DRAFT BUDGET 2014-15

SUBMISSION FROM THE SCOTTISH COUNCIL FOR DEVELOPMENT AND INDUSTRY

SCDI is an independent membership network that strengthens Scotland's competitiveness by influencing Government policies to encourage sustainable economic prosperity. SCDI's membership includes businesses, trades unions, local authorities, educational institutions, the voluntary sector and faith groups.

General comments on the Scottish budget

Analysis by the Centre for Public Policy in the Regions (CPPR) has suggested that the reduction planned by HM Treasury in the Scottish capital budget is now nearly complete. However, 60% of the planned reduction in the resource budget is still to take place, with the deepest cuts scheduled for 2016-17 and 2017-18.

The latest figures suggest that the economic recovery in Scotland and the UK is strengthening. This is to be welcomed, however it is still very weak in historic terms and, in contrast with countries such as the US and Germany, UK output is still well below its pre-recession level. Moreover, while manufacturing and construction have picked up in recent months, the slow recovery of the last year appears to lean heavily on increased household consumption. With earnings falling for many in real terms and high-levels of household debt, higher spending has been generated by lower savings ratios. In contrast, business investment is at a historic low and net exports have had a minimal impact on growth. SCDI believes that it has been necessary since the recession to stimulate greater demand in the economy, but the sustainability of the recovery must be questioned unless it can be rebalanced towards longer-term sources of growth.

The Scottish and UK governments have both recognised that growth in the economy pre-recession had become unbalanced and that there is a need to rebalance its sources from consumption to higher investment and net exports. The report of the London School of Economics' Growth Commission found that the UK had relatively underperformed on innovation, infrastructure and skills (particularly those furthest from the labour market, a major cause of inequality).

In SCDI's view, this suggests that there is a pressing need to strengthen the private sector recovery and prepare Scotland's budget and public services in order to minimise the impact of the cuts planned for 2016-17 and 2017-18, and, in doing so, prioritise investment in those areas which, as identified by the Growth Commission, would encourage more balanced and sustainable economic growth in the long-term: skills, innovation and infrastructure. The "decisive shift" in resources to preventative spending should continue. SCDI comments on spending outwith the economy, energy and tourism portfolio below; and comments in relation to the portfolio in response to the Committee's questions.

Skills and Innovation
SCDI has welcomed the priority given by the Scottish Government to funding commitments to apprenticeships, higher education and supporting the Skills Investment Plans for economic growth sectors, but we have been concerned that the budget reductions for further education would harm the quality of provision.

Rates of return on investment in human capital across a range of outcomes are at their highest in the early years, particularly for people from disadvantaged backgrounds. Investment in preschool programmes must be a long-term priority.

Many key growth sectors of the Scottish economy will require a pipeline of talent with strong technical, communication, problem-solving and commercial skills. It is essential that schools, through the Curriculum for Excellence, encourage and equip more young people for opportunities to pursue these rewarding careers.

SCDI believes that - with Scottish Government expenditure on higher education as a percentage of GDP below the OECD average and Scotland's international competitors prioritising investment in higher education - the Scottish Government should maintain the higher education budget in real terms. Within this allocation, there is a need to grow the provision of STEM and postgraduate places to meet the demands of key growth sectors of the Scottish economy for high-level skills.

The higher education research budget, which is increasingly successful in leveraging private investment, should also be maintained in real terms. The creation of the Scottish Knowledge Exchange Organisation offers a significant opportunity to enhance the contribution of Scotland's research excellence to increasing sustainable economic growth. SCDI has warmly welcomed the creation of innovation centres and believes that extra funding should be made available to support proposals to extend the concept to more key growth sectors.

SCDI believes that there is a need for financial and structural stability for further education. This will enable the sector to realise the potential benefits of regionalisation of colleges for learners and implement those changes which result from the Wood Commission on Developing Scotland's Young Workforce. SCDI would welcome the introduction of a national funding framework to support partnerships in provision and services between schools and colleges. SCDI appreciates why the Scottish Government has prioritised funding at young people, but we are concerned that lifelong learning appears to have a lower profile than previously as upskilling and reskilling are increasingly important.

