent. That is an intrinsic part of the devolution settlement. The Treasury has accelerated capital expenditure and the Scottish Government has chosen to deploy it through the town centre regeneration fund, which I am pleased to hear has benefited Stromness.

**Liam McArthur:** I appreciate that the Treasury will not apply any conditions but, presumably, there was an expectation prior to the financial difficulties, or economic crisis, in which we find ourselves that that money would be forthcoming for capital spending in future years. From what you are saying, it sounds as if it had not been earmarked for any other purpose prior to the request being made to the Treasury.

**John Swinney:** I have to set out annually the detail of the Government's expenditure programme. I do that year by year in the context of the spending review. Any future decisions on allocation of capital expenditure are set out in the budget document for 2010-11, which is the next year for which we are considering these questions.

11:00

**Tom McCabe (Hamilton South) (Lab):** In the pre-budget report of 2008 and the subsequent budget in April 2009, we received around £84 million of consequentials. Has all that generosity now been allocated?

**John Swinney:** Not all of it has been allocated. We have made a series of announcements so far in relation to the college estate and capacity in the further education sector, but we still have some consequentials to allocate.

**Tom McCabe:** Have you any idea when you will do that?

**John Swinney:** I am looking to do that reasonably swiftly. As Mr McCabe will appreciate, given his perspective, taking decisions on that at an advanced stage in the year has to be judged carefully. There are some issues about which we have uncertainties such as, in particular, the cost of the vaccine for swine flu. A position is evolving on the basis of the scientific advice that we are receiving. That is a significant factor, which the Deputy First Minister and I are considering in deciding how these issues will be taken forward. Obviously, I have to make decisions in advance of the spring budget revision in January.

**Tom McCabe:** Does that situation encourage you to think slightly differently about setting a contingency in future?

**John Swinney:** It would be an advantage if we were in a position to retain a contingency—that would be desirable. Given the spending environment in which we are now operating, in which the sustained year-on-year real-terms increases have levelled off during this spending review period and, as we all realise, we will move into a period of real-terms reductions in spending, it will be a challenge to identify a contingency. That does not in any way undermine the advantage of retaining a contingency. Indeed, the fact that we are operating under tight financial management perhaps increases the advantage and necessity of doing that. I can see advantages to Mr McCabe's suggestion.

**Tom McCabe:** Do you think there is any advantage in holding some money at Her Majesty's Treasury?

**John Swinney:** No, although I am very grateful to my predecessors for all their wise endeavours in that respect.

**Tom McCabe:** You did not say so at the time.

**John Swinney:** I thought at the time that it was a super idea, Mr McCabe. You are in danger of rewriting history this morning.

However, in the future financial context, I would be chary of passing end-year flexibility to HM Treasury, bearing in mind the scale of the debt with which it is wrestling. I can imagine that the proceeds of end-year flexibility from the Scottish Government might have the label "payment of debt" attached to them. I will perhaps not take the risk of following Mr McCabe's precedent.

**The Convener:** I detect wisdom and experience in that last remark.

**David Whitton (Strathkelvin and Bearsden) (Lab):** Looking at today's weather, I can understand why there is increased funding of almost £19 million for routine and winter maintenance on trunk roads, which is funded by savings from rail services. Where were those savings in rail services made?

**John Swinney:** The savings on rail services essentially came from negotiations involving the Office of Rail Regulation and Transport Scotland on track access charges. We had originally made provision to meet the cost of track access charges as part of the contractual arrangement with First ScotRail. After the negotiation in which Transport Scotland was involved, those costs were reduced, so we had the opportunity to redeploy those resources. Essentially, a one-off benefit has emerged in year. We have used the resources to support the routine and winter maintenance budget, because, as we all appreciate, there are many calls on that budget for support. The consequence of that decision will be greater workflow for the companies and individuals who operate on the trunk road network.

**David Whitton:** There is nothing in the autumn budget revision documents about proposed savings from the cancellation of the Glasgow airport rail link. Have you had a chance to reflect on how you will redistribute the money that you save as a result of cancellation?

**John Swinney:** It would be presumptuous of me to make plans of that sort. The draft budget is with the Parliament for consultation and a decision, so it would be premature of me to make a judgment in that respect.