Infrastructure
SCDI welcomes the emphasis which the Scottish Government placed on capital spending in the previous Spending Review, including the transfers from the resource budget, and believes that this should continue in this Spending Review. A strategic approach is needed with the investment programme to ensure that it has the greatest impact on increasing long-term sustainable economic growth. The Scottish Government

should work to maximise the funding available from all sources for capital investment and seek to accelerate key infrastructure projects. Projects which improve internal and external connectivity for key sectors and city regions are a particular priority, such as the electrification of more lines in the Scottish railway network. Direct air routes to key and emerging markets should be supported, with the reintroduction of an air route development fund. The Scottish Government should also support projects which would stimulate local economic activity – affordable housing for a growing population, retrofitting energy efficiency measures to reduce fuel poverty and carbon emissions, and tackling the £2 billion road maintenance backlog to safeguard these assets.

The Aberdeen city-region has been identified in many reports as having one of the strongest economies of any UK city and as one of the best-placed for growth. Driven by the offshore oil and gas industry, private sector investment is high. However, there is concern that Aberdeen will not be able to keep pace with its competitors as a global energy hub, which are international, technologically advanced, well-connected, and vibrant cities such as Dubai and Singapore, and a risk, in particular, that long-term public infrastructure issues could strangle its growth. Aberdeen cannot be perceived as unattractive in terms of its social amenities or ease of doing business if it is to retain and attract the most skilled and talented people to work in the city and preserve its international status. Improvements to airport infrastructure and international routes, rail links with the rest of Scotland and the UK, arterial roads, broadband and mobile connectivity and Aberdeen city centre, needs to be a higher strategic priority for Scotland. Both enhancing the competiveness of Aberdeen and its industries, while better connecting the city with the rest of Scotland, will increase the opportunities available and enable people and businesses in other regions to access them. Scottish Budget decisions should reflect the scale and the urgency of action required to realise the opportunities for the Scottish economy in the North East.

SCDI fully supports the significant commitment of the Scottish Government to dual the A9 between Perth and Inverness. Safety on this route is a major concern for SCDI's members, but we have also expressed the concern of many of them over the effectiveness and economic impact of the proposal to introduce average speed cameras on long sections of the A9 to address high speeds, without addressing the frustration and dangerous overtaking that is a consequence of slower moving vehicles. This makes it even more important that action to progress the Scottish Government's commitment is accelerated where possible.

Private sector recovery

A key National Outcome for the Scottish Government is that Scotland is the most attractive place for doing business in Europe. Taxation is an important aspect of Scotland's competitiveness and SCDI fully supports the maintenance of business rate parity with the rest of the UK. The Scottish Government should also provide certainty for businesses planning investments by ruling out new or increased levies and reduced reliefs, and by setting out the planned rates for the new Land and Buildings Transaction Tax which will replace Stamp Duty Land Tax in 2015.

How has the Scottish Government's budget over the years 2012-13 and 2013-14 supported these core areas of interest?
The Committee has highlighted its core areas of interest. SCDI has the following comments on those areas identified by the Committee in its call for evidence.

Access to finance, a supportive business environment and assisting city regions
While the creation of the Scottish Investment Bank and the Scottish EDGE fund to support and encourage entrepreneurial activity can only make a difference at the margins to the wider issue of access to finance, they are nonetheless welcome initiatives which have supported growth and start-up businesses.

The enterprise agencies have rightly focussed their resources on supporting sectors of comparative advantage and high-growth potential companies.

SCDI works closely with the Scottish Government and Scotland's seven cities in the Scottish Cities Alliance. The funding for the cities strategy was welcome and it is important that this continues as the Alliance moves into the delivery phase.

Delivering 25,000 Modern Apprentices and the Opportunities for All initiative
The Scottish Government has rightly found additional funding to support young people into work, such as the provision of additional Modern Apprenticeships. However, there is a need to ensure that the quality and sustainability of training provision is not weakened by the drive to achieve a headline target and that there is a clear link with correcting market failures and realising market opportunities.

As previously stated, the Opportunities for All initiative for 16-19 year olds has been welcome and appears to have made a difference to the outcomes for this key group. However, the reduction in the number of part-time places in further education should be reversed as it is limiting the opportunities for upskilling and reskilling of other groups, such as women, and thus their participation the labour market and ability to access higher-quality jobs, and economic productivity.