**David Whitton:** So is there still a chance that you might reconsider?

**John Swinney:** As you know, I am a minister who treads carefully in ensuring that I fully respect the position of the Parliament and its committees—in all their decisions—so it would be premature of me to make such a judgment.

**David Whitton:** I am delighted to hear that.

**Linda Fabiani (Central Scotland) (SNP):** I will be even more anoraky than Derek Brownlee was. I am interested in knowing more about the decreases in the annually managed expenditure budgets for NHS and teachers' pensions. You mentioned that the discount rate was increased by Westminster. Why was it increased? How often does that happen? When we consider the raiding of pension funds that has gone on in Westminster, it is clear that the issue is sensitive. Are you confident that what Westminster is doing adequately protects the pensions of NHS staff and teachers?

**John Swinney:** The discount rate is reconsidered annually by the Treasury, which issued information on the rate on 6 February in public expenditure system paper PES (2009) 01. The discount rate is reviewed in the light of market conditions at the end of January each year. In that sense there is volatility, because market conditions in January might be markedly different from conditions at other times in the year, as we well know. The decision is based on the cost of AA-rated corporate bonds—in essence, it is a market judgment, which has proved to be a reasonably reliable judgment about the sustainability of funds. Of course, as with all aspects of actuarial assessment, there is a risk that the assessment is not correct, but I think that the risk is effectively managed in relation to the payment of pensions.

I should point out that that judgment has no effect on members of the public, because the pensions are assured; it has an effect on the public finances. It is how the pensions are funded that we are wrestling with. The Treasury guarantees that the pensions will be paid and its assumptions are based on its best calculation of the resources that it will require to fund pensions. Members of the public have that assurance—provided that the public finances are in a sufficient state of reliability to meet the expectations that are set by the Treasury.

**Linda Fabiani:** I take it that the discount rate goes up or down annually. In the current devolved settlement, does it make sense to follow Treasury guidelines on such matters? For example, the Treasury's deflator of 1.5 per cent has been used throughout the budget.

**John Swinney:** We have no control over annually managed expenditure; it shows in elements of our budget, but I have no discretion over it. In that respect, we clearly observe and follow the direction of HM Treasury.

I think that the judgment that I made in the 2010-11 budget to restate the deflator to accord with the Treasury reflects a prudent approach to assessing the impact on the public finances.

**David Whitton:** In the health and wellbeing budget, there is a reduction of £50 million in the anticipated level of capital receipts and there is a corresponding reduction in capital expenditure. Which capital projects have been affected by that?

**John Swinney:** We are talking about capital sales that take place in health boards throughout the country. There will be a huge range of projects in relation to which officials have judged that this is not the time to undertake a particular asset sale, so in consequence capital programmes—the projects could be anything from equipment enhancements to developments of new facilities—might be delayed for a limited period.

We make provision in the budget for income that we expect from asset sales and say what we expect it to be used for. You have identified a balancing item, which reflects the timing of when it is appropriate to realise assets. If the committee wants further information on that, I can share what I can with you.

**David Whitton:** Thank you. That might be useful.

The education and lifelong learning budget line shows a number of movements of funds, to which the schools budget is contributing almost £24 million. Where in the schools budget have those savings been found?

**John Swinney:** Some of the work on the schools budget reflects an annual adjustment that we make when we are clear about the number of teachers who will be trained within the year, which does not become clear until later in the year. Other transfers have been made in the education budget in relation to protecting vulnerable groups, which have been made possible by judgments on the extent of the teacher training budget.

**The Convener:** We move to the formal debate.

*Motion moved,*

That the Finance Committee recommends that the draft Budget (Scotland) Act 2009 Amendment Order 2009 be approved.—[*John Swinney.*]

**The Convener:** Under standing orders, the debate cannot last more than 90 minutes—[*Interruption.*] Given that no member wants to speak, I invite the cabinet secretary to wind up the debate.

**John Swinney:** After such an extensive range of contributions, I am lost for words as to where I might start. I will not detain the committee further.

*Motion agreed to.*

**The Convener:** The committee will formally communicate its decision to the Parliament by way of a short report. The Parliament will be asked to consider a motion on the order next week. I thank the cabinet secretary and his team for coming.

As agreed, we move into private session to consider our draft reports on the Public Services Reform (Scotland) Bill and the financial memorandum to the Home Owner and Debtor Protection (Scotland) Bill.

11:14

*Meeting continued in private until 12:37.*

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