Given the opportunities in related industries, the launch of initiatives such as the Energy Skills Academy and Women in Science and Engineering has been welcome. However, there remains some concern about the range of skills and training initiatives, and a view that the landscape needs to be further simplified.

What progress has the Scottish Government made in delivering its overarching purpose - focus Government and public services on creating a more successful country, with opportunities for all of Scotland to flourish, through increasing sustainable economic growth - through its spending decisions over the last two years and in relation to NPF targets and indicators?
SCDI has previously said that it is difficult to find a clear link between budget decisions by successive Scottish governments and their priority of sustainable economic growth. In response to the public spending reductions, in 2011 published a series of Budget

Principles which we recommended should be applied to decision-making by the Scottish Government and Parliament.

First principle:
Increasing sustainable economic growth is now an even higher priority for the Scottish Government and public services
Public funding should prioritise increased productivity in the medium to long-term, by re-balancing the economy towards net exports and higher innovation, investment and skills. Increasing sustainable economic growth will generate greater funding for public services. Sustained public funding is needed to support the transition to a low carbon economy.
Key question: What does this spending contribute to sustainable economic growth?

Second Principle:
Scottish budgets should ring-fence priority outcomes, rather than departmental budgets
Ring-fencing of specific budgets assumes perfect efficiency of provision in that area and there is clear evidence of scope for efficiencies within every portfolio. All spending programmes should be realistically re-evaluated and decisions should be based on an analysis of their long-term contribution to Scotland's sustainable economic growth and wellbeing. A national debate should be encouraged on the priority outcomes and the level and form of taxes which could deliver them, particularly in view of the rising cost-pressures on public services, demographic changes and increasing public expectations of services.
Key Question: What are Scotland's priority outcomes and what departmental allocations would best support and protect them?

Third Principle:
The core functions of public sector bodies must be identified and resourced. This represents an opportunity to develop new models and partnerships for public service delivery.
The Scottish Government and public services need to take a more strategic long term view of priorities and direct scarce resources where there are clear needs and benefits to users. Across all areas, there are opportunities to look at shared services, integration and smarter working. As well as securing value-for-money for the public purse, procurement should be accessible to SMEs and third sector organisations and encourage business growth and community benefit. A percentage of the annual procurement budget should be ring-fenced to stimulate innovation.
There is likely to be an increased role for user charging for certain services, such as roads.
Key Question: Does this spending offer a sustainable way of providing services for priority public needs and benefits?

Fourth Principle:
Public spending should be subject to a 'Scottish Exports Test'
Priority should be given to spending which supports a Scottish Exports Target – SCDI has proposed this is to double the value of Scotland's international exports in the next ten years. Spending can be targeted in a range of areas to support higher exports e.g. health spending which supports growth of Scotland's life sciences sector. A more commercial, export-orientated mindset should be 'mainstreamed' in all parts of government, not just enterprise. The 'Scottish Exports Test' should also apply to legislation in the Scottish Parliament.
<u>Key Question: Does this spending pass the Scottish Exports Test?</u>

Fifth Principle:
The capital investment programme is a high priority, but business cases should be re-evaluated rapidly to ensure that projects are prioritised with current economic opportunities
Scotland's 'national assets' have huge importance. All initiatives should be examined to determine whether or not they enhance those assets. The Scottish Government will need to place a higher priority in its own resource allocation to capital spending than has been projected by the UK Government. Opportunities for re-profiling of the planned capital investment programme should be considered in light of changing economic and public expenditure context. Creative thinking and public-private partnerships are needed on new investment vehicles from strategic to community levels e.g. local authority pension funds into energy assets. Priority should be given to developing assets which will generate revenues for the Scottish economy and those which through a public share, may generate revenues for Scotland's finances in the medium to long-term.
<u>Key Question: Is capital spending sufficiently aligned with current economic priorities?</u>

Sixth Principle:
Scotland's public spending should be reviewed to ensure inter-generational equity and funding to create new education, training and job opportunities for young people
Young people face particular challenges and, in the overall priorities for public spending, the Scottish Government should prioritise measures which support enhanced life chances for young people. The international competitiveness of Scotland's higher and further education sector must be secured. Since devolution the Scottish Parliament has committed itself to a larger range of universal benefits than other parts of the UK. Certain universal entitlements may need to be limited because they are not achieving their objectives, or are no longer fiscally and economically sustainable in view of changing circumstances and demographic projections
<u>Key Question: Does this spending enhance the skills and employment opportunities of our young people over the medium to long-term?</u>

With reference to these Principles, the Scottish Government has, on the positive side, has placed a higher priority in its own resource allocation to capital spending than was projected by the UK Government – although the UK Government has, more recently, recognised the need for increased capital expenditure – and, through the shift to preventative spending, taken a more strategic long term view of priorities and directed scarce resources where there are clear needs and benefits to users. The Scottish Government has acted to secure the international competitiveness of Scotland's higher education sector.

While the Scottish Government has undoubtedly given extra focus to sustainable economic growth, including support for exports, innovation, investment, skills and the low carbon economy, a more fundamental shift in public expenditure to prioritise increased productivity in the medium to long-term is not apparent. While there are good examples of the development new models and partnerships for public service delivery, and of creative thinking and public-private partnerships in new investment vehicles, the wider benefits of these have yet to be realised. Similarly while some parts of government other than enterprise have shown more commercial, export-orientated mindset, this has not yet been 'mainstreamed'. The Procurement Reform Bill will be introduced to the Parliament this autumn.

On the negative side, there has not been a more strategic re-evaluation of all spending programmes based on an analysis of their long-term contribution to Scotland's sustainable economic growth and wellbeing. The ring-fencing of departmental budgets rather than priority outcomes has continued, and there has been no evaluation of universal entitlements to ensure that they are fiscally and economically sustainable in view of changing circumstances and demographic projections, and that the spending is the most effective way to achieve outcomes. In particular, it difficult to make the case that a wholly strategic, outcomes-based approach has been taken to spending decisions when the largest departmental budget, heath, is singled out for protection before other allocations are made. The potential role of user charging for certain services has not been debated.

Is the NPF an effective method of measuring performance and are sufficient resources being allocated to track progress against the targets and indicators?

SCDI welcomed the introduction of the NPF in 2007 as providing an overarching, long-term direction for the Scottish Government and devolved public services, and a 'business plan' of improved national performance for Scotland plc. While NPF is generally an effective method of measuring Scotland's performance, not all the factors which determine progress on the indicators are the responsibility of the Scottish Government or devolved public services, or indeed of government at any level, so its effectiveness in measuring their performance is more nuanced.

SCDI understands that the NPF has motivated and focussed the development of some partnerships in the public sector to plan more strategically, align budgets and deliver the national outcomes, for example around carbon reduction, youth employment and shared services. But these have taken a significant time to emerge following its introduction. A joined-up, collaborative approach is essential at a time of declining resources and more rapid progress needs to be made. However, it is not clear - certainly outwith government and its agencies – that the NPF has had a demonstrable influence on policy or budgetary processes and changes at a Scottish Government or local government level. The private and third sectors are largely unaware of the NPF, and have, generally, not been given sufficient opportunity to help shape its outcomes or indicators, despite being key to the delivery of many of them, or effectively engaged in these partnerships. Communication needs to be improved at a national and local level if the NPF is to help deliver transformation and outcomes which can only be achieved through cross-sector working and resources, and is to bolster public accountability.

For a number of years, SCDI has supported the introduction of a Scottish Office of Budgetary Responsibility to provide independent analysis of Scotland's finance and economy and suggested that one of its roles should be to independently confirm in reports to the Scottish Parliament whether or not the Scottish Budget is consistent with the achievement of the outcomes and indicators in the NPF.

SCDI supports the Scottish Government's overarching purpose to focus Government and public services on creating a more successful country, with opportunities for all of Scotland to flourish, through increasing sustainable economic growth. SCDI believes that increasing sustainable economic growth is a key challenge for many developed countries, including Scotland. Even prior to the credit crunch, GDP growth and per capita income growth were far lower than in previous decades, and output and real GDP per head are still well below their pre-recession levels. Long-term public spending commitments and entitlements were made on the presumption of GDP growth around historic averages. Economic stagnation would have damaging social consequences for the young and shortfalls in GDP growth would only increase future deficits and debt, require higher taxes or lower public spending, or probably a combination of all three.

However, the economic history of last decade or so has demonstrated that, in addition to the overall level of GDP growth, the kind of growth is important i.e. the balance between consumption, investment and net exports. SCDI also recognises that GDP is not the only economic performance measure. It is concerned that, in more recent times, growth has not been matched by better living standards and agrees that it should be supplemented with other indicators of economic wellbeing, such as one tracking median household incomes. As suggested by Oxfam through its Humankind Index an indicator on the quality of work could also enhance measurements of the performance the labour market.

While important in their own right, indicators can never fully describe progress towards the national outcomes and a wider overview of performance remains key. SCDI believes that some indicators should be reviewed to ensure that the measurements are as robust and related to national outcomes as possible. The incorporation of Scottish Natural Heritage's Natural Capital Asset Index, which measures the quality of Scotland's natural assets including resource efficiency and ecosystem resilience, would improve information on the sustainability of growth – as well the environmental factors which are very significant in the attractiveness of Scotland as a place to live, work, visit and locate a business. SCDI understands that work is currently taking place on a measurement of resource use with Gross Value Added to inform action to increase efficiency. Especially as heat comprises a larger proportion of energy use than electricity, in addition to the current indicator for renewable electricity production, a new indicator for renewable heat production would more accurately encompass performance to improve the sustainability of Scotland's energy generation.

How should resources allocated to the economy, energy and tourism portfolio in the draft 2014-15 budget be applied to support these core areas of interest and NPF targets and indicators and achieve long-term economic growth?

In response to the Committee's second question, SCDI commented on areas of the economy, energy and tourism portfolio which should continue to be supported, such as key sectors and high-growth companies through the enterprise networks and the Scottish Investment Bank, Business Gateway and entrepreneurship through the Scottish EDGE fund. Spending in areas which will leverage substantial private sector innovation and investment are particularly important in making the most significant difference to long-term economic growth. The impact of spending on innovation should be maximised through a joined-up approach across budgets, such as enterprise, higher education and health. With some large and emerging markets growing more strongly than the domestic market, support for companies to internationalise must remain a high priority.

The Scottish economy needs to be ready to capitalise on the offshore renewables market opportunity and specific and substantial investments on related onshore renewables infrastructure need to be made in sufficient time.

With the eyes of many in the world on Scotland next year as a result of the Ryder Cup and Commonwealth Games, the tourism industry should be resourced to take advantage of this one-off opportunity to attract new international visitors.

What alternative spend would you propose to better support each core area of interest and from what area should such resources be diverted?

SCDI appreciates the pressure on the Scottish budget. The Scottish Government's short-term scope for flexibility in its spending would appear limited, some of which is due to fiscal consolidation, some of which is self-imposed.

A number of recommendations were made by the Scottish Government's Independent Budget Review and/ or Commission on the Future Delivery of Public Services on how to address public spending challenges, ensure the sustainability of Scotland's public services and improve outcomes for the people of Scotland which it has not implemented. These should be revisited as a matter of urgency. Innovation in public services needs to be encouraged, both to meet the changing needs and increasing expectations of users and to reduce costs in the long-term.

Given the structural challenges facing the Scottish economy, in common with many other developed countries, there needs to be an ongoing shift in public funding to prioritise budgets which increase productivity in the medium to long-term and address, above all, weaknesses in skills, innovation and infrastructure. While spending across a range of areas supports the Scottish Government's purpose of increasing sustainable economic growth, within the overall allocation, the economy, energy and tourism portfolio should be one of the highest priorities.

Analysis by the CPPR has suggested that if spending on the health service continues to be protected, other budgets could face 25% cuts in real terms from 2009-10 to 2017-18. The ring-fence on the health budget should be lifted. The future of universal entitlements, in view of changing circumstances and demographic projections, was questioned in the Scottish Government's Independent Budget Review. These should be objectively evaluated for their impact on fiscal sustainability and contribution to the NPF's national outcomes. The potential role of user charging for certain services needs to be debated.